

Committee Meeting

of

ASSEMBLY APPROPRIATIONS COMMITTEE

"Committee meeting directed by Assembly Resolution No. 150,
to investigate issuance of bonds by the State, State
agencies, and independent authorities."

VOLUME I

LOCATION: Room 319
State House
Trenton, New Jersey

DATE: September 14, 1993
11:00 a.m.

MEMBERS OF THE COMMITTEE PRESENT:

Assemblyman Rodney P. Frelinghuysen, Chairman
Assemblyman C. Richard Kamin, Vice-Chairman
Assemblywoman Joann H. Smith
Assemblywoman Clare M. Farragher
Assemblyman Richard H. Bagger
Assemblyman John C. Gibson
Assemblyman Walter J. Kavanaugh
Assemblyman Leonard Lance
Assemblyman David C. Russo
Assemblyman Louis A. Romano
Assemblyman John S. Watson
Assemblyman Robert G. Smith



ALSO PRESENT:

Michael J. Basarab
Office of Legislative Services
Aide, Assembly Appropriations Committee

Hearing Recorded and Transcribed by
The Office of Legislative Services, Public Information Office,
Hearing Unit, State House Annex, CN 068, Trenton, New Jersey 08625

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RODNEY P. FRELINGHUYSEN
Chairman
C. RICHARD KAMIN
Vice-Chairman & Sub-Committee Chair
JOANN H. SMITH
Sub-Committee Chair
CLARE M. FARRAGHER
Sub-Committee Chair



New Jersey State Legislature

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JOHN S. WATSON

REVISED

COMMITTEE NOTICE

TO: MEMBERS OF THE ASSEMBLY APPROPRIATIONS
COMMITTEE

FROM: ASSEMBLYMAN RODNEY P. FRELINGHUYSEN, CHAIRMAN

SUBJECT: COMMITTEE MEETING - September 14, 1993

The public may address comments and questions to Michael J. Basarab, Committee Aide, or make bill status and scheduling inquiries to Patricia Scott, secretary, at (609) 984-6798.

The Assembly Appropriations Committee will meet on Tuesday, September 14, 1993 at 11:00 AM in *Room 319, State House.

The meeting has been called by the Chairman to examine the public securities industry and the regulatory structure which oversees it. The Committee will also review the fiduciary responsibilities of State bond issuers and the procedures utilized in recent State bonds sales, including the selection of participants, bond allocation decisions, and fees generated by those involved.

Additional dates will be scheduled as needed.

Issued 9/9/93
*Revised (Room change)

THE CHAIRMAN REQUESTS THAT ALL LEGISLATIVE AGENTS
PLEASE DISPLAY IDENTIFICATION BADGES
WHILE IN ATTENDANCE AT COMMITTEE MEETINGS.



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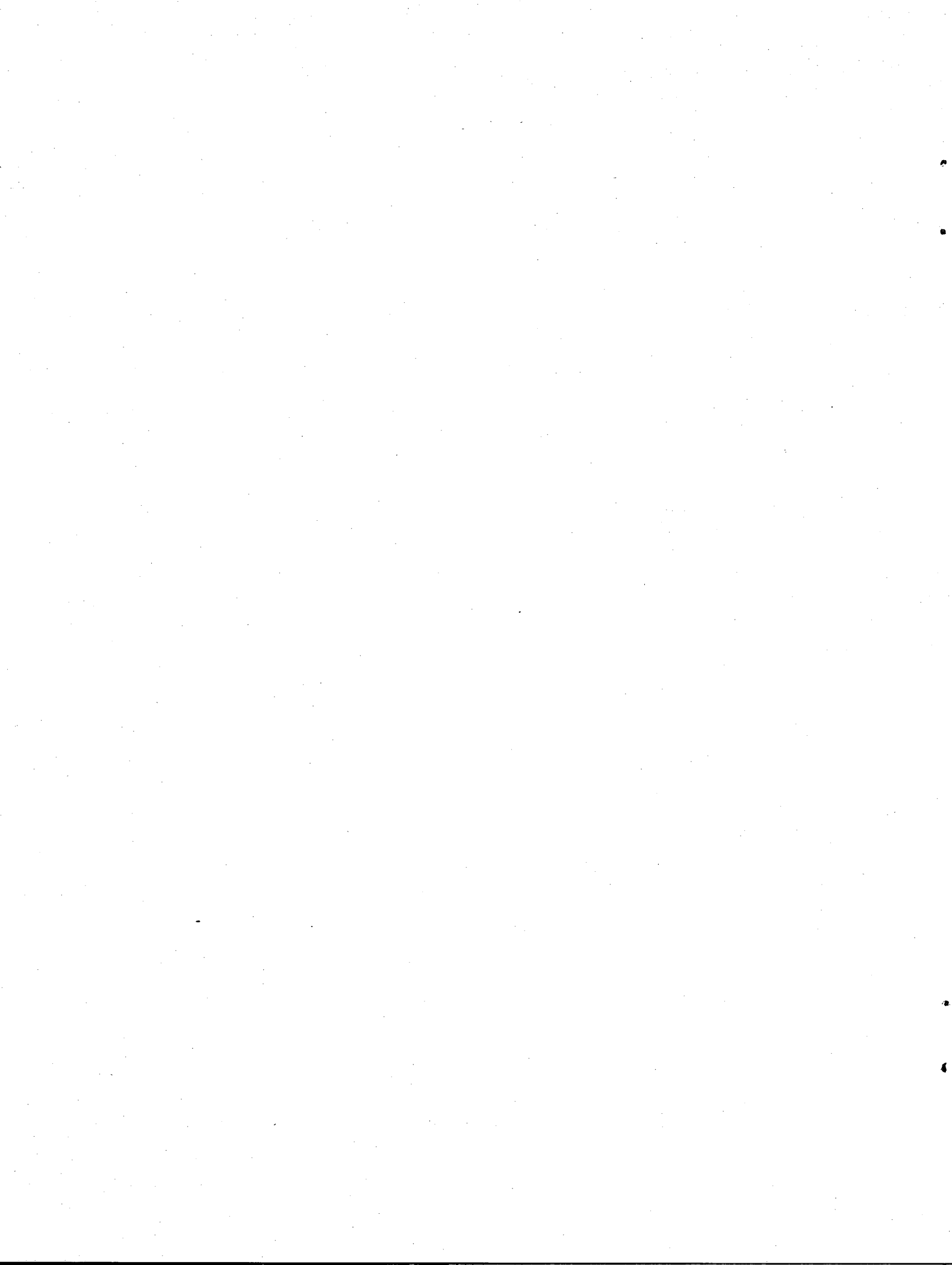


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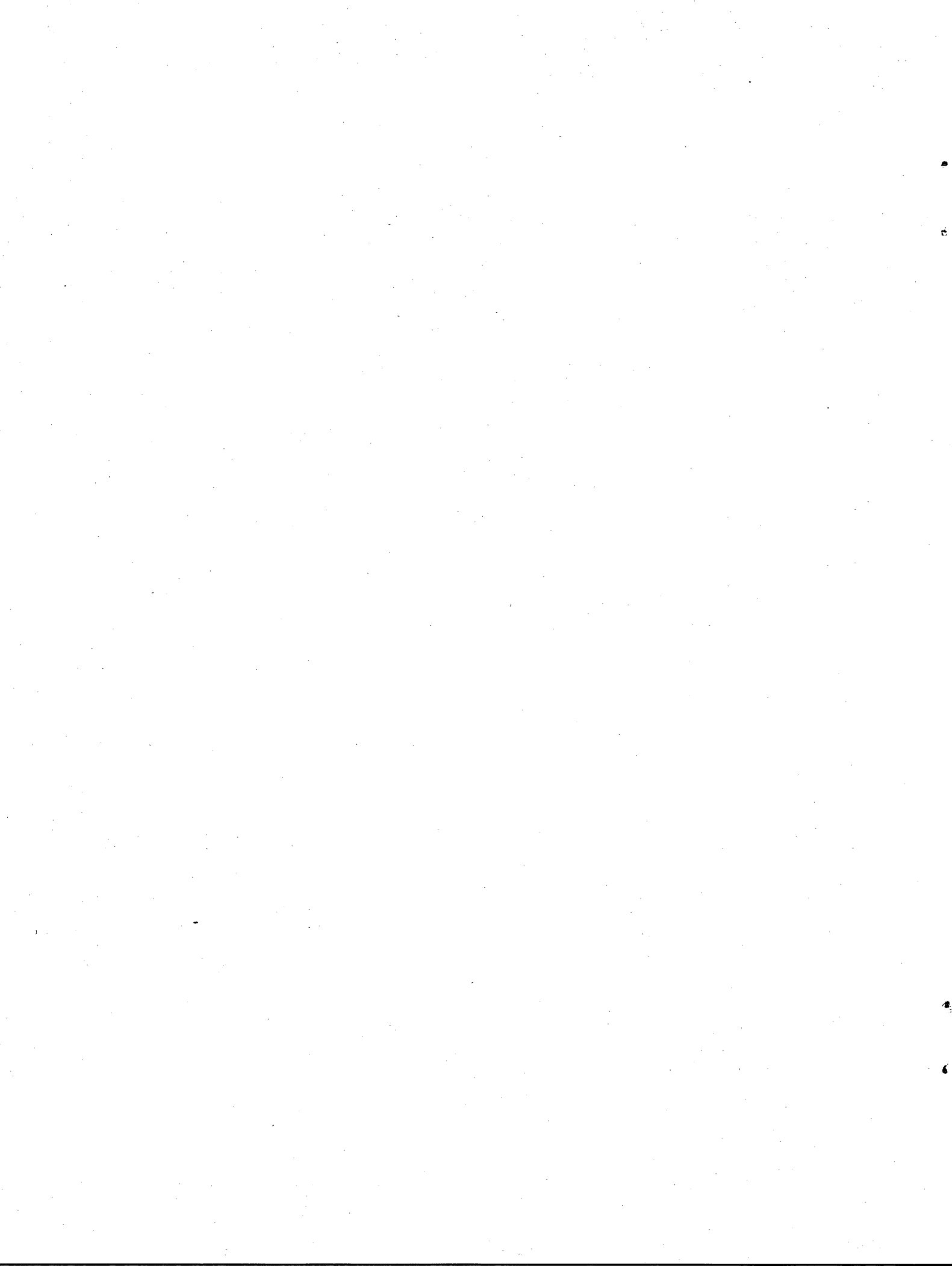


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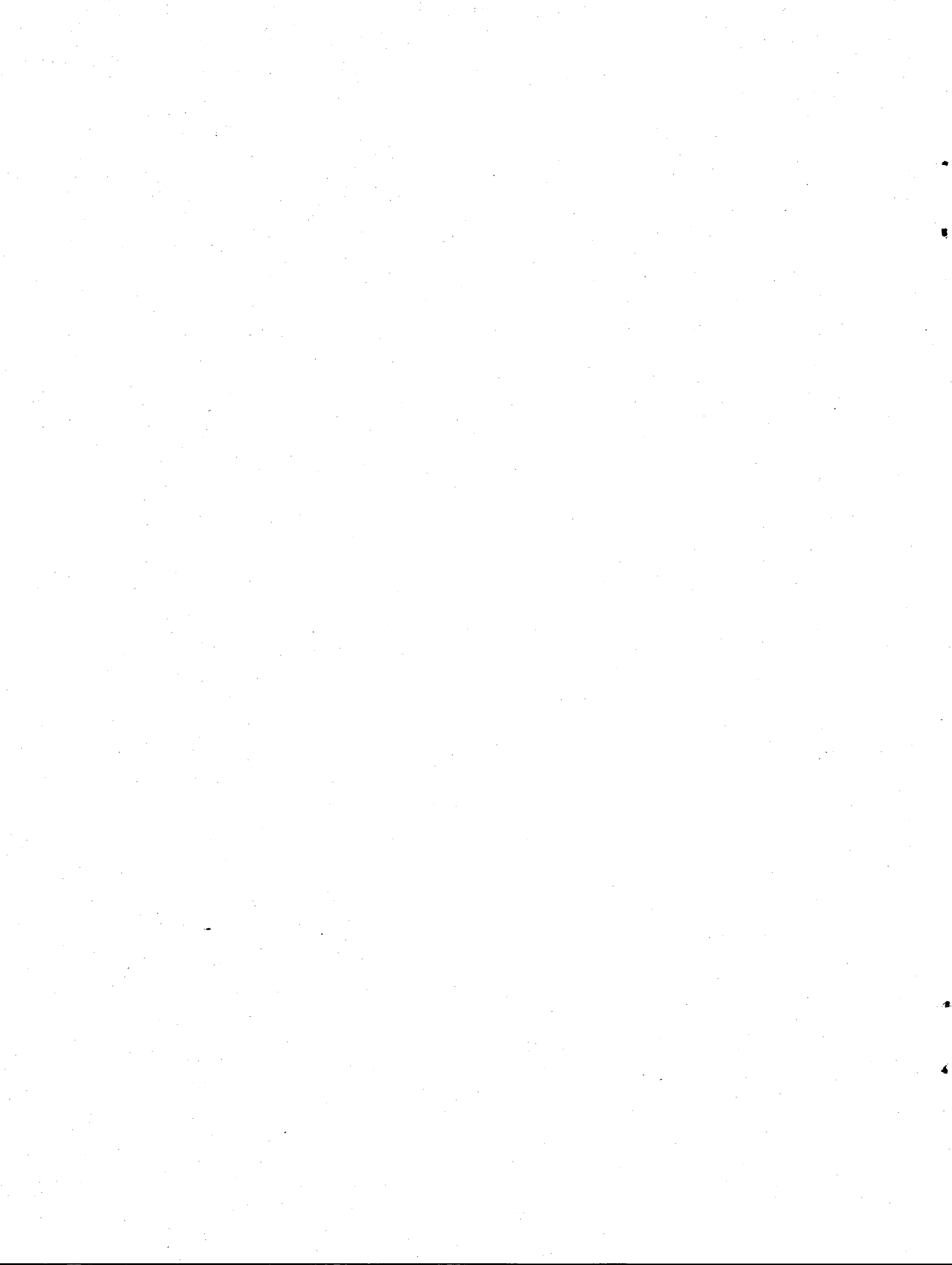
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ASSEMBLYMAN RODNEY P. FRELINGHUYSEN (Chairman): Good morning. I apologize for the late start of the Committee meeting. I would like to thank everybody for being with us this morning.

Before I begin my opening remarks, the Committee must attend to a few points of business, some of which have resulted in the delay of this meeting, for which I apologize. Mr. Basarab, from the Office of Legislative Services, are we in compliance with the Open Public Meetings Act?

MR. BASARAB (Committee Aide): Yes, we are, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Yesterday, the Assembly approved Assembly Resolution No. 150, which authorizes this Committee to undertake an investigation of the State's bonding practices, and to that end, also authorizes subpoena power. Although the Committee has been given the authority to compel the attendance of witnesses, for the record, no subpoenas have been issued for this meeting and the witnesses appearing before this Committee today are present voluntarily. I repeat, today's witnesses are not here by subpoena, nor as a result of threat of a subpoena.

Under the provisions of New Jersey statute 41:2-2, every Committee Chair has the prerogative and the authority to place witnesses under oath. A sworn witness does not have to answer a particular question through a pleading of the Fifth Amendment, nor perjure himself or herself if the answer is knowingly not factually correct.

There will be basically two types of witnesses here this morning and this afternoon, witnesses who will supply background information to the Committee and witnesses of fact.

As the Committee discussed -- Republicans and Democrats -- prior to coming upstairs, we had some questions relative to whether to have sworn testimony or nonsworn testimony. It is my feeling, in fairness, that everybody,

unless there be any strong objections, be sworn in, and I will be doing that throughout the proceedings. I think we have settled that issue quite amicably.

Finally, our Counsel has advised me that it is appropriate that this Committee adopt operating rules for the purpose of conducting these hearings. A copy of the rules has been placed on the desk with an appropriate amendment suggested by a member of the Committee, Assemblywoman Smith. A copy of the rules has been placed on the desk, and I will ask each member at this time to review those rules and that amendment, and that a vote for adoption be taken. For the purposes-- Yes?

ASSEMBLYMAN WATSON: Mr. Chairman, would you state the amendment for the record?

ASSEMBLYMAN FRELINGHUYSEN: The motion is a one-hour notice if, in fact, individuals or other information are needed, such that the members will have an opportunity to know what, in fact, action is proposed.

ASSEMBLYMAN LANCE: I make the motion.

ASSEMBLYMAN FRELINGHUYSEN: There is a motion on the floor made by Assemblyman Lance, seconded by Assemblyman Kavanaugh. Any discussion on the operating rules, which we have a copy of in front of us, with the proposed amendment as well? Any further discussion? (no response) If not, Mr. Basarab, please call the roll.

MR. BASARAB: Mr. Romano?

ASSEMBLYMAN ROMANO: Yes.

MR. BASARAB: Mr. Smith?

ASSEMBLYMAN R. SMITH: Yes.

MR. BASARAB: Mr. Watson?

ASSEMBLYMAN WATSON: Yes.

MR. BASARAB: Mr. Bagger?

ASSEMBLYMAN BAGGER: Yes.

MR. BASARAB: Ms. Farragher?

ASSEMBLYWOMAN FARRAGHER: Yes.

