

STATEMENT by STATE COMPTROLLER ARTHUR LEVITT
to a
HEARING of the NEW YORK STATE SENATE COMMITTEE
on TAXATION and GOVERNMENT OPERATIONS
270 BROADWAY in NEW YORK CITY on MAY 3, 1978.

Chairman Goodman, other members of the Committee: you have asked my views on the fiscal constraints and safeguards which will be needed for New York City after December 31, and on the role of the Municipal Assistance Corporation.

In brief, my view is that the existing constraints should be continued at least for whatever period the City may have securities guaranteed by the Federal Government outstanding; that it may be necessary to extend them for the full term of any new unguaranteed bonds the City issues in the next few years; and that the existing control mechanisms for exercising such constraints are adequate.

As you will remember, the New York City fiscal crisis was triggered when the City was unable to finance its ongoing operations through the public credit markets. At that time, the City's financial requirements included the following components: its deficit, its seasonal needs and its capital budget. When the Financial Emergency Act was passed in September 1975, it was contemplated that if the City were able to demonstrate substantial continuing progress toward the achievement of a balanced budget, investor confidence in the fiscal soundness of the City would be reestablished and the City would be able to regain access to the credit markets.

However, even though the City appears to be fulfilling the Financial Plan in compliance with this statute, the expectations of the Act have not been realized. Private investors do not yet have sufficient confidence in the City's ability to maintain fiscal discipline and manage its affairs within available resources. Without such confidence, they will not buy City securities. And the stark fact is that without attracting such investors -- primarily

commercial banks, property insurance companies, and well-to-do individuals in high tax brackets -- the City will not be able to finance either its day-to-day operations or its capital programs. Thus, the financial crisis remains with us although the City's annual cash needs have been scaled down considerably.

It appears that the length of time originally contemplated by the Financial Emergency Act to bring the City back into the credit markets, three years, was overly optimistic. Personally, I am dubious whether investors will buy long-term City bonds in the foreseeable future without knowing that the budgetary controls will be in existence, if necessary, throughout the term of the bonds. Any apprehension of new deficits after a few years of "good behavior" is likely to deter investors from buying new long-term bonds. In addition, I understand that proposed legislation, under which the Federal government would tender its aid in the form of loan guarantees, requires that a control body independent of the City's governmental structure would continue in existence for the life of the guarantees.

Since it appears that a monitoring mechanism will continue to be required, in my view, the existing mechanism -- consisting of the Emergency Financial Control Board, the Office of the Special Deputy Comptroller for New York City, and the Municipal Assistance Corporation -- provides a reasonable form for that monitoring to continue.

Additionally, in view of the existing investor distrust of the City, I believe there would have to be State legislation which creates a procedure for the City continually to set aside, before interest or principal became due, enough money to pay such amounts. This money would have to be from a readily identified and certain source of City revenue. To preclude any City effort to use it for other purposes, it would have to be put in a separate account in trust for the noteholders or bondholders. I feel sure investors would insist on a depository outside the City government. And a means would have to be provided for easy enforcement of the set-aside requirement.

Bonds and notes might well call for somewhat different set-aside mechanisms. For bonds, most of the money might come from the real estate tax. As you no doubt know, that tax is really the total of two parts, the first sufficient to pay the year's debt service on City bonds, and the second to meet other expenses. The first part could be set aside as it is collected. Probably with some amount as a cushion, the annual set-aside would have to be continued for the life of all new bonds; thus it would become permanent. For notes, the set-aside mechanism would be more complicated because of greater difficulty in predicting the City's receipt of some other taxes and revenues. A model -- though a very imperfect one -- exists in last November's hasty legislation authorizing the aborted City note sale. Again, in my judgment, the arrangement for setting aside funds would have to be permanent, though some of the initial safeguards or margins for error might be dispensed with as experience and confidence were built up.

To keep this concept in perspective, it should be remembered that setting aside revenues -- even governmental revenues -- is not a novel concept. Certain taxes and State aid are earmarked by pay MAC's debt service. I am required to impound State revenues before each maturity of State notes. Indeed, the City recognized the need for a mandated set-aside when it drafted the State statute authorizing the attempted City note sale and providing for me to withhold State aid to pay the notes.

