HEARING
BEFORE THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
NINETY-FOURTH CONGRESS
SECOND SESSION
ON
H.R. 11700
A BILL RELATING TO THE APPLICATION OF CERTAIN PROVISIONS OF THE INTERNAL REVENUE CODE OF 1954 TO SPECIFIED TRANSACTIONS BY CERTAIN PUBLIC EMPLOYEE RETIREMENT SYSTEMS CREATED BY THE STATE OF NEW YORK OR ANY OF ITS POLITICAL SUBDIVISIONS

FEBRUARY 23, 1976

Printed for the use of the Committee on Ways and Means
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NEW YORK CITY PENSION FUND LEGISLATION

MONDAY, FEBRUARY 23, 1976

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10:35 a.m., pursuant to notice, in the committee hearing room, Longworth House Office Building, Hon. Al Ullman (chairman of the committee) presiding.

The CHAIRMAN. The committee will be in order, please.

The purpose of this public hearing today is to obtain the views from the administration and from organizations having an interest in H.R. 11700, a bill which was introduced by Congressmen Rangel, Conable, and Pike relating to the application of certain provisions of the tax laws with respect to the investment of certain New York pension funds.

Without objection, I would like to insert in the record at this point a copy of the press release dated February 9 announcing this hearing, as well as a copy of the bill, H.R. 11700.

[The press release and the bill, H.R. 11700, follow.]

[Press release of Monday, Feb. 9, 1976]

CHAIRMAN AL ULLMAN (D., Oregon), COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES PUBLIC HEARING ON H.R. 11700, A BILL RELATING CERTAIN PROVISIONS OF LAW CONCERNING INVESTMENT OF NEW YORK PENSION FUNDS IN NOTES OR BONDS OF THE CITY OF NEW YORK

The Honorable Al Ullman (D., Oregon), Chairman, Committee on Ways and Means, U.S. House of Representatives, today announced that on Monday, February 23, 1976, the Committee would conduct a public hearing on H.R. 11700, introduced by Congressman Charles B. Rangel of New York, Congressman Otis G. Pike of New York, and Congressman Barton B. Conable of New York, relating to the investment of certain pension funds in notes or bonds of the City and the Municipal Assistance Corporation for the City of New York. This will be a one-day public hearing, to be held in the Main Committee Hearing Room of the Committee on Ways and Means, beginning at 10:00 a.m. on February 23. The hearing will also cover any bills similar to the above which may be pending before the Committee at that time.

H.R. 11700 provides that certain New York City pension funds may hold and acquire notes or bonds of the City and the Municipal Assistance Corporation for the City of New York, pursuant to an agreement of November 28, 1975, without being held in violation of certain requirements and limitations in section 401(a) and 502(b) of the Internal Revenue Code of 1954. Such transactions, to the extent they require waivers or amendments to the agreement of November 28, 1975, would require the approval of the Secretary of the Treasury. Also, the Secretary of the Treasury and the Chairman of the Ways and Means Committee and Finance Committee are to receive periodic reports on the finances of the funds. The provisions of the bill apply through June 30, 1986.

The first witness will be representatives of the Department of the Treasury, to be followed by witnesses from the interested general public.
The limited time available to the Committee in which to conduct this hearing requires that all interested persons and organizations designate one spokesman to represent them where they have a common interest. Any interested individual or organization may file a written statement for the Committee's consideration and for inclusion in the printed record of the hearing instead of appearing in person.

The cutoff date for requests to be heard is the close of business Wednesday, February 18. The request should be addressed to John M. Martin, Jr., Chief Counsel Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515 (telephone: 222-2222). Notification to those requesting to be heard will be made at the first opportunity of the Committee after the cutoff date.

It is requested that persons scheduled to appear submit 75 copies of their prepared statement to the Committee Office, Room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Persons submitting a written statement in lieu of a personal appearance should submit at least three copies of their statement by the close of business Monday, February 23. If those filing for the record want copies of their statement distributed to the members of the Committee, the press and interested public, additional copies may be furnished for this purpose if submitted early on Monday morning, February 23.

[HR 11706, 94th Cong., 2d sess.]

A BILL Relating to the application of certain provisions of the Internal Revenue Code of 1954 to specified transactions by certain public employee retirement systems created by the State of New York or any of its political subdivisions

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) any pension plan or trust which, on December 5, 1975, was a party to the amended and restated agreement of November 28, 1973, set forth on pages 821308, 821309, and 821310 of the Congressional Record published on such date, and any trust forming a part of such a plan, shall not be considered to fail to satisfy the requirements of section 401(a) of the Internal Revenue Code of 1954, and shall not be considered to have engaged in a prohibited transaction described in section 403(b) of such Code, merely because such plan or trust engages in any or all of the following:

(1) (A) Entering into such agreement or agreeing to an amendment of such agreement;

(B) foreclosing any act prohibited by such agreement;

(C) acquiring or holding any bond or note the acquisition or holding of which is provided for by such agreement;

(D) making any election provided for by such agreement;

(E) executing a waiver of any requirement of such agreement;

(F) after the expiration of such agreement, holding any bond or note acquired or held pursuant to such agreement;

(G) performing any other act provided for by such agreement;

(2) On or after August 2, 1975, and before July 1, 1980, considering, for purposes of determining investments to be made by the plan or trust, the extent to which such investments will—

(A) maintain the ability of the city of New York—

(I) to make future contributions to the plan or trust, and

(II) to satisfy its future obligations to pay pension and retirement benefits to members and beneficiaries of such plan or trust, and

(B) protect the sources of funds to provide retirement benefits for members and beneficiaries of the plan or trust; and

(3) After June 30, 1980, considering, for purposes of determining whether to retain investments held on June 30, 1980, the factors enumerated in paragraph (2).

For purposes of paragraph (1), the acquisition or holding of any bond of the Municipal Assistance Corporation for the city of New York on or after August 20, 1975, and before November 26, 1975, shall be considered an acquisition or holding provided for by such agreement.

(b) In the case of—

(1) any amendment to the agreement described in subsection (a) which relates to the application of the factors set forth in subsection (a) to the requirements of section 401(a) or 403(b) of the Internal Revenue Code of 1954 and which is adopted after December 3, 1975, and
(2) any waiver of any requirement of the agreement by a plan or trust after December 5, 1975.

such amendment or waiver shall take effect for purposes of subsection (a) only if, not later than 30 days after the date on which a copy of such amendment or waiver is submitted to the Secretary of the Treasury (or, if later, the date of the enactment of this Act), the Secretary determines that the taking effect of such amendment or waiver for purposes of subsection (a) is not inconsistent with the considerations set forth in subsection (a) (2). No amendment to the agreement which has the effect of extending the expiration date of the agreement to a date later than June 30, 1986, shall take effect for purposes of subsection (a).

(c) The trustees of each pension plan or trust described in subsection (a) shall furnish a copy of the annual report filed by such plan or trust with the New York State Insurance Department for each fiscal year of the plan or trust beginning after June 30, 1975, and ending before July 1, 1986, to the Secretary of the Treasurer not later than 30 days after the date such report is filed with the New York State Insurance Department, together with such additional information to the Secretary of the Treasury as the Secretary of the Treasury may reasonably require. A copy of each such report shall be furnished by the Secretary of the Treasury to the chairman of the Committee on Ways and Means of the House of Representatives and the chairman of the Committee on Finance of the Senate.

(d) The Secretary of the Treasury or his delegate is authorized to prescribe such regulations as may be necessary to carry out the purposes of this Act.

(c) This Act shall be effective on and after August 20, 1975.

The CHAIRMAN. Our first witness this morning is Charles M. Walker, Assistant Secretary for Tax Policy with the Treasury Department. Upon completion of Mr. Walker's testimony and the question and answer period which will follow, we will then hear from a number of New York City organizations that have requested to be heard and which have specific interest in this legislation.

Mr. Walker, we welcome you back to the committee. You may proceed, sir.

STATEMENT OF CHARLES M. WALKER, ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY; ACCOMPANIED BY ROBERT WEINTRAUB, CONSULTANT; AND PATRICIA ANN METZER, ASSOCIATE LEGISLATIVE COUNSEL, TREASURY

Mr. Walker. Thank you very much.

Mr. Chairman and members of this distinguished committee, I am pleased to appear before you today to testify on the New York City pension fund legislation, H.R. 17700.

This legislation is part of the overall program to render financial assistance to New York City. On December 9, 1975, the President signed the New York City Seasonal Financing Act of 1975, authorizing the Secretary of the Treasury to lend up to $2.3 billion at any one time to the city of New York in order that the city might maintain its essential governmental services.

The Seasonal Financing Act was enacted by Congress with the understanding that the agreement dated November 26, 1975, between the Municipal Assistance Corporation, several of New York City's commercial banks, five New York City pension funds and the New York sinking funds would take effect. This agreement, itself, was generally conditioned upon the enactment prior to February 1, 1976, of Federal legislation that "would provide, by way of guarantees or otherwise, for the seasonal financing needs of the city over the period from the effective date thereof through a date not earlier than June
30, 1978, in a maximum amount of not less than $2.3 billion at any time outstanding."

As part of the New York City Agreement, the five pension funds which entered into the agreement—namely, the New York City Employees' Retirement System, the Board of Education Retirement System for the City of New York, the New York City Fire Department Pension Fund, the Teachers' Retirement System for the City of New York, and the New York City Police Pension Fund—agreed to purchase New York City bonds in the principal amount of approximately $2.5 billion through fiscal 1978 on a scheduled basis. The funds agreed to purchase, prior to January 1, 1976, serial bonds of the city with a face amount of $30 million, bearing interest at the rate of 6 percent a year.

All other serial bonds of the city to be acquired by the funds were to bear interest at the rate of 9 percent a year. All of these purchases were conditioned upon receipt of a ruling from the Internal Revenue Service or upon congressional enactment of legislation to the effect that the purchases would not constitute prohibited transactions or otherwise adversely affect the qualified status of the pension funds for purposes of the Internal Revenue Code of 1954.

If the pension funds were to lose their qualified status under the Internal Revenue Code simply by reason of the city bond purchases, the income earned by the funds might be subject to Federal income taxation and participants might be required to pay an immediate tax on current plan assets and contributions to the plans.

As governmental retirement plans, the New York City pension funds are exempt from the prohibited transaction rules of the Employee Retirement Income Security Act, the 1974 pension reform law. However, the prohibited transaction rules that were generally applicable to all pension plans under prior law continue to apply to such governmental plans.

In general, under those rules, a governmental plan will lose its tax exempt status if it (1) lends any trust assets to a substantial contributor without the receipt of adequate security and a reasonable rate of interest; (2) makes any substantial purchase of securities or other property from a substantial contributor for more than adequate consideration; or (3) engages in any other transaction which results in a substantial diversion of trust income or corpus to a substantial contributor. These prohibited transaction provisions appear in section 503(b) of the code.

Moreover, all qualified pension plans, including a governmental plan, must be created or organized for the "exclusive benefit" of employees, as provided under section 401(a) of the code. This has been interpreted to mean that assets may not be diverted for the benefit of the employer unless: (1) the cost does not exceed fair market value at the time of the purchase; (2) a fair return commensurate with the prevailing rate is provided; (3) sufficient liquidity is maintained so as to permit distributions in accordance with the terms of the plan; and (4) the safeguards and diversity that a prudent investor would adhere to are present. If the exclusive benefit rule is not satisfied, a pension plan will lose its qualified status.
In the context of the New York City pension funds, the specific question is whether or not the funds may purchase New York City bonds without violating the prohibited transaction and the exclusive benefit rules set forth in the Internal Revenue Code.

An administrative determination by the Internal Revenue Service with respect to this problem cannot be satisfactorily accomplished under current law. At best, an Internal Revenue Service ruling can only deal with narrow technical issues and a limited amount of bond purchases. For example, the Service cannot rule on the factual problem of valuation or on the question of whether or not an investment is prudent.

The Internal Revenue Service has issued letters of intent to rule favorably on bond purchases made by two of the city pension funds during December of 1975, but these letters are both conditional and limited in scope. They deal only with the receipt of "security" under section 503(b) of the Internal Revenue Code and the qualification of the pension funds under the so-called "exclusive benefit rule" of section 401(a), based upon the representations made, requested assumptions, and supporting documents. Through the ruling process, the Service cannot administratively deal with the more general problems raised under sections 401(a) and 503(b) of the code, nor with investments not covered by a specific ruling request.

Therefore, legislation is needed to enable the pension funds to purchase New York City bonds pursuant to the Agreement without jeopardizing their tax qualified status. The proposed statute, I.L.R. 11700, is narrowly drawn to deal with the problem without causing problems in the administration of the tax laws with respect to other plans and without unnecessarily establishing the unfavorable administrative precedent.

The legislation applies only to action taken by the pension funds which were parties to the agreement and provides that no fund will be deemed to have failed to satisfy the requirements of section 401(a) of the Internal Revenue Code nor to have engaged in a prohibited transaction described in section 503(b) of the code merely because it acts pursuant to the Agreement or, before July 1, 1986, considers, for purposes of making investments, or after June 30, 1986, considers, for purposes of deciding whether to retain investments held on June 30, 1986, the extent to which the investments will (1) maintain the ability of the city of New York to make future contributions to the fund and to satisfy the city's future obligations to pay pension and retirement benefits, and (2) protect the source of funds to provide retirement benefits. For purposes of the legislation, the acquisition or holding of any bond of the Municipal Assistance Corporation on or after August 20, 1975, and before November 26, 1975, will be deemed to have been acquired or held pursuant to the agreement.

The latter provisions are required to cover the Municipal Assistance Corporation obligations purchased by the pension funds prior to November 26, 1975, in connection with the overall program to enable New York City to maintain its essential governmental services and to cover New York City bonds retained by the pension funds following their acquisition pursuant to the agreement. In addition, the language makes
it clear that the Service may not disqualify the New York City pension funds under the prohibited transaction and exclusive benefit rules simply because they take the enumerated factors into account in making an investment decision.

Moreover, H.R. 11700 establishes reporting requirements and procedures with respect to the effectiveness of amendments to or waivers pursuant to the agreement. No amendment to the agreement having any bearing upon the qualified status of the pension funds and no waiver pursuant to the agreement can take effect for purposes of H.R. 11700 until the Secretary of the Treasury has determined that the taking effect of such amendment or waiver is not inconsistent with (1) maintaining the ability of the city to make future contributions to the funds and to satisfy the city's future obligations to pay pension and retirement benefits, and (2) protecting the source of funds to provide retirement benefits. Moreover, the trustees or administrators of each fund must furnish to the Secretary of the Treasury annual reports and such additional information as the Secretary may reasonably require from time to time. This information will then be furnished to the chairman of the House Committee on Ways and Means and to the chairman of the Senate Finance Committee.

Given these important safeguards, the Treasury Department strongly supports the New York City pension legislation as part of the overall program to render financial assistance to the city of New York and to implement the New York City Seasonal Financing Act.

I appreciate the opportunity to appear before your committee and will be glad to answer any questions you might have.

The CHAIRMAN. Thank you, Mr. Secretary. In considering this legislation, the committee must satisfy itself that this does not establish a precedent that might haunt us in the future.

Would you state very briefly why you think this does not set a bad precedent for the committee and why it can be kept within the limitations of the bill?

Mr. Walker. I believe the answer, Mr. Chairman, is that this legislation really amounts to a legislative ruling of the kind the Internal Revenue Service frequently finds itself required to make. As I mentioned in my statement, when a ruling is in process, the Service must consider all the facts and circumstances and make value judgments accordingly.

Typically, as was the case with the two ruling requests that were involved here, there is a close examination of all the facts and circumstances. However, when you look at the scope, breadth and dimension of the New York financing program, it is beyond the scope of the Internal Revenue Service to rule on all aspects of the transaction. The purpose of this legislation is, in effect, to provide a congressional ruling.

I might point out, incidentally, that the Service thus far has only indicated an intention to rule. The ruling has not been issued because of the need to examine in greater detail all of the relevant facts and circumstances.

The CHAIRMAN. Are there questions?

Mr. Schneebeil.
Mr. Schneebeil. Following through on the chairman’s questions, if New York City gets this favorable treatment, why wouldn’t other cities ask for the same type of treatment? How could they be denied this same treatment? If it became national in scope, what effect would this have?

Mr. Walker. It seems to me, Mr. Schneebeil, part of that answer depends on whether other cities can work out or will be faced with the same problem that New York had with the agreement.

Mr. Schneebeil. One of the cities in my State, Philadelphia, is almost presented with the same problem. They are running short on their budget. If we give this treatment to New York City, wouldn’t this be a way out for a lot of cities?

Mr. Walker. It seems to me, Mr. Schneebeil, that this bill is only a followup of the earlier congressional legislation that authorized the making of the interim Government loans in the first place.

Mr. Schneebeil. We recognize that fact, but is that justification for this action if we don’t anticipate at this time that the same action will be probably requested by other cities?

