MEMORANDUM

To Mr. Eugene Feilin, Executive Director
Municipal Assistance Corporation for the City of New York

From Allen L. Thomas
Donald F. Moore

Subject
Application of H.R. 11700 to the Proposed Restructuring Agreement Among MAC, the City of New York and Various Pension Funds and Banks

This memorandum sets forth our views with respect to the application of Public Law 94-236 [H.R. 11700] ("H.R. 11700") to the proposed restructuring agreement.

Relevant Provisions of the Law

H.R. 11700 provides, in pertinent part, that any pension plan or trust which, on December 5, 1975, was a party to the agreement dated November 20, 1975 (the "Agreement"), among the Municipal Assistance Corporation for the City of New York ("MAC"), and several New York City Commercial Banks, Pension Funds and Sinking Funds, will not be deemed to have engaged in a prohibited transaction, as such term is defined in section 503(b) of the Internal Revenue Code of 1954 (the "Code"), merely because such plan or trust:

- enters into the Agreement or agrees to an amendment of the Agreement
- executes a waiver of any requirement of the Agreement
- considers, for purposes of making investments after August 20, 1975 and before January 1, 1979, the extent to which such investments will involve such factors (the "A and B factors") as (H) maintaining the ability of the City of New York to make future
contributions to the plan or trust and satisfy its future obligations to pay pension and retirement benefits to its members and beneficiaries and (B) protecting the source of funds to provide benefits for its members and beneficiaries.

- considers, after December 31, 1978, for purposes of determining whether to retain investments held on that date, the A and B factors.

H. R. 11700 imposes only the following limitations on any of the foregoing actions by parties to the Agreement:

1. Any amendment to the Agreement adopted after December 5, 1975, and any waiver of any requirement of the Agreement after December 5, 1975, which relate to the application of the A and B factors to the requirements of the Code concerning prohibited transactions, may be vetoed by the Secretary of the Treasury if he determines, not later than 30 days after a copy of such amendment or waiver is submitted to him, that the taking effect of such amendment or waiver is inconsistent with the A and B factors; and

2. No amendment of the Agreement which has the effect of extending the expiration date of the Agreement to a date later than December 31, 1978, may be made.

Legislative History and Background

a. General Background

As originally conceived, H. R. 11700 was a simple bill which would have exempted from the prohibited transaction provisions of Section 503(b) of the Code pension plans and trusts
created by States or political subdivisions thereof whose outstanding obligations were guaranteed by the federal government. When it became apparent that such a bill would be too broad in scope, a bill more limited in scope, and limited in its application to those pension plans and trusts which were parties to the Agreement, was drafted with the assistance of the staff of the Joint Committee on Internal Revenue Taxation (the "Joint Committee Staff"). In addition to being limited to parties to the Agreement, H. R. 11700, at the insistence of the Joint Committee Staff, contained a provision that an amendment of the Agreement or a waiver of any of its requirements, which related to the application of the A and B factors, would take effect only if approved by the Secretary of the Treasury not later than 30 days after submission of a copy thereof to him. Another provision required by the Joint Committee Staff provided that no amendment could be made which had the effect of extending the expiration date of the Agreement to a date later than June 30, 1986. Unsuccessful attempts were made on behalf of MAC and the City of New York to have the latter provision deleted as unnecessary in view of the requirement that the Secretary of the Treasury consent to any such amendment.

H. R. 11700 was enacted by the Congress, following hearings before the House Committee on Ways and Means, with only two substantive modifications of the bill as introduced by Congressmen Charles B. Rangel, Otis G. Perry and Barber B. Conable. One modification provided that any amendment of the Agreement or any waiver of any of its requirements would become effective on the date thereof unless
disapproved by the Secretary of the Treasury not later than thirty
days after submission of a copy thereof to him. The second modification
provided that no amendment could be made to the Agreement which has
the effect of extending its expiration date to a date later than
December 31, 1978 (instead of June 30, 1986). Corresponding
date changes were also made to other provisions of H. R. 11700;
for example, the last day before which the plan and trusts may
consider the A and B factors in making investments was changed from
July 1, 1986 to January 1, 1979 and the plans and trusts are
permitted to consider the A and B factors for purposes of determining
whether to retain investments held on December 31, 1978 (instead
of June 30, 1986).

b. Meaning of the "Expiration Date" of the
Agreement.

The Agreement neither contains nor makes any reference
to an expiration date. H. R. 11700, as introduced, provided that
no amendment to the Agreement which had the effect of extending its
expiration date to a date later than June 30, 1986, could be made.
That date was arbitrarily selected and inserted into an earlier
draft version of the bill - a draft version that contained no
provision requiring approval of any amendment or waiver of the
Agreement by the Secretary of the Treasury - at the insistence of
the Joint Committee Staff that there be some outside date beyond
which the proposed legislation would not be effective with respect
to new investments by the plans and trusts. As noted above, attempts on behalf of MAC and the City of New York to remove this restriction from the bill as unnecessary after a requirement of approval by the Secretary of the Treasury was added, were unsuccessful.

At the hearing before the House Ways and Means Committee on H. R. 11700, Dr. Lawrence Goodworth, then the head of the Joint Committee Staff, testified that June 30, 1986 was not a meaningful date because he understood that the Agreement expired in 1978, the last year in which the plans and trusts are obligated under the Agreement to make any investments in New York City Notes or MAC Bonds. Accordingly, he recommended that H. R. 11700 be modified to change the June 30, 1986 date to December 31, 1978. As set forth above, this change was made prior to enactment of H. R. 11700. No other reference is made in the Agreement, in H. R. 11700, or in its legislative history to the term "expiration date".

It appears from the foregoing, that June 30, 1986 was an arbitrary date originally and that the "expiration date" of the Agreement, as that term is used in H. R. 11700, means December 31, 1978, a date beyond which the plans and trusts are not required under the Agreement to invest in MAC Bonds or New York City Notes and a date after which no amendment to the Agreement that obligates them to do so will be effective for purposes of the protection afforded by H. R. 11700.

* The Agreement does provide that July 1, 1986 is to be the last maturity date with respect to certain New York City Notes that may be exchanged for other New York City Notes and the last maturity date with respect to certain MAC bonds that may be exchanged for New York City Notes. It is likely that the June 30, 1986 expiration date was suggested by those dates.
The proposed restructuring agreement cannot, in any sense, be said to extend the expiration date of the Agreement to a date later than December 31, 1978. This is so because the proposed restructuring agreement applies only to funds invested by the plans and trusts pursuant to the terms of the Agreement and the restructuring itself applies only to certain investments previously made by the plans and trusts pursuant to the Agreement. The restructuring takes the form of exchanging certain investments in New York City Notes previously made by the plans and trusts pursuant to the Agreement for MDC Bonds and an alteration of the interest rate and maturity dates of certain other bonds already held. These transactions do not have the effect of extending the expiration date of the Agreement to a date later than December 31, 1978 and, therefore, in our opinion these amendments could be made pursuant to H. R. 11700 either before or after December 31, 1978. The transactions contemplated in the proposed restructuring agreement may, in our opinion, be said to relate to the application of the A and B factors to the requirements of the Code concerning prohibited transactions. Accordingly, a copy of the proposed restructuring agreement should, pursuant to H. R. 11700, be submitted to the Secretary of the Treasury who will have a period of 30 days from the date of submission to veto it.

A.L.T.
D.F.M.

ja
Mr. Eugene Keilin  
Executive Director  
State of New York  
Municipal Assistance Corporation  
Two World Trade Center  
New York, New York  10047

Dear Mr. Keilin:

Thank you for your thoughtful and informative correspondence of November 1, relating to the New York City Retirement Systems' role in the City's fiscal crisis. As you know, the Employee Retirement Income Security Act of 1974 mandates a study by the Congress of Public Employee Retirement Systems. Your willingness to afford this Subcommittee the benefit of your experiences and your expertise is greatly appreciated, and will aid us in attaining the fair and sensitive understanding of the City's Retirement Systems which the Congress must have if it is to effectively assess the need for federal legislation regulating public employee retirement systems.

It would be helpful, I believe, to place in a proper perspective the review of New York City's Retirement Systems in which the Task Force is presently engaged and which has generated so much publicity in recent weeks. As I indicated above, the Pension Task Force of the Subcommittee on Labor Standards is instructed in ERISA to conduct a full study of PERS. Our efforts to date, including the extensive studies which are now underway, have been focused on PERS on a nationwide basis. The events of the last year concerning the City's Retirement Systems' role in the City's fiscal crisis require that a particular effort be expended in understanding the events, issues, and concerns that have been so sharply focused by that participation. Thus, our work with New York City's Retirement Systems represents only a small, although important, part of our general study of PERS. Surely a report on PERS that artificially does not discuss the New York City experience could not achieve the integrity and credibility so vital if it is to prove useful to the Congress.
The analysis you provide of the events of last Fall represent, in my view, a reasonable and wholly good-faith assessment of the complex issues with which the City, State, Federal governments, and Retirement Systems were faced. Your treatment is a compelling and persuasive one, and must be included in any Report that intends to deal with its subject matter fairly and sensitively.

But clearly there are other, differing assessments of these same events that are also reasonable and in complete good-faith. And these differing views, I believe, must be brought to the attention of the Congress if an accurate view of the Retirement Systems is to be achieved. For example, the December, 1975 enactment by the New York Legislature (Chapter 890, Laws of 1975) can be characterized as an attempt by the State to lessen the standard of conduct to which Pension Plan Trustees must adhere in their investment of Plan assets. The Federal legislation, H.R. 11700, permitting the transactions called for in the November 26, 1976 Agreement, is viewed by many as merely an isolated waiver of already lax Internal Revenue Code standards, due to an extraordinary situation in New York, and not as an approval by the Congress of the investment of huge portions of the Retirement Systems' assets in MAC securities. Another important point on which reasonable persons have expressed sharply differing views is the desirability of the original MAC Bonds as an investment vehicle. As you indicate at page 6 of your November 1, 1976 letter, Standard and Poor's has reaffirmed its "A+" rating of the MAC Bonds in question. It is equally true, and equally important, that the Congress be aware that Moody's sharply lowered its rating of the same Bonds. Other important elements that must be brought to the attention of Congress are the substantive challenges to the legality of various parts of the Agreement and related developments which are now pending in both state and federal courts. The recent public statements by Mr. Rohatyn and others, to the effect that despite great progress that has already been made, significant problems still remain, must be included in any Report that is truly complete.

In short, Mr. Keilin, it is my belief that the events surrounding the Systems' substantial investment in MAC and other government Bonds (as part of the Agreement in November 26, 1975), can be interpreted in sharply differing ways by persons who are acting reasonably and in good-faith. The Report which this Subcommittee is mandated to prepare for the Congress, if it is to be a complete and useful document, must sensitively and justly present these varying interpretations.
Your submission is an extremely effective articulation and interpretation of the events with which we are concerned, and will be closely studied by this Subcommittee. Your offer of future assistance and cooperation is also earnestly appreciated. I am confident that a Report can be prepared which will present a true picture of PERS in the United States today, including the New York City Retirement Systems, and that the goal of meaningful reform in these systems, to the betterment of both plan participants and plan sponsors, will thereby be furthered.

With every kind regard, I am

Sincerely yours,

JOHN H. DENT
Chairman

JHD:sh
November 1, 1976

Hon. John H. Dent  
Chairman Subcommittee on Labor Standards 
United States House of Representatives 
House Office Building 
Room 2104 
Washington, D. C.  20515

Dear Mr. Chairman:

We thank you for this opportunity to comment upon the draft staff report of the Pension Task Force of the Subcommittee as such draft relates to the Municipal Assistance Corporation For The City of New York (the "Corporation") and its efforts to aid The City of New York (the "City") to avoid default, bankruptcy and the fiscal and social chaos that would inevitably follow.

The Corporation shares your belief that there is much valuable and useful work to be done by Congress in this area and that such work requires thorough and careful analysis of the many complex factors involved.

The Corporation first became aware of the draft report from the press account in the New York Daily News. No one at the Corporation had been asked by the staff to make any presentation to it or otherwise to reflect upon or contribute to its work. This is unfortunate, because we believe that those of us who have lived with and worked on the City's problems for the last year and a half can make a substantial contribution to the staff's understanding of several of the areas covered by the draft report.
The draft of the staff report which we have been given contains sections dealing with the Corporation, the City and the City Pension System which, we believe, do not take full account of the complex economic, legal and social issues involved in the City's fiscal emergency or the monumental efforts of the State and Federal Governments to deal with the emergency. In the judgment of the Corporation, the course outlined in the draft would inevitably lead to a massive default by the City, not only upon its debt obligations, but also upon its obligations to its employees and pensioners.

November 26, 1975 Agreement

The draft report criticizes the agreement by the five City Pension Funds to invest up to an aggregate of $2.53 billion in bonds of the City or, in certain limited amounts, in bonds of the Corporation.

This commitment to invest is reflected in a voluntary agreement, dated November 26, 1975 (Appendix A), among the Corporation, the eleven New York City commercial banks that are members of the Clearing House Association, the five City Pension Funds which make up the City Pension System and the City Sinking Funds. The November 26 Agreement was the result of extensive negotiations among the parties carried on in early November, 1975. It is one of the interdependent pieces of a financial plan to provide funds desperately needed by the City not only to avoid default on its outstanding debt obligations, but also to provide it with the cash to meet its operating needs during the three-year period during which the City's budget is to be brought into balance as provided in the emergency legislation passed by the State of New York. The November 26 Agreement was also, we believe, a key element underlying the passage by this Congress of the New York City Seasonal Financing Act of 1975 (Appendix B), pursuant to which the Federal government entered into a Credit Agreement (Appendix C), under which it is providing up to $2.3 billion of essential intra-year seasonal financing for the City.

The voluntary agreement of the Pension Funds to purchase bonds of the City or of the Corporation, as reflected in the November 26 Agreement, is but one of many drastic and unprecedented steps taken during 1975 in order to attempt to solve, on a long-range basis, the financial crisis of the City. The State of New York created the Municipal Assistance Corporation For The City of New York by statute in June, 1975 (Appendix D), established the Emergency Financial Control Board by statute in September, 1975 (Appendix E), and enacted legislation imposing a moratorium on payment of principal on
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards


Solution of that financial crisis was believed by all of the participants in such program, including representatives of the Pension System, to be necessary not only to insure that the City would be able to continue to provide essential services to its inhabitants, but also to continue to meet its obligations, and those of its Pension System, to its employees and to those former employees who had retired and were receiving benefits under the Pension System.

The November 26 Agreement incorporates numerous safeguards for the Pension System. First, the $2.53 billion is not to be invested at one time. Rather, it is scheduled to be invested over the entire length of the three-year financial plan during which the City must balance its budget. The schedule of purchases was designed so as not to interfere with the obligations of the Pension System to retired employees. In this connection, liquidity of the other investments of the Pension System and the scheduled cash infusions by the City in the Pension System were taken into account in determining the investment schedule under the November 26 Agreement.

Second, a lengthy list of conditions to obligations of the Pension System to make such investments was included in the November 26 Agreement, at the request of representatives of the Pension System, including the following: the City must be current in the payment of principal and interest on all of its bonds; the City must be current in its contributions to the Pension System; and the City must have received seasonal aid from the Federal government. In addition, the November 26 Agreement requires the City, for the first time, to deliver a full disclosure statement to the Pension System in connection with its purchases of City bonds. There are a total of nine conditions, built into the November 26 Agreement, to the obligations of the Pension System to purchase City bonds thereunder.

State Legislation

In December 1975, after careful consideration and extensive discussions with representatives of the City Pension System and their counsel, the State legislature passed an act designed to clarify the obligations of the Trustees of the Pension System in respect to their purchases of bonds of the City or of the Corporation. This act
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards  

provides, in part, that the Trustees of the Pension System:

"...in determining investments by such systems and funds may consider, in addition to other appropriate factors recognized by law, 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) protect the sources of funds to provide retirement benefits for members and beneficiaries of such systems and funds."

As can be seen, this enactment permits the Pension System, as a matter of law, to take into account (in addition to and not in substitution for other considerations required to be taken into account) all of the economic realities involved. It permits the Trustees to recognize, if in their judgment they think it correct, that the continued existence of the City as a financially viable entity and its continued ability to make payments to the Pension System may be vital to the continued ability of the Pension System to provide the required benefits to all members of the System, including persons already retired and receiving benefits. The legislation recognizes that to do otherwise would be foolishly short-sighted and might lead to a destruction of the Pension System rather than its preservation.

The draft report includes an incorrect reference to the Saglione decision, which involved a legislative requirement that the State Pension Funds invest in the Corporation's securities. In contrast, the legislation described above does not interfere with the discretion of the Pension System with respect to whether to invest in bonds of the Corporation or those of the City. It recognizes that such investments may be made only voluntarily.

Federal Legislation

A striking irony of the draft report is that it omits a discussion of the legislation previously passed by this Congress, after a full hearing, that recognizes and approves of the investment program that the report now criticizes.