You have also asked what the future role of the Municipal Assistance Corporation should be. As defined by its statute, the Corporation's responsibilities are twofold.

First, it is a mechanism through which the City has been able to borrow money in the past and may borrow in the future. The statute provides that revenues which are needed to meet the debt service on MAC borrowings, and to

meet the Corporation's cash requirements, remain outside the control of the City and be set aside through my Office.

Second, the State gives MAC the responsibility and the authority to monitor the City's progress toward the achievement of a balanced budget. MAC's covenants with its bondholders perpetuates this requirement over the life of these bonds, and therefore MAC has a continuing legal responsibility for this effort.

I point with some pride to the fact that we have eliminated much of the duplication that could otherwise have resulted from these parallel mechanisms by contracting with MAC so that the Office of the Special Deputy Comptroller performs the same function for MAC in monitoring and reporting on the City's Financial Plan as it does for the Emergency Financial Control Board. In my opinion, this arrangement has also strengthened the overall control mechanism.

However, I do not believe that MAC would be an effective replacement for the EFCB. Investors and the public regard it as a financing vehicle. I tend to think it should remain such and not be given control powers as well.

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STATE OF NEW YORK
 DEPARTMENT OF AUDIT AND CONTROL
 ALBANY

ARTHUR LEVITT
 STATE COMPTROLLER
 JOHN R. THOMPSON
 FIRST DEPUTY COMPTROLLER

MEMORANDUM TO: Mr. Felix G. Rohatyn

FROM: *J.R. Thompson*
 John R. Thompson
 First Deputy Comptroller

DATE: January 10, 1978

You may be interested in the attached speech which Arthur Levitt gave at the City Club last Friday.

The general thrust was that work should get under way immediately on specific State legislation (1) to continue budgetary standards and a State control mechanism and (2) to provide for effective advance segregation of City revenues to pay principal and interest on new City bonds and notes.

Attachment
 cc: Mr. Eugene Keilin

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MUNICIPAL ASSISTANCE CORPORATION	
JAN 12 '78	
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TALK BY STATE COMPTROLLER ARTHUR LEVITT
to
THE CITY CLUB OF NEW YORK
at
A LUNCHEON IN NEW YORK CITY ON
JANUARY 6, 1978 AT 1 P.M.
HOTEL BILTMORE (19TH FLOOR)

I welcome the opportunity to meet with you at this particular time. More than any other time in the City Club's illustrious 85-year history, the people of the City -- and the State -- need your objective and incisive appraisal of our problems -- and your considered recommendations for coping with them.

Because your concern is centered on New York City, I will depart from my usual practice in reporting to interested groups across the State. That practice -- which I consider one of my duties as the independently elected State Comptroller -- is to discuss one or more of the major responsibilities of my office. These responsibilities are broader than is often realized. They include performance audits which improve the effectiveness of State and local programs and point the way to very substantial savings of taxpayer money; approval of the financial aspects of all State contracts; pre-audit of a million and a half vouchers a year to assure expeditious but proper payment of State bills; the annual sale of nearly \$5 billion of State bonds and notes; operating the State's sophisticated cash management system; providing voluminous

legal and financial advice to thousands of local government entities; and managing the \$9 billion retirement systems I run for government employees outside the City.

Instead of outlining the continuing improvements we are making in those programs, I propose to share a few thoughts about New York City problems.

The City has traveled a long road in the last two and a half years, but we all know that serious problems still abound. There are long-range problems, intermediate-range problems and immediate problems. The long-range problems relate to turning around the City's economy and re-aligning Federal, State and City responsibilities for providing the services an urban area requires. The intermediate-range problems are how to complete the twin tasks of restoring the City's fiscal integrity and modernizing its management. The immediate problem is to get more breathing time -- or, as I prefer to view it, working time -- to address the other problems.

My concern here today is with that immediate problem. A balanced consideration must start by putting it in perspective. In mid-1975, you will recall, the City had staggering amounts of short-term debt coming due almost monthly, chaotic accounting, an unreliable so-called financial information system, underfunded

pension systems, and a budget out of control. Even more serious, many of the people whose actions most directly affected operation of the City -- City officials, community groups, union leaders and State legislators -- clung to the illusion that somehow the City could muddle through without decisive and painful reforms.

