PRESIDENT ARKUSS' REMARKS

The following remarks were delivered by Neil P. Arkuss at the annual meeting on September 22, 1993, as he assumed the presidency of the Association.

I am privileged and honored to become NABL's 15th President today. As you all no doubt recall, the 15th President of the Republic was one James Buchanan, our only bachelor president, who is remembered principally for having had the good sense to get out of town before the shooting started. Many of you have suggested that his timing was better than mine. You need go no further than the September 6 issue of *Business Week,* with its cover story "The Trouble with Munis," to know that this year promises to be "interesting" to say the least.

If the controversies swirling around the industry were not enough, I take over in the year in which the IRS has announced the enhancement of its audit function in the area of tax-exempt bonds. To prove its point, your Association is having its tax returns audited. This event is doubtless in retaliation for all those years of your President criticizing the TEFRA requirements. Not to worry! Our crack accounting team assures us there is nothing to be concerned about. Getting back to our 15th president, Buchanan was a well-recognized constitutional scholar of his time and had served in various important governmental capacities, including ambassador to Great Britain and as President Polk's Secretary of State. I mention President Buchanan because historians tell us that he followed a moderate political course between extremists in the North and South and by the end of what is generally regarded as a failed presidency managed to become the object of severe criticism from all flanks. I will try not to make the same mistake.

In looking at the challenges that the public finance industry faces in the year ahead and in considering how NABL can most effectively represent the interests of its membership, I think it is important that we consider who we are, what we do best and where our skills can best be employed. With the SEC and other governmental agencies, Congressional Committees, the MSRB and the State Treasurers' offices of several states homing in for the "regulatory fix," it is imperative that we as an organization help to identify and describe both the problems to be addressed and the appropriate solutions — as lawyers who have experience in the industry and a healthy skepticism for the benefits to be reaped from increased regulation.

I have had the benefit of counseling on the subjects I am about to address from three former NABL presidents, Jane Dickey, Rick Weber and my partner Jim Perkins, all of whom have influenced considerably my views. I would like to tell you to blame them if you disagree, but to quote the 37th President of the United States, "that would be wrong." I particularly want to thank Jim who has taken the time (and has had almost Job-like patience for more years than I wish to admit) trying to explain the world of municipal bonds to a stubborn tax lawyer.

Before examining the state of municipal affairs, there are certain general principles that most of us (I never use the word "everyone") would agree with. *First* and I think foremost, the purpose of the disclosure rules is to help investors make informed investment decisions. Increasing the amount of disclosure to serve other purposes is destined to be costly, at best, and a complete failure at worst. *Second,* improving the level of service or reducing its cost, or both, in connection with the delivery of professional services to governmental issuers (whether it be bond counsel, underwriting or financial advisory services) is a concern of state and local government issuers — *not a federal concern,* unless you adopt an extraordinarily paternalistic view of the role of the federal government.

One of the biggest problems we face today is the almost mindless inclusion of a variety of very different perceived abuses or shortcomings in the same discussion accompanied by a single panacea. It strikes me, for example, that issues stemming from unethical conduct on the part of public finance professionals are a completely separate kettle of fish from the issues surrounding the need for secondary market disclosure.

So what are the apples and oranges out there? The most prominent apple, I would think, is the controversy over political contributions. The use of political contributions to obtain underwriting, bond counsel or other professional engagements from state and local governments is an abuse. The integrity of the government process and the interests of taxpayers and ratepayers demand that it be dealt with. Political contributions, however, are not for the most part of particular interest to investors, who are concerned

primarily with issues surrounding whether they will receive the principal and interest they were promised. Accordingly, proposals to enhance the disclosure that goes to investors in order to remedy "contribution" abuses are badly misdirected. I think it almost goes without saying that this would overload the disclosure process and further obscure the important information the investor really needs to obtain.

Since the affected interests are state and local, that is where the remedial action needs to be taken. NABL should provide assistance in developing procurement procedures designed to eliminate these contributions in conjunction, perhaps, with the development of state-mandated standards. What I have in mind are objective restraints. Subjective standards are undesirable from an enforcement perspective because motivation is so hard to prove. If the question is, did you make political contributions in order to secure business? — the answer will surely be, NO. If the question is, did you make political contributions, that's something else altogether.

Any restraint will be a restraint on political expression. The legitimate interests of public finance professionals in participating in the political process must be factored into any proposed solutions. Moreover, the scope of the limitations must be sufficiently limited to succeed in a political process that, by its nature, involves the very officials who benefit from the contributions.

One of the remedies that flows from the notion that professionals are securing business, especially underwriting business, through contributions is to force issuers to sell bonds on the basis of competitive bids rather than by negotiated sale. This solution has loads of surface appeal because the competitive process precludes favoritism. On the other hand, few members of this Association would seriously dispute that there are transactions that benefit from negotiation. While it may be legitimate to have a presumption in favor of competitive bidding, issuers need to know all their options. We should assist state and local governments in drafting model criteria for the choice of competitive bidding or negotiated sales.

With respect to financial advisors (and my state, Massachusetts, has had the most "public" controversy in this regard) we are again looking at a more complex set of circumstances than first meets the eye. Financial advisors are hired to do many things, including providing assistance in (1) structuring the transaction; (2) timing of the issue; (3) selecting competitive or negotiated sales; (4) preparing the Official Statement and other written materials; and (5) dealing with underwriters with respect to the pricing and terms of the bond purchase or underwriting agreement.