MR. BASARAB: Mr. Gibson?

ASSEMBLYMAN GIBSON: Yes.

MR. BASARAB: Mr. Kavanaugh?

ASSEMBLYMAN KAVANAUGH: Yes.

MR. BASARAB: Mr. Lance?

ASSEMBLYMAN LANCE: Yes.

MR. BASARAB: Ms. Smith?

ASSEMBLYWOMAN J. SMITH: Yes.

MR. BASARAB: Mr. Kamin? (no response) Mr. Frelinghuysen?

ASSEMBLYMAN FRELINGHUYSEN: Yes. Those rules are adopted.

May I note before I give my opening statement that the Committee is pleased to have -- and the Speaker has approved -- Assemblyman Bob Smith, who is substituting for Assemblyman Mattison. The Committee is joined by the Chairman -- at least he was here -- of the -- the new Chairman of the Assembly State Government Committee, Assemblyman David Russo. I would like that noted formally in the minutes.

Good morning, and thank you all for coming. It is with mixed feelings--

ASSEMBLYMAN WATSON: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: Yes, Assemblyman Watson?

ASSEMBLYMAN WATSON: I'm sorry to interrupt you, but is Assemblyman Russo subbing for Mr. Kamin?

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Kamin is ill disposed and shall be here, but I have asked Assemblyman-- Assemblyman Russo has asked and I have so granted his request to join the Committee and participate in the proceedings. I think past precedent has allowed that opportunity.

It is with mixed feelings that I have convened this Committee today to begin a detailed inquiry into certain aspects of last year's \$1.8 billion bond refinancing plan and the general bonding practices of the Florio administration. On

one hand, it is unfortunate that circumstances have brought us to a point where these hearings are not only warranted, but necessary. Neither I nor any members of this Committee take any pleasure in seeing New Jersey dragged through bond scandal stories in the media day after day. We take no great pleasure in seeing our State held up high as an example of alleged bond improprieties through possible criminal dealings during congressional hearings in Washington, and in this State's and the nation's newspapers.

Our goal is a simple one: We want the administration and all other parties involved in this bond refinancing deal to provide the Legislature and the citizens of New Jersey with a complete, detailed, unsanitized account of the events surrounding this bond sale. We can no longer endure the repeated delays and months of stonewalling by the administration with regard to this entire issue. For almost nine months, we have been asking the administration to supply us with important details about the refinancing plan, but each request for information has been largely ignored.

Some members of the administration questioned the motives of these hearings, but I can assure everyone involved that we are only interested in learning the facts and circumstances surrounding the State's \$1.8 billion refinancing deal and other bonding practices.

As elected officials, we are bound by our oath of office to act in the best interests of the people we represent, and to uphold our State Constitution. This morning, in particular, we wish to hear testimony from expert witnesses. This particular session will better educate us and provide us with new perspectives and insights into the bonding business. More importantly, we hope to know what actions New Jersey can take to restore its good name and reputation in some business and fiscal circles.

As I mentioned on the floor of the Assembly yesterday, these hearings are not a political witch-hunt, but with the Federal Justice Department, the FBI, the Securities Exchange Commission, and Congress conducting their own investigation of our State's bonding practices, how could we possibly sit back and do nothing? It is our hope that these hearings will shed light on the State's bonding practices and hopefully clear the air with respect to numerous allegations of unethical and illegal activity. Today we start a process that we hope will remove the dark cloud hanging over Trenton and restore the integrity of our State government.

Before recognizing Mr. Christopher Taylor, who is seated at the front table -- and Mr. Taylor is the Executive Director of the Municipal Securities Rulemaking Board-- Mr. Taylor, Counsel advises me that if I were to place you under oath, I would have to ask you a series of questions, and I am going to proceed. This is somewhat pro forma, if you would be good enough to respond.

The first question being: Did you receive a subpoena from this Committee compelling your attendance at this hearing today?

C H R I S T O P H E R T A Y L O R: No, Mr. Chairman, I did not receive a subpoena from the Committee.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that the Chairman of this Committee has the authority to administer an oath or affirmation to a witness in any matter now pending before this Committee?

MR. TAYLOR: I understand, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Have you received -- and if you haven't I am sure we can make sure you have a copy of it-- Have you received a copy of the Code of Fair Procedure here today before testifying before this Committee?

MR. TAYLOR: I have not, but that is not necessary.

ASSEMBLYMAN FRELINGHUYSEN: All right. The Code of Fair Procedure gives you certain rights as a witness testifying under oath here today before this Committee. For example, you have the right to be accompanied by counsel, who may advise you of your rights during the proceedings. Do you have counsel present here today?

MR. TAYLOR: I do not have counsel present today.

ASSEMBLYMAN FRELINGHUYSEN: Do you agree to testify here today without having counsel present here with you?

MR. TAYLOR: Yes, Mr. Chairman, I do.

ASSEMBLYMAN FRELINGHUYSEN: Thank you for doing that.

Under the Code of Fair Practice procedure, you also have the right, at the conclusion of your examination by this Committee, to file a brief sworn statement relevant to your testimony for incorporation in the record of this investigatory proceeding. You are advised that we are making a tape recording of the proceeding, and you are entitled to receive a copy of your testimony, at your own expense. (laughter) You also have the right to request a copy of the resolution authorizing this investigation.

Do you have any questions concerning the Code of Fair Procedure or your rights under the law?

MR. TAYLOR: No, Mr. Chairman, I don't have any questions.

ASSEMBLYMAN FRELINGHUYSEN: Do you have any questions about the proceeding today?

MR. TAYLOR: No, I don't.

ASSEMBLYMAN FRELINGHUYSEN: All right. Let me say that Mr. Taylor has also indicated that he has a prepared statement. I would like the record to show -- and I believe all Committee members have a copy of this -- that that statement be included in toto, as we did the rules--

ASSEMBLYMAN WATSON: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: --members, in the transcript of the meeting.

Assemblyman Watson?

ASSEMBLYMAN WATSON: Mr. Chairman, I don't see a statement before us.

MR. BASARAB: He only has one.

ASSEMBLYMAN FRELINGHUYSEN: He has one? Do you have the statement?

MR. TAYLOR: I have a couple of copies of the statement if the Committee would like them.

ASSEMBLYMAN FRELINGHUYSEN: If we can abstract one of those from you, we will make sure that the Committee members have a copy.

MR. TAYLOR: Certainly.

ASSEMBLYMAN FRELINGHUYSEN: I am going to proceed with the oath, and then I am going to recognize Assemblyman Watson for an opening statement as well.

Mr. Taylor, if you would raise your right hand, please. You can stay right in your seat. Do you solemnly, sincerely, and truly declare and affirm that the testimony you give in these matters now pending before this Committee shall be the truth, the whole truth, and nothing but the truth?

MR. TAYLOR: I so affirm.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that if statements you make today are willfully false, you may be subject to penalties under the law, including monetary penalties and incarceration, if you fail to answer a pertinent question or commit perjury, which is the making of a false statement under oath in an official proceeding such as this?

MR. TAYLOR: I am aware of that, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand this?

MR. TAYLOR: I understand this.

ASSEMBLYMAN FRELINGHUYSEN: Is the testimony you are providing today given of your own free will?

MR. TAYLOR: It is given of my own free will, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Lastly, have you been directed or required by anyone to testify here today--

MR. TAYLOR: No--

ASSEMBLYMAN FRELINGHUYSEN: --other than by the Chair?

MR. TAYLOR: --one other than by the Chair.

ASSEMBLYMAN FRELINGHUYSEN: Thank you very much. You are so sworn.

Assemblyman Watson is the Democratic Budget Officer. Assemblyman Watson?

ASSEMBLYMAN WATSON: Thank you, Mr. Chairman. Mr. Chairman, I would just like to make a few comments before we begin to hear from those testifying here today.

I would like to emphasize that none of the people who are testifying today have been subpoenaed. You asked them to testify and they have accepted. I would also like to point out that my Democratic colleagues and I are here ready to participate in these hearings. However, Mr. Chairman, we are here to learn more about the State's bonding practices, particularly in comparison to bonding practices across the country. We are here to look at different practices that have been used over the years and determine which may be better for the taxpayers of the State of New Jersey.

Mr. Chairman, if you allow these hearings to disintegrate into a political sideshow, that, of course, is your prerogative. But, Mr. Chairman, that is a game that any number can play, and my colleagues and I are fully prepared for that contingency.

I would like to make a request today on behalf of my colleagues, the media, and the people of New Jersey. The issue at hand is extremely complicated. There will likely be a great deal of technical testimony which may or may not be contradictory and/or confirmed by various witnesses. As such,

I would request that these proceedings be taped and transcribed. I see that you have arranged that, and I want to thank you, Mr. Chairman.

Finally, Mr. Chairman, the Speaker indicated, in response to my question, that you would allow the Minority side of this Committee to request the presence of any witnesses we may deem necessary. I would just like to confirm that you will be honoring any such request that we may make.

ASSEMBLYMAN FRELINGHUYSEN: I would be happy to confirm that, and so do it. Thank you very much for your statement.

Mr. Taylor, we are pleased to begin our hearing by recognizing you. Mr. Taylor is the Executive Director of the Municipal Securities Rulemaking Board, which establishes the rules governing the activities of brokers and dealers in the municipal securities market. Mr. Taylor, we are interested in learning more about the policy-making and enforcement powers of the MSRB and its sister organization, the National Association of Securities Dealers; the new disclosure rules proposed by the Board; and any insight into the environment which has created the need for these hearings in the first place.

I see from your background that you have some roots -- substantial roots -- in New Jersey, having received your master's in Ph.D. and Economics from Princeton; that you have worked for the MSRB since 1978; and before that that you were with the Federal Reserve Board in Washington. Welcome to Trenton and back to New Jersey. We know, from reading the newspapers, that you testified last Thursday before Congress on this matter, so we are especially interested in what you have to say today. Would you be so kind as to proceed with your statement?

MR. TAYLOR: Thank you, Mr. Chairman. I appreciate your putting my complete statement in the record for the

benefit of the people attending today. I would like to read some of the excerpts from that prepared statement.

The Municipal Securities Rulemaking Board appreciates the opportunity to testify before your Committee in connection with your examination of State bond practices in New Jersey. As you noted, the Congress established the Municipal Securities Rulemaking Board in 1975 and directed it to write rules with respect to transactions in municipal securities affected by municipal securities' dealers.

The MSRB is a self-regulatory organization, and like other self-regulatory organizations such as the New York Stock Exchange, the Board must file its proposed rules with the Securities and Exchange Commission prior to effectiveness. The Board's statutory mandate is, through the regulation of dealers, to protect investors, and the Board has acted diligently to fulfill this mandate. The Board believes that the municipal securities market is a fair, vibrant, and efficient market that has, in the main, performed a debt financing function for local governments and other municipal agencies with efficiency and integrity. At the same time, we are concerned about reported problems in certain areas. Accordingly, the Board is pursuing an aggressive agenda to address these potential problems.

The Board, during its first 10 years of existence, established a substantive body of rules that regulate dealer conduct. These rules address subjects including: record keeping, fair practice, pricing, clearance and settlement, quotations, professional qualifications of persons in the industry, and arbitrations of disputes. Thus, dealers are subject to the full panoply of rules that exist in the equities market. Although the Board has broad authority to write rules governing the activities of municipal securities dealers, I would like to stress that the Board does not have the authority to write rules governing the activities of other participants

in the markets, such as issuers and their agents. Board rules do not apply to independent financial advisers and bond counsel.

Similarly, the regulatory authority of the SEC is limited with respect to municipal securities. Municipal securities are exempt from the registration and prospectus requirements of the Securities Act of 1933, and municipal securities are exempt from the registration and reporting requirements of the Exchange Act.

The Board was created to be the primary rulemaker for the municipal securities market, but the Exchange Act directs that inspection and enforcement functions relative to Board rules be carried out by other agencies. For securities firms, the National Association of Securities Dealers, along with the SEC, carry out these functions. For bank dealers, the appropriate Federal bank regulatory authorities, in coordination with the SEC, have this responsibility.

I would like to conclude my remarks by bringing you up-to-date on a number of Board initiatives to address potential concerns in the municipal securities marketplace. A full description of our activities is provided in our report to Congress, which I provided to your Committee. That report was prepared for the Subcommittee on Telecommunications and Finance of the U.S. House of Representatives, which currently is conducting hearings into the municipal securities marketplace.

I would like to highlight briefly three important areas of recent Board action: issue or disclosure, political contributions, and pricing.

First, to help improve the flow of information in the new issue and secondary market, the Board created the Municipal Securities Information Library System, known as MSIL. In the new issue market, the MSIL system collects issue or disclosure documents from underwriters and makes them available to the market and the general public, in paper and electronic form. Last year, the Board collected and disseminated over 12,000

such documents. In the secondary market, we enhanced the MSIL system to accept and disseminate disclosure documents that are voluntarily provided by trustees and issuers. Unfortunately, to date, the level of voluntary submission has been disappointing. The Board is currently working with issuer and investor groups to expand participation in the system. However, the Board strongly believes that in today's market, with more complex securities and a retail orientation, we have to increase access to secondary market information. Therefore, we plan to adopt a rule requiring underwriters to recommend to issuers that they provide continuing disclosure to the market. The rule also calls for dealers to disclose to customers the importance of secondary market disclosure, and whether the issuer has agreed to voluntarily provide such disclosures.

The Board believes that if issuers and customers are fully informed on the facts, secondary market information will naturally increase because customers will demand and issuers will provide such information. The Board has scheduled a special meeting in late September to develop the specifics of this proposal, and we plan to act on it as quickly as possible. The Board is optimistic that its efforts in this area will result in improvements in the flow of continuing information to the market. However, if these efforts do not produce adequate levels of secondary market disclosure, we are prepared to ask Congress for legislation granting direct SEC regulation of issuer disclosure.

In a second initiative, the Board has published for comment a draft rule on political contributions. The Board recognizes that this is a sensitive issue because of the constitutional questions that arise. However, the Board has decided that a regulatory response is warranted. The draft rule adopts an approach similar to the Foreign Corrupt Practices Act. It prohibits political contributions intended

to influence decisions, and requires disclosure of all contributions made to officials with whom business is being done.

The Board expects to review comments on the draft rule in November, and to adopt a final rule for filing with the Commission at that time. We believe that this rule will eliminate both the perception and any reality that political contributions influence the awarding of municipal securities business.

Finally, the Board has worked hard to find appropriate means to increase price information in this market. In June of this year the Board proposed a pilot program for publishing certain volume and price data from the interdealer municipalities market. This program, which would use trade data already being submitted to a central clearing corporation for clearance and settlement purposes, will disclose price and volume data on a next day basis. The Board views this as its first step toward providing investors, analysts, and other market participants with information that previously has been unavailable. This proposal is currently out for comment, and we expect to review comments at our November meeting.

In summary, while the municipal securities market has grown and changed, the Board has sought to ensure that it remains a fair and efficient market. While some problems have arisen, the Board has taken and will continue to take appropriate action to deal with these concerns.

The Board appreciates this opportunity to testify before your Committee, and I would be happy to answer any questions that you or your Committee members may have. Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Mr. Taylor, for your testimony. A number of members of the Committee have indicated a desire to ask you questions. The first legislator who I am going to recognize is Assemblyman Richard Bagger, and he will be followed by Assemblyman John Watson.

Assemblyman Bagger?

ASSEMBLYMAN BAGGER: Thank you, Mr. Chairman, and thank you, Mr. Taylor, for your testimony here today.

I'm going to ask you a few questions that relate to the enforcement activities of the National Association of Securities Dealers, which I understand to be the MSRB's enforcement arm, and then discuss with you, a little bit, the proposal that you have now pending as a proposed rule relating to disclosure of campaign contributions.

Can you tell me, is the National Association of Securities Dealers currently investigating New Jersey State bond practices?

MR. TAYLOR: My understanding is that the NASD was actually the organization that first turned up concerns in this area and forwarded them on to the U.S. Attorney's office. My understanding is that they are continuing to look into this area, but that primary emphasis has now been turned over to the Justice Department and others.

ASSEMBLYMAN BAGGER: The Asbury Park Press, on May 22 of this year, wrote that unspecified irregularities in a joint securities trading account between Armacon and Merrill Lynch and Company are one subject of the Federal investigation. Is that alleged irregularity the matter that came to the attention of the NASD that triggered this matter?

MR. TAYLOR: Assemblyman Bagger, the MSRB is a standard setting body, and the enforcement is carried out by the NASD. In this, as well as any other enforcement or investigation, they are very careful to keep to themselves the exact specifics of what they're investigating. I, too, read the press, and my understanding is that's where it all began, but the actual specifics they have not disclosed to me, as they should not, as a matter of fact.

ASSEMBLYMAN BAGGER: You're more involved in the rule making end--

MR. TAYLOR: That's correct.

ASSEMBLYMAN BAGGER: --to the investigation end.

Then perhaps turning to some of the MSRB rules, The New York Times of May 20 of this year wrote that Smith Barney executives, speaking on the condition that they not be identified, said Armacon had been paid \$50,000 in the deal, but did not sell any bonds. That transaction was the first in which Armacon had participated in the underwriting syndicate, and it was paid even though it sold no bonds to investors. Can you tell me whether there are any MSRB rules related to allegations of this kind?

