



STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

**ANALYSIS OF QUESTIONNAIRES
SENT TO INDIVIDUAL INVESTORS,
SYNDICATE MEMBERS AND
MANAGING UNDERWRITERS**

August 26, 1977

SECURITIES AND EXCHANGE COMMISSION

STAFF REPORT

ON

TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK

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Chapter Seven

ANALYSIS OF QUESTIONNAIRES SENT TO INDIVIDUAL INVESTORS,
SYNDICATE MEMBERS AND MANAGING UNDERWRITERS

August 26, 1977

I N T R O D U C T I O N

This Report contains an analysis of the responses received from questionnaires sent to individual investors, syndicate members and managing underwriters in connection with the investigation into transactions in securities of the City of New York.

ANALYSIS OF QUESTIONNAIRES SENT TO INDIVIDUAL INVESTORS

THE INDIVIDUAL INVESTORS

As part of its investigation into transactions in securities of the City of New York ("the City"), the staff distributed a Questionnaire to a selective sampling of individual investors believed to have purchased City obligations (See "Method of Inquiry", infra). According to one estimate, no less than 160,000 individual investors owned the major portion of the City's outstanding long-term bonds prior to the moratorium. 1/

Over 500 investors responded to the Questionnaire. The Questionnaire was designed to determine, among other things, the information made available to investors about the City, their understanding of the City's financial condition at the time of their respective transactions and their motives for investing in City securities.

Over 60% of those responding indicated that they had not previously invested in municipal bonds or notes. 2/ More than 25% of investors queried about their income indicated that they earned less than \$20,000 per year. 3/ Over 16% of the respondents were retirees. 4/

1/ See excerpt from an investor analysis made by Lebenthal & Co., attached as Appendix D. A partial list of the communities, within the United States, outside of New York State, in which purchasers of City notes subject to the moratorium resided is attached as Appendix E.

2/ Question 10.

3/ This question was included only in the second of two questionnaires (question 16).

4/ Question 15.

Overwhelmingly, investors who responded to the Questionnaires indicated that they believed or understood that the City was in good or excellent financial condition: 1/

Financial Condition

Excellent	Over 29%
Good	Over 46%
Fair	Over 14%
Poor	Over 3%

Over 92% of responding investors noted as a factor in their investment decision the fact that the investment was "safe and secure". 2/ Investor assessment of risk at the time of purchase was as follows: 3/

Little or no Risk	Over 83%
Normal Risk	Over 13%
High Risk	Over 1%

Over 81% of those asked indicated that they understood or had been advised at the time of purchase that payment of principal and interest on the notes was a first lien on all of the City's revenues. 4/ Several of those responding commented that they believed they would be paid before City employees were paid.

1/ Question 6.

2/ Question 9(d).

3/ Question 6(b).

4/ Question 7(a). This question was asked specifically with respect to notes only in the second questionnaire. The first questionnaire, the results of which are not reflected in the above percentage, posed the question with respect to both bonds and notes.

A number of the polled investors volunteered additional comments concerning their own experiences with these investments. The great majority of these comments were overwhelmingly negative — and indicated that they had been misled. We have included as Appendix A a number of these comments.

The Questionnaire was important to determine the adequacy of disclosure regarding the City's financial condition at the time of its securities offerings. Since the City did not utilize prospectuses or other comparable disclosure documents, the staff sought to ascertain what means of communication, if any, were employed to bring relevant and material information concerning, among other things, the fiscal condition of the City to the attention of prospective purchasers.

The investigation has shown that in late 1974 and early 1975 the City's financial condition was precarious and its ability to remain fiscally solvent was greatly dependent upon continued access to the capital markets. Responses received from the Questionnaires, however, do not indicate that this was the perception held by investors at this time. In this regard, certain questions were designed to elicit the extent of the investors' knowledge of certain acts or practices of the City prior to their most recent purchase of City notes or bonds.

First, investors were asked whether they were aware that "[i]tems traditionally considered to be expense items, since they would reoccur on an annual basis, were included in the capital budget." Of the responses

received, approximately 88% indicated that investors were not aware of this, and approximately 12% indicated that they were. 1/ Second, investors were asked if they had been aware that "[t]he City had incurred short-term debt to provide funds required to close the gap between uneven streams of expenses and revenues." 2/ Approximately 66% of the responses to this question were negative, while approximately 34% were positive. The investors were then asked if they had been aware that "[t]he City's expense budget was prepared without creating any reserves for non-collection of tax revenues." 3/ Of the responses to this question, approximately 97% were "no" whereas approximately 3% were "yes." When asked if they were aware that "[t]he City included on its tax rolls properties not subject to taxation," approximately 96% of the responses were "no", while approximately 4% were "yes." 4/ The final question in this group asked whether the investor was aware that "[t]he City had used non-recurring revenues as a technique for producing a balanced budget in prior fiscal years." 5/ Approximately 95% of the responses were negative while approximately 5% were positive.

A further demonstration of the degree to which the majority of investors were either uninformed or misinformed as to the true nature of the City's affairs is contained in the responses to one question which asked the investors

1/ Question 8(a).

2/ Question 8(b).

3/ Question 8(c).

4/ Question 8(d).

5/ Question 8(e).

for their opinion of the City's bookkeeping and accounting practices at the time of their purchases of City notes or bonds. 1/ More than 80% of the responses indicated that such practices were considered "excellent" or "good," while over 11% classified them as "fair" and less than 8% as "poor." Our investigation has shown that, in fact, the City's bookkeeping and accounting practices were unsound and unclear.

Method of Inquiry

In early 1976 Questionnaires were distributed to investors selected from a list of those persons who had exchanged City securities for MAC bonds and to those who had inquired at the New York Regional Office about the City investigation. Approximately 284 completed Questionnaires were received and tabulated by the staff.

A second set of investors was sent Questionnaires containing minor revisions but similar in substance to the first. These investors had been selected from two classes: investors whose names appeared on confirmations of sales of City securities subpoenaed by the Commission from Chemical Bank, Bankers Trust, Citibank, Manufacturers Hanover, and Chase Manhattan Bank and investors who had contacted the New York Regional office concerning this matter. As of July 5, 1977, 218 completed Questionnaires

1/ Question 6(a). A large number of investors (over 20%) did not respond to this question.

had been returned by investors. Each set of Questionnaires was separately tabulated so that the responses could be analyzed. The Questionnaire forms, with tabulated responses where possible, are included as Appendices B and C. 1/

1/ In Appendices B and C, the total number of each of the responses received by the staff has been inserted beside the question to which it pertains. In some instances, the total number of responses to a question may exceed the number of investors polled because more than one response was called for or the investor had been involved in more than one transaction.

APPENDIX ASELECTED INVESTOR COMMENTS AND COMPLAINTS

"At the time of purchase I believed that the financial position of New York City was excellent. At no time did I ever envision the problems that the city encountered. I believed that the accounting practices of the city vis a vis the Comptroller's Office were sound and truthful. I was informed that these notes were backed by the full 'faith and credit' of the city, and that they had first lien on all city revenue. As far as I was concerned, my investment was sound and very safe.

"I am a young married man with an expectant family and this default/moratorium by the city has left me in a very poor financial position. I am not a "fat cat" but a small investor who thought that the return was excellent, the investment safe and secure, and the one year maturity date suitable for my needs...."

* * *

"Monies involved were an accumulation of the earnings of a lifetime on which Federal, State and City taxes had been paid. In reliance in the honor and integrity of a great city I made an investment purported to be risk free, after so being advised by my banker. Instead I have since learned that some of the City's practices, had they been engaged in by a private businessman. . .would result in his being prosecuted.

"In effect, the City, its leaders, the Federal and State governments and regulatory bodies, and last but certainly in the forefront with their advice, my bankers, have converted a potentially affluent retirement into more years of hard work and a frustrated old age."

* * *

"...My husband and I are too old to convert to ten, and now fifteen, year bonds. We have no other moneys. We have no estate or descendants. Our dreams of retirement utterly shattered. Why are we oldsters being tortured so; in the words of Watergate, 'left swinging in the wind,'? (no promise, no provisions being made for payment or amortization of this debt of honor.)"

* * *

"I will be 71 years old on May 5, 1977. My years are numbered now. I have no children. I cannot say to myself, 'So what, my children will (maybe??) get the money in the notes 20 years from now.'

"I need the money now for my own personal uses. I was hoping to buy a small apartment in a retirement village. Now I cannot do so.

"I have been cheated and misled as have thousands of others who bought the notes...." [Emphasis in original]

* * *

"I am convinced that in this matter I am a victim of 'swindlers'. These notes were well rated; there were no warnings given; or else I certainly would not have risked all the various family member's money as well as my own.

"I am no speculator; I bought these as a short term investment; I was led to believe that with a 'AA' rating, with an opinion that these were legal notes, and that the issuer, the largest city in the U.S.A., this was a prudent investment.

"Now, here I am. I, for one, would refuse to convert to long term papers, for I need these monies now - and in the next five years to put three children through college...."

* * *

"It is my opinion that the city should not have been allowed to sell these notes and bonds. There was no way that an investor like myself had available to me any information regarding the financial difficulty of the city....

"An ordinary uninformed investor was easily swayed by the large full page ads offering these notes and bonds for sale and especially by the list of prestigious underwriters (like Merrill Lynch and many of the large banks). The high interest rate was especially attractive and considering the ads and list of underwriters etc. was instrumental in influencing the purchasers.

"The full page advertisement advertising the city notes with the list of prestigious underwriters such as Merrill Lynch and many others led me to believe that my investments would be sound and without risk...."

* * *

"We are very disillusioned by this breach of faith and integrity by the City of New York. We are a working couple who, while raising a family, found it impossible to accumulate any funds for our future retirement. It was only after our children married that we began to diligently try to save for our old age. Towards that end my wife continued to work past an age when most women are ready to take a well earned rest. Accumulating money is a difficult and formidable task in this era of high prices and rising inflation.

"We were raised and grew up to believe that certain guarantees are beyond doubt and are given as a matter of simple faith and integrity....

"We need the money...."

* * *

"Our belief in the first lien of our bonds on the City was insurmountable. We were shocked that the City could abrogate their obligation to note-holders."

* * *

"My investment for one year notes represents most of my life savings. I am retired and depend on the income in order to live. I would rather starve than go on relief. When I read the ad in the New York Times financial pages I figured that this was an opportunity to get some income slightly more than was paid by the U.S. Treasury. I took money from matured U.S. Securities and from my savings bank and made the investment in 'One of the safest investments in the world.' This was the almost universal opinion. Mayor Beame is a C.P.A. He had a reputation as a man who had watched the city finances for over 30 years. As a C.P.A., I felt he had had an opportunity to make improvements in the accounting system. I had complete confidence in his ability as Budget Director and as the Comptroller of the City of New York. He knew what was going on all the time...." [Emphasis in original.]

* * *

"These RANS of 12/11/74 should not have been marketed by the City of New York....I had to postpone my retirement at age 68 because of this default."

* * *

"I am 59 years old and in good faith, based upon the offering by New York City, I invested a substantial portion of my savings, which I now am unable to use. I am a builder and have encountered very hard times and as a result was seriously affected by the nonpayment of my money...."

* * *

"As owner of a \$10,000 Revenue Anticipation Note of the City of New York, dated 1/13/75 and due 1/12/76, I hereby PROTEST the Breach of Contract imposed upon me by the State of New York, the City of New York, and the involved Banks and Brokers who sold them by assuring us that these notes would be honored as written.

"My note is specific in its clearly defined and binding terms. I quote here a very pertinent condition contained therein, '—and that for the punctual payment of the principal and interest of this Revenue Anticipation Note as the same become due and payable, the faith and credit of the City are hereby IRREVOCABLY pledged.' With the above statement plus all the other parts which guarantee these notes, I cannot understand the right of any government authority to usurp these existing bona fide contracts. My note says 'irrevocably pledged' which permits no one, in any position to change or modify any part of this contract. This means not the due date nor the rate of interest....

"As a Senior Citizen - Retired - and with inflation continually reducing my fixed pension, I find it necessary to change my way of life. I need this money now to pay for all my resettlement problems...." [Emphasis in original]

* * *

"We did not know that the city government would make a distinction to redeem bonds but not their notes...."

* * *

"I must reiterate what was previously said. I have had two heart attacks. My company dismissed me after my last attack when I could no longer actively produce as before. The funds I received in workmens compensation in settlement as well as my pension on reaching 65 was placed in short term city notes so I could retire the following year...."

* * *

"My husband and I were, and are, very unsophisticated regarding financial investments other than Savings Banks. Despite my having endured serious illnesses involving large medical expenses on a small income, we have always managed to be dignified and self-supporting. In recent years, with my enjoyment of better health, and a still modest but increased income, we have been able to save some money by continuing a modest, somewhat stringent life-style. Our goal was to buy either a home, cooperative or condominium and thus now, in our middle years, enjoy a more desirable living environment. The rigors of living in a Manhattan rent-controlled apartment are becoming increasingly difficult despite the increasing rent. We began to consult financial pages of newspapers and magazines reading articles such as the one enclosed (telling of the advantages of municipal bonds) along with information promulgated via the press about the current good financial solvency of the City of New York.

"We were not interested in any long-term investment and the New York City Notes seemed to answer our purpose. An investment for one year for our down-payment on a home or apartment would give us just the right amount of time to look around while accruing a better return on the amount saved for that purpose."

* * *

"I purchased my note because I was over 60 years old, had no pension from the firm I now work for, and resented bitterly having to pay income tax on the interest from the money I saved as a hard-working, thrifty citizen.

"I thought a one year note would help...."

* * *

"...I took out my hard earned money from its safe place in a savings bank where I was guaranteed satisfaction to invest in the City. Now it is not guaranteed and there is no excuse in the world why I shouldn't have my money. I want it back immediately. I am a hard working individual who works for his money and I have always payed taxes to the City without any questions...."

* * *

"...Had I known of the city's financial condition prior to purchase, even an interest rate of double digit proportions would not entice me to buy these notes...."

"...[T]hey added insult to injury by changing the law in the middle of the game by declaring a default, a moratorium...."

* * *

"When the moratorium was declared we felt thoroughly defrauded and misled by the information reported in the newspapers which quoted politicians, bankers and other financial market people prior to the moratorium. Especially after these same people and/or sources indicated by their comments after the moratorium was set up that they were well aware of the financial condition of the city well before these notes were peddled (and I use that word advisedly)."

* * *

"I personally feel that the city had no right to even think of issuing these notes. It is just beyond belief that the city didn't know that they couldn't meet these obligations. This issue was a 'hoax'. Never, never, in this country did I ever think this could happen."

APPENDIX B

1. With respect to each City note and bond that you purchased, please indicate in the appropriate columns set forth below:
 - (a) the name of the bank or brokerage firm from whom you purchased each note or bond;
 - (b) the date(s) of purchase(s);
 - (c) the date(s) of maturity(ies);
 - (d) the rate(s) of interest on the notes or bonds; and
 - (e) the name(s) of the salesperson(s)* of the banks or brokerage firms who assisted you in purchasing these notes or bonds.

If confirmation(s) of your purchase(s) indicates the above information, you may send us the confirmation(s) in lieu of answering this question. We shall return such confirmations to you promptly.

* Salesperson, Account Executive or Registered Representative.

DO NOT SEND US YOUR BONDS OR NOTES

<u>Firm</u> (a)	<u>Date of Purchase</u> (b)	<u>Date of Maturity</u> (c)	<u>Rate of Interest</u> (d)	<u>Account Executive or Salesperson</u> (e)
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

2. Please state in detail all the conversations you had with account executive or salespersons at and prior to each purchase by you of these notes or bonds.

(If more than one conversation please continue on a separate piece of paper and identify which purchase goes with each conversation)

3. Did you learn of the offering of these bonds or notes as a result of:
- (a) Published articles about the proposed offering of bonds or notes of the City. [185]
 - (b) Recommendation by your bankers or broker. [108]
 - (c) Recommendation by a friend, relative or business associate. [34]
 - (d) Some other way. Please specify. [29]

NO RESPONSE - 2

4. Did you receive any of the documents or reports referred to below before paying for the bonds or notes:

(a) A "Report of Essential Facts" for the City of New York:

Yes [13]

No [269]

NO RESPONSE

(b) The "Notice of Sale" describing the offering in which you were participating:

Yes [39] No [230] No Response - 15

(c) A published or reported opinion of counsel dealing with the tax exempt features of the bonds or notes being purchased:

Yes [74] No [197] No Response - 14

(d) The fiscal newsletter for the City of New York:

Yes [10] No [264] No Response - 10

(e) A confirmation of your purchase(s) sent to you by your bank or broker:

Yes [253] No [22] No Response - 9

(f) Literature about the bonds or notes prepared or distributed by your bank or broker:

Yes [30] No [245] No Response - 9

(g) A credit analysis on the City prepared by Moody's

Investor Service, Inc.:	Yes [15]	No [248]	No Response - 21
Standard & Poors Corp.:	Yes [13]	No [242]	No Response - 29
any other rating service:	Yes [7]	No [228]	No Response - 49

Please identify

(h) If you did not receive a credit analysis were you aware of or were you informed of the rating given to such notes or bonds:

Yes [121] No [151] No Response - 13

If your answer is yes, please indicate below what your understanding was of such rating, what such rating meant to you and identify the firm which furnished this rating.

(i) Other information relating to or describing the notes or bonds being purchased:

Yes [32] No [203] No Response - 49

If the answer to (i) is yes, please describe this material in the space below.

If the answer to part 4(f) or 4(i) of this question is yes and such materials are still in your possession, please enclose duplicate copies of the materials with your completed questionnaire.

DO NOT SEND US YOUR BONDS OR NOTES.