In the intervening time, there have been dramatic changes -- in practices and attitudes. Pursuant to directives from my office, accounting is being revised to accord with generally accepted accounting principles. A modern financial information system has been started. A large part of the short-term debt has been converted into long-term debt. There is a plan for improvement of pension funding and a start has been made to implement it. Nearly \$150 million of operational expenses have been shifted from the capital budget to the expense budget. The expense budget is under much tighter control. No informed person any longer questions the existence of serious problems and the need for continued vigorous action. In addition, there has been a truly remarkable amount of talent offered from the private sector and accepted by the City's officialdom. Seldom before has it had the dedicated help of a Shinn, a Margolis, an Ellinghaus, an Axelson, a Rohatyn or a Ravitch, to mention but a few. Taken together, these accomplishments could well be termed a revolutionary achievement.

Despite the progress we have made, it is clear that appreciably more time will be needed before the City can meet its large annual requirements of money by borrowing in the public market. Last November's unsuccessful note sale shows that even a modest amount of short-term notes cannot be sold under present conditions. The sale of long-term

bonds cannot even be contemplated at this time. All Federal loans of seasonal money must be repaid before June 30. The municipal pension funds, the main source of long-term money in the recent past, are apparently unwilling to buy more City bonds. The stark fact is that there is no presently perceived alternative to additional Federal help as the way to provide the extra working time we need after July 1.

Until two days ago, I had thought there was no responsible disagreement on that point. I have not seen the Proxmire-Brooke letter to the President which has just been reported. Frankly, I agree that the City should do its utmost to borrow on its own; however, there must be some mechanism to ensure that if it fails, the money can be obtained elsewhere.

Assuming, as I do, that Federal help is not yet out of the question, it is still not clear to me how the State and the City propose to meet an elementary condition the Federal Government would certainly attach to any help: State and City creation of a reasonable expectation that, given more time, the City will be able to satisfy both its seasonal and long-term needs in the market. I am concerned that there is not yet a framework of State statutes adequate to create that expectation. I am more concerned that time is passing without attention being addressed to drafting and enacting such statutes.

5.

We cannot control the pace of Federal decisions. But it would be highly imprudent to await them before working out other arrangements which should strengthen our case in Washington, which will be necessary whatever form Federal help may take, and which will be equally essential if Federal help is not available. These arrangements will themselves require time -- time for general formulation, time for difficult legislative drafting, time for negotiation and review. And time is short. While our deadline date is June 30, a prudent target date would be March 31. That is the date by which, as a practical matter, arrangements must be completed for the State's annual \$4 billion short-term Spring Borrowing. As you probably know, the State uses the \$4 billion to provide part of its annual \$7 billion program of local assistance. Every local government in the State -- including the City -- is dependent on this assistance. While two years of arduous work has restored investor confidence in the State's credit, there could be some difficulty in carrying out next Spring's borrowing unless it has become reasonably clear by the end of March that the City's operations can be funded beyond June 30.

I am sure that you have read, as I have, of several three-year or four year "Plans" for raising the money the City needs. In general, these plans are well conceived. At the least they stimulate needed thought. They deserve serious discussion. As you may remember, these Plans stress the City's need for Federal help in obtaining long-term money as well as a phased-out extension of short-term loans. They also speak of "bonding out" the City's seasonal

needs and the State's annual \$800 million advance, of speeding the shift of the remaining \$600 million of operational expenses from the capital to the expense budget, of an expensive new program of economic development, and of the City directly or indirectly selling to investors several billion dollars of new bonds. The Plans all proceed on the premise, however, that City bonds -- or a new class of MAC bonds supported only by City bonds -- can be sold in the public market in the near future. This seems also to be the premise of the Proxmire-Brooke letter. What all these Plans omit is consideration of the specific measures which must be taken before there can be any realistic prospect of that result being achieved. In that respect, these Plans are like an architect's rendering of a beautiful building which has no foundation. That does not mean the rendering should be disregarded. But it does mean someone must plan the foundation.