MR. TAYLOR: There is a rule called G-11 which governs the level of syndicate practices, but I would point out that the normal practice of bond underwriting -- and I'm sure that subsequent witnesses will get into this in far greater detail than I would care to right now. Essentially, an issuer contracts, and it is a private contract with an underwriting syndicate to market the bonds of the issuer. How that syndicate operates is governed by a second contract amongst the syndicate members, and it is that contract that is governing and directs payments amongst the various members.

Various members have certain liability associated with these underwritings, and may or may not sell the bonds and still have a liability and a share in the joint profits of the underwriting syndicate.

ASSEMBLYMAN BAGGER: I understand that these are very complex transactions serving very important public purposes. Do MSRB rules regulate the contracts among the members of the underwriting syndicate, or just the contracts of the issuers?

MR. TAYLOR: Only to the extent-- Our rules only govern the contract to the extent that we require a certain amount of minimum disclosure and accounting information to be provided to syndicate members by the syndicate manager. But we

do not govern how liability should be apportioned amongst the members, or how the profits should be divided. They are all -- how do I say, grownups.

ASSEMBLYMAN BAGGER: Can you tell me what is meant by a joint securities trading account, like the one I just referred to from the Asbury Park Press?

MR. TAYLOR: I will let you actually ask that question to the next witness, Mr. McBride, who is a practitioner in this area. But essentially what it is, two dealers get together, again, to contract, to buy a block of bonds and trade a block of bonds. A more mundane example than what you're referring to would be: A large mutual bond fund wishes to sell a very large block of bonds, and a single dealer does not wish to take on the full liability of selling that block into the market and agrees with another dealer to split how they would choose to sell those bonds and what the split of the profits will be.

ASSEMBLYMAN BAGGER: Are there any MSRB rules that apply to joint trading accounts, for example, that might go to capital requirements or disclosure requirements?

MR. TAYLOR: I would-- First of all, capital requirements are set, really, by SEC rule directly on the dealer community. They are not set by the MSRB or even the NASD. Those capital requirements are really a Federal regulation, so we do not have control over that. The NASD, however, enforces those rules.

With regard to disclosure, the only disclosure is standard record keeping requirements that the firm is required to keep.

ASSEMBLYMAN BAGGER: Are those record keeping requirements to be filed anywhere, or just kept by the company?

MR. TAYLOR: No, they have to be kept for inspection by the NASD and/or by the SEC.

ASSEMBLYMAN BAGGER: Are there SEC capital requirements with respect specifically to joint trading accounts?

MR. TAYLOR: I am not intimately familiar with those rules, which are about as complicated as our tax code in this country.

ASSEMBLYMAN BAGGER: What is the relationship between the MSRB and the NASD with the SEC and the Justice Department in enforcement activity? If you can give us a little overview, it might be helpful to the Committee.

MR. TAYLOR: You have clearly mastered all of the various letter combinations there. We'll try not to throw in any more that go with it.

The relationship is, when Congress set us up, Congress said, "We want you to be a self-regulatory organization." By the way, that's sort of a defined term under the Securities Act. Again, just like the New York Stock Exchange or the NASD for other markets, we have to exist, and our rules and regulations are subject to review and approval by the SEC before becoming effective.

In a sense, we are very similar to you in that you write rules and regulations for the populace of the State of New Jersey, but the actual enforcement of those rules is left to someone else. So in some sense, we are the Congress or the legislators, and the NASD are our cops. They go out and they check what goes on in the various securities firms, examine the books and records, and determine whether any violation of our rules have taken place.

We have regular and frequent contact with the NASD staff, and if they turn up a series of practices or a combination of practices, or see some developing trends that would warrant either a change in our rule or the adoption of new rules, they bring that to our attention, and we are constantly querying them on that. So we adopt our rules and rule amendments based on that information that we receive.

For example, you mentioned joint trading accounts. If something turns up in this matter that warrants changes in our rules, we won't hesitate to adopt them. But again, I would go

back and point out that it is precisely the NASD's efforts in examining for compliance with our rules and SEC rules that turned up the matter in the first place.

ASSEMBLYMAN BAGGER: How does the Securities and Exchange Commission become involved? If something is learned by the NASD that involves securities laws, do they forward it on?

MR. TAYLOR: In some instances, yes. The SEC in a sense has overview over the whole regulatory scheme for the securities markets. For example, in our standard setting area, if we should fail to act or act contrary to the purposes of the law, they can step in, amend our rules, or adopt new rules. They also have oversight authority over the NASD with respect to the enforcement of our rules. They can conduct joint exams. They can go in and conduct their own examination if they wish, and what really happens in most instances, if the NASD turns up a violation of -- a serious violation of securities law, SEC rules, they will pass that on to the SEC's enforcement division. They in turn, the SEC enforcement division, obviously keeps in touch with anyone else if they see any other possible violations of law outside the securities law area.

But again, the SEC, the NASD only enforce the rules in the securities law area. They do not enforce public corruption laws or the like.

ASSEMBLYMAN BAGGER: The Philadelphia Inquirer reported on June 25 of this year that the Securities and Exchange Commission had issued subpoenas to 15 State and local government units in New Jersey. Since then an SEC subpoena was received by the New Jersey Sports and Exposition Authority. Do you know what the present status of the SEC investigation is?

MR. TAYLOR: It is ongoing, as they say. It will probably be a considerable period of time before I would expect anything to come out of the SEC in this regard. Their

investigations are very thorough, and they usually take at least six to nine months after the initial information request that you usually see anything substantive coming out of it.

ASSEMBLYMAN BAGGER: Tell us, if you would, an overview of the NASD's system for imposing penalties in terms of fines, censure, suspension, and what sort of--

MR. TAYLOR: In broad terms, what happens is that when the NASD finds a violation of our rules -- or the NASD staff finds a violation of our rules -- they begin a process that is not too dissimilar to any inquiry or any adjudication process. They give the party who has supposedly violated the rules a chance to respond to a list of particulars as to what rule was violated, why it was violated. That response and the staff's allegations go before a committee of -- called the District Business Conduct Committee. The District Business Conduct Committee reviews both sides of the question. They may, in fact, call these parties to testify and give testimony. They may ask for further information. And at some point in the game the District Business Conduct Committee takes action. It decides whether an offense has occurred, and they decide the level of what the offense is.

For example, a failure to keep a customer account record and get the customer's zip code, I think, would be viewed as a very technical violation. If they saw that in a number of instances, they would write a letter of caution to the dealer. They would expect immediate corrective action.

The penalties go up from there, and can go as far up as an actual bar from the business on a permanent basis, and substantial fines. The NASD has not hesitated to do this on a number of occasions where they find that dealers have -- how do I say it -- been very unfair to their customers.

ASSEMBLYMAN BAGGER: Is a suspension fairly high up the order of magnitude of penalties?

MR. TAYLOR: Oh, absolutely. That is basically saying, you know, you should not be in the business for a period of time, and you should correct and think about what's going on. It's a way of reminding people in the dealer community that they have to be very careful what they do.

ASSEMBLYMAN BAGGER: I'd like to move on to discuss for just a couple of minutes the proposal you have pending regarding political contributions. As I understand it, the proposed disclosure rules won't actually prohibit political contributions by securities firms; it will just require disclosure unless the contribution is made with an intent to secure public work. Is that a fair summary?

MR. TAYLOR: That's a fair summary. If I could, there are really two parts to the rule. The first part of the rule says that no securities dealer may make a contribution directly or indirectly for the purpose of obtaining or retaining the business. So the question of intent has come up in that context, and I'll go back to that in a minute.

In any event, the dealer must disclose all political contributions for two years prior to receiving-- If he is awarded business, then he must go back and look back at all his political contributions for the prior two years, and for the subsequent two years must also report to us any contributions he makes to anyone who can influence the awarding of that business.

There has been much discussion in the press about whether or not the -- how intent is proved. I would like to restate for the record again, and again, and again, that the dealer must be prepared to establish that those contributions were made without the intent of influencing the business. So we really have placed an obligation on the dealer to come forward and explain that his contribution was for a correct purpose.

ASSEMBLYMAN BAGGER: The Courier-News, on May 30 of this year, really put their finger right on the issue by writing, "Why would these out-of-state firms contribute except as a quid pro quo for a share of the State's bond business? Could anyone imagine that Lazard Freres, the New York bond house that made \$2.5 million on the deal as the Turnpike's financial adviser, gave \$40,000 because it believes in good government?" Will the NASD and the MSRB as it -- if this rule is adopted, look to the size of political contributions in determining whether enforcement activity is required under this new rule?

MR. TAYLOR: There is no dollar limit on the size of the contribution that can or cannot be disclosed. I think the Board is very conscious that even in a small municipality, a very -- what might seem insignificant contribution in another jurisdiction might be considered to be quite substantial in a particular small locality. We do not place limits on the amount, or provide some safe harbor for dealers for a particular amount of money.

So the NASD will be looking at all of those contributions no matter what their size. I would also point out that disclosure that's made to us will be made available to the public. We believe, as they say, sunshine is the best disinfectant, and the reporters -- many of whom are in this room -- probably would love to get their hands on that data, and we will do everything that we can to help them.

ASSEMBLYMAN BAGGER: As I understand, the Public Securities Association, from which we'll hear shortly, has proposed that the issuers, and not just the underwriters themselves, disclose contributions by all participants in bond work, be it bond counsel, financial consultants, and not just underwriters. How does the MSRB view this proposal?

MR. TAYLOR: The Board's concern is municipal securities dealers. But we are very, very much aware that

there are a variety of participants in the transaction process, some of whom are regulated, some of whom are not regulated at all.

As much as we would like to have -- how do I say it -- a level playing field amongst all of the participants in that, and that everyone understand their responsibilities, the Board does not have jurisdiction over bond lawyers, independent financial advisers, engineers, whatever other consultants are part of the financing process. The Board recognizes that they are part of it, and hopes that they would understand that they would have a duty to the public.

ASSEMBLYMAN BAGGER: The reason-- Just to conclude, Mr. Chairman. The reason we're holding these hearings is to fact find for a number of legislative initiatives that are pending in New Jersey, including a bill sponsored by Assemblyman Russo, the Chairman of the State Government Committee -- Assembly Bill No. 930 -- that would prohibit altogether, political contributions in New Jersey by all participants in public finance.

What are your views on such a proposal, and why did the Board, the MSRB, not pursue such an approach?

MR. TAYLOR: First of all, there were and are certain constitutional questions arising about the Board's authority to adopt a complete ban. Moreover, the Board recognized that people should not necessarily be banned from making political contributions as long as they don't have any influence on the business, or could be perceived as having an influence on the business.

And so we didn't seek to ban all political contributions. It may be that a municipal bond dealer -- and I'll pick on my friend, Mr. McBride, behind me here -- who may live in a jurisdiction in the State of New Jersey, and may wish to give to his local mayor, town councilman, or the like, but as long as he is not using that as a way of seeking the

business, we don't see any reason why that should necessarily be banned. He may be very interested in good government because he has to pay taxes in that jurisdiction.

ASSEMBLYMAN BAGGER: Thank you. Thank you, Mr. Taylor, for your testimony today.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Bagger.

The Chair recognizes Assemblyman Watson.

ASSEMBLYMAN WATSON: Thank you, Mr. Chairman.

Good afternoon, Mr. Taylor.

MR. TAYLOR: Good afternoon.

ASSEMBLYMAN WATSON: I, too, want to thank you for your appearance here today. I know that you're down here on your own free will.

MR. TAYLOR: That's correct.

ASSEMBLYMAN WATSON: And happy to see that. Mr. Taylor, have you seen Treasurer Crane's report on bond underwriting and counsel fees?

MR. TAYLOR: I have not.

ASSEMBLYMAN WATSON: Yhu have not seen the report?

MR. TAYLOR: I have not seen that, Mr. Watson.

ASSEMBLYMAN WATSON: I'm going to make this report available to you. We'll get a copy for you. This is the report, (indicating copy of report) and in this report-- I think it's one of the most comprehensive reports that was ever put together by any state.

Are you aware of Governor Florio's Executive Order requiring competitive bidding for professional services related to bond issuing?

MR. TAYLOR: I am aware of that.

ASSEMBLYMAN WATSON: Could you elaborate a little bit on the Executive Order, with regard to other states, for a minute?

MR. TAYLOR: I would point out that the basic question that has been put to me in the past has been one of: Shouldn't we ban all negotiated underwritings, or shouldn't everything be required to go competitive? I would point out that throughout this country there have been a lot of changes during the 1980s, one of which is that taxpayers are very reluctant to use the general taxing power of the municipality or the state to back bond issues. There has been an increasing movement throughout this country toward project financing, if you will, where -- or user fee type of arrangements to fund projects. And that, by its very nature, creates more complicated bond deals than the standard general obligation bond, and makes it very difficult for investors, quite frankly, to decide how they wish to -- what issues they wish to choose from. It is no longer simply a question of going into the market and seeing one general obligation bond after the other. You really have to make a lot of distinctions.

But by the same token, I think everyone recognizes -- everyone in the industry recognizes -- that there is certainly a time and a place for negotiation, depending on the size, type, and complexity of the deal. The Board believes, quite frankly, that issuers should be allowed whatever flexibility is necessary to accomplish their financing objectives.

If a particular jurisdiction wishes to ban a particular practice, whether it's political contributions or negotiated underwritings, that's a public policy decision for them. But I think they should look at it very carefully because at some future date it might cause -- or cost them some money, in that they may not be able to achieve the lowest possible interest cost for their financing.

ASSEMBLYMAN WATSON: Thank you, Mr. Taylor.

Through you, Mr. Chairman-- How many states require competitive bidding for these practices?

MR. TAYLOR: It's not so much the states as there are -- there are estimated to be anywhere between 50,000 and 80,000 different issuers in the United States. And every state grants to its localities and political subdivisions or agencies a variety of powers, both in terms of revenue raising and in terms of financing. And so there are very--

I am not aware of any statewide requirements, although, Gerry, you might be more aware of whether there is a particular state that has a single rule for all financings in the state. But most states typically allow every one of their jurisdictions a certain amount of flexibility. In some cases it's much greater, and some cases it's much less than you would find here in New Jersey.

ASSEMBLYMAN WATSON: Through you, Mr. Chairman-- Could you identify any state that has a stronger process than we have here?

MR. TAYLOR: As a matter of fact, I think that most people in the industry believe that one of the stronger-- When you say process, I'd like to move a little bit away from whether it's competitive or negotiated.

ASSEMBLYMAN WATSON: Well, competitive then.

MR. TAYLOR: I would say that the State of North Carolina exercises a tremendous amount of oversight over the debt financing of its localities. While it is not focused entirely on the question of competitive versus negotiated, it looks at the whole process.

ASSEMBLYMAN WATSON: They have a stronger feeling about the localities, municipalities in the state, but the state itself, how do they govern their own?

MR. TAYLOR: They are-- At least in North Carolina, they can do both competitive and negotiated deals, if that's what your question is.

ASSEMBLYMAN WATSON: Would you say the State of North Carolina--

MR. TAYLOR: Yes.

ASSEMBLYMAN WATSON: --has a stronger process for state bonding? For state, not the--

MR. TAYLOR: For state obligations as opposed to the localities within the state, I don't think North Carolina differs very much from any other state in the union.

I guess, by way of explanation to the members of the panel here, if there is some way for us all to distinguish between state and state agency debt, municipality debt, and then subsequent other levels of political jurisdiction within the state, it might help to clarify sort of what exactly we're aiming at. At the state level, virtually all states reserve to themselves a certain amount of flexibility or ways of dealing with things. Below the state level there are a variety of restrictions placed on issuers throughout the country.

ASSEMBLYMAN WATSON: Well, we have-- Let me take the order of '92 that applies to the State. And what I am trying to get answered -- and maybe you're doing the best that you can at this point -- where we stand as a State on competitive bidding and where we stand with this Executive Order comparing us with all other states in the United States. And I want the State, not the--

MR. TAYLOR: I guess, Assemblyman Watson, I think that I'm an economist by trade, and I look at the process as not simply one of competitive versus negotiated. It goes into questions of what types of debt are allowed outstanding at both the state level, and at the state level what kind of other practices that go into it. It's not just simply a question of competitive versus negotiated.

There are some states in the union which do not allow anything but general obligation debt to be issued by the state. And so when you try to compare practices between the states, you have to take into account, really, almost 50 different sets of law that govern the way in which the bonds are issued, backed, and sold to customers in the state.

ASSEMBLYMAN WATSON: Through you, Mr. Chairman--

Thank you, Mr. Taylor. You know, I'm aware of the Governor's Executive Order for the State, but I'm also aware that the Governor would like to go the extra mile in the assumption that in getting moneys from bonding companies and ...343..... in the administration and others in the Legislature, I know that the Governor would sign off on not allowing bonding companies to give at all. But I haven't heard anything from the legislative body in regard to this, and I would like to ask you a question -- and this probably would clear up Assemblyman Bagger's situation when he was asking the question.

How do you feel about eliminating all of the funding request that is given by the legislators, administrators, or whatever? How do you feel eliminating all of this?