5. Did you receive any of the documents or reports referred to in Item 4 above immediately after you paid for your notes or bonds?

Yes [73]

No [173]

No Response - 38

If your answer is "yes" please identify such documents or reports.

Again, if the appropriate materials are still in your possession, please enclose duplicate copies of such materials with your completed questionnaire.

DO NOT SEND US YOUR BONDS OR NOTES.

6. At the time you purchased your bonds or notes what was your understanding of the City's financial condition?

Excellent [90] Good [146] Fair [38] Poor [10] No Response-13

Please explain in detail the source(s) of information that led you to believe the City's condition was as you have indicated.

(a) The City's bookkeeping and accounting practices were:

Excellent [56] Good [110] Fair [29] Poor [21] No Response-73

What was the source(s) of information that led you to believe the City's practices were as you have indicated?

(b) What degree of risk, if any, did you perceive to be involved in a purchase of City notes or bonds?

High [4] Normal [25] Little [70] None [180] No Response-7

(c) What were you told if anything regarding a secondary or trading market in City notes and bonds?

7. (a) At the time you purchased your bond(s) or note(s) of the City, were you advised or was it your understanding that payment of principal and interest shall be a first lien on all of the City's revenues?

Yes [255]

No [17]

No Response - 12

- (b) If your answer to the above is yes, please identify the source of your advice or understanding.

- (c) If your answer in (a) is yes, please indicate below the information you received or your understanding of what is meant by a first lien.

8. Prior to the time of your most recent purchase of notes or bonds of the City of New York were you aware of any of the following acts or practices of the City, as identified by New York State Comptroller Levitt in his audits with respect to New York City:

- (a) Items traditionally considered to be expense items since they would reoccur on an annual basis were included in the capital budget;

Yes [31] No [231] No Response - 22

- (b) The City had incurred short term debt to provide funds required to close the gap between uneven streams of expenses and revenues;

Yes [90] No [175] No Response - 19

- (c) The City's expense budget was prepared without creating any reserves for non-collection of tax revenues;

Yes [4] No [258] No Response - 22

- (d) The City included on its tax rolls properties not subject to taxation;

Yes [6] No [257] No Response - 21

- (e) The City had used non-recurring revenues as a technique for producing a balanced budget in prior fiscal years;

Yes [13] No [246] No Response - 25

9. Please indicate which of the following items were factors in your investment decision to purchase City note(s) or bond(s):

- (a) Higher rate of interest payable than in other investments:

Yes [202] No [63] No Response - 19

(b) Tax exempt status with respect to income derived from an investment in City bond(s) or note(s):

Yes [272] No [3] No Response - 9

(c) Favorable rating given to such bonds or notes:

Yes [222] No [28] No Response - 34

(d) A safe and secure investment:

Yes [269] No [6] No Response - 9

(e) Maturity date of the bond(s) or note(s) met your investment needs:

Yes [254] No [13] No Response - 17

(f) If there were other reasons, please summarize them below:

- (a) I am holding these notes and anticipate that I will continue to hold them until the expiration of the moratorium: [140]
- (b) I sold these notes: [8]
- (c) I exchanged these notes or intend to exchange these notes for the obligations of the Municipal Assistance Corporation: [124]

OTHER 1

NO RESPONSE 29

14. Please indicate your highest level of academic study:

Post-Graduate [108]

College Graduate [84]

High School Graduate [71]

Other [27]

NO RESPONSE 9

15. Please indicate your area of employment at time of your last purchase of New York City's bonds or notes:

Self-Employed [68]

Professional [108]

White-Collar Employee [60]

Laborer [3]

Retired [58]

Unemployed [8]

OTHER 9

NO RESPONSE 1

16. Please indicate your marital status:

Single	[33]
Married	[215]
Divorced	[7]
Widow or Widower	[25]
NO RESPONSE	4

17. I would be willing to discuss my situation in further detail with a representative of the Securities and Exchange Commission.

Yes []

No []

Name _____

Home Address _____

Business Address _____

Home Telephone Number _____

Business Telephone Number _____

APPENDIX C

1. With respect to each City note and bond that you purchased, please indicate in the appropriate columns set forth on page 2:
 - (a) The name of the bank or brokerage firm from whom you purchased each note or bond;
 - (b) The date(s) of purchase(s);
 - (c) The date(s) of maturity(ies);
 - (d) The rate(s) of interest on the notes or bonds;
and
 - (e) The name(s) of the salesperson(s)* of the bonds or brokerage firms who assisted you in purchasing these notes or bonds.

If confirmation(s) of your purchase(s) indicates the above information, you may send us the confirmation(s) in lieu of answering this question. We shall return such confirmations to you promptly. In any event, please state the principal amount of the bond or note purchased.

* Salesperson, Account Executive or Registered Representative.

DO NOT SEND US YOUR BONDS OR NOTES

<u>Firm</u>	<u>Date of Purchase</u>	<u>Date of Maturity</u>	<u>Rate of Interest</u>	<u>Account Executive or Salesperson</u>
(a)	(b)	(c)	(d)	(e)
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

2. Please state in detail all the conversations you had with salespersons at and prior to each purchase by you of these notes or bonds.

(If more than one conversation took place, please continue your description on a separate piece of paper and identify which purchase goes with each conversation.)

3. Did you learn of the offering of these bonds or notes as a result of:

- | | |
|---|-------|
| (a) Published articles about the proposed offering of bonds or notes of the City? | [130] |
| (b) Recommendation by your banker or broker? | [71] |
| (c) Recommendation by a friend, relative or business associate? | [28] |
| (d) Some other way? Please specify. | [24] |
| NO RESPONSE | 2 |
-
-
-
-

4. Did you receive any of the documents or reports referred to below before paying for the bonds or notes:

- | | | | |
|---|----------|-------------|----|
| (a) A "Report of Essential Facts" for the City, i.e., a 2-3 page document prepared by the Comptroller's office? | | | |
| Yes [7] | No [201] | No Response | 10 |
| (b) The "Notice of Sale" describing the bonds or notes, i.e., the official several page notice of the Comptroller's office? | | | |
| Yes [6] | No [199] | No Response | 13 |
| (c) A published or reported opinion of counsel dealing with the tax-exempt features of the bonds or notes being purchased? | | | |
| Yes [35] | No [172] | No Response | 12 |

- (d) The fiscal newsletter for the City of New York published by the Finance Administration of the City?
- | | | | |
|---------|----------|-------------|----|
| Yes [2] | No [201] | No Response | 15 |
|---------|----------|-------------|----|
- (e) A confirmation of your purchase(s) sent to you by your bank or broker?
- | | | | |
|-----------|---------|-------------|---|
| Yes [183] | No [28] | No Response | 7 |
|-----------|---------|-------------|---|
- (f) Literature about the bonds or notes prepared or distributed by your bank or broker?
- | | | | |
|----------|----------|-------------|----|
| Yes [14] | No [194] | No Response | 10 |
|----------|----------|-------------|----|
- (g) A credit analysis on the City prepared by Moody's Investor Service, Inc.?
- | | | | |
|---------|----------|-------------|----|
| Yes [4] | No [204] | No Response | 10 |
|---------|----------|-------------|----|
- or Standard & Poor's Corp.?
- | | | | |
|---------|----------|-------------|----|
| Yes [4] | No [203] | No Response | 12 |
|---------|----------|-------------|----|
- any other rating service?
- | | | | |
|---------|----------|-------------|----|
| Yes [2] | No [205] | No Response | 12 |
|---------|----------|-------------|----|

Please identify

- (h) If you did not receive a credit analysis, were you aware of or were you informed of the rating given to such notes or bonds?
- | | | | |
|----------|----------|-------------|----|
| Yes [71] | No [133] | No Response | 15 |
|----------|----------|-------------|----|

If your answer is yes, please indicate below

- (i) The rating;
- (ii) Your understanding of the meaning of the rating, and
- (iii) How you learned of the rating.

- (i) Other information relating to or describing the notes or bonds being purchased?

Yes [22] No [137] No Response 59

If the answer to (i) is yes, please describe this material in the space below.

If the answer to part 4(f)-(i) of this question is yes, and such materials are still in your possession, please enclose duplicate copies of the materials with your completed questionnaire.

DO NOT SEND US YOUR BONDS OR NOTES

6.

5. Did you receive any of the documents or reports referred to in Item 4 above immediately after you paid for your notes or bonds?

Yes [42]

No [148]

No Response 28

If your answer is "yes" please identify such documents or reports.

Again, if the appropriate materials are still in your possession, please enclose duplicate copies of such materials with your completed questionnaire.

DO NOT SEND US YOUR BONDS OR NOTES

6. At the time you purchased your bonds or notes, what did you believe the City's financial condition to be?

Excellent[65]

Good[110]

Fair[39]

Poor[8]

No Response 8

Please explain in detail the source(s) of information that led you to believe the City's condition was as you have indicated.

7.

(a) At the time you purchased your bonds or notes, what did you believe the City's bookkeeping and accounting practices to be?

Excellent [55] Good [107] Fair [18] Poor [9] No Response 32

What was the source(s) of information that led you to believe the City's practices were as you have indicated?

(b) At the time you purchased your bonds or notes, what degree of risk, if any, did you perceive to be involved in a purchase of City notes or bonds?

High [2] Normal [42] Little [44] None [132] No Response 2

(c) What were you told, if anything, regarding a secondary or trading market in City notes and bonds?

8.

7. (a) If you purchased notes, were you advised or was it your understanding at the time of purchase, that payment of principal and interest of the notes shall be a first lien on all of the City's revenues?

Yes [177]

No [22]

No Response 19

- (b) If your answer to the above is yes, please identify the source of your advice or understanding.

- (c) If your answer in (a) is yes, please indicate below the information you received or your understanding of what is meant by a first lien.

8. Prior to the time of your most recent purchase of notes or bonds of the City, were you aware of any of the following acts or practices of the City, as identified by New York State Comptroller Levitt in his audits with respect to the City:

- (a) Items traditionally considered to be expense items, since they would reoccur on an annual basis, were included in the capital budget;

Yes [18]

No [191]

No Response 9

9.

- (b) The City had incurred short term debt to provide funds required to close the gap between uneven streams of expenses and revenues;
- Yes [69] No [136] No Response 13
- (c) The City's expense budget was prepared without creating any reserves for non-collection of tax revenues;
- Yes [6] No [200] No Response 12
- (d) The City included on its tax rolls properties not subject to taxation;
- Yes [12] No [192] No Response 14
- (e) The City had used non-recurring revenues as a technique for producing a balanced budget in prior fiscal years;
- Yes [9] No [195] No Response 14

9. Please indicate which, if any, of the following items were factors in your investment decision to purchase City notes or bonds:

- (a) Higher rate of interest payable than in other investments;
- Yes [171] No [30] No Response 18
- (b) Tax exempt status with respect to income derived from an investment in City bonds or notes;
- Yes [210] No [4] No Response 4
- (c) Favorable rating given to such bonds or notes;
- Yes [132] No [49] No Response 37
- (d) A safe and secure investment;
- Yes [197] No [9] No Response 12
- (e) Maturity date of the bonds or notes met your investment needs;
- Yes [205] No [5] No Response 8

10.

(f) If there were other reasons, please summarize them below:

10. Was your investment in City notes or bonds your first investment in municipal notes or bonds?

Yes [132]

No [80]

No Response 6

11. Apart from City notes or bonds, had you previously purchased any of the following:

Corporate Stock [181]

Corporate Bonds [90]

Other Municipal Bonds [72]

Other Municipal Notes [28]

I had not previously purchased other securities [17]

NO RESPONSE 13

12. At the time that you purchased your notes or bonds, were you advised that the City might defer its obligations to certain of its noteholders through the enactment of a moratorium law?

Yes [0]

No [214]

No Response 4

11.

13. If you held any notes of the City coming due beginning in December of 1975, and subject to the moratorium law, please check the appropriate box below:

(a) I am holding these notes and anticipate that I will continue to hold them until the expiration of the moratorium; [120]

(b) I sold these notes; [13]

(c) I exchanged these notes or intend to exchange these notes for the obligations of the Municipal Assistance Corporation; [54]

(d) I plan to sell the notes prior to maturity. [3]

NO RESPONSE 38

14. Please indicate your highest level of academic study:

Post-graduate [89]

College Graduate [57]

High School Graduate [61]

Other [20]

NO RESPONSE 5

15. Please indicate your area of employment at the time of your last purchase of the City's bonds or notes:

Self-employed [68]

Professional [88]

White-Collar employee [37]

Laborer [2]

Retired [33]

Unemployed [4]

OTHER 5

NO RESPONSE 4

16. Please indicate your annual income bracket at the time you purchased your bonds or notes (optional):

Less than \$10,000	[12]
\$10,000 - \$20,000	[44]
\$20,000 - \$40,000	[79]
Above \$40,000	[62]
NO RESPONSE	22

17. I would be willing to discuss my situation in further detail with a representative of the Securities and Exchange Commission

Yes [] No []

Name _____

Home Address: _____

Business Address: _____

Home Telephone Number: _____

Business Telephone Number: _____

ADDITIONAL COMMENTS:

APPENDIX D

Written Statement, in Part, of James A. Lebenthal,
Executive Vice President, Lebenthal & Co.

Consequences of New York City Default on Individual Bond Owner

Nobody claims to know who the owners of New York City's bonds are, and that is just one of the enormous difficulties in visualizing in human terms the consequences of default by the second largest borrower in our capital society.

The Municipal Bond firm of which I am Executive Vice President, Lebenthal & Co., Inc. with offices located at 1 State Street Plaza, New York, NY 10004, may be in a unique position to supply some hard statistics on the ownership of New York City bonds.

Since 1925, Lebenthal & Company has been specializing in Municipal Bonds, catering almost exclusively to the individual investor.

An analysis of the business records of our firm leads me to the estimate that no less than 160,000 small individual investors own the major portion of New York City's outstanding long term bonds. New York City has a total of \$7,350,610,000 bonds outstanding. I would place the combined ownings of these 160,000 households at approximately \$4,895,000,000, two thirds of the debt outstanding*.

But because the tax free coupon interest from municipal bonds need not be reported and the Treasury Department has no record of municipal bond ownership...because the federal reserve figures are preoccupied with bank ownership and it is only through a process of elimination that we have any governmental figures at all on ownership of households of \$62.3 of the \$207 billion state and local debt outstanding...and because of the natural reticence of people to speak openly about their money, the impression could exist that Municipal Bonds are the private preserve of banks and a few Park Avenue millionaires.

That is not the picture I am now going to present or that is supported by the more than 300 letters Lebenthal & Co., Inc. has received in reply to a request for bondholders on our mailing list to come forward, write and be identified, a small sample of which are appended hereto.

The typical owner of New York City Bonds is on in years.

The bonds represent the family's savings, accumulated over a lifetime. Payment is usually made by check drawn on savings accounts. The bonds are savings.

The average transaction is \$10,000. The average portfolio is less than \$35,000.

* * *

October 15, 1975

* This analysis of the ownership of New York City debt by individuals is limited to funded debt, bonds only, of which Lebenthal & Co., Inc. had been a major underwriter and marketer. Not having been an underwriter of the city's notes, the company has played a negligible role in the marketing of notes and does not possess the expertise to analyze individual ownership.

APPENDIX E

THE FOLLOWING IS A PARTIAL LIST OF THE COMMUNITIES,
WITHIN THE UNITED STATES, OUTSIDE OF NEW YORK STATE,
IN WHICH PURCHASERS OF CITY NOTES SUBJECT TO THE
MORATORIUM RESIDED.

ALABAMA

Fyffe

Talladega

Union Town

Altalla

Sulligent

Fort Deposit

Birmingham

Point Clear

Clayton

Montevallo

Southeast Decatur

ARIZONA

Tucson

ARKANSAS

West Memphis

CALIFORNIA

San Anna

Encino

Downey

Oakland

Beverly Hills

Los Angeles

San Francisco

COLORADO

Denver

CONNECTICUT

Hartford

Bridgeport

Stamford

Norwalk

Southbury

Westport

Old Saybrook

Norfolk

Orange

Rowayton

Byram

Old Greenwich

Fairfield

Weston

Greenwich

West Hartford

New Canaan

Woodmont

Waterbury

Waterford

Newington

Danbury

Salisbury

DELAWARE

Essex

Wilmington

Springdale

New Castle

Darien

DISTRICT OF COLUMBIA

Bloomfield

Washington, D.C.

FLORIDA

Miami Beach

Surfside

Hollywood

Homestead

West Palm Beach

Lake Worth

Coral Gables

North Miami Beach

Highland Beach

Sarasota

Fort Lauderdale

Palm Beach

Boca Raton

North Miami

St. Petersburg

Juno Beach

Delray Beach

Margate

Vero Beach

Sunrise

Hallandale

Satellite Beach

Miami

Key West

Naples

Bal Harbour

GEORGIA

Atlanta

Dalton

ILLINOIS

Chicago

East Alton

Evanston

Park Ridge

Northbrook

Highland Park

Wilmetta

INDIANA

Indianapolis

Bedford

East Chicago

Munster

IOWA

Britt

Manly

Newton

Balmont

KANSAS

Great Bend

Dighton

Clay Center

KENTUCKY

Cadiz

LOUISIANA

Monroe

MAINE

Portland

Lincoln

MARYLAND

Bethesda

Baltimore

Denton

Potomac

Silver Spring

Hancock

Rockville

Chevy Chase

MASSACHUSETTS

Boston

Wellesley Hills

Newton Centre

Newton

Gloucester

Everett

Chestnut Hill

Belmont

MASS. cont.