In February of 1976, this Congress passed a Bill designated H.R. 11700 (Appendix G). That bill was
was designed to exclude from the operation of Section 503(b) of the Internal Revenue Code all transactions provided for in the November 26 Agreement by each member of the City Pension System and to make clear that such transactions do not adversely affect the qualifications of any such member under Section 401 (a) of the Code. These clarifications were necessary in order to permit the Trustees of the Pension System to make the investments in bonds of the City or the Corporation contemplated by the November 26 Agreement.

In addition, H.R. 11700 tracks the language of the State legislation discussed above to the effect that the Trustees may consider, without violating the provisions of Section 401 (a) of the Code, the extent to which such investments maintain the ability of the City to make future contributions to, and satisfy future obligations to pay benefits under, the Pension System and protect the sources of funds to provide retirement benefits.

The identical questions of policy and prudence that are now raised by the draft report were raised by H.R. 11700, albeit in the context of the Internal Revenue Code "qualification" principles. Witness after witness testified that the investments contemplated by the November 26 Agreement were, based on all relevant factors, necessary and appropriate for the Pension System (Appendix H). The Corporation believes that judgments reflected in the passage of H.R. 11700 continue to be correct.

Furthermore, as stated by Congressman Ullman on the floor of the House on behalf of the Ways and Means Committee which considered the bill, "H.R. 11700 is designed to complete the Federal Government's role in assisting the City of New York to achieve an orderly restructuring of its finances." It reflects the considered judgment of the Federal government -- which judgment was first reflected in the New York City Seasonal Financing Act of 1975 -- that the preservation of The City of New York as a financially viable entity is of primary concern to the Federal government as well as to all of the citizens of the City including its pension beneficiaries. The investment program reflected in the November 26 Agreement is an integral part of the financial emergency program, was a prerequisite to the willingness of the Congress to adopt the New York Seasonal Financing Act of 1975 and has been scrutinized and approved by Congress in its passage of H. R. 11700.

Bonds of the Corporation and the City

Finally, we would like to comment upon soundness of bonds of the Corporation and bonds of the City which the
Hon. John H. Dent
Chairman Subcommittee on Labor Standards

draft report criticizes as unsound investments.

Bonds of the Corporation are backed by a sound revenue stream derived from State sales tax, stock transfer tax and State aid sources. Conservative coverage tests have been built into the Corporation's general bond resolutions to insure adequate sources of funds to pay debt service on all of its bonds. The Corporation is current in payment of both principal and interest on all of its bonds.

Although the bond market originally reflected substantial confusion as to the soundness of the Corporation's bonds, recently such confusion has largely been dissipated and the market in the Corporation's bonds has strengthened substantially. In addition, in connection with the marketing of the Corporation's bonds, both publicly and to the Pension System, disclosure statements have been issued that are largely unprecedented in their thoroughness and detail with respect to the sources of payment and other factors affecting the bonds. Further, the Pension System's present holdings of Corporation bonds are entirely of bonds on which Standard and Poor's has reaffirmed its "A+" rating.

As far as the City bonds are concerned, it should be noted that the City is current in payment of both principal and interest on all of its outstanding bonds. City bonds, unlike its notes, are not affected by the Emergency Moratorium Act.

In addition, the City has prepared and issued to the Pension System, in connection with purchases of City bonds under the November 26 Agreement, an official statement that discloses in great detail the factors affecting payment of City bonds.
Conclusion

By its adoption of the New York City Seasonal Financing Act of 1975 and H.R. 11700, Congress took a responsible leadership position in recognizing that the financial viability of The City of New York is vital to the interests of the nation and that continued investments by the City Pension System in bonds of the City, or bonds of the Corporation, are in the best interests of the pension beneficiaries of the City Pension System. Accordingly, we recommend further study and analysis of this complex and important subject that would take into consideration the material outlined in this letter, as well as the Congressional policies reflected in those prior actions.

We thank you for giving us this opportunity to express our views on this vital matter. We have instructed our staff and our counsel to stand ready to give you and your staff any assistance you think useful. In addition, members of the Board of the Corporation will be available to consult with you or to testify before your Subcommittee.

Respectfully submitted,

MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

By

Eugene Keilin, Executive Director

Enclosures
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards  
United States House of Representatives  
House Office Building  
Room 2104  
Washington, D.C.  
20515

SCHEDULE OF APPENDICES

Appendix A Amended and Restated Agreement of November 26, 1975.


11/1/76
Mr. Felix G. Rohatyn  
Lazard, Freres & Co.  
1 Rockefeller Plaza  
New York, New York

Dear Felix:

I enclose a revised draft of the letter to Congressman Dent. This draft letter responds to the draft staff report that was critical to New York City Pension System investments in bonds of the City and the Corporation.

Steve Weinstein and I have redrafted the letter to Congressman Dent in order to soften its attack upon the draftsmen of the staff report.

I am also sending copies of this new draft to Steve for review by him, Gene and Paul. I believe that they will send a copy of the draft to Jim LaRocca for his review.

Please give your thoughts and comments to either Steve or me.

Best regards.

Sincerely,

Allen L. Thomas

ALT:mp
Enclosure
BY HAND

cc: Stephen J. Weinstein  
Melvin L. Heineman  
w/enclosure  
By Hand
Hon. John H. Dent
Chairman Subcommittee on Labor Standards
United States House of Representatives
House Office Building
Room 2104
Washington, D.C. 20515

Dear Mr. Chairman:

We thank you for this opportunity to comment upon the draft staff report of the Pension Task Force of the Subcommittee as such draft relates to the Municipal Assistance Corporation For The City of New York (the "Corporation") and its efforts to aid The City of New York (the "City") to avoid default, bankruptcy and the fiscal and social chaos that would inevitably follow.

The Corporation shares your belief that there is much valuable and useful work to be done by Congress in this area and that such work requires thorough and careful analysis of the many complex factors involved.

The Corporation first became aware of the draft report from the press account in the New York Daily News.
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

No one at the Corporation had been asked by the staff to make any presentation to it or otherwise to reflect upon or contribute to its work. This is unfortunate, because we believe that those of us who have lived with and worked on the City's problems for the last year and a half can make a substantial contribution to the staff's understanding of several of the areas covered by the draft report.

The draft of the staff report which we have been given contains sections dealing with the Corporation, the City and the City Pension System which, we believe, do not take full account of the complex economic, legal and social issues involved in the City's fiscal emergency or the monumental efforts of the State and Federal governments to deal with the emergency. In the judgment of the Corporation, the course outlined in the draft would inevitably lead to a massive default by the City, not only upon its debt obligations, but also upon its obligations to its employees and pensioners.

November 26, 1975 Agreement

The draft report criticizes the agreement by the five City Pension Funds to invest up to an aggregate of $2.53 billion in bonds of the City or, in certain limited amounts, in bonds of the Corporation.
Hon. John H. Dent
Chairman Subcommittee on Labor Standards

This commitment to invest is reflected in a voluntary agreement, dated November 26, 1975, among the Corporation, the eleven New York City commercial banks that are members of the Clearing House Association, the five City Pension Funds which make up the City Pension System and the City Sinking Funds. The November 26 Agreement is the result of extensive negotiations among the parties carried on in early November, 1975. It is one of the interdependent pieces of a financial plan to provide funds desperately needed by the City not only to avoid default on its outstanding debt obligations, but also to provide it with the cash to meet its operating needs during the three-year period during which the City's budget is to be brought into balance as provided in the emergency legislation passed by the State of New York. The November 26 Agreement was also, we believe, a key assumption underlying the passage by this Congress of the New York City Seasonal Financing Act of 1975, pursuant to which the Federal government is providing up to $2.3 billion of essential intra-year seasonal financing for the City.

The voluntary agreement of the Pension Funds to purchase bonds of the City or of the Corporation, as reflected in the November 26 Agreement, is but one of many drastic and unprecedented steps taken during 1975 in order to
attempts to solve, on a long-range basis, the financial crisis of the City. Solution of that financial crisis was believed by all of the participants in such program, including representatives of the Pension System, to be necessary not only to insure that the City would be able to continue to provide essential services to its inhabitants, but also to continue to meet its obligations, and those of its Pension System, to its employees and to those former employees who had retired and were receiving benefits under the Pension System.

The November 26 Agreement incorporates numerous safeguards for the Pension System. First, the $2.53 billion is not to be invested at one time. Rather, it is scheduled to be invested over the entire length of the three-year financial plan during which the City must balance its budget. The schedule of purchases was designed so as not to interfere with the obligations of the Pension System to retired employees. In this connection, liquidity of the other investments of the Pension System and the scheduled cash infusions by the City in the Pension System were taken into account in determining the investment schedule under the November 26 Agreement.

Second, a lengthy list of conditions to obligations of the Pension System to make such investments was
Hon. John H. Dent
Chairman Subcommittee on Labor Standards

included in the November 26 Agreement, at the request of representatives of the Pension System, including the following: the City must be current in the payment of principal and interest on all of its bonds; the City must be current in its contributions to the Pension System; and the City must have received seasonal aid from the Federal government. In addition, the November 26 Agreement requires the City, for the first time, to deliver a full disclosure statement to the Pension System in connection with its purchases of City bonds. There are a total of nine conditions, built into the November 26 Agreement, to the obligations of the Pension System to purchase City bonds thereunder.

State Legislation

In December 1975, after careful consideration and extensive discussions with representatives of the City Pension System and their counsel, the State legislature passed an act designed to clarify the obligations of the Trustees of the Pension System in respect of their purchases of bonds of the City or of the Corporation. This act provides, in part, that the Trustees of the Pension System:

"... in determining investments by such systems and funds may consider, in addition to other appropriate factors recognized by law, the extent to which such investments will (a) maintain the ability of the city of New York (l) to make future contributions to such
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

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) protect the sources of funds to provide retirement benefits for members and beneficiaries of such systems and funds."

As can be seen, this enactment permits the Pension System, as a matter of law, to take into account (in addition to and not in substitution for other considerations required to be taken into account) all of the economic realities involved. It permits the Trustees to recognize, if in their judgment they think it correct, that the continued existence of the City as a financially viable entity and its continued ability to make payments to the Pension System may be vital to the continued ability of the Pension System to provide the required benefits to all members of the System, including persons already retired and receiving benefits. The legislation recognizes that to do otherwise would be foolishly short-sighted and might lead to a destruction of the Pension System rather than its preservation.

The draft report includes an incorrect reference to the Sgaglione case, which involved a legislative direction to the State Pension Funds to invest in the Corporation's securities. In contrast, the legislation described above does not interfere with the discretion of the Pension System
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

with respect to whether to invest in bonds of the Corporation or those of the City. It recognizes that such investments may be made only voluntarily.

Federal Legislation

A striking irony of the draft report is that it omits a discussion of the legislation previously passed by this Congress, after a full hearing, that recognizes and approves of the investment program that the report now criticizes.

In February of 1976, this Congress passed a Bill designated H.R. 11700. That Bill was designed to exclude from the operation of Section 503(b) of the Internal Revenue Code all transactions provided for in the November 26 Agreement by each member of the City Pension System and to make clear that such transactions do not adversely affect the qualification of any such member under Section 401(a) of the Code. These clarifications were necessary in order to permit the Trustees of the Pension System to make the investments in bonds of the City or the Corporation contemplated by the November 26 Agreement.

In addition, H.R. 11700 tracks the language of the State legislation discussed above to the effect that the Trustees may consider, without violating the provisions of Section 401(a) of the Code, the extent to which such
investments maintain the ability of the City to make future contributions to, and satisfy future obligations to pay benefits under, the Pension System and protect the sources of funds to provide retirement benefits.

The identical questions of policy and prudence that are now raised by the draft report were raised by H.R. 11700, albeit in the context of the Internal Revenue Code "qualification" principles. Witness after witness testified that the investments contemplated by the November 26 Agreement were, based on all relevant factors, necessary and appropriate for the Pension System. The Corporation believes that judgments reflected in the passage of H.R. 11700 continue to be correct.

Furthermore, as stated by Congressman Ullman on the floor of the House on behalf of the Ways and Means Committee which considered the Bill, "H.R. 11700 is designed to complete the Federal Government's role in assisting The City of New York to achieve an orderly restructuring of its finances." It reflects the considered judgment of the Federal government -- which judgment was first reflected in the New York City Seasonal Financing Act of 1975 -- that the preservation of The City of New York as a financially viable entity is of primary concern to the Federal government as well as to all of the citizens of the City including its
pension beneficiaries. The investment program reflected in the November 26 Agreement is an integral part of the financial emergency program, was a prerequisite to the willingness of the Congress to adopt the New York Seasonal Financing Act of 1975 and has been scrutinized and approved by Congress in its passage of H.R. 11700.

Bonds of the Corporation and the City

Finally, we would like to comment upon soundness of bonds of the Corporation and bonds of the City which the draft report criticizes as unsound investments.

Bonds of the Corporation are backed by a sound revenue stream derived from State sales tax, stock transfer tax and State aid sources. Conservative covenants tests have been built into the Corporation's general bond resolutions to insure adequate sources of funds to pay debt service on all of its bonds. The Corporation is current in payment of both principal and interest on all of its bonds.

Although the bond market originally reflected substantial confusion as to the soundness of the Corporation's bonds, recently such confusion has largely been dissipated and the market in the Corporation's bonds has strengthened substantially. In addition, in connection with the marketing
of the Corporation's bonds, both publicly and to the Pension System, disclosure statements have been issued that are largely unprecedented in their thoroughness and detail with respect to the sources of payment and other factors affecting the bonds.

As far as the City bonds are concerned, it should be noted that the City is current in payment of both principal and interest on all of its outstanding bonds. City bonds, unlike its notes, are not affected by the Emergency Moratorium Act.

In addition, the City has prepared and issued to the Pension System, in connection with purchases of City bonds under the November 26 Agreement, an official statement that discloses in great detail the factors affecting payment of City bonds.

**Conclusion**

By its adoption of the New York City Seasonal Financing Act of 1975 and H.R. 11700, Congress took a responsible leadership position in recognizing that the financial viability of The City of New York is vital to the interests of the nation and that continued investments by the City Pension System in bonds of the City, or bonds of the Corporation, are in the best interests of the
Hon. John H. Deit
Chairman Subcommittee on Labor Standards

pension beneficiaries of the City Pension System. Accordingly, we recommend further study and analysis of this complex and important subject that would take into consideration the material outlined in this letter as well as the Congressional policies reflected in those prior actions.

We thank you for giving us this opportunity to express our views on this vital matter. We have instructed our staff and our counsel to stand ready to give you and your staff any assistance you think useful. In addition, members of the Board of the Corporation will be available to consult with you or to testify before your Subcommittee.

Respectfully submitted,

MUNICIPAL ASSISTANCE CORPORATION
FOR THE CITY OF NEW YORK

By
Felix G. Rohatyn, Chairman

By
George D. Gould, Chairman
of the Finance Committee
MEMORANDUM

To Messrs. Felix C. Rohatyn
    George D. Gould
    Melvin L. Heineman
    Herbert Elish
    Eugene J. Keilin
    Stephen J. Weinstein

From Allen L. Thomas

Subject Response to Draft Report of House Subcommittee on Labor Standards Pension Task Force

I enclose a draft response addressed to Congressman Dent, as Chairman of the Subcommittee, with respect to the draft report of the Subcommittee's staff which criticized purchases by the New York City Pension Funds of MAC bonds and those of the City. For your information, I also enclose a copy of the draft report and of the New York Daily News story on that draft report.

As you know, we had originally intended to testify before the Subcommittee on this subject. When that scheduled testimony was cancelled and the draft report remanded for further study by the staff, Congressman Dent, through Jim LaRocca of the State's Washington office, asked that we submit our "rebuttal" in letter form to him as Chairman of the Subcommittee.

May I please have the comments and suggestions of each of you. I will incorporate them in a revised draft. I suggest that we send the revised draft to Jim LaRocca for his review (and if he thinks appropriate, for the review of Congressman Dent) prior to putting the letter
in final form for formal submission to the Congressman.

A.I.T.
September 28, 1976

Dear Herb:

The staff draft report which reached the Daily News was the work of a single-minded and troublesome young fellow who deliberately kept his handiwork from all of us - his Chairman, New York State, New York City, and AFSCME, to name a few. The leak was apparently the work of the unthinking staff of a New York Delegation Member - in obvious ignorance of the significance of its contents.

I frankly know of no way to protect against these kinds of circumstances.

Working with AFSCME and others, we have isolated the report for what it is, i.e. the draft of a single staff member. The Subcommittee will not adopt it, and further study has been directed. George Gould and Allen Thomas and I have been in touch in preparing MAC's input.

The author of the staff draft has a long history of trouble-making and is leaving the Hill as of November 1st. This latest flap apparently helped accelerate his departure date.

Herb, we live with a great number of frustrations in the Washington office, including criticism for events over which we cannot exercise control. This was one of those events.

Sincerely,

James L. Larocca

Mr. Herbert Elish
Executive Director
Municipal Assistance Corporation
for the City of New York
Two World Trade Center
New York, New York 10047

cc: David Burke
Felix Rohatyn
September 22, 1976

Mr. Jim La Rocca
Deputy Secretary to the Governor
New York State Washington Office
1612 K Street, NW, Suite 810
Washington, D.C. 20006

Dear Jim:

We at MAC were stunned to see the headline in the Daily News of Tuesday, September 21, about the House Labor Subcommittee Report criticizing the City pension funds' investment in MAC and City bonds.

