As many of you know, my father served for 24 years as New York State Comptroller. I trace to him my abiding interest in the integrity of the municipal debt markets, and my concern over recent examples of public money management gone awry.

Of course, I have professional concerns as well. The municipal bond market is now valued at some $1.2 trillion. It is of critical importance to our nation's future. And it has undergone a fundamental change in the last decade, from a market dominated by commercial banks, to one in which individual investors hold almost 70 percent of outstanding securities, directly or indirectly.

That is why, from my first days as Chairman of the Commission, I have held the reform of the municipal securities markets among my highest priorities.

Only a few weeks after I was sworn into office, I told the Congress that "to some observers, the most significant flaw in the municipal securities market is the lack of trading information available to investors and market professionals."

Today, improvements in market price transparency are well underway. Working with a broad spectrum of industry groups under the leadership of the Government Finance Officers' Association, the SEC crafted a framework for secondary market disclosure through the amendments to rule 15c2-12. These measures went fully into effect this past January first. In addition, a private initiative was undertaken by the Public Securities Association to make selected trade and price information available to the public on a regular basis. We now need to bring to a completion the plan of the Municipal Securities Rulemaking Board to make same-day price reporting of retail trades a reality.

Other problems were waiting in line to be addressed. In my years in the securities industry, I had found myself attending too many fundraisers for candidates I didn't know, seeking office in places I didn't live. At the time I was sworn in, young people entering the municipal securities business were still learning the pernicious practice of "pay-to-play," in which political campaign contributions open the door to underwriting business.

Not only does this subvert a freely competitive business -- it also teaches contempt for the political process. Right from
the start, the industry demonstrated its sincere commitment to reform. In October of 1993, more than 15 of the nation's largest firms agreed in principle to cease making political contributions that attempt, or even appear to attempt to influence the selection of the firm as an underwriter.

Today, the industry has imposed rules that codify the voluntary ban on political contributions, and these rules are bringing to an end the days of pay-to-play. We're now at the next stage of that initiative: how to prevent lawyers and lobbyists from acting as surrogates for firms and making contributions on their behalf. We raised the issue with the industry, and the Association of the Bar of the City of New York, under the leadership of Cyrus Vance, stepped forward with its own plan to discourage the practice among its members. We are now asking issuers, firms, and potential surrogates alike to address this issue and obviate the need for SEC action.

These are positive achievements. To see how much more remains to be done, one need look no further than the problems in Orange County. I want to use this opportunity today to discuss three issues raised by the county's brush with disaster -- the sound management of public funds; preserving public trust in the municipal market; and the Commission's recent enforcement actions in this vital market.

PRUDENT MANAGEMENT OF PUBLIC FUNDS

The municipal bond market is of critical importance to our nation's future. It represents the schools that teach our children, the water we drink, the power that enhances our lives and drives our economy, the roads that take us where we need to go. American investors trust municipal bonds as they do few other instruments, and this has helped make them a popular investment.

And yet, this has been a tumultuous time for the muni market. The Orange County bankruptcy and default followed the loss of an estimated 1.7 billion dollars in public funds through a risky investment strategy. There have been reports of other losses, fortunately less severe than Orange County.

I know the concern you have over these issues. And surely you know better than most the apprehension felt by local taxpayers.

The public has a right to expect that money will be available when needed to keep the schools open, to police the streets, and to meet the other civic needs for which taxes are paid. Such funds can generate additional revenue in the interim, and that is good.
Care must be taken, however, that the return received does not become a narcotic, inducing dependency by being built into annual budgets as a significant revenue source in and of itself. Such an addiction loses sight of the original purpose for raising the funds, and it courts disaster in the event of sudden market changes. Using the treasury function as a profit center has backfired on some sophisticated corporate managers in recent years; as we saw in Orange County, it is no less risky for public officials.

The harsh lessons of the markets have been visited over the past 18 months upon large corporations and dealers, as well as municipal governments. A factor common in many cases has been an absence or breakdown of internal controls.

These developments offer an unprecedented opportunity for all concerned to be sure that proper controls are in place. Surprising investment gains should set off alarms every bit as loudly as surprising losses. At the same time, let us not be seduced by easy cures, such as narrowing lists of permitted investments to only the safest. Instead of eliminating investment tools, we should be ensuring that they are well understood and wisely employed.

Some have called on the federal government to intervene. I told Congress last year that I believe the regulation of state and local investment practices is the responsibility of the states. If there's a role for the federal government in all this, it is to offer our support and to share any knowledge and experience we have that may be of use to local governments.

Treasury Secretary Rubin and I have been actively pursuing such a dialogue for the past eight months. We've met with state and local government officials throughout the country in an intensive outreach effort.

The Commission is especially concerned because what is at stake here is not just the fate of one or two municipalities -- it is the entire mechanism of public finance, which is based on the public's trust. That trust has been eroded by the events of the last year and a half, and that's the second item I'd like to talk to you about.

PUBLIC TRUST AND THE GENERAL OBLIGATION BOND

Americans trust municipal bonds as they do few other instruments. This has worked to keep costs low for issuers. The Orange County bankruptcy filing and default may therefore impose costs on public finance that will be felt for years to come, by issuers miles from Southern California.

There may be another cost imposed as well -- one associated
with the phrase "willingness to pay." Recent headlines speak of actual or looming default because citizens or legislatures are no longer willing to support debt service. And, in Orange County, a large issuer publicly put in question the validity of its own debts. Whether sincere or a negotiating ploy, these expressions of uncertainty may have added a new premium for legal risk.