Mr. Walker. I would suppose that if similar actions were taken by other cities with respect to enabling legislation similar to that which New York has part of that would be a mechanism of this same sort.

Mr. Schneebeil. Would Treasury then support this action, this proliferation?

Mr. Walker. Only if such proliferation were to be built upon an earlier congressional determination to provide the assistance. It seems to me that if the assistance is determined to be warranted and is given, it may not be a complete giving of that assistance unless this further step is taken.

Mr. Schneebeil. We have a gun pointed at our head, and I think we ought to know what we are doing, that this is not going to be a sole action in this one category but is going to be extended to other cities, I think.

Mr. Conable. Would the gentleman yield?

Mr. Schneebeil. Yes.

Mr. Conable. You are saying that half measures aren’t going to help, that once we have committed ourselves to a course of action, we have to put together a total package that will meet the needs of the city?

Mr. Walker. That is my opinion.

Mr. Conable. A half measure is likely to be wasteful and is not likely to see the problem through to the end?

Mr. Walker. You see, I think the key here is that the reason for this piece of legislation is the fact that the assistance that is being provided contemplates the substantial investment by the pension funds. Maybe in other situations the needed financing would come from sources other than pension funds.

Mr. Schneebeil. May I ask one more question?

Could it be that other instrumentalities or other groups that now do not have a tax exempt status might be willing to fund a city’s deficits by lending their money and thus becoming qualified for an exempt status?
MR. WALKER. I don't know how they could become qualified for an exempt status.

MR. SCHNEEBELI. Because they would be doing the same job that untaxed units had done.

MR. WALKER. You mean that the pension funds are doing?

MR. SCHNEEBELI. Yes.

MR. WALKER. At the outset, the pension funds are already exempt.

MR. SCHNEEBELI. That is right. But would other funds that are not already exempt possibly be called upon to lend money to cities and thus become exempt?

MR. WALKER. I can't imagine how that would come about. That would be a problem to face at that time, I think. I don't think this legislation sets a precedent.

MR. RANGEL. Would the gentleman yield?

MR. SCHNEEBELI. I will yield.

MR. RANGEL. Thank you, Mr. Schneebeili.

It appears to me that the Congress has already gone into agreement with the executive branch in an agreement of how the City of New York could receive assistance. Under that agreement the pension funds were supposed to continue the protections that they had had before they voluntarily or involuntarily, but certainly for the good of the city and state entered the agreement. It was the understanding, as I understand it, that Internal Revenue could have ruled in order to make certain that the parties that went into this agreement in good faith would be protected.

In any event, the Congress was placed on notice that even if IRS did rule, it would be a temporary measure and that the Congress would have to act. So what we are trying to stress today is that this is not opening the door for any pension funds to continue exemption and enter into contracts which are not valid, but merely this rounds out an agreement which the Congress had encouraged the city of New York to enter into in order to become the beneficiary of the loan. So that, this legislation standing alone does not provide any vehicle for any municipality or any retirement funds to do anything unless the Congress and the executive branch review the facts of that municipality and go through the same operation. I hope they don't have to go through the same heartbreaks but go through the same thing the city of New York had to do and that is to convince the Congress and executive branch that it is a valid contract and necessary.

MR. SCHNEEBELI. If, Mr. Secretary, one or other cities comes to us with a like proposition, would we have to take each separately or would this legislation cover other cities as well?

MR. WALKER. No, this covers only this agreement.

MR. SCHNEEBELI. If Philadelphia came with the same kind of legislation, we would have to have a separate contract?

MR. WALKER. You would have to have, first of all, the necessary assistance legislation and then follow with the pension legislation if indeed pension funds are to be used.

MR. SCHNEEBELI. On page 2 you state that the first $20 million bears 6-percent interest, but the rest of the $21½ billion fund bears
a 9-percent interest rate. Why that big differential between the first
$30 million at 6 percent and the remainder of the $831/2 billion at 9
percent, when the prime rate is only 6 3/4 percent?

Mr. Walker, I think the 6-percent investments represented roll-
overs of prior obligations, whereas the 9-percent obligations represent
new money.

Mr. Schneirbell. Isn't that 9 percent pretty high? I realize that
is not our problem, but in the light of the prime rate at 6 3/4 percent,
it seems that 9 percent is a pretty good return.

Mr. Walker. I think it may have reflected the risk involved, also.

Mr. Schneirbell. You mean even with the Federal action.

Mr. Walker. Well, it is the city's obligation. All the Federal
action was doing was providing seasonal loans, quite apart from the
investments by the pension funds.

Mr. Schneirbell. An advance fund to be paid back, hopefully.
I would also like to point out to Congressman Rangel that, while
Congress took that action, it was by majority action and not unani-
mous consent. I was one of the ones who voted against it.

Mr. Rangel. I will be aware of that when your city comes to us.

Mr. Schneirbell. Thank you.

The Chairman, Mr. Rangel, did you want to be recognized?

Mr. Rangel. No, Mr. Chairman. Thank you.

The Chairman, Mr. Corman.

Mr. Corman. Mr. Secretary, turning our attention to pages 3 and 4
where we set out the existing limitations on the investment of public
pension funds, which of those needs to be suspended or repealed to
bring us into conformance with the agreements? There are three
provisions on the bottom of pages 3 and 4 on the top of page 4. I take
it that not all of those things are being suspended by this action.

Mr. Walker. This action, Mr. Corman, would result in not ques-
tioning the qualification of the funds despite those requirements.

Mr. Corman. Yes, sir. What I am wondering is which of these
could we keep and still comply with the agreement or could we keep
any of them? I recognize, for instance, that we are saying that you
can lend a substantial amount of the trust assets to a contributor.
You can lend trust assets to a substantial contributor.

Obviously, the city of New York contributed all of it, so that we
know all of that is out. Are there any that could be saved?

Mr. Walker. I am not sure what you mean by saving. I think
each of these entails a risk, Mr. Corman. For example, the code now
includes the three prohibited transactions on page 3.

Mr. Corman. Those three deal with the nature of the person you
are lending the money to and, obviously, they have to be suspended.

Mr. Walker. Yes.

Mr. Corman. For instance, on the next page we say the cost does
not exceed fair market value at the time of the purchase. Are we
waiving that?

Mr. Walker. Well, one of the questions of fact is whether the
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pension funds, which of those needs to be suspended or repealed to
bring us into conformance with the agreements? There are three
provisions on the bottom of pages 3 and 4 on the top of page 4. I take
it that not all of those things are being suspended by this action.

Mr. Walker. This action, Mr. Corman, would result in not ques-
tioning the qualification of the funds despite those requirements.

Mr. Corman. Yes, sir. What I am wondering is which of these
could we keep and still comply with the agreement or could we keep
any of them? I recognize, for instance, that we are saying that you
can lend a substantial amount of the trust assets to a contributor.
You can lend trust assets to a substantial contributor.

Obviously, the city of New York contributed all of it, so that we
know all of that is out. Are there any that could be saved?

Mr. Walker. I am not sure what you mean by saving. I think
each of these entails a risk, Mr. Corman. For example, the code now
includes the three prohibited transactions on page 3.

Mr. Corman. Those three deal with the nature of the person you
are lending the money to and, obviously, they have to be suspended.

Mr. Walker. Yes.

Mr. Corman. For instance, on the next page we say the cost does
not exceed fair market value at the time of the purchase. Are we
waiving that?
of fact; what is the obligation really worth? Instead of letting this be answered upon ultimate examination of the facts down the road, it is handled in the legislation to say that the determination need not be made so long as the purchase is accomplished pursuant to the agreement.

Mr. Corman. In other words, Congress is not making a factual determination that we are complying with one and not exactly saying we are suspending one. We are in limbo. It seems to me that it would be good to make a factual determination that we are not violating one or that we don’t care. I hate to see us legislate and ignore that point.

Mr. Walker. Well, you have the choice, really, of satisfying yourself as a matter of fact that the value is there or in fact saying the exempt status won’t be jeopardized simply because of the investment per the agreement.

Mr. Corman. I am a little lost. Of course the thing that gives me the most problem is four, the safeguards that a prudent investor would adhere to are present. I guess I would feel more comfortable if we decide that Congress had made the decision that that was all right to do and it would be prudent rather than say to the employees in New York that even though not prudent we are going to let you do it anyway.

Mr. Ranger. Would the gentleman yield?

Mr. Corman. I yield.

Mr. Ranger. It seems to me, Mr. Corman, that the question of the soundness of the investment would basically rest with those making the venture and the role of the Congress as they made the decision that it was a sound investment is not to further penalize them and put them in jeopardy of losing their exempt status. It appears to me that for us to sit in the Congress and determine the quality of the investment as it relates to the safety or the preservation of the city of New York would be far more difficult than to leave this to those who are trustees of the pension funds and say that the Congress will not further penalize them.

Mr. Corman. Yes, sir. Maybe that is our duty. But of course, that does mean that what we are saying is that if the trustees decide that this is prudent, we won’t quarrel with them. We are not saying “We are permitting you to invest money in the city of New York even though it may not be prudent.”

Mr. Ranger. If the gentleman would yield further, I think all we are saying in the Congress is that we will protect their status. The Secretary can correct me, but I think that we have not relieved the trustees of their normal obligations as it relates to the funds.

Mr. Walker. I believe that is true. Was there not also some legislation in the State of New York that addressed itself to this precise question and in effect exonerated the trustees from personal liability by pursuing this transaction?

Mr. Ranger. Certainly, it would not be a Federal responsibility.

Mr. Walker. That is correct.

Mr. Ranger. To go beyond the question before us and that is should we penalize the trustees for making this financial venture and entering the agreement with the city of New York.
Mr. Corman. Mr. Chairman, my five minutes are up. I had one more question.

The Chairman. Go ahead.

Mr. Corman. I have one final question about doing this generally for all cities, because I think that is one of the things that we ought to consider. I must say I am going to support this legislation and I think it is reasonable, under the circumstances, but if we just repealed the restrictions that are on page 3 for public entities and permitted them to borrow back their trust funds, we would in truth be repeating whatever requirement there is that public pension funds be funded. Is there such a requirement in Federal law?

Mr. Walker. That is one of the statutory standards for qualification under the Internal Revenue Code, although there is an exception for governmental plans. I think your suggestion, Mr. Corman, might be too broad in impact if you were generally to state by statute that the prohibited transaction tests were not required for governmental pension fund arrangements because one of the forerunners of this particular arrangement, it seems to me, was the fact that there was a lot of hard bargaining that produced this final result. Depending on the circumstances from city to city, if indeed a similar situation arises, hopefully there will be equally hard bargaining before any Federal assistance is brought to bear on it; and once the matters of that analysis have been examined and you finally come down with the enabling legislation, then the degree to which you have to follow through on such matters as those presented by this legislation should be tailored to the precise problem that is faced.

Mr. Corman. We lend ourselves all of our trust funds. I am wondering what would happen if we let every public entity do that. It might not be a bad idea, but I am not sure. Let's see what happens in this one first.

Thank you.

The Chairman. Are there further questions?

Mr. Conable. I have no questions. Thank you, Mr. Chairman.

The Chairman. There are no further questions.

Tell me, Mr. Secretary, while you are here have you satisfied yourself that the agreement and procedure that we worked out with New York City will carry them through the next 2-year period? I have some tables here which would indicate that there will be some rather major shortfalls in their budget picture.

Mr. Walker. I am not personally familiar with the present status of that. My associate here could speak to it, I believe.

Do you have the data on this?

Mr. Weintraub. Yes, I do. My name is Robert Weintraub.

The Chairman. Mr. Weintraub, you may proceed, sir.

Mr. Weintraub. I think, Mr. Chairman, one should view the city plan not as an immutable schedule but as something that will evolve over time. Current shortfalls can be met with larger budget cuts than had been previously anticipated. I think the major factor to keep in mind is that there is a financing constraint and the city must fit its budget against that constraint. I believe there is now the will to do so and I believe that they will do so.
The Chairman. What you are saying in effect is that there will have to be some further disciplines established by the city of New York in order to meet its obligations.

Mr. Weintraub. Yes, Mr. Chairman. I think this is recognized by the city. In their first report to the Secretary on the 15th of February they recognized additional budgetary deficits would arise in the next 2½ years and they evolved what might be called a broad plan to meet these additional deficits. This would include an additional $150 million in required cuts in fiscal year 1977 from the operating budget and on top of that another $150 million for a total of $300 million in 1978, which would bring the 1978 fiscal year cut to a little bit more than $1 billion dollars from the original budget plan that was submitted for fiscal year 1978.

The Chairman. Mr. Secretary, then in view of that, would you state for the record that passage of this legislation would in no way indicate an erosion of the basic agreement and the disciplines that Congress had imposed upon New York City in meeting its crises?

Mr. Walker. I believe that is a correct statement. This legislation has no bearing, really, on the terms of the agreement.

The Chairman. And it is not eroding it in any way. In no way is this legislation establishing any kind of precedent that there will be further concessions made to the city of New York?

Mr. Walker. That is my understanding, Mr. Chairman.

The Chairman. Mr. Schneebeli.

Mr. Schneebeli. Mr. Weintraub made a statement that brings up a question in my mind.

Mr. Weintraub. I think you said that for the 1978 budget there has to be an additional $300 million cut from the present budget and that the committee which reviewed this made this recommendation. What process does this have to go through to be adopted and what likelihood is there that it will be adopted?

Mr. Weintraub. The process is the normal budget process that the city of New York goes through each year, and that has to in turn be agreed to by the Emergency Financial Control Board.

Mr. Schneebeli. What are the indications of their attitude?

Mr. Weintraub. It is my personal opinion that the people who are now on the Control Board are people who understand the need and will see that it is done.

Mr. Schneebeli. The reason for my raising the question, of course, is that the cuts up to this point have brought forth a lot of cries of anguish, and probably properly so, from a lot of people. I am wondering whether New York will endure an additional $300 million cut from the present budget—and I think it is a legitimate question.

Mr. Weintraub. I think it is a legitimate question, but it is my personal and professional opinion that the people who are in charge of presenting the budget to the Control Board, and the people who are on the Control Board understand the necessity of making these very hard cuts and will see that they are made.

Mr. Schneebeli. May I ask what your capacity is before this committee?

Mr. Weintraub. Yes, I am currently on a contract basis to the Treasury Department.
Mr. SCHNEIBERG, I see, you are an official of New York City?
Mr. WEINTRAUB. No, I am not. In fact, I formerly worked for the
Senate Banking Committee.
The CHAIRMAN. Mr. Secretary, would you identify both members
with you at the table.
Mr. WALKER. Mr. Weintraub identified his role. He is on contract
with the Treasury Department.
On my right is Patricia Ann Metzer, Associate Tax Legislative
Counsel of the Treasury Department.
The CHAIRMAN. If there are no further questions, thank you very
much, Mr. Secretary.
Mr. WALKER. Thank you.
The CHAIRMAN. Our next witness this morning is Mr. Herbert Elish,
executive director, Municipal Assistance Corp. for the City of New
York.
Mr. Elish, welcome to the committee.
If you would further identify yourself and your colleagues, we
would be happy to hear you.

STATEMENT OF HERBERT ELISH, EXECUTIVE DIRECTOR, MUNICI-
PAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK,
ACCOMPANIED BY ALLEN L. THOMAS AND DEBORAH B. MORSE
OF PAUL, WEISS, RIFKIND, WHARTON & GARRISON, GENERAL
COUNSEL FOR THE CITY OF NEW YORK

Mr. Elish, Thank you.
Mr. Chairman, and Members of the committee, I am Herbert Elish.
I am the Executive Director of the Municipal Assistance Corp. for the
City of New York as well as the executive director of the New York
State Emergency Financial Control Board.
I have with me two members of the law firm which is the general
counsel for the Municipal Assistance Corp., Paul, Weiss, Rifkind,
Wharton & Garrison, Mr. Allen Thomas and Deborah Morse.
Mr. Schneiberg. Who is the head of the Municipal Assistance Cor-
poration for the City of New York?
Mr. Elish. Mr. Felix Rohatyn is the Chairman of the Municipal
Assistance Corporation.
I wish to thank the committee for affording me the opportunity to
make this statement in support of the passage of H.R. 11700.

BACKGROUND

As part of the effort to alleviate the current fiscal crisis facing New
York City, an agreement was made on November 28, 1975 (the “agree-
ment”), among the Municipal Assistance Corp., for the City of New
York (“MAC”), 11 New York City commercial banks, five New York
City pension funds (the “Pension Funds”), and four New York City
sinking funds.
Pursuant to the agreement, the pension funds obligated themselves,
among other things, to purchase serial bonds of the city of New York
during the period from the date of the agreement through June 30,
1978 in the aggregate principal amount of $2,530,000,000. Within
certain limits each of the pension funds may elect to purchase MAC
bonds in fulfillment of its obligations to purchase bonds of the city of
New York.