This report is potentially very damaging to our efforts. If we had had information about it before it was available to the newspapers, we might have been able to contact the staff and provide information to influence the result.

We would like to know whether or not you have the resources and can attempt to get information about reports such as this while they are being prepared and when we can possibly affect the final product. We would very much like to avoid a recurrence of this situation.

Sincerely,

Herbert Elish

cc: David Burke
Felix Rohatyn
INTERNAL RESERVE CODE OF 1991–NEW YORK
PRINCIPAL LAWS 3405–3407: EFFECTIVE JULY 1996

1. MINIMUM ASSETS REQUIRED TO BE MAINTAINED
2. EXEMPTIONS FROM THE APPLICATION OF THE CODE
3. APPLICATION OF THE CODE TO INDIVIDUALS AND CORPORATIONS
4. RESPONSIBILITY FOR COMPLIANCE WITH THE CODE
5. PENALTIES FOR NON-COMPLIANCE WITH THE CODE
6. AMENDMENTS TO THE CODE

This document contains important information regarding the Internal Reserve Code of 1991–New York, including the minimum assets required to be maintained, exemptions from the application of the code, and penalties for non-compliance. It is essential to consult this code for compliance with state regulations.
MEMORANDUM

March 9, 1976

TO: THE CORPORATION COUNSEL
THE FIRST ASSISTANT CORPORATION COUNSEL

FROM: MR. FRIEDLANDER AND MR. GENN

RE: ATTACHED MATERIAL RELATING TO
H.R. 11700 (PROHIBITED TRANSACTIONS FEDERAL LEGISLATION).

The attached material consists of the following:

(1) Memorandum of March 9, 1976 to Front
Office regarding February 24, 1976
mark-up session of House Ways and Means
Committee.

(2) Copy of pamphlet on bill prepared by
Joint Committee on Internal Revenue
Taxation.

(3) Copy of pages of Congressional Record of
March 1, 1976 showing amended text of bill
and its passage by the House of Represen-
tatives.

We were advised on March 8, 1976 by the City's Washington
office that the amended version of H.R. 11700 (as printed in
the Congressional Record), having been passed by the House of
Representatives on March 1, 1976 and by the Senate on March 4,
1976, is before the President for executive action.
MEMORANDUM

March 9, 1976

TO: THE CORPORATION COUNSEL
THE FIRST ASSISTANT CORPORATION COUNSEL

FROM: MR. FRIEDLANDER AND MR. GENN

Re: Amendments to H.R. 11700
(relating to exemption of City pension systems from "exclusive benefit" and "prohibited transactions" rules) made at "mark-up" session of House Ways and Means Committee held on February 24, 1976

The purpose of this memorandum is:

(a) to summarize the proceedings of the House Ways and Means Committee on February 24, 1976 in relation to the amendments to H.R. 11700 made at the Committee mark-up session held on that date; and

(b) to provide an office record as to these proceedings, for future reference.

Dr. Woodworth, a member of the staff of the Joint Committee on Internal Revenue Taxation, made the presentation of the terms, purposes and effects of the bill to the Ways and Means Committee. He was assisted by a number of staff members of the Joint Committee, including Mr. Strauss,
Mr. Lieber and Ms. Metzer. He was also assisted by Mr. Weintraub, special counsel to the Secretary of the Treasury.

The City's representatives at this Ways and Means Committee meeting, consisting of Peter Kiernan, Assistant to the Deputy Mayor for Finance, Bruce Kirschenbaum, Director of the City's Washington Office, Jonathan Schwartz, Chief City Actuary and myself, were not called upon to make any statement. Accordingly, we attended as observers.

In general, Dr. Woodworth's presentation followed the discussion of the bill set forth in the Joint Committee pamphlet on the bill, a copy of which is attached to this memorandum.

**Amendment to Subsection (a)(2)**

At one point in his remarks, Dr. Woodworth stated that the November 26, 1975 Agreement among MAC, the banks, the City pension funds and the City sinking funds expires in 1978. He referred to Subsection (a)(2) of the bill, which (before the February 24, 1976 amendments) provided in substance that the City pension funds shall not be deemed to be in violation of the "exclusive benefit" and "prohibited transactions" Internal Revenue Code provisions if they consider, on or after August 2, 1975 and before July 1, 1986, in determining investments, certain matters. These matters
are the extent to which the investments in question will enable the City to make its contributions to the pension funds and performance of the City's guarantee of payment of benefits to fund members and beneficiaries (the "City-survival-assures-pension-fund-survival standard").

Dr. Woodworth said that since the November 26, 1975 Agreement expires in 1978 (apparently meaning that the City pension fund purchases of City bonds are to be completed in the City's 1977-1978 fiscal year), there was no need for the Subsection (a)(2) 1986 date referred to above. Accordingly, he recommended to the Committee that the July 1, 1986 date be changed to December 31, 1978.

While Dr. Woodworth was making these statements, the City representatives conducted a quick discussion among themselves as to the effects of this proposed amendment on the pension fund actions called for by paragraph 3 of the November 26, 1975 Agreement.

Paragraph 3 relates to approximately $1 billion of City short-term notes held by the pension funds and the banks. Under paragraph 1 of the Agreement, the pension funds and the banks in effect agree to hold these notes subject to the moratorium and to refrain from exchanging the notes for MAC bonds under any MAC exchange offer. Paragraph 3 provides insubstance that after the moratorium (or any renewal or ex-
tension thereof), the pension funds and banks will, by renewal or exchange or purchase of City notes or by agreement as to presentation of the notes for payment or by contractual deferment of maturity dates, make arrangements whereby the principal of the notes will be paid off at a prescribed rate so that final maturity of any note held or acquired subject or pursuant to paragraph 3 will be no later than July 1, 1986.

Thus, under the elections available to the pension funds and banks under paragraph 3, they could be renewing, purchasing or exchanging City notes (i.e., acting under the Agreement) up to July 1, 1986.

Apparently Dr. Woodworth did not have paragraph 3 in mind when he referred to the November 26, 1975 Agreement as expiring in 1978.

The City representatives decided not to attempt to interrupt Dr. Woodworth and express objections to his proposed change of July 1, 1986 in Subsection (a)(2) to December 31 1978, for the following reasons:

1. Subsection (a)(1) of the Agreement provides in substance, among other things, that the pension funds are not to be deemed in violation of the "exclusive benefit" and
"prohibited transactions" provisions where they acquire or hold any City note the acquisition or holding of which is provided for in the Agreement, or make any election provided for by the Agreement or perform any other act provided for by the Agreement. It therefore seems clear that subsection (a)(1) would effectively prevent Internal Revenue Service from claiming that any actions of the pension funds taken up to July 1, 1986 in relation to City notes pursuant to paragraph three would violate the "exclusive benefit" or "prohibited transactions" provisions. Thus, subsection (a)(1) protects the pension funds as to any transactions under the Agreement and subsection (a)(2) provides overlapping protection thereof which is not indispensable.

2. Messrs. Kiernan and Kirschenbaum had inforamtion to the effect that the recommendation for a change of July 1, 1986 in subsection (a)(2) to December 31,
1978 was not originated by the Joint Committee on Internal Revenue Taxation, but rather resulted from an unwillingness on the part of Ways and Means Committee members to approve legislation creating the appearance of long-term authorizations for actions of City officials in this area.

3. If any need for an amendment to subsection a(2) appears in 1978, it can be sought at that time.

The Ways and Means Committee accepted Dr. Woodworth's recommendation and voted to substitute December 31, 1978 for July 1, 1986 in subsection (a)(2).

Bill amendment relating to Secretary of Treasury approval of amendments to the November 26, 1975 Agreement and his approval of waivers of Agreement requirements

Lines 3 to 14 on page 4 of the bill set forth provisions of subsection (b) in general prescribing that any amendment of the Agreement of November 26, 1975 involving "exclusive benefit" or "prohibited transactions" matters and any waiver of Agreement requirements by a pension fund will not take effect unless the Secretary of the Treasury,
within 30 days after submission of the amendment or waiver to him, determines that such amendment or waiver is consistent with the "City-survival-assures-pension-fund-survival" standard.

On page 2 of a letter, dated February 4, 1976 to James La Rocca, Director of the Washington D.C. office of the State of New York, Donald F. Moore of Paul, Weiss, Rifkind, Wharton & Garrison, general Counsel for MAC, recommended that the above-described provisions set forth on lines 3-14 of page 4 of the bill be modified as follows:

"It would be preferable to provide that any such amendment or waiver becomes effective as of the date of the amendment or waiver with the proviso that it becomes ineffective for all purposes if the Secretary certifies within the stated period that it is inconsistent with the considerations set forth in subsection (a)(2)."

Mr. Moore, on page 3 of his letter, recommended that the following matter be substituted for above-mentioned lines 3-14:

"such amendment or waiver shall take effect for purposes of subsection (a) on the date of such amendment or waiver; provided, however, that 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 inconsistent with the considerations set forth in subsection (a)(2), in which event such amendment or waiver shall not be deemed to have been effective for any purpose."

At the Ways and Means Committee mark-up session of February 24, 1976, Representative Rangel moved to amend lines 3-14 on page 4 of the bill. I am informed that the text of his proposed amendment is the same as that recommended by Mr. Moore.

Representative Rangel's proposed amendment was voted by the Ways and Means Committee.

City's proposed addition to Ways and Means Committee's report on the bill

After the Ways and Means Committee had concluded its consideration of H R 11700, the City representatives conferred with Mr. Weintraub, and later with Dr. Woodworth and Messrs. Strauss and Lieber, concerning paragraph 3 of the Agreement (relating to City notes) and the amendment substituting December 31, 1978 for July 1, 1986 in subsection (a)(2).

Mr. Weintraub agreed that subsection (a)(2),
before the amendment, would have given the pension funds added protection as to transactions up to July 1, 1986 under paragraph 3 of the Agreement.

He suggested that a paragraph be added to the Ways and Means Committee's report on H R 11700, stating that the protection given the pension funds by the bill covers transactions underparagraph 3. This suggestion was accepted by the Joint Committee staff members.

Mr. Kiernan drafted and delivered to the Joint Committee office a proposed paragraph (concurred in by the other City representatives) to be included in the Committee report on the bill, with an accompanying explanatory note for the Joint Committee staff. The text of this material is as follows:

"Subsection (a)(1) of the Act covers, among other things, any exchange, renewal, rollover, or reinvestment, as provided for in the November 26, 1975 Agreement, of City Notes now held under the Moratorium.

For Report. Covers exchanges etc. provided for by Paragraph 3 of the Agreement. Pursuant to Paragraph 3, any such Notes, after expiration of the Moratorium, must mature no later than July 1, 1986. (See ¶ Paragraph 3 condition (A)"

Peter J. Kiernan
212-566-6722
Chairman Ullman of the Ways and Means Committee directed the Joint Committee staff to complete a revision of H R 11700, with the amendments made by the Committee, and a Committee report on the bill, by midnight, February 25th, 1976.

Copies to:

City officials

Deputy Mayor for Finance
Mr. Keilin
Mr. Kiernan
Mr. Kirschenbaum
Mr. Lewis
Mr. Wood
Mr. Hartman
Miss Friedwald
Mr. Schwartz

MAC and General Counsel to MAC

MR. Elish
MR. Keegan
MR. Moore
MR. Thomas
APPLICATION OF PENSION PROVISIONS TO NEW YORK CITY'S FINANCIAL PROBLEMS

PREPARED FOR THE USE OF THE COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

FEBRUARY 24, 1976
A. RECENT EVENTS RELATING TO NEW YORK CITY'S FINANCIAL DIFFICULTIES

Since March, 1975, a series of measures have been taken by the State of New York, City of New York, commercial banks, certain pension and sinking funds, and the Federal Government to alleviate the City of New York in its financial difficulties. In early April, the State provided an advance payment of $800 million to the City for welfare payments due in June, 1975. In May, the State advanced the City an additional $800 million advance payment for welfare funds due in July, 1975. In June, however, it became apparent that the City would be unable to market its securities. The State created the Municipal Assistance Corporation for the City of New York (MAC) with the authority to use $2 billion of its securities to finance the purchase of City notes. In the course of providing the City with a source of credit, MAC also rolled over much of the short-term obligations of the City into longer term MAC bonds with maturities of up to 15 years. MAC securities debt service payments are financed by receipts from the City's stock transfer and sales taxes. Also, MAC securities are backed by the "Moral Obligation" of the State.

In mid-July, 1975, MAC was experiencing difficulties in marketing its securities. Faced with almost certain default by the City, the State legislature passed the Financial Emergency Act which put together a $2.3 billion financing package to meet the City's financing needs through December, 1975. The legislation also created a seven-member Emergency Financial Control Board to administer the City's finances. The Board must adopt a three-year financial plan which moves the City toward a balanced budget by the end of the fiscal year (June 30) 1978. The Board must approve plans for decreasing the City's dependence on short-term borrowing to finance operating expenditures in the capital budget, for controlling growth in expenditures, and, if necessary, for freezing employee wages. In late October, 1975, the City presented to the Emergency Financial Control Board the three-year financial plan which was subsequently accepted.

By early November, 1975, it became apparent that Federal assistance would be a necessary ingredient to achieve complete and orderly restructuring of the City's finances. Also, it became apparent that temporary relief from short-term debt payments would be necessary. On November 14, 1975, the State legislature passed the Emergency Moratorium Act for New York City which established a conditional three-year moratorium on enforcement of outstanding short-term obligations of the City. The moratorium became effective only for those holders of City notes who are first offered an opportunity to exchange their short-term obligations for long-term MAC bonds.

To secure additional financing, the City entered into an agreement on November 26, 1975, with 11 New York commercial banks:1 five

---

pension funds, the emergency sinking fund, and the Municipal Assistance Corporation. The agreement of November 26, 1975, generally provides for purchases and exchanges of certain securities under specified conditions.

The pension funds agreed to purchase $2.33 billion of serial bonds of the City according to a schedule in the agreement and under certain conditions. In particular, these conditions include enactment by the State Legislature of legislation which was enacted on December 4, 1975, which indemnifies the trustees and others from financial loss arising from any suit resulting from the purchase by the funds of the securities, or resulting from the sale of assets held by the funds to purchase the securities. Also, their participation is conditioned on a favorable ruling by the Internal Revenue Service, or the passage of legislation by the Congress so that the purchases do not constitute prohibited transactions or otherwise adversely affect the tax-qualified status of the pension funds.

Participation of other parties to the agreement, most importantly the 11 commercial banks, is conditioned on participation of the pension funds.

Last December the Congress also provided assistance for New York City. After discussions with the Administration, the Congress provided for direct Federal loans which would be repayable at the end of each year to smooth the normal seasonal fluctuations of the City's budget receipts in each fiscal year. These loans cannot exceed $2.33 billion at any time. The bill, H.R. 10181 (Public Law 94-143) took effect December 9, 1975, and terminates June 30, 1978.

During December, the Internal Revenue Service twice provided restricted 'letters of intent to rule.' Several of these New York City pension funds relied on these letters of intent to purchase New York City securities.

B. PRESENT LAW REQUIREMENTS FOR STATE AND LOCAL GOVERNMENTAL PENSION PLANS

Present law generally provides qualified plans with substantial tax benefits. Employers, within certain limits, are permitted to deduct contributions made to these plans for covered employees; earnings on the plans' assets are exempt from tax; and covered employees defer payment of tax on employer contributions made on their behalf until they actually receive the benefits, generally after retirement when their incomes and as a result applicable tax rates tend to be lower.

Also, special 10-year income averaging is allowed for lump-sum distributions, and certain estate tax and gift tax exclusions are provided. The employers, which are governments in the case in point in this legislation, are not required to make contributions, and therefore obtain no benefit from tax deductions or the special tax-exempt status accorded trusts under qualified plans.

However, the tax benefits for government employees are sufficient to encourage the adoption of qualified plans by governmental units. As

---

1 New York City Employees Retirement System, Board of Education Retirement System for the City of New York, New York City Fire Department Pension Fund—Article 1-11; Teachers Retirement System for the City of New York, and the New York City Police Pension Fund.
2 Sinking Fund of the City of New York, Rapid Transit Sinking Fund of the City of New York, the Water Sinking Fund of the City of New York, and the Transit Subsidies Sinking Fund of the City of New York.
a result, many governmental units have established retirement plans designed to qualify under the Internal Revenue Code.

Under the code, a qualified plan must be for the exclusive benefit of employees and their beneficiaries. A plan or trust which breaches the exclusive benefit rule of the code is disqualified. If a government plan is disqualified, the special tax treatment for employees under qualified plans is denied. In such a case, the employees would be taxed currently on the value of their vested benefits, the special estate and gift tax exclusions would not be available, and no special treatment would be accorded to lump-sum distributions.

Under the Internal Revenue Code certain sanctions also are applied where a trust engages in a "prohibited transaction". The Employee Retirement Income Security Act of 1974 (ERISA) tightened the prohibited transaction requirements, but these new requirements are not applied to governmental plans. Therefore, the prohibited transactions of concern here are only those which were already in existence before ERISA was enacted.

