OPENING STATEMENT

OPEN MEETING

ARTHUR LEVITT, CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

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U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Opening Statement for Chairman Levitt

Good morning. Today the Commission is considering two significant initiatives relating to the municipal securities markets which have been proposed by the Municipal Securities Rulemaking Board. The first item on the agenda is the MSRB's proposed rule G-37, prohibiting a linkage of political contributions and municipal securities business. The proposed rule change is intended to address practices known as "pay to play."

The municipal securities market in this nation is both diverse and important. The market is made up of approximately 50,000 issuers including state governments, cities, towns, counties and special subdivisions, such as special purpose districts and public authorities. There are approximately 1.3 million municipal securities issues outstanding, representing approximately $1.2 trillion in securities. In 1993, 17,000 new issues took place with a record value of $335 billion. The proceeds from the issuance of municipal securities are used to fund some of the most basic needs that we all take for granted: clean water, school districts, and airports, to name a few. Given the size and depth of this market, the perception that certain practices call into question the integrity of the market take on added significance.

Concerns have been raised about the means municipal securities dealers employ to obtain municipal securities business. There have been reports of municipal securities dealers, their employees, and related parties, allegedly making payments, political contributions, or entering into business ventures with political figures to obtain the underwriting business of municipal securities issuers. These practices directly affect municipal securities markets by increasing costs borne by issuers, dealers and ultimately investors, by creating artificial barriers to competition, and by undermining underwriter and market integrity.

The MSRB has proposed a series of measures designed to reduce "pay to play" practices in the awarding of municipal securities business. These measures include a prohibition against municipal securities dealers conducting certain types of municipal securities business with an issuer if the dealer or affiliated persons, subject to exceptions, made political contributions to officials of the issuer who could influence the awarding of that business. The measures also include separate provisions requiring municipal securities dealers to maintain records and to disclose aggregate information to facilitate compliance and examinations. The goal of these proposals is to promote investor confidence in the integrity of the municipal securities market.

The MSRB has tailored its proposal to accomplish this goal with minimal disruption to the municipal securities industry and the state and local political process to which that industry is linked. These provisions are "potent medicine." But the damaging effects of "pay to play" practices, both real and perceived, make such medicine, even if unpleasant, necessary.

The rule furthers important objectives of the Act. It is intended to prevent fraudulent and manipulative acts and practices by removing conflicts of interest inherent in the process of selecting underwriters for negotiated municipal securities offerings.

This proposal has elicited significant comment from market participants. The Commission received 68 comment letters, 33 of which expressed opposition to the proposal. The Commission has considered carefully all of the issues raised by the commentators, including questions about the constitutionality of the proposal and its impact on small, woman- and minority-owned firms. I am satisfied that the proposal passes constitutional muster, and that it will not have any uneven impact on particular market participants. Having balanced these considerations against the benefits to be gained by implementation of this proposal -- specifically, the important consideration of maintaining the integrity of the municipal securities market -- I am prepared to support this proposal.

The Commission also has considered the timing of the implementation of this proposal. Some commentators have requested a delay in the effectiveness of the rule. Because the proposal furthers important statutory objectives, I believe the proposal should be implemented as soon as possible to ensure that investor confidence in this market is restored and maintained.

In addition to the new political contribution rule, the Commission will also be considering revisions to the MSRB's rules governing the suitability of recommendations made to customers. This issue was first raised over two years ago by Commissioner Rick Roberts, whose unflagging efforts to better protect investors have been a major factor in bringing this rule proposal before us today.

The proposed rule change would clarify and strengthen the existing language of the Board's suitability rule that requires suitability determinations to be made when recommending transactions to customers. The proposed rule change would also clarify the obligation of dealers to make reasonable efforts to obtain specific types of customer suitability information for all accounts that are not "institutional accounts" and clarify the definition of "institutional account."

Since the adoption of suitability rules in the late 1970's, there have been significant changes in the municipal securities markets. The number of retail investors has increased and the introduction of more complex, and in some cases, speculative municipal securities has become a characteristic of today's market. In addition, there have been a number of defaults by municipal issuers in recent years, including some in unrated and conduit bonds.

It is critical, therefore, that dealers have clear policies to ensure that sales personnel do not recommend securities to customers without proper regard to the nature of the security being recommended and the customer to whom it is being recommended. Any analysis of the proposed changes to the suitability rule must take account of the extent to which they achieve this objective.

Last month, the Commission announced three initiatives to reduce the mysteries of the municipal market for investors. These initiatives would increase disclosure by municipal issuers, and require dealers to give more information to customers on their compensation and the rating status of the bonds being sold. These initiatives will serve to greatly decrease the opportunity for fraud in the municipal securities marketplace.

Taken together, the Commission and MSRB efforts will provide investors with a higher level of confidence that the municipal securities market is a fair market, free from fraudulent practices and conflicts of interest. In the end, the perception of fairness serves all market participants well -- investors, brokers and dealers, and most importantly, issuers.

The MSRB has acted quickly and decisively to address these important issues. The final result is two carefully crafted, workable proposals that will benefit the industry greatly. I believe they deserve a great deal of credit and thanks for their efforts. They have done a great service to investors in municipal securities.

Bob Colby, Deputy Director of the Division of Market Regulation, will now present the proposal.