REMARKS OF SENATOR HARRISON A. WILLIAMS, JR.

BEFORE THE DEALER BANK ASSOCIATION

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It is a pleasure to be with you this morning at the Dealer Bank Association's annual conference.

Over the years, many of the officers and members of this Association have appeared before the Senate Banking Committee, and with increasing frequency, before my Securities Subcommittee especially on matters involving our municipal securities markets.

Without question, the municipal securities markets are deeply and directly affected with a tangible public interest. In broad terms, they are the financial lifeline for governmental units of all size to borrow the necessary funds for appropriate public purposes. When that lifeline is no longer available to state and local governments, as has occurred in the not to distant past, the problems for citizens and government officials at all levels are enormous.

Today, our municipal markets are confronted by a battery of problems. Some are external -- shifts in national monetary policy and overall economic conditions. Some are unique and, hopefully, unparalleled -- such as the unfortunate circumstances which have beset the City of New York. Still others are subtle -- such as the shifting investment patterns of major financial institutions. And there are legal problems as well -- such as the appropriate role of the Federal securities laws.

Whatever the source of the problem, government borrowers must have unimpeded and economical access to our capital markets so that the delivery of essential public services will not be jeopardized or interrupted. There are no facile solutions or quick fixes. Coordinated policy to ensure a steady and reliable flow of capital to state and local governments for appropriate public purposes is needed. And I am hopeful that the new Administration will give the highest priority to this endeavor.

One essential element of such a solution can be found in the further, measured application of the Federal securities laws to the issuers of municipal securities.

In the Securities Acts Amendments of 1975, Congress indicated its intent to eliminate serious threats to the integrity of the capital raising system upon which local governments rely. As you well know, this omnibus securities bill subjected the municipal securities industry to the securities laws and created the Municipal Securities Rulemaking Board.

I believe the Rulemaking Board has made a serious and sensible start towards establishing a fair and equitable system of regulation to protect investors and govern bank and non-bank competitors. Consistent with its Congressional charge, the Board is standardizing and rationalizing industry practice and prescribing fundamentals of investor protection -- confirmation and qualification requirements are just two examples. In the end, enhanced investor confidence in the integrity of the markets, and the professionals who service it, will benefit state and local borrowers.

Now, I believe the time has come to complete the cycle by extending the principles, but not necessarily the present provisions, of the Federal securities laws to municipal issuers. Last year I introduced legislation to accomplish this purpose. And in the near future, I will reintroduce the Municipal Securities Full Disclosure Act of 1977 and press for its prompt enactment.

The bill will parallel last year's bill in most respects. Like the previous version, the bill will require the preparation of annual reports and distribution statements and specify their contents. The content of the required disclosures will be borrowed from the "Disclosure Guidelines for Offerings of Securities by State and Local Governments," prepared by the Municipal Finance Officers Association.

The SEC would be authorized to establish uniform accounting standards and practices to be followed by issuers and to assure that the disclosure documents reach investors. But the bill will in no way contemplate, or under any circumstances permit, direct regulation of the issuer by the SEC through registration, waiting periods, or through prefiling of sale documents. To the maximum degree practicable, it will respect the public nature of governmental borrowers and will not treat them like private corporations.

To minimize the SEC's role, the bill will 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, offers or sales of municipal securities approved by a State authority will be exempt from Federal requirements.

A major improvement over last year's bills will be several new provisions designed to clarify the obligations and liabilities of issuers, underwriters and others engaged in the distribution of municipal securities. Definite standards of conduct and limitations on liability will replace the present confusion over the ill-defined course of compliance with the antifraud provisions in both a negotiated and competitive bid context. And the bill will contain explicit remedies to enable investors to enforce their rights against issuer and issuer officials and specify the relief which a court may award.

Subjecting state and local units of government to the Federal securities laws is not an action to be taken lightly. All other alternatives must first be explored, and if workable, adopted.

Two possible non-federal solutions have already been explored. Under the first, state government could impose the necessary disciplines. This has been the pattern since municipalities were first exempt from the securities laws 44 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.

The second is the voluntary and “market forces” approach. As a condition for the purchase of municipal securities, this solution envisions that underwriters and investors will impose disclosure requirements. This has been happening in several instances during the past year, but there are several drawbacks. For one thing, financial information is not prepared on a uniform basis. Rarely is it 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. Finally, a voluntary approach will never properly allocate the responsibilities and liabilities for preparing and verifying disclosure information.

In my view, there is no more effective approach than the elimination of the issuers’ exemption and its replacement with new provisions carefully tailored to fit the unique nature of government borrowers. Moreover, I believe the Congress has both the authority and the responsibility to strengthen the credibility of cities among taxpayers, voters, and investors alike, and to enhance their future access to the credit markets.

Many of the factual and policy reasons underlying the original “Federal hands off” position are either no longer compelling or are no longer true.