Under the rules applicable to government plans, a pension trust which engages in a prohibited transaction loses its tax exemption (sec. 503(a)(1)(b)). For this purpose, a prohibited transaction is any transaction in which the trust lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to the creator of the trust, to a person who has made a substantial contribution to the trust, or to certain other persons. A trust may also breach the prohibited transaction rules, for example, if it makes any substantial purchase of securities or any other property for more than adequate consideration in money or money's worth from such a person or if it engages in any other transaction which results in a substantial diversion of its income or corpus to such a person (sec. 503(b)).

Generally, the Internal Revenue Service has treated a transaction which violates the prohibited transaction rules as a violation of the exclusive benefit rule. As indicated above failure to meet the exclusive benefit rule also can cause the disqualification of the trust and the plan of which the trust is a part.

C. Problems

Several of the steps taken by the City of New York to remedy its financial condition involve City pension funds. Under present law, the ability of these funds to assist the City without endangering their qualified status depends on the application of the exclusive benefit and prohibited transaction rules. For example:

1. Under the agreement of November 26, 1975, five New York City pension funds became obligated to retain certain securities of the City of New York and to purchase new debt of the City (and in some circumstances MAC). It may be argued that by entering into the agreement the funds violated the exclusive benefit rule.

---

*Further, a trust does not qualify unless under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be within the taxable year or thereafter used for or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries. (Sec. 401(a))

*The comparable provisions of ERISA administered by the Department of Labor are similarly inapplicable to governmental plans (ERISA sec. 401(b)).
(2) The funds may also be found in violation of the exclusive benefit rule if they retain City securities as required by the agreement of November 26, 1975 because it can be argued that this retention is not for the exclusive benefit of employees. In order to permit the trustees of the pension funds to take factors other than the exclusive benefit of employees into account in determining fund investments, on December 4, 1975, the State of New York adopted legislation permitting the trustees to take into account for investment purposes the extent to which investments will maintain the ability of the City of New York (1) to make future contributions to the retirement systems and funds, and (2) to satisfy its future obligations to pay pension and retirement benefits to members and beneficiaries of those systems and funds. The legislation also authorizes the trustees to take into account the extent to which investments will protect the source of funds to provide retirement benefits for members and beneficiaries of the retirement systems and funds. If these factors are taken into account New York State law (but not Federal law) in effect permits them to depart from the exclusive benefit rule.

(3) The agreement of November 26, 1975, requires the funds to acquire New York City (and in some circumstances MAC). To acquire the debt pursuant to the agreement, it is understood that the funds have been required to liquidate some of their investments under unfavorable market conditions. In addition, the liquidated investments may be less advantageous to employees than the New York City or MAC debt. Under these circumstances, they may be violating the exclusive benefit rule.

(4) The New York City debt to be acquired by the funds is backed by the credit of the City. Questions may be raised as to whether the security for the debt is adequate in view of the City's present problems, especially since the Internal Revenue Service has taken the position that the pledge of an employer's general assets does not provide adequate security for purposes of the prohibited transaction rules.

(5) In addition, funds available to pay off MAC bonds are limited to funds appropriated by the State of New York. At least two of the funds were created by the State of New York. If the MAC bonds are not backed by adequate security, their acquisition by these funds will violate the prohibited transaction rules.

D. BILL BEFORE COMMITTEE

Mr. Rangel, together with Mr. Pike and Mr. Conable, has introduced a bill (H.R. 11709) permitting the five pension funds to carry out the provisions of the agreement of November 1975, without being considered in violation of the exclusive benefit or the prohibited transaction rules.

More specifically, the bill provides that a pension plan or trust which, on December 5, 1975, was a party to the agreement of November 28, 1975 (and any trust forming a part of such a plan) will not be considered in violation of the exclusive benefit rule or the prohibited transaction rules of the code merely because it: (1) enters into the

---

Footnotes:
- H.R. 11709, which was introduced August 3, 1975, the funds acquired MAC debt which, as of November 26, 1975, amounted to $655 million.
- Rev. Est. 76-131, 1970-1 CTR. 135. The ruling does not specifically refer to an employer which is a government unit.
November 1975 agreement or agrees to an amendment to the agreement, 
(2) forbears from any act prohibited by that agreement, (3) acquires 
or holds any bond or note the acquisition or holding of which is 
provided for by the agreement, (4) makes any election provided for 
by the agreement, (5) executes a waiver of any requirement of the 
agreement, or (6) performs any other act provided for by the agree-
ment. In addition these plans or trusts can continue to hold any bond 
or note acquired or held pursuant to the agreement after the expiration 
of the agreement. As a result, the bill will add uncertainly as to 
whether these acts (or forbearance) violate the exclusive benefit rule 
or the prohibited transaction rules.

Even with respect to transactions not provided for by the agree-
ment the requirements of present law as to the exclusive benefit 
rule and the prohibited transaction rules are set aside only to the 
extent these investments will maintain the ability of the City of New 
York to make future contributions to the plans and trusts and to 
satisfy its future obligations to pay pension and retirement benefits to 
members and beneficiaries of the plans and trusts. The bill would also 
authorize the trustees to take into account the extent to which the 
investments will protect the sources of funds to provide retirement ben-
efits for members and beneficiaries of the plans and trusts. These fac-
tors, which correspond to the tests in the New York Act of December 
4, 1975, require a balancing of the interests of the employees (and 
their beneficiaries) and the City.

The factors set out above may be taken into account during the 
period beginning August 20, 1975 (the date MAC bonds were first 
acquired by the trusts) and ending June 30, 1986. Also, the bill pro-
vides that the exclusive benefit rule and the prohibited transaction 
rules will not be violated if, after June 30, 1986, the trustees consider 
these factors for purposes of determining whether to retain invest-
ments held on June 30, 1986. Because the pension funds purchased 
MAC bonds before the date of the agreement, and these purchases 
were not provided for by the agreement, the bill additionally provides 
the acquisition or holding of MAC bonds on or after August 20, 1975, 
and before November 26, 1975, are to be considered acquisitions and 
holdings provided for by the agreement.

The bill provides special rules with respect to amendments of the 
agreement and waivers of requirements of the agreement. Under these 
provisions, if an amendment of the agreement relates to activity (or 
forebearance) described in the bill, and is relevant in determining 
whether the exclusive benefit rule or the prohibited transaction rules 
of the code are satisfied, the amendment is to be considered a part 
of the agreement described in the bill if within 30 days after the 
amendment is submitted to the Secretary of the Treasury (or 30 days 
after the date of enactment of the bill, if later), the Secretary of 
the Treasury finds that the amendment is not inconsistent with a 
balanced policy of protecting the security of employee benefits and 
 improving the financial condition of the City of New York. Under the 
bill, any of these amendments must be consistent with the policy of 
maintaining the ability of the City of New York to make future con-
tributions to the plans and trusts and to satisfy its future obligations 
to pay pension and retirement benefits to members and beneficiaries of
the plans and trusts. Also, an amendment must be consistent with the
policy of protecting the sources of funds to provide retirement benefits
for members and beneficiaries of the plans and trusts. (These are the
same factors which the plans and trusts may consider in making in-
vestment decisions.) Similar rules would apply to waivers of require-
ments of the agreement. Of course, the fact that the bill does not rec-
ognize these amendments and waivers without the approval of the
Secretary of the Treasury does not prevent them from being effective
for other purposes.

To limit the duration of the special rules provided by the bill, the
bill provides that 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, is to be recognized for purposes of the bill.

Also, the bill provides that the pension plans and trusts are to fur-
nish to the Secretary of the Treasury a copy of their annual reports
filed with the New York State Insurance Department for each fiscal
year beginning after June 30, 1975, and ending before July 1, 1986.
These reports are to be filed with the Secretary of the Treasury not
later than 30 days after the date the reports are filed with the New
York State Insurance Department. In addition, the bill provides that
the plans are to furnish the Secretary of the Treasury with such addi-
tional information as he may reasonably require. The additional in-
formation could be required at more frequent intervals than the re-
ports. A copy of each report and the additional information furnished
to the Secretary of the Treasury is also to be furnished to the Chair-
man of the Committee on Ways and Means of the House of Repre-
sentatives and the Chairman of the Committee on Finance of the
Senate.

The bill will be effective on and after August 20, 1975.
As in the previous exposition resolutions, this measure does not involve any change in procedure for, or participation in, the exposition.

The United States remains the most important producer of machinery, new technology, and equipment for the recycling industry. In light of the ever-increasing costs of imported fuels, it is in the interest of all Americans to provide an arena where all the information is as possible, leading to sustainable and healthy decisions of payments. In the past these expenses have generated millions of dollars in sales of American industrial products.

For these reasons, Mr. Speaker, I urge all my colleagues to join with me in supporting House Joint Resolution 93, a non-controversial and highly beneficial resolution of the International Petroleum Expedition.

Mr. DIGGS, Mr. Speaker, I have no further requests for time.

The SPEAKER. The question is on the motion offered by the gentleman from Michigan (Mr. McGovern) to have the House consider the joint resolution (H.J. Res. 299).

The motion was taken and (two-thirds having voted in favor thereof) the rules were suspended and the joint resolution was passed. A motion to reconsider was laid on the table.

Mr. DIGGS, Mr. Speaker, I seek unanimous consent that the Committee on International Relations be discharged from further consideration of the Senate joint resolution 93 (H.J. Res. 299), authorizing the President to invite the States of the Union and foreign nations to participate in the International Petroleum Expedition to be held at Tulsa, Okla., from May 10, 1976, through May 22, 1976, and ask for its immediate consideration.

The Clerk read the title of the Senate joint resolution.

The SPEAKER. Is there objection to the request of the gentleman from Michigan?

There was no objection.

The Clerk read the Senate joint resolution, as follows:

H.J. Res. 299

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the President of the United States is authorized and requested to invite by proclamation, or in such other manner as he may deem proper, the States of the Union and foreign nations to participate in the International Petroleum Expedition, to be held at Tulsa, Okla., from May 10, 1976, through May 22, 1976, for the purpose of exhibing equipment, equipment, equipment, and other products used in the production and marketing of oil and gas, and to sell or grant permission for the promotion of foreign and domestic trade and commerce in such products.

The Senate joint resolution was ordered to be read a third time, was read the third time, and passed, and a motion to reconsider was laid on the table.

A similar House joint resolution (H.J. Res. 299) was passed by the House.

GENERAL LIAFKE

Mr. DIGGS, Mr. Speaker, I seek unanimous consent that all Members may have 5 legislative days in which to review and extend the terms of the joint resolution just passed.

The SPEAKER. Is there objection to the request of the gentleman from Maryland?

There was no objection.

MESSAGES FROM THE PRESIDENT

Mr. Speaker, in writing from the President of the United States, the following messages were transmitted to the House by Mr. Marks, one of his secretaries:

RELATING TO TRANSACTIONS BY CERTAIN PUBLIC EMPLOYEES RE- TIREMENT SYSTEMS COVERED BY THE FEDERAL INSURANCE POLITICAL SUBSIDIES

Mr. ULLMAN, Mr. Speaker, I move to suspend the rules and pass the bill H.R. 11790 relating to the application of certain provisions of the Internal Revenue Code of 1973 to certain public employee retirement systems covered by the State of New York or any of its political subdivisions, as amended.

The Clerk read as follows:

H.R. 11790

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the provisions of any pension plan or trust, which on December 3, 1978, was a party to the amended or restated agreement of November 20, 1975, set forth on pages 81601, 81603, and 81611 of the Congressional Record published on March 1, 1978, and which are to be automatically closed as part of such a plan, shall not be construed to fail to comply with the requirements of section 201 (a) of the Internal Revenue Code of 1973, as amended, and shall not be construed to have caused in a prohibited transaction described in section 403(b) of such Code on the date on which such plan or trust was closed.

This bill shall be effective on and after August 20, 1976.

The SPEAKER. Is a second demanded?

Mr. CONANT, Mr. Speaker, I demand a second.

The SPEAKER. Without objection, a second will be considered ordered.

There was no objection.

Mr. ULLMAN, Mr. Speaker, the President, in his message contains the request that the resolution be referred to the Committee on Finance of the Senate for consideration.

Mr. ULLMAN added and was given permission to revise and extend his remarks.

Mr. ULLMAN, Mr. Speaker, H.R. 11790 is designed to complete the Federal Government's role in reducing the city of New York's share of its total debt burden, and the Municipal Assistance and Reorganization Corporation in reorganization the city's public debt.

The bill allows New York City, under certain conditions, to operate in the city of New York, as the United States is authorized to acquire, hold, and sell the Municipal Assistance Corporation, H.R. 11790, and enter into any agreement or act to acquire, hold, or sell the Municipal Assistance Corporation, H.R. 11790, and enter into any agreement or hold any obligation of the Municipal Assistance Corporation for the city of New York on or after August 20, 1976, and before November 25, 1976, be considered an acquisition or holding pursuant to such agreement.

(b) In the case of—

(1) any amendment to the agreement described in subsection (a) with respect to the application of the Trustees set forth in subsection (a) to the requirements of sections 402(a) or 403(b) of the Internal Revenue Code of 1973 and which is adopted after December 3, 1975, and

(2) any amendments or modifications of the agreement by a plan or trust on or after December 3, 1975, such amendments or modifications shall take effect immediately and shall be treated as if they were made on the date on which a copy of such amendment or modification is submitted to the Secretary of the Treasury for purposes of subsection (a) as if the agreement were amended or modified in accordance with the requirements of section 403(b) of the Internal Revenue Code of 1973, if such amendments or modifications are otherwise in compliance with the requirements of section 403(b) of the Internal Revenue Code of 1973.

No amendment to the agreement which has the effect of extending the date of the operation of the plan in effect on or after December 3, 1975, shall take effect for purposes of subsection (a).

(c) The trustees of each pension plan or trust described in subsection (a) shall furnish to the Secretary of the Treasury 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 with the fiscal year in which the plan or trust was required to be operated in accordance with the requirements of subsection (a) unless the New York State Insurance Department, and shall furnish such additional reports and other information 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.

The resolution contains that the delegate is authorized to propose required regulations as may be necessary to carry out the purposes of this Act.

This bill shall be effective on and after August 20, 1976.

The SPEAKER. Is a second demanded?

Mr. CONANT, Mr. Speaker, I demand a second.

The SPEAKER. Without objection, a second will be considered ordered.

There was no objection.
Mr. BAUMAN. Mr. Speaker, the gentleman from Oregon raises a question to work. And I think that the Congress owes to the city of New York and to its taxpaying participants in that agreement to pass this legislation, at least, to give the city an opportunity to work. There may be problems ahead, and there may have to be further detailing in the agreement, but I think that the commercial men in New York do not have as serious a crisis as it has faced in the past. Of course, I cannot be sure if it will work, but I think we owe it to them to pass this legislation and at least give the city an opportunity to work.

Mr. RANGST. Mr. Speaker, will the gentleman yield?

Mr. DELANO. Mr. Speaker, in further response to the gentleman from Maryland, the trustees of the pension funds involved share the same concerns about the funds as the gentleman does. Furthermore, they have expressed their minds as to whether the purchase of the municipal obligations in fact violated the exclusion benefits and other provisions in the Internal Revenue Code.

The participation of the pension funds was made with the understanding that the purchase would not jeopardize the tax-exempt status of the funds. The Internal Revenue Service issued letters of Income which the pension funds relied on as assurance that bond purchases would not constitute unauthorized transactions. It was thus determined that congressional action would be necessary to avert the loss of tax-exempt status of the pension funds.

The Congress manifested its intent to assist the city of New York in December when it adopted H.R. 10641 providing up to $33.3 billion in Federal loans to the city of New York and the total proceeds of the bonds. The tax-exempt status of the bonds purchased by the city has been secured.

Mr. CONASHEL. Mr. Speaker, I yield myself such time as may be necessary.
agreement provides for the purchase by those pension plans of approximately $3.5 billion in bonds of the city, under certain conditions.

Those conditions, it is believed, would include first, the enactment of direct federal financial assistance to the city, second, enactment by the State of New York of legislation indemnifying the trustees of the pension plans and others from any financial loss arising from suit stemming from purchase of the bonds of either the city or the state, or from the sale of assets by the funds in order to make purchases, and third, receipt of either a favorable ruling from the Internal Revenue Service or passage of appropriate legislation by the Congress, to the effect that such purchases would not constitute "prohibited transactions" or otherwise have adverse income tax or other adverse impact upon the "qualified status" of the pension funds under the Internal Revenue Code. Participation of the other parties to the agreement, particularly the commercial banks, is conditioned upon participation of the pension funds.

In early December 1975, the New York State Legislature passed the appropriate legislation indemnifying trustees and others in the event of suit. In the meantime, also in December, Congress provided financial assistance to the city of New York to smooth out, by direct Federal loans, seasonal fluctuations in the city's budget receipts during the fiscal year. Last, the Internal Revenue Service provided restricted "letters of intent" to "rule" in December with respect to the acquisition by the funds of additional New York City debt securities.

