The original documents are located in Box 78, folder "New York City, May – October 1975 (3)" of the L. William Seidman Files at the Gerald R. Ford Presidential Library.

PROPOSED ATTENDANCE FOR MEETING ON NEW YORK CITY:

September 2, 1975 - 6:45 p.m.

Governor Hugh L. Carey
David Burke, Secretary to the Governor
Peter Goldmark, Budget Director of the State of New York
John Hiemann, Superintendent of Banking
Felix Rohatyn, Advisor
Judge Simon Rifkind
Arthur Leavitt, State Controller
Bill Ellinghaus, Chairman of the Board, MAC
Michael Nadel, Asst. Counsel to the Governor

Administration:

The President
Donald Rumsfeld
L. Wm. Seidman
Alan Greenspan
Edwin Yeo
Richard Dunham
Rod Hills

9/2/75

Attendance list for 6:45 p.m. meeting:

Governor Hugh L. Carey, NYC

David Burke, Secretary to the Governor

Peter Goldmark, Budget Director of the State of New York

John Hiemann, Superintendent of Banking in the state

Felix Rohatyn, Advisor

Judge Simon Rifkind

Arthur Leavitt, State Controller

Michael Nadel, Asst. Counsel to the Governor

Bill Ellinghaus, Chairman of the Board, MAC

(NY State Security Officer)

LWS

w/ Prasson

NYC — 6.

Revised:
9/2/75
8:00 p.m.

STATEMENT OF PRESIDENT GERALD R. FORD

For the past six months, the President has been increasingly concerned about the financial conditions of New York City. At his request, Treasury Secretary William Simon and other Administration officials have been monitoring the situation.

Governor Carey and his associates from New York met this evening with the President and Administration officials and described the financial circumstances of New York City and his recommendations for the New York State Legislature.

Governor Carey described the difficult period of adjustment that will be needed to restore confidence in the City's financial practices and its long term economic well-being.

As their efforts to restore the city's economic health proceed, the President said he would ask Federal Departments and agencies to continue to stay in close touch with the officials involved and to report to him as appropriate.

However, the President indicated that he continues to believe that Federal financial assistance is not a solution to New York City's problem. Under our system of Government, it is not, and should not be, the job of the Federal Government to manage the finances of State and local governments. If funds were provided to New York, equity would require the Federal Government to provide assistance to other cities, a process that could lead to the Federalization of city affairs. In addition, the Executive Branch has no authority to provide additional direct financial assistance.

NYC 9/2

STATEMENT OF PRESIDENT GERALD R. FORD

For the past six months, I have been increasingly concerned about the financial conditions of New York City. At my request, Treasury Secretary William Simon and Chairman Arthur Burns have been closely monitoring the situation. They and their senior advisers have spent, and are continuing to spend, a large portion of every day seeking sound and workable approaches to the problem.

Governor Carey informed me today that in his opinion, the City of New York may have no alternative but to default on the payment of its obligations next week, unles the New York State Legislature enacts new legislation at its emergency session called for Thursday, and a proposed financing plan can be subsequently implemented.

Such a default would be a major tragedy not only for the people of the City and State of New York, but also for all of us throughout the Nation. What is even more tragic is that the circumstances which have given rise to the situation could have been anticipated and corrected.

But now is not the time for recrimination. Indeed as the Governor of New York, the State Legislature, and all those involved seek to work out a solution, it is a time for constructive effort.

Governor Carey has asked the Federal Government to assist the City and the State during the difficult period of adjustment that is needed to restore confidence in the City's financial practices and its long term economic well-being. We will do what we can but we continue to believe that Federal financial assistance would not solve New York City's problem. Under our system of Government, it is not, and should not be, the job of the Federal Government to manage the finances of State and local governments. If funds were provided to New York, equity would require the Federal Government to provide assistance to every other city, a process that would inevitably lead to the virtual Federalization of city affairs. I can not recommend such a policy.

In addition, the Executive Branch has no power to provide direct financial assistance without congressional action. This could not be accomplished in the time available even if it were desirable.

I encourage the efforts of the State and city to work out their problems. As their efforts to restore the city's economic health proceed, I have asked all Federal Departments and agencies involved to assist the city and the State in any way which is consistent with existing Federal laws and regulations.

THE WHITE HOUSE

WASHINGTON

September 2, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN

SUBJECT: New York City Situation

This memorandum reports on the current financial situation in New York City and reviews the impact of the possible default by New York City and the appropriate actions by the Administration at this time.

Current Status

Last night, at the request of New York State and New York City officials, a group of Administration officials met with Messrs. Rohatyn, Burke, Goldmark, Hyman and Haynes of New York at the Department of the Treasury. Representing the Administration were William Seidman, Alan Greenspan, Ed Yeo, Rod Hills, Richard Dunham, Gerald Parsky, Robert Gerard, and Roger Porter.

It was agreed at the outset that the meeting was informal and off-the-record.

Mr. Burke stated that default would take place about September 11 unless further financing was made available. He reported that Governor Carey has called a special session of the New York State Legislature for this Thursday, September 4. In expectation of the special session, Felix Rohatyn, for MAC, has put together a Financial Borrowing Package for about $2 billion that would provide funds to the city through the end of November. MAC has also proposed a three-year plan to bring the New York City budget into balance. A description of the elements of the financial borrowing package and the MAC statement is attached at Tab A.

However, Burke indicated that it was doubtful if the package could be accomplished since it involves many uncertain pieces including use of both city and state pension funds. Governor Carey must decide whether to propose the financial package and/or an orderly default plan. Burke indicated that he considered the proposal of an orderly default plan the most likely because the financial package does not seem practical nor does it provide a long-term solution.

Mr. Rohatyn, for MAC, intends to send a letter to Governor Carey indicating that the financial package entails a high risk position for the State, that no one is confident that the market will be reopened in December, and that the package could put the State's credit in jeopardy. Absent federal assistance, either direct or in guarantees, he does not believe that there is any way to avoid the pending default.

Mr. Yeo asked whether New York State and MAC were and had been operating under the assumption that there would be no direct federal assistance. All present agreed that this was the assumption under which they had operated.

Mr. Burke also indicated that Governor Carey intends to meet with Chairman Burns at 4:00 p.m. today and that Governor Carey has requested a meeting with you.

Action Required in the Event of a Default

Our overall objective is to minimize the adverse impact of a default. Specifically we will be prepared:

(1) To provide a workable mechanism to deal with the City's financial affairs;

(2) To insure public order and provide essential services;

(3) To provide for the continuing flow of federal payments;

(4) To protect the banking system;

(5) To provide for the continued operation of essential financial institutions;

(6) To insure order in the capital markets, including access to credit for issuers which may be tainted by a default with particular regard to New York State.

Actions underway to implement these objectives are reviewed at Tab B.

New York City Actions: Promises and Performance

A summary of the actions taken by New York City, those actions promised but not yet performed, and those proposed actions on which we have not been able to obtain information is attached at Tab C.

Effect of a New York City Default on Specific Banks

A compilation prepared by the Treasury of survey data obtained from the FDIC, the Federal Reserve, and the Comptroller General on the effect of a New York City default on specific banks is attached at Tab D. In summary, a substantial number of banks will suffer critical capital impairment. None of these are major banks.

An additional analysis is being prepared on the impact on savings and loan institutions which is expected to reveal some erosion of capital in these institutions.

Effects of a New York City Default on New York State's Financial Position

A preliminary analysis of the effect of a New York City default on New York State and New York State agencies credit, prepared by the Treasury, is attached at Tab E. A detailed report will be available tonight.

In summary, it appears that the State's financial position is below average -- vulnerable but defendable. However, it appears likely that certain components of the New York State Housing Finance Authority will default.

Legal Procedures to Regulate the Payment of New York City's Debts in the Event of Default

A memorandum from Rod Hills outlining legal procedures to regulate the payment of New York City's debts in the event of default is attached at Tab F.

Draft Presidential Statement

A draft Presidential statement, prepared by the Treasury, is attached at Tab G.

Requested Meeting with Governor Carey

Governor Carey intends to meet with Chairman Burns at 4:00 p.m. today and has requested a meeting with you subsequent to his meeting with the Federal Reserve. There are both advantages and disadvantages to meeting with Governor Carey.

Advantages:

1. Meeting with Governor Carey evidences your sympathy with the people of New York and a desire to discuss a major financial difficulty.

2. The meeting could result in new information or options.

Disadvantages:

1. It is likely that the meeting will be used as a platform to indicate that the Federal Government's lack of responsiveness is causing New York City to default.

2. A Presidential meeting with Governor Carey involves you in a matter that could be handled by the Secretary of the Treasury and the Federal Reserve in accordance with your previous directive.

It is recommended that if you decide to meet with Governor Carey that the meeting occur after you have had an opportunity to fully review the results of the meeting between Governor Carey and Chairman Burns.

It is also recommended that you meet with your advisers today to discuss the New York City situation.