Pursuant to the 3-year financial plan adopted by the New York
State Emergency Financial Control Board on October 20, 1975 (now
being revised) a total of $6.8 billion was required to be provided to
New York City in cash or cash savings during the 2 1/2-year period
ending June 30, 1978. The $2.5 billion agreed to be provided by the
five New York City pension funds through purchases of bonds of the
city of New York is an essential part of this $6.8 billion. (Such agree-
ment to purchase by the pension funds was, we believe, a key assump-
tion underlying the passage and implementation of the New York
City Seasonal Financing Act of 1975, pursuant to which the Federal
Government will provide up to $2.3 billion of necessary seasonal
financing for New York City.)

Under the credit agreement between the city and the Federal Gov-
ernment, the maximum amount of seasonal financing during the fiscal
year ending June 30, 1976 is $1.5 billion. To date, the city has bor-
rowed all but $390 million of this. On March 1 and March 15, 1976,
the city must borrow $250 million and $70 million respectively. Ac-
cordingly, all financing requirements for the balance of this fiscal year
must be provided by the pension funds, including a further borrowing
of approximately $185 million, pursuant to the agreement, scheduled
for March 12, 1976.

If, for any reason, the March 12 borrowing from the pension funds
is not forthcoming, it is anticipated that no other funds will be avail-
able and the city will face the very real prospect of default at that
time.

The obligations of the pension funds to make such purchases, how-
ever, are expressly conditioned under the agreement upon the happen-
ing of a number of events, including the enactment of a New York
State law protecting the trustees of the pension funds with respect to
such purchases and the enactment of Federal legislation providing,
by way of guarantee or otherwise for the seasonal financing needs of
New York City. Both such laws have already been passed. A further
condition upon the obligation of the pension funds is that:

The Internal Revenue Service shall have ruled, or the Congress of the United
States shall have provided, that purchases of obligations by the pension funds
pursuant to this Agreement shall not constitute prohibited transactions or other-
wise adversely affect the qualified status of the pension funds for the purposes
of the Internal Revenue Code of 1954, as amended, ...

If this last condition upon the obligations of the pension funds to
purchase bonds of the city of New York is not met, the pension funds
may elect not to purchase such bonds.

THE PROBLEM

Basically, sections 401(a) and 503 of the Internal Revenue Code of
1954, as amended (the "Code") contain provisions pursuant to which
the proposed purchase of city obligations by the pension funds might
be construed to be "prohibited transactions" which would terminate
the tax exempt status of the pension funds under section 501(a) of
the code with the consequent loss of the substantial tax advantages afforded under the tax laws to participants and beneficiaries of the pension funds.

Mr. Chairman, I think the Secretary has reviewed the law. If you would prefer, I can skip what follows which is, I think, repetitive.

The Chairman. Without objection, your full statement will appear in the record.

Mr. Ezzer. Thank you very much.

I will move to the conclusion. The proposed bill H.R. 11700 is designed, therefore, to exclude from the operation of section 503(b) of the code all transactions provided for by the agreement by each of the pension funds which were parties to the agreement and to make clear that such transactions do not adversely affect the qualifications of any of the pension funds under section 401(a) of the code.

In addition to assuring that the purchase or continued holding of any bond or note pursuant to the agreement does not violate the provisions of sections 401(a) and 501(a) of the code, the proposed bill permits the trustees of the pension funds, in determining other investments to be made during the period from the date of the agreement until July 1, 1986, and the retention of such investments thereafter, to consider, without violating the provisions of section 401(a) of the code, the extent to which such investments (i) maintain the ability of the city of New York to make future contributions to, and satisfy future obligations to pay benefits under, the pension funds, and (ii) protect the sources of funds to provide retirement benefits.

The proposed bill further provides that any amendment of the agreement, or any waiver of any requirement of the agreement, which relates to matters covered by sections 401(a) or 503 of the code will be effective only if the Secretary of the Treasury determines that such amendment or waiver is not in consistent with the considerations set forth above and no amendment which has the effect of extending the expiration date of the agreement beyond June 30, 1986 may be made.

Although there are strong arguments that the purchase of MAC bonds by the pension funds will not, in any event, constitute a prohibited transaction, the proposed bill makes clear that such purchases, including such purchases between August 20, 1975 and the date of the agreement, do not violate the provisions of section 401(a) or 503 of the code.

Finally, the proposed bill requires the trustees of the pension funds to furnish to the Secretary of the Treasury each year after June 30, 1975 and before July 1, 1986 a copy of the comprehensive report filed by each of the pension funds with the New York State Insurance Department together with such additional data as the Secretary of the Treasury may reasonably require and authorizes the Secretary of the Treasury to prescribe such regulations as may be necessary to implement the purposes of the proposed bill.

As I stated earlier, if the pension funds do not purchase approximately $155 million of New York City bonds on March 12, 1976, it appears probably that the City will default in its obligation at that time.

Passage of the proposed bill is as essential to the implementation of the proposed agreement and the emergency financial plan for the
city of New York as was passage of the Trustee Indemnification Act by the State of New York and passage of the New York City Seasonal Financing Act of 1975 by the Congress.

For those reasons I most strongly urge the prompt passage of H.R. 11700.

Thank you.

[The prepared statement follows:]

STATEMENT OF HERBERT ELISH ON BEHALF OF THE MUNICIPAL ASSISTANCE CORP. FOR THE CITY OF NEW YORK AND THE NEW YORK STATE EMERGENCY FINANCIAL CONTROL BOARD

Good Morning, my name is Herbert Elish. I am the Executive Director of The Municipal Assistance Corporation For The City of New York and the Executive Director of the New York State Emergency Financial Control Board. I wish to thank the Committee for affording me the opportunity to make this statement in support of the passage of H.R. 11700.

BACKGROUND

As part of the effort to alleviate the current fiscal crisis facing New York City, an Agreement was made on November 20, 1975 (the "Agreement"), among the Municipal Assistance Corporation For The City of New York ("MAC"), eleven New York City Commercial Banks, five New York City Pension Funds (the "Pension Funds"), and four New York City Sinking Funds. Pursuant to the Agreement, the Pension Funds obligated themselves, among other things, to purchase serial bonds of the City of New York during the period from the date of the Agreement through June 30, 1978 in the aggregate principal amount of $2,539,000,000. Within the certain limits each of the Pension Funds may elect to purchase MAC bonds in fulfillment of its obligations to purchase bonds of the City of New York. Pursuant to the Three-Year Financial Plan adopted by the New York State Emergency Financial Control Board on October 20, 1975 (now being revised), a total of $6.8 billion was required to be provided to New York City in cash or cash savings during the 2½ year period ending June 30, 1978. The $2.5 billion agreed to be provided by the five New York City Pension Funds through purchases of bonds of the City of New York is an essential part of this $6.8 billion. (Such agreement to purchase by the Pension Funds was, we believe, a key assumption underlying the passing and implementation of the New York City Seasonal Financing Act of 1975, pursuant to which the Federal Government will provide up to $2.8 billion of necessary seasonal financing for New York City.)

Under the Credit Agreement between the City and the Federal Government, the maximum amount of seasonal financing during the fiscal year ending June 30, 1976 is $1.5 billion. To date, the City has borrowed all but $330 million of this. On March 1 and March 15, 1976, the City must borrow $250 million and $70 million respectively. Accordingly, all financing requirements for the balance of this fiscal year must be provided by the Pension Funds, including a further borrowing of approximately $185 million, pursuant to the Agreement, scheduled for March 12, 1976. If, for any reason, the March 12 borrowing from the Pension Funds is not forthcoming, it is anticipated that no other funds will be available and the City will face the very real prospect of default at that time.

The obligations of the Pension Funds to make such purchases, however, are expressly conditioned under the Agreement upon the happening of a number of events, including the enactment of a New York State law protecting the trustees of the Pension Funds with respect to such purchases and the enactment of Federal legislation providing, by way of guarantee or otherwise for the seasonal financing needs of New York City. Both such laws have already been passed. A further condition upon the obligation of the Pension Funds is that: "the Internal Revenue Service shall have ruled, or the Congress of the United States shall have provided, that purchases of obligations by the Pension Funds pursuant to this Agreement shall not constitute prohibited transactions or otherwise adversely affect the qualified status of the Pension Funds for the purposes of the Internal Revenue Code of 1954, as amended."

If this last condition upon the obligations of the Pension Funds to purchase bonds of the City of New York is not met, the Pension Funds may elect not to purchase such bonds.
THE PROBLEM

Basically, sections 401(a) and 503 of the Internal Revenue Code of 1954, as amended (the "Code"), contain provisions pursuant to which the proposed purchase of city obligations by the Pension Funds might be construed to be "prohibited transactions" which would terminate the tax exempt status of the Pension Funds under section 503(a) of the Code with the consequent loss of the substantial tax advantages afforded under the tax laws to participants and beneficiaries of the Pension Funds.

Section 503(a) of the Code provides that trusts under pension plans created by any State or political subdivision thereof which are qualified under section 401(a) of the Code shall not be exempt from taxation under section 501(a) of the Code if they engage in any "prohibited transaction" described in section 503(b). Section 503(b) of the Code provides, among other things, that it is a "prohibited transaction" for such a pension plan to lend any of its assets, without the receipt of adequate security and a reasonable rate of interest, to the creator of such plan or to a corporation controlled by such creator. Under current Treasury regulations, the purchase by a pension plan of notes or obligations issued by the plan's creator is considered a loan by the pension plan to its creator and is, therefore, subject to the foregoing requirements of adequate security and a reasonable rate of interest. Treas. Reg. § 1.503(c)-1(b). Current Treasury regulations further define "adequate security" as security which is so pledged to the pension plan that it may be sold, foreclosed upon or otherwise disposed of in the event of a default in the repayment of the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan. Treas. Reg. § 1.503(c)-1(b).

Some, if not all, of the Pension Funds are qualified plans under section 401(a) of the Code. In addition to the problems described above which arise under section 503 of the Code, section 401(a) requires that all plans qualified thereunder be for the "exclusive benefit" of participants in the plan and their beneficiaries.

In connection with purchases of New York City bonds by some of the Pension Funds in December, 1975, the Internal Revenue Service ("IRS") was asked to issue a ruling that such purchases did not constitute prohibited transactions under section 503(b) of the Code or violations of the "exclusive benefit rule" of section 401(a). IRS did not issue such rulings but instead issued very limited letters of intent to rule that such purchases did not constitute lending without the receipt of "security" and did not violate the "exclusive benefit rule". IRS expressly stated that it would not issue a ruling with respect to the adequacy of such security or with respect to the operation of the "exclusive benefit rule" upon the continued holding of such bonds by the Pension Funds. IRS has since expressed its disapproval to issue such a ruling both with respect to the December purchases and subsequent purchases and has indicated that legislation is the appropriate remedy. Accordingly, if the condition for the further purchase of New York City obligations by the Pension Funds, set forth above, is to be met, Federal legislation is necessary.

THE PROPOSED BILL

The proposed Bill, H.R. 11709, is designed, therefore, to exclude from the operation of section 503(b) of the Code all transactions provided for by the Agreement by each of the Pension Funds which were parties to the Agreement and to make clear that such transactions do not adversely affect the qualifications of any of the Pension Funds under section 401(a) of the Code.

In addition to assuring that the purchase or holding of any bond or note pursuant to the Agreement does not violate the provisions of sections 401(a) and 501(a) of the Code, the proposed Bill permits the trustees of the Pension Funds, in determining other investments to be made during the period from the date of the Agreement until July 1, 1956, and the retention of such investments thereafter, to consider, without violating the provisions of section 401(a) of the Code, the extent to which such investments (1) maintain the ability of the City of New York to make future contributions to, and satisfy future obligations to pay benefits under, the Pension Funds, and (2) protect the sources of funds to provide retirement benefits.

The proposed Bill further provides that any amendment of the Agreement, or any waiver of any requirement of the Agreement, which relates to matters
covered by sections 401(a) or 503 of the Code will be effective only if the Secretary of the Treasury determines that such amendment or waiver is not inconsistent with the considerations set forth above and no amendment which has the effect of extending the expiration date of the Agreement beyond June 30, 1980 may be made.

Although there are strong arguments that the purchase of MAC bonds by the Pension Funds will not, in any event, constitute a prohibited transaction, the proposed Bill makes clear that such purchases, including such purchases between August 20, 1975 and the date of the Agreement, do not violate the provisions of section 401(a) or 503 of the Code.

Finally, the proposed Bill requires the trustees of the Pension Funds to furnish to the Secretary of the Treasury each year after June 30, 1975 and before July 1, 1986 a copy of the comprehensive report filed by each of the Pension Funds with the New York State Insurance Department together with such additional data as the Secretary of the Treasury may reasonably require and authorizes the Secretary of the Treasury to prescribe such regulations as may be necessary to implement the purposes of the proposed Bill.

As I stated earlier, if the Pension Funds do not purchase approximately $185 million of New York City bonds on March 12, 1976, it appears probably that the City will default in its obligations at that time.

Passage of the proposed Bill is an essential to the implementation of the proposed Agreement and the emergency financial plan for the City of New York as was passage of the Trustee Indemnification Act by the State of New York and passage of the New York City Seasonal Financing Act of 1970 by the Congress.

I most strongly urge the prompt passage of H.R. 11790.

The Chairman. Thank you very much.

Mr. Elshih. The Municipal Assistance Corp. was the body that put together the financing package which became the basis for the congressional legislation and permitted the city to proceed to bring its budget into balance in the fiscal year ending June 30, 1973.

In addition, it has a continuing responsibility to ensure that the financing remains in place and that, as the financial plan of the city is amended, the financing that is available will cover the city for the period in question.

The Chairman. Is yours a governmental organization?

Mr. Elshih. Yes, sir. It is a public benefit corporation established by the Legislature of the State of New York.

The Chairman. When was it established?

Mr. Elshih. In, I believe, May of this year. I am sorry. It was June of 1975.

The Chairman. June of 1975. Does it extend indefinitely?

Mr. Elshih. It is indefinite. It must exist at least for such time as our bonds are outstanding and we have bonds outstanding for 20 years, so that it is for an indefinite period by the legislation.

The Chairman. Are there questions?

Mr. Schneebeli.

Mr. Schneebeli. Mr. Elshih, is there any scheduled retirement of MAC bonds bought by the pension funds? It would have to come out of surplus. Is there any scheduled surplus by 1980? How long are these bonds going to be outstanding?

Mr. Elshih. MAC bonds?

Mr. Schneebeli. That the pension funds buy. Is there any scheduled retirement or will they be held by the pension funds for the foreseeable future?
Mr. Elsif: If you will excuse me, I will try to get the figure.

Starting in about August the pension funds were purchasing MAC bonds. I believe that the combined figure of MAC and city bonds purchased, is approximately $1 billion and I believe that most of the MAC bonds mature prior to 1986.

Mr. Schneeberg: Is there any scheduled retirement plan or is it just going to be a rollover? As they mature in 1986 is there any plan to retire them or will they just be rolled over?

Mr. Elsif: No, I think that the MAC bonds are to be retired.

Mr. Schneeberg: From what funds?

Mr. Elsif: The MAC bonds are covered by dedicated revenues of the State, State sales tax and the stock transfer tax of the State and in the city 3-year plan part of the debt service that is required is debt service for that coverage for the retirement of the MAC bonds.

Mr. Schneeberg: This 9-percent interest they are paying on these MAC bonds, what percentage of the city income does that represent?

Mr. Elsif: The 9-percent figure that I believe you refer to in the credit agreement is for the purchase of the city bonds that are being purchased.

Mr. Schneeberg: How much of the city income does that represent? How much are they paying for financing services?

Mr. Elsif: I would have to get the exact number. I do not have the figure but I could supply that to the committee.

[The information follows:]

The City of New York will pay approximately $61,000,000 in interest for fiscal year 1976-77 on the 9 percent bonds issued to the five City pension funds pursuant to the terms of the November 20, 1975 Agreement, which is approximately 0.7 percent of the City's total income for that fiscal year.

Mr. Schneeberg: Mr. Weintraub indicated that there was a proposed $300 million cut by fiscal 1978. Do you propose that this will be approved by the responsible organizations?

Mr. Elsif: Yes, sir, I do. The current status reports are now going forward on the revision of the plan based upon new revenue and expense estimates that the city has provided. It is everybody's intention and firm resolve to insure that the city's budget will be brought into balance, as required by legislation, on June 30, 1978. I might say, has taken very significant steps to date to meet this deadline, including making severe budget cuts. Further plans are going forward to do whatever else is necessary.

Mr. Schneeberg: If quite a few State funds are earmarked to pay off these MAC bonds, to retirement, is it the State's position that they will pay off the MAC bonds, and not the city, or will it be a combined effort?

Mr. Elsif: The revenues that are involved, such as the sales taxes and stock transfer taxes are revenues that would otherwise flow to the city. Before the revenue flows to the city the amount necessary for the MAC debt service is taken out by the State for that purpose.

Mr. Schneeberg: I see. Thank you very much, Mr. Chairman.

Mr. Rangel, Mr. Chairman.

The Chairman, Mr. Rangel.
Mr. Rangel. Mr. Elish, the November 26, 1975 agreement, was that agreement conditional on the Federal Government providing the $2.3 billion over a 3-year period to the city of New York?