This legislation is necessary in order to permit the funds to exist without endangering their tax-exempt status. Specifically, a qualified plan under the Internal Revenue Code must be for the "exclusive benefit" of employees and their beneficiaries. If a plan breaches this requirement, it will be disqualified. Should the New York City pension plans become disqualified, their special tax treatment would end and employees would no longer be taxed currently on the value of vested benefits. Special credits and offsetting tax exclusions would not be available, and lump sum distributions would be accorded special treatment.

Also, under rules applicable to government plans, a pension fund which engaged in a "prohibited transaction" would lose its tax exemption. Such prohibited transactions would include any in which the trust breached any part of its income or its principal, without receiving adequate assurance or a reasonable rate of return to the contribution made to the trust, any person who had made a substantial contribution to the trust, and any other person. A fund could also breach these rules by purchasing in substantial amounts securities or other property for more than adequate consideration, or by engaging in any act which resulted in substantial diversion of income or principal, to such a person.

Given the relationships between these funds and the city of New York, it is clear that permanence under the circumstances in the event of the purchase would raise a number of questions regarding whether or not the transactions. It was then determined that congressional action would be necessary to avert the loss of tax-exempt status of the pension funds.

The Congress insisted its intent to assist the city of New York beginning December when we adopted H.R. 10443 providing up to $3.3 billion if Federal loans in New York City, H.R. 1170B, is a necessary part of the local package of measures to save the city from default. The bill has the full support of the Treasury. I urge you to give it your support.

Gerald R. Ford

Mr. ULMAN. Mr. Speaker, I ask unanimous consent that Members may have a legislative day in which to review and extend their remarks on the legislation presently under consideration.

The SPEAKER. The question is, the gentleman from Oregon (Mr. ULMAN) that the House suspend the rules and pass the bill H.R. 1170B, as amended.

The Speaker took the question.

Mr. ASBIIDROOK, Mr. Speaker, I object to the vote on the ground that a quorum is not present and make the point of order that a quorum is not present.

The Speaker. Evidently a quorum is not present.

The Sergeant at Arms will notify absent Members.

The vote was taken by electronic device, and there were 286, noes 45, not voting 22, as follows:

[Roll No. 76]

YEAS--286

Ahern, waves lb., Connors, Don H.,

Alexander, Fairbanks, J.,

Andrews, D., Cleveland, D.,

Andrews, W., Connolly, C.,

Anderson, C., Costello, C.,

Anthony, B., Cotter, C.,

Anthony, I., Dainart, E.,

Arnold, H., Demon, R.,

Austin, D., Demazur, R.,

Averill, M., DeSalle, E.,

Baird, N., Delancy, J.,

Balch, D., Delaney, R.,

Ball, F., Delano, D.,

Balisterri, S., Delano, T.,

Barnard, A., Denton, D.,

Bartlett, R., Denney, H.,

Baskin, D., Derwin, W.,

Bayard, B., Dever, R.,

Beans, A., Dever, R.,

Beard, B., Dickey, R.,

Beckman, A., Dibb, H.,

Belcher, D., Diamante, L.,

Beliveau, J., Dingle, H.,

Benjamin, B., Doak, H.,

Benson, R., Doremus, J.,

Bernard, R., Dorman, D.,

Bertel, W., Dorsey, B.,

Bertino, J., Dorsey, L.,

Betz, J., Dorsey, T.,

Bianchi, B., Doughty, R.

Bissell, D., Downing, C.,

Blackwell, H., Donovan, B.,

Bland, G., Drake, J.,

Branum, R., Dregne, P.,

Brannan, I., Dreyer, R.,

Braswell, J., Dressler, R.

Brancher, M., drive, G.,

Braun, F., Dunn, P.

Buck, V. M., Dye, N.,

Bullock, P., Dye, R.,

Bull, W., Dye, R.,

Bull, W., Edgerton, C.

Buxton, J., Edgerton, T.,

Byrd, J., Edwards, C.,

Bryant, T., Edwards, J.

Bryson, T., Edwards, N.,

Bryan, H., Edwards, W.,

Bryan, W., Edwards, W.

Bunyan, J., Edwards, W.,

Bunyan, J., Edwards, W.

Bunyan, J., Edwards, W.

Bunyan, J., Edwards, W.

Bunyan, J., Edwards, W.

Bunyan, J., Edwards, W.

Bunyan, J., Edwards, W.

Bunyan, J., Edwards, W.

Bunyan, J., Edwards, W.
CONGRESSIONAL RECORD -- HOUSE

In recent years, our national sense of fairness and equity has led to an increasing number of Federal programs of aid to education. The Federal government has recognized a responsibility to help ensure adequate educational opportunities for those with special needs, such as the educationally deprived and the handicapped. We have appropriately provided States and communities with added resources to help them improve opportunities for all students. At the same time, we have enhanced our aid into too many narrow and restrictive categorical programs. As a result, we have made it more difficult for the schools to educate.

It is time that we reconcile our good intentions with the recognition that we at the Federal level cannot know what is best for every school child in every classroom in the country.

In my State of the Union address, I spoke of the need for a real real for a new vision and a new balance in our system of Federal support of education that respects the responsibility and freedom of the leaders of our State, local governments. Our experience in education demonstrates that these principles are not anathema to political considerations, but that the concrete actions we must take to help assure the survival of our system of free government. We must continually guard against Federal control over schools.

I am proposing today the Financial Assistance for Elementary and Secondary Education Act which will consolidate 21 existing programs into one block grant. The focus of this block grant will be on improved educational opportunities for those with special needs — the educationally deprived and the handicapped. Federal funds will be provided with a minimum of Federal regulations and an emphasis on local control. The proposal is based on the conviction that education needs can be most effectively and creatively met by allowing States greater flexibility in the use of Federal funds.

I am particularly pleased at the extent to which my proposal reflects extensive consultations with individuals, organizations representing publicly elected officials and leaders in the education community. The proposal has been modified and strengthened since the time of my State of the Union message as a result of suggestions we received. I am convinced it represents essential changes in our system of providing aid to education.

My proposals will consolidate programs in the following areas:

—Elementary and Secondary Education
—Education for the Handicapped
—Adult Education
—Vocational Education

To assure that students with special needs have the opportunity to participate in these programs, I propose legislation providing that 75 percent of a State's allocation be spent on the educationally deprived and the handicapped. This will ensure that our Federal efforts are directly benefiting those in need. The remaining 25 percent can be used for other educational purposes.

The proposal also includes a procedural safeguard that allows for the termination of programs if they are not effective. This will ensure that Federal funds are being used efficiently and effectively.

In conclusion, I urge my colleagues to support this proposal as a crucial step in reforming our education system and ensuring that all children have access to quality education.
Statement Presented To
HOUSE WAYS AND MEANS COMMITTEE
In Support Of
H.R. 11700

February 23, 1976

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

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.

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 pre-requisite 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 pre-requisite 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 Funds pursuant to this Agreement shall not constitute prohibited transactions or otherwise adversely affect the qualified status of the Pension Funds . . . " [7 (o) vi]. 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 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 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 26, 1975 without endangering their qualified status.

We, therefore, support H.R. 11700.

Submitted by
REUBEN W. MITCHELL
in behalf of
The United Federation of Teachers
Local 2 (A.F.L.-C.I.O.)

Affiliated with the New York State AFL-CIO, New York City Central Labor Council and the New York State United Teachers ✫
February 20, 1976

James Keegan, Esq.
The Municipal Assistance Corporation
for The City of New York
2 World Trade Center
45th Floor
New York, New York

Dear Jim:

Attached are three final copies of Herbert Elish's statement. Please note that in addition to the deletion you suggested on the last page, we have added the clause that begins with the words "with the consequent loss" at the end of the first paragraph on page 4.

Best regards.

Sincerely,

Donald F. Moore

DFM:ja
enc.
By Hand
February 19, 1976

Hon. Herbert Elish
Executive Director of The Municipal Assistance Corporation For The City of New York
Two World Trade Center - Rm. 4540
New York, New York

Dear Herb:

Enclosed are three copies of a draft of your statement before the House Ways and Means Committee on Monday, February 23, 1976.

Please let me have your comments as soon as possible so that we may transmit a copy to Jim LaRocca in Washington as early as possible tomorrow.

Please note that I have placed pencil brackets around the first full paragraph on page 4 and the first paragraph on page 5 of the statement. You may simply wish to skip over those paragraphs when reading the statement.

Sincerely,

\[
\]

Donald F. Moore

DFM:ja
enclosures

BY HAND

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 26, 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 $2,530,000,000. 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 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 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 agreement to purchase by the Pension Funds was, we believe, a key assumption 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 $2.5 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 $1.3 billion. To date, the City has borrowed all but $320 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 such 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 any of the conditions 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 and their obligations under the Agreement will be limited to the purchase of $500,000,000 of MAC 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.

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 debentures 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 disinclination to issue such a ruling both with respect to the December purchases and subsequent purchases and has indicated that legislative action 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. 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) or 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 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, 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 $185 million of New York City bonds
on March 12, 1976, it appears that the City will default in its obligations at that time. The financial collapse of New York City is likely to have a far more serious impact upon the participants and beneficiaries of the Pension Funds than the investments in City obligations and MAC bonds pursuant to the Agreement.

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.

I most strongly urge the prompt passage of H.R. 11700.
February 11, 1976

Mr. Alvin D. Lurie
Assistant Commissioner for Employee Plans
and Exempt Organizations
Internal Revenue Service
Room 3408
1111 Constitution Avenue, N.W.
Washington, D. C. 20224

Dear Mr. Lurie:

In pursuance of our telephone conversation earlier today, I enclose a photocopy of a letter dated February 5, 1976, addressed to Commissioner Alexander from Congressman Charles Rangel.

Sincerely,

Donald F. Moore

DFM:ja
enc.
The Honorable Donald C. Alexander  
Commissioner  
Internal Revenue Service  
IRS Building  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

Dear Mr. Alexander:

As part of the effort to alleviate the current fiscal crisis facing New York City, an Agreement was made on November 26, 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 $2,530,000,000. 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.

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 any of the conditions 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 and their obligations under the Agreement will be limited to the purchase of $500,000,000 of MAC bonds.

Section 503(a) of the Internal Revenue Code of 1954, as amended (the "Code"), provides that pension plans created by any State or political subdivision thereof which are qualified under section 501(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 a creator. Under current Treasury regulations, the purchase by a pension plan of notes or debentures 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 501(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 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). The Service 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". The Service expressly stated that it would not issue a ruling 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 disinclination to issue such a ruling both with respect to the December purchases and subsequent purchases and has indicated that legislative action 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 appears to be necessary.

In an effort to develop an appropriate legislative remedy, lawyers for the Pension Funds, New York City, New York State, the Municipal Assistance Corporation, and the Emergency Financial Control Board for New York City prepared a draft bill in concert with the staff of the Joint Committee on Internal Revenue Taxation. Both Treasury and the Service participated in the development of the draft. This draft was introduced yesterday as H.R. 11700 and is attached hereto.

The bill would exclude from the operation of section 503(b) of the Code all transactions provided by the Agreement by each of the Pension Funds which were parties
to the Agreement and make clear that such transactions do not adversely affect the qualification 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) or 501(a) of the Code, the 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.

Although there are strong arguments that the purchase of U.S. bonds by the Pension Funds will not, in any event, constitute a prohibited transaction, the 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 sections 401(a) or 503 of the Code.

Finally, the 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 Bill.

I understand from Chairman Ullman that the Ways and Means Committee will address itself to this Bill at the earliest possible opportunity. Because of the current schedule this may mean that the Committee will
not be able to act on the bill until the last week of February. (Public hearings are scheduled on this matter for February 23rd, 1976.) There is every indication, however, that the Committee will act favorably and that the remedy will be provided. Of necessity, Senate action must follow House action.

It is my understanding that the next purchase by the Pension Funds of New York City obligations is scheduled for February 17, 1976. It would seem altogether appropriate for the Service to extend its limited letters of intent to rule to cover the expected February transaction on the basis that the legislative remedy is making progress and will, in all likelihood, be in place as soon as possible.

Thank you for your prompt consideration of this most urgent matter.

Sincerely,

[Signature]

CHARLES B. RANGEL
Member of Congress

cc: Governor Hugh Carey
    Mayor Abraham Beame
    Comptroller Harrison Goldin
    Chairman Al Ullman
    Chairman Russell Long
    Congressman Barber Conable
    Congressman Otis Pike
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 Barber 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 26, 1975, without being held in violation of certain requirements and limitations in section 401(a) and 503(b) of the Internal Revenue Code of 1954. Such transactions, to the extent they require waivers or amendments to the agreement of November 26, 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, 1980.

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: 202-225-3625). 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.
February 9, 1976

Donald F. Moore, Esq.
Paul, Weiss, Rifkind, Wharton & Garrison
345 Park Avenue
New York, New York 10022

Dear Don:

Thank you for keeping me advised with copies of successive drafts of what, I gather, has now become HR. 11700, which was introduced on February 4, 1976.

Last month there was some talk that a further investment by the New York City pension funds would be required in February.

To such investment an extension of the Internal Revenue Service intent to rule or the enactment of HR.11700 (or a substantively similar bill) remains a pre-condition.

May I assume that, since the enactment of HR. 11700 in time seems unlikely, the Wachtell, Lipton firm will be pursuing the extension of the intent to rule?

Another condition to further investment is delivery to any New York City pension fund so requesting of an official statement with respect to The City, in form and
substance satisfactory to the trustees of the pension fund, which shall include the current status of The City's financial plan. Periodic follow-up on this requirement with various City officials has brought no substantive response. I would appreciate it if you would call this to Allen Thomas's attention. This will save me writing a separate letter.

Best regards.

Sincerely,

William Josephson

WJ:seg

cc: Mr. Arthur Tibaldi
Julius Topol, Esq.
Bertram Perkel, Esq.
February 4, 1976

(212) 644-8662

AIR COURIER

Mr. James L. LaRocca
Director
Washington Office
State of New York
1612 K Street, N.W.
Washington, D.C. 20006

Dear Jim:

In pursuance of our telephone conversation earlier today, I suggest that the following modifications of the Bill as introduced by Congressman Rangel might be appropriate if they can readily be made:

1. Subsection (b) (page 4) of the proposed Bill now provides that any amendment to or waiver of the agreement of November 26, 1975 which relates to the application of subsection (a) to the requirements of section 401(a) or 503(b) of the Internal Revenue Code after December 5, 1975, will take effect only if, not later than 30 days after he receives a copy of such amendment or waiver, the Secretary of the Treasury determines that such amendment or waiver is not inconsistent with the considerations set forth
in subsection (a)(2). In other words, such an amendment simply does not become effective until the Secretary makes such a certification and the proposed bill appears not to require him to take any action. If he fails to make such certification within 30 days, it appears that the amendment does not become effective. It would be preferable to provide that any such amendment or waiver becomes effective as of the date of the amendment or waiver with the proviso that it becomes ineffective for all purposes if the Secretary certifies within the stated period that it is inconsistent with the considerations set forth in subsection (a)(2).

2. The last sentence in the flush material at the end of subsection (b)(2) now reads: "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)." This sentence was in the prior draft of the proposed bill on the assumption that the Secretary of the Treasury would have no power to veto any amendment to the agreement. Now that the Secretary of the Treasury has the power, in effect, to veto any amendment which is inconsistent with the considerations set forth in subsection (a)(2), this sentence becomes
unnecessary and should be deleted.

Both of the foregoing changes could be effected by substituting for the flush material at the end of subsection (b)(2), the following:

"such amendment or waiver shall take effect for purposes of subsection (a) on the date of such amendment or waiver; provided, however, that 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 inconsistent with the considerations set forth in subsection (a)(2), in which event such amendment or waiver shall not be deemed to have been effective for any purpose."

Sincerely,

Donald F. Moore
Mr. James L. LaRocca  
Director  
Washington Office  
State of New York  
1612 K Street, N.W.  
Washington, D. C. 20006

Dear Jim:

Enclosed are an original and one copy of a statement which I have arbitrarily dubbed "in support" of the proposed Bill. I believe the statement describes the problem and the solution presented by the Bill in sufficient detail.

Please call me if you have any questions.

Sincerely,

Donald F. Moore

DFM: ja
enclosures
Statement in support of Proposed Bill to exclude from certain provisions of the Internal Revenue Code specified transactions by certain public employee retirement systems created by the State of New York or any of its political subdivisions.

Background

As part of the effort to alleviate the current fiscal crisis facing New York City, an Agreement was made on November 26, 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 $2,530,000,000. 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.

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 any of the conditions 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 and their obligations under the Agreement will be limited to the purchase of $500,000,000 of MAC bonds.

The Problem

Section 503(a) of the Internal Revenue Code of 1954, as amended (the "Code"), provides that 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 debentures 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). The Service 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". The Service 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 disinclination to issue such a ruling both with respect to the December purchases and subsequent purchases and has indicated that legislative action 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. , 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 qualification 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) or 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.

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 sections 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 authorize the Secretary of the Treasury to prescribe such regulations as may be necessary to implement the purposes of the proposed Bill.