________ Agree to meet with Governor Carey

________ Do not agree to meet with Governor Carey

TAB A

MAC PROPOSED FINANCIAL PACKAGE

The MAC financial package includes the following elements:

New York State commitment conditioned on securing $1.25 billion from other sources	$750 million

The $750 million would include three parts:
- (a) $250 million in long term, open MAC bonds
- (b) $250 million in short term subordinated MAC bonds
- (c) $250 million in State loans using Mitchell-Lama housing project properties as collateral

Mandated purchase of City paper by New York City Pension Fund	$500 million
Mandated purchase of City paper by New York State Pension Fund	$250 million
Real Estate Tax Advance	$150 million
State Insurance Fund Investment	$100 million
Use of New York City Sinking Funds (requires legislation)	$180 million
Bank roll over of existing notes	$120 million
New investment by commercial banks	$250 million
Total	$2.3 billion

The financial package would carry the city until the early part of December. However, the City would need an additional $3.7 billion of short term financing to complete the present fiscal year ending June 30, 1976.

It is acknowledged that there would be great difficulty in mandating the state and city pension funds in view of the likely opposition of the State Comptroller and the trustees of the city pension fund.

M.A.C. Statement on City's Finances

Following is the text of the document released yesterday by the Municipal Assistance Corporation summarizing past and present deficits of New York City and containing current projections of city revenues and expenses through the fiscal year 1977-78.

An introduction to the document said it represented "the combined judgment of the offices of the Governor, the Controller of New York State, the Mayor and the Controller of the City of New York." It added that "it was presented to the Municipal Assistance Corporation today by these officials as a realistic statement of the city's fiscal situation for use in its financing efforts."

Analytical Framework

PAST DEFICIT: The listing of past deficits through fiscal year 1974-75 relies on judgments based on audits presently in progress by the State Controller, on findings of the City Controller and on estimates by the city and state budget offices. This cumulative past deficit must be amortized by present and future M.A.C. financing. Other audits and further examination of city records may require modification of these figures.

DEFICIT FOR 1975-76: The deficit for 1975-76 is based on similar judgments and estimates. It does not reflect expense items in the capital budget, which will be reduced according to the schedule provided in the M.A.C. legislation. Any balance of proceeds from M.A.C. borrowing not dedicated to past deficits will be applied toward the 1975-76 deficit.

REVENUE ESTIMATES: The revenue estimates represent the best combined evaluation and modifications of city estimates of revenue growth by major category through fiscal year 1977-78. All estimates assume no tax increases during this period other than real-estate taxes necessary to pay debt service.

EXPENDITURES FOR 1976-77 AND 1977-78: Welfare expenditures are assumed to remain at projected fiscal year 1975-76 levels. City expenditure estimates assume various growth rates for different components of the budget, and were used as working figures for this document.

3-Year Projection of Income and Expenses

New York City Tax Levy
1975-76 Through 1977-78
(Millions of Dollars)

INCOME	1975-76	1976-77	1977-78
Executive budget—real-estate taxes	$3,246	$	$
Less: Provision for uncollected taxes	—260		
Estimated real-estate tax collections	2,986	3,190	3,300
Executive budget—general-fund income	4,170		
Less: Provision for uncollected income	—90		
Estimated general-fund income	4,085	4,298	4,512
Less: M.A.C. debt service, administrative costs and capital reserve fund	—391	—611	—611
Total general-fund income	3,694	3,687	3,901
Total tax-levy income	6,680	6,877	7,201
Less: Provision for estimated uncollectable state/Federal aid, and other revenue shortfall	—197	—197	—167
Total tax levy available to support city expenditures	6,483	6,680	7,034
EXPENSES ANTICIPATED BY CITY	7,209	7,422	7,835
DEFICIT	(726)	(742)	(801)
DETAIL OF BUDGET EXPENSES ANTICIPATED BY CITY			
Welfare and medical assistance (excluding administration)	852	877	877
Pensions	897	956	1,039
Debt service	1,752	1,624	1,699
Miscellaneous mandated	335	345	374
Departments and Agencies (reflects wage freeze in 1975-76)	2,606	2,789	2,963
All other	767	831	883
	$7,209	$7,422	$7,835

1975-76 and Prior-Year Deficits

Millions of Dollars

Real-Estate Taxes		
Reserve for real-estate taxes		$260
Amount of prior year uncollected taxes to be written off that have resulted from court tax cancellations, in-rem foreclosure proceedings, tax exemptions and abatements for government-subsidized privately owned housing	$ 502	—
General-Fund June Accrual		
When funds come in, treat as cash for the year collected		—
General-Fund Shortfall	358	—
1974-75		
1975-76	99	—
State Aid, Federal Aid and Other Receivables		60
1971-1972	12	—
1972-73	90	—
1973-74	256	—
1974-75	250	—
1975-76		150
New York City Stabilization Reserve Corp.	520	
Deletion of Increment in General-Fund Borrowing for 1975-76		30
M. A. C. Costs and Debt Service for 1975-76		264
Accrual Payroll Conversion (12 days) for 1975-76 (Including Education)	105	10
Police, Fire and Correction Overtime for 1975-76-Cash to Accrual	25	—
*Various O.T.P.S. Items for 1974-75 and 1975-76 Cash to Accrual	95	10
June 30, 1975, Tax Deficiency Deficit (net)	100	—
Shortfall in Limited Profit Housing and Parking Revenues		47
State Education Aid—To eliminate the need of the city to borrow against state aid received after the close of the fiscal year	170	—
Total:	$2,582	$831
Less: Savings from pay freeze		105
	$2,582	$726

*In addition, $15 million of savings will be used for this purpose in 1975-76.

Unless other steps are taken by the city or other measures are made available to the city to reduce the deficits, it will be necessary to achieve savings equivalent to a reduction of approximately 46,000 people from the entire city payroll in fiscal 1977-78 in order to balance the budget in that year.

In addition, savings (in other than personal services) to the extent of $200-million annually would have to be achieved by 1977-78. Some of this would occur naturally in association with the work force reductions; other amounts would have to be cut in areas such as contracted services, maintenance and utilities, and vender purchases.

The tables that follow indicate on both a yeary and a cumulative basis the magnitude of dollar restrictions necessary.

Savings by Year

(millions of dollars)

Years	Personal Service	Other than Pers. Serv.	Total
75-76	112	40	152
76-77	224	80	304
77-78	224	80	304

Cumulative Savings

(adjusted for inflation)

	75-76	76-77	77-78
1975-76	152	163	174
1976-77		304	325
1977-78			304
Total	152	467	803
Deficit	(726)	(742)	(801)
Net*	(574)	(275)	2

*The estimates reflect cumulative deficits through 1976-1977 totalling $3,431-million, (2,582-million from 1974-75 and prior years, $574-million from 1975-76 and $275-million from 1976-77) $2,950-million of the tota deficit will be funded through the proceeds of initial M.A.C. issues and amortized over the life of these bonds. The remaining $481-million wil have to be funded and amortized through additional debt issues. Since the relatively short maturity and reserve fund requirements on M.A.C. debt produce a debt-service schedule that declines significantly subsequent to 1977-78, the $481-million in additional debt issues can be service after 1977-73 from that portion of the sales-tax revenues that had previously been used for M.A.C. debt service.

TAB B

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POSSIBLE ACTIONS WITH RESPECT
TO DEFAULT BY NEW YORK CITY

At the request of the President, Secretary Simon has designated Under Secretary Edwin Yeo as Chairman of the Federal effort. He chairs a steering group consisting of Richard Dunham, Deputy Director, Domestic Council, Roderick Hills, Deputy Counsel to the President, Antonin Scalia, Assistant Attorney General, and Calvin Collier, Associate Director (Economic and Government) of the Office of Management and Budget. Robert Gerard of Treasury is acting as staff coordinator.

I. Financial Mechanism

Insuring a workable mechanism for controlling the financial affairs of the City in the event of default is perhaps the most important priority. An effective mechanism of this nature will in and of itself do much to satisfy the remaining objectives.

The model for such a mechanism is the corporate bankruptcy provisions of existing Federal law. Simply stated, such provisions place in the hands of a Federal judge plenary control over the financial inflows and outflows, as well as the assets, of a debtor.

Existing municipal bankruptcy provisions of Federal law are inadequate in that they require prior written consent of 51 percent in interest of the city's security holders to a reorganization plan before a Federal court can obtain jurisdiction. Although certain constitutional provisions are implicated in any revision of the municipal bankruptcy law, it appears possible to amend the law to eliminate the 51 percent requirement, thus assuring the opportunity for prompt and secure Federal court jurisdiction over the City's financial affairs.

At the same time, there is one loophole in existing law. If default occurs and the City is sued by a security holder, it may seek a Federal stay of such suit by filing, among other things, a reorganization plan and a statement to the effect that there is a "reasonable prospect" that the 51 percent consent requirement can ultimately be met. Such a stay may be granted for 60 days and extended for an additional 60 days. To effect a permanent solution, the requisite consents would still have to be obtained. The stay route, however, would prevent a major potential

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source of chaos: a number of legal actions resulting in conflicting injunctions--e.g., one payment to court ordering note holders, not the police; another ordering the reverse, etc.

II. Public Order

In the event of default, the City may be financially unable to meet payrolls. In addition, there is a possibility that the City's mechanism for making payments may cease to function. This poses two threats. First, in the event payrolls are not met (for either reason) or serious uncertainties as to pay develop, a general or partial strike could occur and could involve the police and/or firemen. Second, in the event assistance payments are not made there could be rioting beyond the capacity of local authorities to control.

Legally, the State has primary responsibility to deal with such matters in the first instance. Accordingly, our preparation must be along two lines. First, we must assess the resources (and the mobilization time required) of the state in this regard. Second, we must assess both our legal authority and practical ability to act, both on the assumption that the State will act and on the assumption that it will not.