Mr. Elish. Yes, sir, it was.

Mr. Rangel. And a part of that agreement was either an Internal Revenue Service ruling or a change in the law to make certain that the trustees of the pensions do not lose their tax exemption; is that correct?

Mr. Elish. That is correct, sir.

Mr. Rangel. So that this legislation that is before the committee today which I introduced really is not a new transaction but merely a ratification of the legislation that the Congress has already passed and the President has signed into law; is that correct?

Mr. Elish. That is correct, sir.

Mr. Rangel. And if the Congress fails to enact this legislation, what it amounts to as relates to MAC and the city of New York and the other parties to the agreement is that it would actually tear asunder the agreement that has been entered into and ratified by the Congress?

Mr. Elish. I believe that is a fair characterization.

Mr. Rangel. Thank you.

Thank you, Mr. Chairman.

The Chairman. Are there further questions?

If not, Mr. Elish, thank you very much for your testimony.

Mr. Elish. Thank you.

The Chairman. Our next witness this morning is Kenneth S. Axelsson, deputy mayor of the city of New York.

Mr. Axelsson, Mr. Deputy Mayor, we are glad to have you before the committee. It is my understanding that you are accompanied by Mr. Bernard Friedlander and Mr. Jonathan Schwartz. If you would further identify your colleagues for the record, we would be very happy to hear you, sir.

STATEMENT OF KENNETH S. AXELSON, DEPUTY MAYOR OF THE CITY OF NEW YORK, ACCOMPANIED BY BERNARD FRIEDLANDER, OFFICE OF THE CORPORATION COUNSEL, AND JONATHAN SCHWARTZ, ACTUARY

Mr. Axelsson. Thank you.

On my right is Jonathan Schwartz, the chief actuary for the New York City pension plans and on my left is Mr. Bernard Friedlander from the New York City corporation counsel's office.

The Chairman. We are glad to have both of you.

You may proceed, sir.

Mr. Axelsson. Members of the committee, my name is Kenneth S. Axelsson and I am the deputy mayor for finance of the city of New York.

On behalf of Mayor Beame and the people of the city of New York, I want to thank you for the opportunity to discuss H.R. 11700. This legislation has profound significance for the city and its efforts to restore its fiscal integrity and to cope with fiscal consequences not within its control.
As you know, the city of New York is not a party to the November 26, 1975 agreement between the Municipal Assistance Corporation, major New York banks, sinking funds, and five NYC municipal pension systems. It is a beneficiary.

That agreement provides, in part, that the pension systems will purchase $2.53 billion of city serial bonds over a 5-year period. The practical effect of these purchases is to function solvency. Such purchases are now contingent on the passage of the proposed legislation.

The agreement is part of an intricate financing arrangement that stayed off default. Its promulgation, along with State legislative action including the imposition of new taxes, led President Ford to declare his support of legislation, which the Congress enacted, that authorizes seasonal financing of up to $2.3 billion per year to the city for 3 years. That Federal action was the final element of a complex plan.

The Federal loan proceeds and the pension funds are received and expended under unparalleled public supervision and scrutiny. The city matches expenses and revenues against its comprehensive 3-year financial plan which projects a balanced budget by the end of fiscal year 1978. We are firmly and absolutely committed to balancing our budget, as required by law, by this date. Moreover, the plan itself and its major components are under the close control of the Emergency Financial Control Board. The board is an instrument of the State, created by the legislature, chaired by the Governor and mandated to assure the city lives within its financial plan.

An arm of the control board is the special deputy comptroller who audits the financial transactions of the city. This includes close watch over mandated reductions in expenses including personnel reductions. The reporting and monitoring are constant.

The city also has a reporting obligation to the Department of the Treasury as required by the credit agreement executed among the city, the Municipal Assistance Corp., the Emergency Finance Control Board, the State of New York and the United States. This also entails analysis of the city's financial activities and the progress and projections of its financial plan. The first of these monthly reports was delivered February 15, 1976.

As a result of these auditing and reporting requirements and the structure of developing a financial plan which calls for a balanced budget in 3 years—the city is developing a financial management sophistication uncommon in government, particularly municipal government. The major elements of this fiscal reform have been accomplished. The city is putting into place a new system of accounting, budgeting and reporting which completely revises past practices. The city is installing extensive new data processing systems to improve the accuracy, control and efficiency of its accounting and budgeting activities. This type of project would take five years to implement in private industry. The city will have the major components in place by July 1, 1977.

The city is demonstrating it has the talent, capacity and willingness to restore its fiscal integrity. In October we identified our budget gap and we charted a course to a solution. We will reduce our rate of expenditures by $200 million this fiscal year, as we planned.
We have had more than 40,000 separations from our payroll in the last 12 months. Moreover, as the revisions to our financial plan announced last week indicate, we now have the informational capacity to monitor and control our financial activity that we did not previously have.

Our methods are painful but professional and we are producing meaningful results. But we cannot succeed in this endeavor without this legislation.

It is also important to discuss other relevant phenomena that are not within the city's control. The city has an expense budget of approximately $12 billion. Yet only $3.2 billion of that amount are controllable levy funds. The balance is comprised of such relatively uncontrollable items as debt service, welfare and medical costs, and pension contributions.

Therefore, cuts in expenditures must be made—not from a $12 billion total budget—but from the controllable segment of our budget which is one-quarter of that amount.

The city reported to the Treasury on its financial plan February 15. The report states that the amount by which the city must further reduce its level of expenditures permanently, or increase its revenues in order to achieve a modest surplus in fiscal year 1977/78 is $821 million. This is $207 million more than the amount projected in the original financial plan. This difference is due primarily to such items as tax shortfalls of $100 million, welfare, health and energy cost increases of $82 million and a reduction in real estate tax revenues of $51 million. Construction is at a virtual standstill.

These changes reflect the continuing effects of recession and inflation. The elimination by the Congress of the out-of-State stock transfer tax has caused a loss of $78 million in projected revenues despite the tremendous volumes of transactions in recent months.

Finally, the restructuring of our debt completed November 26, 1975 resulted in increased debt service obligations of $80 million a year.

The new “budget gap” figure of $821 million does not include the impact of possible revenue reductions in the proposed Federal and State budgets. We cannot control that either.

There is no doubt, then, that if the financing program set forth in the November 26, 1975 agreement cannot be effected, the city will not have the flexibility to react. With that financing, the progress the city has made to date, and the innovation, skill and thoroughness of its new methods and controls, I am hopeful we will renew investor confidence.

The legislation under consideration is a critical link in this process. It is both necessary and logical.

When the Congress included governmental pension systems in the prohibited transactions provisions of the Internal Revenue code of 1964, it did so to protect pension rights.

In December the Congress passed the New York City Seasonal Financing Act of 1975. The intent was to enable the city to avoid default.

I submit that if the proposed New York City pension systems purchases are not exempted, vested rights will not be protected but destroyed. The city will not be able to continue its pension contributions nor resolve any underfundings that may exist.
These facts should be considered in light of the progress the city has made. In this regard, I can also report that Richard Shinn, president of the Metropolitan Life Insurance Co. and chairman of the mayor's Management Advisory Committee which is studying the city's pension systems, has advised Mayor Beame, prior to release of the committee's final report, that in each of the next 5 years a substantial excess of retirement systems' receipts over disbursements is expected. So the pension systems are strong as long as the city can continue its contributions. This is an additional reason why the systems made the decision to purchase city bonds.

The intent of the Seasonal Financing Act will also be violated if this legislation is not enacted. The loans are a Federal Investment. That investment certainly will have been made in vain if the financing agreement, of which the loans are a part, cannot be effected. In fact, this legislation is the next logical step in the implementation of the congressional will expressed in December.

Finally, when Congress considered the Federal loan legislation, it was aware that Federal participation was an integral part of the November 26, 1975 financing package. It was also aware that the pension systems purchases were an equally essential part of the agreement. The need for an IRS waiver on a legislative exemption is set forth specifically in paragraph 7 of the agreement. The principle underlying these purchases was tacitly approved, therefore, when the loan act was enacted.

Members of the committee, I welcome the support of the Department of the Treasury in this effort and I ask for yours.

Thank you.

The Chairman. Thank you very much, Mr. Axelsson.

Are there any questions?

Mr. Conable.

Mr. Conable. Let me ask you the mechanism for securing the consent of the trustees in the pension funds. They apparently were participants in the negotiations at the time this total package was put together. Were they acting under duress when they did this? What was the relationship at that time? I am sure there was some resistance to the idea that they purchase these bonds and yet they were aware I am sure also of the implications if New York City defaulted. Can you just tell us a little something about the circumstances when this investment was negotiated?

Mr. Axelsson. Yes. At the time this was negotiated, the pension funds were brought into the discussions and the circumstances confronting the city and the proposed financing arrangements were described in detail to them. As you may know, the unions are involved in the approval of these transactions in the pension funds and these groups considered and reached the conclusion voluntarily on their own that it was in the long term best interests of the funds and of the pensioners, the beneficiaries of these funds to make these investments.

Mr. Conable. Were there any concessions made to the trustees of the pension funds at that time relative to the future course of relationship between them and the city?

Mr. Axelsson. Indeed not.

Mr. Conable. There was no consideration of any sort?

Mr. Axelsson. None at all.
Mr. Conable. As I recall, some effort was made to try to force State pension money into the investment in MAC bonds at one point and there was a court decision against this requirement; isn't that correct?

Mr. Axelsson. We were not directly involved in the city with discussions of that type so that I am really not qualified to speak to it.

Mr. Conable. The legislature was considering a law which would have required some State investment in these funds; is that correct? There was no relationship between that and these city investments?

Mr. Axelsson. I would like to ask Mr. Friedlander to comment on that point.

Mr. Friedlander. The law to which you referred was a suit against the State comptroller as the trustee of the New York State employees retirement system and therefore the suit was not directly against trustees of the city pension funds.

Mr. Conable. There was no relationship between the two?

Mr. Friedlander. No relationship except to the extent that a legal principle was established that the trustees would not be compelled.

Mr. Conable. Compelled?

Mr. Friedlander. Compelled to that.

Mr. Conable. I have it straight. Thank you.

The Chairman. Are there further questions?

Mr. Martin.

Mr. Martin. Yes, I have just a couple of questions, Mr. Chairman. Mayor Axelsson, among the list of relatively uncontrollable items such as debt service you include medical costs. I don't know that it is so, personally, but I have seen references from time to time that among the benefits that you provide for citizens is free hospital care that is available for everyone. I am asking first, whether that is so, and second, whether this is something that you are characterizing as uncontrollable or whether you have been able to do something about that?

Mr. Axelsson. I should explain that New York City operates a municipal hospital system. In addition, there are what are called voluntary hospitals in New York and proprietary hospitals. All these provide medical services to the residents of New York City. Most of the costs of operating all three hospitals are paid through so-called third party plans.

You are familiar with the Blue Cross type of payment. The biggest portions are paid through the medicaid programs. The medicaid programs are established, the criteria involved are set at the State level and the reason that this is designated is that the delivery of those services is mandated upon the city. The costs are paid against State criteria and the cost to the city is its portion of that mandated cost of the State.

Mr. Martin. I see. When you refer to uncontrollable medical costs you are speaking of those that are mandated by the State?

Mr. Axelsson. Yes.

Mr. Martin. All right. I am also generally aware that for some time the city provided free tuition at the city's universities. Is that still true or do you regard that as an uncontrollable cost?

Mr. Axelsson. We do not regard it as really uncontrollable at all. This matter has received a great deal of attention by the city admin-
istration this year and the mayor on a number of occasions has publicly stated his position that the city can no longer afford to finance the city university system in the manner in which it has been financed in the past. Higher education in the State of New York is the responsibility of the State and intensive discussions have been underway for an extended period of time now to try to work out the long-range program to transfer this responsibility to the State.

There are a number of alternatives that are available with which to deal with the residual costs involved, one of which is the imposition of tuition. There are other matters, however, that the city university system has already taken action on. For example, it imposes fees that are the equivalent to tuition at the graduate school level. It has recently proposed, and you may have seen it in the papers today, the closing of several of the colleges in the system within the city.

A month ago it announced a higher reading level for admission into the city system thus restricting the complete open admissions policy that has been practiced in recent years. It has also instituted higher standards for the retention of students within the system. So the elimination of the excess costs involved here is moving forward. We expect to relieve the city of this burden. We must relieve the city of this burden and it is hoped and expected that in a very short period of time a workable solution to phase this out will be in place.

Mr. Martin. Thank you for the answer that you gave.

You have indicated that in regard to academic requirements you have already made some strides that will reduce the cost and that at this point you are discussing what to do with regard to tuition charges. You are not sure at this point, I take it, how that will turn out, as to whether there will be imposed tuition or whether there will not.

Mr. Axelsson. I would only say that at this point that one of the considerations that is under intensive study is a phased takeover by the State university system which, of course, would involve the imposition of tuition on a basis comparable to that that the State university system uses elsewhere.

Mr. Martin. What control, if any, do you have over the benefit levels of the pension fund? That is, outside of the administration.

Mr. Axelsson. Well, those are subject to collective bargaining. They are also established and enacted into law at the State level and over the short term, therefore we have no power over those benefit levels.

Mr. Martin. I thank you.

I have no further questions, Mr. Chairman.

The Chairman. Are there further questions?

Earlier, I asked the Secretary about the financial situation in New York. I have a table here which would indicate that for fiscal 1975-76 and 1976-77 and also into 1977-78 there will be shortfalls in the budget situation as against the assumptions that were made at the time that the agreement was entered into. The Secretary indicated that there would have to be further disciplines established in the city of New York. Is that your understanding also?

Mr. Axelsson. Yes, indeed. The filing that was made with the Secretary of the Treasury on February 15, which was the first of the required reporting to the Secretary, set this out based upon a submission
which the city had made to the Emergency Financial Control Board just prior to that time. The city went through a careful reexamination of its financial plan because of a number of things that had happened since that plan was initially promulgated last October 20.

In the first case we had identified certain expenses which were running ahead of our estimates. Welfare payments was one of those. We had also identified certain revenues that were running behind our estimates. The sales tax receipts in the city were not responding as we had expected that they would. They were lagging behind the experience the city had previously had in coming out of the recessionary period.

There were other items such as the new tax bill which was enacted and imposed on the citizens and so we went through a comprehensive reexamination of our financial plan in order to bring it up to date and that disclosed that we had an additional shortfall of $297 million. We had originally a shortfall of $734 million. Our original plan had been to divide that into approximately three segments and to take a proportionate bite in each of the 3 years. Thus, our program for the current year was a cost reduction program of $200 million. That is substantially in place on target and we expect to have that realized by the end of this year.

However, this additional shortfall that we now believe may come to pass will increase our cost reduction or increase revenue needs in the last 2 years of the plan up to a level of $821 million. We currently are in intensive discussions to determine the additional steps that will be required in order to enable us to balance our budget in the third year and we are presently scheduled to report on our progress on that program to the Municipal Finance Control Board on March 5.

The CHAIRMAN. Thank you.

I just want to reemphasize my feeling, and I think the feeling of the Members of Congress that, whereas I was willing to help alleviate the problem of the city of New York, at this point I certainly don't want this legislation if we can pass it out of the committee and the Congress, and I hope we can, to indicate in any way that there is any softening of our understanding of the agreement, that this essentially is a part of that agreement and not a softening of the agreement.

Would you agree to that?

Mr. Axelsson. Yes, indeed.

The CHAIRMAN. As one Member of Congress I feel it would be very difficult to get any further concessions beyond what are made in the contract. I want to commend you and Mayor Beame and the rest for doing what you have done. It has been a tremendously difficult problem but I don't want to give you any encouragement that there will be any softening of the attitude here. As a matter of fact, I think there has been some softening. I know that you will do what you think you have to do to stay within those limitations.

Mr. Corman. Mr. Chairman.

The CHAIRMAN. Mr. Corman.

Mr. Corman. I want to ask if you are familiar with the recent Supreme Court decision that gave the beneficiary the option of drawing either AFDC or unemployment insurance? Up to that time anyone entitled to unemployment insurance could not draw AFDC.
I wonder if you have now or could get for us how much that decision has cost the city of New York? It would be one-fourth. I pay about one-fourth of AFDC payments.

Mr. Axelson. About a fourth, yes, sir.

Mr. Corman. It would be about a fourth of the benefits for all of those people who could get more on AFDC than they do on UI. And, of course, take that option.

Mr. Axelson. I do not have that information at hand but I will be glad to submit it.

Mr. Corman. If we could get that in the next few days it would be good because this committee is going to be considering a change in the law which would permit a beneficiary to draw his unemployment insurance and merely supplement with AFDC which I think would save you some money. I would be curious to know how much.

Have I made the request with sufficient specificity so that you know what I am talking about?

Mr. Axelson. We will investigate that and get a response to you.

Mr. Corman. Thank you.

[The information follows:]

City of New York,
March 18, 1976.