MR. TAYLOR: The Board believes, quite frankly, and we have done it with our proposed rule, eliminated any political contributions that are going to be used to influence the awarding of business in this State and any other state. And the Board feels very strongly that political contributions, or any other types of payments have no place in the decisions to award business. They have no place whatsoever.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman, I know our witnesses have time constraints, and--

ASSEMBLYMAN WATSON: I would just say that I have as much leeway as my--

ASSEMBLYMAN FRELINGHUYSEN: I'm going to give you opportunity to-- And I know Assemblyman Smith, as well, has desired to ask some questions of Mr. Taylor.

While I know all the witnesses have time constraints, I understand that Mr. Cobbs, who has joined us late, is under a particularly rigorous time schedule. And if I can ask, maybe, Mr. Taylor, if you would be so good as to yield the table to Mr. Cobbs. As Chair, I'd like to recognize--

ASSEMBLYMAN WATSON: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: Mr. Watson?

ASSEMBLYMAN WATSON: I just would like one more question.

ASSEMBLYMAN FRELINGHUYSEN: One short question, and then I'm going to recognize Mr. Cobbs. If Mr. Taylor could be good enough to-- We'll get back to questions and answers with Mr. Taylor.

Assemblyman Watson?

ASSEMBLYMAN WATSON: At the end of a bonding transaction, Mr. Taylor, how long does an underwriter have to report on the transaction?

MR. TAYLOR: Report to whom, and what is he to report? Our rules require that certain aspects of a bond underwriting be reported to syndicate members within 60 days of the signing of the -- with the issuer.

ASSEMBLYMAN WATSON: That's my question. I do have some more questions later.

Mr. Chairman, I will honor your request.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Watson.

Thank you, Mr. Taylor. We will get back to you.

The Chair would like to recognize Mr. William Cobbs, who is the Chairman of the Public Resource Advisory Group in New York City. He has a number of years of experience in public finance, and has advised both the States of New York and New Hampshire, and a number of other states with regard to their financial affairs.

Mr. Cobbs, thank you for being here. I am required by law to read you a series of questions that relate to witnesses under oath, and I'll do it very quickly.

Did you receive a subpoena from this Committee compelling your attendance at this hearing today?

W I L L I A M C O B B S: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: No. Do you understand the Chairman of this Committee has the authority to administer an oath of affirmation to a witness in any matter now pending before this Committee?

MR. COBBS: About five minutes ago I did, but that's no problem.

ASSEMBLYMAN FRELINGHUYSEN: All right. Have you received a copy of the Code of Fair Procedure here today before testifying before this Committee?

MR. COBBS: About five seconds ago I got that.

ASSEMBLYMAN FRELINGHUYSEN: All right. The Code of Fair Procedure gives you certain rights as a witness testifying under oath here today before this Committee. For example, you have the right to be accompanied by counsel who may advise you of your rights during the proceeding. Do you have counsel present here today?

MR. COBBS: No.

ASSEMBLYMAN FRELINGHUYSEN: You don't. Do you agree to testify here today without having counsel present with you.

MR. COBBS: I do.

ASSEMBLYMAN FRELINGHUYSEN: You have-- Under the Code of Fair Procedure, you also have the right, at the conclusion of your examination by this Committee, to file a brief sworn statement relative to your testimony for incorporation in the record of this investigatory proceeding.

You are advised we are making a tape recording of this proceeding, and you are entitled to receive a copy of your testimony, and I'll make it at my expense.

MR. COBBS: Thank you, Assemblyman.

ASSEMBLYMAN FRELINGHUYSEN: You also have the right to request a copy of the resolution authorizing this investigation.

Do you have any questions concerning the Code of Fair Procedure or your rights under that law?

MR. COBBS: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: Do you have any questions about the proceedings today?

MR. COBBS: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: If not, will you please raise your right hand.

Do you solemnly, sincerely, and truly declare and affirm that the testimony you shall give in the matters now pending before this Committee shall be the truth, the whole truth, and nothing but the truth?

MR. COBBS: I do.

ASSEMBLYMAN FRELINGHUYSEN: Is the testimony you are providing today given of your own free will?

MR. COBBS: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Have you been directed or required by anyone to testify here today, other than--

MR. COBBS: Have I been-- Sorry?

ASSEMBLYMAN FRELINGHUYSEN: Have you been directed or required by anyone to testify here today?

MR. COBBS: I was asked to testify.

ASSEMBLYMAN FRELINGHUYSEN: You were asked by the Chair.

All right. If you have some comments?

MR. COBBS: No, sir, I don't. I was asked to testify. I was given a list of areas to be covered. I guess-- I will say that, by way of so-called expertizing ourselves, the Public Resource Advisory Group is an independent financial firm, which means we don't underwrite, trade, invest, engage any potential conflict of interest. We only work with the public sector, again, to avoid any type of conflict of interest, and we have no fee-sharing arrangements with any underwriters, or with anyone for that matter.

For the last two-and-a-half years, we've been the largest financial advisory firm, as ranked by Securities Data for this year. And although they're not particular rankings,

I'm pretty sure we've done more work with the states than any other financial advisory firm. We work with California. We work with New York, with Connecticut, New Hampshire, Virginia. We worked with Oklahoma, Oregon, Vermont, and most recently we've been hired by Massachusetts and Maryland. Both of those states, first time use of a financial adviser. We are very pleased with Massachusetts to bring them -- get them back into the competitive market after their fiscal difficulties.

In Maryland, we're particularly pleased, because as you may know, the State of Maryland has a reputation for having if not the best, certainly some of the best financial management practices in the country. So it is a real single honor for us to be chosen by the State of Maryland to help them.

I just wanted to give you some background on our firm. But we have never worked in New Jersey, despite our rankings and our work for the state --with the state level -- we have never worked in New Jersey.

ASSEMBLYMAN FRELINGHUYSEN: Thank you.

MR. COBBS: That is why I'm here today.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Mr. Cobbs.

I believe Assemblyman Lance, you have some questions for Mr. Cobbs?

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman.

Mr. Cobbs, good morning to you.

What are the main functions performed by financial advisers in large state revenue and general obligation bond sales? Would you give us a little background on that, Mr. Cobbs?

MR. COBBS: I think that the primary function is to help an issuer to achieve the lowest cost of money consistent with his risk posture and long-term financing needs. There are several in that are in a bond issue, and if you want all the various detailed functions, I can go through that, but to me that is the overall objective and fiduciary responsibility, if you want to call it that.

ASSEMBLYMAN LANCE: To sum it up, I guess, to save the taxpayers the most money possible consistent with fiduciary responsibility.

MR. COBBS: Consistent with risk posture and long-term financing needs. Yes, sir.

ASSEMBLYMAN LANCE: And, Mr. Cobbs, what are your fiduciary responsibilities to the issuer?

MR. COBBS: Well, I think it is to make sure that the issuer will receive the lowest cost of money consistent with his risk posture and long-term financial needs. I say, "with posture." For instance, if there were a large project financing, the issuer might not want to cover that risk by putting a GO credit behind it, because if there were a failure, let's say a private company in that project, the taxpayers could be responsible for it even though the failure had been from the company's standpoint. So it may not be best to do a GO financing. It might be best, from the taxpayers' standpoint, to do a revenue bond.

And I say long-term financing needs because issuers like New Jersey or New York City, where we are the financial adviser, and California, which are two largest issuers in the country; they come every quarter, and it is necessary that they not necessarily push for the last one basis point, because that leaves a sour taste in the market. It could cost them five basis points the next time. That's why I make those two caveats, sir.

ASSEMBLYMAN LANCE: As a financial adviser with, I might say, vast public experience in this area, what qualities are most valued, in your opinion, in selecting financial advisers?

MR. COBBS: Well, I think integrity has to be the most important thing. And that's why we're so-- We're independent. We only work for the issuer, which means there is no possible conflict of interest.

Nothing against my friend, Mr. McBride -- I shouldn't say friend; I'll say friendly adversary -- when we do an issue. They could have a conflict of interest as an underwriter because they represent both the issuer and the people who buy the issuer's securities. We don't do that, so we have a constituency of one; and that is, the issuer. And our fiduciary responsibility is to that constituency of one, the issuer.

ASSEMBLYMAN LANCE: Mr. Cobbs, how do you go about responding to a request for proposal for your services? How do you calculate your fee for the work that you do as a financial adviser?

MR. COBBS: Well, it's pretty simple. I've got examples of responses we've made in New Jersey. Basically, because we are an employee-owned firm with not very deep pockets, we tend to work on a retainer basis, or an hourly basis, and we have pretty standard fees.

And on a project financing, we would only work on those two bases. Occasionally, for a GO issuer we will work on a combination of contingency or completion fees, and the other two. Again, for us this comes to the heart of the conflict of interest question. If your only compensation is the completion of interest, it could raise the conflict if there is a question of proceedings with the financing. When your sole compensation is to be received from bond proceeds, it certainly makes it difficult for somebody to say no to a bond issuer. It really does raise a-- It could be a more stark conflict of interest. You know, you only get paid if a bond issue goes through, but a bond issue may not be best for the issuer. What do you do?

So we do, in some cases, like GO issuers where they more or less have to issue every quarter or every year, work on a combination basis. But we just don't have the internal cash

flow, being independent financial advisers, even though we've been number one for the last two-and-a-half years, to work on these other bases.

ASSEMBLYMAN LANCE: The reason I ask that question is that on the Turnpike bond sale in this State, the fees proposed and collected by Lazard Freres seem to me to be quite large, my understanding that it reached \$2,275,000. As I understand it, Lazard's fee was to have been \$50,000 as an annual cap, not including additional work done for financial restructuring.

In its confirmation letter, Lazard said that the restructuring work would involve paying partners, roughly, \$250 per hour. It would take four partners working a full day, 284 days to earn a fee of \$2,275,000. Moreover, as I understand it, Lazard didn't even have four partners in public finance, and certainly wouldn't have assigned all of them to this one job anyway. And based upon your experience -- your tremendous experience nationwide -- what is your reaction to what I consider to be an extremely large fee of \$2,275,000?

MR. COBBS: I do have a copy of our proposal for the New Jersey Turnpike Authority. We had received a previous request from them -- a very complex trans -- for a fee. We did not respond because we were only given 24-hours notice. I think Chase Manhattan won that.

On this one, we were also only given 24-hours notice, but we applied. And we were told also there was a \$50,000 max -- maximum. To provide you some relief, our total annual revenues are not a whole lot more than \$2.2 million. So for us a \$2.2 million fee would be very, very attractive.

When we were told there was a \$50,000 cap on this, annual, we said, "We can't work for that much. That \$50,000 is unrealistic to do this type of transaction." And we gave them a fee proposal, which I'll be glad-- Our partners: David Rush, who is the President, and myself, at \$225 an hour; our

Managing Directors of which three are partners-- So we have five partners, and three other Managing Directors are 190-- Vice Presidents are 150, and all the way down to 85 for research analysts.

But we did tell the Turnpike Authority that \$50,000 was not sufficient to do all the structuring work, and we thought it would be more like a \$300,000 to a \$400,000 fee. I do not have that anywhere in writing. That is only a verbal comment made by my partner and President of the firm, David Rush, to someone from the Turnpike Authority.

ASSEMBLYMAN LANCE: Following up on that, Mr. Cobbs--

ASSEMBLYMAN WATSON: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: Excuse me. Assemblyman Watson, you have a question?

ASSEMBLYMAN WATSON: Excuse me, Assemblyman, yes.

The document that you have in front of you--

MR. COBBS: It's our proposal--

ASSEMBLYMAN WATSON: --is that for public consumption?

MR. COBBS: I'll be glad to give it to you, if you want.

ASSEMBLYMAN WATSON: I would like to have -- to make that part of the record, sir.

ASSEMBLYMAN FRELINGHUYSEN: Yes, we'd like, if we can include a copy-- If you'd be good enough to give us that, we'll include it as part of our entire record. Thank you.

Assemblyman Lance?

MR. COBBS: Sure.

Again, Mr. Watson, we do not have the total fee. That was in a telephone conversation -- the \$300,000 to \$400,000 estimate of what our time charges would be.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Lance?

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman.

To be completely clear, with the \$400,000 at the top end -- \$300,000 to \$400,000 -- would \$400,000 likely be it, or would there be any additional?

MR. COBBS: That's what we told him it would be.

ASSEMBLYMAN LANCE: That's \$400,000, whereas Lazard in this matter earned, according to our estimation, \$2,275,000.

MR. COBBS: I don't know. That's what you told me, sir.

ASSEMBLYMAN LANCE: That is a dramatic difference. It is five times what you say you could have done it--

MR. COBBS: That is what-- That is an estimate of the President of our company, what we would have done it for, what our time billings would have been.

But again, we were not part of the transaction. We could only give an estimate, because we were not retained. We don't have a log of the hours spent, so I can't tell you that, sir. When we give billings, we give a monthly billing or a transaction billing, and we show hours by each individual in the firm and the task performed.

ASSEMBLYMAN LANCE: I know that you're under limited time constraint, but the nub of the issue for me, as I stated on the floor of the Assembly yesterday, concerns the reinvestment of bond proceeds.

MR. COBBS: Yes, sir.

ASSEMBLYMAN LANCE: And I think we can debate back and forth whether it is a good idea to have negotiated bond arrangements or competitive bidding.

MR. COBBS: Excuse me. Can I correct my testimony?

ASSEMBLYMAN LANCE: Sure.

MR. COBBS: I'm sorry. We told him \$200,000 to \$300,000. I apologize. I'm going through my notes -- \$200,000 to \$300,000. I apologize.

ASSEMBLYMAN LANCE: So it's even less?

MR. COBBS: Two-hundred to three-hundred thousand dollars was what Mr. Rush told the person from the Turnpike. I'm sorry. I was just trying to verify in my notes.

ASSEMBLYMAN LANCE: So, my public school math would indicate one-seventh, or one-eighth--

ASSEMBLYMAN FRELINGHUYSEN: Just for the record, Mr. Cobbs, you mentioned twice in your statement that you only had 24-hours notice?

MR. COBBS: Yes, sir, on both the Turnpike--

ASSEMBLYMAN FRELINGHUYSEN: Is that something that you find to be common?

MR. COBBS: No. And if you ask for recommendations, we think it, when things should-- Frankly, to us it appeared that the RFP was just being done to approve a selection that already had been made, just being done for window dress.

ASSEMBLYMAN FRELINGHUYSEN: All right.

MR. COBBS: And we refused to put in a proposal on the first one, that Chase Manhattan, because it was a very complex RFP, and we just couldn't give it justice.

But one recommendation we would make is for the State to open up the process by giving people time -- adequate time -- to respond. That 24 hours is not adequate time.

ASSEMBLYMAN FRELINGHUYSEN: Thank you for that.

Assemblyman Lance?

ASSEMBLYMAN LANCE: And Mr. Chairman, following up on that, I would like to see what our current statutory framework is on requiring time frames, so that all who choose to bid can have an adequate opportunity to bid.

MR. COBBS: I would like that.

ASSEMBLYMAN LANCE: I'm surprised to learn that it's only 24 hours. And I wonder whether any statute was violated. I'm not saying that that occurred, but I would like to know what the statutory framework currently is, and if there is no decent time frame, that's certainly an area where the Legislature and the executive branch--

MR. COBBS: I think a minimum of a week is--

ASSEMBLYMAN LANCE: Yes, sir.

MR. COBBS: --is required, unless it's something that's really, really, really extraordinary.

ASSEMBLYMAN LANCE: I said yesterday, and I repeat today, that my chief concern with what has gone on in this State in recent times concerns the reinvestment of bond proceeds.

Are you aware, Mr. Cobbs, of the situation by which Lazard Freres was granted the authority to reinvest bond proceeds -- reinvest them on a short-term basis -- without a competitive bid?

MR. COBBS: I don't know. I only have heard that and read it. Our experience--

I want to say this in the sense of what the so-called practice-- Our experience is, is that an issuer will get the lowest -- get the best price, lowest bid, whether they're buying or selling securities, if it's competitive.

There are four or five exceptions to that. And that's a very large issue, which a billion-eight certainly is, although we did do a billion-six for California, competitively. If it's a so-called story bond with a very complex structure-- So we credit, which is ratings below "A" level--

ASSEMBLYMAN LANCE: Which certainly is not New Jersey.

MR. COBBS: Which is not-- And a very volatile market, which we don't have right now. Or if you want to use derivative products, you know, swaps or things like that. The same in taking -- on securities. It is--

We have found, and we have actually argued with underwriters and they have come back and said to us we were wrong; you get better prices when you bid out the investments. A billion-eight, though, is a lot of money to be bidding for in the Treasury market.

We-- The largest issue, I think, we've done where we've bid out was a billion-one on the New York City refunding, and we frankly recommended to the city that they parcel that amount out among these various underwriters, because if you get

in and you have too few people start competing for two securities-- The whole idea of inflation is you drive up the prices, so the issuer won't get the best.

We can't tell you it's always best to do competitive, but normally it is. We think probably-- I don't know the facts on this, but when we had a comparable size refunding for New York City, we suggested that they bid out part of the escrow.

ASSEMBLYMAN LANCE: And did they?

MR. COBBS: They did. And we looked at-- We tried to look at the bids they got. We have Munifacts Plus, so we're on-line although we don't have a trading desk. And I can't tell you that we're going to be as good as Mr. McBride's firm, but we can come within a thirty-second, or a sixty-fourth, probably, in seeing if they're reasonable.

