MEMORANDUM

TO:      Board Members and Representatives

FROM:    Stephen J. Weinstein

DATE:    November 16, 1976

RE:      HOUSE PENSION TASK FORCE

Enclosed is a copy of the letter submitted by the Corporation to the Pension Task Force of the United States House of Representatives Subcommittee on Labor Standards, concerning the Task Force's draft report on public pension fund investments.

Enclosure

S JW/ mp
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.
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

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

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
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 Sgaglione 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 KelNn, Executive Director

Enclosures
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards  
United States House of Representatives  
House Office Building  
Room 2164  
Washington, D.C.  
20515  

SCHEDULE OF APPENDICES  

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


11/1/76
November 15, 1976

Mr. Eugene Keilin
Executive Director
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 artifically 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.
Mr. Eugene Keilin

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.
Mr. Eugene Keilin

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,

[Signature]

JOHN H. DENT
Chairman

JHD:sh
Mr. Eugene Keilin

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Sincerely yours,

[Signature]

JOHN H. DENT
Chairman

JHD:sh
November 3, 1976

Howard Klein, Esquire
Counsel
Subcommittee on Labor Standards
U. S. House of Representatives
Rayburn House Office Building - Room 2104
Washington, D. C. 20515

Dear Mr. Klein:

I am enclosing an additional attachment to the Municipal Assistance Corporation's submission to the Pension Task Force, dated November 1, 1976. A copy of the New York State Legislation (Chapter 890, Laws of 1975) relating to Pension System investments, referred to on page 3 and 4 of our letter, is enclosed.

I would appreciate your including this additional item in your official record.

Sincerely,

Stephen J. Weinstein
Deputy Executive Director

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

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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.

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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
Hon. John H. Dent
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attempt 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.

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Hon. John H. Dent
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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 (1) 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
Hon. John H. Dent
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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
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

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 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.

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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. Dent  
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 G. 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.L.T.
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 and its efforts to aid The City of New York to avoid default, bankruptcy and the fiscal and social chaos that would inevitably follow.

We commend you for your wisdom in remanding the draft for further study by the staff. MAC shares your belief that there is much valuable and useful work to be done by Congress in this area, but that such work requires thorough and careful analysis of the many complex factors involved. Premature release of poorly analyzed data can harm the very people whose protection the Subcommittee seeks to promote.
MAC first became aware of the draft report from the press account in the New York Daily News. No one at MAC 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 at best, because those of us who have lived with and worked on the City's problems for the last year and a half could have, we believe, made a substantial contribution to the staff's understanding of the area covered by the draft report.

The draft of the staff report which we have been given contains sections dealing with MAC, the City and the City Pension System which reflect such a low level of understanding of and appreciation for the complex economic, legal and social issues involved as to lead us to believe that its authors are either primitively naive or flagrantly biased. They ignore the depth and complexity of the fiscal emergency in which the City finds itself. They ignore the monumental efforts of the State and of the Federal governments to deal with that emergency. Finally and most importantly, they ignore the plain and obvious fact that the course they outline 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. The social chaos that would follow such a default would dangerously undermine all
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

institutions of the largest city in the nation, including the very pension system which the authors of the draft report seek to defend.

**November 26, 1975 Agreement**

The draft report singles out for criticism 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 MAC.

This commitment to invest is reflected in a voluntary agreement, dated November 26, 1975, among MAC the eleven New York Clearing House Banks, 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
Hon. John H. Dent
Chairman Subcommittee on Labor Standards

$2.3 billion of essential intra-year seasonal financing for
The City of New York.

The voluntary agreement of the Pension Funds to purchase New York City or MAC bonds, 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 of New York. 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 serious historic underfunding of the Pension System, as described in the draft report, made it most likely that, unless City's financial problems were solved on a long-range basis, it would be unable in the long run to continue to provide pension benefits even to those employees who had already retired and were receiving such benefits.

The November 26 Agreement incorporates numerous safeguards for the Pension System. First, the $2.53 billion
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

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 has been 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 were included in the November 26 Agreement, at the insistence 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.
Hon. John H. Dent
Chairman Subcommittee on Labor Standards

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 City and MAC bonds. 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 (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 readily be seen, this enactment merely 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
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards  

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. It should be obvious that no invidious purpose is served by this legislation as is implied by the authors of the draft report.

The draft report's reference to the Sgaglione case is both gratuitous and incorrect. The Sgaglione case involved a legislative direction to the State Pension Funds to invest in MAC securities. The legislation described above does not interfere at all with the discretion of the Pension System with respect to whether to invest in MAC bonds or those of the City. Indeed, it recognizes that such investments may be made only voluntarily.

Federal Legislation

The most striking irony -- or hypocrisy -- of the draft report is that it totally ignores the legislation previously passed by this Congress, after a full hearing, that recognizes and approves of the very investment program that the report now holds up for criticism.

In February of 1976, this Congress passed a Bill designated H.R. 11700. That Bill was designed to exclude
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

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 City bonds, or those of MAC, contemplated by the November 26 Agreement.

In addition, H.R. 1100 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, albeit in the context of the Internal Revenue Code "qualification" principles, by H.R. 11700. 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. It would be inappropriate in the
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

extreme for the staff to attempt to undo the judgments made only a few months ago by this Congress and reflected in H.R. 11700 by urging the adoption of the draft report.

Furthermore, as stated by Congressman Ullman on the floor of the House on behalf of the Way 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. It should not now be upset.

MAC Bonds and City Bonds

Finally, we should say a word or two about the
MAC bonds and the City bonds which the draft report so roundly -- and on such little information -- criticizes. Neither is the unsound investment as characterized by the draft.

MAC bonds 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 MAC's general bond resolutions to insure adequate sources of funds to pay debt service on all of its bonds. MAC 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 MAC bonds, recently such confusion has largely been dissipated and the market in MAC bonds has strengthened substantially. In addition, in connection with the marketing of MAC 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
Hon. John H. Dent  
Chairman Subcommittee on Labor Standards

Emergency Moratorium Act.

Finally, 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 of the City and that continued investments by the City Pension System in bonds of the City, or bonds of MAC, are in the best interests of the pension beneficiaries of the City Pension System. Accordingly, we endorse your remand of the draft report for further study and reconsideration in light of the Congressional policies reflected in those prior actions and in light of the material outlined in this letter.

We thank you for giving us this opportunity to express our views on this vital and complex matter. We
Hon. John H. Dent
Chairman Subcommittee on Labor Standards

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 MAC 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