Hon. James C. Corman,
Rayburn House Building,
Washington, D.C.

Dear Congressman Corman: Deputy Mayor Axelson has asked me to respond to your inquiry of February 28 regarding the prohibition of Aid for Dependent Children (AFDC) recipients from receiving unemployment insurance benefits (UIB).

Since the courts have ruled that a state or local government cannot force a potential recipient to receive AFDC-U or UIB, and that it is a choice left to the individual, we feel that most people in New York City are choosing AFDC-U. This is probably the case since New York State's UIB make no allowances for dependents and have a flat maximum of $56 per week.

We feel confident that removal of the prohibition would mean considerable savings to local, state and federal government throughout the country and particularly in New York. It is difficult for us to give you precise amounts since our information retrieval systems are not capable of determining the work experience profiles of our AFDC-U recipient population.

However, we are attempting to develop such information and want to assure you that we feel the necessary legislation is worthwhile. We support your efforts in this matter completely and hope to work with you in developing and passing such legislation.

Sincerely yours,

Bruce Kirschenbaum,
Director, Washington Office.

Mr. Corman. That is all, Mr. Chairman.

The Chairman. Are there further questions?

If not, thank you very much, Mr. Mayor for appearing.

Mr. Axelson. Thank you.

The Chairman. Our next witnesses will be a panel of union and/or pension fund representatives, the first members being Battalion Chief Edwin F. Jennings and Capt. John J. McGarty, New York Fire Department Pension Fund; representing the New York City Board of Education District Council 37, Jack Bigel, consultant; representing the Policeman’s Benevolent Association, New York City, Kenneth McReeley, president; the Sergeants Association, New York Police De-
partment, Sgt. Marold Melnick, president; the Uniformed Fire Fighters Association, Local 94, New York City, Michael Maye, president, and United Federal of Teachers, Bernard Goldberg presenting a statement of Reuben Mitchell.

Let me say that I am very pleased to welcome the members of this distinguished panel to the Ways and Means Committee. We appreciate your cooperation in appearing as a panel. Unless you indicate to the contrary; we will recognize you in the order that I have introduced you.

Mr. Jennings, are you the leadoff spokesman here?

PANEL CONSISTING OF UNION AND/OR PENSION FUND REPRESENTATIVES: NEW YORK FIRE DEPARTMENT PENSION FUND, BATTALION CHIEF EDWIN F. JENNINGS, FIRST VICE CHAIRMAN, ACCOMPANIED BY CAPT. JOHN J. McGARTY; NEW YORK CITY BOARD OF EDUCATION, DISTRICT COUNCIL 37, JACK BIGEL, CONSULTANT; POLICEMEN'S BENEVOLENT ASSOCIATION, NEW YORK CITY, DOUGLAS WEAVING; SERGEANTS ASSOCIATION, NEW YORK POLICE DEPARTMENT, SGT. HAROLD H. MELNICK, PRESIDENT; UNIFORMED FIREFIGHTERS ASSOCIATION, LOCAL 94, NEW YORK CITY, MICHAEL J. MAYE, PRESIDENT; UNITED FEDERATION OF TEACHERS, BERNARD GOLDBERG

Mr. Weaving. Mr. Chairman, before you begin, I would like to have the record show that Mr. McFeely of the Patrolmen's Benevolent Association of the city of New York is represented by Douglas Weaving. The CHAIRMAN. Mr. Jennings.

STATEMENT OF EDWIN F. JENNINGS

Mr. Jennings. Mr. Chairman I am the president of the Uniformed Fire Officers Association and in that capacity sit on the New York Fire Department Pension Fund as first vice chairman, and during the negotiations with MAC, between MAC and the trustees of our funds, I conferred with our actuarial consultant, Mr. Jack Bigel from Program Planners, who is sitting on my left.

Unless you have specific questions of me I would like to refer comments to Mr. Bigel.

STATEMENT OF JACK BIGEL

Mr. Bigel. Mr. Chairman, gentlemen, my name is Jack Bigel. I am the pension consultant to the Municipal Labor Committee, and the gentlemen who are present are for the most part members of that committee and are also the trustees of the respective retirement system.

As Chief Jennings has said, he sits on the fire department system. Next to him is Captain McGarty, who sits on the police retirement system.
Next to him is Sergeant Melnick, who is also a trustee of the police department system.

Alongside of him is Douglas Weaver, who sits on the same system and at my far right is Michael Maye, president of the Uniformed Firemen’s Association, who is a member of the fire department system.

On my left is Bernard Goldberg, a trustee of the New York City Teachers Retirement System, and I am speaking today not only for the Committee but the three union trustees of the New York City Employees Retirement System, who are Victor Gotham of the American Federation of State, County and Municipal Employees, Ellis Van Riper, who is President of Local 100 Transporting Workers Union of America, and John DeLarry, who is president of the Uniformed Sanitationmen’s Association.

We are here, Mr. Chairman and gentlemen, in support of H.R. 11700. As a matter of fact, the committee ought to know that the retirement systems met in great part their commitments to the city’s fiscal plan for 1975–76. They have already purchased $360 million of city bonds and they have in accordance with their agreement with the chairman of Big MAC rolled over $1.2 billion. That has already been done.

There is still an outstanding commitment. We have already purchased $350 million of the $500 million due for 1975–76. All of this has been done, in accordance with the agreements worked out with the Governor of the State of New York in his capacity as chairman of the New York State Emergency Fiscal Control Board and Felix Rohlin in his capacity as chairman of the Municipal Assistance Corp.

Mr. Chairman, I was struck by two questions put to the Deputy Mayor. I think he answered them rather generally. I think the questions deserve a fuller answer, and I should like to start with the first question, which, as I understood it, was any pressure placed on the union trustees before they voted this commitment.

I can state as the consultant for the unions present in every single meeting with the governmental and MAC officials already referred to that at no time was any pressure placed on them in terms of utilization of the assets of the retirement systems as part of the fiscal plan.

I would say, however, there were many pressures that were placed upon the labor leaders, since all of these gentlemen are also labor leaders. Most of those pressures did not emanate from the State of New York or the city of New York, or from Big MAC. Among other concessions that were made—and we don’t regard this development as a concession—was in fact that city employees would have to pick up a larger share of the pension contributions and that is going into effect on April 1, 1976 and that will represent an effective cut in take-home pay of 2 or 2 ½ percent, depending on which plan the members are participants in. This means that as of April 1, 1976 there will be an additional aggregate contribution of some $107 million.

With respect to the commitment of the assets themselves, I would say that the pressure of the situation was the compelling factor, and in my formal statement to the committee we have indicated what these pressures were. We have, Mr. Chairman, 341,000 active members of our 5 retirement systems and we have currently 1,538 beneficiaries. That means people who have already retired or pensioners who retired and
died and therefore in accordance with whatever option he or she may have selected, some member of the family is getting that benefit.

We also have, of that 341,000, some 71,000 people already eligible for retirement currently in the employ of the city of New York, and therefore the first consideration that I think all the trustees had in mind was what would happen to the 100,000 beneficiaries, what would happen to the 71,000 people eligible for retirement in the event the city went into default, and I think you will find our exhibit describing that on page 6 of our prepared statement.

Our current assets were $7.7 billion. That includes all five systems. The comptroller of the city of New York, our chief financial officer, advised us that if we had to liquidate that portfolio that would shrink by some 30-odd percent, its value would be $4.4 billion. There were employee contributions that would be immediately withdrawn, and on the basis of the calculations on page 6, and the text thereafter, it was the conclusion I believe of every member of the board of directors of each of the retirement systems, that the assets at hand in the event of the city's bankruptcy would enable the systems to meet their obligations primarily to the retired members and to those eligible for retirement for a period not in excess of 6 to 8 years if the words of the employer contributions and the employee contributions which go hand in hand were to be discontinued.

In fact, all of our systems which were actuarially reserved would have been closed systems held in trust for those already retired.

The second consideration made by all of the trustees appears in our table on page 8. We estimated there what would happen in the event that this investment was made, and I think Mr. Chairman, that table reflects that in the event we made that investment that we would be able to meet all of our obligations to the members, those retired, those who would retire in orderly fashion over the period of the next 3 years, we would be able to purchase the city bonds which, is the primary purchase to be made, and we would still wind up with a considerable surplus.

If you look at the last line on my table 4 on page 8, that indicates what the percentage of our assets would be at the end of each one of these three years in city bonds. It would be 14.3 percent in 1975–76, would rise to 26.8 percent in 1977–78.

For those of us who have been involved in the retirement systems for a considerable period of time this is not a shocking proportion, and I have attached as one of our appendices which you will find on page 13 what the customary method of funding or of vesting the assets of the systems was from 1950 through 1975 in terms of its investment in city paper.

You will see that in 1950, 73.5 percent of all the assets of retirement systems were in city paper.

May I say parenthetically, Mr. Chairman, that that policy began to change in 1960 and 1961 by virtue of union pressure and you will see each year thereafter the declining proportion of purchases in city bonds so that in 1974–75 that was reduced to 4.3 percent.

If there is any interest in the current portfolio of the systems, you will find that on page 14, and then on page 15 we give you what has occurred in terms of the various holdings.
Mr. Chairman, these briefly were the considerations that the union leaders had in mind, and the trustees of the retirement systems, in approaching the very grave responsibility of committing any assets of the retirement systems as part of this fiscal package.

We are all satisfied that it was an appropriate investment. We trust that we will be able to fulfill the balance of the commitment made over the next period of 2½ years, and obviously we know that that is incumbent on passage of the bill before you.

We thank you for the opportunity to be heard, and the time you have made available to me, and there may be other members of our contingent who may wish to make a statement.

The Chairman: Thank you, Mr. Bigel.

Without objection your full statement will appear in the record, together with the supplemental materials. We appreciate the tables, the explanatory information all of which will be very helpful to the committee.

[The prepared statement follows:]

STATEMENT OF JACk BIGEL, NEW YORK CITY BOARD OF EDUCATION, DISTRICT COUNCIL 37

H.R. 11700 has the unanimous support of the unions involved in the Municipal Labor Committee, and of all unions whose members' pension benefits are provided by any of the five actuarial New York City Retirement Systems.

The legal background immediately precedent to the pending measure is covered in the statement to this Committee by the representative of the Municipal Assistance Corporation and the New York City Emergency Financial Board.

In addition, Committee members may find helpful a paper published in the New York Law Journal (February 13, 1976) which presents the legal problems confronting the boards of trustees of each of these retirement systems.

I have taken the liberty of attaching this statement to my own paper, since the same law firm referred to in the caption, represented District Council 37 in the drafting of the bill finally approved by the New York State Legislature and signed into law on December 4, 1975 (Chapter 890 of the Laws of 1975).

With the Committee's approval, I should like to deal with the economic problems and the actuarial considerations faced by the union leaders, namely Victor Gobin, B.C. 37, Albert Shanker, United Federation of Teachers and Barry Feinstein, Teamsters Union in their many discussions with Governor Hugh Carey, Felix Rohatyn, Chairman of Municipal Assistance Corporation and their staffs.

The eventual objective, staving off the City's bankruptcy, was a mutual concern. The problem faced particularly by the labor representative was the feasibility of utilizing some of the 7.7 billions in assets held by the retirement systems, as part of the fiscal package to avert default.

What would be the impact on the 341,144 active members and the 100,533 pensioners and/or their beneficiaries?

<table>
<thead>
<tr>
<th>System</th>
<th>1974-75 active members</th>
<th>1975-76 active members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Police</td>
<td>31,415</td>
<td>32,315</td>
</tr>
<tr>
<td>Fire (1973-74)</td>
<td>13,133</td>
<td>13,598</td>
</tr>
<tr>
<td>N.Y.C.F.S.</td>
<td>266,262</td>
<td>269,065</td>
</tr>
<tr>
<td>Teachers</td>
<td>85,358</td>
<td>85,748</td>
</tr>
<tr>
<td>Board of Education</td>
<td>6,634</td>
<td>6,629</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>341,144</strong></td>
<td><strong>348,533</strong></td>
</tr>
</tbody>
</table>

Source: Actuary, City of New York.
In addition to a guarantee of benefits to the 100,533 beneficiaries, what about the benefits earned by the 71,267 persons who are eligible for retirement?

**Table 2: Number of City Employees Eligible for Retirement (Valuation Date, June 30, 1974)**

<table>
<thead>
<tr>
<th>Retirement system</th>
<th>Eligibility requirements for service retirements</th>
<th>Number eligible as of June 30, 1974</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Police</td>
<td>20 yrs of service regardless of age</td>
<td>4,658</td>
</tr>
<tr>
<td>2. Fire</td>
<td>25 yrs of service regardless of age</td>
<td>2,371</td>
</tr>
<tr>
<td>3. Teachers</td>
<td>20 yrs of service, age 55 or age 55 regardless of service</td>
<td>2,151, 152</td>
</tr>
<tr>
<td>4. RWERS:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPP-15F</td>
<td>25 yrs of service and age 55; or age 55 regardless of service</td>
<td>75, 248</td>
</tr>
<tr>
<td>Police (linesmen)</td>
<td>20 yrs of service regardless of age</td>
<td>3,250</td>
</tr>
<tr>
<td>Transit</td>
<td>20 yrs of service and age 55</td>
<td>8,340</td>
</tr>
<tr>
<td>5. Board of education</td>
<td>If requirements in CPP (HYGRS)</td>
<td>1,400</td>
</tr>
</tbody>
</table>

Note: Total eligible equals (9) + (2) + (3) + (4) + (5) + (7) = 71,267.

The fiduciary responsibilities of union leaders who are also trustees—as many are—were explored in depth among themselves and with their attorneys. The classical concept holds that trustees of a retirement system and/or plan must protect the integrity of its assets; moreover, his primary responsibility is to all participants and beneficiaries of the plan.

That concept was applied in the most literal sense, using as our database, a balance sheet of the assets, liabilities and payment obligations of all five retirement systems provided by my chief actuary, Max Weintraib, P.S.A. Mr. Weintraib has been an actuary for forty years, first with the New York State Insurance Department and then as chief actuary of the New York State Retirement System from 1944 until 1967 when he retired.

The first demonstration illustrated in Table 2 was based on the assumption that the city was bankrupt; that no employer contributions would be available in future; and that only the systems' assets would be available for investment and to meet current and future obligations.

**Table 3: Impact of Default on The Five Retirement Systems for the Fiscal Year 1975-76**

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book value</td>
<td>$7,725</td>
</tr>
<tr>
<td>Market value</td>
<td>4,650</td>
</tr>
<tr>
<td>Value of net of employee withdrawals</td>
<td>3,900</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee contributions</td>
<td>0</td>
</tr>
<tr>
<td>Investment income</td>
<td>250</td>
</tr>
</tbody>
</table>

| Total income | 250 |

| Disbursements: | |
| Annual benefit payments including death benefits | 980 |

| Not annual deficit | (750) |

1 Retained by the Comptrollers Office assuming MAC securities equal 46.  
2 Assuming retirement of all eligible.

Table 3 was developed taking into account the market rather than the book value of the assets, since assets would have to be liquidated in order to pay current and future benefits. In addition, of the $7.7 Billion in assets, some $1.5 Billion represents the accumulated contributions of the employees themselves. Under law, employees would be able to withdraw about half of that total amount from the retirement systems. In the event of a bankruptcy, it must be assumed that employees will need any and every source of income available to them. This would also include the actual retirement of the 71,000 eligibles shown in Table 2.

This demonstration shows that bankruptcy of the city would result in the retirement systems generating an annual deficit of $750 million. At that rate,
the retirement systems would exhaust their entire reserve in a matter of seven or eight years, at the maximum and all payments to all retirees and beneficiaries would thereafter cease.

| TABLE 4.—PROJECTION OF PURCHASES OF NEW YORK CITY AND MAC SECURITIES  
| (in millions of dollars) |
|-------------------------|----------------|----------------|
| Assets—Beginning of year |        |        |        |
| Contribution expenses    | $7,725  |        |        |
| Emplyee contributions    | 1,901   | 1,761  | 1,360  |
| Investment income         | 235     | 236    | 236    |
| Total Income             | 1,780   | 1,752  | 1,296  |
| Benefit and other payments | 1,690  | 1,735  | 1,310  |
| Net addition to assets   | 623     | 797    | 937    |
| Assets—End of year       |        |        |        |
| New York City and MAC securities owned at Dec. 30, 1975 | 967 | 1,190 | 2,190 |
| New purchases from net addition to assets (Dec. 1, 1975—June 30, 1976) and refinancing | 1,953 | 1,800 | 500 |
| Purchase from sale of assets | 0   | 204    | 0      |
| Total additions of such securities | 1,953 | 1,976 | 500 |
| New York City and MAC securities owned at end of year | 1,897 | 2,190 | 2,689 |
| Ratio of total assets invested in New York City and MAC securities (percent) | 14.3 | 24 | 16.8 |

1 Employee contributions for the fiscal year 1975–76 were obtained from the actuary’s letter to the retirement systems. Employee contributions for the later fiscal years were estimated to increase at the rate of 10 percent a year. When finally calculated, they will be determined on the following basis:

2 Contribution expenses were estimated to be 10% of payroll base.

3 All other assets include all disbursements listed in the controller’s report, other than those relating to the buying and selling of securities.