So we do think there are circumstances, and this may have been one of them, sir, where they should have negotiated maybe with more than one firm.

ASSEMBLYMAN LANCE: It's my position that it should have been competitively bid. But regardless of whether that should have occurred, you are stating that there should have been several involved, regardless of whether it should have been competitively bid.

The reason I raise this whole topic is that it is clear that the experts in our State government, Robert F. Lurie, the Director of the Office of Public Finance in the State Treasurer's office, and Roland Machold, the Director of the Division of Investments in the Department of the Treasury, both of them nonpartisan, highly regarded members of the executive branch, both recommended to the Treasurer that competitive bidding occur in this case for the reinvestment of the bond proceeds. And despite the fact that Director Lurie and Director Machold so advised the Treasurer, that was not done.

Now, can you comment in your professional capacity, your expert capacity, as to--

MR. COBBS: As I say, our predilection is to bid things out. And one of the caveats we would have, is a large issuer, maybe in this case, the State officials who were advising, didn't think that size would affect the bid.

So, I'm sure they were closer to-- I'm at a very arms-length distance. As I say, we have done no work at the state level in New Jersey, so I can't comment closely on what's happened here, only on newspaper accounts.

ASSEMBLYMAN LANCE: Are you familiar, Mr. Cobbs, with what occurred in Kentucky regarding Lazard Freres?

MR. COBBS: I've read newspaper reports, sir.

ASSEMBLYMAN LANCE: I won't -- not at this time pursue that aspect. I point out for the record, and will, at later this afternoon, include questioning regarding what seems to me to be an unfortunate situation in Kentucky regarding Lazard Freres that occurred prior to Lazard reinvesting our bond proceeds late last year.

Given time constraints, and the opportunity for the minority to ask questions, that's all I have at the moment, Mr. Chairman. Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Okay. Thank you, Assemblyman Lance.

Any questions? Assemblyman Smith?

ASSEMBLYMAN R. SMITH: Several, if I might?

Mr. Cobbs, you were a little bit of a surprise. Yesterday we had a list of witnesses, and you weren't on it. This morning at 11:00 we found out you were going to be here, so we probably had just a little less notice than you had.

You mentioned earlier on--

MR. COBBS: I'm sorry. I was asked-- I got a letter a long time ago. I'm sorry.

ASSEMBLYMAN R. SMITH: Okay. You indicated you were given a list of areas to cover?

MR. COBBS: Yes, sir.

ASSEMBLYMAN R. SMITH: And what was that list of areas to cover?

MR. COBBS: The role of the financial adviser; fiduciary responsibilities of the financial adviser; fiduciary responsibilities of the bond issuer; and bond practices in other states.

ASSEMBLYMAN R. SMITH: You indicated, and I quote, "never worked in New Jersey, and that's why I am here today."

MR. COBBS: At the State level.

ASSEMBLYMAN R. SMITH: Right, "and that's why I am here today." What did you mean by that?

MR. COBBS: We think the process is not very open, sir. Despite the fact we're the leading--

ASSEMBLYMAN R. SMITH: And you're hoping that as a result of this Committee's action, that the process might be opened up somewhat?

MR. COBBS: For everybody. As an example, a friend of mine -- a friend of mine, a competitor -- he was, again, an independent financial adviser. That person and I were being interviewed by a reporter about the situation just as it was breaking out here. And we were trying to direct their attention out here to a situation, because they have had about as much luck as we have. And that person said, "I wouldn't do business in New Jersey."

ASSEMBLYMAN R. SMITH: So you're hoping--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Smith, through the Chair, please.

ASSEMBLYMAN R. SMITH: Always, Mr. Frelinghuysen.

ASSEMBLYMAN FRELINGHUYSEN: It's a pleasure to have you back on this Committee--

ASSEMBLYMAN R. SMITH: Thank you, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: --but there are channels we follow here.

ASSEMBLYMAN R. SMITH: Through you, Mr. Chairman, through you, Mr. Chairman--

The role that your company serves is one of a financial adviser?

MR. COBBS: That's right.

ASSEMBLYMAN R. SMITH: Okay. Is a financial adviser selected by competitive bid?

MR. COBBS: I'm sorry?

ASSEMBLYMAN R. SMITH: Is a financial adviser selected by competitive bid?

MR. COBBS: The lowest price? I think rarely.

ASSEMBLYMAN R. SMITH: Okay, and why not?

MR. COBBS: Because I think you could get someone come in and -- who doesn't have any experience, doesn't have the resources, and put in--

ASSEMBLYMAN R. SMITH: So someone has to make a judgment call on who is the appropriate financial adviser for that particular agency, authority, or state and whatever. And they may use a whole bunch of factors that are appropriate to their needs.

MR. COBBS: Right, right. Yes, sir.

ASSEMBLYMAN R. SMITH: Then competitive bidding is not appropriate in that situation, because you have--

MR. COBBS: I think price should be a consideration.

ASSEMBLYMAN R. SMITH: A factor?

MR. COBBS: Yes, sir.

ASSEMBLYMAN R. SMITH: Okay. You indicated before that you were an unsuccessful competitor for the Turnpike business, and quite frankly, I thought that was a little amazing for that statement to be made in light of the fact that you're being asked to testify about the successful bidder. But that being said, are you stating for the record that the services that you offered the Turnpike were exactly the same--

MR. COBBS: I have not seen--

ASSEMBLYMAN R. SMITH: --as the services provided by Lazard Freres?

MR. COBBS: I have not seen anybody else's proposal.

ASSEMBLYMAN R. SMITH: You really can't say whether the price--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman, again--

ASSEMBLYMAN R. SMITH: Through you, Mr. Chair.

ASSEMBLYMAN FRELINGHUYSEN: --through the Chair. We're not in a courtroom here.

MR. COBBS: I will say that we have competed with other firms, and we feel like we are the best.

ASSEMBLYMAN R. SMITH: Right. But-- Through you, Mr. Chair--

You really can't say for a fact--

MR. COBBS: No.

ASSEMBLYMAN R. SMITH: --that the price that you offered to the Turnpike in any way measured up to whatever proposal or service--

MR. COBBS: No, I didn't purport that, sir.

ASSEMBLYMAN LANCE: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Lance, point of order?

ASSEMBLYMAN LANCE: Yes. I'd merely point out that the testimony is that it would cost the taxpayers of this State one-seventh what it did, and we perhaps should investigate further whether the services would have been the equivalent.

This is a person who has a national reputation, rated number one, as I understand it, in the nation. And in Mr. Cobbs' modesty, he has not stated that the services would have been identical, but I want to go on the record as saying that based upon his national reputation, it seems to me that his services certainly would have been competitive, and he has testified they would have cost the taxpayers one-seventh the amount that it did cost the taxpayers.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Lance, for that point. And I'm sure that Assemblyman Smith didn't mean to impugn the witness'--

ASSEMBLYMAN R. SMITH: Mr. Chairman, if I might? I would have to say I think that statement is inappropriate. And it's inappropriate unless Mr. Lance is going to tell me that he has expertise in the bonding practices of this State, and can make the comparison between the services of Lazard Freres and the services in the proposal of Mr. Cobbs.

In effect, Mr. Lance is testifying as an expert witness on this matter.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Smith, I just want to caution you, this isn't a courtroom.

ASSEMBLYMAN R. SMITH: I understand that.

ASSEMBLYMAN FRELINGHUYSEN: You've got your skills well honed.

ASSEMBLYMAN R. SMITH: No, this is not--

ASSEMBLYMAN FRELINGHUYSEN: But Mr. Cobbs is here to provide a prospective on bonding practices in general, and specifically the view of many people who work in this -- in his particular profession, as to how New Jersey runs its business and what our reputation is.

ASSEMBLYMAN R. SMITH: Well, respectfully, Mr. Chair, this is a quasi judicial proceeding in which there is subpoena power to this Committee, and in which witnesses are being sworn in. And the evidence that they are offering is being offered to the people of the State of New Jersey to indicate whether our practices are inappropriate, or possibly corrupt. And quite frankly, I think we should be somewhat careful about the evidence which we admit to this proceeding.

But that being said, we're talking about a negotiated versus a competitive process.

MR. COBBS: That's right.

ASSEMBLYMAN R. SMITH: All right, the differences? In New Jersey, by way of information, we have as a goal to offer participation by minority- and women-owned firms in our bonding process.

MR. COBBS: Yes, sir.

ASSEMBLYMAN R. SMITH: Would you agree that that's a laudable goal?

MR. COBBS: Yes, sir.

ASSEMBLYMAN R. SMITH: All right. If you have a competitive bidding situation, is there any guarantee to the people of this State that women- and minority-owned firms--

MR. COBBS: You can make a real effort. My wife, who is minority, has been the Director of Finance of the Dade County School Board, and they have similar programs. They make a real effort, and they do their work competitively, and they go to all the bidding syndicates and try to insist-- And they ask them to-- And they give them a list of minority- and women-owned firms, and ask all of the bidding groups to include-- So you can-- We work in Los Angeles, and as you know, Mayor Bradley has just stepped down there, and we worked very hard with Mayor Bradley to ensure that there would be minority participation in all the competitive sales.

ASSEMBLYMAN R. SMITH: Let me put the question directly to you, if I might--

ASSEMBLYMAN FRELINGHUYSEN: Excuse me. Again, Assemblyman Smith, through the Chair.

ASSEMBLYMAN R. SMITH: Through the Chair, always through the Chair.

ASSEMBLYMAN FRELINGHUYSEN: Thank you.

ASSEMBLYMAN R. SMITH: When you have a competitive bid, are you guaranteed that minority- and women-owned firms will participate?

MR. COBBS: You cannot be guaranteed, sir

ASSEMBLYMAN R. SMITH: Okay.

MR. COBBS: You can ask-- You can ask them. You can ask the bidding syndicates and give them a list and say, "These are firms who qualify," and try to get them included.

And I will say that Dade County School Board has been successful. They may not be the level of participation that people would want, but there is participation. And in Los Angeles, we have been mostly successful, sir.

ASSEMBLYMAN WATSON: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: Point of order, Assemblyman Watson?

ASSEMBLYMAN WATSON: Yes. I would just like to ask a question that was stated by our good Assemblyman Lance, that your company is number one in the country. Could you tell me, you were rated on what?

MR. COBBS: On volume, sir.

ASSEMBLYMAN WATSON: On volume?

MR. COBBS: Of bond issues.

ASSEMBLYMAN WATSON: Were you also rated on your low bidding?

MR. COBBS: No, but we have-- Los Angeles, we were just selected again by the wastewater for low bidding. I think in Massachusetts we were low. In New York City, when we got picked up, we were picked up for low bidding.

I will admit, for a financial adviser, it's very difficult for so-called professional services like-- I want you to understand that it's much easier for a bond issuer, where you can come in and see the basis -- bid on the basis of true interest costs.

On the other hand, I will say that we believe our ability to give services is second to none, and probably better than most. My partner has a Ph.D. in math. We did a cost of a refunding for New York State. We sent out RFPs to 25 firms, and we got back 25 proposals. Only five could do it. Only one firm still in the business could match our numbers.

ASSEMBLYMAN FRELINGHUYSEN: Your point, Assemblyman Watson, and then we're going back to Assemblyman Smith.

ASSEMBLYMAN WATSON: Mr. Chairman, just to stay with my thought here, and you may have answered my question, because you're number one on volume, but are you number one on quality of service?

MR. COBBS: I think-- You'd have to ask our clients. We've got a number of long-term relationships in New York State, since 1981. Baltimore County, I think, since 1982. The Northeast Maryland Waste Disposal Authority since 1980.

ASSEMBLYMAN WATSON: But you're stating your opinion.

MR. COBBS: I'm trying to give you some empirical data. These long-term relationships indicate some client satisfaction, sir.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Watson, this gentleman's firm isn't selected--

ASSEMBLYMAN WATSON: No. But there was a statement made as number one in the country, cutting back on whatever was given to other--

MR. COBBS: I said it's ranked by--

ASSEMBLYMAN WATSON: --and what I'm asking here is to clear it up.

MR. COBBS: It's ranked by Securities Data, sir.

ASSEMBLYMAN WATSON: And you're saying that on volume-- You're on volume. Now you're stating your opinion, but not an independent opinion.

MR. COBBS: Well, I tried to-- Sir, I tried to give you this evidence of these long-term relationships -- indicates a fairly high degree of client satisfaction. It's the only thing-- You can call up our references. And we've worked in New Hampshire since '83, for the state. I'll be glad to give you a list of references, sir.

ASSEMBLYMAN FRELINGHUYSEN: I believe the witness has an impeccable reputation, and many people have raised the

question as to why you're a witness. And I think it's important for you to--

MR. COBBS: I wonder too, sir. I feel like a lamb being led to the slaughter, but I'm here.

ASSEMBLYMAN FRELINGHUYSEN: Well, I'm glad you're here, because one of the purposes of this Committee -- and we're not losing the idea behind our being here -- is whether, in fact, the way the State has been running its bonding practices have been in the best interests of the taxpayers.

And we've heard some testimony, and you may be right to take issue with it, but perhaps we haven't been dealt the right deck, and in fact, the taxpayers may not have been as well-served as perhaps they should.

Assemblyman Smith?

ASSEMBLYMAN R. SMITH: (Slight tape malfunction at this point. Several words inaudible.) --minority based businesspeople to participate. I'd like women-owned firms to participate. I would like Xanadu-based businesses to participate.

MR. COBBS: That's exactly what New York City does, sir.

ASSEMBLYMAN R. SMITH: Okay. If that governor was the recipient of campaign contributions, would you know? So if the governor directed you to direct that business to a contributor to his or her campaign, you would follow the direction of that governor, not knowing whether or not--

MR. COBBS: No, if a firm were not competent, I would not, sir.

ASSEMBLYMAN R. SMITH: But if they were competent?

MR. COBBS: I'm sorry, if it were a competent firm--

ASSEMBLYMAN R. SMITH: But if they were competent contributors to the governor's campaign, you would have no way of knowing?

MR. COBBS: I would not know. No, sir.

ASSEMBLYMAN R. SMITH: If the Senate President of Xanadu approached you and said, "There are a number of wonderful based businesses in Xanadu that should be given consideration," you, not knowing that the Senate President of Xanadu had received campaign contributions, you'd be happy to take whatever advice -- or his advice under consideration, would you not?

MR. COBBS: I'd take his advice, yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Smith, recognizing that the witness has some time constraints, if you could perhaps summarize your questions?

ASSEMBLYMAN WATSON: Mr. Chairman, as the elected officer on this side of the aisle, I think after in timing Assemblyman Bagger, and in timing Assemblyman Lance, they were given all the time that was necessary to at least get to their points here. I would only request of my Chairman to give our side the same amount of respect as you gave your side of the aisle.

ASSEMBLYMAN FRELINGHUYSEN: There will be ample opportunity.

ASSEMBLYMAN WATSON: I don't think we're going to have any heavy debate on this. I think that--

ASSEMBLYMAN FRELINGHUYSEN: All of our witnesses are here voluntarily. Some of our witnesses--

ASSEMBLYMAN WATSON: But when it gets to us, they have some time constraints here. You said there were time constraints with Mr. Taylor, he's still sitting here.

MR. COBBS: I have a New York City meeting at 2:30. I'm sorry.

ASSEMBLYMAN FRELINGHUYSEN: All right. A few more questions, and Mr. Cobbs may be asked again to come back. And if he's willing, one more question.

ASSEMBLYMAN R. SMITH: Well, several -- two, three, Mr. Chairman -- very brief.

With regard to a negotiated process, again, versus a competitive process, we indicated earlier, and I believe that you agree that it's a judgment call on the part of the party that's issuing or wanting to issue the bonds. And we talked about one of the considerations in that were interest rates. As I understand the bond issue in question that we're studying, it's back in December of 1992, all right. And as I also understand, while I'm not a great interest rate mogul, in the last year, it seems to me that interest rates have had a tremendous swing.

MR. COBBS: Yes, sir.

ASSEMBLYMAN R. SMITH: A tremendous swing.

MR. COBBS: Yes, sir.

ASSEMBLYMAN R. SMITH: Is it a fair statement that there are no guarantees in life with regard to interest rates; that interest rates go up and they go down?

MR. COBBS: Sir, the statement I made a minute ago, that one of the instances that we think it should be negotiated is very large size, and a billion-eight is very large size, so--

ASSEMBLYMAN R. SMITH: So, quite frankly, a negotiated sale on a billion-eight bond issue is not really out of line? It's not necessarily bad judgment?

MR. COBBS: No, sir. No, sir. I didn't-- I don't think I said that, sir.

ASSEMBLYMAN R. SMITH: And if one of the considerations in that was a lock-in on rate, that's not necessarily a bad consideration? That's not something that is ill advised or bad judgment?

MR. COBBS: If any of us had known interest rates were going through this much in the last year, we'd be on a yacht off the Greek Isles, if we had known that. A year ago interest rates did not look bad; I will tell you that, sir.

ASSEMBLYMAN R. SMITH: No question about it. No question.

All right, with regard to that lock-in--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Smith--

Mr. Cobbs, what are your time constraints?

MR. COBBS: I need-- I have a 1:11 train. I'm sorry.

ASSEMBLYMAN FRELINGHUYSEN: We better get you going.