Medford

Brookline

Cambridge

Dedham

Lexington

Chilmark

Wayland

Amherst

Melrose

Needham

Marblehead

Wenham

Andover

Worcester

MICHIGAN

Detroit

Ionia

MINNESOTA

Minneapolis

MISSISSIPPI

Tupelo

Gary

MISSOURI

St. Louis

Chesterfield

NEBRASKA

Holdrege

NEW HAMPSHIRE

Center Harbor

NEW JERSEY

Teaneck	Cliffside Park	Englewood
Franklin Lakes	Short Hills	Ridgewood
Whippany	Harrington Park	Nutley
Hawthorne	Tenafly	N. Plainfield
Bayonne	South Orange	Milford
Upper Montclair	Saddle Brook	Aldine
Highland Park	Clifton	Elberon
Maplewood	Perth Amboy	Irvington
Saddle River	Oradell	Oakhurst
North Brunswick	Englewood Cliffs	Union
Montclair	Millburn	Weehawken
Newark	Bayonne	Fort Lee
Hackensack	Jersey City	East Orange
Roselle Park	New Milford	Little Falls
Elizabeth	Livingston	Franklin Lakes
Basking Ridge	Rutherford	Trenton
Patterson	Orange	Summit
Springfield	Rahway	Sumerset
Westfield	Morganville	

NEW JERSEY con't.

Deal	West Orange	West New York
Union City	Closter	Edgewater
Mountainside	Madison	Wyckoff
Haworth	Eatontown	Englishtown
Hillsdale	Belleville	Kinnelon
Verona	Essex Falls	Oakhurst
Tinton Falls	Kearney	Morristown
Matawan	Linden	Cresskill
Glen Park	Harrington Park	Asbury Park
Princeton	Trenton	Fairfield
Wayne	Paramus	West Allenwest
Demarest	Lincroft	Upper Montclair
New Providence	Woodbridge	North Arlington
Scotch Plains	Passaic	Palisade
Lincoln Park	Fair Lawn	Wayne
North Caldwell	Florham Park	Gilette
Chatham	Long Branch	Glen Ridge
Mount Vernon	Colonia	Bernardsville
Red Bank	East Brunswick	Morris Plains
Upper Saddle River	Cherry Hill	Bradley Beach
Springfield		

NEW JERSEY cont

Dover

Paterson

River Vale

Edison

Lyndhurst

Colts Neck

Lakewood

Garfield

Ridgefield

North Bergen

Iselin

Hoboken

Keasbey

West Paterson

Bridgewater

Murray Hill

Voorhees

Bergenfield

NEW MEXICO

Santa Fe

NORTH CAROLINA

Eden

Raleigh

Charlotte

NORTH DAKOTA

Wimbledon

OHIO

Tiffin

Columbus

Hamilton

Cincinnati

Fremont

PENNSYLVANIA

Philadelphia

Cheltenham

Dowington

Allentown

Pa. cont.

Bla Cynwyd

Mt. Lebanon

Yardley

Pittsburg

Dallas

Easton

Jennerstown

Mansfield

Havertown

Millersburg

Ellwood City

Chambersburg

State College

Morristown

Wayne

Newton

RHODE ISLAND

Barrington

Providence

Wakefield

Cranston

Johnston

Woonsocket

Little Compton

Bristol

Warwick

TENNESSEE

Dunlap

Columbia

Brentwood

Nashville

Madison

TEXAS

Houston

Greenville

Huntington

San Antonio

VERMONT

Burlington

E. Thetford

Morrisville

VIRGINIA

Newport News

Richmond

Charlottesville

Alexandria

Virginia Beach

Williamsburg

WASHINGTON

Williamson

WISCONSIN

Racine

Oregon

Milwaukee

ANALYSIS OF QUESTIONNAIRES SENT TO SYNDICATE MEMBERS

August 26, 1977

As part of the Commission's investigation, those institutions that participated in the underwriting and sale of City securities were requested to respond to a Questionnaire. The names of the participating organizations were obtained from tombstone advertisements in the newspapers, The Daily Bond Buyer and from other relevant sources. The Questionnaire was mailed to approximately 304 organizations participating in the sale or distribution of the Notes or Bonds between April 4, 1973 and June 30, 1975. 1/ The following report represents a compilation obtained from the responses of ninety-three organizations which returned the Questionnaire.

The report focuses on the responses in the following areas: understanding or belief concerning the duties of the managing underwriter and bond counsel; investigation and analysis of information concerning the underwriting of New York City Notes or Bonds; the decision to participate; customer sales; and conclusory remarks.

1/ Approximately seven organizations which returned the Questionnaire were not a part of the tabulation of results (as of June 20, 1977). Question One (regarding the extent of individual syndicate members' participation), Question Thirty-four (regarding the monthly position of the accounts of the individual syndicate members during January 1, 1973 to May 30, 1975), and Question Thirty-one (concerning the participation in the underwriting of Revenue Anticipation Notes ("RANs") and Tax Anticipation Notes ("TANs")) are not a part of the report. The text of these Questions is included in Exhibit A.

I. UNDERSTANDING OR BELIEF OF THE DUTIES OF THE MANAGING UNDERWRITER AND BOND COUNSEL

This section encompasses the responses to Questions Ten, Eleven and Twelve of the Questionnaire.

Question Ten states:

What was your organization's understanding as to the role or duties of the managing underwriter in connection with the underwriting of the Notes or Bonds? For example,

- (A) Did you believe that the managing underwriters had or assumed the responsibility to verify or investigate the accuracy, completeness, or veracity of the information prepared and presented to them by the City and/or received by them from other sources (1) Before inviting your organization to be a syndicate member; (2) Before the pricing meetings; or (3) Before sale and distribution of the Notes or Bonds to the public?
- (B) Did your organization understand or believe that the managing underwriters had an obligation to bring to your attention any negative aspects relating to the Notes or Bonds?
- (C) Did your organization understand or believe that the managing underwriters' decision to underwrite the Notes or Bonds was in and of itself an express or implied approval of the credit-worthiness of the City's fiscal position and its Notes or Bonds?

In each instance, state the basis for the understanding or belief.

- (D) In any event, please reflect your understanding or belief of the managing underwriters' role or duties.

* * * *

The majority of the syndicate members relied upon the managing underwriters and expected that they would fulfill those duties described in Question Ten; however, a few organizations qualified their statements. For example, one firm noted that it believed that managing underwriters did not necessarily have an obligation to bring any negative aspects relating to the Notes or Bonds to the attention of the syndicate members. The firm also stated its belief that many negative aspects are opinion. 1/

1/ Response No. 1 to the Syndicate Members Questionnaire (hereinafter cited, e.g., "Response No. ___").

Another firm observed:

. . .but other members of the syndicate also exercise the responsibility to report developments which have come to their attention. 1/

One response reflects not only the ability of the syndicate member but also that of the customer to assess the risks.

We do not believe that another organization can be held responsible for the activities of our firm. We believe we have a responsibility to monitor our own actions and we believe that our sales of these securities were, in the main, to customers who were capable of assessing the risks themselves although admittedly inadequate information was provided by the City. 2/

In response to Question Ten (D) the members of the underwriting syndicates do not agree as to the limitations or the scope of the duties of managing underwriters.

Without stating the basis, certain organizations narrowly perceived the duties of the managing underwriter. For instance, one organization believed the duties of managing underwriters were merely to organize the selling group. Other organizations emphasized the managing underwriters' managerial capacity such as, e.g., duties to ...

Form syndicate, Pricing, Book presale orders for account, Submit bid, Run the books. 3/

Duties to form the underwriting group, to analyze the information provided, and to prepare the circular in the manner normally presented to prospective investors, to determine the bid, to allocate the bonds, to manage the closing, and to distribute profits, if any. 4/

1/ Response No. 2.

2/ Response No. 3.

3/ Response No. 4.

4/ Response No. 5.

Other replies emphasized, in effect, that the duties were more than merely managerial:

The manager's prime function is to syndicate and submit a bid and if he is aware of a major problem in the issuer's finances, it should be pointed out to the syndicate members. 1/

One bank emphasized the essential research to be completed prior to the organization of the syndicate:

This is a Cardinal Rule that applied to all new issues regardless of name. The obligation of the managing underwriter is to ascertain that the issue has been legally authorized and that its credit worthiness has been fully verified by its municipal research staff before any syndicate membership is organized. 2/

Another syndicate member replied as follows:

It is our opinion that the managing underwriter was and is responsible for managing the account from the point of view and with the implied understanding that he would not form or re-activate an underwriting syndicate for a potentially defaulting issuer. 3/

One bank characterized the role of the managing underwriter as follows:

The managing underwriters were in effect structuring accounts which, if successful, would be offering the bonds to institutions and the general public therefore becoming the responsible architect of such offerings. 4/

The various duties of the managing underwriter were described by a major banking institution as follows:

-
- 1/ Response No. 6.
 - 2/ Response No. 7.
 - 3/ Response No. 8.
 - 4/ Response No. 9.

The managing underwriter's first responsibility is to make an appropriate credit analysis of all relevant credit factors concerning the issuer. If, based on that analysis, the managing underwriter concludes that the issuer has the ability to pay its obligations at maturity, its next responsibility is to contact those institutions that generally bid with the syndicate and to ascertain their interest in participating in the syndicate. After the syndicate is formed, the managing underwriter's principal responsibility in a competitive bid offering is to represent the syndicate in making the best possible bid for the securities. If the syndicate is successful in winning the bid, the managing underwriter's role is to ensure maximum participation from the members and to effect complete distribution of the securities. The managing underwriter is also responsible for maintaining records of the account and reporting any profit or loss to the syndicate. 1/

In the description of the duties of the managing underwriter, some prominent institutions attributed greater responsibility to the rating services or to the City than to the managing underwriter. One firm states:

The manager had the right to believe in the accuracy and veracity of figures prepared by the City. We dropped when we feared this trust was misplaced. 2/

1/ Response No. 10.

2/ Response No. 12.

We also believed in the security of general obligation notes and bonds, the pledge of the full faith and credit of the issuer, and the federal statutes regarding the sanctity of the contract. 1/

The nature of the relationship between the City and the managing underwriters was thought to be a key to the duties of the managing underwriters.

We felt that because of the close relationship of Chase Manhattan to New York City's fiscal affairs that they would have kept syndicate members informed of any deleterious news. 2/

Another firm indicated:

Chase Manhattan had maintained a unique relationship with the City to be in a position to easily assume these responsibilities. The Bank certainly had the staff capability. 3/

Some firms clearly recognized the important responsibilities of the managing underwriters in municipal securities offerings. As one financial institution put it, the managing underwriters had a duty...

To utilize their substantial research staff to investigate the credit worthiness of municipal credits before forming an underwriting syndicate. 4/

Another concluded, the managing underwriter had the duty. . .

To delve as deeply as possible into the figures supplied, including the negatives but probably not to call the government employees "liars". 5/

One organization presents an historical overview describing the relationship between the New York banks and the City officials:

The managing underwriters of the syndicates in which [we] participated were New York banks. Historically, those banks took the largest percentage of each City underwriting and frequently

1/ Response No. 13

2/ Response No. 14

3/ Response No. 15

4/ Response No. 16.

5/ Response No. 17.

purchased City securities for their portfolios. Further, representatives of those banks were members of committees, such as Technical Advisory Committee on City Debt Management, that advised and worked with the City in connection with its debt offerings. 1/

Another response emphasized significant acts of the managing underwriter that formed a basis for the reliance of syndicate members:

Also relied on the fact that managing underwriters were also lending to the City separate and apart from the particular underwritings. 2/

* * *

In addition to Question Ten's request for a description of the duties of the managing underwriter, Questions Eleven and Twelve requested the organizations to describe their understanding of the role of bond counsel.

Question Eleven states:

Please describe your understanding of the role or duties of Bond Counsel in connection with the underwritings of Notes or Bonds.

* * *

Generally, the understanding of the syndicate members was that bond counsel performed "legal duties" although the basis for such assessment was rarely articulated.

One organization evaluated the role of bond counsel as follows:

Our understanding is Bond Counsel('s) duty to render that the bonds are in fact being legally issued. 3/

Another organization described the role as follows:

Our understanding of the role of Bond Counsel is that he verifies the legality of the issue, its tax exempt status and its situation with respect to pending litigation. 4/

1/ Response No. 18.

2/ Response No. 19.

3/ Response No. 20.

4/ Response No. 21.

Others characterized the legal duties of bond counsel as a:

Duty to . . . approve legality. 1/

Duty to . . . pass only on the legality of the proceeding, sale, etc., as they affect the bonds. 2/

Duty . . . to make sure bonds are issued in accordance with the Constitution and local finance laws of New York State. 3/

One organization thought that if the issue is validly executed, bond counsel need not make a financial analysis. It stated:

. . . we believe it is Bond Counsel's obligation to determine that any state or local law or constitutional requirements have been complied with at the issuance. Analysis of financial material and ability to repay the issue was validly executed and constituted the valid obligation of the issuer. 4/

A Chicago organization in its cover letter submitted the following pertinent observation:

I can add this sidelight. I entered this industry with our firm in mid-1974 when we were in the process of developing a negotiated underwriting department. I found a great deal of resistance to the concepts of due diligence and full disclosure. I can remember many battles in which our firm insisted on disclosure which was resisted by others (including both lawyers and large underwriting firms). Needless to say, 2 1/2 years later, the procedures we were fighting for then are virtually universally accepted now. The change has been that dramatic. 5/

* * *

1/ Response No. 22.

2/ Response No. 23.

3/ Response No. 24.

4/ Response No. 25.

5/ Response No. 26.

Question Twelve states:

To your knowledge, did Bond Counsel, prior to rendering its approving opinion, verify or investigate the accuracy, completeness, or veracity of the figures and textual information prepared and presented by the City in conjunction with the underwritings of the Notes or Bonds?

If Bond Counsel did any of the above, state the basis for your knowledge.

* * *

There were few comments in response to this question. Few organizations had actual knowledge of whether bond counsel, prior to rendering its approval, verified or investigated the accuracy, completeness or veracity of the figures and textual information prepared by the City in conjunction with the underwritings of the notes or bonds. They assumed bond counsel had enough information to render an opinion.

Generally, the syndicate members indicated that the managing underwriters' and the bond counsel's performance of their duties would eliminate the need for their own inquiry and analysis. This was based in part on the assumption that New York City underwriters and the City officials had a close relationship. The syndicate members stated that in deciding whether to participate in the offering of City securities they relied upon their confidence in the managing underwriters, the rating services and the approval of bond counsel.

II. INVESTIGATION AND ANALYSIS OF INFORMATION CONCERNING THE UNDERWRITING OF NEW YORK CITY NOTES AND BONDS

This segment deals with questions relating to the scope of the syndicate members' independent investigation of the offering of City securities.

Question Three states:

Has your organization had, or does your organization have, a municipal research department, or designated employees who do municipal research? If so, please provide the following information:

- (A) The approximate date when such department or activity was begun;
- (B) The number of employees engaged in such research;
- (C) The number of employees engaged in such research at the time your organization participated in the sale of the Notes or Bonds;
- (D) The background of each employee described in response to (B) and (C) above.

* * *

Approximately seventy firms reported that they did not have a municipal securities research department at the time of their participation. However, approximately ten of them reported that they now have municipal research departments. A few organizations had municipal research departments at the time of their participation. For instance, one organization reported that it had a municipal securities research department that was formed in 1954 and consisted of two employees, both with underwriting and credit analysis backgrounds. Three firms reported municipal securities research departments that had been in existence since 1968. One institution started a department in 1969; two in 1971.

* * *

Question Seven states:

Specifically describe any independent inquiry your organization made prior to your participation in the underwritings of the Notes or Bonds with respect to:

- (A) Fiscal information prepared and presented by the City; and**
- (B) Fiscal information concerning the City prepared and presented by any other sources (identifying the sources).**

Few organizations responded affirmatively to this Question. Some of them answered by referring to the City's Notice of Sale, a phone call to the managing underwriter, or to the receipt of the published ratings. The majority of firms, however, reported that they did not engage in any independent analysis, prior to participation in the underwritings of the notes or bonds with respect to fiscal information prepared and presented by the City and fiscal information concerning the City prepared and presented by other sources. One organization explained its inaction by stating that independent inquiry is not part of the standards for municipal underwriting. Only a few organizations stated that they had conducted their own analysis. As an explanation to a negative response some respondents indicated a reliance on the managing underwriter to provide the necessary inquiry.

* * *

Question Eight states:

Prior to your participation in the underwritings of the Notes or Bonds, did your organization consult with any outside technical experts, such as accountants, or municipal securities analysts, with respect to:

- (A) The subject matters referred to in question 4?**
- (B) The feasibility of engaging in the underwritings of the Notes or Bonds?**
- (C) The fiscal affairs or status of the City?**

Specify who was consulted, the dates of consultations, and the action, if any, taken or conclusions reached.

* * * *

With few exceptions, the organizations responding stated that they did not consult with any outside technical experts, such as accountants, or municipal securities analysts, prior to participation in the underwritings of the Notes or Bonds.

Question Nine states:

Who in your organization analyzed or verified the veracity, completeness, or accuracy of the figures and textual information prepared and presented by the City in the Notices of Sale and Reports of Essential Facts in connection with your participation in the underwritings of the Notes or Bonds?

* * * *

The majority of organizations stated that no one person performed this function, or that they relied on the managing underwriter.

* * * *

Question Thirty-two states:

Subsequent to January 1, 1970, did your organization receive, compile or obtain statistical information with respect to the adopted or modified expense budget of the City?

[N.B. This calls for information distinct from question 4(E)(4)]
If yes, please indicate:

- (A) The type of information received, compiled or obtained;
- (B) The source of any information received;
- (C) Whether the information was of estimated figures;
- (D) The persons who received this information;
- (E) The uses, if any, which you made of any information received.