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.
January 30, 1976

The Honorable John R. Thompson
Deputy Comptroller
Department of Audit and Control
Alfred E. Smith State Office Building
Albany, New York 12225

Dear John:

I thought it would be useful to confirm with you my understanding of the possible inclusion of the State in the legislation we are now preparing to exclude from certain provisions of the Internal Revenue Code transactions of the New York City pension plans. As you know, we are seeking to pass a bill for the purpose of insuring that the New York City pension plans do not jeopardize their status under Section 401(a) by their participation in the Emergency Financial Plan for New York City. In the context of considering this legislation the question arises whether the State pension plans would require similar legislative relief when they engage in certain purchases of State or State agency obligations.

After our discussion by telephone this morning, I am assured that you and the Comptroller do not anticipate any need for inclusion in this legislation. Accordingly, this office is proceeding in efforts to pass a bill affording relief only to the New York City pension plans to the extent they are participants in the November 26th agreement.

Sincerely,

James L. Larocca

JLL/EEW
December 19, 1975

Mr. Robert Strauss
Joint Committee on Internal Revenue Taxation
Room 1015, Longworth House Office Building
House of Representatives
Washington, D.C. 20515

Dear Mr. Strauss:

In accordance with our telephone conversation of December 18, 1975, enclosed is a redraft of the draft bill relating to financial assistance rendered to New York City which we received on December 17, 1975. In preparing this draft bill, we have received comments from the offices of the Corporation Counsel of The City of New York, the Comptroller of The City of New York, the Governor of the State of New York, the Municipal Assistance Corporation for The City of New York, The Teachers' Retirement System for the City of New York, and representatives of a trustee of the New York City Employees' Retirement System. However, we are not authorized to represent those parties. Technically, we represent only the trustee of the New York City Employee's Retirement System.

Section (a) of the enclosed draft bill is new. It is intended further to limit the applicability of the bill to the five New York City retirement systems involved and to make clear their status as pension plans or trusts for Federal pension law purposes. You will recall that the prior draft assumed their pension plan or trust status.
The enclosed draft bill deletes any reference to bonds of the Municipal Assistance Corporation. The Municipal Assistance Corporation for The City of New York (the Corporation's full name) is a public benefit corporation created by act of the Legislature of the State of New York. It is a legal entity separate and apart from The City of New York, which is a municipal corporation, and the five retirement systems. The Board of the Municipal Assistance Corporation is independent of The City of New York.

Hence, we have been of the opinion that purchase by the five New York City retirement systems of Municipal Assistance Corporation obligations is not analogous to the purchase of obligations of a subsidiary or other affiliate of an employer organization and therefore would not be a prohibited transaction under Section 503(b). But if the Treasury Department has any question about this opinion, we have no objection to the reinsertion of the reference to the Municipal Assistance Corporation for The City of New York, if that reference is not limited to purchases prior to November 26, 1975. As you know, one of the provisions of the Amended and Restated Agreement made as of the 26th day of November, 1975 (the "Agreement") gives an option to the New York City retirement systems to purchase Municipal Assistance Corporation obligations. While to date none of the systems has indicated an interest in doing so, any legislation should not imply that purchases of Municipal Assistance Corporation obligations after November, 1975 raise section 503(b) or section 401 issues.

All concerned would prefer that the Agreement not be locked into federal statute. As you know, it was drafted under time pressure, and it is far from perfect. Also, it relates to a volatile situation, and it may well have to be amended from time to time. We note in this connection that the Intergovernmental Emergency Assistance Act, which is the basic substantive authority for federal assistance to The City of New York, does not attempt to prohibit or regulate amendment of the Agreement.

If, nevertheless, the Federal Government wants a clear legal as well as a practical veto over future amendments to the Agreement, the enclosed draft provides for a veto which would make any amendment ineffective if not consented to by the Secretary of the Treasury or his delegate within thirty days. We think that the Secretary's non-consent should not lead to disqualification of the retirement systems, with resultant injury to the innocent
Mr. Robert Strauss  

- 3 -  

December 19, 1975  

participants in the systems, but should only serve to prevent the proposed amendment from taking effect.

We have deleted any reference to prior approval or later consent to waivers of conditions of the Agreement, because, in the context of closings held to date, such a provision would be unworkable.

In accordance with our discussion, we deleted in its entirety subsection (b), dealing with indemnification, for the many reasons we gave you over the telephone.

The enclosed draft bill requires the retirement systems to submit annual rather than quarterly financial reports, since quarterly reports are not feasible.

The enclosed draft bill would be effective on and after November 24, 1975, which is the date on which the retirement systems voted to enter into the Agreement.

We understand that consideration of this legislation at the current session of the Congress is now considered extremely unlikely. We stand ready to work with you at any time next week or the week after towards the end of reaching agreement on legislation which can be passed as early in the new year as possible.

Sincerely,

William Josephson

cc: Stanley Buchsbaum, Esq.  
Assistant Corporation Counsel  
The City of New York

Mr. Herbert Elish  
Executive Director  
Municipal Assistance Corporation

Carr Ferguson, Esq.  
Wachtell, Lipton, Rosen & Katz

Bernard Friedlander, Esq.  
Assistant Corporation Counsel  
The City of New York
cc:  Mr. Bernard Goldberg  
The Teachers' Retirement System  
for the City of New York  

Kenneth Hartman, Esq.  
Deputy Comptroller  
The City of New York  

Mr. James LaRocca  
Director of the New York State  
Office, Washington  

S. Michael Nadel, Esq.  
Governor's Counsel's Office  

Mr. William T. Scott  
Third Deputy Comptroller  
The City of New York  

Allen Thomas, Esq.  
Paul, Weiss, Rifkind, Wharton & Garrison  

Julius Topol, Esq.  
General Counsel  
District Council 37  

William L. Wood, Jr., Esq.  
Counsel to the Comptroller  
The City of New York
CONGRESS
Session
H.R.__________

IN THE HOUSE OF REPRESENTATIVES

Mr. __________________ introduced the following bill;

which was referred to the Committee on _____

A BILL
(Insert title of bill here)

Relating to financial assistance rendered to the City of New York by certain pension funds.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled. That (a) Each of the following pension plans shall, for purposes of sections 401(a) and 501(a) of the Internal Revenue Code of 1954, be deemed to be a trust created or organized in the United States:

(1) the New York City Employees' Retirement System;
(2) the Teachers' Retirement System of The City of New York;
(3) the New York City Police Pension Fund, Article 2;
(4) the New York City Fire Department Pension Fund,
Article 1-B; and

(5) the Board of Education Retirement System for
The City of New York.

(b) Any such pension plan or trust which, on December 5, 1975, was a party to the amended and restated agreement set forth on pages S21308, S21309, and S21310 of the Congressional Record published on such date shall not be considered to fail to satisfy the requirements of section 401(a) of the Internal Revenue Code of 1954, or to have engaged in a prohibited transaction described in section 503(b) of such code, merely because such plan or trust engages in any or all of the following:

(1) entering into such agreement or agreeing to an amendment of such agreement,

(2) performing any act required or permitted by such agreement,

(3) forebearing from any act prohibited by such agreement,

(4) holding any bond or note which it is required or permitted to hold by such agreement,

(5) after the termination of such agreement, holding any bond or note acquired or held pursuant to such agreement,

(6) making any election provided by such agreement,

(7) executing a waiver of any requirement of such agreement, or

(8) after November 22, 1975, and before July 1, 1986, considering, for purposes of determining investments, 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.

For purposes of paragraphs (2), (3), (4), (5), (6), and (7), an amendment of such agreement adopted after December 5, 1975, shall be considered to be a part of such agreement as of the date of such amendment; provided, however, that if an amendment of such agreement is adopted after December 5, 1975, the Secretary of the Treasury or his delegate may, within thirty days after the effective date of such amendment, give notice of his non-consent to such amendment, in which event such amendment shall not be deemed to have been effective for any purpose.

(c) The plan administrator (within the meaning of section 414(g) of the Internal Revenue Code of 1954) of a pension plan described in subsection (a) shall furnish an annual report regarding the financial condition of such plan to the Secretary of the Treasury for each plan fiscal year beginning after June 30, 1975, and ending before July 1, 1986. Such report shall
contain such information as is required by the Secretary of the Treasury or his delegate and shall be filed at the time and in the manner prescribed by the Secretary of the Treasury or his delegate. 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 the purposes of this Act.

(e) This act shall be effective on and after November 24, 1975.
December 5, 1975

The Honorable Al Ullman
Chairman
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman,

I am writing respectfully to request that you consider the enclosed amendment to the pending tax bill which is vital to the financial arrangements concerning the City of New York which we have made during the last ten days or two weeks.

As President Ford announced during his press conference on November 26, 1975, eleven major banks, four New York City sinking funds and five New York City employee pension funds have entered into a comprehensive agreement with respect to New York City's finances over the next three years. A copy of that Agreement is enclosed.

Under paragraph 7 of the Agreement, the five pension funds agreed to purchase $2,530 billion of New York City serial bonds. Originally, we had thought it would be possible for them to purchase instead obligations of the Municipal Assistance Corporation for the City of New York. However, statutory limitations on the Municipal Assistance Corporation's issuing authority and the requirements of other aspects of the Agreement made as of the 26th day of November, 1975, made it impossible for Municipal Assistance Corporation to issue more than $500 million of its obligations in this connection.

The change from Municipal Assistance Corporation to City obligations created a special problem for the pension funds under section 503(b) of the Internal Revenue
Code of 1954, as amended. Although people do not ordinarily think of public employee pension funds as being qualified exempt organization pension funds under sections 401 and 501 of the Internal Revenue Code, like private employee pension funds, under the statute they certainly appear to be, and inquiries at both the New York District Office and the National Office of the Internal Revenue Service confirm this.

As you know, section 503(b) of the Internal Revenue Code of 1954, as amended basically prohibits employee pension funds from investing in employer securities.

It is, therefore, one of the conditions of the $2,530 billion pension fund investment referred to above that the Internal Revenue Service shall have ruled or the Congress of the United States shall have provided that the proposed purchases of New York City obligations not constitute prohibited transactions or otherwise affect the qualified status of the pension funds. See paragraph 7(e)(vi) of the agreement made as of the 26th day of November, 1975. Our conversations with the Internal Revenue Service indicate that there is little statutory or regulatory basis for a favorable administrative determination in this connection.

I have, therefore, had drafted and enclose in the form of a bill a simple amendment to section 503(a) which would take care of this situation. I hope that if this proposed legislation, after you and your staff have examined it, is found worthy of consideration, arrangements could be made for it to be added to the Tax Reform bill in committee or on the floor of the Senate.

Naturally, we are not wedded to any particular form of words, and my staff as well as the lawyers for the pension funds are available to meet with your staff at any time to provide further information or to discuss any required changes in the proposed legislation.

I would be most grateful for your urgent consideration and response to this matter. The proposed pension fund investment is a critical element of the financing arrangements for New York City.

Sincerely,

[Signature]

Enclosures (2)
December 5, 1975

The Honorable Russell B. Long
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman,

I am writing respectfully to request that you consider the enclosed amendment to the pending tax bill which is vital to the financial arrangements concerning the City of New York which we have made during the last ten days or two weeks.

As President Ford announced during his press conference on November 26, 1975, eleven major banks, four New York City sinking funds and five New York City employee pension funds have entered into a comprehensive agreement with respect to New York City's finances over the next three years. A copy of that Agreement is enclosed.

Under paragraph 7 of the Agreement, the five pension funds agreed to purchase $2,530 billion of New York City serial bonds. Originally, we had thought it would be possible for them to purchase instead obligations of the Municipal Assistance Corporation for the City of New York. However, statutory limitations on the Municipal Assistance Corporation's issuing authority and the requirements of other aspects of the Agreement made as of the 26th day of November, 1975 made it impossible for Municipal Assistance Corporation to issue more than $500 million of its obligations in this connection.

The change from Municipal Assistance Corporation to City obligations created a special problem for the pension funds under section 503(b) of the Internal Revenue Code of 1954, as amended. Although people do not ordinarily think of public employee pension funds as being qualified exempt organization pension funds under sections 401 and 501 of the Internal Revenue Code, like private employee pension funds, under the statute they certainly appear to be, and inquiries at both the New York District Office and the National Office of the Internal Revenue Service confirm this.
The Honorable Russell B. Long

December 5, 1975

As you know, section 503(b) of the Internal Revenue Code of 1954, as amended basically prohibits employee pension funds from investing in employer securities.

It is, therefore, one of the conditions of the $2,530 billion pension fund investment referred to above that the Internal Revenue Service shall have ruled or the Congress of the United States shall have provided that the proposed purchases of New York City obligations not constitute prohibited transactions or otherwise affect the qualified status of the pension funds. See paragraph 7(c)(vi) of the agreement made as of the 26th day of November, 1975. Our conversations with the Internal Revenue Service indicate that there is little statutory or regulatory basis for a favorable administrative determination in this connection.

I have, therefore, had drafted and enclose in the form of a bill a simple amendment to section 503(a) which would take care of this situation. I hope that if this proposed legislation, after you and your staff have examined it, is found worthy of consideration, arrangements could be made for it to be added to the Tax Reform bill in committee or on the floor of the Senate.

Naturally, we are not wedded to any particular form of words, and my staff as well as the lawyers for the pension funds are available to meet with your staff at any time to provide further information or to discuss any required changes in the proposed legislation.

I would be most grateful for your urgent consideration and response to this matter. The proposed pension fund investment is a critical element of the financing arrangements for New York City.

Sincerely,

Hugh

Enclosures
Mr. ______ introduced the following bill which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 to exclude certain transactions by the public employee retirement systems of the State of New York and its political subdivisions from the requirements of Section 503.

Be it enacted by the Senate and the House of Representatives of the United States of America in Congress assembled,

That subsection (a) of Section 503 of the Internal Revenue Code of 1954, as amended, which relates to the denial of exemption to organizations engaged in prohibited transactions, is amended by adding at the end thereof a new paragraph to read as follows:

"(3) CERTAIN ORGANIZATIONS EXCLUDED. Notwithstanding the provisions of paragraph (1), an organization shall not cease to be exempt from taxation under section 501(a) for any fiscal year beginning after June 30, 1974 because it has engaged in a transaction described in subsection (b) if --

(A) such transaction consisted of the purchase of (including exchange of property for), extension of time for payment of principal of, or waiver of all or part of the interest
on, bonds, notes or other obligations issued by the State of New York or any political subdivision or public corporation thereof; and

(B) such organization is an organization described in section 414(d) established and maintained by the State of New York or a political subdivision thereof."

- 2 -
AGREEMENT made as of the 26th day of November, 1975, among the Municipal Assistance Corporation For The City of New York (the “Corporation”) and each of the undersigned New York City Commercial Banks (the “Banks”), New York City Pension Funds (the “Pension Funds”) and the New York City Sinking Funds (the “Sinking Funds”).

The Corporation is proposing to offer to exchange (the “Exchange Offer”) certain of its bonds (the “MAC Bonds”) for certain outstanding short-term obligations of The City of New York, listed on Schedule A attached hereto (the “City Notes”).

The Governor of the State of New York on November 25, 1975 made the following public announcement:

I wish to compliment the Legislative Leaders and the members of the New York Assembly and Senate on their work today. We have met. I believe, all the conditions laid down by the President as a prerequisite to his consideration of Federal involvement in the fiscal crisis facing New York City. We fully anticipate a favorable Federal response in recognition of the unusual and difficult steps taken by the people of New York.

While those achievements are a source of great satisfaction to all of us concerned about the potential default of New York City, for the State of New York it is only the first step. I shall ask the Legislature to return to Albany on December 3 to meet the problem of the State’s own budget gap and to fully dispose of that matter through legislation during this extraordinary session. I am calling upon Comptroller Arthur Levitt to certify the existence and size of the gap on or about November 30th using the latest revenue figures available to him at that time. In addition, the Legislature will be asked to complete its work on the “moral obligation” agencies of the State—strengthening their reserves and removing those programs that will not pass the most rigorous credit test. This action is necessary to the long term build-out program that I shall then propose.

In my letter of November 14th to the Secretary of the Treasury Simon I committed myself to this legislative program. That commitment remains.

In reliance on the foregoing announcement, each of the Banks, Pension Funds and Sinking Funds, severally and not jointly, agree with the Corporation as follows:

1. Each of the Banks and Pension Funds hereby agrees, severally and not jointly, not to tender or otherwise accept any offer for exchange of any City Notes held by it for MAC Bonds pursuant to the Exchange Offer. Each of the Banks and Pension Funds understands that, as a result of its not tendering or otherwise accepting any offer for exchange for its City Notes pursuant to the Exchange Offer, under the provisions of the New York State Moratorium Act for the City of New York enacted by the State Legislature at an extraordinary session and signed by the Governor on November 15, 1975 (the “Moratorium Act”), its City Notes will be subject to the moratorium therein provided for (the “Moratorium”).

2. Notwithstanding any determination by any court of competent jurisdiction or by the State Legislature, which determination is applicable generally to all City Notes subject to the Moratorium and is not by its specific terms made applicable to the Banks or Pension Funds, that results in an increase in the rate of interest paid upon City Notes subject to the Moratorium (but does not affect the validity of the Moratorium on payment of principal), each of the Banks and Pension Funds hereby agrees that, after the scheduled date of maturity thereof, no interest need be paid on City Notes held by it subject to the Moratorium in excess of a rate of 6% a year.

