January 3, 1976

The Honorable Roderick Hills
Chairman
Securities and Exchange Commission
Washington, D.C.

Dear Chairman Hills:

The Board has now had an opportunity to review the proposed Interpretive Statement by the Commission on disclosure of holdings of securities of New York City. As I anticipated, the implications of such a proposal for the U.S. banking system and the financing of the Nation's State and local governments are disturbing to the Board, particularly in light of current economic conditions and the timing of the proposal. The Board urges your thoughtful attention to the following considerations.

The Statement would require that reporting bank holding companies that have investments in New York City obligations in an amount equal to 10 per cent or more of their equity capital show their total investment in New York securities, and the amount of such securities subject to the moratorium or any other agreement modifying terms. It also requires reporting on the amount of such New York City securities coming due in three years or less, apparently on the assumption that these holdings might be subject to some type of exchange agreement. Finally, the proposal would require a discussion of the effect of the moratorium, exchanges, or agreements on future income from New York City securities in comparison with the income recorded in 1975.

We fully appreciate that the SEC views its responsibilities under the securities laws as requiring that information be furnished that will assist investors in making judgments about the effects of the New York City situation on the income and business of registrants. However, in our judgment, highlighting the measure of financial support that the banking system has extended to New York City would, under current uncertainties regarding the City's financing, lead to unwarranted inferences with respect to the soundness of the banks involved; it could well exacerbate the City's problems and those of other municipalities; and it would also be likely to mislead investors in registrants' securities.

The recent actions taken by the City of New York to strengthen its fiscal position, coupled with the actions taken by New York State and the interim financial assistance authorized by the Federal Government, have resulted in considerable improvement of New York City finances. The Board would point out that history demonstrates that the chance of ultimate loss of principal on municipal securities, especially by investors in general obligation bonds, is very small. There are excellent reasons, grounded in experience, for believing that the prospects for principal loss on New York City securities are remote. A requirement to disclose the book value of New York City securities would seem to imply that there is serious doubt about the repayment of principal. This is hardly the case.

The City of New York, the State of New York, and the Federal Government have been struggling in recent months to find a solution to a critical economic and financial problem. An essential element is the need to reopen the public market for the City's debt obligations. This goal could not be achieved without exchange, restructuring, or renegotiation of existing debt. One need only ponder what impact the proposed disclosure requirements would have had if they had been in place at the time New York City was in process of renegotiating and restructuring its debts. The requirement of disclosure could well have prevented New York City from working out an acceptable arrangement with its banking creditors. Logically extended, a precedent so established would reduce the ability of other troubled municipalities to rearrange their debt structures. In the Board's judgment, such a development would be clearly contrary to the public interest.

We know of no case in which the solvency of a banking organization is jeopardized by its holdings of New York City securities, or those of any other municipality for that matter. Banks today hold approximately $100 billion or nearly one-half of the total outstanding volume of State and municipal securities. These holdings are generally regarded as conservative investments. They are widely used for pledging and collateral purposes. The Commission's proposal could have the effect of creating unwarranted doubts about the investment quality of State and local securities generally and about the managerial competence of financial institutions that hold them. Even though these effects may seem localized by the present proposal, they would reach an investment sector whose wariness has already been unduly aroused. We firmly believe that any official action by the Commission should be so designed as not to rekindle uncertainties that are now in process of being resolved by events and governmental action.

In an earlier conference with you, extensive consideration was given to the question of how best to inform investors, actual and potential, of the extent of portfolio deterioration in any given accounting period. Our position is that the income shortfall from non-performing loans is best suited to that purpose because it reflects recorded events and neither heightens nor diminishes in the investors' minds the significance of what has occurred. In conjunction with the record of loan losses, it fulfills, in our opinion, the disclosure need. We believe this procedure to be preferable to ad hoc criteria based upon transitory public concern or to arbitrary categories of loans or investments.

With respect to the Commission's specific proposal, as expressed in items 1 through 4 on pages 3 and 4 of the Statement, we believe that the disclosure contemplated in item 4 is satisfactory and that it would meet adequately the needs of investors. The other data would be subject to misinterpretation, distortion, and over-emphasis -- particularly if they were supplied in response to the direction of a government agency. Such misinterpretation could precipitate a shift of deposits and other funds out of institutions with significant New York City holdings, thereby causing serious financial problems for the affected institutions. This clearly would not be in the interest of either the public in general or the investors whom the Statement is intended to aid.

In view of the aforementioned risks to the banking system and the economy, we would urge the Commission to proceed with great caution and possibly consult with other economic agencies in the government. It is the Board's view that fuller consideration is needed of the implications of the proposed action on individual banks, on the banking system, on the financial resources of State and local governments, on the municipal securities market, and on investors in securities of State and municipal governments and of financial institutions.

With respect to Exhibit B, the proposed amendment to Article 3 of Regulation S-X dealing with concentration of investment in the securities of a particular issuer, the Board agrees that excessive concentration in the obligations of any one or related group of obligors can result in undue exposure. However, the threshold criteria and the definitions set forth in the proposal seem too restrictive and should be reexamined. The Board stands ready to assist in a survey of financial institutions in order that meaningful criteria may be identified. We would be glad to discuss such assistance at your or your staff's convenience.

In closing, I want to express our Board's appreciation of the opportunity you have given us to comment on your proposals.

Sincerely yours,

Arthur F. Burns

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