* * * *

No firm explicitly reported that it received statistical information subsequent to January 1, 1970 with respect to the City's adopted or modified expense budgets.

* * * *

Question Thirty-three states:

Subsequent to January 1, 1970, did your organization receive, compile, or obtain statistical information with respect to the General Fund of the City? If yes, please indicate:

- (A) The type of information received, compiled or obtained;
- (B) The uses, if any, which you made of any information received.

* * * *

No syndicate member responding received statistical information with respect to the General Fund of the City. However, a few mentioned that they received the Notice of Sale or the Rating Services reports in response to this question to indicate that those who prepared these reports received the statistical information with respect to the General Fund.

* * * *

Question Four, subsections (A)-(D) states:

Regarding your organization's decision to participate in any of the underwritings of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

- (A) Relied upon its own independent research of the fiscal affairs and condition of the City;
- (B) Received, utilized, or relied upon information or studies, etc. prepared and distributed by the managing underwriter (i.e., the underwriter who formed and organized the selling group). Please indicate when such information or studies, etc. were received (before or after your commitment) and also provide the Commission with copies thereof;
- (C) Received, utilized, or relied upon the information and data contained in the Notices of Sale and Reports of Essential Facts prepared and issued by the Office of Comptroller of the City;
- (D) Received, utilized, or relied upon the reports and ratings prepared and published by:

- (1) Moody's Investor Services, Inc.;
- (2) Standard and Poor's Corporation; and
- (3) Pitch's Investors Service.

* * * *

The majority of firms reported they did not rely upon independent research of the fiscal affairs and conditions of the City. Twelve institutions reported that they relied upon some independent research, and four firms reported that they relied extensively upon independent research.

The majority of firms did not receive, utilize, or rely upon information or studies prepared by the managing underwriter. Of those firms which reported that they received information or studies, only a few stated they received the information before their commitment.

One firm explained the significance of any written information.

As in any other underwritings we sought to align ourselves with a syndicate comprised of members who could distribute bonds. So from the standpoint of written information, we referred to our syndicate's ability to successfully underwrite and distribute. 1/

The majority of the firms stated that they received the Notices of Sale; however, the extent of utilization was not made clear. A majority also stated that they received and greatly relied on the reports and ratings prepared and published by the rating services, primarily Moody's and Standard and Poor's.

* * * *

1/ Response No. 27.

Question Four (E) states:

Regarding your organization's decision to participate in any of the underwritings of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

- (E) Received, utilized, or relied upon any of the following material:
- (1) Monthly Statements prepared by the Office of the Comptroller of the City summarizing the City's Cash Receipts and Disbursements;
 - (2) The Annual Report of the Comptroller of the City with respect to the City;
 - (3) The Fiscal Newsletter of the City;
 - (4) The Executive Budget of the City;
 - (5) The Capital Budget of the City;
 - (6) The Reports of the Comptroller of the City issued pursuant to Sections 113, 212, and 220 of the City Charter;
 - (7) Audit Reports of the Comptroller of the State of New York with respect to the City;
 - (8) Newspaper articles, or articles in other periodicals relating to the City's budgetary process and fiscal condition.

[Feel free to elaborate in your own words in answering items (4)(E)(1) to (8).]

With respect to Question 4(E)(8), specifically describe the extent to which your organization (I) Maintained a file of such articles; (II) Referred to such articles for original or basic information; (III) Viewed such articles as accurate or reliable; and (IV) Viewed such articles as full and fair disclosure regarding the City's fiscal condition, events, or problems, etc.

* * * *

With the exception of The Fiscal Newsletter of the City and articles from newspapers or periodicals, only one or two firms stated that they did receive and utilize the material listed in Question Four (E).

Approximately 20% of the firms answered that they received, utilized or relied upon the Fiscal Newsletter of the City.

Approximately forty-three of the ninety-three firms reported that they received, utilized, or relied upon newspaper articles, or articles in other periodicals relating to the City's budgetary process and fiscal condition. Few, however, maintained a file of such articles and few described the extent to which they referred to such articles for original or basic information, or viewed such articles as full and fair disclosure of the City's fiscal condition.

One organization reported:

...The major publications do in fact offer full and fair disclosure regarding the City's fiscal condition, events and problems. 1/

Another organization responded in this way:

During the period in question many conflicting articles appeared in the papers and other periodicals. The political and conflicting statements made by public officials produced contradictory stories which could not be accurately assessed without having had access to the City's financial record. No file of such material was maintained.

Still another institution stated:

We viewed these articles as no more reliable than any other news articles, and did not view them as a disclosure vehicle for the City. News articles are subject to varying interpretations of the same facts by different authors. Full disclosure by the City may only be made by direct releases of the City over which they have control and not via third parties. 3/

* * * *

Question Four (F) stated:

1/ Response No. 28.

2/ Response No. 29.

3/ Response No. 30.

Regarding your organization's decision to participate in any of the underwritings of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

(F) Relied upon any of the following statements contained in the Notices of Sale and Reports of Essential Facts:

(1) Bonds (and notes) will be valid and legally binding general obligations of the City, all the taxable real property within which will be subject to the levy of ad valorem taxes to pay said bonds (and notes) as well as the interest thereon without limitation as to rate or amount;

Yes [] No []

(2) The State Constitution requires the City to pledge its full faith and credit for the payment of the principal of its bonds (and notes) and the interest thereon and to make annual appropriations for the amounts required for the payment of such interest, and the redemption of its bonds;

Yes [] No []

(3) Payment of debt service shall be the first lien on all the City's revenue;

Yes [] No []

(4) If . . . the appropriating authorities fail to make the required appropriations for the annual debt service on the bonds and certain other obligations of the City, a sufficient sum shall be set apart from the first revenues thereafter received and shall be applied for such purposes;

Yes [] No []

* * * *

The overwhelming answer of the financial institutions was that they relied upon the statements contained in the Notices of Sale and Reports of Essential Facts describing the issues of bonds or notes.

* * * *

Question Four, subsection (G) stated:

Regarding your organization's decision to participate in any of the underwritings of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

(G) Relied upon the belief or understanding that the managing underwriter had made an investigation, study, or analysis of any of the following areas prior to the formation of the selling syndicate:

(1) The credit worthiness of the City's Notes or Bonds;

Yes [] No []

(2) The fiscal soundness of the City;

Yes [] No []

(3) The sufficiency of revenues of the City to meet its maturing obligations;

Yes [] No []

If your answers to the foregoing questions of item 4 are that your organization did receive, rely and utilize the information, etc. referred to, please elaborate as to the importance or relevance of such information to your organization's decision to participate in the underwritings of the Notes or Bonds.

To the extent that there were written reviews, summaries, or analyses prepared by your organization with respect to the information described in item 4, please furnish copies thereof, and indicate whether such reviews, summaries, or analyses were for internal or external use.

* * * *

In answer to Question Four, subsection (G), a few organizations had a negative response such as:

The question is biased and unfair. All underwriters should make credit decisions. All of us act on facts given to us. Questions such as this, if answered in the negative would

certainly hinder our lead underwriters in the future.
Questions such as these merely look for a scapegoat. 1/

However, the majority of the firms had an affirmative response. One such response follows:

Having worked in the bond department of a large bank in a large City I know that we were fairly up to date on the finances of the City (Chicago) and the other political subdivisions surrounding and involving the City; I assume the New York Banks would have the same information about their City. 2/

The ordinary expectation was that the managing fee included payment for a credit analysis.

One responding firm said ...

A managing fee was charged by the managing underwriters and we would have assumed that such a fee was paid, in part, for analysis of the credit for the benefit of the account. 3/

Another offered this view:

If we had not relied on the managing underwriters' analysis of the credit worthiness of the City's Notes and Bonds, etc. we would not have underwritten the Bonds. 4/

One organization summarized its reasons why it made no independent analysis in this way:

It was our belief and understanding that the Notes and Bonds were prior liens on New York City's revenue sources which did give ample coverage. The decision to underwrite was further buttressed by the rating agencies to rate the Bonds and Notes as investment grade and by

1/ Response No. 31.

2/ Response No. 32.

3/ Response No. 33.

4/ Response No. 34.

the belief that the New York managers had stayed close to the fiscal situation. No independent reviews by our organization were made.... All sales and purchases were conducted through other broker-dealers with one exception.... 1/

* * * *

Question Five states:

To your knowledge, what investigation or analysis did the managing underwriters make with respect to the City's overall fiscal affairs and structure prior to deciding to underwrite the Notes and Bonds and before inviting your organization to participate in the underwriting?

* * * *

The majority of the syndicate members believed that prior to deciding to underwrite the Notes and Bonds and before forming the syndicate the managing underwriters had made some investigation or analysis with respect to the City's fiscal affairs and structure. However, most of them reported that the basis for this belief was assumption or speculation. A substantial number of firms reported that even though they relied upon the managing underwriters they had no knowledge of any investigation.

One organization stated:

Our belief was that our standing syndicate majors were in constant contact with City officials due to the frequency of City debt offerings and their banking relations. We further believe that before taking on their usual heavy commitments when underwriting these bonds these majors would use their sources to update their analysis of the City. As a member of a standing syndicate no invitation to participate in the underwriting of the certain bonds was necessary. 2/

Generally, the syndicate members believed that the managing underwriter performed the necessary investigation and analysis of information concerning

1/ Response No. 35.

2/ Response No. 36.

the underwriting of New York City Notes or Bonds. The limited extent of receipt, utilization, or reliance on any of the published information buttressed such an assumption. This assumption supported the continued participation in the underwriting by the syndicate members even though they had no actual knowledge of the managing underwriter's investigation or analysis.

III. THE DECISION TO PARTICIPATE

This phase of the report deals with the factors that were relevant to the decisions of the syndicate members to participate in the underwriting of City Notes and Bonds. Generally, the responses indicate the absence of any independent investigation by syndicate members and the presence of an historical relationship between syndicate members and the managing underwriters. It is clear that the syndicate members had a long history of participation in New York City securities offerings and that this was an important factor in their continued participation.

One syndicate member offered this view of the New York City bond market:

In the later 1960's and early 1970's the market for New York City Bonds (and in fact the municipal bond market generally) became quite volatile and beginning in about 1972 we decided to participate in the underwriting accounts involving New York City bonds only. In anticipation of an underwriting profit only. It was our impression at the time (and still is) that the New York State Constitution would probably protect the bond holder ultimately but an inherent investment risk and in particular marketability risk of New York City bonds prohibited us from selling to our public clients. In the 30 years this company has been in business it has always been the company's policy to sell bonds with much higher investment characteristics than those of the City of New York. It should be noted that we have never participated in the underwriting of any of the various notes issued by the City of New York, since it was our impression at the time that the enormous amount of notes being issued practically resembled a "pyramid scheme" and it appeared that the only way they could be paid off was by some form of "rollover" and if the day ever came when nobody would buy new notes there would undoubtedly be trouble. 1/

1/ Response No. 37.

Question Two states:

Describe the factors which your organization took into account in deciding to participate in the underwriting of the Notes or Bonds. If possible, in your response to this question, list in descending order of importance the factors which you deemed the most relevant in your decision-making process.

* * * *

The order in which the factors were most often mentioned is as follows:

- (1) profitability;
- (2) favorable ratings;
- (3) customer demand;
- (4) general market and resale market conditions;
- (5) historical relationship with the underwriter;
- (6) historical participation in New York City bonds;
- (7) reliance on the managing underwriter;
- (8) New York City's reputation;
- (9) reliance upon legal requirements;
- (10) favorable pricing;
- (11) favorable information supplied by the City;
- (12) exclusive dealing in Municipal Bonds; and
- (13) the tax exemption.

One relevant factor mentioned frequently by the syndicate members was favorable bond ratings by independent rating services. The basis for the syndicate members' reliance upon the rating services was their view that the rating services would investigate the City's published information and accounting practices before issuing a favorable rating. The rating services' actions in this regard are discussed in a separate section of this report.

* * * *

Question Sixteen states:

Did anyone in your organization ever meet with or have any discussions with any of the City's accountants, or employees of the Comptroller's office to discuss accounting practices and procedures of the City?

If yes, give details as to dates, parties attending, and highlight the matters discussed.

* * * *

The syndicate members' belief in the rating service studies explains the fact that only five organizations reported any discussions with the City's accountants or employees of the Comptroller's Office. The vast majority of syndicate members reported that there was no consultation by them with the City officials as to the City's accounting practices.

* * * *

Question Thirteen states:

During the time period January 1, 1975 through May 30, 1975, did any employees of your organization attend any meetings with

(A) Other syndicate members (other than marketing and price meetings);

Yes [] No []

(B) City officials;

Yes [] No []

(C) Or Bond Counsel

Yes [] No []

with respect to the underwritings?

If yes, to the extent that your organization or its employees has maintained records, give details as to dates, parties attending, the matters discussed, including whether the Notice of Sale or Report of Essential Facts was discussed.

* * * *

Few organizations reported meetings with other syndicate members other than for purposes of marketing or pricing.

* * * *

Question Seventeen states:

Was any person in your organization, at any time after January 1, 1970, a member of any advisory group which sought to give advice, suggestions, etc., to the City or its officials with respect to either the City's overall fiscal affairs or the issuance of its Notes or Bonds? If yes, state the names of the individuals so involved, the name and purpose of the advisory group, and dates of service.

* * * *

Only three organizations of ninety-three firms responding to this question reported affiliation with any advisory group which provided advice to the City. The extent of affiliation and relation to the advisory group was unclear.

* * * *

Question Twenty-seven states:

When your organization participated in the underwritings of the Notes or Bonds, were you aware of any of the following observations made by New York State Comptroller Levitt in his audits of the City;

(A) Items traditionally considered to be expense items were included in the capital budget;

Yes [] No []

(B) The accounts receivable from State and Federal governments for the years ended June 30, 1973 and 1974 by the City had been over-stated;

Yes [] No []

(C) Such over-statement referred to in (B) above enabled the City (1) to incur expenditures without having additional revenue sources, and (2) to borrow against these "over-stated receivables";

Yes [] No []

(D) In several instances, the City's recorded receivables were less than the amounts borrowed by the City;

Yes [] No []

(E) The City's expense budget was prepared without creating any reserve for non-collection of tax revenues;

Yes [] No []

(F) The City included on its tax rolls significant amounts of property which were not subject to real estate taxes or for which taxes could not be collected;

Yes [] No []

(G) The City has used non-recurring revenues as a method for producing a balanced budget;

Yes [] No []

(H) The City's accounting system did not provide for a General Fund "fund balance" account which would show each year the annual and cumulative results of the City's operating budget;

Yes [] No []

(I) The City had recorded the sum of \$150 million as a General Fund "source of revenue" in 1974 and the sum of \$370 million in 1975 as receivables due to the miscellaneous revenue accounts, such recordings were allegedly based upon anticipated borrowings from the Stabilization Reserve Corporation?

Yes [] No []

* * * *

Generally, the syndicate members were unaware of the above information.

One syndicate member explained:

Information provided by NYC [sic] was extraordinarily voluminous--so much so, that it was difficult to focus

an analysis in detail before the sale date. The criteria was whether the Notes or Bonds would pay. The information provided seemed to indicate there would be money for this payment. In this sense the information seemed adequate. For example, the Notes' repayment was based upon budget projections of revenues flows which showed an adequate margin for their repayment—especially as it was thought that they stood ahead of other NYC [sic] obligations. "Rollovers" of the Notes was an accepted practice, and like the Federal debt it was believed that the practice could continue. Even, if a drastic loss of confidence by investors and the "Street" over NYC's [sic] ability to pay occurred—preventing issuance of "rollovers"—the belief was there that the existing obligations would be honored no matter the circumstances.

A first lien on revenues is a first lien, and coupled with the full faith and credit pledge of the City to honor these obligations to the taxing extent necessary, there was no question as to the City having the ability to pay. Subsequently, political decisions of the City have rendered these suppositions invalid, leastways for the Notes. 1/

* * * *

Question Twenty-eight states:

- (A) In your opinion did you or do you consider the matters referred to in Item 27 to be material or significant?
- (B) If you were aware of the State Comptroller's "observations" as set forth above, what evaluation did you give to such "observations" in determining to participate in such underwriting and to offer the Notes and Bonds to your customers?

* * * *

Nearly all of the syndicate groups agreed that the information in the Levitt audits were material or significant. A few indicated that their view was with the benefit of hindsight.

Those few syndicate members who were aware of the State Comptroller's observations apparently gave little or no evaluation to such "observations" in determining whether to participate in any underwriting.

* * * *

Question Twenty-nine states:

When your organization participated in the underwritings of the Notes or Bonds, were you aware that the accounting principals and procedures in effect for the City accounts during the fiscal year ending June 30, 1975, and prior years, generally employed a cash basis for recognizing expenses and an accrual basis for recognizing revenues?

Yes [] []

If your answer is yes, describe how you knew.

* * * *

Most of those who participated in such underwritings were not aware of the indicated accounting principles and procedures in effect for the City accounts during the fiscal year ending June 30, 1975 and prior years.

* * * *

Questions Twenty-five and Twenty-six state:

At the time your organization sold the Notes or Bonds to your public customers, what was your understanding of the City's financial condition? Did you believe that the condition was

Excellent [] Good [] Fair [] Poor []

Please elaborate.

At the time your organization sold the Notes or Bonds to your public customers, what was your understanding of the City's bookkeeping and accounting practices? Did you believe that they were

Excellent [] Good [] Fair [] Poor []

Please elaborate.

* * * *

The syndicate members, in response to the above questions, generally rated the City's financial condition "fair" and the bookkeeping and accounting practices "good."