Assemblyman Smith-- Let me assure Assemblyman Smith
Mr. Cobbs is--

ASSEMBLYMAN R. SMITH: Last question. Last question,
Mr. Cobbs.

ASSEMBLYMAN WATSON: I think you missed your train.

ASSEMBLYMAN R. SMITH: Well, we'll get you a State
Trooper to get you there.

But anyway--

MR. COBBS: I feel I've got a (indiscernible) today.

ASSEMBLYMAN R. SMITH: Last question: With respect to
that lock-in on interest rates, if the consideration for the
lock-in on interest rates is the ability to reinvest the bond
proceeds on a short-term basis, is that good or bad judgment?
Or is that a judgment call?

MR. COBBS: Oh, you should lock-- If you go to
invest, you should do it that day, because the market can move.

ASSEMBLYMAN R. SMITH: No, no, no. If the
consideration-- Is it good or bad judgment, or can't you
determine, whether the consideration offered to the bonding
company--

MR. COBBS: Sir, I'm just--

ASSEMBLYMAN R. SMITH: --is to have the ability to
reinvest the bond proceeds on a short-term basis? Is that good
or bad judgment?

MR. COBBS: I guess you'd have to-- You'd have to
look at the interest-- You'd have to look at the interest rate.

ASSEMBLYMAN R. SMITH: It's a judgment call?

MR. COBBS: Yes, sir, a judgment.

ASSEMBLYMAN R. SMITH: Thank you.

MR. COBBS: You have to look at interest rate relationships at that time.

ASSEMBLYMAN R. SMITH: I have no more questions.

ASSEMBLYMAN LANCE: Mr. Chairman, I have one question.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Smith.

Assemblyman Lance, make it quick. Mr. Cobbs wants to catch that train.

ASSEMBLYMAN LANCE: I certainly will.

Mr. Cobbs, is Lazard Freres either a women- or minority-owned company, or does it have its principle location in the State of New Jersey.

MR. COBBS: No. But I want to say in behalf of Lazard, that Jack DeMagni, (phonetic spelling) who is the senior partner there, is a resident of New Jersey, and he has always, in my opinion, been one of the top flight people in this field. I really do want to say that in behalf of Lazard.

When I was in corporate finance at Diller and Reed, (phonetic spelling) I always felt that Lazard was about the only firm that could compete with us from an analytical standpoint. So even though they are about our-- We consider them a very heavy -- very strong competitor, they are a top quality firm. I want to say that.

Could I go on the record about one thing about bond practices?

ASSEMBLYMAN FRELINGHUYSEN: Yes, Mr. Cobbs.

MR. COBBS: The question-- I'll be real quick. The question was raised about other states, and I agreed that the Treasurer's paper is a very important first step. It is fairly new. Frankly, Florida had a reputation which was not dissimilar to New Jersey as being a difficult place to do business. In fact, when I think of New Jersey, I'm reminded of the story about the two traveling sales guys coming out of the "Death of a Salesman," and one of them looks at the other and

says, "I always heard that New England was a tough place to do business." Well, that's how I think of New Jersey, a tough place to do business.

But that's how Florida used to be. Florida made a big change. All possible sales are competitive, the same as New Jersey is trying to do. They control fees very closely for all participants so there is a lower profit margin, and therefore, less incentive to get in to all of this kind of thing we've been -- you know, that goes on. That is just not for underwriters; it's for financial advisers like ourselves, and for bond counsel. The staff is very closely involved in the transaction, both the selection and the pricing. The selection process is as open as possible, and there is an after transaction review of the entire process.

And I want to point out in Maryland they do almost all their issues competitively, and they have very close control of fees.

So those might be two models that have been running. I think New Jersey is off to a good start right now, and I hope it will be seen through, the way Florida has done it.

We found that we don't have, sometimes, enough time to respond here, and frankly, we just have had no luck. And I think it's been true with other financial advisory firms.

I do appreciate-- Thanks for inviting me.

ASSEMBLYMAN FRELINGHUYSEN: Thank you for your testimony, Mr. Cobbs.

The Chair again recognizes Mr. Christopher Taylor, and I believe there were some additional questions toward him. Assemblyman Watson, were you through with your questions? (no response)

Assemblyman Smith?

ASSEMBLYMAN R. SMITH: Mr. Taylor, with respect to the disclosure requirements of the MSRB, they are in effect now, is that true?

MR. TAYLOR: You're going to have to be-- Which disclosure requirements are you--

ASSEMBLYMAN R. SMITH: Political contributions.

MR. TAYLOR: No, the rule is out for comment. All of our rules go--

ASSEMBLYMAN R. SMITH: It's a proposed rule?

MR. TAYLOR: It is a proposed rule. It will be reviewed by the Board at its November meeting, and once the Board agrees on the final language of the rule, it will be submitted to the SEC for approval.

ASSEMBLYMAN R. SMITH: Okay. Does the proposed rule require the disclosure of contributions by the family members of the employees of the bonding firms.

MR. TAYLOR: It does not require the disclosure by family members because we cannot reach to the family members. Our jurisdiction only reaches to the dealers. However, I point out that the rule makes it very clear, and the accompanying statement makes it very clear that if the dealer were to use a family member for that purpose, he would be -- he or she would be in violation of the rule. And I would also point out that there are public disclosure laws in all 50 states that would allow someone to determine whether or not the husband or wife of a dealer was, in fact, giving political contributions?

ASSEMBLYMAN R. SMITH: How-- I agree with you -- through the Chair -- that you have to disclose political contributions, but how could there be any revelation of the intent of those contributions.

MR. TAYLOR: I don't-- I'm not suggesting that there would be revelation of intent. What it would be is, it would open to question whether or not the dealer was violating our rule by indirectly funneling contributions to someone who could influence the award.

ASSEMBLYMAN R. SMITH: How could you ever-- Through the Chair-- How could you ever prove the intent of the individual making the contribution?

MR. TAYLOR: As I stated earlier, Assemblyman Smith, it is not for me to prove that the intent was for the purpose of influencing the awarding of business, but it is up to the dealer to show me that he is not trying to influence the business.

ASSEMBLYMAN R. SMITH: All right. Let me ask the reverse question, through the Chair-- How can the dealer prove that it was not his intent to influence the bond sale?

MR. TAYLOR: That is going to be-- That is going to be his very difficult task. And we will not specify in advance exactly what he might do, or might not do. But if someone can show me that he is doing it for all the right reasons, and is, in fact, getting the business, I would point out that our rule does not prohibit people from making political contributions as long as it isn't in association with the doing of municipal securities business in that jurisdiction.

ASSEMBLYMAN R. SMITH: All right. You indicated that there was no dollar size of a contribution that would necessarily indicate to you or to the MSRB or to the NASD that there was an attempt to influence the ultimate placement of a bond issue.

MR. TAYLOR: That's correct.

ASSEMBLYMAN R. SMITH: Okay. Today Assemblyman Bagger was kind enough to point out some prior news articles. In today's Star Ledger there is an article concerning the granting of subpoena powers to this Committee. And there is a quote from the State Chairman, Ray Lesniak, and also rebuttal by the Star Ledger saying that research done for the State by the Democratic Committee and provided to the Star Ledger shows that the Republican State Committee took in at least \$1,657,000 since 1984 from firms involved in the bonding business. Most of the money -- one-and-a-half million -- was received when Kean was in office. Only about \$209,000 has been donated to reelection committees -- \$12,800 individual Republican

legislative candidates in 1989 and '91; \$105,000 campaign committee for Republican gubernatorial candidate Christine Whitman; \$160,000 for the legislative majorities; \$45,000-- And that hikes the total to \$2,022,607.

And let me, to be fair, say that the article goes on to say that the Democratic State Committee and the Governor's reelection campaign have received contributions from bonding firms as well.

Doesn't that seem to you to be an attempt to influence the placement of the bonding business in the State? I mean, on its face--

MR. TAYLOR: Whether it's an attempt to, or not an attempt to influencing the bonding business, that is precisely why the Board adopted the proposed rule, and is in the process of putting it in place, because in fact, what has gone on since the beginning of the summer has been story after story in the press about contributions and the awarding of business.

And we want to make it very clear that when we get done with this, the only basis on which business should be awarded is on merit; that political contributions should play absolutely no role in the awarding of business.

ASSEMBLYMAN R. SMITH: Through the Chair-- Is it your opinion-- You said the rule was adopted by the Board?

MR. TAYLOR: It's been put out for comment.

ASSEMBLYMAN R. SMITH: All right. Is it your opinion that when the rule is adopted, that this practice will cease?

MR. TAYLOR: I certainly believe it will. It will not necessarily stop an individual from making a contribution. It will stop an individual from making a contribution for the purpose of influencing the business, because that individual is going to have to be very careful about what they do, and is going to have to show me and the other regulators why they are making that contribution. And that's going to be a very difficult task.

ASSEMBLYMAN R. SMITH: Okay. Just a few brief ones, and maybe inappropriate to you. If they are inappropriate, please let me know and I'll stop.

The same question I asked Mr. Cobbs about whether or not, when a state government decides that it wants to place business with firms that have a state presence, or minority-owned firms, or women-oriented firms, that that is a judgment call. If the state considers that to be a laudable goal, that is a judgment call on the part of the issuing authority?

MR. TAYLOR: If the state or the political subdivision wishes to set up a set of criteria for achieving some sort of public purpose, that is precisely what legislators are supposed to do; which is, determine what is public policy in that--

ASSEMBLYMAN R. SMITH: And governors and public authorities?

MR. TAYLOR: Pardon?

ASSEMBLYMAN R. SMITH: And governors as well, not just legislators.

MR. TAYLOR: It is a matter of public policy. How that jurisdiction chooses to develop that public policy is up to them.

ASSEMBLYMAN R. SMITH: And is it-- Would it be a fair statement as well that MSRB takes no position whether a negotiated rate or a competitive bidding process is better for an individual jurisdiction?

MR. TAYLOR: It is up to the jurisdiction and the circumstances under which the bond deal is being put together.

ASSEMBLYMAN R. SMITH: It's a judgment call?

MR. TAYLOR: It is a judgment call.

ASSEMBLYMAN R. SMITH: Thank you, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Smith.

Any further questions for Mr. Taylor, and then we're going to get on to Mr. McBride.

Assemblyman Lance?

ASSEMBLYMAN LANCE: Thank you.

I think Assemblyman Smith has raised a good point regarding contributions. I would hope that you would take back to the MSRB the thought that perhaps sunshine is not a complete disinfectant, and I have long believed in all areas of financing of campaigns there ought to be a cap set. And I have legislation to that effect in.

I know that your recommendation at the current time is not to cap what can be contributed, although you state that it cannot be contributed to influence a decision. But I hope you take that to the MSRB, that there are at least some of us who believe that in all of these areas, that contributions cannot be completely prohibited. A cap would be a good idea. That is certainly my judgment.

MR. TAYLOR: Well, Assemblyman Lance, in that regard the difficulty that the Board faces is not in writing a rule that applies to certain levels of state government or local government, but trying to write a rule that covers transactions all across this country. And with all due respect to East Overshoe, Montana, the fact of the matter is, \$400 worth of contributions to a city councilman in East Overshoe might be considered to be influencing the decision, whereas in the State of New Jersey that might -- a contribution to a State legislator or to the Governor might not be viewed-- A \$400 contribution might not be viewed as having any possible influence on that decision-making process.

So we are faced with a difficult task of writing rules across the board like that. I appreciate your concerns, and I tell you quite frankly, it was debated at great length at the Board and rejected, because we did not want any appearance of political contributions influencing the decision to award municipal securities business.

ASSEMBLYMAN LANCE: I respect that. However, there are, of course, limits on what can be contributed to congressional campaigns, and they apply across the board, although the running of a congressional campaign in this State is a great deal more expensive than the running of a congressional campaign in Montana. And there are national limits, I point out, regarding both the House of Representatives and the United States Senate.

MR. TAYLOR: That is true.

ASSEMBLYMAN WATSON: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: Yes.

Assemblyman Lance, are you through?

ASSEMBLYMAN LANCE: I'm finished.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Watson?

ASSEMBLYMAN WATSON: I only have just a statement.

You know, I don't care if you give \$5 or \$50,000. What we're looking at here, as far as the citizens and all are concerned, is perception. Perception is what we're looking at, and you know, whether we should take anything at all from the bonding--

You know if we eliminate it all, perception is gone. We don't have to deal with it. But I don't see anyone so far, other than the Governor, saying he would like to strike it all out, but nobody said anything.

ASSEMBLYMAN FRELINGHUYSEN: Okay. Thank you, Assemblyman Watson. Anything further?

Mr. Taylor, thank you very much for your testimony. We appreciate your being here.

MR. TAYLOR: Thank you, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: The Chair recognizes Mr. Gerald McBride, speaking on behalf of the Public Securities Association. He's on the Board of Directors of the PSA, which represents banks, dealers, and brokers who underwrite, trade, and sell public securities.

Mr. McBride is also an Executive Vice President of Prudential Securities, and Manager of the Tax Exempt Division, and I'm sure has a number of other credentials which people may care to question him about.

Moving right along, I must ask you some of these boilerplate questions relative to questions for witnesses under oath.

Did you receive a subpoena from this Committee compelling your attendance to this Committee hearing today?

G E R A L D P. M c B R I D E: I did not, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand the Chairman of this Committee has the authority to administer an oath or affirmation to a witness in any matter now pending before this Committee?

MR. McBRIDE: Yes, Mr. Chairman, I do.

ASSEMBLYMAN FRELINGHUYSEN: Have you received, as I expect you have, a copy of the Code of Fair Procedure here today before testifying before this Committee?

MR. McBRIDE: I have received that.

ASSEMBLYMAN FRELINGHUYSEN: The Code of Fair Procedure gives you certain rights as a witness testifying under oath here today before this Committee. For example, you have the right to be accompanied by counsel who may advise you of your rights during the proceeding. Do you have counsel here present today?

MR. McBRIDE: I do not have counsel.

ASSEMBLYMAN FRELINGHUYSEN: Do you agree to testify here today without having counsel present here with you?

MR. McBRIDE: I do so, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Under the Code of Fair Procedure you also have the right, at the conclusion of your examination by this Committee, to file a brief sworn statement relevant to your testimony for incorporation into the record of this investigatory proceeding. You are advised that we're

making a tape recording of this proceeding, and you are entitled to receive a copy of your testimony, and I'll do that at my expense. You also have a right to request a copy of the resolution authorizing this investigation.

Do you have any questions concerning the Code of Fair Procedure or your rights under that law?

MR. McBRIDE: I do not, sir.

ASSEMBLYMAN FRELINGHUYSEN: Do you have any questions about the proceedings today?

MR. McBRIDE: I do not.

ASSEMBLYMAN FRELINGHUYSEN: Will you please be so good as to raise your right hand. Do you solemnly, sincerely, and truly declare and affirm the testimony you shall give in these matters now pending before this Committee will be the truth, the whole truth, and nothing but the truth?

MR. McBRIDE: I do so.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that if the statements you make today are willfully false, you may be subject to penalties under the law, including monetary penalties and incarceration if you fail to answer a pertinent question or commit perjury, which is the making of a false statement under oath in an official proceeding such as this?

MR. McBRIDE: I do.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand this?

MR. McBRIDE: I do, sir.

ASSEMBLYMAN FRELINGHUYSEN: Is the testimony you are providing today given of your own free will?

MR. McBRIDE: It is.

ASSEMBLYMAN FRELINGHUYSEN: Have you been directed or required by anyone to testify here today?

MR. McBRIDE: I have not been directed or required to testify here today. I am doing so of my own free will.

ASSEMBLYMAN FRELINGHUYSEN: Thank you so much.

Do you have a prepared statement or comment?

MR. McBRIDE: I do have a prepared statement, of which I think each one of the members have before them.

ASSEMBLYMAN FRELINGHUYSEN: If there be no objection, while you're certainly welcome to comment on that prepared statement, the Chair would like to ask those who are transcribing this hearing to include that statement in toto within the recorded script of this public hearing.

MR. McBRIDE: That is fine.

I would like to point out before I read my statement that I do not have any time constraints, (laughter) and I am the Mr. McBride that was referred to by two of the former witnesses, Mr. Taylor and Mr. Cobbs.

I also would like to point out for the record that independent financial advisers are not under the jurisdiction of any regulatory body, as the broker dealer community are. For instance, Mr. Cobbs has absolutely no regulatory body that he reports to. Independent financial advisers are not under the control of the NASD, the SEC, or the MSRB.

Thank you and good afternoon. As stated earlier, my name is Gerald McBride. I appear before you this afternoon in my capacity as Chairman of the Public Securities Association, Municipal Securities Division. I am also an Executive Vice President of the Tax Exempt Division of Prudential Securities Incorporated. PSA is the international trade organization of banks and securities firms that underwrite and trade municipal securities, U.S. Government and agency securities, mortgage-backed securities, and money-market instruments. PSA's member firms account for about 95 percent of the nation's securities industry.

The municipal securities market is the most important capital financing mechanism available to state and local governments. Every day, states and localities issue millions of dollars of bonds. Approximately \$235 billion of bonds were issued in 1992 to finance a wide variety of public investment.

Bonds are issued to build roads and bridges, water and sewer systems, schools and other public buildings, airports, colleges and universities, and public and nonprofit hospitals, among many other uses. The safety and efficiency of the municipal bond market help to ensure that public borrowers are able to finance debt at the lowest possible cost.