III. Federal Payments

As suggested above, one potential source of unrest would be an interruption in the flow of Federal payments for welfare, medicaid and other forms of assistance. Two issues are presented. First, what legal impediments exist in the event the City is unable to meet its matching share obligations. Second, how can the USG and/or the State assure continuing flows in the event the City's payment mechanism ceases to operate because of strikes, etc.

OMB has identified three HEW programs which constitute the bulk of Federal payments potentially affected by a default. With respect to these programs, further work is required in determining the legal implications (primarily as a matter of State law) of the City's possible failure to meet matching requirements. In addition, it is necessary to develop a mechanism to administer these programs in the event of the City's failure to do so.

To date, very little is known about the remaining programs. Further information will be developed to permit a determination whether coverage of such programs is essential to the success of the plan.

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IV. Banking System

The main threat to the banking system is psychological. A New York City default would not meaningfully impair the capital of any of the major banks. The real risk is that such potential failures, coupled with the other uncertainties attending a default, could cause a worldwide lack of confidence in the major U.S. institutions.

Accordingly, we must act to insure that no liquidity problems arise and that bank failures are averted. The FED has already announced that discount windows will be open. The FDIC will be ready to purchase convertible capital notes of banks threatened with large capital impairments. To avoid "bail out" charges, such purchases would involve severe penalties for bank officials responsible for the imprudent levels of ownership.

V. Operation of Essential Financial Institutions

In the event of civil disorder certain financial institutions--e.g., New York Fed, Stock Exchange--may be unable to open due to inability of employees to travel, security concerns, etc. Such closing could impair essential financial operations of the USG and undermine national and international confidence in our markets.

We are exploring possible contingency action under two assumptions: (1) conditions force a closing of one-two days; (2) a closing of longer duration. We will have to identify the specific functions which cannot be interrupted. Alternative means, if any, for performing such functions must be developed.

VI. Orderly Markets

Overall order (or disorder) in the capital markets will be largely a function of our success in implementing the other elements of the plan. However, there is one area of special concern. In mid September, four housing agencies (New York State Housing Finance Authority, New York State Dormitory Authority, New Jersey Housing Finance Authority, and Massachusetts Housing Finance Authority) will need to fund out or roll over maturing short term securities. These agencies have recently had difficulties in raising funds in the public market for two reasons. First, overall market uncertainty caused by

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New York City's problems. Second, lack of understanding of the underlying financial resources of the agencies. Such understanding was less necessary as long as the moral obligation commitment was viewed as a reliable credit basis. In the wake of UDC, this is no longer the case and these securities are generally being looked at as straight revenue bonds.

Our primary concern is with New York State Housing Finance Authority. Most of the Dormitory Authority's September obligation has been prefunded. Massachusetts and New Jersey have experienced substantially less difficulty than the New York agencies and will be less "tainted" by further adverse events.

An indepth review of Housing Finance Authority's underlying financial soundness is being conducted in New York. Although hard, audited, results will not be available in time to meet September's requirements, we do expect to have sufficient information to determine whether notes can be privately placed in September.

In addition, consideration should be given to the possibility of employing Section 802 of the Housing Act of 1974. Section 802 permits Federal guarantees of taxable state housing agencies obligations and provides a one-third interest subsidy.

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TAB D

EFFECT OF A NEW YORK CITY DEFAULT ON SPECIFIC BANKS

The attached table is based on a survey of holdings by the Comptroller of the Currency (national banks), the Federal Reserve (state chartered banks which are members of the Federal Reserve) and a sample of 10% of the 8,000 state chartered non-member banks.

Banks with significant holdings of NYC obligations have been divided for the purposes of that survey into three categories, banks holding NYC obligations equal to (1) 50-75% of capital; (2) 75-124% of capital; and (3) over 125% of capital.

Banks in the last category will be severely impacted by default; banks in the second category will be vulnerable as a result of default.

The Regulatory authorities will approach each bank on a case by case basis. In the case of some banks, the principal owners may be able to provide additional equity capital. For example, the Comptroller of the Currency feels that Mr. Safra, who is the principal shareholder in the Republic National Bank, has access to additional capital.

Banks in the final category, the severely impacted group, would be contacted immediately following a default by NYC. A meeting would be arranged at which the bank's condition would be reviewed with management. If additional capital is needed, as perceived by the regulatory authorities, the possibility of the Board of the bank raising capital, the merger of the impacted bank with another bank, and the purchase by FDIC of subordinated notes or convertible subordinated notes will be explored. The end result should be a plan of action to deal with each individual impacted bank.

The three regulatory authorities agreed some weeks ago that they would not require an immediate write-off of the difference between the book value (purchase price by the banks) and the market value of defaulted NYC obligations. Their plans are to have a six month grace period. This delays the technical impact of default on the solvency of impacted banks until the expiration of the grace period and would give the regulatory authorities time to arrive at solutions for each impacted bank.

While very real in terms of each bank, the grace period will probably not delay the public's awareness regarding holdings of NYC obligations by specific banks. The securities laws will probably require that banks disclose to the investing public their holdings of NYC debt.

We have two principal weapons to deal with the financial impact on the banking system of a default by NYC.

1. The Federal Reserve will be in a position to fulfill its role as a "lender of last resort." In this role they insure that liquidity needs are met much as they did following the collapse of Penn Central.

2. The Federal Reserve's ability to help in cases involving insolvency is limited. Where a bank must charge off losses against capital and the result is a sharp reduction or elimination of capital, only the FDIC can help. Chairman Frank Wille has assured me that:

> "The Board of the FDIC is determined that no insured bank should fail as a result of NYC's default. To this end, it is prepared to receive sympathetically, in necessitous cases certified by the appropriate bank agency, requests for short-term FDIC capital assistance, on a subordinated basis, with the terms of such assistance to be negotiated on an individual basis in order to protect the public interest and to assume repayment to the FDIC in a timely fashion. The FDIC Board is prepared to receive such requests for capital assistance from banks both within and without the New York metropolitan area."

This means that the FDIC would purchase convertible capital notes of severely impacted banks. This would save many banks. In the most extreme cases, however, this technique would not work because a bank must have some equity left in order to function. In cases where equity was totally wiped out, a likely alternative to liquidation would be an assisted sale by FDIC of the destroyed bank to another bank.

Banks with NYC Holdings Totalling 125% or More of Capital

	Capital	NYC Holdings	%
Deak N/B Fleischmanns, N.Y.	382,223	756,802	198
Flushing N/B Flushing, N.Y.	2,397,880	4,978,000	207.6
Gulley National Bank Gulley Bridge, W. Va.	1, 264,407	2,402,374	190
First National Bank of South Charleston, W. Va.	2,784,026	3,480,033	125
First N/B Cape Canaveral, Fla.	2,849,386	4,217,092	148
First National Bank of Princeton-Naranja, Fla.	522,339	1,206,603	231

Banks with NYC Holdings Totalling 75-124% of Capital

	Capital	NYC Holdings	%
Harbor N/B Boston, Mass.	3,017,833	3,603,293	119.4
Columbus N/B Providence, R. I.	6,758,958	8,300,000	122.8
Citibank (Suffolk), N.A. Bay Shore, N. Y.	3,163,180	3,780,000	119.5
Century N/B New York City, N.Y.	6,672,842	6,072,286	91
Sterling N/B New York City, N.Y.	49,755,220	49,257,668	99
First N/B of Norfolk Norfolk, N. Y.	642,166	687,018	107
N/B of Roxbury Roxbury, N. Y.	455,403	455,403	100
American Bk. & Tr. Co., New York City, N. Y.	25,353,000	28,970,000	114.3
First National Bank of St. Mary's, W. Va.	729,180	554,177	76
Boca Raton N/B Boca Raton, Fla.	7,693,530	7,078,048	92
Flagship N/B of Westland Hialeah, Fla.	1,272,661	1,043,582	82
American N/B Champaign, Ill.	1,208,511	1,136,000	94
Roodhouse N/B Roodhouse, Ill.	520,619	505,000	97
Warren Bank Warren, Mich.	5,985,000	4,600,000	76.9
First N/B Mountain Home, Ark.	631,522	581,000	92

Banks with NYC Holdings Totalling 75-124% of Capital

	Capital	NYC Holdings	%
First National Bank Fairfax, Minn.	452,041	443,000	98
Central N/B & Trust Co. Des Moines, Iowa	14,598,958	14,015,000	96
National Bank of Caruthersville, Missouri	844,578	701,000	83
Farmers & Merchants N/B Hennessee, Okla.	754,118	641,000	85
San Luis Obispo N/B	1,909,821	2,139,000	112