My remarks today are addressed to the design of some basic elements of that foundation. I regard this as a first-things-first approach. Much of what I have to say may be considered "obvious". But even the "obvious" sometimes needs articulation. Even "obvious" things require doing -- and preparatory spadework.

It may help to keep in mind our basic goal in asking for the time which Federal help will provide: to re-establish the City's ability to sell its short-term notes and long-term bonds in the public market. Stated more prosaically, the goal is to induce banks, insurance companies and well-to-do individuals to buy the City's notes and bonds.

Thus a threshold question is what such investors will require as an inducement -- besides a reasonable rate of tax-free interest. In general terms, the answer is clear: real assurance, from the outset, that their interest and principal will be paid on time. The Federal officials, I am sure, would want such assurance to be held out to private investors before extending any Government loans or guarantees. The question then translates into exactly what arrangements investors would consider adequate to give them that assurance. The theoretical minimum is probably what you or I would view as adequate if we were investing our own money. The practical minimum may be greater. Given the large amounts involved, it would probably have to encompass additional protection to meet demands of the proverbial investor "West of the Hudson" -- even demands we may consider unreasonable.

In view of the existing distrust of the City, I believe there would have to be State legislation which created a mechanism for the City continually to set aside, before interest or principal became due,

enough money to pay it. This money would have to be from a readily identified and certain source of City revenue. To preclude any City effort to use it for other purposes, it would have to be put in a separate account in trust for the noteholders or bondholders. I feel sure investors would insist on a depository outside the City government. And a means would have to be provided for easy enforcement of the set-aside.

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To keep this concept in perspective it should be remembered that setting aside revenues -- even governmental revenues -- is not a novel concept. Certain taxes and State aid are earmarked to pay MAC's debt service. I am required to impound State revenues before each maturity of State notes. Indeed, the City recognized the need for a mandated set-aside when it drafted the State statute authorizing the recently attempted City note sale and providing for me to withhold State aid to pay the notes.

Logically, a set-aside of revenues should by itself satisfy investors. As we all know, however, the investment community does not always act on pure logic. To digress a moment, the aborted City note sale last November illustrates that fact. When asked to rate the notes, Moody's concluded that "we see nothing which should prevent the timely payment of these obligations". It added that "the security features for these notes appear adequate" -- a reference to State aid being set aside. Yet, because there was the "possibility of bankruptcy in future years" -- ~~and~~ after the notes would have been paid -- the service gave them its lowest investment rating and thereby killed the sale. With Wall Street professionals adopting such ~~the same~~ reasoning, it would hardly be surprising if investors generally -- especially out-of-State investors -- insist on protection beyond that which may be really necessary.

With that consideration in mind, it seems clear that the revenue set-aside must be accompanied by the additional assurance that the City's annual expense budgets will be balanced -- realistically balanced. The point here is that balanced budgets will preclude the possibility the City could be tempted even to try any other use of the set-aside money. The State's Emergency Financial Control Board is due to expire at year-end. There seems to be universal agreement on what is needed, new State legislation prescribing stringent guidelines for City budgeting and establishing machinery to enforce them. The machinery could take several forms -- extension of the Control Board, revamping of MAC or designation of some other independent fiscal and monitoring agent. In my judgment, the legislation would have to remain in effect for a period of at least ten years and conceivably for the anticipated duration of new bonds.

As I have said, I find it disturbing that no work is under way to draft the detailed and technical statutes which will be required. It will not be easy, I realize, to accommodate the understandable home-rule sensibilities of City officials or the apprehensions of representatives of City employees. That is all the more reason for getting to work on the legislation without further delay.

A prototype of measures to do the two things I have mentioned -- set aside revenues to pay debt service and control City budgeting --

can be found in legislation enacted in 1976 for Yonkers. It took several months to get agreement on its main features. But it enabled that city, which had also been foreclosed from the market, to make a public sale of \$84 million of long-term bonds -- a large amount for a city of its size. The sale funded accumulated deficits and put Yonkers on a road which should lead to full financial health. For one reason or another, the Yonkers prototype may not be acceptable for New York City, but it points the direction which could be taken.