Municipal securities are one of the safest investment vehicles available to investors. Historical default rates among municipal issuers are second lowest only to United States Treasury bond issues. However, recent allegations related to political influence in the market may cast doubt upon the safety and soundness of municipal securities as investments. PSA is concerned that such a loss of confidence among investors, even if unfounded, could lead to a significant loss of market liquidity and efficiency, and ultimately to higher financing costs for the state and local government borrowers who benefit from that market. Focusing this Committee's attention on municipal regulatory issues through this hearing will help maintain public confidence in such a market.

My testimony this afternoon will focus on roles of underwriters and other participants in the market, competitive and negotiated sales, the role of political contributions made by market participants to state and local officials, and the role of such contributions in awarding business to firms, and secondary market disclosure by municipal issuers.

The participants in the financing process are as follows: Like most industries, the municipal bond industry enlists the various skills of many participants. Distinct parts are played in the market by brokers, bankers, salesmen, traders, underwriters, lawyers, financial advisers, accountants, state and local government treasurers and directors of finance, and institutional and individual investors. But all are employed to one end: to raise money and to support a secondary market for debt securities of state and local government units.

The starting point for any municipal security is, of course, the issuer. Municipal securities are issued pursuant to express state and local laws authorizing their issuance. Moreover, each new issue usually requires the approval of the legislative body of the issuer. In the case of general obligation bonds, approval by voter referendum is often required. With the advent of many kinds of revenue bonds, state and local governments have established many new governmental units to issue bonds.

Bond counsel is the next item. Essentially, every municipal security issued is accompanied by an opinion of bond counsel. That opinion addresses the main legal issues: that the bonds constitute legal, valid, and binding obligations of the issuer, and that interest on the bonds is exempt from Federal income taxation under applicable tax laws.

State and local governments may often seek the advice of a financial adviser or other professional experts such as Mr. Cobbs, who just appeared. Financial advisers perform a variety of tasks. They analyze the financing needs of the community, structure an issue, help choose an underwriter or organize a competitive sale, deal with the rating agencies, and advise on other matters of importance.

Accountants conduct a professional examination and verification of an issuer's financial statements for the purpose of rendering an opinion as to their fairness, consistency, and conformity with accounting principles.

Engineering consultants perform feasibility studies on state and local projects to ensure that those projects are necessary and capable of being accomplished.

Rating agencies: Because of the large number of different issues in the marketplace, bond ratings or debt ratings often play a greater role in the municipal securities market than in the corporate marketplace. The two dominant agencies in the ratings field are Moody's Investors Service,

Inc. and Standard & Poor's Corporation. The agencies assign a rating to the issue which reflects the likelihood that the issuer will be able and willing to support future debt service payments.

Bond insurers analyze municipal credits to determine their insurability. This involves evaluation of financial reports, demographics, legal issues, and feasibility studies. Insured issues automatically receive one or more Triple-A rating, thereby reducing the issuer's borrowing costs over the life of the issue. Bond insurance helps bond issuers gain market access, especially if they are small or infrequent borrowers. The municipal bond marketplace is dominated by individual investors who value knowing that principal and interest payments will always be paid in full and on time.

The underwriters: The enormous task of underwriting, marketing, and trading municipal securities is undertaken by the dealer departments of commercial banks and securities firms. A typical underwriting department employs one or more individuals whose full-time responsibility is to work on competitive and negotiated underwritings. These individuals are primarily responsible for setting prices and the yields on the new issues their firm underwrites each week. Underwriters work closely with traders and salespeople to determine the marketability and appropriate yields for an issue. Traders maintain the secondary market for securities by actively buying bonds and selling them to other dealers and investors in the secondary market. Dealer firms frequently employ a large staff of salespeople who are responsible for making contact with institutional investors, in addition to large firms having retail distribution capabilities.

Senior Manager: The senior manager is the lead underwriter that serves as the lead underwriter for an account. The senior manager generally negotiates the interest rate and purchase price in a negotiated transaction, or serves

as the generator of the consensus for the interest rate and purchase rate to be submitted in a competitive bidding situation. The senior manager signs the contracts on behalf of the account, and generally receives either a fee or a slightly larger spread for its services in this capacity.

The various investors: Three classes of investors dominate the municipal marketplace. Number one is the retail investor, consisting of individuals such as yourself, acting directly or through the agency of trust companies and investment counsel. Number two, retail proxies; that is, bond funds consisting of managed closed-end funds, open-end funds, and unit investment trust funds; and three, institutional, particularly commercial banks and property and casualty companies, although the various calamities we had this year have taken them out of the marketplace for the most part -- them, meaning the casualty companies. The principal characteristic of all buyers of municipal bonds is that they are in a sufficiently high tax bracket that they can benefit from the tax exemption.

The negotiated and competitive bid process: Municipal securities offerings are typically sold through either a competitive or negotiated bidding process. The choice of either type of sale is dependent on a variety of factors, including credit considerations, issuer preference, and market conditions.

The competitive sale: Competitive bond sales are typically used for more traditional offerings of municipal securities. The issuer will typically work with a financial adviser to determine the structure and timing of the bond sale. The offering is then advertised in financial publications in order to notify municipal dealers of the terms of the offering, including information relating to structure, the time and date on which bidding will occur, and other details which are pertinent to the offering.

Municipal dealers will line up syndicates to bid on the bonds. On the date of the sale the syndicates bidding for the bonds will estimate the interest rates necessary to sell the bonds to the investor, and then submit bids to the issuer or its agent. The syndicate offering to purchase the bonds at the lowest yield, or the highest price, is named the winning bidder, and upon approval by the issuer awarded the bonds. The syndicate then offers the bonds to their customer accounts at established reoffering yields.

Versus the negotiated sale: Negotiated sales are typically used for bond offerings which entail complicated financial planning and project management considerations, such as a refunding or revenue bond issues. The issuer will distribute a Request for Proposal -- RFP -- solicitation which basically asks underwriters to submit their qualifications and credentials. The issuer then reviews the RFP responses and selects a senior manager team for the transaction

The senior manager works with the issuer in order to structure the financing plan for the bond sale. The underwriter provides a wide variety of services in conjunction with the sale, including premarketing efforts, investor relation meetings, credit agency presentations, and other related marketing services. The manager will also advise the issuer on when the bonds should be offered for sale in order to take advantage of optimal market interest rate conditions.

On the sale date the senior manager on the transaction will price the deal and seek orders from interested investors, institutional and retail. After demand for the bonds is evaluated, the manager may change the structure and/or size of the deal in order to meet investor demand. The manager then sets the final terms of the offering and purchases the bonds from the issuer. The manager also provides a number of post sale services for the issuer, such as secondary market-making activities and advice for long-term capital projects.

Gross underwriting spreads is the next topic. The "spread" is one of the most misunderstood aspects of the municipal bond underwriting business. Listening to Mr. Cobbs, I would probably have to state that again. The gross underwriting spread is simply the difference between the offering price to the public by the underwriter and the purchase price the underwriter pays to the issuer. This spread includes all expenses incurred by the dealer in bringing the bonds to market, as well as any profits earned on the deal.

Average underwriting spreads in the municipal market have declined substantially since the early 1980s. Even though new issuance of municipal securities has increased steadily, increased competition among underwriters has caused spreads to remain subject to downward pressure. For instance, in 1985 the average gross spread for all long-term municipal issues was \$16.61 per \$1000 par value. By 1992, gross spreads had fallen to \$9.32 per \$1000, a 43.8 percent reduction. The decline continued into 1993. Gross spreads for all long-term municipals averaged \$8.62 in the first half of 1993, an additional decline of 7.5 percent from the 1992 level.

Gross spreads of both negotiated and competitive issues have experienced declines since the early 1980s. This trend has been especially pronounced for negotiated issues. In this category, gross spreads have fallen from \$17.31 per \$1000 in 1985 to \$9.35 in 1992, a decline of 46 percent. The spread for competitive issues, meanwhile, had dropped from \$10.79 per \$1000 in 1985 to \$8.99 in 1992, a 16.6 percent drop.

As with spreads on negotiated issues, spreads on competitive issues have continued to narrow during the first half of 1993. They averaged \$8.64 per \$1000 in the first half of 1993 versus \$8.99 in 1992. Thank God all these numbers are written down, so that you can ask the questions. (laughter)

The bottom line is that, whether looking at competitive or negotiated municipal issues, the gross spread represents

less than one percent, a very reasonable rate for issuers of municipal securities.

It is important to note that negotiated sales are very competitive. As I previously noted, underwriters compete vigorously for senior manager slots. PSA believes that the elimination of negotiated sales as an alternative may ultimately increase financing costs for issuers.

The question of political contributions: Recent developments in the municipal market have focused considerable attention on the role of political campaign contributions made by securities firms, financial advisory firms, bond counsel firms, consulting firms, and individuals to elected officials who influence the awarding of service contracts related to bond offerings.

PSA strongly believes that in the vast majority of state and local bond issues, political contributions made by potential bond underwriters, financial advisers, bond counsel, engineers, and others play no role in the decision of which firms an issuer chooses to participate in an offering. Members of this Committee similarly accept political contributions from individuals and organizations with interests in the legislation on which they work. However, contributions to members of this Committee should not and do not influence their voting decisions on particular legislation. Similarly, most state and local officials, elected and appointed, are concerned with one primary and overriding goal in issuing debt: to secure the lowest cost of borrowing for the taxpayers who will be burdened with interest payments as long as bonds are outstanding. It is our opinion that for the most part, political contributions do not affect their decisions.

Nevertheless, even the appearance of impropriety can have devastating effects on public confidence in the municipal market. For this reason, PSA has proposed that the Securities and Exchange Commission promulgate rules requiring issuers to

disclose political campaign contributions. Recipients of political contributions are best suited to make these disclosures because only they can be assured of possessing all the relevant information. These disclosures should cover contributions made by all underwriters and other participants -- again, financial advisers, attorneys, accountants, etc., etc. -- competing in the selection process for roles in the municipal securities offerings to any public official having influence in that process. In addition to contributions from corporate entities and partnerships, contributions from employee political action committees and from officers, partners, and employees of organizations competing in a municipal securities offering should be included.

Issuers should also be required to disclose potential conflicts of interest. To ensure ready access and minimize additional costs on any market participants, including issuers, these disclosures should be filed with a centralized repository capable of disseminating the information in a useful format to the public.

PSA supports the efforts of the MSRB to address the issue of political contributions. The MSRB has proposed a rule, which in essence would prohibit political contributions made solely for the purpose of securing or retaining business with a state or local issuer, as stated earlier by Kit Taylor. However, we are concerned that because the MSRB's jurisdiction does not extend to bond counsel, independent financial advisers, consulting engineers, and others that participate in bond offerings, the disclosure provided under the proposal would be incomplete and misleading. PSA believes that new political contribution disclosure requirements should be applied to all participants in a municipal bond issue. The only parties in a position to provide such comprehensive disclosure of political contributions are the issuers

themselves. For this reason, PSA recommends that the SEC require issuers to disclose political contributions received from all participants in the municipal finance process.

As you know, the U.S. municipal bond market is one of the safest securities markets in the world. Despite the safety of municipal debt instruments and their relatively low rate of default, however, PSA believes that municipal bond investors are still entitled to have ongoing access to information related to the financial health of the governments and authorities whose bonds they hold. Currently, such information is not readily available for a vast majority of municipal bond issuers -- a major problem in the municipal industry.

Efforts to elicit voluntary ongoing disclosure of financial information -- which PSA has long supported -- have met with very limited success. Over 50,000 states, cities, counties, towns, and authorities issue debt securities on a periodic basis. However, the National Association of Municipal Analysts, which since January 1992 has issued certificates of recognition to bond issuers who agree to provide continuing secondary market disclosure, has thus far issued only 205 certificates.

There is no requirement for issuers or any other municipal market participants to provide even rudimentary secondary market information. We have reluctantly concluded that voluntary efforts alone will be insufficient to improve the quality of secondary market information.

PSA therefore recommends that the SEC promulgate regulations requiring issuers to submit secondary market information to the MSRB's Continuing Disclosure Information system. All issuers should be required to submit basic information such as that suggested under the American Bankers Association Guidelines. In addition, issuers that borrow \$1 million or more annually should be required to submit information regarding any material fact that should be known to

the market. PSA stands ready to work with Congress, the SEC, issuers, and others in determining definitions of materiality.

If congressional action is deemed necessary to enable the SEC to promulgate such rules, PSA would support such action. We leave to others to determine whether our recommendations can be implemented within the authority granted under current law.

In summary, we believe that the municipal securities market continues to play an important role in raising the necessary capital for state and local governments across the nation. The market is efficient and continues to function well. Restrictions on the use of negotiated sales may ultimately result in increasing rather than decreasing the cost of financing for issuers of municipal securities.

Promulgation of the regulations recommended here may in itself serve to moderate excesses in political campaign contributions, and would provide for a more efficient marketplace. It is in the interests of issuers and members of the municipal finance community to preserve public confidence in the municipal securities market. PSA believes that promulgation of these regulations will accomplish this goal, and we look forward to working with this Committee, Congress, the SEC, bond issuers, and any and all others in that regard.

Thank you for the opportunity to present our views.

ASSEMBLYMAN FRELINGHUYSEN: Mr. McBride, thank you very much for your testimony and for being with us this afternoon. The first one to ask questions will be Assemblyman Gibson.

ASSEMBLYMAN GIBSON: Thank you, Mr. Chairman.

Mr. McBride, good afternoon.

MR. MCBRIDE: Good afternoon, sir.

ASSEMBLYMAN GIBSON: I notice from your resume that you're a graduate of the two Big Five schools in the Philadelphia area. It's only safe to advise you that I graduated from Villanova.

MR. McBRIDE: Some of us can get in good schools, and some of us can't. (laughter)

ASSEMBLYMAN GIBSON: Your presentation was very thorough, but I may want to recover some points just for some emphasis, and to help some of the members of the Committee who are not as familiar with the procedure. Can you give us an overview of what activities your members perform in a state bond issue?

MR. McBRIDE: The members of the PSA perform in the access to the State issue, or during the process of a state issue?

ASSEMBLYMAN GIBSON: In the process.

MR. McBRIDE: Okay, in the process of a state issue. If, in fact, an issue has been determined to be competitive or negotiated, we take a bifurcated role. Let's say competitive.

If, in fact, an issue is designed to be sold at competitive bid, there have been -- if the issue has been in the marketplace for many many years -- the issuer -- they are known as historical groups, which means that there has been a syndicate that had been assembled years ago to bid on that issue, given the identified parameters at a particular period of time, following whatever the parameters are that are dictated to by either the issuer and/or the issuer and their financial adviser.

In a negotiated process it is basically the same process. A syndicate is appointed most of the time by the issuer, if an issue is determined to be negotiated.

Now, the process by which you are appointed obviously is different, because in a competitive bid you form a syndicate voluntarily. In a negotiated issue, you compete to be appointed as the manager of the issue, and then the other members of the management group are also appointed. Many times you are requested by the issuer as the manager of the negotiated issue. If you think that you need a syndicate, and

many times you are also given the liberty to appoint a syndicate -- many times, not all the time.

They are the two different types of issues, and they are the two different accesses that the memberships have.

ASSEMBLYMAN GIBSON: Thank you.

Mr. Chairman, through you to Mr. McBride.

Describe the importance of the senior underwriter for structuring the bond sale.

MR. McBRIDE: The importance of the senior in reference to a negotiated issue, Mr.--

ASSEMBLYMAN GIBSON: You might as well cover both of them. He applies to both, I assume.

MR. McBRIDE: Yes. Yes, they do. We'll take the competitive issue again first, being that I responded to the competitive issue initially.

In a competitive issue the role of the senior manager is to gather the price ideas and structure if, in fact, the structure is left open. Many times in a competitive issue the structure is dictated, and you have no chance at all to change the parameters. But if, in fact-- We'll assume for this conversation that you can structure the issue any way you want to on a competitive issue. The role of the senior manager is to gather the information from all of the members of the syndicate as to how they think the issue can best be structured and thus, best sold.

The second role would be to gather the price information as to where the various members of the syndicate think the issues can be sold -- at what level, at what yield level.

That is really the main role of the senior manager. They submit the bid. They then accept all orders from the members of the syndicate if, in fact, they are successful in being the high bid. They then allocate the bonds according to the MSRB rules and according to priorities, and then they sign

the bond purchase agreement and agreement among underwriters is submitted and checked by the senior manager. And all of the rules of the MSRB are checked to make sure that we're in compliance.

On a negotiated basis the exact same thing happens. The senior manager of a negotiated issue interfaces with the issuer of the bonds to determine if, in fact, there are strict restrictions -- strict parameters, rather -- on whether or not you can sell derivative bonds; whether or not you can sell zero coupon bonds; whether or not you want the bonds to have a premium; whether or not the call provisions are extraordinary call provisions -- anything that has to do with the overall structure of the issue. That is the role of the senior manager.

The senior manager then has the responsibility of reporting back to the comanagers, and the syndicate members if there are syndicate members, what the parameters are.

Thus, once all of those parameters are understood, there becomes a similarity between the negotiated sector and the competitive sector. You price the issue, and you start to accept the orders.