Banks with NYC Holdings Totalling 50-75% of Capital

	Capital	NYC Holdings	%
National Bank of Fairhaven Fairhaven, Mass.	1,919,532	1,076,858	56.1
Republic N/B Brooklyn, N. Y.	95,000,000	51,300,000	54
First N/B of Dryden Dryden, N. Y.	1,982,193	1,129,850	57
Community N/B Staten Island, N. Y.	7,886,797	4,653,210	59
Freedom N/B New York City, N. Y.	3,102,113	1,706,162	55
Citibank (Mid-Hudson) N. A. Woodbury, N. Y.	3,816,981	2,023,000	53
Industrial N/B of Washington, D.C.	2,675,202	1,417,857	53
The Bank of St. Albans, St. Albans, W. Va.	2,228,000	1,200,000	53.9
Citizens Bank Smithville, Tenn.	785,000	495,000	63.1
First N/B of Crestview, Fla.	1,879,377	1,165,214	62
First N/B Hialeah, Fla.	9,197,958	6,070,652	66
First N/B of Merritt Island, Fla.	2,747,378	1,648,427	60
Pan American Bk of Ormond Beach, N.A. Ormond Beach, Fla.	850,248	425,124	50
First N/B of the Upper Keys Tavernier, Fla.	2,397,944	1,702,540	71
Metropolitan Bank Tampa, Fla.	1,833,000	1,000,000	54.5

Banks with NYC Holdings Totalling 50-75% of Capital

	Capital	NYC Holdings	%
Columbia N/B of Chicago Chicago, Ill.	2,929,851	1,963,000	67
Elliott St. Bk. Jacksonville, Ill.	4,098,000	2,060,000	50.3
Peoples Bank & Tr. Co. of Sylacauga, Ala.	662,000	430,000	65.0
Hiawatha National Bank Hager City, Wis.	536,842	306,000	57
American N/B Eau Claire, Wisconsin	6,759,459	5,002,000	74
First N/B of Nevada, Missouri	993,333	596,000	60
Kansas State Bank Kansas, Ill.	389,000	260,000	66.8
Barclays Bank of New York New York Ciry, New York	31,519,000	17,215,000	54.6
State Bank of Niantic Niantic, Ill.	857,000	435,000	50.8
Endicott Trust Co. Endicott, New York	9,457,000	5,230,000	55.3

TAB E

MEMORANDUM (Preliminary)

Subject: Effect of NYC Default on New York State and New York State Agencies Credit

This memorandum sets forth our preliminary views concerning the above question. It is based in part on information and analysis supplied by Morgan Guaranty Trust Co. of New York. It will be expanded to reflect an in-depth review of the factual data which has been initiated.

We have limited our analysis to evaluating the consequences of impaired ability to do necessary, as opposed to discretionary, funding. All New York State issuers are paying more for money as a result of NYC's problems and will pay even more if NYC defaults. The question addressed here is whether issuers will be unable to borrow and be forced to default as a consequence.

New York State

New York State is a fundamentally sound credit. Its outstanding debt is \$6.9 billion (\$3.3 billion long term, \$3.6 billion short). Although the State's own direct debt load (4.6% of estimated property values) is above the state median (1.5%), it is adequately secured by sufficiently diversified revenue sources, including personal income taxes (39.4%), business taxes (16%), consumption and use taxes (37.3%) and other miscellaneous receipts. The State's credit position has been eroded through the increased issuance of indirect obligations, or "moral obligation" debt, currently estimated to be in excess of $6.5 billion, including both long-term and short-term obligations.

Unlike NYC, NYS does not and has never borrowed to finance deficits. It does use the short term credit market to smooth out seasonal variations in cash flow. Most of NYS' short term borrowing for its 1975-1976 fiscal year (April 1 - March 31) has been done. It does have an $800 million note maturity on September 15 and, largely as a result of having advanced substantial cash to NYC, must roll over $500 million of the maturity.

We are concerned that inadequate attention has been paid to the structure of this $500 million borrowing. In an unsettled market -- especially if NYC defaults -- a business as usual approach just won't work. We will be working with the banking community to provide for the orderly handling of this borrowing. Although there is basis for doubt, we think in the final analysis that the money will get raised and the State will not default.

<u>NYS Agencies</u>

Two important state agencies -- NYS Housing Finance Agency (HFA) and NYS Dormitory Authority (DA) -- have note maturities on September 15. We understand that DA will have sufficient cash to pay off the maturing notes.

The HFA situation is more complex. There are 11 programs under HFA and each can be looked at as a separate REIT, the borrowing of which is secured only by revenues from that program (as well as the State "moral obligation" which is now ignored in the market). Of the 11 programs, 5 are dormant, 2 are financially sound, but need to refund short term debt, and 4 need to borrow but are fundamentally unsound financially.

Of the $50+ million September 15 maturity, all but $3 million is for one of the 2 sound programs. The bankers are hopeful that they can finance the sound portion this week, thus avoiding a potential collision between default and this sound program's current needs.

Looking at October and beyond, the picture is far more cloudy. However, our principal basis of concern is the weakness of the programs. A default by NYC in September would impede a solution to this problem, but would not, in our view, be the determining factor.

MEMORANDUM

NJ

THE WHITE HOUSE

WASHINGTON

September 3, 1975

TO ECONOMIC POLICY BOARD MEMBERS

THROUGH L. WM. SEIDMAN

FROM ROD HILLS R.H.

Representatives of New York City and State have stated publicly that they are preparing legislation to amend the federal bankruptcy act that would, in their opinion, be necessary in the event of default by New York City.

Attached is an analysis of Chapter 9 of the Federal Bankruptcy Act and the type of changes that we believe will be sought.

Since these changes make it easier for a municipality to work out a "plan of composition" in the event a default occurs, they could cast some doubt as to the value of municipal debt generally. Conversely, because they do make it feasible for a plan to restructure debt, it is easier to preserve some values in municipal debt after default occurs.

The Justice Department will be asked to testify on any new legislative proposal for the City, and we may wish to give some policy direction to that testimony.

It should be noted that legislation involving Chapter 9 has been pending in Congress for some time.

COPY NO. 4A

ADMINISTRATIVELY CONFIDENTIAL-EYES ONLY

MUNICIPAL FINANCIAL ADJUSTMENT PROCEEDINGS AND SUGGESTED REVISIONS

I. Type and Scope of the Proceeding

A. The present provisions of the Bankruptcy Act dealing with municipal debt adjustment are found at 11 U.S.C. §§ 401-403, Bankruptcy Act Sections 81-83 (Chapter IX).

1. Chapter IX allows the voluntary filing of a petition by a city, town, county, water district, school district, port authority, or similar municipal bodies.

2. Chapter IX has been found to be constitutional in that it permits only voluntary filings where not prohibited by the State. See United States v. Bekins, 304 U.S. 27 (1938).

B. Chapter IX should be left intact in order to minimize the effect of a new chapter on the finances of small municipalities or their sub-entities; a new chapter modeled on Chapter IX should be proposed.

1. The new chapter should be made applicable only to cities with a population of over 1,000,000 residents. (This figure could be adjusted upward to minimize the effect of the proposed legislation on certain cities.)

2. There is no constitutional impediment to so streamlining the class of debtors affected by the proposed legislation so as to affect only a very small percentage of large cities. Hanover National Bank v. Moyes, 186 U.S. 181 at 188 (1902).

3. Subentities of a municipality that qualifies as one of the class of debtors benefited by the statute should be permitted to file a petition in order to maximize the effectiveness of a plan of composition; however, such a filing should not be mandatory so as to avoid the complication of including independently solvent districts, authorities, etc.

II. Jurisdictional Aspects of the Proceeding

A. The present Act allows no interference with the sovereignty of the States or their political subdivisions; a provision to this effect should be included in any proposed revision of municipal financial adjustment proceedings. See 11 U.S.C. § 403(c)(i).

1. Constitutional considerations: Congressional authority to legislate under Article I, Section 8, cl. 4 is restricted by the provisions of the Tenth Amendment. A constitutional barrier is presented should any proposed statutory provision so interfere with State sovereignty as to deny the State's right preserved under the Tenth Amendment to control its own fiscal affairs.

a. See Ashton v. Cameron County Irrigation District, 298 U.S. 513 (1936) and United States v. Bekins, 304 U.S. 27 (1938).

b. Since involuntary proceedings against a municipal corporation without State consent are not contemplated, we foresee no impediment to the proposed statutory provision presented by the Tenth Amendment.

2. State consent to proceedings undertaken pursuant to the proposed statutory provisions should be explicitly provided for in the statute.

a. Although commentators in discussing the present provisions of Chapter IX have stated that where a State is silent regarding the availability of Chapter IX to its municipalities, such silence implies the State's consent to the availability of Chapter IX, any proposed legislation should state that if no State prohibition exists the municipal instrumentality may file a petition under its provisions.

b. It should be noted that proposed bills now under consideration by the Congress take this approach which dispenses with express State permission whenever a municipality desires to avail itself of the relevant bankruptcy remedies available to it. (House Document 93-137, Part II, Sept. 6, 1973 (containing the bill later proposed by the Commission on Bankruptcy Laws) and S. 235, 94th Cong., 1st Sess. 1974 (proposed by a committee of Bankruptcy Referees)).

c. Cf. Municipal Assistance Corporation Act, 5 McK. N.Y. Sess. Laws 237, Chapter 168, June 10, 1975, 198th Sess. This Act represents the State of New York's attempt to aid municipalities, who are unable to sell sufficient securities to permit them to refund their outstanding obligations or to meet their cash requirements, through a State corporation's issuance of bonds. We have found no provision therein nor in any other law of New York prohibiting the proceeding.

3. There is no trustee in a Chapter IX proceeding and the municipality remains in control of its property, revenues and expenditures. The new chapter should propose to continue this scheme as do the above mentioned proposed bills before Congress regarding Chapter IX.

B. A provision specifically stating that the chapter does not impair or limit laws governing the use of Federal funds should be added.