One syndicate member explained its response as follows:

...Good tax collections, general obligation bonds, high property values, vitality, both business and cultural. New York City was the largest and richest city in the world, as well as being the financial and business capital of the world. 1/

....

Auditors of both New York City and New York State were checking and cross-checking each other's work and certifying findings to the federal government among others.

Other institutions stated:

We felt the accounting procedures were old fashioned and needed to be upgraded. 2/

Assessment of the financial condition...was Good.

The difference between that opinion and our later opinion was the large number of bonds and the frequency with which they were coming to market. 3/

And another syndicate member put it this way;

After late 1974 it became apparent that the City was increasing the size and frequency of its Note offerings. In early 1975 Mayor Beame announced that it would not be necessary to maintain that size or frequency of Note offerings. While that was a favorable sign, it was short-lived. After the February and March 1975 pricing meetings it became apparent that the City's financial condition was in question. 4/

But, the majority of the organizations did not question the City's accounting practices. As one firm stated:

Until the February and March 1975 pricing meetings it was [our] understanding and belief that the City's accounting practices were sufficient to justify reliance on its book as an accurate indicator of the true financial position of the City. 5/

Another view was expressed as follows:

1/ Response No. 39.

2/ Response No. 40.

3/ Response No. 41.

4/ Response No. 42.

5/ Response No. 43.

We felt that the debt was high and that the City probably had problems, but that the importance of this City in terms of the entire Country was so great that default was considered a remote possibility.

From our distance, there was no reason to believe that the financial information published was anything but accurate. 1/

* * * *

Question Fifteen stated:

Did your organization believe that the City provided sufficient financial information and other data concerning its affairs as to the Notes or Bonds being offered and sold, to enable your organization to make an informed judgment of creditworthiness of the City and its Notes and Bonds?

Nearly all the responses expressed the view that the City was creditworthy.

As one syndicate member stated:

...we trusted the integrity of the City's financial statements. 2/

Several institutions based their view on the ratings provided by the major rating services. Thus, one syndicate member stated:

Prior to our final decision to participate in the issue Moody's had determined to rate the bond within its top four rating categories. We relied upon this information in reaching our decision to remain in the underwriting syndicate. 3/

Another indicated:

Yes at that time. This was based upon the opinion as to legality of the issue rendered by Bond Counsel, the assumed discharge of responsibility by the Account Manager and the continuance of market grade ratings by the major rating services led us to believe that the City had provided sufficient information for us to make a proper judgment with regard to the creditworthiness of the City. 4/

1/ Response No. 44.

2/ Response No. 45.

3/ Response No. 46.

4/ Response No. 47.

A few members questioned the adequacy of the information being provided by the City. An example:

What we received was very limited and certainly not enough to do an in-depth analysis and come to an informed judgment. 1/

* * * *

Question Fourteen states:

At the time of your organization's participation in the underwritings of the Notes or Bonds, please describe your understanding of the purpose of the Notices of Sale and Reports of Essential Facts, which were prepared and distributed by the City. For example, did your organization expect that, if there were,

- (A) Any material changes in accounting practices and policies by the City, they would have been described therein?
- (B) Any developments of material matters affecting the City's financial condition one way or the other, they would have been described therein?
- (C) Any overestimates of revenues for prior years from the Federal or State Governments to the City, or from real estate tax sources, such would have been disclosed therein?
- (D) Any renewals or "rollovers" or Notes, the need for or the reasons therefor would have been described therein?
- (E) Any budget gaps, budget deficits, cash deficits, or deficit financing then in existence, such would have been disclosed therein?

If you did not expect to find the information referred to immediately above and other relevant information in the Notices of Sale and Reports of Essential Facts, did your organization find such information in any other source?

Yes [] No []

If yes, please describe such source.

* * * *

1/ Response No. 48.

One firm provided this response:

The degree and quantity of information was no different from that being furnished at the time by other issuers of general obligation bonds. Thus the answer in that context is yes, without giving a great deal of thought or consideration as to whether the financial information was adequate. We assumed it was sufficient and reasonably accurate. That is the way the municipal bond market functioned at that time. 1/

Generally, the syndicate members were unaware of the accounting practices of New York City. They indicated that normally the managing underwriter and bond counsel or the rating services were the entities with the responsibility for acquainting themselves with information concerning the City's accounting practices. However, the syndicate members reported negative information was not conveyed to the syndicate members by the managing underwriter, bond counsel or by the independent rating services.

1/ Response No. 49.

IV. CUSTOMER SALES

Question Six states:

Did your organization prepare any "sales literature" with respect to the Notes or Bonds? If so, identify the person(s) in your organization responsible for its preparation, and indicate whether it was in fact distributed or given to your customers. Please furnish copies thereof.

* * * *

The majority of the syndicate managers responding to this question indicated they did not prepare any "sales literature" with respect to the Notes or Bonds.

* * * *

Question Thirty states:

At the time that your organization sold the Notes or Bonds to your public customers, did you and your salesmen advise such customers about the possibility that the City might defer or be compelled to defer meeting its obligation to certain of its noteholders through the enactment of a moratorium law?

* * * *

Almost every syndicate manager reported that no advice was given by salesmen to their public customers concerning the possibility that the City might defer or be compelled to defer meeting its obligation to certain of its noteholders through the enactment of a moratorium law.

* * * *

Question Eighteen states:

In selling the Notes or Bonds to your customers, did your organization recommend the purchase of such Notes or Bonds?

If yes, set forth

- (A) The approximate dates (periods) when such recommendations were made; and
- (B) In detail, the basis for such recommendations.

* * * *

Thirty-six syndicate members reported they had recommended the purchase of securities; forty-seven reported they made no recommendation.

The bases given by the organizations which recommended New York City Notes or Bonds are: rating services; profitability; reputation of the underwriter; independent evaluation; information supplied by the City; and, favorable market conditions. Before responding to whether a recommendation was made one organization commented:

It is difficult for us to understand what is meant by "recommendations." In trying to recollect correctly, some at the bank contend we never "recommended" New York City to our customers; others argue to the contrary, since we did in fact buy New York City bonds for our own portfolio. Our portfolio purchases, as well as any recommendations, "were made on the mistake or assumption that all was being properly reflected by the City to various underwriters and purchasers of their bonds." 1/

The ratings provided by the major rating services were set forth as a basis for the recommendations of City Notes or Bonds. Particularly significant was the fact that Moody's upgraded the ratings from "Baa" to "A" in 1972. Additionally, one organization stated:

There were many favorable comments from various respected City officials about the underlying value and essential soundness of New York City. From time to time our customers were aware that by purchasing New York City

1/ Response No. 50.

Bonds they could get an "A" rated bond which afforded them a generous yield compared to other "A" rated credits. 1/

* * * *

Question Nineteen states:

In connection with any recommendations made to your public customers with respect to the Notes or Bonds, what instructions, if any, did your organization give to its salesmen regarding the type of statements or representations you considered permissible, and those that you considered impermissible, if any?

* * * *

The majority of the syndicate's members reported that the question was inapplicable because no recommendations were made to public customers. Others reported that no specific instructions were given to prospective and actual purchasers. Some syndicate members did not respond, stating that no instructions were given because no recommendations were made.

One organization elaborated with respect to its instructions to its sales personnel:

Since we are a fairly small dealer bank operation, we are dependent on many correspondents for our business. Recognizing the time it takes to develop this loyalty and its importance to our continued profitability we have always instructed our sales people to emphasize quality in building a portfolio. In the past, as is the case today, we think it important not to bear heavily on a customer to buy bonds which would detract from upgrading his portfolio. We have always instructed our sales people that the following three things, listed in order of their importance, should be stressed: safety, maturity and yield. 2/

Another syndicate member pointed to the higher yield and impossibility of default of City Notes or Bonds as the basis for its recommendation:

1/ Response No. 51.

2/ Response No. 52.

The risk as we saw it at the time which we underwrote New York City bonds related basically to downgrading and loss of some marketability. At that time, we thought that the higher yields available on New York City obligations were a result of the high number of bonds outstanding in the market and that possibly these bonds could be downgraded. We did not think there was any possibility at that time of a New York City default. 1/

* * * *

Questions Twenty and Twenty-one state:

What degree of risk, if any, did your organization believe was involved in the investment in the City's Notes or Bonds compared to other municipalities general obligation securities of similar rating and maturity?

Specifically describe the risks, if any, which your salesmen were instructed to relate to your public customers regarding the Notes or Bonds?

* * * *

Notwithstanding the fact that New York City notes and bonds had a higher yield, most of the organizations responded that they believed the degree of risk involved in the investment in the City's notes and bonds was similar to that of other municipalities with general obligation securities of a similar rating.

* * * *

Question Twenty-two states:

What steps did your organization take to determine if the Notes or Bonds were suitable for the investment needs and objectives of your public customers in accordance with Rules 15b10-3 and 15c1-7 of the Rules and Regulations promulgated under the Securities Exchange Act of 1934; or in accordance with the applicable rules of the National Association of Securities Dealers or Stock Exchanges?

* * * *

1/ Response No. 53.

In answer to this question, twenty-seven syndicate members indicated that they relied upon "normal procedure" but it was not clear whether "normal procedure" included a consideration of the rules specified. Some of them responded that the question was inapplicable without specifying a reason or by stating no response was necessary because they had no public customers.

Some simply did not answer. A few other organizations offered the following comments:

The most frequently repeated quotation that we heard from investors buying New York City Bonds was, "If New York City bonds aren't good, what is?" 1/

New York City bonds were not singled out for separate or special suitability determinations. As is the case with all securities transactions recommended to [our] customers, registered representatives are not permitted to solicit transactions if they have reasonable ground to believe that the recommendation is unsuitable for the customer in light of his investment objectives, financial situation and needs. The Branch Manager reviews customers' accounts on a periodic basis and considers among other things, suitability of a particular investment in regard to the customer's investment objective and economic status. 2/

* * * *

Question Twenty-three states:

Did your organization obtain any indications of interest from your public customers with respect to the Notes or Bonds before the actual sales were consummated? If yes, indicate:

- (A) When such indications of interest were "firmed up";
- (B) How these indications were "firmed up";
- (C) Whether confirmations were sent to customers; and

1/ Response No. 54.

2/ Response No. 55.

(D) Whether and when Notices of Sale and the Report of Essential Facts were sent to customers.

* * * *

The majority of organizations claimed that they did not obtain indications of interest from public customers with respect to the Notes or Bonds before the actual sales were consummated.

Those few who reported obtaining indications of interest stated such indications were "firmed up" after the award was made to the underwriting syndicate. The indications of interest were confirmed by telephone and most of the organizations sent a written confirmation only on request. One firm reported the procedures it used as follows:

Although [we do not obtain] 'indications of interest' in the sense that they are obtained in registered public offerings of corporate securities, the Firm does from time to time obtain presale orders from public customers in connection with public offerings of municipal securities. It did obtain certain presale orders with respect to the Notes and Bonds, which were "firmed up" when the Notes and Bonds were bought by the underwriters and sold to the public. The manner in which such a presale order was 'firmed up' was for the Firm to forward a 'when-issued confirmation' confirming the purchase. Subsequently, when the Notes or Bonds were ready for delivery, the Firm sent a "money confirmation" to each such purchaser, indicating that payment for the securities purchased must be made. The Firm did not send copies of the Notices of Sale or Reports of Essential Facts to its customers. 1/

Another stated:

Indications of interest were ordinarily solicited prior to submission of a bid by the underwriting group in which we participated. If the bid was successful, we solicited firm orders and sent a "when, as, and if" confirmation to each customer who gave a firm order. Prior to the closing, and at the earliest date at which it was possible to compute

1/ Response No. 56.

the precise amount due, each customer was sent a final confirmation. Copies of the circulars prepared by the lead managing underwriting were not sent to customers. Subsequent to December 31, 1975 [we] revised [our] procedures to require that offering circulars be sent to all customers who place firm orders for municipal securities. 1/

* * * *

Question Twenty-four states:

Did there come a time when your organization instructed its salesmen to cease recommending the purchase of the Notes or Bonds to the public? If so, state when, and why such recommendation was made at that time.

* * * *

Eighteen organizations (of the thirty-six who made recommendations) did not submit a date when the organization instructed its salesmen to cease recommending the purchase of City Notes or Bonds to the public. Those syndicate members that responded affirmatively said that they stopped recommending City securities sometime between early 1974 and the default of 1975. Some syndicate members stated that purchases of City securities were executed strictly upon the buyer's order. There was one organization which printed a "no solicitation" legend on the confirmations sent to its customers. The basis for a continued recommendation was described by one organization as follows:

We felt and still do feel that New York City will continue to pay principal and interest on its outstanding obligations. 2/

1/ Response No. 57.

2/ Response No. 58.

V. CONCLUSORY REMARKS

In essence, it would appear that the syndicate member organizations believed that the financial information published by the City was sufficient to enable them to make a judgment of creditworthiness as to the City's securities. Their belief as regards the adequacy of the information furnished by the City was not grounded upon independent investigation. The syndicate members claim that they relied on the managing underwriter's investigation to provide the independent investigation of the City's financial condition and accounting practices. Yet, the majority were unaware that any such investigation had occurred.

The syndicate generally believed the rating services did investigate the City's financial condition.

One syndicate member indicated it was in a precarious position describing its plight as follows:

At a N.Y. City syndicate meeting with a few hundred members, we are presented with a price and profit scale. As a participant we are not able to voice our opinion as to price, profit margin, couponing etc. since we have just a fraction of one per cent participation. Our sole alternative is to accept the terms or drop from the underwriting. 1/

The syndicate members indicate they had minimal, if any, control in the underwriting process. For a syndicate member to have requested additional information or to have pursued any independent investigation would have required that it have the ability to accomplish this objective. No syndicate member had such ability. Their alternatives were limited -- to accept the offering or to drop it.

1/ Response No. 59.

Exhibit A

1. If your organization ever participated in the underwriting of any of the notes or bonds of the City of New York (the "City") listed in the Appendix (the "Notes or Bonds"), please supply the following information:
 - (A) The Date of Sale;
 - (B) The Total Amount of the Offering;
 - (C) The Amount of Your Participation;
 - (D) The Amount of Your Take-Down;
 - (E) The Amount Placed in the Portfolio or Investment Account; *
 - (F) The Amount Placed in Fiduciary Accounts; * and
 - (G) The Amount Sold to Your Public Customers. **

31. With respect to each revenue anticipation note ("RAN") or tax anticipation note ("TAN") of the City which your organization underwrote, please indicate if and to what extent your organization was aware of the following:
 - (A) The source, basis, and purpose of the revenues or tax which supported the issuance of each such RAN or TAN;
 - (B) The date that the revenues or taxes were due or would become due;
 - (C) The manner in which the revenues or taxes to be received were determined, i.e. whether it was by estimate, formula, audit, or confirmation;
 - (D) How proceeds from each RAN or TAN issue were actually utilized;
 - (E) Whether the revenues or taxes to be received against the issuance of the RAN or TAN were, in fact, received in their entirety;
 - (F) If any portion of the revenues to be received was not actually received, the fiscal remedial steps taken, if any, by the City;

* As of the date of completion of each underwriting of the Notes or Bonds in which your organization participated.

** Please provide this office with a list containing the names of all public customers and their addresses who purchased the Notes and Bonds from your organization.

- (G) If any portion of the revenues or taxes to be received was not received, the manner in which the City paid off the RAN or TAN at maturity.
34. Provide the Commission with information showing the monthly position of your organization's portfolio and dealer accounts in the Notes or Bonds, for the period January 1, 1973 to May 30, 1975 as of each monthly closing trade or settlement date (Specify which).?

ANALYSIS OF QUESTIONNAIRES SENT TO

MANAGING UNDERWRITERS

This Section of the Report is a summary and analysis of responses to the Securities and Exchange Commission's Questionnaire for Managing Underwriters, dated January 31, 1977, received from Bankers Trust Company ("Bankers Trust"), the Chase Manhattan Bank ("Chase"), Weeden and Co., Incorporated ("Weeden"), Citibank, N.A. ("Citibank"), Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Merrill Lynch"), and Chemical Bank ("Chemical"). The Questionnaire was prepared in connection with the staff's investigation into the sale and distribution of certain notes and bonds issued by the City of New York.

Questionnaires were sent to a group of organizations that acted as the principal underwriters of City Notes and Bonds during the period under investigation. These Questionnaires differed from those sent earlier to non-principal participants in the selling syndicates for New York City's securities, because syndicate members had previously indicated that they had placed virtually total reliance on the managers of the syndicate for review, research and appraisal of the City's financial condition.

Chase and Citibank participated as the managing underwriters in the majority of the issues of New York City's bonds, and as managing or principal underwriters for many issues of the City's notes. Therefore, their responses are particularly important for an understanding of the role of the managers. Manufacturers Hanover Trust Company did not respond

to the Questionnaire. 1/

The Questionnaire for managing underwriters consisted of fourteen questions. This portion of the report will present, in numerical order, the text of each question followed by an analysis of the responses.

If your organization ever participated in the underwriting of any of the notes or bonds of the City of New York (the "City") listed in the Appendix (the "Notes or Bonds"), please supply the following information:

- (A) The Date of Purchase;
- (B) The Date of Closing or Delivery;
- (C) The Total Amount of the Offering;
- (D) The Amount of Your Participation;
- (E) The Amount of Your Take-Down;
- (F) The Amount Placed in your Portfolio or Investment Accounts;*
- (G) The Amount Placed in your Fiduciary Accounts;* and
- (H) The Amount Sold to Your Public Customers.

* As of the date of completion of each underwriting of the Notes or Bonds. Also, if any of the Notes or Bonds placed in these Accounts were sold out of the Accounts prior to maturity or redemption, indicate the amounts and dates of such sales, and the reasons therefor.

