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Although my remarks will focus on the United States, I mean no disrespect for our Canadian friends. I'm not an expert on their marketplace -- and even if I were, I'm not sure that they'd welcome my commentary. In fact, I'm not even sure that American treasurers welcome my commentary. But, welcome or not, I believe and hope that some of the ideas I'll discuss will also be of interest to our neighbors from the north.

I have a special bond with this audience -- as you may know, my father served for 24 years as New York State Comptroller. From my youngest days, he impressed upon me the duty to care for the assets of the people prudently. He considered it a sacred trust. I regard his profession -- yours -- as one of the most important to the ordinary citizen, who often knows nothing of its existence, beyond the fact that taxes are paid, schools are built, roads are paved, and the pension check arrives on time.

I trace to my father my abiding interest in the integrity of the municipal debt markets, and my concern over recent examples of public money management gone awry. I know these are your concerns as well, and that you've spent many hours thinking about and addressing them.

Of course, I have professional concerns as well. The municipal bond market is now worth about \$1.2 trillion. It is of critical importance to our nation's future, representing our schools, our roads, and our water supply. And it's undergone a fundamental change in the last decade, from a market dominated by institutional investors, to one in which individual investors hold 70 percent of outstanding securities.

If you can put up with advice from an official of a government that is somewhat larger, if not always better managed than your own, I'd like to talk to you today about three aspects of the municipal market: the prudent management of public funds; the preservation of public trust; and the integrity of the offering process.

#### PRUDENT MANAGEMENT OF PUBLIC FUNDS

Perhaps no question is as pressing today for finance officials as prudent investment. Large sums of public money have been lost through investment strategies so laden with risk that the notion that they were undertaken in fulfillment of the public

trust seems incomprehensible. I know the tremendous concern each of you has with such losses. And surely you know better than I the tremendous concern this has generated among state and 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 they paid their taxes. When such funds can generate additional revenue in the interim, so much the better. 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; it is no less risky for public officials.

Our markets have undergone dramatic changes. Complex instruments have been developed that are capable of producing breathtaking returns -- or breathtaking losses. The three basics of public fund management, however, have not changed: safety, liquidity, and yield -- in that order.

In the complex markets of the 1990s, safety is no longer synonymous with credit quality. When investment terms and liquidity needs are mismatched, a volatile market can quickly eviscerate investments with even the most impeccable credit rating.

There are two important steps that can help assure safety: a written investment policy, and independent oversight. A written and publicly available investment policy, coupled with current internal portfolio information, reinforces accountability. But without an independent review of actual performance on a frequent basis, a written policy can quickly become just so many words. Your councils, boards, and supervisory bodies should review lists of authorized investments regularly, and monitor the results closely. Surprising investment gains should set off alarms every bit as loudly as surprising losses.

At the same time, care must be taken not to be seduced by easy cures, such as narrowing lists of permitted investments to only the safest. That's like trying to avoid the dangers of electricity by outlawing it. One of the most common ways to hedge against risk is to diversify, which is to increase choices. Instead of eliminating investment tools, we should be ensuring that they are well understood and wisely employed.

Frequent valuation, or marking to market, is also useful, especially where a high degree of liquidity is needed.

State treasurers are clearly aware of these points. In the wake of the Orange County disaster, the National Association of State Treasurers formed a task force to update its 1989 guidelines on state-managed Local Government Investment Pools. The report of this task force, released last month, recommends a written investment policy, independent third party oversight, frequent valuation, and improved and continuing disclosure of pool investment policy and operations to participants, among others.

Much public attention has been focused on derivatives and other volatile instruments. This turbulent year has produced some thoughtful advice, in particular the report prepared by the Derivatives Policy Group, which is actually a series of commitments by six firms that are significant market participants. The report provides useful guidance for end-users as well as for dealers and intermediaries.

All customers -- whether it's your neighbor down the street, your local municipality, or a large, international corporation -- must take responsibility for understanding what they are buying and how it fits their investment objectives. But we must never forget that responsibility is a two-way street.

I know that the GFOA has been active in expressing its views on the responsibilities of a broker-dealer to its customers, particularly those that may be classified as "institutional" investors. They have commented, for example, on proposals put forward in the past year by the National Association of Securities Dealers regarding the NASD's so-called "suitability rule." I'm limited in what I can say about the NASD's most recent proposal, because I anticipate that the SEC will be presented with a rule filing on this issue very soon. I can say, however, that the question of striking an appropriate balance between the obligations of broker-dealers and the responsibility of customers is critical.

The GFOA has recommended practices that promote the wise use of potentially volatile investment instruments. It has urged that finance professionals understand that market, interest rate and liquidity risk can all play a powerful role in the safety of any investment.

And it has underscored a rule that should apply to any investment strategy: exotic instruments should only be considered by entities that have the required expertise and resources. If I may continue the analogy: Electricity is a wonderful thing, but if you don't understand it, you have no business trying to wire a house by yourself.