1. The present Chapter provides that the plan itself cannot require actions by the debtor which are unlawful. 11 U.S.C. § 403(e)(6).

2. The present Chapter does not specifically deal with the treatment of Federal funds during the proceedings and this silence should be clarified. (Note Art. 5 General Municipal Law § 99-h (McKinney 1974 supp.)).

C. There should be no provision for trustees' avoidance powers.

1. All other bankruptcy proceedings provide for the avoidance of: (1) prefential transfers within four months of bankruptcy, (2) fraudulent conveyances in certain circumstances, and (3) liens obtained within certain periods. See 11 U.S.C. §§ 96, 107 and 110 designed to enhance equitable distribution of the debtor's assets.

2. Bankruptcy authorities favor the exclusion of such remedies in municipal debt adjustment proceedings. See the proposed bills cited _supra_; 5 Collier or Bankruptcy ¶ 81.27

a. Such avoidance powers may constitute interference with the governmental and fiscal affairs of the debtor in contravention of the Tenth Amendment, discussed _supra_.

b. Such powers would complicate the proceedings.

c. Since there are usually provisions preventing a judgment creditor from obtaining a judgment lien against a municipality, some of the avoidance powers are unnecessary. _Cf._ 7B McKinney's Consolidated Laws of New York Ann. CPLR 5203(a)5.

D. The duration of the bankruptcy court's jurisdiction should be clarified.

1. The present Act contains no provision on this point.

2. Commentators have suggested retention of jurisdiction until the court is satisfied that the plan is successfully in operation. See e.g., George H. Hempel, "An Evaluation of Municipal Bankruptcy Laws and Procedures", Journal of Finance Vol. XXVIII No. 5 p. 1339, December 1973.

E. The binding effect of the proceedings on creditors should be clarified.

1. The present Act provides that all creditors, whether secured or unsecured, and whether or not their claims are filed or allowed, are bound by the provisions of the confirmed plan (11 U.S.C. 403(f)). Therefore, they cannot challenge the plan outside the proceedings.

2. As in present Chapter X proceedings, this provision should be clarified to apply to unscheduled creditors without notice of the proceedings. See 11 U.S.C. § 624(1).

3. Present Chapter IX provides for a discharge of all debts dealt with in the plan and there is no exception for unscheduled creditors without notice, as is the case in straight bankruptcy and Chapter XI proceedings.

4. Provision for the discharge of unscheduled debts, together with a provision providing for a totally binding plan, has proved constitutional in the Chapter X context. See 6A Collier, supra ¶ 11.18.

F. The new chapter should provide for an automatic stay upon the filing of all suits against the debtor and all proceedings to enforce liens.

1. The present Chapter allows the bankruptcy court discretion in granting such a stay. The Chapter also allows the filing of a petition seeking a stay by a municipality which is attempting to enter Chapter IX but which has not completed all requirements for filing a petition to enter Chapter IX. 11 U.S.C. 403(c).

2. The stay would be granted without hearing and those seeking relief from the stay must proceed affirmatively in the bankruptcy court.

a. Such a provision avoids delay and is necessary where the debtor has no power to avoid liens already obtained.

b. The New Bankruptcy Rules provide for such a stay, as do the above mentioned bills now before Congress.

III. Operation of the Proceeding

A. The requirements of a petition initiating the proceeding should be modified.

1. The present Chapter requires the debtor to file a petition alleging insolvency and the petition must be accompanied by a plan of composition that has been accepted by creditors owning 51 percent of the outstanding debt of the municipality. A list of all known creditors must also be attached.

2. The 51 percent requirement is not constitutionally mandated. See Hanover National Bank v. Moyses, supra; Campbell v. Alleghany Corp. 75 F.2d 947, 954-955 (4th Cir. 1935), cert. denied 296 U.S. 581.

3. Several commentators have suggested reducing the 51 percent requirement and both proposed bills eliminate it entirely. The total elimination of the prior acceptance requirement is desirable.

a. The petition would merely state that the city is unable to meet its debts as they matured. S. 235 § 9-202.

b. A list of creditors could be filed with the petition or at a time the court directs. See S. 235 § 9-301.

c. Rather than requiring creditors to answer the petition, as in 11 U.S.C. 403(b), creditors opposed should affirmatively challenge the petition. See S. 233 § 9-203.

B. The present provisions classifying creditors should be retained.

1. Chapter IX now provides for the modification or alteration of the rights of creditors generally; secured, unsecured, municipal bondholders, and holders of bonds to be paid out of special assessments, revenues, taxes, etc., 11 U.S.C. § 403.

2. There is no constitutional impediment to the alteration of the debts of bondholders. 5 Collier, supra, § 81.09, note 9. Furthermore, Chapter X has been consistently upheld even though vested rights are affected and even secured creditors may be subordinated. 6 Collier, supra, ¶ 0.01 and ¶ 3.26; Matter of Prima Co., 88 F.2d 785 (7th Cir. 1937).

C. The requirements for confirmation of the plan should be revised.

1. Presently, Chapter IX requires that creditors owning two-thirds of the claims in a class whose claims have been filed and allowed and affected by the plan must consent to the plan.

2. There is no constitutional reason for the two-thirds requirement. S. 235, § 9-307(c) suggests majority approval only.

3. A revision requiring only majority approval would contribute to the likelihood of acceptance and eliminate some delay.

4. Chapter IX provides for separate classes of creditors; those entitled to priority (for example, the United States Government), unsecured creditors generally, and secured creditors.

   a. Secured creditors are not in one class but in separate classes, defined according to the property upon which they have liens. 5 Collier, supra, ¶ 81.15. For example, bondholders with liens on specific revenue would constitute separate classes, defined according to the particular bond issue involved. This coincides with general State law. See e.g., N.Y. General Municipal Law Art. 14-C § 407. (McKinneys 1974).

   b. If any class of creditors affected by the plan in a material way did not accept the plan, Chapter IX requires that they be paid in full or that their liens be protected. 11 U.S.C. § 403(d).

   c. In order to accelerate confirmation of the plan, a time limit for acceptance should be established. Hempel, supra, suggests 90 days.

D. Presently, Chapter IX proceedings are handled by the District Court Judge rather than by the bankruptcy judge, as in Chapter X. There appears to be reason to revise this.

IV. Miscellaneous

Any disruptive effects of the proposed chapter might be reduced by the inclusion therein of a specific provision for the limited duration of such proceedings.

THE SECRETARY OF THE TREASURY
WASHINGTON

SEP 9 1975

MEMORANDUM FOR THE PRESIDENT

Subject: New York City

The attached paper reviews options for Federal financial intervention in the NYC crisis. This crisis originated in an inability of the political mechanism in NYC to reconcile expenditures with available revenues. For years, the gaps have been financed through the issuance of short term debt, but investors will now no longer finance these gaps. A stagnant tax base resulting from NYC's structural economic problems intensifies the problems, by foreclosing substantial new revenue sources. And entrenched political interests inhibit actions to reduce expenditures substantially.

Governor Carey and other interests -- e.g. banks, city labor unions, representatives of welfare and other social services interests -- have dealt with the issue of default adroitly, at least in a political sense. Drawing on widespread apprehension as a result of the crunch of '74 and the financial impact of the recession, they have coupled NYC's default with the integrity of the banking system, the ability of municipalities and states to raise money in the future and the continuance of the present upswing in economic activity.

They have designed a "financial plan" which mandates use of state and city employee pension fund money and the purchase of Big MAC obligations by the State. This "plan" has a dual trigger mechanism. The approximately $2.0 billion raised under "the plan" would carry the City through the end of November. By that time the reconciliation process mentioned above would have had to progress sufficiently so as to enable the City to reenter the public markets to finance $3.7 billion in additional funds to carry it through the first half of calendar '76. Second, Big MAC will, under the plan, have to be able to tap the bond market for $750 million to repay the State by the end of its fiscal year (3/31/76).

If the reconciliation process is not well underway by the end of November, NYC will default and this event creates the risk of, but will not necessarily result in, a default by the State and its agencies as well.

A solution pressed upon us is Federal involvement, through a direct loan, a partial guarantee of City or Big MAC securities or a full guarantee. A guarantee or direct assistance would eliminate the threat of default. Unfortunately, it is inconceivable that a guarantee could be limited to NYC or Big MAC securities. First, it would be unfair to exempt NYC from the painful process of reconciling income with outgo. Second, it would be difficult to pass legislation limited only to NYC. There are other municipalities where the pain of reconciliation is just as extreme as that felt by NYC, but where the totals involved are not nearly so dramatic.

If this assumption is correct, a guarantee for NYC would only begin the process of guarantees and/or direct loans for state and local governments. As this developed, the incentive for other municipalities to endure the stress of reconciling income with outgo would be reduced. Structural deficits in countless municipalities would be the end result of this process. A substantial increase in Federally-guaranteed debt of states and municipalities would be the end result. And why not a guarantee for Atlanta's badly needed rapid transit system or Detroit's partially completed major hospital. This in turn would crowd out those sectors of our economy that do not enjoy a guarantee; for example, much of the housing sector, individuals and corporations. In turn, these groups would bring to bear strong pressures to obtain guarantees for themselves.

The economic aspects of structural municipal deficits financed through the issuance of guaranteed securities would parallel to a significant degree the impact of large direct deficits by the Federal Government. Strong additional pressure would be brought on the Federal Reserve to provide reserves to facilitate the financing of those deficits and to reduce the incidence of crowding out.