* * *

The responses to Question One did not permit any general conclusions to be drawn as to the extent of participation by each of the organizations in underwriting City Notes and Bonds. For the most part, no response was given to Question One. It was asserted that the staff had already examined

1/ In brief, after considerable delay the bank refused to respond to the Questionnaire and, finally, a Commission administrative subpoena. More recently, Manufacturers Hanover Trust has responded to the Questionnaire in a letter by referring the Commission to testimony taken of one of its officers. The staff has concluded that the references were insufficient as responses to the Questionnaire. The subpoena remains outstanding. Because of the need to complete this and other parts of the Report, the decision was made to defer recommendation of action.

documents from which the staff could ascertain the answer to Question One. Those organizations responding to Question One generally indicated that, in response to part (G), no City Notes or Bonds were placed in fiduciary accounts maintained by that organization.

Question 2

Please describe the factors which your organization took into account in deciding to participate in the underwriting of the Notes or Bonds. List, in descending order of importance, the factors which were deemed the most relevant in the decision-making process.

* * *

Generally, in no particular order, the factors cited by the organizations were (1) marketability, (2) profitability (including both primary and secondary markets), (3) history of participation in New York City notes or bonds, (4) history of participation as an underwriter of Municipal notes or bonds, (5) redeemability, (6) credibility of the City information, (7) legality, (8) history of participation in the particular selling syndicate, (9) rating, (10) tax exemption, (11) public media information, (12) maintenance of New York City as the financial center, (13) the well being of New York City citizens.

The responses of the organizations were, in relevant part,

(Weeden) If one were obliged to describe the factors which Weeden took into account in deciding to participate in the underwriting of City paper, and then attempt to put those factors in descending order of importance, the answer would include by rank soundness of credit, price, market conditions and customer interest. The problems with the question and therefore the answer are first that it assumes these elements are capable of separation and evaluation, let alone ranking, and second, that one can re-create one's state of mind several years ago. The realities "pre-crisis" of New York City paper were that when managing underwriters invited Weeden to join in a syndicate to make a bid we were pleased to be asked to join and when we did join we assumed that honest data given out by the City and analyzed by the expert staffs of the managing underwriters and their bond counsel and by the rating agencies which followed the City's financial affairs carefully would result in a price which fully reflected all of the so-called "factors" ranging from soundness of credit to customer interest.

* * *

(Chase) No particular factor can be identified as most important in the process of determining to underwrite a particular issue of Bonds or Notes; each decision was made in light of the facts and circumstances known at the time. As in the case of all underwriting decisions, the relevant factors considered in deciding whether to underwrite issues of Notes or Bonds included investment quality, market acceptance, yield, general market conditions and internal funding requirements.

* * *

(Citibank) Citibank considered all available relevant factors. The factors were numerous and varied from issue to issue. They were contained in from time to time the City's Notices of Sale and Reports of Essential Facts, various City annual and monthly reports relating to its fiscal condition, independent rating service reports, newspaper and magazine articles and other public media sources relating to the City's fiscal condition. It is not possible to specify generally, in their descending order of importance, those factors which Citibank deemed the most relevant in the decision-making process.

* * *

(Bankers Trust) Bankers Trust is unable to list the factors it took into account in deciding to participate in the underwriting of Notes and Bonds or to rank such factors by their relative importance. Among the factors which played a role, however, were:
(a) Bankers Trust's historical participation in New York City underwritings; (b) New York City's satisfactory history of debt repayment; (c) the marketability of the Notes and Bonds, and (d) Bankers Trust's reasonable belief that the Notes and Bonds would be paid when due.

* * *

(Merrill Lynch) Merrill Lynch took the following factors, which are listed in their order of importance to Merrill Lynch, into account in deciding whether to participate as a member of a syndicate that would offer and sell Notes or Bonds: (1) the Notes and Bonds were backed by the full faith and credit of the City, and bond counsel would deliver a legal opinion to that effect at the closing; (2) the rating of the Notes and Bonds; (3) indications of interest by institutional and retail investors in purchasing the Notes and Bonds; (4) the condition of the municipal bond market in general and, in particular, the market for the City's Notes and Bonds; and (5) the effective yield and maturity of the Notes and Bonds.

* * *

(Chemical Bank) It is impossible specifically to list or quantify all of the factors which the Bank or its representatives took into account in deciding to participate in the underwriting of an issue or issues of the Notes or Bonds. Moreover, to give any meaningful ranking of the importance of such factors is just not feasible. Such factors were and are in many respects of a subjective nature and their individual relevance and relative importance varied over time and from issue to issue. Although it is thus not possible meaningfully to describe all the factors taken into account by the Bank in its participation in underwriting City Notes and Bonds, as requested by Question 2, the Commission may be aided by the following summary of general considerations which may have been subject(s) of review by the Bank or its representatives in connection with any particular underwriting of City Notes or Bonds: The long-standing position of the Bank as a leading or

participating underwriter in issue of the City of New York, and its belief in the intrinsic worth of such securities as evidenced by its portfolio holdings thereof; the requirements of Federal, State and local law, primarily dealing with the fact that the Bank can only underwrite U.S. Government and direct obligations of State and municipal securities; the Bank's desire to remain active in the market for municipal securities, and the circumstance that City Notes and Bonds were an extremely important component of the market; the Bank's assessment of the market for City Notes or Bonds (which as indicated constituted a substantial portion of the market for municipal obligations), the obvious attraction under the Federal tax laws of holding tax exempt obligations and consequent prospects for profit or loss to the Bank (which in relation to total net profits or losses of the Bank was not material) resulting from its participation in such underwriting; the composition at any point in time of the Bank's portfolio and the desirability of including City Notes and Bonds in its portfolio from the standpoint of both long- and short-term liability management; the competitive position of the Bank; the Bank's desire to maintain the City's position as a financial center and the consequent benefit not only to the Bank's business, but also the well-being of the City and its citizens.

The Commission is also referred to the responses to Questions 4, 5, 6, 8, 10, 11, 12, 13, and 14.

Question 3

At the time of your organization's participation in the underwriting of the Notes or Bonds, did it have a municipal research department, or designated employees who did municipal research? If so, please provide the following information:

- (A) The approximate date when such department or activity was begun;
- (B) The number of employees engaged in such research;
- (C) The background of each such employee.

* * *

Responses to this question are quite significant in that most members of the underwriting syndicates indicated that they relied, to a great extent, upon the managing underwriters to analyze and investigate data furnished by the City. 1/ However, none of the managing underwriter organizations indicated that they had done any extensive research at the time of any participation although certain of them reported increased activity in their municipal research departments in late 1974 and 1975.

Chase identified a Public Finance Group which was formally begun in 1971 and which included six employees who engaged in municipal research during the years 1973-1977. However, three of those employees were transferred to "another area of Chase" in February, April and June of 1974.

Citibank reported that during the designated time of participation two employees "followed certain events pertaining to the offering of municipal securities."

Chemical reported that no formal research department existed although two unnamed employees, one with seventeen and the other with three years of experience, had responsibilities that included research and analysis relating to the activities of the Bank's Investment Division respecting municipal securities.

1/ See, e.g., the Analysis of Questionnaire sent to Syndicate Members.

Merrill Lynch had a research department which was organized prior to 1970. The portion of that department which analyzed municipal securities was staffed by two employees.

The creation of Weeden's municipal research department is described by Weeden as follows:

Weeden participated in the October 16, 1974 City Bond offering and lost over \$1 million for our efforts. That jolting loss, plus the New York Daily News editorial of October 22, 1974, and similar disclosures in the press were the competent producing causes of our decision to hire someone able to research municipal paper. Accordingly, in late December 1974, David Breen was hired as Weeden's municipal research analyst, to commence work January 1, 1975. Mr. Breen had previously worked for Fitch Investors Service (January 15, 1974 to December 31, 1974) and Standard & Poor's (April, 1971 to January 4, 1974). Weeden was attracted to Mr. Breen by his prior writings on the City, as well as the recommendations of his employers.

Question 4

Regarding your organization's decision to participate in the underwriting of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

- (A) Relied upon its own independent research of the fiscal affairs and condition of the City (cf. item 6, infra);
- (B) Received, utilized, or relied upon the information and data contained in the Notices of Sale and Reports of Essential Facts prepared and issued by the Office of Comptroller of the City;
- (C) Received, utilized, or relied upon the reports and ratings prepared and published by:
 - (1) Moody's Investors Service, Inc.
 - (2) Standard and Poor's Corporation; and
 - (3) Fitch's Investors Service.

Please indicate whether the reports ever caused you to question the ratings, and if so, why.

- (D) Received, utilized, or relied upon any of the following material:
- (1) Monthly Statements prepared by the Office of the Comptroller of the City summarizing the City's Cash Receipts and Disbursements;
 - (2) The Annual Report of the Comptroller of the City with respect to the City;
 - (3) The Fiscal Newsletter of the City;
 - (4) The Executive Budget of the City;
 - (5) The Capital Budget of the City;
 - (6) The Reports of the Comptroller of the City issued pursuant to Sections 113, 212, and 220 of the City Charter;
 - (7) Audit Reports of the Comptroller of the State of New York with respect to the City;
 - (8) Newspaper articles, or articles in other periodicals relating to the City's budgetary process and fiscal condition.

[Feel free to elaborate in your own words in answering items (4)(D)(1) to (8)].

With respect to item 4(D)(8), specifically describe the extent to which your organization (I) Maintained a file of such articles; (II) Referred to such articles for original or basic information; (III) Viewed such articles as accurate or reliable; and (IV) Viewed such articles as full and fair disclosure regarding the City's fiscal condition, events or overall problems, etc.

- (E) Relied upon any of the following statements contained in the Notices of Sale and Reports of Essential Facts:
- (1) Bonds (and notes) will be valid and legally binding general obligations of the City, all the taxable real property within which will be subject to the levy of ad valorem taxes to pay said bonds

(and notes) as well as the interest thereon without limitation as to rate or amount;

Yes []

No []

- (2) The State Constitution requires the City to pledge its full faith and credit for the payment of the principal of its bonds (and notes) and the interest thereon and to make annual appropriations for the amounts required for the payment of such interest; and the redemption of its bonds;

Yes []

No []

- (3) Payment of debt service shall be the first lien on all the City's revenues;

Yes []

No []

- (4) If ... the appropriating authorities fail to make the required appropriations for the annual debt service on the bonds and certain other obligations of the City, a sufficient sum shall be set apart from the first revenues thereafter received and shall be applied for such purposes.

Yes []

No []

* * *

Generally, the organizations reported that they received, relied upon or utilized the data listed in the question. For instance, Citibank stated:

Citibank generally received the material described in sub-paragraphs 4(B) through (D), and utilized and relied on some of it, together with the material described in subparagraph 4(A), to varying degrees in deciding whether to participate in the underwriting of the Notes or Bonds. It is not possible, however, to state whether a specific item was utilized or relied on by Citibank in its decision concerning any given issue of the Notes or Bonds.

Citibank maintained a file of newspaper articles relating to the City's budgetary process and fiscal condition. Employees in the Credit Supervision Section of Citibank's Money Market Division referred to this file from time to time for information regarding the City's budgetary process and fiscal condition.

Chemical similarly asserted that it received, utilized, and relied upon most of the information specified. Chemical pointed out that the practice of the underwriting industry was to rely primarily upon the rating agencies. Where time permitted, Chemical supplemented such information with data provided by the City. Newspapers were thought to provide a great deal of material information for the potential purchasers and sellers of City Notes and Bonds, although Chemical did not place "total credence" in such articles. Chemical further indicated that:

With respect to the matters itemized in subparagraphs (E)(1)-(4) of Question 4, the Bank understands that each of the statements concerns legal requirements of the New York State Constitution and Local Finance Law; and the Bank's activities with respect to the City's Notes and Bonds were premised upon the applicability of, and compliance by all parties concerned with the requirements of, those laws.

Chase's views were similar to those of Chemical and Citibank.

Banker's Trust, however, was unable to state the "extent" if any to which it "relied" on the information sources referred to in Question Four either in general or in connection with any particular securities issue at any particular time, subject to the following:

A. Bankers Trust at all times took into account the views of its personnel engaged in municipal securities research and of those experienced in the municipal securities field.

B. New York City did not make Reports of Essential Facts available in connection with Note offerings until the BAN offering of March 14, 1975. In connection with that offering and the BAN offering of March 20, 1975 the availability of the Report of Essential Facts was a material factor in the Bank's decision to participate as an underwriter of those issues.

C. Bankers Trust did not subscribe to the reports or ratings of Standard & Poor's or Fitch's Investors Service.

D. Bankers Trust is unable to state whether any specific document listed in items (1) through (8) of subparagraph (D) were "relied upon" with respect to any specific issue. However, the documents, reports and information listed therein, with the exception of items (6) and (7), were generally received by Bankers Trust and reviewed by it in the course of an on-going examination of the fiscal condition of New York City. With respect to item (8), Bankers Trust did maintain a file of such newspaper and periodical articles. The reliability and accuracy of such articles was evaluated separately with respect to each article, and it is, therefore, impossible to state whether such articles were generally viewed as accurate or reliable. Such articles constitute substantial evidence that information concerning New York City's financial condition was in the public realm and generally known.

E. Bankers Trust believed and understood, at the time of each underwriting of Notes and Bonds, that all statements contained in the Notice of Sale and/or Report of Essential Facts in connection with such Note or Bond issue were true and accurate. Bankers Trust is unable to state the extent to which it "relied" on any such statement.

Merrill Lynch wrote:

Merrill Lynch's decision to participate in a syndicate that would offer and sell the Notes or Bonds was based upon the factors enumerated in Merrill Lynch's answer to Question 2 and, in particular, upon the fact that the Notes and Bonds were backed by the full faith and credit of the City.

Merrill Lynch received and reviewed the Notices of Sale and had available to it the Reports of Essential Facts. Merrill Lynch also received and reviewed the ratings and reports prepared by Moody's Investors Service, Inc. and Standard & Poor's Corporation, but it did not receive the ratings and reports of Fitch's Investors Service. With respect to subsection (D) of Question 4, Merrill Lynch received and reviewed the Annual Report of the Comptroller of the City and the Fiscal Newsletter, but Merrill Lynch did not regularly receive the documents referred to in subsections (D)(1), (4), (5), (6) and (7).

Mr. Jean Rousseau, Vice President and Manager of the Municipal Bond Department of Merrill Lynch, regularly read articles relating to the City that appeared in the following

publications: The New York Times, The Daily News, The New York Post, The Wall Street Journal and The Daily Bond Buyer. To the extent that Mr. Rousseau or any other employee of Merrill Lynch who worked on matters relating to the Notes or Bonds maintained a file of newspaper articles relating to the City, Merrill Lynch has turned such documents over to the Commission in response to the Commission's subpoena to Merrill Lynch. Merrill Lynch considered the newspaper coverage relating to the City to be effective and comprehensive dissemination of current information relating to the City's fiscal affairs to the investing public.

Merrill Lynch's answer is "Yes" to subsections (E)(1), (2), (3), and (4) of Question 4.

Weeden's response to Question four is as follows:

4. A. Prior to Mr. Breen joining Weeden in early January 1975 we did no independent research on New York City paper or on any other security we trade as market makers other than keeping ourselves posted (i) on what the rating agencies were writing in respect of bonds, (ii) what was publicly available in the general and financial press on both the debt and equity issues we trade and (iii) faithfully attending meetings called by the managing underwriters of syndicates of which we were members.

B. We have no present record of having received from the City in the Pre-Breen period Notices of Sale or Reports of Essential Facts, but we assume the underwriters did obtain such Notices and Reports, as did the rating agencies and bond counsel upon whom we relied. Whether information and data contained in such Notices and Reports were "utilized" or "relied upon" by Weeden would depend primarily upon whether the managers, the rating agencies or bond counsel incorporated any such information or data in the materials furnished Weeden as a member of the syndicate. That was Pre-Breen. Obviously, once Mr. Breen was on board he sought on his own all the information and data he could and reached his own conclusions, witness his widely publicized January 10, 1975 speech before the City Club of New York... After that speech and the extraordinary response by the Mayor and the Comptroller, Weeden approached the underwriting of City paper with our suspicions aroused and with much greater reliance on bond counsel rather than rating agencies.

C. Weeden has long been a subscriber to Moody's and Standard & Poor's; and until Mr. Breen joined Weeden, we relied heavily on the rating agencies as the prime investigators of the City's fiscal practices. Weeden never had any reason to question the adequacy of their data or their ratings until we took a beating on the October 16, 1974 Bond offering and began reading items

D. Judging from the files which exist today, it would seem that Pre-Breen, Weeden did not itself seek out any of the materials listed in items 1 through 7 which is not to say none were received, utilized or relied upon. Obviously we tried to keep posted on materials in the newspapers and the various financial periodicals which focus on municipal paper. With respect to items 1 through 8 Weeden apparently did not keep files of materials received in any systematic way although it is very possible that much was thrown out when Weeden moved its entire trading operation from New York to Jersey City in early 1976. In any case, Post-Breen we do seek, utilize and rely upon all information that we can reasonably get and maintain files of the same, but even now the research done on a competitive underwriting is quantitatively and qualitatively different from that done on a negotiated underwriting, a critical distinction which is nowhere mentioned in this questionnaire.

E. Pre-Breen the answer is "Yes" to all four questions. Post-Breen we came to Question 3.

The organizations had been asked to specifically describe the extent, if any, to which they relied, received or utilized various types of information. Most of the organizations did not state the extent to which they relied or utilized various information. For instance, in the 4(A) category concerning reliance upon its own independent research, Chase stated:

On the basis of the information published by the City, the Municipal Research Division conducted Credit research and analysis with respect to the City. Chase officials relied upon the Division's work product.