3. Each of the Banks and Pension Funds hereby agrees to do one of the following: (a) at the termination of the “moratorium period” under the Moratorium Act and any renewal or extension thereof (i) to exchange City Notes held by it on the date hereof for short-term notes of the City, to
renew such City Notes or to purchase short-term notes of the City, in each case such renewed City Notes or such short-term notes of the City bearing interest at the rate of 6% a year and being in a principal amount equal to the principal amount of City Notes held by it on the date hereof, or (ii) to agree to present such City Notes for payment (or, if the City so agrees, to defer contractually the maturity of such City Notes) at times and in amounts resulting in a reduction of original principal amount in accordance with clause (b) hereof such City Notes to bear interest at the rate of 6% a year, and such interest to be paid to the holder of such City Notes on each interest payment date; (iii) hereafter from time to time upon the maturities of any such short-term notes of the City held by it hereunder, to exchange such short-term notes of the City for, or at its option to purchase, other short-term notes of the City bearing interest at the rate of 6% a year and in a principal amount which shall be reduced annually, beginning with the first such exchange under this clause (b), by an amount equal to the fraction of the original principal amount of its City Notes of which the numerator is four and the denominator is the number of full three month periods remaining from the end of the Moratorium or any renewal or extension thereof to July 1, 1986; (provided, however, that the foregoing obligations shall be subject to the performance or existence of the following conditions: (A) the final maturity date of the last short-term note of the City received in exchange or purchased hereunder shall not be later than July 1, 1986; (B) the City timely pays (i) interest at maturity with respect to the City Notes, at their respective stated rates to their respective scheduled dates of maturity, and thereafter interest at least annually at the rate of 6% a year and (ii) interest at maturity with respect to such short-term notes at the rate of 6% a year; (C) at the time of any exchange, renewal or purchase of such short-term notes hereunder the City shall have timely paid when due principal and interest on all bonds of the City outstanding at such time; (D) at the time of any exchange, renewal or purchase of such short-term notes hereunder the City shall not be under the jurisdiction of any court pursuant to any proceedings under the federal bankruptcy laws or Title 6-A of the Local Finance Law (or any statute analogous in purpose or effect to any such law or to such Law); (E) at the time of any exchange, renewal or purchase of such short-term notes hereunder there shall be delivered to and for the benefit of the exchanging or renewing holders or purchasers an unqualified approving opinion as to legality from recognized bond counsel and such other documents as counsel for the Banks and the Pension Funds shall reasonably request in form and substance satisfactory to such counsel; (F) at the time of any exchange, renewal or purchase of such short-term notes hereunder the Mayor and the Comptroller of the City of New York and the New York State Emergency Financial Control Board and such Board if the City is then in existence shall have certified that the budget of New York City for the fiscal year of New York City in which such exchange, renewal or purchase occurs is balanced. If at any time any option to exchange, renew or purchase short-term notes pursuant to paragraph 3 could not be effected by reason of the non-satisfaction of any condition specified in clauses (B) through (F) hereof, any City Notes retained pursuant to paragraph 3(a)(ii) may be presented for payment in full.

4. The Sinking Funds hereby represent that the only short-term notes of the City held by them are bond anticipation notes dated January 13, 1975 and maturing January 13, 1976, in aggregate principal amount of $200,000,000 (the “Sinking Fund BANs”). The Sinking Funds hereby agree to purchase serial bonds of the City, bearing interest at the rate of 6% a year, in aggregate principal amount of $200,000,000 upon or in payment of the Sinking Fund BANs. The bonds so purchased by the Sinking Funds shall mature and be subject to payment of such annual installments of principal as shall be necessary, after first taking into account the other holdings of the Sinking Funds, to meet the legal obligations of the Sinking Funds.

5. (a) Each of the Banks hereby agrees with respect to bonds of the Corporation held by it which are listed on the schedule furnished by it to the Corporation prior to its execution of this Agreement and identified as its schedule referred to in this Paragraph and which bonds consist of either Series C, D, E, H or J Bonds of the Corporation (hereafter called “Bank Series Bonds”), and each of the Pension Funds and Sinking Funds may at its election agree with respect to any of the bonds of the Corporation it holds (hereinafter called the “Fund Bonds”) that commencing February 1, 1976 (i) such Bank Series Bonds
and such Fund Bonds will, notwithstanding the terms thereof, bear interest at the rate of 6% a year payable on February 1 and August 1 in each year; (ii) each such Bank Series Bond and Fund Bond will mature on February 1, 1986, subject to redemption, in part, on February 1, in each of the years 1977 through 1985 in the respective principal amounts calculated to provide for level debt service on such Bank Series Bond and Fund Bond held by it to February 1, 1986; (iii) such Bank Series Bonds will be stamped by such holder with a stamp reading: "Principal of and Interest on this Bond are payable in accordance with an Agreement dated as of the 26th day of November, 1975 among the Municipal Assistance Corporation for The City of New York and certain Pension Funds, Sinking Funds and Banks"; (iv) no such Bank Series Bond and Fund Bond will be transferred, assigned or delivered by such holder unless the same is first exchanged for a newly issued bond of the Corporation, in an amount equal to the unpaid principal amount of such exchanged Bank Series Bond and Fund Bond which newly issued bond shall be issued pursuant to the first General Bond Resolution of the Corporation dated July 2, 1975 and shall bear interest and mature (subject to redemption in accordance with the first General Bond Resolution) as hereinabove provided in this paragraph.

(b) Each of the Banks, Pension Funds and Sinking Funds hereby agrees on February 1, 1976 to exchange bonds of the Corporation, in an amount at least equal, in the case of Banks, to the amount of Series A and B bonds listed on the above-referred to schedule by each Bank and, in the case of such Funds, bonds equal to the amount of bonds of the Corporation that were heretofore purchased by such Funds from the Corporation less Fund Bonds with respect to which an election has been made under clause (a) above, for newly issued bonds of the Corporation issued pursuant to the first General Bond Resolution of the Corporation, dated July 2, 1975, bearing interest at the rate of 6% a year and maturing on February 1, 1986, subject to mandatory sinking fund payments calculated to provide for level debt service from February 1, 1977 to February 1, 1980; provided, however, that if prior to February 1, 1976 the consent of the requisite holders of Series A or B bondholders in the case of the Series Aor Series B Bonds, respectively, of the Corporation is obtained to a revised amortization schedule for either or both of such Series held by the Banks (the Corporation agreeing to solicit such consents) resulting in a maturity on February 1, 1986 and mandatory sinking fund payments calculated to provide for level debt service from February 1, 1977 to February 1, 1986, such bonds so held by the Banks shall be treated in the same manner as in the case of and for purposes of this Paragraph 5 shall be deemed to be Bank Series Bonds; provided, further, however, that if in the case of the Series A term bonds such consent is not obtained prior to February 1, 1976, each Bank, unless, prior to August 1, 1976, it effects the exchange required by this clause (b) with respect to the Series A term bonds, shall continue to hold its Series A term bonds, and hereby agrees to a reduction of the interest rate on the Series A term bonds held by it to 6% per annum, commencing February 1, 1976, payable February 1 and August 1 in each year, and may not otherwise elect to modify the sinking fund or redemption provision of such bonds.

(c) The Corporation hereby agrees not to issue any new bonds of the Corporation based upon debt service savings to the Corporation resulting from the operation of this Paragraph 5.

(d) Notwithstanding anything to the contrary in this paragraph 5, the undertaking of each such holder under this paragraph shall be subject to the following: (A) the Corporation shall adopt a Series Bond Resolution and take such other steps on or before February 1, 1976 to permit the transactions provided for in clauses (a) and (b) above; (B) the Corporation shall have paid interest on the bonds held by such holder on February 1, 1976 at the respective rates of interest stated in such bonds; (C) on February 1, 1976, the City shall not be in default in the payment of the principal or of interest on any debt obligations of the City; and (D) there being no failure of any condition (which has not been waived) to the performance of any obligation of the Pension Funds under Paragraph 7.

6. Each of the agreements referred to in Paragraphs 3 and 5 is subject to agreement to and fulfillment of such agreements by all other parties referred to in such Paragraphs 3 and 5 and to 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 $2,500,000,000 at any time outstanding.

7. The Pension Funds hereby agree, severally and not jointly, to purchase serial bonds of the City, substantially in the proportions set out in Schedule B, in the principal amount of $2,530,000,000 as follows:

(a) Prior to January 1, 1976, $30,000,000 serial bonds of City bearing interest at the rate of 6% a year and maturing on such date or dates as shall be mutually agreed upon: (it being understood that urban renewal notes of the City in the amount of $30,000,000, dated April 18, 1975 and maturing December 17, 1975, and held by the Pension Funds, are to be paid with proceeds of federal grant funds segregated therefor);

(b) As soon as possible but prior to June 30, 1976, up to $500,000,000 serial bonds of the City; during the 1976-1977 fiscal year of the City up to $1,500,000,000 principal amount of serial bonds of the City; during the 1977-1978 fiscal year of the City up to $500,000,000 principal amount of serial bonds of the City; all such bonds shall bear interest at the rate of 9% a year and shall mature on such date or dates as shall be mutually agreed upon;

(c) To the extent the City is required by law to amortize, prior to June 30, 1978, any principal of the bonds of the City purchased by the Pension Funds pursuant to this Paragraph 7, the Pension Funds agree to purchase additional serial bonds of the City in an amount equal to such principal amortization and bearing interest at the rate of 9% a year and maturing on such date or dates as shall be mutually agreed upon;

(d) Any Pension Fund may, at its election, purchase MAC Bonds (issued pursuant to its second General Bond Resolution), up to an amount equal to its proportionate share of the difference between $1,000,000,000 and the principal amount of MAC Bonds issued pursuant to the Exchange Offer, in fulfillment of its obligation to purchase an equal amount of bonds of the City pursuant to this Paragraph 7, and any such MAC Bonds so purchased shall bear interest at the rate of 8% a year and mature July 1, 1986, subject to mandatory sinking fund payments calculated to provide for level debt service to July 1, 1986;

(e) The obligations of the Pension Funds to purchase bonds pursuant to this Paragraph 7 shall be subject to agreement to and fulfillment of such agreements by all other parties referred to in this Paragraph 7 and shall be conditioned upon each of the following facts being true on the date of each such purchase: (i) the City shall have timely paid when due principal and interest on all bonds of the City outstanding at such time, (ii) the City shall not be under the jurisdiction of any court pursuant to any proceedings under the federal bankruptcy laws or pursuant to title 6A of the Local Finance Law, (iii) a State law containing provisions with respect to the legal status of the Pension Funds and their Trustees' responsibilities, satisfactory to such Trustees, shall have been enacted and shall be effective, (iv) the City shall have made to the Pension Funds all contributions and other payments required by law, (v) the City shall, in connection with each purchase prior to February 1, 1976, or the first date on which the first seasonal financing moneys have been received by the City pursuant to the Federal Legislation referred to in Paragraph 6 (whichever is earlier), deliver to any Pension Fund so requesting a report of essential facts of the City in the form promulgated by the State Department of Audit & Control, and in connection with each purchase thereafter shall deliver to any Pension Fund so requesting an official statement with respect to the City in form and substance satisfactory to the Trustees of the Pension Funds, each of which shall include a current status of the City's financial plan as required and approved by the Emergency Financial Control Board. (vi) 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, and (vii) the Federal Legislation referred to in Paragraph 6 above shall have been enacted and shall be in force; and
(1) If any of the Pension Funds elects not to make any purchases of bonds of the City as a result of a failure of any conditions set forth in clause (v), (vi) or (vii) of Paragraph 7(e), such Pension Fund shall nevertheless, as soon as possible but prior to June 30, 1976, purchase its proportionate share of $500,000,000 of MAC Bonds pursuant to Paragraph 7(d) above.

8. This Agreement shall become effective upon its execution by the Corporation and by each of the Banks, Pension Funds and Sinking Funds.

9. Any reference herein to "City Notes held" or "short-term notes of the City held" by a Bank shall refer only to City Notes or short-term notes of the City, respectively, owned by such Bank for its own account.

10. Any Bank or Pension Fund which is the holder of a City Note subject to Paragraph 3(a)(ii) hereof may sell, assign or transfer any such Note provided that the transferee shall be satisfactory to the City and shall have agreed in writing in form and substance satisfactory to the City to exercise the same options and on the same terms and conditions as the Bank or Pension Fund so selling, assigning or transferring such Note has agreed to exercise under Paragraph 3.

In Witness Whereof, each of the parties has caused this instrument to be executed by its duly authorized officer as of the date first above written.

Municipal Assistance Corporation For The City of New York

By ........................................

Banks

First National City Bank

By .................................

Bankers Trust Company

By .................................

United States Trust Company

By .................................

The Chase Manhattan Bank

By .................................

Marine Midland Bank

By .................................

National Bank of North America

By .................................

Morgan Guaranty Trust Company

By .................................

Irving Trust Company

By .................................

Bank of New York

By .................................

Manufacturers Hanover Trust Company

By .................................

Chemical Bank

By .................................
Pension Funds

New York City Employees' Retirement System

By ........................................

Board of Education Retirement System for the City of New York

By ........................................

New York City Fire Department Pension Fund

By ........................................

Teachers' Retirement System for the City of New York

By ........................................

New York City Police Pension Fund

By ........................................

Sinking Funds

Sinking Fund of the City of New York

By ........................................

Rapid Transit Sinking Fund of the City of New York

By ........................................

Water Sinking Fund of the City of New York

By ........................................

Transit Unification Sinking Fund of the City of New York

By ........................................
## SCHEDULE A
(amounts in millions)

<table>
<thead>
<tr>
<th>Type</th>
<th>Amount</th>
<th>Date of Issue</th>
<th>Date of Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>R.A.N.</td>
<td>$400.0</td>
<td>12/13/74</td>
<td>12/11/75</td>
</tr>
<tr>
<td>R.A.N.</td>
<td>$500.0</td>
<td>1/13/75</td>
<td>1/12/76</td>
</tr>
<tr>
<td>R.A.N.</td>
<td>120.0</td>
<td>1/13/75</td>
<td>1/12/76</td>
</tr>
<tr>
<td>R.A.N.</td>
<td>290.0</td>
<td>2/14/75</td>
<td>2/13/76</td>
</tr>
<tr>
<td>B.A.N.</td>
<td>341.270</td>
<td>3/14/75</td>
<td>3/12/76</td>
</tr>
<tr>
<td>B.A.N.</td>
<td>150.0</td>
<td>3/14/75</td>
<td>3/12/76</td>
</tr>
<tr>
<td>B.A.N.</td>
<td>220.0</td>
<td>6/30/75</td>
<td>5/28/76</td>
</tr>
<tr>
<td>T.A.N.</td>
<td>90.0</td>
<td>6/11/75</td>
<td>6/10/76</td>
</tr>
<tr>
<td>T.A.N.</td>
<td>190.0</td>
<td>6/11/75</td>
<td>6/10/76</td>
</tr>
<tr>
<td>B.A.N.</td>
<td>51.5</td>
<td>6/11/75</td>
<td>6/11/76</td>
</tr>
<tr>
<td>B.A.N.</td>
<td>250.0</td>
<td>10/17/75</td>
<td>10/ 1/76</td>
</tr>
<tr>
<td>B.A.N.</td>
<td>59.875</td>
<td>10/17/75</td>
<td>10/15/76</td>
</tr>
<tr>
<td>R.A.N.</td>
<td>6.750</td>
<td>11/10/75</td>
<td>11/ 9/76</td>
</tr>
</tbody>
</table>
SCHEDULE B

(amounts in millions)

New York City Employees' Retirement System .................. $1,175
Teachers' Retirement System for The City of New York ........ 860
New York City Police Pension Fund ............................ 365
New York City Fire Department Pension Fund .................. 50
Board of Education Retirement System for The City of New York .... 50

$2,500

The fund(s) owning the urban renewal notes referred to in Paragraph 7(a) shall purchase an additional $30,000,000 of bonds of the City pursuant to such Paragraph 7(a) (in proportion to their holdings of such urban renewal notes).
December 5, 1975

The Honorable Russell B. Long  
Chairman  
Committee on Finance  
United States Senate  
Washington, D.C. 20510  

Dear Mr. Chairman,

I am writing respectfully to request that you consider the enclosed amendment to the pending tax bill which is vital to the financial arrangements concerning the City of New York which we have made during the last ten days or two weeks.

As President Ford announced during his press conference on November 26, 1975, eleven major banks, four New York City sinking funds and five New York City employee pension funds have entered into a comprehensive agreement with respect to New York City's finances over the next three years. A copy of that Agreement is enclosed.

Under paragraph 7 of the Agreement, the five pension funds agreed to purchase $2,530 billion of New York City serial bonds. Originally, we had thought it would be possible for them to purchase instead obligations of the Municipal Assistance Corporation for the City of New York. However, statutory limitations on the Municipal Assistance Corporation's issuing authority and the requirements of other aspects of the Agreement made as of the 26th day of November, 1975 made it impossible for Municipal Assistance Corporation to issue more than $500 million of its obligations in this connection.