If the Federal Government attempted to control local finances to protect it from exposure under guarantees, it would become enmeshed in the local politics of thousands of political subdivisions. Direct Federal aid, a guarantee or a partial guarantee might avoid default. But it also would begin the Federalization of state and local affairs.

William E. Simon

William E. Simon

SEP 8 1975

DECISION MEMORANDUM

SUBJECT: Financial Assistance for New York City

This memorandum has been prepared in light of the pending action by the New York State Legislature to provide funds for New York City -- primarily through State borrowing and through purchases of City and/or MAC debt by public employee pension funds. The Legislation poses a risk to the State's credit and increases the likelihood that the State (and various State agencies) would be severely impacted in the event New York City defaults.

These concerns have led to more strident demands that the USG indicate a willingness to provide financial assistance to New York City to avoid a default in December. This memorandum sets forth the options available (with appropriate legislation) at the Federal level.

This memorandum is in two parts. Part I sets forth the options for a new program of direct Federal financial assistance to New York City. Part II explores the possibility of using existing Federal resources to ameliorate the problems.

Part I: Direct Financial Assistance

Background

The analysis contained herein is premised upon the following assumptions:

1. The State Legislature will enact the Governor's legislative package, providing sufficient funds (approximately $2 billion) to carry the City through December 1.

2. Implementation of the package will exhaust the cash flow resources of the State, its pension funds and the banking system in New York State with respect to additional financial assistance to New York City.

3. New York City will not be able to borrow in the public market by December 1.

As a practical matter, enactment of the Legislation will impose two market access requirements:

- -- the City will be required to borrow $3.7 billion in net new cash between December 1 and June 30, 1976, the end of its fiscal year;
- -- Big MAC will be required to borrow $750 million by March 31, 1976 (the end of the State's fiscal year) to refund the State TAN issue.

Forms of Assistance - General

There are two basic options:

1. A Federal guarantee of securities issued by the City, the State or MAC; or

2. A direct Federal grant or loan to the City, the State or MAC.

Either basic option will require legislation. As discussed more fully in the treatment of options, an important consideration is the breadth of any assistance program. Since, as a practical matter, any proposal involves a Federal allocation of credit, it is essential that constraints closely approximating free market constraints be imposed. If constraints on the amount of and eligibility for assistance are not imposed, any assistance program will be abused by borrowers attempting to use such assistance as their primary source of financing.

Before evaluating specific forms of assistance, the threshold question of whether to provide any form of Federal financial assistance is presented.

Pros

- -- Would avert a default by the City and/or the State.
- -- Would eliminate the risk of a major financial collapse precipitated by a City and/or State default.
- -- Would show Administration concern for urban problems.
- -- Would protect banks from losses, thus reducing the risk of a series of insolvencies leading to a loss of confidence in the banking system.

Cons

-- Would eliminate requirement for limiting expenditures to level of revenues at State and local government level.

-- Would increase USG borrowing costs by increasing USG demand for credit.

-- Would increase the borrowing costs of all other borrowers, and could close the credit market to certain marginal borrowers.

-- Would conflict with Administration policy against new spending.

-- Would set a bad precedent by opening the door to any borrower (or class of borrowers) in financial difficulties who can claim potential impact on financial system.

I. Guarantees

A guarantee would involve an agreement by the USG to pay the debt service on a loan (evidenced by a note or bond) if the underlying borrower failed to pay. Within the guarantee concept, there are numerous sub-options. A guarantee can be full (an agreement to pay all unpaid debt service) or partial (an agreement to pay a specified percentage of unpaid debt service). A Federal guarantee program could be made available (1) to all municipal debt; (2) to a specified annual dollar amount outstanding; or (3) to a single issue of New York debt to finance New York City's $3.7 billion shortfall.

Evaluation of Options

1. General Guarantee Concept

Pros

-- Makes N.Y. Securities marketable

-- Requires no immediate USG cash outlay

-- May be more palatable to Congress than cash outlays.

Cons

-- Requires extensive supervision if USG's contingent financial interests are to be protected.

-- Expansion of Federal credit drives up USG borrowing costs.

-- Could reduce or deny market access to borrowers (crowding out).

-- Eliminates incentives for fiscal restraint; i.e., balancing of revenues and expenditures.

2. Full vs. Partial

Full Guarantee

Pros

-- Easier to administer

-- More certain to insure a market for the bonds.

-- Lowest borrowing cost for issuer.

Cons

-- More USG contingent exposure

-- More adverse impact on other borrowers.

Partial Guarantee

Pros

-- Less USG contingent exposure.

-- Less adverse impact on other borrowers.

Cons

-- More difficult to administer.

-- May not create a market for the bonds.

-- Higher borrowing cost to issuer.

3. Scope of Program

All Municipal Debt

Pros

-- Most fair.

-- Provides greatest amount of assistance nationwide.

-- Easy to administer, no allocation or eligibility decisions.

-- No prejudice to municipalities which need to borrow.

Cons

-- Greatest USG exposure.

-- Largest adverse impact on USG borrowing costs, borrowing costs of other issuers.

-- Broadest elimination of incentives for fiscal restraint.

-- If Federal supervision is involved, would require large bureaucracy.

Specified Annual Dollar Limit

Pros

-- Limits USG exposure.

-- Limits impact on capital markets.

-- Limits outlays for Federal supervision.

Cons

--Difficult to administer.

-- Severe problems of allocation.

-- Depending on allocation mechanism, may not satisfy New York City's requirements.

-- Severe prejudice (competitive disadvantage) to tax-exempt borrowers which do not obtain guarantee.

One-Shot Guarantee of Special NYC Issue

Pros

- -- Least USG exposure.
- -- Least impact on markets, other borrowers.
- -- Easiest to administer.

Cons

- -- Unfair to all other borrowers.
- -- Rewards NYC for its fiscal irresponsibility.
- -- May be difficult to obtain Congressional support.

II. Insurance and Re-insurance

Insurance of new issues of municipal bonds cannot be distinguished -- in form or in substance -- from a guarantee. Re-insurance cannot be distinguished -- insofar as the USG is concerned -- from a partial guarantee. Insurance and guarantees involve the identical legal commitment from the insurer or guarantor: an irrevocable agreement effective on the date of issue to make debt service payments if the issuer fails to make such payments. Unlike traditional casualty insurance, once the commitment is made, the insurer never has the opportunity to reevaluate the risk or adjust the premium. All he can do is retain the right to participate in the issuer's affairs (compare the rights the USG reserved under the Lockheed guarantee program).

Under reinsurance, a private entity would be responsible for writing the policy and would bear a portion of the risk. The theory is that the private entity would take on the supervisory role, and would have a financial incentive to supervise vigorously, thus avoiding the problem of excess Federal involvement. However, the resources the private insurance sector is willing to commit to these risks are so limited (maximum exposure of $8-15 million principal per issue), that with respect to issuers of any size, the Federal share of insurance would have to be close to 100%. In these cases, the market problems outlined above would continue to be present. And, in light of the fact that the option of withdrawing the insurance is permanently foreclosed at the outset, it is doubtful whether any private insurance company could exercise a degree of effective control over the affairs of a New York, Los Angeles, or Chicago.

Pros and Cons

Because insurance and re-insurance are identical to a full guarantee and a partial guarantee, those pros and cons are fully applicable.

III. Direct Loan or Purchase of Securities

This form of assistance has two distinguishing features. First, it involves an immediate cash outlay by the USG. Second, the City (or other borrower) would not be forced to go into the market itself -- accordingly, the USG would have to borrow in the open market to make the loan.

Apart from these features, the considerations -- and sub-options -- regarding the direct loan approach are virtually identical to those involved with respect to guarantees. The pros and cons of various programmatic features -- e.g. purchase all debt, purchase dollar limit, purchase NYC alone -- are the same.

One different sub-option can be identified. To create incentives for fiscal reform (and restored public market access) the USG could make loans available on a matching basis; i.e., for every $5 the City raises in the public market, the USG will provide $1. Recognizing the importance of self-reliance, most existing USG assistance to State and local government is in matching form.

Matching Loans

Pros

-- Preserves incentives for fiscal restraint.

-- Requires less funding from USG, reducing adverse market impact.

Cons

-- If City is unable to restore market confidence, will not be adequate to prevent default.

Direct Loan vs. Guarantee

The similarities notwithstanding, there are certain advantages and disadvantages to a direct loan program which stem from the above-described distinguishing features.

Advantages of Direct Loan

-- Does not directly affect the municipal market; indeed, by eliminating a portion of demand from the market, may cause a short term improvement in market conditions for other borrowers.

-- Direct cash payment insures City will receive funds.

Disadvantages

-- Requirement of actual USG borrowing (as opposed to intangible expansion of USG credit) may have more severe and immediate effect on USG borrowing cost, borrowing costs of other borrowers.

-- Direct cash outlay would directly increase USG budget deficit, further lessening USG flexibility regarding fiscal policy.

IV. Three Year Advance of City's Share of Welfare

It has been claimed that the City's welfare burden is a national concern: the poor and disadvantaged, as well as illegal aliens, gravitate to NYC. Accordingly, it has been suggested that we seek legislation authorizing an advance to the City in an amount equal to the City's share of welfare costs for three years: approximately $2.7 billion. In return, the USG would receive a 10 year City bond, bearing interest at Treasury bond rates. In addition, beginning three years from now, the City would establish a sinking fund to repay the bond when due.