Whether an issuer should hire a financial advisor that is itself a substantial underwriter in other transactions is best left to the judgment of the issuer. Negotiated underwriting experience may be viewed as useful in helping structure a transaction. It may also be helpful in decisions affecting timing and competitive vs. negotiated sales. Issuers should select advisors with full knowledge of the tradeoffs. In this connection, lest it be said that I have pulled my punches, a financial advisor rendering advice with respect to the sale of the bonds to underwriters should have no arrangement to participate directly or indirectly in the underwriter's profit from that transaction. Of equal importance, a firm that proposes to serve as financial advisor should disclose to the issuer material fee-sharing arrangements with underwriters in other transactions. We as members of the public finance bar should assist in developing documentation to implement these propositions.

This leads me, for reasons that are not too terribly clear, to the issues of unreasonable compensation or unfair bond allocations. Instances have been alleged in which firms have been compensated in amounts greatly exceeding their apparent contribution. The payment of unreasonable compensation to a favored firm, whether it is simple cronyism or something more subtle, is unethical and erodes the public trust. Procurement documents should bar this practice. We can help draft the provisions.

Artificial bond allocations can present similar problems. In an issue that sells like proverbial "hotcakes," a generous allocation of bonds to a syndicate member may be a reward for other favors. It can be artificial either because the sales effort really has been made by others or because no effort was needed to sell the beauties in the first place. The remedy for this practice is not obvious. Opening this process up to the direction of public officials or the formulation of articulated standards may be a major mistake. On balance,

the issuer may be best served by leaving this one alone — depending on the enlightened self-interest of the syndicate managers to regulate this practice. If some of the underlying problems caused by the necessity to repay political favors are curbed, this practice is less likely to survive unchecked.

Finally, no mention of regulatory infiltration of the municipal bond area is complete without at least something about secondary market disclosure. In my view, it would be a mistake to mandate secondary market disclosure across the board. How can we mandate disclosure without determining in advance what it is that must be disclosed? To prescribe a laundry list — in 10-K style — presupposes that everything on that list would be material to investors in every case. This is manifestly not so. Even now, disclosure of the truly material is diluted by massive disclosure of the immaterial. What really should be disclosed is that which would in fact make a difference to investors. The laundry-list approach would disserve that goal. Moreover, had the laundry-list approach been applied to some of our most disastrous cases (such as WPPSS), it is doubtful that it would have brought out the real problems.

Institutional investors and underwriters can require secondary market disclosure without any new law by insisting on contract provisions that specify the data to be reported if they believe that such disclosure would be cost-effective. NABL should encourage this process by assisting in the development of model bond indenture provisions.

The instances most commonly cited as demonstrating the need for legally mandated secondary market disclosure do not involve the creditworthiness of the issuer at all, but rather relate to whether the bonds have been or are likely to be called in the near future. We all would be greatly served if issuers and underwriters were strongly encouraged to provide that kind of information, perhaps through the MSRB. Only if this voluntary process fails should a legal mandate be considered and then it should be limited to this particular problem, as to which it does not appear too terribly difficult to define what ought to be disclosed.

For the same reasons I see no occasion for the repeal of the Tower Amendment. That would legally mandate the laundry-list approach. The result would be more disclosure in the sense of even more voluminous and more costly disclosure than at present, but not necessarily better disclosure. The truly material information would be even harder to find in the Official Statement than it is now and the false security of the laundry list would make the unearthing of unique problems (as in WPPSS) less likely rather than more likely.

It should come as no great surprise that what I am suggesting in all of this is that we add our expertise as lawyers to the process of reforming our industry in a manner designed to keep the baby happily in the tub with its ducky. Even the *Business Week* cover story acknowledges that the municipal market is "sound" and we should be doing everything in our power to keep it that way. I will ask the Board at its meeting tomorrow to establish a Task Force to deal with the issues I have outlined today, headed by Jane Dickey, Drew Kintzinger and Dale Collinson. I hope they will bear in mind my admonition that a single solution is no solution at all. This is a plea for all of you to volunteer your services in this regard. Do not hesitate to contact them or me with your ideas or an expression of willingness to be part of the Task Force. If your experience has been similar to mine, your issuer and underwriter clients have been asking for your advice in these areas and we encourage you to contribute your experience to the NABL efforts over the coming year.

On the tax front, I think we will see some regulatory activity — presumably in the definition of "private activity bonds." I fully expect to learn this year where sewage disposal ends and pollution control begins. Perhaps we will also see further arbitrage rules in the complex area of derivatives (isn't it ironic that you have a tax lawyer as your President this year?). We also may see some new financing proposals or opportunities under the Clinton health care proposals.

I cannot conclude without mentioning the superb job done last year by Jane Dickey. If you think it was easy being that "other president" from Little Rock — with half your firm off in Washington — and all the attendant difficulties — you're wrong. Jane worked tirelessly often under extremely trying circumstances and represented us all with grace and humor. She is an impossible act to follow.

Finally, I would remind you of the words of Mark Twain in describing the music of Richard Wagner. He is reputed to have said, "It's not as bad as it sounds."