Let me highlight just a few of these arguments.

First, the character of the municipal securities investor has changed substantially. Especially in recent years, as inflation has pushed incomes into higher tax brackets, more middle income individuals have purchased municipal securities as tax shelters. As a group their participation in the primary market is surging.

Unless more information about an issuer’s financial condition is made available to facilitate informed investment decisions, there will be less investor participation, lower ratings, and underwriter antipathy -- meaning less total borrowing at higher interest rates.

Second, this market has grown in proportions never imagined in 1933. The most rapid growth has occurred since 1950. Annual sales volume rose from $5.3 billion in 1950 to over $60 billion in 1975. At year end 1975, a record total -- $235 billion -- in debt was outstanding.

Third, there is now widespread concern over the condition and financial stability of many of our largest cities. Revelations of massive mismanagement and impenetrable financial records has created a “crisis” over the quantity, quality, and reliability of financial information concerning state and local issuers. Municipal taxpayers, voters and existing and prospective bond holders deserve to receive more reliable and uniform data than in the past.

The fourth and most difficult argument is the legitimate concern that application of the securities laws to State and local issuers would increase costs and otherwise interfere with essential capital raising efforts.

Based upon recent experience, I no longer believe this argument withstands analysis. 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 responsibilities to prospective investors. In too many instances borrowing costs have reached burdensome and uneconomic levels.

No small part of these disruptions is that issuers, underwriters and others have become "gunshy" about their liability exposure under the antifraud provisions of the Federal securities laws. And not without good reason. The SEC has asserted broad authority over the municipal securities industry and markets. It has sued, for the first time, a quasi-governmental issuer in California. It is investigating New York City and Philadelphia. And beyond these specific actions, the Commission maintains that it has sufficient power to effect explicit disclosure standards for municipal issuers and duties for underwriters.

Municipal professionals, in particular, are on the horns of a dilemma. You are fully subject to the jurisdiction of both the Board and the SEC. Your responsibilities to investors can be spelled out in enormous detail. Moreover, there is no legal doubt over their enforceability through SEC administrative, injunctive, and criminal proceedings, or through private actions by injured investors. The Constitution affords no protection. And the paucity of SEC pronouncements and judicial interpretations -- including the Hochfelder decision -- provides little in the way of guidelines or safe harbors to shield you from serious, or even spurious, actions.

Under these circumstances, the absence of legislation addressing the information reasonably necessary for investors, and the respective responsibilities of issuers, underwriters and others in producing it, may well impose the costs and pose the interference which we all seek to eliminate.

Now let me turn to another proposal to assist cities and states to obtain financing at the lowest possible costs -- bank underwriting of municipal revenue bonds.

As you may know, my Subcommittee has undertaken an ambitious study of the securities activities of commercial banks and the Glass-Steagall Act. Few aspects of the Glass-Steagall Act have been more litigated, legislated, or lobbied -- than the sections which prohibit banks from underwriting revenue bonds. Hopefully, with the completion of our study, the matter will be put to rest.

The arguments for and against bank revenue bond underwriting are well-known. The purpose of our study will be to reevaluate them again in light of the pressing need to reduce issuer borrowing costs, general conditions in our banking system, and the new regulatory framework governing the municipal securities markets.

As a threshold matter, of course, it must be proved that bank revenue bond underwriting will lower borrowing costs. If this is done, the remaining issues of unfair competition, conflicts of interest, and concentration of economic power must also be resolved. A framework is already in place in the Municipal Securities Rulemaking Board. And additional legislation is always a possibility. Each of the bills the Senate Banking Committee considered -- and considered favorably -- in the past has contained clear limitations to guard against self-dealing, potential conflicts of interest, and unsound banking practices.

One thoughtful article has been brought to my attention in which the author makes an impressive case for permitting bank revenue bond underwriting.

His solution to the perceived problems of fair competition is interesting and I want to close my remarks this morning by reading it to you.

> (Quote) Banks should be permitted to participate in revenue bond underwriting, but only through creation of security affiliates, capitalized and regulated like non-bank dealers, and insulated as completely as practicable from the fortuitous advantages bank affiliation would otherwise provide. Only in this way will the principle of free and fair competition in the underwriting of municipal revenue bonds truly be served (End Quote)

This is plausible. But it would be ironic if, following completion of our study, legislation were enacted to re-establish securities affiliates for national banks. I imagine even the suggestion of such legislation would raise more than a few eyebrows in Congress and cause some discomfort to my predecessors in the Seventy-Third Congress -- Senator Glass and Representative Steagall.

On that note let me close by acknowledging the contributions the members and officers of the Dealer Bank Association have made over the years -- in Washington and elsewhere -- to make the municipal securities markets as near perfect as possible. And I look forward to a continued, productive dialogue with you in conquering the challenges of the future.

Thank you.