Pros

-- Would provide a substantial portion of the City's cash needs.

-- Would not disrupt municipal bond market.

Cons

-- Would be difficult politically to confine to NYC.

-- Would require substantial borrowing by USG, driving up USG borrowing costs and affecting other borrowers.

-- Could be viewed as a concession of broader Federal responsibility in the welfare area, tying our hands with respect to upcoming welfare reform proposals.

Part II: Use of Existing Resources

I. Federal Reserve

Two avenues of assistance are available through the Federal Reserve. First, the Federal Reserve Banks are authorized to supply liquidity to the banking system by accepting for discount financial assets held by the bank. Discounting is in effect a secured loan to the bank, but it is important to note that the bank remains liable to the Fed for the full amount of loan. Accordingly, if a bank were to discount NYC Securities with the Fed, the bank would still bear the risk of loss. Dr. Burns has announced that the "discount window" will be available to banks impacted by the New York crisis.

The discount window is not a source of direct assistance to New York City. However, the Federal Reserve banks are empowered to make direct loans -- secured or unsecured -- to any borrower "in exigent circumstances."

Direct Fed Loan

Pros

-- Would provide NYC with the necessary cash.

-- Would not require legislation.

-- Would eliminate the risk of a major financial collapse precipitated by a City and/or State default.

-- Would show Federal concern for urban problems.

Cons

-- Would set a bad precedent by opening this avenue of assistance (which has never been used in comparable circumstance) to borrowers who can claim broad impact on financial system.

-- Would place Fed in the role of the City's bankers and could lead to pressure for further loans to protect initial loan.

II. GNMA Program

GNMA has the general legal authority to purchase mortgages of all types. It must, however, obtain periodic authority from Congress for actual blocks of purchases. It has recently used up a $5 billion block; legislation is now pending (and expected to pass soon) giving GNMA an additional block. The City owns $700 million in mortgages on existing low and moderate income properties ("Mitchell-Lama" projects) which would qualify for GNMA purchase.

Pros

-- Provides a substantial Federal commitment.

-- Would not disrupt municipal market or disadvantage other borrowers in that market.

Cons

-- Would be inconsistent with Congressional purpose to use GNMA to generate new housing starts.

-- Would impede recovery in housing sector.

-- Would establish dangerous precedent: many state and local agencies own mortgages they have been unable to fund through long term debt.

III. Change Method of Medicaid Reimbursement

By shifting Medicaid hospital payments from a reimbursement to an advance basis, we could provide $75 million. To make the shift, the State would also have to change its method, requiring a $37.5 million outlay by the State.

Pros

-- Provides some cash assistance.

-- Since most Federal assistance is on an advance rather than reimbursement basis, would not represent a basic policy change.

Cons

-- Shift nationwide, involving $500 million, would involve a substantial one time cost to the USG

-- Benefit to City small in relation to overall need.

-- State matching requirement could burden State.

IV. Advance Revenue Sharing

The third quarter revenue sharing payment ($64 million to the City, $57 million to the State) is scheduled to be made in the first week of October. The fourth quarter payment (in the same amounts) is payable in the first week of January. These payments can legally be made any time in the relevant quarter.

Pros

-- Provides some financial assistance.

Cons

-- Would not provide new cash: NYC's problem is no longer so much one of timing of cash flow, as of total amount.

-- Would have to be provided nationwide imposing substantial cost on USG.

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

September 16, 1975

Dear Mr. Chairman:

I am writing in response to your letter of September 5, 1975, requesting an analysis of the potential impact of an inability by New York City to meet its obligations as they mature. It is clearly appropriate that we fully evaluate the potential consequences of such an event and the methods available for dealing with them.

As you know, I shall be testifying before your Committee on the 24th of September on many of the questions that you have raised, and in that testimony I plan to cover these issues in full detail. In the meantime, in order to be responsive to your needs as well as those of your colleagues, I would like to offer brief comments on each of the points that you have mentioned.

Financial Markets

As I have said many times in commenting upon the possible impact of a default by New York City upon our financial system, we are dealing in the realm of personal judgments; absolute certainty is simply not possible. Based upon past experience, however, I have great faith in the resiliency of our financial markets and, subject to the willingness of most market professionals to view the situation objectively, I believe those markets are capable of handling a default with no more than moderate and relatively short-lived disruption. I must add that to some extent, the possibility of a New York City default has already been discounted in the marketplace. Although a variety of complex factors have contributed to the current high levels of tax-exempt yields, one element is the expectation of a New York City default. Accordingly, if default were to occur, we would expect only a moderate degree of further adjustment.

Other Issuers of Tax-Exempts

New York City's well publicized difficulties have clearly resulted in more intensive scrutiny of the underlying soundness of all tax-exempt credits, a healthy development in our view. We would expect the levels of care employed in analyzing potential tax-exempt investments to rise even further in the event of a default, in effect rewarding issuers whose financial affairs are entirely in order. We do not believe, however, that any other issuer will default as a direct consequence of a default by New York City.

Banking System

As the Committee is aware, the Treasury Department along with the bank regulatory agencies has reviewed the exposure of the banking system in the event of a default by New York City. Based upon that review, we have concluded that a default would not cause solvency problems for any major bank. We have identified certain smaller banks which may face material capital reductions as a result of a default. These few banks are being carefully watched by the appropriate regulatory agencies, which will take the necessary steps to insure that no innocent parties are adversely affected by the impact of a New York City default on certain banks.

Overall Economic Outlook

As a result of widespread publicity, the nation is fully aware of the financial situation in New York City and is particularly sensitive to the unique aspects of the situation: specifically, the city's massive deficit spending. Given these levels of awareness, we do not believe a default would undermine fundamental confidence in our economy or cause financial institutions to adopt unnecessarily restrictive credit policies.

Indeed, just the contrary may be true. If the Federal government were to act to prevent default -- by guaranteeing New York City or MAC debt, for example -- there is a serious risk that the capital and the credit markets would react adversely. The expansion of the Federal credit involved would have a measurable impact on borrowing costs throughout the capital markets, and would exacerbate the market access problems of marginal issuers. And any attempt to compensate through a relaxation of monetary policy would fuel expectations of future inflation, strengthening investor reluctance to commit funds for the long term.

In recent weeks, many prominent figures, including a number of leaders of the financial community, have predicted that a default could place an intolerable degree of strain upon our financial system, and possibly upon the whole of our society. As I indicated earlier, absolute certainty with regard to the possible repercussions of a default is simply not possible. Nonetheless, there would appear to be little objective evidence to support such conclusions. Indeed, I am deeply concerned about some of these statements because I believe they increase the element of risk to our financial system. Accordingly, as we work together in seeking the best possible outcomes to this matter, it is essential that all parties concerned excercise restraint and sound judgment with due regard to the importance of the issues at stake.

Until we meet on the 24th, my staff stands ready to continue working with the Members and staff of the Joint Economic Committee in exchanging factual and other information.

Sincerely yours,

Bill Simon

William E. Simon

The Honorable
Hubert H. Humphrey
Chairman
Joint Economic Committee
Washington, D. C.

9-17 NYC

THE UNDER SECRETARY OF THE TREASURY

WASHINGTON, D.C. 20220

MEMORANDUM FOR THE HONORABLE L. WILLIAM SEIDMAN
Assistant to the President for
Economic Affairs

FROM: Edwin H. Yeo III
Under Secretary for Monetary Affairs

SUBJECT: Response to Humphrey letter regarding impact of default by New York City

As we discussed, I am attaching the most recent draft of the above response. I would appreciate your views on the draft, as well as your views on the question whether we should attempt to avoid sending any response at this time, instead reserving our comments until Bill testifies on the 24th.

Attachment

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

Dear Mr. Chairman:

I am writing in response to your letter of September 5, 1975, requesting an analysis of the potential impact of an inability by New York City to meet its obligations as they mature. It is clearly appropriate that we fully evaluate the potential consequences of such an event and the methods available for dealing with them.

Any financial reversal has two aspects: a tangible and objective aspect on the one hand and a psychological aspect on the other. It would be inadequate to limit the analysis to only one of these aspects. And confusing the two would further cloud our evaluation of the impact of default. Indeed, I sense that such confusion is in large part responsible for some of the more extreme predictions which have dominated this dialogue in recent weeks.

There are three relevant terms and concepts. There is "insolvency" which, simply stated, means that a person or a city has current obligations which exceed its available funds. "Default" is a technical legal term describing a debtor's refusal or inability to pay a creditor who has demanded payment. "Bankruptcy" simply describes a legal proceeding -- provided for in the Constitution -- under which an insolvent person in default turns over to a court the job of deciding how his financial resources will be apportioned among creditors.

At this point, it is important to draw a distinction between the options available in the event of a corporate default and those available with respect to a municipal default. If a corporation defaults and is subsequently brought under the jurisdiction of a Federal bankruptcy court, one option -- albeit often not the most desirable one -- is liquidation: the sale of assets to satisfy the claims of creditors and the subsequent disappearance of the corporation as a continuing entity. Both common sense and Constitutional principles preclude such an option with respect to municipal defaults.