4 Includes 10% securities.

The second demonstration, shown in Table 4, illustrates the impact on the distribution of assets of the retirement systems assuming investment in New York City and/or MAC securities over the next three fiscal years.

The assumptions underlying this exhibit were as follows:

- the yield on the New York City securities would be approximately 9%, considerably higher than the systems’ overall rate of investment return;
- the contribution of over $8.5 billions by the City through 1977/78 would make it possible to purchase those securities with a minimum liquidation of present holdings;
- Table 4 shows the projected experience over the three years of the fiscal plan.

With employee contributions continuing, employee contributions would also continue and total an estimated $96 million.

Investment income would generate an estimated $1.06 billion over the three year period. During this period, retirement benefits and other payments to members would total $3.065 billion.

The systems would in short, show an increase in assets of $2.3 billion during those three years after meeting all obligations.
Table 4 also shows the ratio of MAC/City bond investments to total assets for each year of the fiscal plan. The change in this ratio would increase from 14.9% in 1975/1976 to 26.8% in 1977/1978.

The data presented in the following tables were available to trustees, the chief actuary and investment advisors of the various systems by November 24, 1975.

On that date, the boards of trustees met and approved participation in the fiscal package which averted default.

There is no doubt that participation was motivated by the objective of maintaining the solvency and integrity of the systems, thereby enabling the trustees to discharge their obligation to all participants and beneficiaries.

Attached to this statement is an appendix with several tables presenting the investment policy and practice of the systems over a period of 26 years. It places in historical perspective the current and future holdings in MAC/City bonds.

In conclusion, the ability of the city retirement systems to meet their total commitment to the three year fiscal plan developed by the New York State Emergency Fiscal Control Board depends on the passage of HR 11760.

This was clearly stated in a letter to Honorable Al Ullman, Chairman of this distinguished committee, from Victor Godbey, District Council 37, wherein he stated: "...the trustees cannot easily determine whether a particular purchase of New York City obligations is legally permissible. In accordance with the Agreement, to which specific reference is made in the legislative history of the Seasonal Financing Act, legislation is needed to permit the retirement systems to continue participating in New York City's financial arrangements without incurring a risk of loss of tax exemption. If the retirement systems should cease to be qualified pension plans under the Internal Revenue Code, the principal detriment would fall upon those systems' members and beneficiaries."

I thank you for the opportunity to be heard and the time you have made available to me.

### APPENDIX—A 1: HOLDINGS OF NEW YORK CITY SECURITIES BY THE NEW YORK CITY RETIREMENT SYSTEMS COMPARED TO TOTAL ASSETS, 1959-60 TO 1974-75

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Holdings of New York City securities</th>
<th>Holding as a percent of assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1959-60</td>
<td>$450,617,701</td>
<td>79.4%</td>
</tr>
<tr>
<td>1960-61</td>
<td>603,753,249</td>
<td>74.6%</td>
</tr>
<tr>
<td>1961-62</td>
<td>529,063,198</td>
<td>72.8%</td>
</tr>
<tr>
<td>1962-63</td>
<td>519,063,198</td>
<td>74.4%</td>
</tr>
<tr>
<td>1963-64</td>
<td>519,063,198</td>
<td>87.6%</td>
</tr>
<tr>
<td>1964-65</td>
<td>519,063,198</td>
<td>98.1%</td>
</tr>
<tr>
<td>1965-66</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
<tr>
<td>1966-67</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
<tr>
<td>1967-68</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
<tr>
<td>1968-69</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
<tr>
<td>1969-70</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
<tr>
<td>1970-71</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
<tr>
<td>1971-72</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
<tr>
<td>1972-73</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
<tr>
<td>1973-74</td>
<td>519,063,198</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

### APPENDIX A.2.—Holdings of New York City Retirement System, by Type of Security, 1960-61 to 1974-75

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>New York City securities</th>
<th>U.S. Government securities</th>
<th>Public utilities</th>
<th>World Bank, foreign and corporate securities</th>
<th>Common stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-61</td>
<td>$3,846,070.59</td>
<td>$464,112.15</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1961-62</td>
<td>1,978,123.59</td>
<td>468,228.66</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1962-63</td>
<td>1,081,013.28</td>
<td>475,510.47</td>
<td>1,466,728.47</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1963-64</td>
<td>1,327,955.73</td>
<td>542,121.88</td>
<td>1,204,566.17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1964-65</td>
<td>1,459,406.71</td>
<td>598,836.10</td>
<td>1,338,442.61</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1965-66</td>
<td>1,647,668.09</td>
<td>492,326.69</td>
<td>1,563,675.75</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966-67</td>
<td>1,446,961.22</td>
<td>492,822.69</td>
<td>1,467,216.21</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1967-68</td>
<td>1,459,954.73</td>
<td>555,318.88</td>
<td>1,512,886.09</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1968-69</td>
<td>1,341,579.47</td>
<td>542,321.88</td>
<td>1,405,813.01</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1969-70</td>
<td>1,270,576.79</td>
<td>527,377.89</td>
<td>1,341,839.41</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970-71</td>
<td>1,199,798.84</td>
<td>527,377.89</td>
<td>1,341,839.41</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1971-72</td>
<td>1,056,684.55</td>
<td>281,712.24</td>
<td>1,156,712.27</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1972-73</td>
<td>856,649.95</td>
<td>44,848.25</td>
<td>942,262.62</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973-74</td>
<td>330,733.90</td>
<td>115,495.71</td>
<td>2,823,519.40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1974-75</td>
<td>330,733.90</td>
<td>115,495.71</td>
<td>2,823,519.40</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### APPENDIX A.3.—Change in Asset Portfolio of New York City Retirement System, 1960-61 to 1974-75

<table>
<thead>
<tr>
<th>Type of security</th>
<th>1960-61</th>
<th>1974-75</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York City securities</td>
<td>85.7%</td>
<td>9.3%</td>
<td>-76.5%</td>
</tr>
<tr>
<td>U.S. Government securities</td>
<td>15.4%</td>
<td>1.4%</td>
<td>-14.0%</td>
</tr>
<tr>
<td>Public utilities</td>
<td>13.6%</td>
<td>37.3%</td>
<td>+23.7%</td>
</tr>
<tr>
<td>World Bank, foreign and corporate securities</td>
<td>7.2%</td>
<td>25.3%</td>
<td>+18.1%</td>
</tr>
<tr>
<td>Common stock</td>
<td>0%</td>
<td>16.5%</td>
<td>+16.5%</td>
</tr>
<tr>
<td>Other</td>
<td>1.1%</td>
<td>16.6%</td>
<td>+15.5%</td>
</tr>
</tbody>
</table>

### APPENDIX A.4.—Projection of Retirement System Disbursements During 1975-76

<table>
<thead>
<tr>
<th>Type of payment</th>
<th>In the event of no default</th>
<th>In the event of default</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement allowance</td>
<td>$560</td>
<td>$1,980</td>
</tr>
<tr>
<td>Death benefits</td>
<td>40</td>
<td>0</td>
</tr>
<tr>
<td>Pre-retirement</td>
<td>40</td>
<td>0</td>
</tr>
<tr>
<td>Post-retirement</td>
<td>40</td>
<td>0</td>
</tr>
<tr>
<td>Loans to members</td>
<td>25</td>
<td>0</td>
</tr>
<tr>
<td>Refund of contributions</td>
<td>125</td>
<td>0</td>
</tr>
<tr>
<td>Transfer to other systems</td>
<td>75</td>
<td>0</td>
</tr>
<tr>
<td>Supplemental pension</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total disbursements</td>
<td>1,980</td>
<td>980</td>
</tr>
</tbody>
</table>

1 Assumes retirement of all eligible during 1975-76.


### APPENDIX B

#### Pension Outlook

(By Mayer Siegel)

#### The Duty of Prudence

Section 404(a)(1) of the Pension Reform Act (the “Act”) requires a fiduciary to discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and (a) for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administration of the plan, (b) with the care, skill, prudence and diligence under
the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like powers, (c) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so, and (d) in accordance with the documents and instruments governing the plan insofar as they are consistent with the provisions of the Act.

Section 401(a) of the Internal Revenue Code (the "Code"). In effect prior to its amendment by the Act, provided that a qualified plan must be established "for the exclusive benefit" of the sponsor’s employees and their beneficiaries.

**Prudent Man Rule**

The Internal Revenue Service (the "Service") has long held that the exclusive benefit rule of Section 401(a) incorporates within it the local law "prudent man rule". For example, in Rev. Rul. 69-494 the Service held that the trustees of a qualified plan may invest in securities of the employer if purchased at no more than fair market value, the trust maintains sufficient liquidity to pay benefits when due, and the local "prudent man rule" is observed. The Service further held that the normal requirement that investments yield a return equal to the prevailing rate does not apply with respect to obligatory investments in employer securities.

While the enactment of Section 401(a) (1) of the Act probably did not change, at least conceptually, the fiduciary duties of a trustee, the harsh glare of publicity focused by the Act upon the obligations of fiduciaries and the granting of wide enforcement powers to the Department of Labor (the "DOL") have caused practitioners to concentrate on trustees’ obligations.

In the private trust field, the courts have traditionally held that the primary duty of a trustee is to preserve the trust corpus. He also has a duty to enhance the corpus by earning a reasonable return therein in such manner as not unduly to risk the principal.

**Complex Problems**

In selecting trust investments, the trustee of a private trust could not, save in unusual circumstances, take into account factors extraneous to the preservation and enhancement of the trust corpus. However, the importance of pension and profit sharing trusts to our national economy, the vast reservoir of capital which they hold, and the unique and continuing relationships between the settlor (the employer) and its qualified trusts raise problems of a complexity and importance which could not have been dreamed of by Judge Putnam when he enunciated the "prudent man rule" in *Harvard College v. Amory*, 9 Pick. 448 (Mass. 1830).

Indeed, the legislative history of the Act recognizes that doctrines developed in the private trust area may not be entirely applicable to pension plans, by providing that the fiduciary obligations of the trustees of a qualified trust are to be interpreted "bearing in mind the special nature and purpose of employee benefit plans." H. Conf. Rep. 83-1280 at 302.

Suppose the trustees of a qualified pension trust are requested by the board of directors of the employer which established the trust to invest 5 percent or 10 percent of the assets of the pension trust in the employer’s securities. Such a transaction would not be prohibited under Sections 406 and 407 of the Act, but it would be subject to the exclusive benefit and prudent man rules.

**Further Example**

Suppose, further, that the employer informs the trustees that, unless they authorize this investment, the employer will become insolvent and thus unable to make further contributions to the plan. Under these circumstances, would it be prudent for the trustees to make the investment? Would it be prudent for the trustees not to make the investment? If the failure to do so would mean a cessation of employer contributions to the plan?

A similar situation could arise in the case of a profit sharing plan. If the trust instrument so provided, Section 407 of the Act would permit the trustees of profit sharing plans to invest more than 10 percent of plan assets in employer securities without violating the Act’s prohibited transaction rules. What is a trustee’s obligation when faced with a request—or demand—for assistance in
such a case? Does the nature of the employer-plan relationship justify a major commitment of assets to securities that may carry a higher risk of loss and a lower rate of return than alternative investments?

PROBLEMS FACING CITY

Those very questions have recently confronted the trustees of the New York City public employee retirement systems. An essential part of the arrangement whereby New York City has thus far avoided bankruptcy has been an undertaking on the part of the trustees of these systems to invest over 30 percent of the assets of the New York City pension funds in obligations of the City and of the Municipal Assistance Corporation ("MAC").

Last September the State Legislature ordered the trustees of the five principal New York City public employee retirement systems to invest $500 million in obligations of MAC and declared such investments to be "reasonable, prudent and proper."

Investment of Funds by Pension and Retirement Systems Act, N.Y. Laws 1975, ch. 888, Section 7; amendment, ch. 810, Section 14. The New York State Court of Appeals in *Spagnone v. Lucido*, 37 N.Y.2d 591 (Sept. 29, 1975), held that Article V, Section 7, of the State Constitution, forbidding the impairment of the "benefits" of public employee retirement systems, prohibited the Legislature from substituting its judgment of prudence for that of the trustees. The court argued that one of the "benefits" to which the beneficiaries of a pension plan are entitled is the discretion and judgment of the trustees in determining whether an investment is prudent. To remove from the trustees of the New York City retirement systems by legislative fiat their obligation to exercise their discretion in selecting investments is to deprive beneficiaries of an important benefit, and hence it is unconstitutional under Article V, Section 7.

Following the *Spagnone* decision, New York City solicited voluntary investments in city or MAC obligations by the city retirement systems. An amendment to the Retirement and Social Security Law, Section 176, enacted concurrently with the Investment of Funds by Pension and Retirement Systems Act, purported to indemnify trustees against any liability for violations of the prudent man rule resulting from investments in MAC obligations. N.Y. laws 1975, ch. 570, Section 13. However, this "indemnity" was to be provided from the assets of the affected systems and was thus an exemption clause rather than a true indemnity provision.

TRUE INDEMNITY SOUGHT

In view of the holding that the legislative abrogation of the prudent man rule was unconstitutional, the trustees of the New York City retirement systems were not satisfied with an exculpatory statute and insisted, as a condition to further investments in obligations of the city or MAC, that the Legislature enact a true indemnity provision that would protect the systems' assets from losses resulting from imprudent investments and define the standards of prudence which trustees would be required to follow in investing in City and MAC securities.

Accordingly, the New York State Legislature, on Dec. 4, 1975, enacted Chapter 808 of the Laws of 1975 (the "Pension Act"), which provided for the payment of judgments obtained against the trustees on behalf of a city retirement system as a result of future investments in obligations of the City of New York or MAC out of the New York City Personal Income Tax Fund, subject to certain prior claims of bondholders and to provision for essential city services. The Pension Act further provided that, in exercising their discretion to purchase obligations of the City of New York or MAC, the trustees could consider "the extent to which such investments will (a) maintain the ability of the City of New York (1) to make future contributions to such systems and funds and (2) to satisfy its future obligations to pay pension and retirement benefits to members and beneficiaries of such systems and funds and (b) to protect the sources of funds to provide retirement benefits for members and beneficiaries of such systems and funds."

RULING

Since an Act of the New York State Legislature, obviously, has no effect upon provisions of the Code, the trustees requested a ruling from the Service that the purchase by the New York City retirement systems of obligations of the City
or of MAC would not constitute prohibited transactions under Section 503(b) (1) of the Code and would not violate the “exclusive benefit rule” of Section 401(a) of the Code.

Governmental pension plans are generally not subject to the Act. However, they submit to the provisions of the Code in effect prior to its amendment by the Act. Section 503(b) of the Code prohibits, inter alia, a loan by a pension trust to the employer maintaining the plan unless the loan is adequately secured. Thus, the trustees were concerned that the purchases of New York City obligations would constitute prohibited transactions if they were held to be not adequately secured. Also, as indicated above, such purchases would be in violation of the “exclusive benefit rule” if they were deemed imprudent.

The Service issued a reply stating that the requirement of Article VIII, Section 10, of the New York State Constitution, that the city levy taxes sufficient to service its debt obligations, constitutes “security,” although the Service would not rule that such security was, in this particular case, “adequate.”

The Service further stated that, if the retirement systems’ investments in city securities satisfied the requisites of Rev. Rul. 69-494, the initial purchases in December of obligations of the City would not violate the “exclusive benefit rule.” No Assurances were given concerning projected later purchases.

LEGISLATION SOUGHT

Since the Service would not rule as to the factual elements of the transaction—i.e., whether the security was adequate, whether the purchase price of the obligations exceeded their market value, whether the city pension funds continued to maintain sufficient liquidity, whether such obligations yielded a fair return, whether the trusts were diversified and, of course, whether the investments were in fact prudent—efforts are being made by the trustees to secure the enactment of federal legislation safeguarding the qualified status of the city retirement systems.

It seems to me that the judgments made by the trustees of the New York City retirement systems to purchase obligations of the City and MAC, and the public policy expressed in the Pension Act, were correct, inasmuch as the extent of the chaos which would have followed the financial collapse of New York City is unforeseeable, and the detrimental effect upon the employees of New York City who are covered under these plans could have been substantially more adverse if the investments had not been made.

It must be pointed out that there are a number of differences between the financial problems of New York City and those of any private employer:

DIFFERENCES DETAILED

(1) The Pension Benefit Guaranty Corporation (the “PBGC”) guarantees accrued pensions (up to certain limits) in the case of a private pension plan but not in the case of municipal pension plans.

(2) New York City has a direct obligation, under the State Constitution and the statutes establishing the various retirement systems, to provide promised pensions, whether or not the retirement systems have sufficient assets for this purpose. Generally, private employers do not have such an obligation.