As you are aware, there have been some discouraging comments from Washington. One of them is that the State must increase what a Senator called its "weak, feeble effort" to help the City. The Governor refuted that characterization by detailing the very substantial assistance, regular and special, which the State has been providing out of a total budget smaller than the City's. It includes, to mention but one item, the special advance of \$800 million which the State plans to make next Spring for the third year -- \$800 million that the State must itself borrow. Moreover, there are serious financial, practical and legal obstacles to any significant increase in the State's contribution. The State has just completed the arduous restoration of its own credit in the aftermath of the City and UDC defaults. Responsible Federal officials must realize the folly of pushing the State into a precarious position as the price for avoiding another City crisis. True, the Governor

has proposed some State tax cuts, his assumption necessarily being that the State could otherwise show a surplus in its next fiscal year. There is reason to believe, however, that some tax reduction is necessary for the economy of the City as well as other parts of the State. From a practical standpoint, which realists in Washington should appreciate, the Legislature is most unlikely to approve the alternative use of that projected surplus to provide extra help to the City without granting comparable help to the rest of our local governments -- which would cut in half any money which could be made available to the City. Finally, the State has very limited sources of new money. At \$4 billion, its Spring Borrowing has reached the maximum of short-term notes the market will absorb even if the Legislature should authorize additional notes to help the City. With respect to bonds, the State is Constitutionally prohibited from selling them without approval of the electorate as well as the Legislature. The Constitution also prohibits any State guarantee of City bonds or notes.

I find another published proposal both disturbing and impractical. It is that the State Retirement Systems should buy a large amount of new City bonds or notes. As trustee of two of those systems, I could and would agree to no such commitment. For one thing I am a trustee. My investment of trust assets must conform to the legal requirements of the Prudent Man Rule. I must compare all available investments and select those which best meet

the requirements of safety, rate and diversification. The beneficiaries of the trust are nearly 750,000 individuals who work or have worked for the State and some 2500 local governments outside New York City. Unlike beneficiaries of the City pension funds, they have no direct interest in the City's finances. In addition, the State systems are likely to be called on to make a back-up commitment, as in 1977, to buy part of the State's 1978 Spring notes or actually to buy some of them as in 1976.

Personally, I am cautiously optimistic that the necessary Federal help will ultimately be forthcoming. To date the Federal loan program has not cost the Treasury a dime. In fact, it has probably resulted in a profit. Federal officials also acknowledge the significant progress the City has made in the last two and ^ahalf years. Nonetheless, I can understand their reluctance to continue the precedent of a special program for this City. I can understand also the frustration of members of Congress who may have believed the City's need for special help would be a thing of the past by next June. The hard fact, however, is that an extension of Federal assistance may still be vital as the City's "bridge to the public market". It may be the only real hope of averting a resurgence of the 1975-76 crisis for the City and maybe the State and the financial community. It would be a tragedy if the Federal Government withdrew its lifeline just as the City is headed for shore. I would hope that reason will prevail along the Potomac.

However, I suggest that it will measurably advance that result if the City and State move promptly to draft and enact the legislation I have described as the foundation for the City's ultimate return to the capital market.



STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
ALBANY

ARTHUR LEVITT
STATE COMPTROLLER
JOHN R. THOMPSON
FIRST DEPUTY COMPTROLLER

MEMORANDUM TO: Governor Carey
Speaker Steingut
Senate Majority Leader Anderson
Assembly Minority Leader Duryea
Senate Minority Leader Ohrenstein

FROM: John R. Thompson
First Deputy Comptroller

DATE: January 19, 1978

Pages 5-9 of Arthur Levitt's attached speech deal with the pressure for the State retirement systems to invest in new NYC (or MAC) bonds or notes.

Attachment



TALK BY STATE COMPTROLLER ARTHUR LEVITT

to

THE MUNICIPAL LAW SECTION OF THE NYS BAR ASSOCIATION
AT A LUNCHEON IN THE NEW YORK HILTON ON JANUARY 19,
1978.

There are several reasons I look forward to joining you every year and addressing you every other year. For one thing, as a lawyer myself it is a pleasure to be back home, in a sense, with my professional colleagues. As the elected State Comptroller, I welcome the opportunity to share a few thoughts on State and local finance with an intelligent and well-informed audience with representation from all types of local government and all parts of the State.

