U.S. House of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn House Office Building
Washington, D.C. 20515

May 8, 1984

Honorable John S.R. Shad
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

This is in response to your letter of April 27, 1984, responding to our letter of January 25, 1984, which requested an analysis of certain issues relevant to the regulation of municipal securities and the Commission's position and views with respect to those issues.

We want to commend the staff involved in the preparation of the report. It is an excellent analysis of the legal issues involved, and certainly will be an important source of information for us.

However, we would observe that the Commission failed to answer certain key questions raised in our letter. For example, question 13 asked the Commission's current position on legislation developed by the Commission in 1976 to enhance disclosure and accounting with respect to municipal securities issuers. The Commission referred to earlier bills, but noted: "Since no similar bill is pending before Congress, the current Commission has not considered such proposals." Question 14, similarly, asked the Commission's view on a suggestion made by former Commissioner A. A. Sommer that provisions similar to Section 11 of the Securities Act of 1933, imposing standards of care and liability for parties to the distribution, might be useful in connection with offerings of municipal securities. The Commission responded: "The Commission has not formally considered this proposal, and thus has not taken a position on it, or on the substantial policy issues it raises."

There are also other questions, numbers 9, 10, and 11, to which the Commission failed to respond fully and completely.

Perhaps there was some misunderstanding on your part about the purpose of our January 25th request. We asked for the Commission's views on these matters in order to obtain those views, and not in order to be told that the Commission had not thought about the questions. Indeed, we assumed the substantial delay in your response was occasioned by the need for time to formulate careful responses and recommendations to the more difficult questions.

Related to our concerns about the municipal securities market is the growing sense that the government-bond market can no longer regulate itself. In 1982 the collapse of two firms, Drysdale Government Securities Inc. and Lombard-Wall Inc., rocked the industry and continue to have a lingering effect on investor confidence.

Last Wednesday, insurance broker Marsh & McLennan Cos. discovered more "unauthorized" government-bond trading that will boost its extraordinary after-tax losses to $90 million (or $165 million before taxes), fast approaching the company's entire 1983 profit of $123.5 million. At the same time, a small government-securities trading and investment firm, Lion Capital Group, and four related entities filed bankruptcy-law petitions, leaving a number of school districts and other public agencies with possible losses totaling $26 million. Several of the local school districts entered into "repos" through a money-market broker, National Money Market, Irvine, California, and were not aware that they were dealing with Lion.

As you know, the $1.8 trillion stock market has an elaborate system of statutory and administrative law and several regulators, including the Commission, the National Association of Securities Dealers and the separate stock exchanges, to protect individual investors and the integrity of the markets. However, the $2.269 trillion government bond market, which plays a vital role in helping to finance Federal deficits and where, according to the Federal Reserve, trading runs at more than $45 billion a day -- more than 10 times the volume of all U.S. stock trading, has no formal government regulation or self-regulatory bodies. The Federal Reserve Board merely monitors daily activity. Treasury bond dealers do not have to meet minimum capital and other rules, like securities dealers do. There are also no margin rules limiting how much investors can borrow to finance stock purchases. Huge positions can be amassed with small amounts of cash, with disastrous results.

We would appreciate the Commission's recommendations for legislation or regulations which would enhance the integrity of the government-bond market and address the deficiencies apparent in the current system. Also please provide us with a report on the Marsh & McLennan transactions, including what happened and how, who was responsible, what safeguards were or were not in place, and any adverse effects on the securities industry, e.g., brokerage firms who extended margin credit in the transactions.

This inquiry raises a number of difficult policy questions which may require that you consult with other agencies or departments, such as the Federal Reserve Board or the Department of the Treasury. It should not delay your response to our municipal securities questions. After you have given the matter preliminary thought, please contact us as to the date we can expect an answer to the government-bond market part of our inquiry.

We appreciate your cooperation and full attention to this request.

With best wishes,

Sincerely yours,

John D. Dingell, Chairman
Subcommittee on
Oversight and Investigations

Timothy E. Wirth
Chairman, Subcommittee
on Telecommunications,
Consumer Protection and
Finance