Similarly, Bankers Trust and Citibank were unable to state the extent they took into account the views of their personnel who were

engaged in municipal research; and Weeden did no independent research prior to 1975.

Generally, the organizations relied upon the rating services and the full faith and credit of the City.

Question 5

Specifically describe the analysis or study, if any, which your organization made of the matters set forth below (1) Before submitting bids for the Notes or Bonds; (2) Before inviting other organizations to join the syndicate for the purchase and re-sale of the Notes or Bonds; (3) Before taking down any of the Notes or Bonds; (4) Before re-sale of the Notes or Bonds:

- (1) The creditworthiness of the City's Notes or Bonds;
- (2) The fiscal soundness of the City;
- (3) The sufficiency of revenues of the City to meet its maturing obligations;
- (4) The financial data or information presented by the City in the Notices of Sale and Statements of Essential Facts; and
- (5) Deficits or budget gaps, if any, of the City.

If your organization's procedures for analysis or study of the above matters changed at any time(s) during the time frame in which it participated in the sale of the Notes or Bonds, described when, why and how they changed.

* * *

The organizations generally treated the matters listed in (1)-(5) as indistinguishable in the decision to participate and either did not distinguish the stages in the underwriting process indicated in the Question or only discussed one stage.

For instance, Chase reported:

A weekly memorandum containing the Municipal Research Division's assessment, based on published information, of the investment quality of various municipal securities for which bids were to be submitted, including from time to time Bonds and Notes, was made available to the Municipal Securities Division of Chase prior to bids being submitted. Such information was therefore available at about the time of formation of any underwriting syndicate and prior to submission of a bid, takedown of any securities from a syndicate, or resale of securities taken down. In reaching an assessment of investment quality, the factors listed in question 5 were considered.

The weekly memoranda submitted by Chase are twelve memoranda prepared between December 4, 1973 and April 11, 1974, 19 memoranda prepared between January 23, and December 2, 1974; and 2 memoranda prepared between January 7, 1975 and February 4, 1975. Generally, these memoranda identify the issue, rating service rating, credit ratings, City's debt per capita, Debt Est./ Full Value, Debt Service/Revenues, Taxes/Est. Full Value, and the Current Tax delinquency. Commentary captioned: "Purpose and Status"; "Economic Bases"; "Financial Management"; and "Credit" followed. Numerical information within these sections changed with each memorandum. The "Purpose" and "Status" sections changed with each memorandum generally to identify the issue. However, for the most part the substance of each section remains the same.

The information within the captions includes a general consideration of the matters listed in subsections (1)-(5). However, Chase did not state how this "analysis" bore upon its decision to participate in the underwritings.

As to the responses of the other organizations, three of the six banks referred the Commission to answers given in Questions Two and Four, documents already submitted to the Commission, stated that they were never a lead managing underwriter, or employed a combination of these responses. Parts of the more extensive answers indicated that there was little, if any, distinction between the time periods of the underwriting process which would warrant further analysis.

Bankers Trust reported that the factors (1) - (5) were inseparable in an assessment of creditworthiness, and that the analysis conducted could not be distinguished as to time frame. Bankers Trust stated that it made use of all available information in "all phases of the underwriting process."

Bankers Trust believes that the items referred to in subparagraphs (1) through (5) are inseparable elements to be considered in assessing the creditworthiness of the issuer. The fiscal soundness of New York City, the sufficiency of its revenues to meet its maturing obligations, budget deficits and financial data reflecting its fiscal condition are all factors which have an impact on the public assessment of the creditworthiness of the City's Notes and Bonds. Also, since New York City was regularly issuing Notes and Bonds, it is impossible to distinguish between the amount of study and analysis conducted by Bankers Trust in any of the four particular time frames mentioned in question number 5. Bankers Trust conducted an on-going study of the fiscal condition of New York City and its securities, making use of publicly available information through all phases of the underwriting process.

Beginning in approximately February 1975 Bankers Trust's analysis and study of the creditworthiness of New York City securities intensified with the situation.

Chemical Bank answered in a similar vein:

Chemical reviewed and analyzed the City's creditworthiness and fiscal soundness on a continuing basis; such review and analysis was based in large part upon the information described in the response to Question 4, and in light of those factors summarized in the response to Question 2. Such review and analysis was neither limited to nor necessarily entailed or focused upon any of the individual matters set forth in paragraph (1) through (5) of Question 5. Chemical's basic procedures for review and analysis of these matters did not change over time.

Merrill Lynch's answer was similar to Chemical's, referred to factors already stated in response to Questions Two and Four and further noted:

Merrill Lynch was never the "lead manager" of a syndicate that offered and sold the Notes or Bonds; accordingly, Merrill Lynch never invited other firms to join any such syndicate, but rather was itself invited by the lead manager to join certain of such syndicates. The factors that Merrill Lynch analyzed in deciding whether to participate in a syndicate that would offer and sell the Notes or Bonds are enumerated in Merrill Lynch's answer to Question 2. Merrill Lynch also received and reviewed certain material described in its answer to Question 4. All of the factors enumerated in Merrill Lynch's answer to Question 2 were analyzed prior to the submission of a bid, the taking down of any Notes or Bonds, or the re-sale of any Notes or Bonds by Merrill Lynch. Merrill Lynch regarded the fact that the Notes and Bonds were legally backed by the full faith and credit of the City and that City officials repeatedly assured that such obligations must be honored first among all claims against or obligations of the City as the overriding and paramount consideration in deciding whether to participate as a member of a syndicate that would offer and sell the Notes or Bonds, rather than the matters enumerated in Items (1) through (5) of Question 5 or any other matters. Merrill Lynch's procedure for analysis, as set forth in this answer, did not change at any time during the time in which Merrill Lynch participated as a member of a syndicate that offered and sold the Notes or Bonds.

Weeden added:

Since Weeden was never a managing underwriter of any City paper during the crisis period of June 1974 to March 1975, these questions are out of focus, as

would be our answers. The facts, of course, remain the same. Pre-Breen we relied on the City to supply accurate figures and for the managing underwriters, the rating agencies and bond counsel to carefully analyze such data for the benefit of all parties, including ourselves and the public. Following the report on the broad tape of Breen's speech of January 10, 1975, ... and the extraordinary press release by the Mayor and the Comptroller in response ... and the subsequent exchange of correspondence with the Mayor ... we no longer gave much credence to information given by the City and focused instead on the advice of new bond counsel.

Question 6

Specifically describe any independent investigation or inquiry your organization made prior to participation in the underwriting of the Notes or Bonds with respect to:

- (A) Fiscal information prepared and presented by the City; and
- (B) Fiscal information concerning the City prepared and presented by any other sources (identifying the sources).

Please provide the staff with any written reports made by employees, members or officers of your organization regarding the Notes or Bonds in this context.

* * *

In response to this Question, Chase, Citibank, Bankers Trust and Merrill Lynch referred the Commission to information and documents already submitted or to responses already submitted in answer to another question in the Questionnaire.

For instance, Chase responded as follows:

Various sources of published information were reviewed from time to time by the Municipal Research Division, in assessing the investment quality of City Bonds and Notes. The most important of such sources are listed in the response to Question 4 herein. In addition, materials published by the Citizens Budget Commission were used on a regular basis to supplement sources of information prepared by the City. Weekly Reports of the Municipal Research Division which referred to the City have been previously furnished to the SEC.

Chemical stated:

The Bank relied on bond counsel with respect to verification of fiscal information concerning issuance of City Notes and Bonds, and, in addition, attempted to verify such information in its possession as it does with all other information with regard to municipal issues. Primarily, it compared new items of information coming into its possession with similar information received from other sources and with similar information previously in its possession. Given the complexities of the budgetary and fiscal affairs of entities like the U.S. Government, the State of New York or the City of New York, accurate independent verification is almost impossible. For example, sources of funds quite often are found by government officials which were not known to be available to the private sector. Any written reports in the Bank's possession respecting such matters have previously been produced to the Commission. The Commission is also referred to the responses to Questions 2 through 5 and 8 through 14 and to the testimony of Bank officers given in this proceeding.

Generally, the organizations stated that they reviewed the information that was prepared by the City. Chemical Bank reported that it compared current information with past information. However, in answer to Question Six, no organization reported that it questioned the information published by the City or by another source.

Question 7

Did your organization prepare any sales literature, brochures, write-ups, etc. with respect to the Notes or Bonds for delivery to customers or others? If so, identify the person(s) in your organization responsible for its preparation, and indicate whether it was in fact distributed or given to your customers. Please furnish copies thereof.

* * *

Traditionally, sales literature may be prepared to advertise aspects of the securities issue and to stimulate interest. Generally, the responses to Question Seven indicated that there was little sales literature prepared by the managing underwriters. Chase, Bankers Trust, and Chemical Bank prepared no sales literature. Citibank referred the Commission to documents already submitted.

Only Merrill Lynch submitted an extensive report as to the sales literature it prepared. Its answer stated:

Yes, Mr. John S. de Graffenried was the Manager of the Municipal and Corporate Bond Sales Development Department and, in such capacity, had ultimate responsibility for the content of any such sales literature and its distribution to Merrill Lynch's customers. With respect to any such advertisements placed by Merrill Lynch in newspapers or magazines the Advertising Department of Merrill Lynch would approve the format of such advertisements.

The following materials were distributed by Merrill Lynch to its account executives who made such materials available to customers:

- (1) a brochure, dated January 15, 1973, entitled "A Fresh Look at New York City";
- (2) a brochure, dated August 16, 1973, entitled "Discount Tax-Exempt Municipal Bonds - 'A Way to Increase Your Yield'";
- (3) a brochure, dated August 16, 1973, entitled "Advantages of Discount Tax-Exempt Notes";
- (4) a brochure, dated April 5, 1974, entitled "A Fresh Look at New York City"; and
- (5) a brochure, dated February 5, 1975, entitled "Tax-Exempt Notes - The Long and Short of It."

The following advertisements relating to the Notes or Bonds were placed in newspapers or magazines by Merrill Lynch:

- (1) an advertisement, run in January, 1973 entitled "New York taxpayers: Merrill Lynch tells how you could get a 3-way tax exemption with upgraded New York City bonds";
- (2) an advertisement relating to the offering of \$620,000,000 principal amount of Revenue Anticipation Notes; and
- (3) an advertisement run in December, 1973 and another advertisement run in April 1974, both entitled "Merrill Lynch is bullish on New York City tax-free bonds."

Such materials have been produced to the Commission by Merrill Lynch in its response to the Commission's subpoena.

Question 8

Prior to your organization's participation in the underwriting of the Notes or Bonds, did it consult with any outside technical experts, such as accountants, or municipal securities analysts, with respect to:

- (A) The subject matter referred to in item 5?
- (B) The feasibility of engaging in the underwriting of the Notes or Bonds?
- (C) The fiscal affairs or status of the City?

Specify who was consulted, the date of consultations, and the action, if any, taken or conclusions reached.

* * *

Three organizations -- Chase, Merrill and Weeden -- reported no consultation with outside technical experts. Chase stated:

Chase did not independently consult outside technical experts, although reports and ratings of Moody's Investors Service, Inc. and Standard & Poors Corporation (referred to in response to question 4(C) above) were reviewed.

Weeden noted:

Prior to or in conjunction with accepting an invitation to join a syndicate for the purpose of bidding on City paper we were the beneficiaries of whatever information the manager, the rating agencies and bond counsel elected to give out. We were never invited to join the Mayor's Committee or the Comptroller's Committee, nor did any member of either committee undertake to brief us on what was going on. Weeden did not engage or seek out "outside technical experts" nor are we confident we understand the terms as used in the questionnaire nor even whether such "experts" exist, let alone whether they would have spoken to us and talked freely if questioned.

The three banks which reported consultations with outside technical experts submitted no other information. For instance, Citibank stated:

During the course of Citibank's participation in the underwriting of the Notes or Bonds, it consulted with persons, experts and non-experts, concerning the subject matters referred to above.

It is not possible to specify who was consulted, the dates of consultation, or the action, if any, taken or conclusions reached.

And, Bankers Trust stated:

As has been stated previously in response to question number 5, the matters referred to in subparagraphs (A), (B) and (C) are considered by Bankers Trust to be interrelated elements which affected its decision to participate in an underwriting of New York City securities. Therefore, it is impossible to distinguish consultations with outside technical experts with respect to any particular matter referred to therein. At various times, Bankers Trust did discuss the financial condition of New York City with issuers of reports on municipal securities and analysts at other banks and brokerage firms.

Chemical Bank stated:

Except for its normal business discussions with other members or potential members of underwriting groups, the Bank only consulted with outside public sources of information to supplement its review and analysis. The Bank does not know whether some or any of such public sources of information might be considered by the Commission to be "technical experts" as that term is used in Question 8, but the Commission is referred in this respect to documents previously produced to the Commission and to the testimony of Bank officers given in this proceeding.

Question 9

What was your organization's understanding as to the role or duties of a managing underwriter in connection with the underwriting of the Notes or Bonds? For example,

- (A) Did your organization believe that a managing underwriter had or assumed the responsibility to verify or investigate the accuracy, completeness or veracity of the information prepared and presented to them from other sources?
- (B) Did your organization understand or believe that a managing underwriter had an obligation to bring to the attention of the syndicate any negative aspects relating to the Notes or Bonds?
- (C) Did your organization understand or believe that a managing underwriter's decision to underwrite the Notes or Bonds was in and of itself an express or implied approval of the creditworthiness of the City's fiscal position and its Notes or Bonds?

In each instance, state the basis for the understanding or belief.

- (D) In any event, please reflect your understanding or belief of a managing underwriter's role or duties in this connection.

* * *

The typical response from syndicate members, when asked to describe the extent of their independent investigation prior to participation in the underwriting syndicate, was that they relied upon the managing underwriter to investigate the creditworthiness of the Notes or Bonds, and generally expected to be notified of any negative aspects relating to the Notes or Bonds. Generally, the managing underwriters did not understand the

duties of the managing underwriter to include those referred to in Question Nine, sections (A), (B) and (C). Chase understood its duty to include a responsibility to disclose material non-public information, if known, or to abstain from the offering. However, Chase submitted that this situation did not occur. Chase stated:

As managing underwriter of a syndicate formed to bid for Notes or Bonds, Chase assumed the responsibilities set forth in the syndicate agreement. Chase did not believe that the decision of a managing underwriter to underwrite Notes or Bonds constituted approval of the credit worthiness of such securities, or that the managing underwriter assumed the responsibility for verifying or investigating the veracity of information prepared by third parties. Of course, if Chase actually had known of material non-public information about the City at the time of an offering of Bonds or Notes, it would have assumed a responsibility to either disclose such information or abstain from participation in such offering. This situation did not, however, occur.

Citibank stated:

We believe this question to be inappropriate in the present context. We understand that the staff is in the process of preparing a report for the Commission, which report might comment adversely upon New York City and others involved in the sale of its securities and might conceivably recommend enforcement action against them. Citibank would be happy to respond to this question in the context of a rulemaking or other proceeding in which the Commission was generally studying the municipal securities market and considering whether some new legislation or regulation was necessary or appropriate in connection therewith.

In addition, this question is inappropriate in that it calls for a legal opinion and/or conclusion of law.

Citibank answered Questions 9, 10, 11 and 12 with the same response.

Bankers Trust's response was a composite of that received from Chase and Citibank:

Bankers Trust understands that the managing underwriter had a duty at all times to comply with the law, and that it had a duty at all times not to knowingly misrepresent facts concerning securities it underwrote or knowingly to omit material facts regarding such issues. To the extent that item 9 would require Bankers Trust to express an opinion or to state its belief as to what the legal requirements applicable to municipal securities underwritings are or were, we believe that such a request is inappropriate in the context of an investigation conducted for enforcement (as distinct from regulatory) purposes.

Chemical referred to syndicate agreements previously submitted to the Commission. These agreements describe the contractual duties of the managing underwriter, but do not address the description of duties in Question Nine subsections (A), (B) and (C). Chemical noted:

The Bank's understanding as to the role and duties of a managing underwriter in connection with the underwriting of City Bonds is contained in contracts among members of Bond underwriting groups, copies of which in the possession of the Bank have previously been produced to the Commission; and the Bank understands the role of a managing underwriter of a Note underwriting group had similar responsibilities. The Bank believes that pursuant to these contracts a managing underwriter would have brought to the attention of the other members of an underwriting group any materially negative aspects relating to the issue not thought to be known to such members of which the managing underwriter became aware and understands that the participation of the managing underwriter in any issue implies its belief in the creditworthiness of the obligations being underwritten.

Merrill Lynch stated:

The lead managing underwriter had the responsibility of organizing the syndicate, communicating the syndicate's bid to the City, coordinating the selling activities of the syndicate after having ascertained that the appropriate closing documents would be obtained, including the legal opinion from bond counsel to the effect that the Notes or Bonds were validly issued and backed by the full faith and credit of the City.

(A) Merrill Lynch does not understand what "information" and what "other sources" the Commission is referring to in Question 9. Merrill Lynch assumes that the Commission is asking whether Merrill Lynch believed that the managing underwriter had the responsibility to verify or investigate the accuracy of statements made in the Notices of Sales and the Reports of Essential Facts. The Notices of Sales and the Reports of Essential Facts were public official documents prepared by the City. The Notice of Sale was not a disclosure document, but simply an advertisement by the City for bids on a proposed offering that would set forth the terms of the proposed offering. Merrill Lynch did not regard the Report of Essential Facts as a disclosure document, but rather as a document that contained only certain information about the City. Therefore, Merrill Lynch did not believe that the managing underwriter had the responsibility to verify the accuracy of statements made in these public official documents. Merrill Lynch did believe that the managing underwriters had the duty to verify that the Notes or Bonds were validly issued and backed by the full faith and credit of the City and that such duty was satisfied by obtaining a legal opinion to that effect from bond counsel.