(3) The impact of the bankruptcy of a private employer is not nearly as great as that of a default on the part of the City of New York.

STRIKING SIMILARITIES

Nevertheless, there are also striking similarities between the private and municipal funds. While private employers are not contractually obligated to provide pensions (except in the case of certain collective bargaining agreements which provide for contractual liability), they do not normally terminate such plans in the absence of severe financial adversity, so that the establishment of a plan is frequently the practical equivalent of a contractual obligation. Moreover, in the case of profit-sharing plans, the guarantees provided by the PBGC are inapplicable. And while the consequences to society of the failure of a private employer are less severe than those of a collapse of a great municipality, the consequences to the employees affected are quite similar.

Accordingly, I would hope that the law will develop, in both the private and the public pension fields, so that, given the appropriate circumstances, the
trustees of a qualified pension or profit sharing plan will be permitted to consider, as a factor in determining its investment policy, the effect upon the employer which establishes and maintains the plan. Moreover, trustees of such plans should be permitted to consider the effect of their investment policy upon the communities in which their participants reside. Thus, trustees should be permitted to invest a portion of pension fund assets in local housing as well as in municipal securities, rather than be constrained by a narrow interpretation of the “prudent man rule” to limit themselves to the securities of major corporations and government units.

TEMMING CONTRIBUTIONS TO QUALIFIED PLANS

Section 404(a)(6) of the Code, as amended by the Act, provides that a taxpayer shall be deemed to have made payment of a contribution to a qualified plan on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the income tax return for such taxable year (including extensions thereof).

Prior to its amendment by the Act, Section 404(a)(6) of the Code was applicable only to accrual basis taxpayers and required such taxpayers to accrue the obligation before the end of the taxable year in order to take advantage of the right to make contributions during that portion of the subsequent taxable year ending on the due date for the filing of the taxpayer’s income tax return. Cash basis taxpayers did not have this privilege and, therefore, were required to make contributions in respect of a taxable year on or before the last day of that taxable year.

On Jan. 5, 1976, the Service issued T.I.R. 1481 (Rev. Rul. 76-28) which sets forth guidelines interpreting both Section 404(a)(6) of the Code, as amended by the Act, and Section 902 of the Tax Reduction Act of 1975, which accelerates the applicability of Section 404(a)(6) to contributions made to H.R. 10 plans of cash basis taxpayers in respect of 1975.

SERVICE RULING

The Service held that, in the case of both accrual basis and cash basis taxpayers, if an employer makes a payment to its qualified plan prior to the due date for the filing of its income tax return in respect of the preceding taxable year and claims such payment as a deduction on its income tax return for such preceding taxable year (or, in the case of a contribution by a partnership on behalf of a partner, the contribution is shown on Schedule K of the partnership return for such year), such deduction will be deemed to have been made in respect of the preceding taxable year. Any such claim of a deduction is irrevocable.

Thus, in the case of an H.R. 10 plan, an employer can claim a deduction for 1975 if such deduction is made on or before April 15, 1976 (or later, if an extension is obtained). In the case of an accrual basis taxpayer, it is no longer necessary that the employer “accrue” an obligation to make the contribution prior to the end of the preceding taxable year.

T.I.R. 1481 further states that Code Section 404(a)(6), as amended by the Act, is applicable only to taxable years ending with or within plan years which are subject to Section 410 (i.e., the new eligibility provision) of the Act, except that, as indicated above, the provisions of Section 404(a)(6) are applicable to H.R. 10 plans with respect to contributions made for 1975.

The Chairman. Who would like to be heard?

Sergeant Melnick.

STATEMENT OF SGT. HAROLD H. MELNICK

Sergeant Melnick. Thank you.

Let me state that in our statement, which I have distributed copies of, is a bumper sticker called “Cheer Up. You Too Could Be A Fiduciary.”

I think it really applies here, having a background of some 15 years involved in the area of pensions and investments, and in 1975 as president and chairman of the International Foundation of Employee
Benefit Plans, the world's largest jointly trusted group involved in the pension area.

Mr. Ullman spoke on two occasions for us, in 1974 and 1975, at our Washington legislative update sessions.

Let me state that last year we educated 11,000 people in the area of welfare plans and pension trusts. I have just one of the booklets that we have published, and it is a small one and it is titled, Prohibited Transactions and Some Permissible Ones. I am not going to spend any length of time talking about 401(a) and 503(b) and talk in terms of prohibitive transactions because I certainly could make many analogies as to what has taken place with regard to the fiduciaries in the city of New York and their pension systems. There comes a time when one has to make that kind of a decision, do we allow the city of New York to self-destruct or do we act on the basis of what is closely recognized that we have the assets, we have the financial capabilities, to go ahead and to back up the city, the city in which we make our living, the city which we love—and make no mistake about it.

We feel that the city had to be protected. Over the years the city has been good to us but the fact remains that we had an obligation, an obligation to save the city because of what we knew with regard to the financial problems faced by the city and our pensioners.

When I talk in terms of saving the city I think you have to recognize that as trustees we had a clear understanding of what was about to take place and what the alternatives were. When we look at bankruptcy and/or default, when we look at an erosion of the pension system or self-destruction of a pension system by our refusal to supply assets and refusal to back up the city, all it results in is that our beneficiaries, the people who have put their money into the funds eventually would find an erosion of their pensions. Therefore, recognizing that we had assets of $7.7 billion, we had an obligation to use some of those assets for the city like anybody else would have done.

We can talk in terms of the prudent man rule but I think it is time we talked in terms of what would have been done by the people who are knowledgeable, especially in the area of fiduciary responsibilities.

In a conversation with probably the most knowledgeable man in the United States regarding fiduciaries and pensions, who has been privileged to work on behalf of Congress and others, the Department of Labor, with regard to pensions, he is the executive vice president of Martin A. Siegel Co., Bob Tilove, I posed the same question that you people are asking us today, "As fiduciaries do you think it is a wise thing to invest in the City of New York?" and the answer came back, very clear, "What alternative did you have?"

The answer came back clear, emphatically, that "I would have done the same thing you people did when you people voted to go ahead and supply the city of New York with your pension fund money and loan collateral or call it what you may."

The fact is that when we recognize, as we go down the pike, that kind of obligation we had to go ahead and do it. The time had come to take action and in consideration of saving the city we acted.

Today we are asking for your imprimatur on that action. It was quite clear to us at that time that there was a question about it. The course that we would have liked to have followed would have been to-
go into court and to get a declaratory judgment barring any future
civil action against any of the fiduciaries but of course time was im-
portant. Could we go to the courts to get the courts to take us out
of the area of the prudent man rule? Time did not permit same.

We sought the other area, of legislation. That is exactly what we
did. We said, "We need some legislation. Somebody has to recognize
the fact that while we sit here as trustees we are not going to let the
city go under." This was our opportunity and you have the oppor-
tunity today to let the city of New York help themselves.

This is a "bootstrap" operation. We are not asking for any financial
assistance in this bill, all we are saying is to support the position that
we took as prudent men because we recognized the alternative. The
alternative was the destruction and along with it, without question,
the effect that would have not only on the rest of the State but on
the rest of the Nation.

I think there is absolutely nothing wrong and if you examine most
of the regulations with regard to the prudent man rule and prohibited
transactions of ERISA, you will see that they are allowing some vari-
ations. Nothing is clear-cut when it comes to the prudent man rule.
It is strictly case by case. In some cases, transactions are questionable
and in the gray area. Well, this is one of those transactions where the
trustees had a most difficult decision to make. We are not compensated
as trustees but, recognizing our obligation not only to our beneficia-
 ries but recognizing the major obligation to our municipal employer
we didn't have to be coerced into it. We voluntarily chose to go the
route and the only route and, while this may be an emotional appeal, I think
I could make that same kind of case if I were to talk for hours on pro-
hibited transactions and some permissible ones.

I think you gentlemen can recognize the position we were in and we
acted in the same manner that you people would have done in our
place. We couldn't afford to let the city of New York go under.

Thank you.

[The prepared statement follows:]

**STATEMENT OF SGT. HAROLD H. MELNDAR, SERGEANTS BENEFICIARY FUND**

In police parlance a signal "103" radio transmission means a police officer is
in need of help. For a member of the N.Y.C. Police Department to ignore such
an urgent emergency plea would be unbelievable. Similarly, it is unconscionable
for fiduciaries of a public retirement fund to ignore the financial plight of their
municipal employer. Yet under existing L.R.S. Code, as manifested in 401A and
506B, the well intentioned fiduciary is inhibited in his response to such a plea by
the monitoring provisions of the code.

Passage of HR 1170 calling for a relaxation of these restrictions is a MUST.
No meaningful actions towards self help can be rendered unless you permit us
this opportunity.

As a responsible labor leader, I and my colleagues as well, have always rec-
ognized our obligation to deal responsibly with the City of New York and addi-
tionally, to be sensitive to the needs of the people of the City of New York whom
we serve. Recognition of this public stance has led us to initiate and follow a "NO
STRIKE" policy as being in the best interest of New York.

Aware of our City's plight, we voluntarily choose to invest our pension funds in
the City's future. Without such a financial transfusion there would be no such
future.

We love our city, make no mistake about it.

The City of New York has never failed us. The City has been good to us. The
City of New York allows us to raise our families under decent conditions. We
have an obligation to voluntarily recognize that which is obvious. The alternatives to our failure to timely respond to the City's fiscal need, would be shockingly improvident and the height of ingratitude.

Obviously, no employee (beneficiary) of any Municipal Pension Plan would or could be immunized against the calamitous catastrophic effects of a city in chaos. Bankruptcy of New York City unquestionably, would constitute a mushrooming cloud of fiscal disaster that would ultimately spread its disastrous effects on the entire nation. Failure to recognize this specter is the height of folly.

Simply stated, the time had come to act affirmatively. And we did.

One must see, what there is to be seen. One must act, the way one should act.

The realities of the situation (crisis) dictates that the City be aided, the employees benefited, and the trustees protected.

There is no adverse interest in such an act or violation of prudence but rather reflects a mutuality of interest and an abundance of old fashioned common sense. Accordingly, my colleagues and I enthusiastically endorse passage of this legislation being in the best interests of all concerned.

The above statement is presented on behalf of the Superior Officers Council composed of the Captains Endowment Association, the Lieutenants Benevolent Association and the Sergeants Benevolent representing all ranks above police officer and detective in the N.Y.C. Police Department.

The Chairman. Thank you, Sergeant Melnick.

Would any of the other gentlemen wish to make a statement?

I would suspect Mr. Goldberg would ask to be heard. We are glad to hear you, sir.

STATEMENT OF BERNARD GOLDBERG

Mr. Goldberg. I regret that Mr. Mitchell is suddenly ill and cannot attend.

My name is Bernard Goldberg. I am a teacher in the New York City educational system. I am also a trustee of the New York City Teachers Retirement System and chairman of the United Federation of Teachers Pension Committee.

I speak today on behalf of the United Federation of Teachers. The United Federation of Teachers is the collective bargaining agent of the teachers and the related professional personnel employed by the New York City Board of Education. Our members constitute the bulk of the active and retired membership of the New York City Teachers Retirement System. We are very much aware of the value of a sound retirement system and have worked zealously over the years to strengthen it. In supporting the legislation under consideration here today we are primarily motivated by our desire to protect the interests of the teachers as present and future beneficiaries of the retirement system.

The trustees of the retirement system did not enter into this agreement lightly. We did not seek the opportunity of investing a large portion of our assets in New York City obligations. However, life presented us with the alternatives of fiscal bankruptcy of our city. We were forced to extend our concept of fiduciary responsibility to protect the source of future contributions to our retirement system. Were this source of funds endangered by city bankruptcy, the interests of our members as present or future beneficiaries of the retirement system would be jeopardized. The New York State Legislature, in a special session in December 1975, enacted legislation endorsing this ex-
tension of the concept of fiduciary responsibility. The United Federation of Teachers did, likewise, endorse this concept.

We believe that the provision of the Internal Revenue Code regarding prohibited transactions are wise and salutary. We would not advocate that they be weakened or repealed. However, we do advocate that where exceptional circumstances involving a large and damaging impact on our social fabric do arise, that these circumstances be examined on an ad hoc basis and special provisions of the code be investigated to meet these exceptional needs. We firmly believe that special circumstances do here exist to modify the code to enable the New York City pension funds to fulfill their part in the agreement of November 26, 1975 without endangering their qualified status.

We, therefore, urge the support of H.R. 11700.

Thank you.

[The prepared statement follows:

STATEMENT OF REUBEN W. MITCHELL, ON BEHALF OF THE UNITED FEDERATION OF TEACHERS

My name is Reuben W. Mitchell, I am presenting this statement on behalf of the United Federation of Teachers, I am also a trustee of the New York City Teachers' Retirement System, elected by the members of the System.

The United Federation of Teachers is the collective bargaining agent of the teachers and related professional personnel employed by the New York City Board of Education. Our members constitute the bulk of the active and retired membership of the New York City Teachers' Retirement System. We are very much aware of the value of a sound retirement system and have worked zealously over the years to strengthen it. In supporting the legislation under consideration here today, we are primarily motivated by our desire to protect the interests of the teachers as present and future beneficiaries of the Retirement System.

As is well known, on November 26, 1975, we became parties to an agreement between the Municipal Assistance Corporation for the City of New York, various Commercial Banks and the New York City Pension Funds. Part of the agreement committed the New York City Pension Funds to invest $2.5 billion in Municipal Assistance Corporation bonds and/or New York City bonds over the next 2½ year period. The completion of this agreement was a prerequisite to the enactment of Federal legislation to advance certain short term loans from the Federal government to the City of New York. Subsequent to the agreement, the Congress of the United States did enact the aforementioned legislation and our President did approve it and we are now operating in conformity with it.

The trustees of the Retirement System did not enter into this agreement lightly. We did not seek the opportunity of investing a large portion of our assets in New York City obligations. However, life presented us with the alternatives of fiscal bankruptcy of our City. We were forced to extend our concept of fiduciary responsibility to protect the source of future contributions to our Retirement System. Were this source of funds endangered by City bankruptcy, the interests of our members as present or future beneficiaries of the Retirement System would be jeopardized. The New York State legislature, in a special session in December, 1975, enacted legislation endorsing this extension of the concept of fiduciary responsibility. The United Federation of Teachers did, likewise, endorse this concept.

A stipulation in the agreement signed on November 26, 1975 provided that a prerequisite for continued investment of pension funds be that "the Internal Revenue Service shall have ruled or the Congress of the United States shall have provided, that such purchases of obligations by the Pension Fund pursuant to this Agreement shall not constitute prohibited transactions or otherwise adversely affect the qualified status of the Pension Funds . . . . " [7 (e) vii. Were this stipulation not met, all our joint efforts to avoid New York City bankruptcy would be nullified.

We believe that the provision of the Internal Revenue Code regarding prohibited transactions are wise and salutary. We would not advocate that they be
Weakening or repealed. However, we do advocate that where exceptional circumstances involving a large and damaging impact on our social fabric do arise, that those circumstances be examined on an ad hoc basis and special provisions of the Code be enacted to meet these exceptional needs. We firmly believe that special circumstances do here exist to modify the Code to enable the New York City Pension Funds to fulfill their part in the agreement of November 29, 1975 without endangering their qualified status.

We, therefore, support H.R. 11709.

The Chairman. Thank you, Mr. Goldberg.
Is there anybody else who wishes to testify?

Mr. Pike.

Mr. Pike. Thank you, Mr. Chairman.

I would like to say that supporting this legislation is going to be one of the easiest things I have done in a long time. I suspect that these trustees invested their funds in these MAC bonds with about the same enthusiasm that Congress decided that they would commit themselves to help the city of New York. The only thing I can say is that to me the whole package makes a great deal more sense, knowing that the unions themselves have committed themselves to the overall problem.

As I look at the chart that Mr. Bigel provided showing us the way that the investment funds had been taken out of the municipal securities, it presents a frightening picture. As I see them going back in again, it becomes very obvious that all of these people have a real vested interest in the success of the program. It makes me feel better for having participated in setting it up.

The Chairman. Mr. Mikva.

Mr. Mikva. At the risk of being a nippicker, I have to say that I am somewhat troubled. I intend to vote for this bill but the underlying decisions that have already been made give me some trouble. The first thing in the world I would want to do is see the Internal Revenue Service second-guess those decisions. That clearly is not going to solve the problem.

I don't know what I would have done if I had been a member of the New York Legislature and I don't know what I would have done if I had been a trustee of one of these funds. I think that in the understandable concern and desire to solve the problems of a great municipality we may have set up a new category of pension law which was not the way I learned it in law school, and wasn't the way I tried to look out for pension funds when I was in the State Legislature of Illinois.

I don't know how I would feel if I were an attorney counseling you trustees. I think I would advise you to resign at once, because I think that there are some serious problems that we can't solve and I am not sure that the State Legislature of New York can solve in all its wisdom.

I don't think that you can equate the rights of future beneficiaries with present beneficiaries. I don't think you can do that by either an act of the State Legislature of New York or by an Act of Congress.