Corporate debt and equity markets have had to cope with broken contracts time and again. But municipal bonds are different. Local government bonds typically carry the "full faith and credit" of the issuer -- a pledge that investors will be repaid before anyone else. So strong is this obligation that even during the Depression, virtually all the debt that defaulted was repaid with interest, and with interest on the interest.

Since the Depression, no general obligation bond of a major issuer has ever defaulted, until now. The consequences have been heavy for Orange County, but a default also severely unsettles a group just as important to local government as taxpayers -- the bondholders who lend it money, whether as individuals or through mutual funds -- hardworking women and men throughout America looking for a decent, secure investment for their savings, whether for their children's schooling; or to start a business someday; or perhaps for retirement.

This time of difficulty in municipal finance will doubtless produce lessons for all of us. One lesson we should not draw, however, is the wrongheaded notion that Chapter 9 may be an alternative to responsible but unpopular decisions to fulfill the obligations incurred by local governments. Chapter 9 should be a last resort -- not an easy way to avoid debts, or a safe haven for fainthearted officials.

It's been said that trust is won with difficulty and easily lost. Municipal bonds -- and the municipal bond market -- have enjoyed a solid reputation because of the valiant efforts of many in the past. We must all work to maintain and enhance public faith in the market.

THE DISCLOSURE OBLIGATIONS OF PUBLIC OFFICIALS

The third and final subject I'd like to discuss with you today has to do with the Commission's enforcement activities in the municipal market. I've mentioned the Orange County bankruptcy several times. Local government officials who authorize the issuance of municipal securities have serious responsibilities under the federal securities laws.

Enforcement actions are a necessary, if unpleasant, part of any capital market -- including the municipal market. As the Government Finance Officers Association told the Commission in the summer of 1994: "Enhanced enforcement activity can do more to
focus previously non-compliant issuers and underwriters on their responsibilities that any other." GFOA then went on to call specifically for "enforcement actions that put market participants on notice that they will be penalized for their actions." We received the same encouragement from bond lawyers.

While Orange County has garnered the lion's share of attention, it has not been our only municipal case. Over the past three years, our Division of Enforcement has brought 20 cases involving the municipal securities markets -- and in fact, only the Orange County matter names the issuer. Many of the enforcement actions we've brought actually concern fraud against an issuer. These actions have involved virtually every market participant: national and regional underwriting firms, national and local financial advisory firms, employees of those firms, bond counsel, underwriters counsel, and consultants as well as elected officials.

These cases are all based on failures to disclose, whether issuer financial problems, facts and associated risks relating to the tax-exempt status of the obligations, or conflicts of interest, including pay-to-play. Virtually all involve violations of the basic antifraud sections -- Section 17(a) of the Securities Act and Section 10 and rule 10b-5 of the Exchange Act. In more than a few instances, there have also been parallel criminal proceedings, which should be a pretty good signal that the conduct involved was not "borderline."

This weeding-out process doesn't mean that the entire garden has gone bad. To the contrary, the vast majority of market participants have been playing by the rules. Weeding can only make the garden healthier, and these cases make it clear to any observer that discipline is being maintained.

The SEC's actions have led to a renewed interest in the securities law obligations of state and local governments. This is a message we've been stressing for 20 years, and we welcome the chance to repeat it:

Public entities that issue securities are primarily liable for the content of their disclosure documents and are subject to proscriptions under the federal securities laws against false and misleading information in their disclosure documents.

Issuers of municipal securities are not subject to the same registration and reporting provisions of securities laws as those on the corporate side. The complex set of rules known as line item disclosure do not apply. However, the antifraud provisions most certainly do apply.

They are really quite simple at their core. They call for
full disclosure of information material to investors making an investment decision.

And materiality, the Supreme Court tells us, is determined by what a hypothetical reasonable investor would want to know in order to decide whether to sell, buy, or hold.

What does that mean for a local government official? The Commission's report on the conduct of members of the Orange County Board of Supervisors points out that:

In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading.

Does this mean that local government officials can't rely on experts, lawyers and financial advisors?

Of course they can -- just as officials of public companies do. That reliance, however, must be reasonable. You should also keep in mind the Commission's admonition in 1989 that:

Because they are ultimately liable for the content of their disclosure, issuers should insist that any persons retained to assist in the preparation of their disclosure documents have a professional understanding of the disclosure requirements under federal securities laws.

Public officials who authorize the issuance of securities by a municipal government are not guarantors of such investments. Their responsibilities, however, do include some reasonable attention to providing accurate disclosure to the investors who buy their bonds and notes.

This is not overly complex; it requires neither an MBA nor a Ph.D. When, as in Orange County, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps, appropriate under the circumstances, to prevent the dissemination of materially false or misleading information.

I hope my talk today has conveyed a sense of how passionately we care about the municipal market. We will do everything we can to foster its liquidity, fairness, and the perception of its fairness.

As recently as a few years ago, for most Americans,
municipal finance was a kind of sleepy backwater, misunderstood and underappreciated. Today, it's been catapulted into the headlines. Citizens have worked hard to pay their taxes, only to see them swept away like a losing bet on a roulette wheel. Investors have loaned their savings to municipalities in need of cash, only to see the very obligation to repay brought into question.

You and I can change these things -- but we can't do it alone.

For the sake of our cities, our states, and our nation, let's continue to work together to create a municipal market that's worthy of the 21st century.