The change from Municipal Assistance Corporation to City obligations created a special problem for the pension funds under section 503(b) of the Internal Revenue Code of 1954, as amended. Although people do not ordinarily think of public employee pension funds as being qualified exempt organization pension funds under sections 401 and 501 of the Internal Revenue Code, like private employee pension funds, under the statute they certainly appear to be, and inquiries at both the New York District Office and the National Office of the Internal Revenue Service confirm this.
The Honorable Russell B. Long

December 5, 1975

As you know, section 503(b) of the Internal Revenue Code of 1954, as amended basically prohibits employee pension funds from investing in employer securities.

It is, therefore, one of the conditions of the $2.530 billion pension fund investment referred to above that the Internal Revenue Service shall have ruled or the Congress of the United States shall have provided that the proposed purchases of New York City obligations not constitute prohibited transactions or otherwise affect the qualified status of the pension funds. See paragraph 7(e)(vi) of the agreement made as of the 26th day of November, 1975. Our conversations with the Internal Revenue Service indicate that there is little statutory or regulatory basis for a favorable administrative determination in this connection.

I have, therefore, had drafted and enclose in the form of a bill a simple amendment to section 503(a) which would take care of this situation. I hope that if this proposed legislation, after you and your staff have examined it, is found worthy of consideration, arrangements could be made for it to be added to the Tax Reform bill in committee or on the floor of the Senate.

Naturally, we are not wedded to any particular form of words, and my staff as well as the lawyers for the pension funds are available to meet with your staff at any time to provide further information or to discuss any required changes in the proposed legislation.

I would be most grateful for your urgent consideration and response to this matter. The proposed pension fund investment is a critical element of the financing arrangements for New York City.

Sincerely,

[Signature]

Enclosures
Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 503 of the Internal Revenue Code of 1954 be and hereby is amended as follows:

SEC. 1. By striking in subsection (b) of section 503 the phrase "For purposes of this section," and by inserting in lieu thereof "For purposes of this section, and except as provided in subsection (h),".

SEC. 2. By adding a new subsection (h) to section 503 as follows:

"(h) CERTAIN GOVERNMENTAL PLANS EXCLUDED. -- Subsection (b) shall not apply to a plan described in section 401(a) which is referred to in section 4975(g)(2) if the creator of such plan is a State or political subdivision thereof, the outstanding obligations of which have been guaranteed by the United States or any agency or instrumentality thereof."
The following will be added to the Internal Revenue Code of 1954, as amended, as a new Section 501(c)(20):

Section 501(c)(20) - State or local governmental employees' retirement systems or pension funds created to provide benefits for the employees of any State or political subdivision thereof, or any agency or instrumentality of the foregoing, provided payment of such benefits is an obligation of any such governmental unit, agency or instrumentality.

Section 503(a)(1)(B) will be amended by adding the parenthetical phrase "other than an organization described in section 501(c)(20)" in the second line of paragraph (B) between the words "or (3)" and "shall not be exempt". Thus, as modified, Section 503(a)(1)(B) would read as follows:

Section 503(a)(1)(B) - An organization described in section 491(a) which is referred to in section 4975(g)(2) or (3)(other than an organization described in section 501(c)(20)) shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after March 1, 1954.
December 3, 1975

BY HAND

Victor Marrero, Esq.
Assistant General Counsel
New York State Executive Chamber
1350 Avenue of the Americas
10th floor
New York, New York 10019

Dear Vic:

This is further to my letter of November 26, 1975 to Mr. Herbert Elish transmitting the proposed legislation to amend the Internal Revenue Code to make possible under section 503 the proposed pension fund investment in New York City obligations.

A.I. Zwerdling, Esq., who is Counsel to the American Federation of State, County and Municipal Employees in Washington, D.C., and Mr. William Welsh discussed this matter on the telephone with me yesterday.

They advised that the pending tax bill will be heard in the House under a closed rule which will not permit amendment. Therefore, the best opportunity to obtain the necessary legislation this month--and of course it is critical that it be enacted this month--would be to
solicit its urgent consideration by Senator Long and Representative Ullman with the suggestion that if they concur in the desirability of this legislation it be added during the Senate's consideration of the bill, either in committee or on the floor.

To accomplish this purpose, they suggested that the Governor write Senator Long and Representative Ullman, and I have taken the liberty of drafting such a letter for the Governor's signature. A copy is enclosed, as are copies of the two enclosures referred to in the letter.

I trust that you will be able to review this matter and make arrangements for the Governor to sign the proposed letter as soon as possible. If the Governor does sign the letter, please make sure that I receive a copy. Naturally, I would be glad to discuss with you any changes you would like to make in the letter or any alternative ways of proceeding.

Sincerely,

Bill

William Josephson

WJ:seg

Enclosures

cc: Mr. Herbert Elish
    Allen Thomas, Esq.
The Honorable Russell B. Long  
Chairman  
Committee on Finance  
United States Senate  
Washington, D.C. 20510  

The Honorable Al Ullman  
Chairman  
Committee on Ways and Means  
House of Representatives  
Washington, D.C. 20515  

Dear ____________

I am writing respectfully to request that you consider the enclosed amendment to the pending tax bill which is vital to the financial arrangements concerning The City of New York which we have made during the last ten days or two weeks.

As President Ford announced during his press conference on November 26, 1975, eleven major banks, four New York City sinking funds and five New York City employee pension funds have entered into a comprehensive agreement with respect to New York City's finances over the next three years. A copy of that agreement is enclosed.

Under paragraph 7 of that agreement, the five pension funds agreed to purchase $2.530 billion of New York City serial bonds. Originally, we had thought it would be possible for them to purchase instead obligations of Municipal Assistance Corporation. However, statutory limitations on the Municipal
Assistance Corporation's issuing authority and the requirements of other aspects of the agreement made as of the 26th day of November, 1975 made it impossible for Municipal Assistance Corporation to issue more than $500 million of its obligations in this connection.

The change from Municipal Assistance Corporation to City obligations created a special problem for the pension funds under section 503(b) of the Internal Revenue Code of 1954, as amended. Although people do not ordinarily think of public employee pension funds as being qualified exempt organization pension funds under sections 401 and 501 of the Internal Revenue Code, like private employee pension funds, under the statute they certainly appear to be, and inquiries at both the New York District Office and the National Office of the Internal Revenue Service confirm this.

As you know, section 503(b) of the Internal Revenue Code of 1954, as amended basically prohibits employee pension funds from investing in employer securities.

It is, therefore, one of the conditions of the $2.530 billion pension fund investment referred to above that the Internal Revenue Service shall have ruled or the Congress of the United States shall have provided that the proposed purchases of New York City obligations not constitute prohibited transactions or otherwise affect the qualified status of the pension funds. See paragraph 7(e)(vi) of the agreement made as of the 26th day of November, 1975. Our conversations with the Internal Revenue Service indicate that there is little statutory or regulatory basis for a favorable administrative determination
in this connection.

I have, therefore, had drafted and enclose in
the form of a bill a simple amendment to section 503(a)
which would take care of this situation. I understand that
the tax bill which has been reported to the Committee on
Ways and Means is proceeding through the House under a
closed rule. It was my hope that, if this proposed legis-
lation, after it has been examined by your respective staffs
and your selves, is found deserving of consideration,
arrangements could be made for it to be added to the tax
bill in committee or on the floor of the Senate.

Naturally, we are not wedded to any particular
form of words, and my staff as well as the lawyers for the
pension funds are available to meet with your staff at any
time to provide further information or to discuss any
required changes in the proposed legislation.

I would be most grateful for your urgent consider-
ation and response to this matter. The proposed pension fund
investment is a critical element of the financing arrangements
for New York City.

Sincerely yours,

Governor

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 26, 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 $2,530,000,000. 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 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 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 agreement to purchase by the Pension Funds was, we believe, a key assumption 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 $2.5 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 $1.3 billion. To date, the City has borrowed all but $320 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 such 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 any of the conditions 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 and their obligations under the Agreement will be limited to the purchase of $500,000,000 of MAC 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.

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 debentures 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 disinclination to issue such a ruling both with respect to the December purchases and subsequent purchases and has indicated that legislative action 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. 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) or 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 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, 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 $185 million of New York City bonds
Mr. Herbert Elish  
Executive Director  
Municipal Assistance Corporation  
1350 Avenue of the Americas  
New York, New York 10019

Dear Herb:

I am writing to you because the Municipal Assistance Corporation has, with the Governor's Office, been most directly involved in the Washington negotiations.

As you know, section 7(e)(vi) of the proposed agreement made as of the 24th day of November 1975 envisages an Internal Revenue Service ruling or a Congressional enactment with respect to the issues raised by section 503 of the Internal Revenue Code of 1954, as amended.

Mayer Siegel, Esq. of this firm has discussed the issues with the New York District Office of the Internal Revenue Service yesterday and will continue those discussions with the National Office today. While the relevant revenue procedures indicate that the Internal Revenue Service is prepared to issue rulings on section 503 issues, his discussions to date confirm our judgment that this is not an area in which the Internal Revenue Service should be asked to rule.
Accordingly, we have drafted the enclosed bill which should be included on the agenda of further Washington discussions. The bill applies to New York State as well as City retirement systems in view of the likelihood that similar issues exist or will exist in the relationship between the State of New York and its retirement systems.

Unless I hear otherwise, we will assume that responsibility for the pursuit of this matter is in the hands of your colleagues or yourself.

Best regards.

Sincerely,

William Josephson

WJ:seg

Enclosure

cc:  Mr. Jack Bigel
     Mr. Bernard Goldberg
     Mr. Victor Gotbaum
     Martin Lipton, Esq.
     Victor Marrero, Esq.
     Bertram Perkel, Esq.
     Richard Sigal, Esq.
     Allen Thomas, Esq.
     Mr. Arthur Tibaldi
     Julius Topol, Esq.
IN THE HOUSE OF REPRESENTATIVES
November , 1975

Mr. introduced the following bill which was referred
to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 to exclude certain
transactions by the public employee retirement systems
of the State of New York and its political subdivisions
from the requirements of Section 503.

Be it enacted by the Senate and the House of Representatives
of the United States of America in Congress assembled,

That subsection (a) of Section 503 of the Internal Revenue Code
of 1954, as amended, which relates to the denial of exemption to
organizations engaged in prohibited transactions, is amended by
adding at the end thereof a new paragraph to read as follows:

"(3) CERTAIN ORGANIZATIONS EXCLUDED. Notwithstanding
the provisions of paragraph (1), an organization shall not cease
to be exempt from taxation under section 501(a) for any fiscal year
beginning after June 30, 1974 because it has engaged in a transaction
described in subsection (b) if --

(A) such transaction consisted of the purchase of
(including exchange of property for), extension of time for pay-
ment of principal of, or waiver of all or part of the interest
on, bonds, notes or other obligations issued by the State of New
York or any political subdivision or public corporation thereof;
and
(B) such organization is an organization described
in section 414(d) established and maintained by the State of New
York or a political subdivision thereof."
November 13, 1975

Mr. Felix G. Rohatyn
Chairman
Municipal Assistance Corporation
2 World Trade Center
New York, New York 10047

Dear Mr. Rohatyn:

The undersigned are aware that the Trustees of the Municipal Employees Retirement Systems are presently considering the investment of $2.5 billion in new securities as part of an overall program to meet the needs of the City of New York between now and the end of fiscal year 1977-78 and are considering agreeing to a conversion of MAC securities presently held by these systems to a new MAC issue of 6%, 10 year bonds and to a conversion of city notes held by the systems for a new city issue of 6%, 10 year bonds. The aggregate amount of securities to be converted is $1.2 billion.

The undersigned agree to use their best efforts to cause the Trustees to approve, in the exercise of their discretion, the items referred to above.

The undersigned understand that the Federal and State governments require that the ITHP portion of the City's contribution to the systems be reduced by 50%. This will increase the employees' annual contributions by $107 million.

The above commitments are subject to the completion of a financial package assuring funding of the City government through Fiscal Year 1977-78, including the Federal guarantees of securities, or other Federal funding, required to complete the financial package.

Sincerely,

Vicor Gomb
Executive Director, District Council 37

Albert Shanker, President
Local 2, United Federation of Teachers

John J. Delury
President, Uniformed Sanitationmen's Association, Local 831 I.B.T.
November 13, 1975

BY HAND

Mr. Herbert Elish
Executive Director
Municipal Assistance Corporation
2 World Trade Center, Room 4540
New York, New York 10047

Dear Herb:

In connection with the draft bill and supporting memorandum you are considering, enclosed is a copy of a memorandum dated November 12, 1975 from one of my associates, George Lander, which indicates that a home rule message is necessary to the enactment of the legislation in question.

George tried to review his conclusion with the Corporation Counsel's office, but could not find anyone who would cooperate.

Usually there is no difficulty obtaining the necessary home rule message.

Sincerely,

William Josephson

cc: Mr. Victor Gotbaum
    Julius Topol, Esq.
MEMORANDUM

November 12, 1975

TO: William Josephson  
   E. Thomas Veal

FROM: George Lander

RE: District Council 37 1359-2

ISSUE: Is a home rule message necessary for the adoption of the proposed legislation relating to the New York City Retirement Systems?

CONCLUSION: This legislation would be a special law relating to the "property, affairs or government" of a local municipality and the New York State Legislature is forbidden from enacting such law unless it first receives a home rule message from New York City.

ANALYSIS: The New York State Constitution in pertinent part reads as follows:

"[The Legislature] shall have the power to act in relation to the property, affairs or government of any local government only by general law, or by special law only (a) on request of two-thirds of the total membership of a legislative body or on request of its chief executive officer concurred in by a majority of such membership ..." Article 9, Section 2.

A special law is defined in the New York State Constitution as follows:

"...a law which in terms and in effect applies to one or more, but not all, counties,...cities, towns or villages" Article 9, Section 3.

Since the proposed legislation relates almost entirely to
New York City and its retirement systems it would qualify as a special law. The question of whether this type of legislation would affect the "property, affairs or government of any local government" was considered by a 1943 opinion of the Attorney General. The legislation there dealt with the reduction of the retirement age of various members of the New York City Employees Retirement System. The conclusion of that opinion was:

"The New York City Employees Retirement System relates to the 'property, affairs or government' of the City and is primarily of local concern. The Legislature may not act with relation thereto by other than general laws, except on City message." 1943 Op. Atty. Gen. 420.

Since the constitution requires that the Legislature shall have the power to act only on request of the affected municipality it appears that the home rule message must precede final passage by the Legislature.

The procedure for a home rule message is set out in Section 40 of the Municipal Home Rule Law. This requires that the New York State Legislature be requested to enact such a bill. Such request must be made by either two-thirds of the legislative body of the municipality or a majority of such legislative body with the concurrence of the chief executive officer. It further requires that the message shall declare that "a necessity exists for the passage of such bill" and it must include the reasons for such necessity. The validity of such legislation is not subject to judicial review.
on the grounds that such necessity did not in fact exist. The form of the request and the form in which it is communicated to the Legislature is promulgated by resolution of both houses of the State Legislature.

The proposed legislation can only be enacted by the State Legislature because Section 113 of the Retirement and Social Security Law prohibits any municipality from enacting any law that would change, modify, amend or repeal any provision relating to pension or retirement systems, with certain exceptions not here pertinent.
August 8, 1975

Dear Governor Carey:

I have carefully reviewed and discussed with the Executive Committee of the New York City Municipal Assistance Corporation the bill (S.6804) to authorize New York City once again to reduce its contributions to the city retirement systems by the amount of estimated excess interest to be earned by the various pension funds.

We were aware of the city's request for this legislation and have been deeply concerned over its implications. The measure is an extension of similar legislation approved last year and represents the very same unsound financing and accounting practices which have so impaired New York City's fiscal base and eroded investor confidence in its securities. Absent continuing legislative authorization to renew this financing, the revenues generated by this bill are non-recurring. Such one time revenue sources, if discontinued, create an instant gap in the budget. Inevitably they develop irrefutable pressures for self-perpetuation year after year, backed by the painful consequences that failure to renew would entail. The beginning of such a trend is evidenced here, the second year that authority for these revenues has been requested. Irreversible dependence on one time revenues is particularly troublesome in the case of funds of the city's retirement systems. For, it is public knowledge that New York City's retirement systems are under-funded.

We must note, however, that the city included this item as a revenue source in its original 1975-76 proposed budget and that the adopted expense budget continues to carry these funds. We note also that since the measure was introduced in the budget, the city, with the support and encouragement of the New York City Municipal Assistance Corporation, has taken significant steps to achieve substantial economies and to eliminate several objectionable financial practices.
To deprive the city of these revenues would force corresponding additional budget reductions. Mindful that we face the very same dilemma that we suggest must be avoided, we feel that it would not be in the city's best interest at this time to cause an unexpected revenue short fall in the expense budget. We therefore recommend that you approve the bill, though we reached our position reluctantly and with the understanding that we will vigorously object to any effort to plan for these revenues in connection with future city budgets and will oppose any legislation hereafter introduced to permit it.

Sincerely,

[Signature]

Herbert Elish

Honorable Hugh L. Carey
Governor
State of New York
Executive Chamber
State Capitol
Albany, New York 12224