I think that there are some serious questions of the rights of the cestui que trust that I am not sure have been answered. I say that not because I want to be critical. As I indicated, I don't envy the task that any of you have. I must say, Mr. Goldberg, that your testimony just sharpens that concern that I had when I first saw those investments.
being made by the pension funds. I realize the Hobson’s choices that you had in many instances. For all that I hope that my decision to vote for this bill and the Congress enthusiasm to pass this bill out will not be taken as our smoothing over the whole bag of problems that still remain about the pension funds making their heavy investment in the future solvency of New York City.

Mr. Goldberg. Mr. Chairman.

The Chairman. Yes, Mr. Goldberg.

Mr. Goldberg. Speaking for the New York City Teachers Retirement System trustees, we did not agree to invest the money on a Save-the-City basis, period. We firmly believed that the beneficiaries present and future were better protected by our entering into this agreement than in refusing entry into the agreement.

Were there any doubts in our minds on that score, we would not have agreed to making those purchases, even though it would have meant the city going into bankruptcy.

The Chairman. Sergeant Melnick.

Sergeant Melnick. Let me clarify it for you, Mr. Mikva. One of the reasons that the past beneficiaries or, let’s say, the present retirees could be affected as much as the future retirees by the fact that if there was no fresh money coming into the pension funds for the next several years that the pension funds would be exhausted in a matter of time and therefore they would have suffered just as much as future retirees. You are right. It was Hobson’s choice, exactly. The point is that when one is faced with either we go out of business and self-destruct, or faced with the fact that we can come to the aid of the city and save it, there wasn’t much choice. It certainly wasn’t anything that we went into feeling elated about. We regret that there were no other means of financing the city. We looked toward the Federal Government. We looked more toward the State government. Unfortunately, it wasn’t there. Therefore we were placed in the kind of position of doing what we had to do. It isn’t easy to sleep nights when you have to make decisions like this, and that is what we are, but the fact is we had to make that decision and we made it and made the best choice.

I talked with counsel from all over this Nation. I got the same answer from each and every one of them, you either do it through legislation or you do it through a declaratory judgment. Well, we tried. We got the State legislature to come in with some special legislation and what we are asking you people to do today is more or less back us up on the decision that was made.

Right or wrong, it was the only decision that could be made at that time, and I for one think of my beneficiaries as my colleagues do but I also think of the interests of all the people of the city of New York, our employer, and in their interests we had to go ahead and do it. That was a choice that we hope we will never have to make again.

The Chairman. Are there further questions?

Mr. Rangel.

Mr. Rangel. Mr. Chairman.

I would like to take this opportunity to thank the leaders of the unions and the trustees of the assets of the union membership for testifying this morning. I do hope that our Federal Government as it
relates to the social security funds expects to have the same high standards in protecting those funds for retirees as they expect from the trustees of our municipal retirement funds.

I think that a special burden was placed on the leaders of the unions, especially those that represent such sophisticated memberships as the firemen, policemen, teachers, and other municipal employees where pension gains have been made after many long years of struggle at personal sacrifice.

It did offer the union leaders and trustees an opportunity to continue the expected adversary relationships that exist between unions and city employees. I think that this time what the trustees and leaders did was to recognize that we all are part of city government the same way we would expect the citizens of the United States to recognize that if we didn’t have debt ceilings, if we didn’t have deficits, that perhaps we too would have to make considerations that are not the easiest ones to make, but certainly ones where the city was proudest of the type of leadership exemplified by the trustees and leaders of our municipal unions.

For this I think the city of New York owes a special debt of gratitude. I hope that the Congress would recognize, as was stated by the panel, that this was an attempt where people became not trustees alone, not leaders of labor alone, but became citizens of the city of New York and went into not adversary proceedings but a partnership with the city.

For these reasons I am confident that the U.S. Congress will join with us in our effort.

Thank you.
The CHAIRMAN. Are there further questions?
Mr. Martin?
Mr. Martin. Yes, Mr. Chairman. I have a couple of questions.
I want to commend all of you, both for your professional responsibilities and the way you have faced up to what you have described as, and what very obviously is, a very difficult choice to make.

I am inclined to support H.R. 11700 because otherwise it would leave you with an insurmountable barrier to be able to balance the responsibilities that you have to your present members who are actively working in the profession that you represent, as well as those formerly in those professions and who are now retired.

In response to Mr. Mikva’s statement, Mr. Goldberg said, and others I believe said earlier, that you recognized that one of your responsibilities was to protect the beneficiaries of present retirees and I would assume that that means that there are insufficient funds in the pensions that you represent so that the proceeds from that cannot meet the levels of retirement benefits that you have agreed to provide for pensioners.

Perhaps I am misreading that but it gives me a qualitative impression at least that you are saying that in an actuarial sense the funds are not adequate. I will be happy for you to respond in just a moment. So that, like social security, you have to use present employees’ contributions to pay a portion of the benefit levels, which means that those contributions, or the part that you have to use for current benefits, are not then available for investments for future benefits.

Am I reading that correctly?
Mr. Brest. I think that we were probably not very clear on that. What we said, using table 3 on page 6 of my statement was that if the city got into bankruptcy and therefore there was an elimination of employer and employee contributions, since these plans are contributory, that we would have to utilize the current assets to meet the obligations to the beneficiaries and, as our table shows, sir, our assets of $7.7 billion would have shrunk since we would have had to liquidate them at market value.

We indicated further that employee contributions which total about $7.7 billion would be withdrawn by the employees since that is their legal right and that therefore there would be available a sum somewhere near about $3.9 billion in all the five systems to meet all of the obligations to those already retired.

We said further that there are some 71,000 employees currently eligible to retire, that in the event of bankruptcy and some of the consequences thereof in terms of its impact on payrolls, its slack, et cetera, it was our assumption that these employees would exercise their legal right of retirement in order to provide themselves with some form of income; that based therefore on those considerations, solely the assets currently on hand, that those assets could last only for 6 to 8 years.

On the other hand, we point out—and that was our balance sheet, my table 4 on page 8—that if both employers and employee contributions would continue, that there would not be this abnormal withdrawal of employee contributions, that they would stay in, that what we chart here on page 8 would be the normal continuation of the operation of the system and, if you look at that table, you will see that the obligations, the total liabilities of the systems related to contributions still leaves us with a surplus in each year, and that has been the case for all the years of the operations of the five retirement systems.

So that, while there may be a question, and I think that is another question as to whether or not our systems are adequately funded, and that is supposed to be the subject of a report that will be issued probably in the next two weeks, I think everybody will find that all of the dread speculations about the enormous underfunding of these retirement systems will kind of shrink to very manageable proportions.

I am speculating, but I do believe that that finding will be that if there is any underfunding it is in a rather small amount.

I hope I have clarified the confusion that I created. I was simply trying to indicate, say, that if we went into bankruptcy our systems would be closed and that the conditions consequence would be a liquidation that we felt would finally result in total exhaustion of assets in about to 8 years.

Mr. Martin. I thank you, both for the clarifying statement and also for what I would say was an unnecessary generosity in taking upon yourself the entire burden of the confusion. In fact, most of the things that you just stated you had said before, and I had not sorted them correctly into place in my own mind, and therefore the confusion was more on my part than yours.

You are saying, then, that current contributions are and are not needed to meet current benefit levels. That satisfies my specific line of inquiry.
I wonder in addition to the reports that you have just made reference to, that will be forthcoming in a couple of weeks, whether you would be able to make available to us a summary of the levels of benefits that are available for these various funds.

Mr. Bieler. It is my belief that that report will summarize the levels of benefits by both system and by variance within systems.

Mr. Martin. For our present understanding, could you give me approximately the level of benefits, say, for someone who has 20 years of service in the police retirement fund, as to what the benefit would be, approximately, in relation to a full retirement.

Would it be 100, 90, 75, or 50 percent, just in a rough figure? I know it varies from rank to rank and salary levels.

Mr. Bieler. I should defer to the representatives of the police department system but my own very quick offhand calculation is that a policeman retiring after 20 years of service, would retire at a maximum of about $7,000 or $7,500, but that benefit would then be reduced by virtue of whatever option he selected, and I would say very approximately that that benefit would be reduced by approximately 30 percent, depending on options selected, so that his benefit would be roughly in the neighborhood of about $5,000, maybe a couple of hundred more than that, say somewhere between $5,000 and $5,500.

Mr. Martin. Is that approximately the answer?

Sergeant Melnick. That is correct.

Mr. Martin. And is it the same sort of situation with fire fighters?

Mr. Bieler. I think they are on exactly the same level of benefit.

Mr. Martin. What could we refer to as a full retirement. Let's say if someone had started work at 20 and continued to work to 40, and became eligible and then continued to work until 55 or 60.

Mr. Bieler. You would have a mandatory 65 retirement age so that a policeman would have to enter at age 15.

Mr. Martin. Thirty years is mandatory retirement?

Mr. Weaving. Age 65 is mandatory.

Mr. Martin. What about the teachers? I know in the schedule on page 4 you use 65. That is not a mandatory retirement age for teachers.

Mr. Goldberg. Seventy is the mandatory retirement age. However, the benefit structure is not the same as police and fire fighters.

Mr. Martin. If you could give a brief summary.

Mr. Goldberg. A teacher cannot retire after 20 years of service and collect benefits at any rate. Benefits would be delayed until age 55.

Mr. Martin. Then what would that benefit level be?

Mr. Goldberg. At 55, after waiting the 15 years, the benefit level percentagewise would be roughly similar, and the option reductions would be just about the same.

Mr. Martin. That is close enough. Thank you, sir.

Mr. Waggonner. Mr. Chairman.

The Chairman. Mr. Waggonner.

Mr. Waggonner. Could someone tell me whether or not overtime is considered for base pay purposes in computing retirement benefits in the New York City employment systems?

Mr. Bieler. Overtime is not part of the base pay.

Mr. Waggonner. Is not part of what pay?
Mr. Bigel. They are not part of the base pay. They are, however, used in the calculation of the retirement allowance. However, there are very few agencies where there is any overtime and I think our first statement ought to be that overtime is not something that the unions require. It is the exercise of management's judgment. I would say 90 percent of the agencies there is absolutely no overtime. You will find overtime possibly in an emergency in the police department. You will find overtime in a corrections department, again only in emergency conditions, and there is some overtime in the transit authority, and in discussions I have held very recently with management there they apparently feel that the utilization of overtime is cheaper from the viewpoint of their overall payrolls than hiring additional people.

Mr. Wagonner. Mr. Bigel, there has been some talk that retirement of municipal employees in the city is based not upon a multiyear average but upon the salary of the last year of employment. Is that correct?

Mr. Bigel. Yes, that is the formula.

Mr. Wagonner. Then it is possible that even though overtime does not exceed or equal more than about 10 percent of the total payroll, in fact in the overall there is very little doubt that those people in their final year would be the people who work overtime to get inordinately high pensions. Is that possible?

Mr. Bigel. I would say theoretically that is possible. However, I have just done a study on overtime in the transit authority and that is not the way it turns out.

Mr. Wagonner. What about authorities other than transit?

Mr. Bigel. What is that, sir?

Mr. Wagonner. What about some of the other areas of employment?

Mr. Bigel. I have no knowledge of any of the other agencies. I have made no study but I have to believe, since I know that only management can order overtime, that an employee cannot work overtime at his own volition, that this is a management problem and that management ought to shoulder the responsibility for that.

Mr. Wagonner. Management might order the overtime but does management select the individuals who work overtime?

Mr. Bigel. No, sir. Overtime is worked, as I recall it unless it varies in other departments, on a seniority basis.

Mr. Wagonner. I have just a couple of other brief questions.

Mr. Jenkinas. Pardon me, sir. May I comment on overtime as it relates to the fire department.

As a result of the budget crisis layoffs and the high attrition rates during 1975, the fire department sustained overtime costs approximately $20 million in 1975. The reason for that is that we have 1,700 fewer firefighters and 280 fewer officers following the impact of the budget crisis.

As you may or may not be aware, the highest fire incidence in this country occurs in the five boroughs of New York City. We have appealed to the decisionmakers at all possible levels in the city of New York contending that layoffs and attrition in order to cope with budgetary problems was counterproductive because of the excessive costs of overtime which, in effect, increases pension benefits for prospective re-
times, so that in the Fire Department we have had a number of people retiring where their retirements would be influenced greatly by the fact that they worked a great amount of overtime during 1975.

Mr. WAGGONNER. We have some bills on the floor and must go to the House. Can you quickly give me the answers to three questions. What is the employer percentage of contribution to the retirement system, just the percentage of pay? Is it 6 or 7 percent, or what is it?

Mr. JENKINS. In the first system the employee contributes 25 percent and the employer 75 percent.

Mr. WAGGONNER. When did the employee start making a contribution as a City employee in New York City?

Sergeant MELNICK. 1940, basically.

Mr. WAGGONNER. Are there any systems where the employees do not make contributions?

Sergeant MELNICK. Only closed systems.

Mr. WAGGONNER. What is a closed system?

Sergeant MELNICK. That is a system in which there is no active participant in that system employed today.

Mr. WAGGONNER. Mr. Chairman, I know we have to go.

Mr. BISHOP. May I amplify that?

Mr. WAGGONNER. Let me say one thing because I have to go. I am not unfriendly. I am extremely critical. I am going to vote for your legislation, for this proposal. However, I find it somewhat ironic that you whom the public at large blames for being large contributors to the financial plight of New York City, come here today professing to be the saviors of New York City by investing some of your provision money. I am happy to have you do it because I think it is going to temper your demands in time to come and make you more responsible than you have been. I think it might help.

Thank you, Mr. Chairman.

The CHAIRMAN. Let me say that it is my understanding that you are not responsible for the benefit package. That is by State legislative enactment. But you do have a great responsibility. I will recommend that we pass this legislation. However, I don't envy your jobs. As you have indicated, you had a Hobson's choice and the alternatives have not been good. But I want to renew the charge that I think all of us place in you that you must be ultimately responsible to the people who will benefit from the pension package.

I know that you look very seriously on that responsibility. I think this action had to be marginal and I don't know whether it can be totally justified, but I don't envy the alternatives that you had before you.

Thank you very much.

The committee will stand adjourned until 10 o'clock tomorrow morning, when we will go into executive session on the bill before us.

[Whereupon, at 12:25 p.m. the committee was adjourned.]
Hon. Al Ullman,
Chairman, Committee on Ways and Means, U.S. House of Representatives,
Washington, D.C.

Dear Mr. Chairman: As Executive Director of District Council 37 of the American Federation of State, County and Municipal Employees and an employee representative on the Board of Trustees of the New York City Employees Retirement System ("NYCERS"), I am writing you in support of H.R. 11700, introduced by Mr. Rangel on February 4, 1976.

H.R. 11700 would assist the continuance participation of NYCERS and other New York City public employee retirement systems in the financial arrangements which have been made pursuant to the New York City Seasonal Financing Act to restore New York City's financial health. An integral part of these arrangements is the Amended and Restated Agreement of November 21, 1975 (the "Agreement"), by which NYCERS and other retirement systems agreed to invest approximately $2.5 billion in New York City obligations over a three-year period. This Agreement was one of the principal factors that led the President to recommend Federal financing assistance for New York City and Congress to enact the Seasonal Financing Act.

While the Agreement was being negotiated, concern was expressed that retirement system purchases of New York City obligations might be deemed to be a loan without adequate security by a tax-exempt trust to its creator or a substantial contributor. Such a transaction would jeopardize the tax-exempt status of NYCERS and the other participating retirement systems, with consequent detrimental effects on their members and beneficiaries.

Therefore, the retirement systems' obligation to invest under the Agreement was made conditional upon the enactment of legislation, or an equivalent ruling by the Internal Revenue Service that such an investment would not adversely affect the retirement systems' standing as tax-exempt entities.

In December, two purchases of New York City obligations were made in accordance with the Agreement. Prior to each purchase, the IRS ruled that the purchase did not constitute an unmortgaged loan. Those rulings, however, left to the trustees of the retirement systems the burden of determining important questions of fact—in particular, whether the security for the obligations purchased was adequate and whether the obligations were purchased at a fair price and provide a reasonable rate of return. In addition, the IRS declined to issue a ruling that would cover future purchases.

Because little or no authority is available concerning the adequacy of security in the form of municipal taxing power and because New York City's present circumstances are unique, the trustees cannot easily determine whether a particular purchase of New York City obligations is legally permissible. In accordance with the Agreement, to which specific reference is made in the legislative history of the Seasonal Financing Act, legislation is needed to permit the retirement systems to continue participating in New York City's financial arrangements without incurring a risk of loss of tax exemption. If the retirement systems should cease to be qualified pension plans under the Internal Revenue Code, the principal detriment would fall upon those systems' members and beneficiaries.

For the foregoing reasons, we urge your Committee to report H.R. 11700 to the House of Representatives with a recommendation of passage.

Very truly yours,

Victor Gotbaum, Executive Director.