My usual practice in talking to groups with a more specialized orientation is to report on some phase of my office's activities which directly affects the particular group. In your case, however, the range of your interests and competence is so wide as to make selection of a topic itself a problem. Indeed, in the two years between my talks here there is usually substantial progress to report with respect to many of my responsibilities which are of concern to you. This year is no exception. Thus I have been tempted to discuss the increasing effectiveness of our performance audits, which point the way to very substantial savings of taxpayer money at State and local levels;

the growing sophistication of the State's cash management; the help we are giving local governments in drafting disclosure documents for their bonds and notes and in bringing their accounting closer to generally accepted accounting principles; recent legislation affecting the State-operated retirement systems I administer for local as well as State employees; or even improvements in our pre-audit function to permit more expeditious handling of over a billion and a half vouchers a year.

On reflection, though, I propose instead to bring you up-to-date on the subject I discussed here two years ago. Then I will report and comment on the extremely heavy pressure being exerted on me to commit assets of the State-run retirement systems to New York City.

Two years ago my talk dealt with the difficulties I foresaw in carrying out the State's annual \$4 billion Spring Borrowing in 1976. I chose that subject partly because I knew you were interested in the well-being of the State as well as that of your localities. My main reason, however, was that almost all of the \$4 billion is used to make payments of State aid to your local governments -- for education, welfare and general-purpose revenue sharing. Any State problems in carrying out its Spring Borrowing automatically become your problems in the most real sense.

The difficulties I foresaw, you will recall, were substantial. They did not arise from any weakness in the State's own finances. Hard revenues scheduled to be received later in the year were more than ample to pay the short-term notes the State proposed to sell. However, the emotional fall-out from New York City's horrendous situation had made important investors -- especially out-of-State banks and insurance companies on which we depend for purchase of a significant part of our notes -- reluctant to buy any paper bearing a New York label. Hard as it was to believe, even the major New York banks on two occasions had refused to make bids on relatively small issues of the State's full-faith-and-credit bonds.

As it turned out, my forecast of extreme difficulties proved to be no exaggeration. Nonetheless, by extraordinary efforts -- and with cooperation from the Governor, the Legislature, leading financiers of national repute and others -- I was able to accomplish the 1976 Spring Borrowing. I negotiated individual sales of two-thirds of the notes to nearly 200 institutions throughout the country, though at an unprecedented 7% short-term tax-exempt rate of interest. In consideration of the soundness of the notes and that rate of interest, the trustees of various State-related funds -- including the State-operated pension funds -- saw their way clear to take the remaining third.

As I said in my annual report for the State's 1975-76 fiscal year, we had weathered what was probably the worst financial crisis in the State's history -- certainly the worst since the eighteen forties.

Needless to say, the 1976 notes were all fully paid at maturity. As that year progressed, we took a number of constructive actions to allay investor apprehensions in future years. These actions, combined with a lessening of emotionalism in the capital market, produced the desired results. In 1977 our Spring Borrowing became almost routine once more. The entire \$4 billion of notes was sold to an underwriting syndicate which successfully retailed them. A normal 4.4% interest was paid. The State-run pension systems, while still required to make an appreciable back-up commitment, were not called on actually to buy any of the notes.

In my annual report for the State's 1976-77 fiscal year I was thus able to say that investor confidence in the State had been fully restored -- a remarkable achievement in such a short space of time.

As we approach the 1978 Spring Borrowing, I am cautiously optimistic. I use the word "cautiously" in view of a new cloud on the horizon: the recent uncertainty over continuation of Federal help to New York City after June 30. That uncertainty is unlikely to be dispelled until late Spring, and it is bound to have some adverse effect on the State's seasonal financing.

One aspect of the discussions about the Federal help is disturbing, even alarming. Since it directly affects the interests of present and past government workers in all of your localities -- except New York City -- I think you will share my concern.