In this respect, a default by a state or local government is closely analogous to a default by an individual person. In either case, if a bankruptcy proceeding ensures, resources essential to the maintenance of life in the one case and essential services in the other, are protected from the demands of creditors. It is important to re-emphasize this point: if New York City defaulted, it would continue to exist and to operate. The City will not, as recently implied by statements from heretofore responsible quarters, fall into a chasm which will magically open along Park Avenue, or be drawn into a massive whirlpool in New York harbor.

In short, it is essential not to confuse the legal and idiomatic meanings of the term bankruptcy. In common parlance, we may use bankruptcy to define a condition devoid of substance or resources. By that definition, New York has not been and is not now bankrupt. And a default in the future will not change this. If it does default, however, and wishes to deal with its creditors in an orderly way, a proceeding under the Federal bankruptcy laws may be the most appropriate solution.

If the City defaulted on an obligation to redeem maturing debt for cash, one immediate question is whether the City could continue to provide essential services: police and fire protection, sanitation, mass transit, water and sewage facilities. Any prediction in this regard is dependent upon the willingness of the City's employees to act in the public interest. If such is the case, it is my view that such services will continue to be available after a default.

There may be creditors of the City who, in an attempt to perfect their claims, will seek judicial assistance in preventing the payment of public employee salaries. This risk only underscores further the importance of providing a mechanism under which the claims of all legitimate creditors can be dealt with in a single proceeding. Accordingly, we have developed amendments designed to cure the inadequacies of existing Chapter 9 of the Federal Bankruptcy Act, and we expect shortly to submit them to Congress for prompt, and hopefully favorable, consideration.

But it is nevertheless fair to ask what the impact would be if the City were unable -- for whatever reason -- to provide such services in the event of default. As prudence dictates, the Office of Management and Budget and the Domestic Council have looked closely at this question. Based upon that evaluation, we have concluded that State and Federal resources are adequate to insure that all assistance programs will continue to operate and that essential services will be provided.

I do want to reiterate that we have absolutely no reason to believe that these plans will ever need to be implemented. But we would not have fulfilled our responsibilities to the people of New York and the nation at large had we not been prepared for all eventualities.

Financial Impact

Let me now address the most important part of your inquiry: the impact of a default on our financial system. As I have said many times, we are dealing entirely in the realm of judgments; absolute certainty is simply not possible. My own judgment is based upon an analysis of the factual circumstances and upon my own professional experience of more than twenty years in the investment banking business. I have great faith in the resilience of our financial markets and, subject to the willingness of most market professionals to view the situation objectively, I believe these markets are capable of handling a default with no more than moderate, and relatively short-lived, disruption.

These views are based in part on the following considerations. First, there is evidence that the markets -- and particularly the municipal market -- have to some degree already discounted the possibility of a New York City default. I view such discounting as an indication of the markets' ability to attempt to cope in advance with an unknown event. At the same time I recognize that other professionals would draw the opposite conclusion, finding in such market behavior the seeds of more serious disruptions if default were to occur. Second, there is no reason to believe that either market participants or the public at large will misunderstand the causes of a potential New York City default. Given the widespread publicity of New York's problems and the causes thereof, I believe there is little risk that such a default would be viewed as indicative of a pervasive economic malaise. Moreover, any default which might occur could possibly be confined to a limited number of New York City note maturities. The City probably has adequate financial resources to meet its debt service obligations on its first lien bonds. Finally, any default should be followed by prompt efforts -- probably under the supervision of a Federal judge -- to restructure the short term debt, insuring that holders of defaulted obligations receive full value in the shortest possible time.

We reach similar conclusions regarding the potential impact on our banking system. As the Committee is aware, we, in conjunction with the Comprtroller of the Currency, the Federal Reserve Board and the FDIC, have taken a close look at the holdings of New York City securities in our banking system. We have found that no major bank would be threatened in the event of a New York City default. Moreover, less than 50 of the 14,000 banks in this country own New York City securities in amounts which would threaten solvency in the event of a default and a subsequent writedown of these securities.

With respect to these few banks, all of which have been identified by the regulatory agencies and are being closely watched, various mechanisms are available to insure that none will fail:

1. Where possible, bank directors will be required to contribute additional capital.

2. Certain banks may be sold to, or merged with, other banks or bank holding companies.

3. As a last resort, the FDIC may provide capital in the form of convertible subordinated debt, at the same time imposing appropriate sanctions on the bank officials directly and indirectly responsible for the bank's exposure.

Conclusions with respect to the impact on other tax-exempt credits, particularly those in New York State, are somewhat more complex. A variety of factors -- e.g., the unsettled condition of the market, structural inadequacies in the market, inflation and the anticipation of future inflation -- have all combined to cause a notable shift in the quality and liquidity preferences of tax-exempt investors in the past twelve months. All credits are being increasingly scrutinized for evidence of underlying quality. It would be reasonable to expect this phenomenom to accelerate in the event of default by a major, widely-held, issuer. But any governmental unit which conducts its financial affairs in a prudent manner should have access to the markets, such scrutiny notwithstanding.

We have taken a particularly careful look at the credits within New York State to determine whether any credit would be unable to withstand an increased level of scrutiny. With respect to the great majority of credits -- including that of the State itself -- we believe there is little risk that a default by New York City would directly precipitate other defaults, given appropriate public policies. We are concerned that certain programs of the New York State Housing Finance Agency may have inadequate revenue sources and may be forced to rely on the State's moral obligation pledge to meet its obligations. At the same time, it is important to note that the difficulties of New York City did not cause the problems which the housing agency faces; the difficulties merely served as a catalyst in inducing investors to review the fundamentals of all tax-exempt credits. Similarly, a solution to New York City's problems -- from whatever source -- is unlikely to result in return to an attitude of laxity with respect to investor evaluation of tax-exempt credits.

Our objective conclusions notwithstanding, there is an element of risk which warrants mention. As efficient as our financial system may be, it is vulnerable on one front: prophecies of doom, however unsound, occasionally turn out to be self-fulfilling. And when such prophecies come from within the system itself, the risk is even greater.

In recent weeks, many prominent figures, including a number of leaders of the financial community, have predicted that a default could place an intolerable degree of strain on our financial system, indeed our society. While, as I indicated earlier, absolute certainty is simply not possible when predicting the unknown, there would appear to be little support for such conclusions in the facts as we understand them. I am deeply concerned about these statements because I believe they introduce an element of risk to our financial system which would not otherwise be present. As we inquire further into the potential impact of a New York City default, it is essential that all parties concerned be sensitive to the possibility that the evaluation process, if abused as it recently has been, may itself be responsible for precipitating serious adverse consequences.

Mr. Chairman, in this letter I have attempted to set forth Treasury's objective conclusions concerning the potential impact of a default by New York City. Based on those conclusions, we cannot agree that Federal financial assistance -- given the burdens it would impose on the capital markets and the economy and the unwise and constitutionally suspect reordering of Federal, state and local relationships which would result -- is warranted in these circumstances. At the same time, I must re-emphasize that if men who are perceived to be experts in this field continue to predict a national disaster with little, if any, support in the facts, a default could have national consequences, objective considerations notwithstanding.

I look forward to exploring these matters with you in greater detail on the 24th.

Sincerely yours,

William E. Simon

The Honorable
Hubert H. Humphrey
Chairman
Joint Economic Committee
Washington, D.C.

Congress of the United States
JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)
WASHINGTON, D.C. 20510

September 5, 1975

The Honorable William E. Simon
Secretary
Department of the Treasury
Washington, D.C. 20220

1838

Dear Mr. Secretary:

As Chairman of the Joint Economic Committee I have become increasingly concerned that New York City's deepening financial crisis will have profound adverse implications for other major cities and quite possibly for other major sectors of our economy. However, I have seen no significant and thorough analysis assessing the full economic impact of a default either to allay my suspicions or to confirm my fears.

In response to this gap in information, I have asked the staff of the Joint Economic Committee to examine in greater detail the economic implications of a default by New York City and also to review the efficacy of various proposals to lessen the adverse economic impact. As part of this effort the Committee and its staff will discuss these important issues with experts around the country.

In order to provide the Congress with an accurate and complete description of this problem, it is essential that the Committee receive the Administration's assessment of the economic impact of a New York City default and any analysis of this situation that has been prepared by the Department of Treasury staff. Specifically we would like you to assess, in as analytical terms as possible - the impact of a full or "partial" default on the market for tax exempt securities issued by other municipalities, particularly large cities; the impact of a full or partial default on the market for tax exempt securities issued by states, particularly New York State; the impact of a full or partial default on bank liquidity and the financial stability of the banking system; the impact of a full or partial default on the strength of economic recovery, focussing particularly on the economic impact of declines in investor confidence and on caution by lending institutions; and the impact of a full or partial default

The Honorable William E. Simon
Page Two
September 5, 1975

on other money markets, particularly the corporate bond market, and on the stock market.

It would also be helpful if you could supply the Committee with any contingency plans that the Administration is prepared to undertake to either ameliorate the possibility of default or to minimize the economic impact of default. If specific actions have been rejected, either to prevent default or to minimize its impact, it would be helpful if you could provide an explanation for the rejection.

Since the financial situation of New York City is becoming more serious by the day, the Committee would appreciate as prompt a response as is possible. I hope that you will be able to provide us with your assessment of this situation by Friday September 12.

I greatly appreciate your efforts in responding to the Committee's request.

Sincerely,

Hubert H. Humphrey
Hubert H. Humphrey
Chairman
Joint Economic Committee