(B) Merrill Lynch did not believe that a managing underwriter had an obligation to bring to the attention of the other syndicate members adverse information regarding the City's fiscal condition because such information was already in the public domain. Merrill Lynch did, however, believe that any member of a syndicate would have the responsibility of informing the other syndicate members of any non-public, adverse information of which it had knowledge that related to the City.

(C) No.

The basis for Merrill Lynch's answer to this Question 9 is standard industry practice.

Instead of answering "yes" or "no" to the description of duties of the managing underwriter in Question Nine, sections (A), (B) and (C), Weeden ordered its response to state that it relied in the first instance upon the City and in the second instance upon the managing underwriter, bond counsel and rating services. Weeden responded:

There were but two syndicates bidding on City paper during the 1974-75 crisis period and the managing underwriters of each had employees (some former City employees) whom Weeden believed were extremely knowledgeable about the City's fiscal affairs. Accordingly, we relied completely in the first instance on the City to give out accurate facts and then on the managing underwriters, along with bond counsel and the rating agencies to analyze such facts and keep us fully advised. After the Breen speech, the broad tape excerpt of it, the Mayor's and Comptroller's press release and the letter exchange with the Mayor, we had little faith in the information being given out by the City and relied instead upon the investigation of new bond counsel. In fact, of course, there was very little City paper issued after the Mayor's letter of February 25, 1975 in which, at that late date, he was still insisting that Mr. Breen was "yelling fire" in a crowded theater when there is no fire.

Bankers Trust submitted one characterization of the extent of the duties of a managing underwriter: "The managing underwriter had a duty at all times to comply with the law and it had a duty at all times not to knowingly misrepresent facts... or omit material facts." Other responding organizations similarly recognized an obligation to disclose material, non-public adverse information in their possession relating to the City's fiscal affairs.

One point worth noting is that while Chase believed that its decision to be a managing underwriter of the City's Notes or Bonds did not constitute approval of the creditworthiness of such securities -- a view to which Merrill subscribed -- Chemical stated:

... the participation of the managing underwriter in any issue implies its belief in the creditworthiness of the obligations being underwritten.

Further, those organizations responding uniformly believed that a managing underwriter did not have a responsibility independently to verify or investigate information received from sources outside the organization.

Question 10

Please describe your understanding of the role or duties of bond counsel in connection with the underwritings of Notes or Bonds. And specifically discuss the following:

- (A) Did you believe that designated bond counsel had a duty to disclose to the underwriters who purchased the Notes information which was brought to their attention concerning the sufficiency of revenues or taxes behind the Notes?
- (B) Did you believe that designated bond counsel had a duty to make some investigation as to the basis for the City's estimates of revenues to be received against which the City was issuing Tax Anticipation Notes and Revenue Anticipation Notes?

* * *

Generally, the managing underwriters responded that they had believed bond counsel had the duties described in Question 10.

Chase believed that subsections (A) and (B) described bond counsel's duties and stated:

It was Chase's understanding that bond counsel was to provide a legal opinion as to the validity of Notes or Bonds, as the case may be. It was further assumed that bond counsel would receive from the City such data as bond counsel required to enable

it to determine in connection with rendering its opinion that there were taxes or revenues in anticipation of which tax anticipation notes or revenue anticipation notes could be issued under the relevant provisions of the State's Local Finance Law. Chase believed that bond counsel would call to Chase's attention any material facts concerning the sufficiency of such taxes and revenues. Chase was aware that Bond counsel dealt directly with various City officials in the process of preparing to render its opinion, but was not aware of specific steps taken to verify information obtained.

Citibank and Bankers Trust did not respond to Question Ten. Bankers Trust stated:

We believe that such a request is inappropriate in the context of an investigation conducted for enforcement (as distinct from regulatory) purposes.

Merrill Lynch expected that bond counsel would do whatever was necessary to provide or to deliver a legal opinion to the effect that the notes or bonds were validly issued, backed by the full faith and credit of the City and exempt from taxes.

Merrill Lynch wrote:

It was the responsibility of bond counsel to deliver an opinion at the closing substantially to the effect that the Notes or Bonds had been validly issued by the City, were backed by the full faith and credit of the City, and the interest on the Notes or Bonds was exempt from Federal, New York State, and New York City income taxes. It would be the responsibility of bond counsel to do whatever was necessary to enable them to render such an opinion. If bond counsel were not able to render such an opinion, bond counsel would have to explain to the syndicate members the reasons for not being able to do so.

Chemical's response was similar to that of Merrill Lynch.

Weeden distinguished the investigation necessary for a competitive underwriting from the investigation necessary for a negotiated underwriting and stated:

Yes to both A and B, but we are not clear on the extent of the investigation appropriate or feasible in competitive underwritings of exempt securities as distinguished from negotiated underwritings of non-exempt securities. In any given week Weeden can participate in from 20 to 40 competitive underwritings of exempt securities.

Generally, the responses were formulated to suggest that the managing underwriters had an understanding that bond counsel had a duty to perform an independent investigation, although the extent of independent investigation expected was unclear. The managing underwriters stated that they believed that the bond counsel, rather than they, had the duty to investigate the sufficiency of revenues or taxes and the basis of the City's estimates.

Question 11

At the time of your organization's participation in the underwritings of the Notes or Bonds, please describe your understanding of the purpose of the Notices of Sale and Reports of Essential Facts which were prepared and distributed by the City. For example, did your organization expect that, if there were

- (A) Any material changes in accounting practices and policies by the City, they would have been described therein?
- (B) Any developments of material matters affecting the City's financial condition one way or the other, they would have been described therein?

- (C) Any overestimates of revenues for prior years from the Federal or State Governments to the City, or from real estate tax sources, such would have been disclosed therein?
- (D) Any renewals or "rollovers" of Notes, the need for or the reasons therefor would have been described therein?
- (E) Any budget gaps, budget deficits, cash deficits, or deficit financing then in existence, such would have been disclosed therein?

If you did not expect to find the information referred to immediately above and other relevant information in the Notices of Sale and Reports of Essential Facts, did your organization find such information in any other source?

Yes []

No []

If yes, please describe such source and what you found.

* * *

Generally, the stated understanding regarding the Notices of Sale was that they were a mere advertisement or notification of a future offering. The managing underwriters stated that they did not expect the information referred to in this Question to be included in the Notices or in Reports of Essential Facts. In contrast, the syndicate members deemed the matters referred to in subsections (A)-(E) to be material and expected that these matters would be included in the Notices of Sale and the Reports of Essential Facts.

Chase did not respond to the question directly but stated:

It was Chase's view that Notices of Sale and Reports of Essential Facts were designed to notify prospective purchasers of a competitive offering of Notes or Bonds. It was Chase's assumption that the contents of such Notices and Reports were in accordance with the requirements of the State's Local Finance Law and regulations issued thereunder.

Information published by the City, including that referred to in response to Question 4, was Chase's source of information regarding the topics referred to in paragraphs (B) through (E) of Question 11. The information on these topics contained in such sources, was referred to, in general terms, in weekly reports of the Municipal Research Division and the reports of the Municipal Research Division to the Municipal Credit Portfolio Review Committee, copies of which have been furnished to the SEC. No information with respect to material changes in accounting practices and policies of the City as such was disclosed in materials reviewed by the Municipal Research Division.

Bankers Trust reported that a reason why the Reports of Essential Facts were not reliable sources for material information was that they were not prepared in connection with Note issues until March 14, 1975.

It was Bankers Trust's understanding during its participation in the underwriting of the Notes and Bonds that the primary purpose of the Notice of Sale was to announce the sale to the public and to provide a summary statement of the City's authority to issue a particular security.

Reports of Essential Facts were not prepared in connection with Note issues until March 14, 1975. Bankers Trust did expect such Reports when issued by the City to contain such facts, including those outlined in subparagraphs (A) through (E), as might be essential to an evaluation of the creditworthiness of the security being issued at that point in time. Prior to February, 1975, it was Bankers Trust's understanding that a Report of Essential Facts prepared in connection with a bond issue would contain reference to material changes in accounting practices and policies by New York City, but would not be expected to provide information as to the matters described in subparagraphs (B) through (E). Any information obtained by Bankers Trust with respect to such matters was publicly available information.

Merrill Lynch reported:

The Notices of Sale were the means by which the City advertised for bids on a proposed issue of Notes or Bonds, and such Notices of Sale set forth certain terms and conditions with respect to the proposed offering. The Reports of Essential Facts were public official documents prepared by the City that contained certain information about the City. Merrill Lynch did not regard the Reports of Essential Facts as disclosure documents. Merrill Lynch did not distribute the Reports of Essential Facts to its customers, except that Merrill Lynch did distribute to its customers the Report prepared by the City in connection with an offering of revenue anticipation notes on March 7, 1975, because a majority of the members of the syndicate had agreed that all syndicate members should distribute that Report, as supplemented by press release from the Comptroller, to the purchasers of the Notes.

Merrill Lynch's answer is "No" to subsections (A) through (E) of Question 11. Merrill Lynch found the information referred to in subsections (A) through (E), as well as other relevant information relating to the City, in the publications referred to in Merrill Lynch's answer to Question 4.

Chemical Bank reported:

The Bank understands that the Notice of Sale was in substance a form on which an upcoming issue of City Notes or Bonds was announced and that the Report of Essential Facts was a summary of basic statistical and debt information respecting the upcoming issue. More detailed information as to such matters as those referred to in subparagraphs (A) through (E) of Question 11 might be reflected in some or all of the other sources referred to in the response to Question 4....

Weeden (which was not a managing underwriter) reflected the response of the syndicate members, which was contrary to the stated expectations of the managing underwriters.

We do not believe that Notices of Sale and the Reports of Essential Facts were in fact "distributed by the City." They may have been available either before or after the fact to those knowledgeable enough to know whom to ask and determined enough to keep asking until they got them. Passing those problems with the question, the answer is "yes" to A through F and "no" on the use of other sources before Mr. Breen was hired.

Chemical Bank, Merrill Lynch and Chase reported that the City publications (e.g. Monthly statements; Annual Report, etc.) listed in Question Four were the sources for the accounting practices information. However, Chase submitted that:

No information with respect to material changes in accounting practices and policies of the City as such was disclosed in materials reviewed by the Municipal Research Division.

Bankers Trust submitted that:

Any information obtained by Bankers Trust with respect to such matters (A)-(G) was publicly available information.

Question 12

Did your organization believe that the City provided sufficient financial information and other data concerning its affairs as to the Notes or Bonds being offered and sold to enable your organization to make an informed judgment of the creditworthiness of the City and its Notes or Bonds. If your answer is in the affirmative, state why.

* * *

With certain caveats to their answers, two of the three responding managing underwriters believed that the City provided sufficient financial

information to allow an informed judgment of creditworthiness to be made.

Chase noted:

During the relevant period it was the belief of the Municipal Research Division that the City was providing sufficient financial information which would enable the Municipal Research Division to make a reasonably informed judgment of the creditworthiness of the City's Notes and Bonds. This belief was grounded on the fact that published information contained information of the type contained in reports by other municipalities and of the type usually used as a basis for analysis of municipal credits. Of course, Chase had no opportunity to verify such published information since the actual records and books of the City were not available to Chase.

Chemical Bank reported that the information available was assumed accurate and that its own analysis and the rating services' analysis did not find the information questionable. It stated:

Based on the assumption that the financial information and other data provided by the City on which the Bank relied in its analysis was accurate and in the absence of any clear and convincing source of information described in the response to Question 4, 5 and 6 ... (including reports of the rating services and other publicly available information), which would come to the Bank's attention in the course of its own review and analysis, calling into question information and data provided by the City, the Bank believed that it was in a position to make an informed judgment of the creditworthiness of the City and its Notes and Bonds.

Merrill Lynch reported that it relied on the full faith and credit of the City, the New York State Constitution, the legal opinion of bond counsel and the verbal assurances of the Mayor and Comptroller as the basis for its judgment of creditworthiness, rather than the published financial information.

Citibank and Bankers Trust refused to respond to the question.

Question 13

With respect to each revenue anticipation note ("RAN") or tax anticipation note ("TAN") of the City which your organization underwrote, please indicate if and to what extent your organization was aware of the following:

- (A) The source, and method of computation of the revenue or taxes which supported the issuance of each RAN or TAN;
- (B) The date that the revenues or taxes were due or would become due;
- (C) The manner in which the revenues or taxes to be received were determined, i.e. whether it was by estimate, formula, audit, or confirmation;
- (D) How proceeds from each RAN or TAN issue were actually utilized;
- (E) Whether the revenues or taxes to be received upon which the issuance of the RANS or TANS were based, were, in fact, received in their entirety;
- (F) If any portion of the revenues to be received was not received, the manner in which the City paid off the RAN or TAN at maturity.

* * *

Citibank stated, in response to this Question:

It is not possible to specify the state of Citibank's awareness with respect to each of these matters for each particular issue of revenue anticipation notes and tax anticipation notes.

Chase stated:

Chase was aware of the matters set forth in question 13 insofar as (1) it assumed on the basis of Bond Counsel's opinion that the computation of anticipated taxes or revenues was in accordance with the relevant provisions of the Local Finance Law, (2) the source of anticipated taxes or revenues was identified in the relevant notice of sale, (3) the Certificate of Award signed by the Comptroller of the City in connection with each issue of Notes specified anticipated taxes or revenues; and (4) the Municipal Research Division

was able to determine on an aggregate basis from examination of information published by the City (a) amounts and due dates of anticipated taxes and revenues, (b) whether portions of such taxes and revenues remained uncollected at the end of a fiscal year, and (c) the apparent method of reserving for or financing any such taxes and revenues remaining uncollected.

Bankers Trust stated that it believed that the items identified in subparagraphs (A) through (E) were covered in the investigation of bond counsel. Bankers Trust therefore stated that it considered it reasonable to rely on bond counsel's conclusions as to these matters. As to the balance of the items, Bankers Trust, although purportedly maintaining a constant general review of the City's fiscal condition, did not consider investigation with respect to those items as "...appropriate to its function as an underwriter...."

Chemical Bank stated:

The Bank understood and was aware of the fact that the source and method of computation of City revenues or taxes were subject to the provisions of the New York State Constitution. The Bank understood and was aware of the fact that property tax collection schedules are published by the City and actual receipts and monthly cash value were reported by Moody's as part of their "MIG" reports and in the monthly report of the Comptroller. With respect to the manner in which anticipated revenues were determined, the Bank understood that State and Federal aid to the City was usually determined by a formula or by way of reimbursement under certain aid programs. The Bank's awareness of the other matters referred to in Question 13 was premised on publicly available information contained in sources described in the response to Question 4, ...

Merrill Lynch reported:

It was Merrill Lynch's understanding that TANS were issued against real estate taxes levied and due during the fiscal year in which such TANS were issued and that RANS were issued against specifically identified revenues

from state and federal sources due during the fiscal year in which such RANS were issued. As to compliance with legal requirements in connection with the issuance of TANS and RANS, Merrill Lynch relied upon the opinion of bond counsel. With respect to the matters referred to in subsections (D) through (G) of Question 13, Merrill Lynch did not regard such post-closing events as relevant inasmuch as the TANS and RANS were backed by full faith and credit of the City.

Weeden, placing reliance on bond counsel, the City, rating agencies and the managing underwriters, also emphasized that the frequency of rollover of Notes "...obscured the specifics of any given issue."

Question 14

- (A) What was your organization's understanding of the type of accounting system employed by the City of New York during the period January 1973 to May 1975?
- (B) Please provide the staff with any reports, whether intended for internal or external use, made by employees, members, or officers of your organization regarding the City's accounting system during such period.

* * *

Merrill Lynch's, Chemical Bank's and Weeden's response were as follows:

It was Merrill Lynch's understanding that the City accounted for revenues on an accrual basis and for expenditures on a cash basis. Any such report referred to in subsection (B) of Question 14 would have been produced by Merrill Lynch to the Commission in its response to the Commission's subpoena.

* * *

Chemical Bank understood that the City's accounting system was subject to requirements of State law and was premised on a modified cash basis approach. Reports made within the Bank regarding the City's

accounting system, if any, have been produced to the Commission pursuant to the subpoena addressed to the Bank dated January 16, 1976.

* * *

Weeden used to believe the City employed generally accepted accounting procedures. The New York Daily News editorial...destroyed that myth; and the letter exchange with the Mayor in January and February 1975 left little doubt that those in charge were unwilling publicly or privately to concede the gravity of the problem.

Chase, a principal underwriter of many New York issues wrote:

Chase is unable to respond to this question because no information fully stating the basis of the accounting system employed by the City was made available. (Reports if any, are already submitted).

Citibank wrote:

- (A) This question is so general, vague, and ambiguous that Citibank is unable to frame a response.
- (B) The information requested is reflected in the documents produced by Citibank pursuant to SEC subpoena.

Bankers Trust stated:

Bankers Trust does not understand the meaning of the phrases "type of accounting system" and therefore is not able to respond to subparagraph A. All documents which would be responsive to subparagraph B have previously been furnished to the Staff.

CONCLUSION

While conclusions with respect to the role which the managing underwriters played in connection with the collapse of the City's finances are drawn elsewhere, we believe that it is important to note that the organizations responding to the Questionnaire did little, if any, independent investigation relating to the financial affairs or creditworthiness of the City in connection with the underwriting process. Rather, reliance was purportedly placed by the managing underwriters on, among other things, the City's "full faith and credit" and investigation by bond counsel and the rating services.