Some have called on the federal government to intervene. I said in my testimony before the Congress earlier this year that I

believe regulation of state and local investment practices is best left to 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 you.

This federal-state dialogue is long overdue, and our meeting today is but the first of many I intend to have with state and local finance officers in an intensive outreach effort over the next six months. It's in our mutual interest to publicize successful techniques for risk management, and to discuss the various approaches to protecting public funds. I pledge to you today that I'll work to address the problem through speeches, articles, and perhaps even videos.

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 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. No one understands that better than this group.

There may be another cost imposed as well -- one associated with the phrase "willingness to pay," which has at its roots financing structures that avoid constitutional debt limits. This development is not unique to California -- it is a reality of municipal finance in almost every state, and has been for a long time. You'll forgive me if I again refer to my father.

In 1974, he released a study that examined New York State's debt obligations. The report emphasized the enormous power that governments wield when they issue debt, in effect committing taxpayers' dollars for years into the future. It emphasized the tremendous ethical responsibility borne by issuers of municipal securities. And it concluded that "debt is at the same time one of the most important of the fiscal mechanisms available to government -- and one of the most vulnerable to misuse." He raised special concerns about the propensity of his state to avoid constitutional limits on debt through the proliferation of debt-issuing agencies.

The problems in Orange County made me recall my father's warnings. The financing vehicles that were of such concern to him have become a mainstay for many communities. And now a large issuer has publicly put in question the validity of its own debts, including these very instruments.

Whether sincere or a negotiating ploy, this expression of uncertainty may add a new premium for legal risk. The pledge to repay, once sacred, may soon hold no more credence than the marriage vows of a bigamist.

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, if the 50-basis-point premium the County's taxpayers recently had to pay is any measure. 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 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 enjoy a solid reputation today because of the valiant efforts of many in the past. My fondest hope is for that legacy to remain untarnished.

#### PUBLIC TRUST AND THE INTEGRITY OF THE OFFERING PROCESS

I'll close these remarks with a brief word about one other matter that threatens municipal finance: questions about hidden arrangements and the integrity of the offering process, especially those surrounding the practice known as "pay-to-play."

We've made great strides in our efforts to improve this market, yet we find ourselves in a situation in which an internationally renowned financial magazine like The Economist can still refer to "America's notoriously corrupt municipal bond market," as it did on April 15th of this year, and Fortune magazine can headline an article "The Big Sleaze in Muni Bonds," as it did not long ago.

The power and the popularity of the municipal market demand that it operate with complete honesty and integrity. It does not do so now.

In sentencing a defendant in a recent pay-to-play case in Florida, U.S. District Court Judge Roger Vinson called the facts of the case "symptomatic of a pervasive problem in government today. Government officials believe they are entitled to special treatment by lobbyists." Referring to the bribes and numerous dinners given to the defendant by a local underwriting firm, Judge Vinson stated that such practices "corrupt the integrity of our government. There is no area where the temptation is greater than in the area of bond issues."

And in its recent, unanimous decision upholding the MSRB's Rule G-37, the Court of Appeals for the District of Columbia stated quite clearly, "Underwriters' campaign contributions self-evidently create a conflict of interest in state and local officials who have power over municipal securities contracts, and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity."

Not only does pay-to-play undermine the integrity of the offering process -- it also harms issuers and the taxpayers that stand behind them. You need look no further than the actions filed against Stifel, Nicolaus two weeks ago and against the underwriters and financial advisers to the Camden County Municipal Utilities Authority earlier this year.

Some jurisdictions -- Florida, for example -- have made the ban on pay-to-play a matter of law. Connecticut recently adopted legislation that went further than most, barring contributors and State treasurers alike from doing business together. The City of New York has also demonstrated leadership on this issue; in its recent request for services, the City asked potential counsel whether they disclosed their political contributions.

And now, the Association of the Bar of the City of New York has recommended adoption of a disciplinary rule barring pay-to-play among lawyers. This, in turn, has prompted the American Bar Association to review the problem on a national level.

I recognize that Rule G-37 poses a challenge for those of you who are elected to office. But it's a challenge that I

believe will be easily met, for the rule is fair, and it applies equally to your political opponents -- all candidates are deprived of this source of campaign contributions. I believe it's a small price to pay for the integrity of our markets.

There's one other aspect of market integrity: Last month we opened a new chapter in municipal finance -- a chapter we wrote together -- as the first phase of secondary market disclosure took effect. Before they bring an issue to market, underwriters now need to know that issuers have agreed to provide annual financial information, as well as notice of certain types of events. I deeply appreciate the contributions of many of you in crafting the final rule, including the limited requirements for small issuers.

My friends, as recently as a few years ago, for most Americans, municipal finance was a kind of sleepy backwater, misunderstood and underappreciated. The three subjects I've discussed today -- prudent management, public trust, and the integrity of the offering process -- would hardly have raised a stir.

Today, they've 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. And all Americans have seen the currency of public trust debased by bribery and graft.

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.

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