In grasping for alternative sources of money for the City, Federal and City officials -- with, I am sorry to report, at least tacit support from some State officials -- have focused on the State-run pension systems. Since I am the sole trustee of two of the three such systems -- the third is the Teachers' Retirement System with a board of trustees -- I have been singled out as the public target of the pressure. Demands are being made that I make a blanket commitment to buy a very substantial amount of new City or MAC bonds or notes which, so far as has been stated, would carry no special protection to distinguish them from City securities that private investors have been refusing to buy. My reply has been that I would make no such commitment because it would violate my fiduciary responsibilities as a trustee. At the same time, I have said that I would consider investment in any specific bonds or notes if, but only if, they were structured in such a way as to meet the criteria long established in American law for investments by a fiduciary, by a trustee. In general, as you well know as attorneys, the overriding criterion is that any investment be in the interest of the trust beneficiaries -- the cestui que trust. In particular,

the criteria are safety of principal and interest (that is, virtually iron-clad assurance that the principal and interest will be paid when due), an interest rate equal to that of alternative investments, and diversification of the whole portfolio by type and maturity.

Mayor Koch's immediate reaction was to assail me personally. He declared that Arthur Levitt would be responsible if New York City goes bankrupt. That is irresponsible nonsense. But I am sure you can understand how I feel, as a person and as an elected official, to be on the receiving end of such demagoguery. I have great respect for Ed Koch generally and am confident he will reconsider his views as he gets a broader perspective.

There is one thing he and others overlook to begin with. It is something which I believe to be of special concern to you. You may have noted that I have referred to the funds in question as "State-run pension funds," not "State pension funds". For these funds are not owned by the State. Nor are they owned, except in a technical sense, by me. The real owners are nearly 750,000 present or former employees of the State and of over 2500 local government bodies -- other than New York City. The funds are an accumulation of money these individuals have contributed from their paychecks or their employers have paid as part of their agreed compensation. Their interests must be paramount in investment of that money.

Another thing. The Legislature has not simply authorized me to invest the funds in my discretion -- as it has with respect to surplus money the State itself has on hand from time to time. On the contrary, it has directed me to invest them explicitly as a trustee. Indeed, two years ago the Court of Appeals ruled that the members of the retirement systems had a Constitutional right to have the funds invested in accordance with fiduciary principles as applied by me as their trustee. The Court voided an attempt by the Legislature and the Governor to direct me to buy a fixed amount of MAC bonds. For any of you who may be interested, the citation is Sgaglione v. Levitt, 37 NY 2d 507. Incidentally, I also have a statutory Investment Advisory Committee to help me. That Committee, composed of eleven experienced leaders of the investment world, has unanimously endorsed my refusal to make any blanket commitment of the trusteed funds for New York City.

Last Friday a New York Times editorial on the subject came like a breath of fresh air. Let me read part of it:

"(I)n fairness, Mr. Levitt cannot be faulted for taking seriously his obligation as a trustee.

There are risks which other bond buyers can accept for their own accounts but which he cannot accept on behalf of the state's pensioners."

and

"Senators Proxmire and Brooke . . . should move to make such investments on his part more defensible."

The way out, the editorial continued, was to take a leaf from an existing Federal statute, the Housing and Community Development Act, and provide a 90% Federal guarantee for a new issue of City bonds which would be offered to the State-run pension systems and perhaps to other investors. If 10% State backing were added, the Times presumed I would regard such City securities as a prudent investment. Subject to the interest rate and the quantity of the securities being acceptable, the Times' presumption is correct. Needless to say, this proposal is far different from the demand for a blanket commitment which has been presented to me.

Besides employees, past and present, of the 2500 local government bodies, those bodies themselves would appear to have an interest in having the pension funds invested in accordance with trust principles. They are what is known as "participating employers" who have elected to have their workers included in the State-run systems. It would not be surprising if the trust concept was an important element in leading them to make the election. I suggest that those of you who are currently active municipal attorneys should familiarize your clients with this matter.

Perhaps I am a born optimist. I cannot help but believe that responsible public officials -- Federal, City and State -- will ultimately recognize that I must and will remain faithful to my fiduciary responsibilities. If the funds in my charge are to be used for the City, I must be offered securities with sufficient built-in special protection to qualify them as being of investment grade. Instead of castigating me, these officials should be using their considerable ingenuity to structure and develop securities of that kind.