

f - Municipal Securities
Regulation

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

January 25, 1984

FRANK M. POTTER, JR.
 CHIEF COUNSEL AND STAFF DIRECTOR

Honorable John S.R. Shad
 Chairman
 Securities and Exchange Commission
 450 5th Street, N.W.
 Washington, D.C. 20549

Dear Chairman Shad:

As you know, after revelations of abuses in the municipal securities market, the Securities Amendments of 1975 created a regulatory scheme directed at the trading practices of municipal broker-dealers. Pursuant to the 1975 amendments, the Municipal Securities Rulemaking Board was created to promulgate specific rules relating to the qualification of securities professionals who deal in municipal securities, rules of fair practice, recordkeeping requirements and other matters.

Inspections of municipal securities dealers and enforcement of the rules of the MSRB were delegated to the appropriate bank regulatory agencies, as well as the Securities and Exchange Commission. The MSRB itself does not conduct inspections, nor does it enforce its own rules. Moreover, the MSRB is specifically prohibited from requiring the disclosure of information by issuers.

Soon after passage of the 1975 amendments, efforts were begun to address further problems in the municipals market and to correct what were viewed as inadequacies in the new regulatory scheme. These efforts arose from concerns about New York City's financial crisis, and SEC findings that New York City bonds were sold to investors without adequate disclosure of the city's true financial condition. Legislative proposals to remove the exemptions from registration for municipal securities, as well as proposals to otherwise enhance disclosure relating to municipal securities, were considered by the Congress but were not enacted.

The recent default of the Washington Public Power Supply System (WPPSS) on \$2.25 billion in bonds for the construction of two nuclear power plants -- the largest municipal default in history -- has again raised concerns about the effectiveness of the

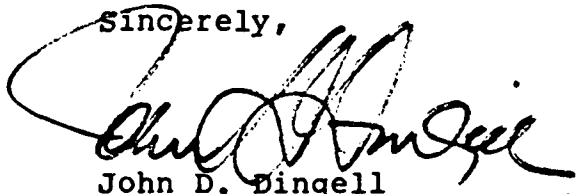
current regulatory scheme. Questions have been raised about the activities of various underwriters of WPPSS bonds, the activities of the financial adviser to WPPSS, and the activities of brokers who sold WPPSS bonds to public investors. Questions also have been raised about the basis for the ratings on the bonds issued by the rating services and about the adequacy of information given to bond purchasers. The Commission recently made public its Formal Order of Investigation In the Matter of Transactions in Washington Public Power Supply System Securities (January 11, 1984, HO-1556).

✓ The purpose of this letter is not to address current law enforcement efforts at the Commission. As has previously been discussed with Commission staff, it is expected that the Commission will keep the Subcommittees advised of the progress of those efforts. While enforcement efforts are critical, we seriously doubt that they will result in the restoration of substantial investor losses, nor do we believe that enforcement alone can restore investor confidence in this important market. However, we believe it is important that we again assess the regulatory scheme applicable to municipal securities in light of the WPPSS facts.

We have attached a list of questions and would appreciate your response to those questions, supplemented with any additional facts you believe are relevant to an assessment of the current regulatory scheme relating to municipal securities. If you have any questions concerning your response, please call Marti Cochran at 225-9304 or Mike Barrett at 225-4441, staff of the Subcommittees.

Thank you for your assistance and cooperation.

Sincerely,



John D. Dingell
Chairman
Subcommittee on Oversight
and Investigations



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

Enclosure

ATTACHMENT

1. With respect to corporate and municipal issuers, please state the differences in regulatory requirements relating to the obligations of issuers to disclose information in: a) offering statements covering the issuance of new securities; b) periodic reports; and c) other statements or publications.
2. Specifically, what would have been the differences in information made available to public investors if the disclosure requirements relating to nonexempt issuers had been applicable to WPPSS?
3. Please state the differences in regulatory requirements relating to the obligations of underwriters of corporate and municipal securities and state what would have been the differences in the obligations of underwriters of WPPSS bonds if the bonds were not exempt securities.
4. With respect to securities sales representatives, are there any differences in regulatory requirements relating to the sale of municipal and corporate securities?
5. While the rating services, as such, have no specific obligations under the federal securities laws, please state the nature of the liability of rating services registered as investment advisers with the Commission in: a) actions brought by the Commission; and b) actions brought by private parties.
6. With respect to financial advisers to municipal securities issuers, how do their requirements differ from the requirements under the Investment Advisers Act?
7. With respect to securities firms serving as underwriters of the bonds, advisers to investment companies holding the bonds, and brokers with public customers investing in the bonds, are there differing requirements relating to conflicts of interest depending on whether bonds are corporate or municipal bonds?
8. Are there any differences in the rules relating to insider trading involving municipal securities compared with nonexempt securities?
9. Following the New York City crisis, voluntary guidelines for the disclosure of information in offering statements were adopted by the Municipal Finance Officers Association. Does the Commission know whether, in the case of WPPSS, these guidelines were complied with? Does the Commission believe they were sufficient?

10. The American Institute for Certified Public Accountants undertook an effort to improve standards of accounting for municipal securities issues. Has the Commission assessed the adequacy of the voluntary program?

11. When Congress determined in 1933 to exempt municipal securities from the registration requirements of the federal securities laws, one of the reasons for granting the exemption was the belief that the principal purchasers of such securities were institutions, which were able to protect themselves. However, the character of the municipals market has changed dramatically, with substantial changes in recent years. A September, 1983 report of the General Accounting Office noted that, while in 1972, households purchased 16% of all new municipal bond sales, just a decade later, in 1982, household purchases accounted for 87% of all new municipal bond sales. Does this information indicate a need to reassess the policy underlying exemptions for municipal securities?

12. That same GAO report also contained facts which may indicate the difficulty in removing the current exemption from registration. It noted that an estimated 52,000 political entities have debt outstanding, with a total of about 1.5 million separate issues. In contrast, the corporate market has only about 10,000 issuers, with under 100,000 separate issues of stocks and bonds outstanding. Does this indicate a need to address the concerns about municipal securities disclosure by a means other than requiring the filing of registration statements by all municipal issuers?

13. In 1976, the Commission developed legislation to enhance disclosure and accounting with respect to municipal securities issuers. What is the Commission's current position on the legislation?

14. In a March 11, 1976 speech, former SEC Commissioner A.A. Sommer, Jr. suggested that provisions similar to Section 11 of the 1933 Securities Act, which are applicable to registered public offerings, might be useful in connection with offerings of municipal securities. What is the Commission's view on this suggestion?

15. Does the Commission believe the present authority of the MSRB is adequate? Has the Commission assessed the adequacy of the MSRB's activities?