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WM. MICHAEL KITZMILLER, STAFF DIRECTOR
 THOMAS M. RYAN, CHIEF COUNSEL

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

April 4, 1985

CHAIRMAN'S OFFICE
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SEC. & EXCH. COMM.

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

Dear Chairman Shad:

I anticipate introducing the enclosed legislation, the Public Securities Act of 1985, for myself and a number of cosponsors on April 15, 1985.

The bill would amend the Securities Exchange Act of 1934 to provide for the establishment of a Public Securities Rulemaking Board to provide improved protection for investors in the government-related securities markets. This initiative is necessitated by a string of serious disasters in recent years: Winters Government Securities in 1977, Drysdale Government Securities Inc. and Lombard-Wall Inc. in 1982, Lion Capital Group last year, and E.S.M. last month. While this is primarily a dealer market, the E.S.M. failure victimized school districts and city governments and led to a "run" by Ohio depositors that forced a temporary closing of 71 private-insured savings and loan associations.

In recent weeks, Committee staff have met with primary dealers, and representatives of the Federal Reserve Board, the National Association of Securities Dealers, the Municipal Securities Rulemaking Board, the Public Securities Association, and others to develop legislation which would make it more difficult for marginal operators to compromise the market or its participants while providing mechanisms to insure against interference with the efficiency, liquidity and integrity of the giant market in U.S. Treasury securities. We recognize that the successful operation of that market is essential to the successful operation of our fiscal and monetary policy.

We were advised by Commission staff that other commitments made it impossible for them to participate in the technical

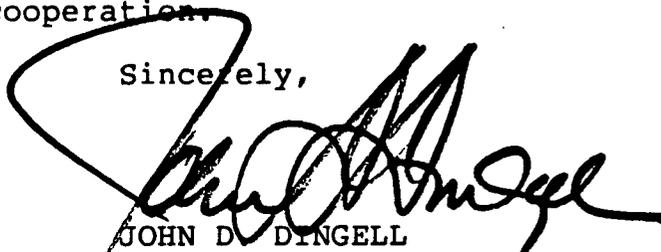
Honorable John S.R. Shad
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development of this draft. However, I am asking that the Commission review the enclosed bill and submit whatever comments deemed appropriate at your earliest opportunity. It may be helpful if you could authorize Alan Rosenblat to give the draft a review for technicals and communicate those directly to Assistant Legislative Counsel Steve Cope at 225-6060 no later than Friday, April 12, 1985.

The Subcommittee on Telecommunications, Consumer Protection, and Finance will be scheduling hearings in the near future. You will, of course, be notified and asked to testify.

Thank you for your cooperation.

Sincerely,



JOHN D. DINGELL
CHAIRMAN

Enclosure

cc: SEC Commissioners
Alan Rosenblat

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SUBCOMMITTEE ON
 TELECOMMUNICATIONS, CONSUMER PROTECTION, AND FINANCE

April 4, 1985

M E M O R A N D U M

WM. MICHAEL KITZMILLER, STAFF DIRECTOR
 THOMAS M. RYAN, CHIEF COUNSEL

TO: Members, Committee on Energy and Commerce

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

RE: Proposed legislation to provide regulation of government
 securities dealers: "The Public Securities Act of 1985."

Background

The recent failure of E.S.M. Government Securities Inc., which caused a savings and loan panic in Ohio and resulted in millions of dollars of losses to cities and other investors, provides dramatic evidence of the inability of the Securities and Exchange Commission and other federal and State regulators to prevent serious failures in the government securities market.

Unsupervised, speculative trading practices and the failure to conform to strong financial standards led to the collapse of Drysdale Government Securities, Inc. and Lombard-Wall Inc. in 1982 and Lion Capital Group last year. After each of these events, Congress was given assurances by the Federal Reserve that steps were being taken to prevent their recurrence. After each of these events, the SEC, which has no supervisory regulatory authority over unregulated government securities dealers, has come in after-the-fact, asserting its antifraud jurisdiction. The SEC has acknowledged, however, that it does not have the statutory authority to inspect the books and records of these securities dealers or take other steps which might have prevented the fraudulent activities.

We recently learned that the SEC was told of problems at E.S.M. in 1977, when it received complaints from the Comptroller of the Currency about practices at the firm. After four years, during which the SEC was unable to gain access to E.S.M.'s books and records, the SEC closed its inquiry. We now know that the fraud at E.S.M. was well underway during the time the SEC was prevented from inspecting its books and records.

As many of you may know, Chairman Dingell and I questioned the SEC about the need for greater authority to police the government securities market more than one year ago. We continued to raise the issue in a series of letters over the past year. Questions were raised again by a number of Members at a hearing in the Subcommittee on Telecommunications, Consumer Protection and Finance on March 21st, at which SEC Chairman John Shad, on questioning by Rep. Rinaldo, promised that the SEC would report to the Subcommittee within 90 days with recommendations. Following that hearing, Chairman Dingell and I directed the staffs of the Full Committee and the Subcommittee to contact relevant federal agencies and interested industry participants to discuss legislation to address the serious regulatory gaps apparent to all of us.

Proposed Legislation

The attached draft legislation would amend Section 15B of the Securities Exchange Act of 1934. Section 15B was added by amendments to the Exchange Act in 1975, to bring previously unregulated municipal securities dealers under the regulation of a newly-created self-regulatory organization, the Municipal Securities Rulemaking Board, composed largely of industry participants. The Board promulgates regulations requiring the registration of all municipal securities dealers, subjecting them to customer protection, anti-fraud, record-keeping and other requirements, and providing for inspections of their books and records. The rules of the MSRB are enforced by the NASD, the SEC and the appropriate federal bank regulators.

The draft legislation would expand the authority of the MSRB to include dealers in Treasury securities and government agency securities, and would rename the MSRB the "Public Securities Rulemaking Board." This would provide uniform regulation of government securities dealers, subjecting them to inspections, books and records requirements and other protections.

The legislation was drafted in an effort led by Chairman Dingell's Full Committee staff, with the Subcommittee staff and personal staffs of Reps. Luken, Swift, Rinaldo and Oxley participating, along with others. Following meetings involving the Federal Reserve, the Municipal Securities Rulemaking Board and the National Association of Securities Dealers, some changes were made to accommodate certain of their comments. The draft bill has also been sent to the SEC. None of these bodies has taken a position on the draft legislation at this point. Meetings have also been held with representatives of the Public Securities Association and the SIA, and additional meetings with industry participants are scheduled for next week.

Chairman Dingell and I, along with other Members who have participated in this process, intend to introduce the legislation following the Easter recess. We would be interested in any

comments you might have on the legislation, and would also ask that you or your staffs contact us by Friday, April 12, to indicate your interest in co-sponsoring the legislation. You may contact Consuela Washington (5-2927) of the Full Committee staff; Marti Cochran (5-9304) of the Subcommittee staff or Scott Cooper (5-2605) of Rep. Swift's staff to indicate your interest in sponsoring the legislation or to ask any questions about the bill.