If, in fact, there is excessive demand in a negotiated issue versus a competitive issue, you have the ability to restructure an issue. You can change the call provision; you can change the first coupon; you can move a serial bond and block it, and move it out to -- with more bonds and make a bigger term. You can reduce the size of a term issue. You can incorporate derivatives, the use of either inverse floaters or embedded caps or zero coupon bonds, anything that will help you to get the very best net interest cost, or complete interest costs.

ASSEMBLYMAN GIBSON: The financial adviser, is he the one that selects the senior underwriter?

MR. MCBRIDE: No, he's not. I think that the financial adviser, again, can play many roles. It all depends on the strength of the issuer, meaning that many, many times an

issuer will defer to their financial adviser for advice, and that's why the financial adviser has been retained. But most times the senior manager of a negotiated issue is appointed by the issuer. There may be influences from the financial adviser for good reasons.

ASSEMBLYMAN GIBSON: What do you see as the proper level of regulation by the Federal government?

MR. McBRIDE: What do I see as the proper level of regulation by the Federal government? I-- Can you expound on that question a little bit more? In what respect? I mean, we have the SEC, and we have the NASD, and we have the MSRB.

ASSEMBLYMAN GIBSON: Are they too overregulated at this point? Should there be less regulation?

MR. McBRIDE: In my estimation, we have all the regulation that we need. What we need to do as members of the broker dealer community is to enforce the rules that we do have, not pile on more rules, regardless of what aspect of the industry we are talking about.

ASSEMBLYMAN GIBSON: I'd like to get your group's view on political contributions.

MR. McBRIDE: Sure.

ASSEMBLYMAN GIBSON: Do you think the bond dealer should be prohibited from donating to campaigns?

MR. McBRIDE: I don't think we have the right, nor does the MSRB have the right, to, say, state or mandate that we cannot make political contributions, because we are protected under the First Amendment in the Constitution. I don't believe that political contributions-- I would strongly state that anyone who can be proven to be making political contributions for influencing business should be prosecuted, quite frankly.

ASSEMBLYMAN GIBSON: As individuals, it seems to me that you certainly should have the right. We talked about that a little earlier with prior witnesses. I just wonder how that

as a firm, should have a right as a firm? Is there any (indiscernible) that they have, that a firm should not have the right?

MR. McBRIDE: Your question is--

ASSEMBLYMAN GIBSON: As individuals, they certainly have the right--

MR. McBRIDE: Right.

ASSEMBLYMAN GIBSON: --and I don't think anybody is going to change that. My question is-- Put a little twist on it, how about as a firm that is in this business?

MR. McBRIDE: I think that individual firms have the right to make political contributions because we don't know what the reason for the political contribution is. It may be because of good government. I hope that is why most political contributions are made. Then you have to remember that we are talking about the municipal end of the business, but the firm is a complete broker/dealer, so there are political contributions that are made to support various governmental movements that are good for industry.

ASSEMBLYMAN GIBSON: Somewhere along the line, the understanding is that you described MSRB's supposed disclosure rules which provided no clear vision of that. It sounded like that was what you--

MR. McBRIDE: No, I didn't.

ASSEMBLYMAN GIBSON: You didn't make that--

MR. McBRIDE: No.

ASSEMBLYMAN GIBSON: Okay. All right, I don't have any further questions.

ASSEMBLYMAN KAMIN: Thank you, Mr. Gibson.

Assemblyman Watson, what is your question?

ASSEMBLYMAN WATSON: Thank you, Mr. Chairman.

Good afternoon, Mr. Cobbs.

MR. McBRIDE: No, I am Mr. McBride.

ASSEMBLYMAN WATSON: McBride? I'm sorry.

MR. McBRIDE: Mr. Cobbs was the one who referred to me.

ASSEMBLYMAN WATSON: I'm sorry, I'm getting too--

Are you familiar with the New Jersey campaign financing requirements?

MR. McBRIDE: Tangentially I am, yes, sir. I am familiar, but I don't think I can give you verse -- quote and verse.

ASSEMBLYMAN WATSON: Through you, Mr. Chairman-- Do you realize that all contributions must be reported, and such reports include disclosure of employment information on the contributors?

MR. McBRIDE: I am aware of that, yes.

ASSEMBLYMAN WATSON: I know that Assemblyman Russo has legislation in to ban contributions from your kind of operations, bonding companies. Do you think that banning contributions from those involved in the bonding process would eliminate public perception of contributions by bond deals and restore public confidence by doing so?

MR. McBRIDE: Based on the fact of perception, I would say yes, because I think there are an awful lot of people who misunderstand why political contributions are made. But then I think that also extends from an awful lot of other explanations of why many things are done. The general public, in essence, does not really read into what goes on.

ASSEMBLYMAN WATSON: Through you, Mr. Chairman-- Just as a matter of follow-up with regard to perceptions, most of what happens in these contributions and financing campaigns is a matter of perception, as far as people are concerned. I think we are driven by how our constituents perceive us in our duties here and how we arrive at our decisions. Based upon that-- I must state that this is such a complicated situation for us to be dealing with. And also it is a matter of how we feel the trust is put in us. But then when we began to discuss

the pros and cons of what we are doing here today, and of course our good Assemblyman's piece of legislation, my feeling is that we are always--

If one makes a mistake in this business, then it is generalized that we are all the same. And that is the perception that is beginning to fester in regard to total campaign financing, of individuals who would like to aspire to higher office, or office.

My feeling is that if we eliminate these contributions, it would -- as I stated before, it would take away the perception of what we are dealing with. But how do you feel about it, to eliminate it, as our Assemblyman has a bill that would do that? How do you feel about the elimination of funding through your--

MR. McBRIDE: Well, Assemblyman Watson, you made a comment just a few moments ago that I thought was interesting. You said that we are all subject to mistake and-- If I may paraphrase, you said that we are then painted with a broad brush. I must say to you that that is also true of the dealer community. If one were to make a mistake -- and we are all subject to mistake-- But if one were to make a mistake, it is very, very disturbing when I am hit with a few of the bristles of that broad brush.

To respond to your question as to whether or not I would like to see political contributions done away with, on a personal basis I think that would be wonderful. As a matter of fact, I couldn't think of anything that would be more beneficial to a lot of individuals. But I also think that we have the right, as individuals, to make political contributions. And if, in fact, we are making political contributions to influence -- as you have heard from the other two people who testified, and you have heard from my statement-- If, in fact, the political contributions are made

to influence, that is wrong, and I am not naive. I do not sit here and state to you that -- or make that statement to you because it was written for me, because that is what I feel.

But, in fact, you have the right to make a political contribution, or support anyone you want to support. That is one of the great things we have about the protection of our Constitution. If, in fact, we are making excess political contributions -- "we" now meaning in general -- are making political contributions in excess, you don't make excessive contributions because you believe in good government. You make excessive political contributions because you want to influence people, and that I would like to see done away with.

ASSEMBLYMAN WATSON: Through you, Mr. Chairman-- I thank you for your answer. But the other side of that is, where do we draw the line on excess as far as the public is concerned? Again, I could say \$100 would be excess to a lot of my constituents. Now, it's just there. It is part of what is taking place today in our country -- all over the country. And, you know, my feeling is that we are being perceived as operating government through those who can influence us through money.

I think the Governor going that extra mile, especially considering what they are doing here today, to not only put it into being, but, in fact, to eliminate the funding, would eliminate the misperception.

Thank you, Mr. Chairman.

MR. McBRIDE: If I may respond--

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Watson. Mr. McBride?

MR. McBRIDE: I would think that if, in fact, it were to be found that political contributions were to be banned in the State of New Jersey, for instance -- of which I am a resident -- I do not believe that that should lead you to think that you should do away with negotiated underwriting, because

the process of negotiated underwriting hopefully was intended to access the very best interest rate that you could. So I don't-- Although there is a connection, there certainly is a difference.

Thank you, sir.

ASSEMBLYMAN WATSON: Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman.

The Chair recognizes the new Chairman of the State Government Committee, Assemblyman Dave Russo, who is sitting in with us today. Assemblyman Russo?

ASSEMBLYMAN RUSSO: Thank you. From your experience, what would you attribute to the change in the profit margins of the underwriting spreads in the last-- To what would you attribute the change in the spreads in the last eight, nine years?

MR. McBRIDE: The reduction in spreads?

ASSEMBLYMAN RUSSO: That's right.

MR. McBRIDE: Excessive competition. I guess I shouldn't say "excessive competition," although sometimes I think it is excessive -- but competition.

ASSEMBLYMAN RUSSO: Meaning the marketplace and competition?

MR. McBRIDE: Yes, the marketplace itself.

ASSEMBLYMAN RUSSO: That has been the big change, and that is why it has become more competitive. Has there been a change with regard to the way bids are done, meaning competitive versus negotiated, or not really?

MR. McBRIDE: No, not really.

ASSEMBLYMAN RUSSO: Just apparently a factor of the -- a function of the market?

MR. McBRIDE: The marketplace itself-- We are going to refer to the municipal marketplace.

ASSEMBLYMAN RUSSO: Sure.

MR. McBRIDE: The municipal marketplace is no longer a cottage industry. It is no longer just an esoteric business. It used to be a very esoteric business. It really and truly was a cottage industry. It has become a very liquid, very complex, very, very difficult marketplace. It has caused many of the broker/dealer firms to invest in more quantitative type people; invest in more software; invest in more intelligence, which has caused a greater competitive spirit. Obviously, when you make those investments, you are looking for a return, and a return to the municipal industry has been that-- There is obviously a growing marketplace, but there has been a reduction in spread because of the competitive nature now that exists, that did not exist 20 years ago in the municipal industry.

ASSEMBLYMAN RUSSO: Do you feel that negotiated bidding should be banned, or should it still be a combination system?

MR. McBRIDE: I think only if I am appointed it should be okay. It should be banned if we are not-- (laughter) No, I do not think it should be banned; no, I do not think it should be banned. There are many, many reasons why it should not be; I think real strong, absolute reasons why.

ASSEMBLYMAN RUSSO: Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman, for your questions.

The Chair recognizes the Vice-Chair of the Committee, Assemblyman Kamin, and then there are others who wish to -- to be followed by Assemblyman Smith. Vice-Chair, Assemblyman Kamin.

ASSEMBLYMAN KAMIN: Thank you, Mr. Chairman, Mr. McBride.

Just for the record, I think it might be appropriate to read a portion of the Governor's Executive Order 92, since Mr. McBride, I think, has addressed this key point in response to Mr. Russo's questions, and also to Assemblyman Gibson about

the difference and the necessity, or the desirability of having negotiated as well as competitive. This is what it says:

"Competitive bidding is the only method of awarding contracts that consistently produces the best economic results and highest degree of integrity." Clearly, your responses today show that you do not agree with that statement.

MR. McBRIDE: That is correct. I do not agree with that.

ASSEMBLYMAN KAMIN: It is interesting that that statement was made from an administration that over a year ago said that additional oversights and restrictions on the bond business would, in fact, be counterproductive.

If I could ask you for maybe some of your brief comments, Mr. McBride, on the role of consultants, those who are outside the securities industry and advise the finders. Could you elaborate on their role and how they are often used in the securities business?

MR. McBRIDE: Consultants or finders, sir?

ASSEMBLYMAN KAMIN: Well, both.

MR. McBRIDE: Okay. Consultants are used -- as I have stated earlier, and I think as Mr. Cobbs has so thoroughly informed you-- They are used as an independent or a go-between between the broker/dealer and the issuer for the purpose of assessing the very best market structure, what they need. Maybe the issuer doesn't have the expertise. That doesn't make them uninformed, but this is a complex market we are dealing with. And if you have an independent financial adviser, they can offer you the best advice because of their knowledge as to whether or not the structure that has been presented is the best structure; and whether or not the yield that we are talking about is, in fact, the best yield that can be obtained at that given time; or if, in fact, the participatory involvement of the various members of the group is the best makeup. I think that is for all that the financial adviser serves as.

As far as a finder, and there are many different types of finders, finders can be an eternal source in large firms. For instance, if you are a broker/dealer and you happen to have a member of your firm that sits on the board of a hospital, and they know that the hospital is going to need some funding, that individual will bring to the attention of the various parties, whether it be in a public finance or in a corporate finance area, that something is needed. And that individual would then be labeled as a finder. Some firms, if, in fact, you are allowed to vote -- or you can't vote obviously if you are a member of a board and it is on a non-for-public hospital-- You wouldn't be allowed to vote as to who could be appointed. And if you are appointed as a senior manager on an negotiated issue to do a financing process for a project -- for a hospital, you could be labeled as a finder.

ASSEMBLYMAN KAMIN: The MSRB was really the outgrowth of the bond scandals of the '70s with Tennessee, as I recall?

MR. McBRIDE: I don't think it was an outgrowth of scandals; I think it was an outgrowth that the industry was growing and we needed to have regulatory procedures.

ASSEMBLYMAN KAMIN: A much better way to put it. Thank you.

Mr. McBride, if I could ask you just to elaborate perhaps-- Does the MSRB have any written rules as far as what is appropriate in the way of compensation for those consultants and finders?

MR. McBRIDE: No, they do not -- not that I know of, according to the MSRB rules.

ASSEMBLYMAN KAMIN: How about internally from major securities firms? Do you have rules set up, for example, by Prudential?

MR. McBRIDE: Do we have rules?

ASSEMBLYMAN KAMIN: Yes.

MR. McBRIDE: At Prudential for payment of--

ASSEMBLYMAN KAMIN: Guidelines, internally, yes.

MR. McBRIDE: For investment bankers?

ASSEMBLYMAN KAMIN: Yes.

MR. McBRIDE: Investment bankers, like people who work--

ASSEMBLYMAN KAMIN: For the outside, for finders, to determine what is, in fact, fair compensation for--

MR. McBRIDE: For outside finders we do not have written rules. In fact, if we have a consultant or an outside finder in the very, very preliminary stages, if, in fact, we determine that this person can be helpful to us, we will then discuss what is the proper procedure for payment, if, in fact, there is to be any payment.

On an internal basis, we have the same process. On an internal process, we do have a written procedure because people are controlled by our firm. I shouldn't use "controlled by our firm." They are employees of our firm.

ASSEMBLYMAN KAMIN: See, the problem in our particular case is, we are looking through what has happened here in New Jersey, as one of those finders/consulting firms was, in fact, very close to the administration. It is our view that that is a red flag and was improper, and we wondered how major security firms would respond knowing that -- certainly retroactively knowing that information.

ASSEMBLYMAN ROMANO: Mr. Chairman, is his microphone on? I can't hear him. Is it on?

ASSEMBLYMAN KAMIN: It's on, I believe, Assemblyman.

MR. McBRIDE: I would think, if I am correct-- The firm you are referring to, I think, was a listed financial adviser, though -- a financial consultant.

ASSEMBLYMAN KAMIN: Yes.

MR. McBRIDE: Not a consultant as I think in the framework that you may have initially asked me that question.

ASSEMBLYMAN KAMIN: But not with the capabilities of, in fact, the sale of securities?

MR. McBRIDE: No, that is correct. They did not have, as far as I knew, a distribution capability at all.

ASSEMBLYMAN KAMIN: In your experience, is that unusual for someone without the distribution capability to, in fact, play such a major role in an underwriting?

MR. McBRIDE: Well, if you are playing the role as a financial consultant -- or a financial adviser, no. If you are playing the role of a financial consultant and you are allocated bonds to sell, yes, that is very unusual.

ASSEMBLYMAN KAMIN: Thank you. Thank you, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Smith I believe has some questions.

ASSEMBLYMAN SMITH: Mr. McBride, in your testimony you -- at page 9 -- were kind enough to provide some idea of what the average spreads are for long-term municipal issues over a period of time. You point out that spreads have decreased, and so on. Let me read you one sentence, however: "By 1992, gross spreads had fallen to \$9.32 per \$1000," which is a very significant reduction from what it used to be in 1985. Are you familiar with the general obligation refunding, the topic of which is the subject of this hearing?

MR. McBRIDE: Yes, I am.

ASSEMBLYMAN R. SMITH: Okay. Are you familiar with the spread on that bond issue?

MR. McBRIDE: No, not offhand.

ASSEMBLYMAN R. SMITH: All right. Well--

MR. McBRIDE: I'm sure I was, but--

ASSEMBLYMAN R. SMITH: The Treasurer of the State forwarded a report to the Chairman -- through you, Mr. Chairman -- that indicated the spread per bond was \$7.54--

MR. McBRIDE: Okay.

ASSEMBLYMAN R. SMITH: --which appears to be considerably better than the average gross rate in 1992.

MR. McBRIDE: That's what makes up averages.

ASSEMBLYMAN R. SMITH: What's that?

MR. McBRIDE: That is what makes us the averages, though. One could be seven and one could be 14.

ASSEMBLYMAN R. SMITH: Sure, that is why it is an average.

MR. McBRIDE: Correct.

ASSEMBLYMAN R. SMITH: But it does appear that New Jersey did fairly well in terms of spread.

MR. McBRIDE: Based on those numbers, yes.

ASSEMBLYMAN R. SMITH: The question has been asked before, but I want to reaffirm -- again, through the Chairman -- with regard to some comparison between negotiated and competitive rates. There are obviously some advantages to each alternative. It really becomes a judgment call based on the issuing authority. Would you agree with those statements?

MR. McBRIDE: Correct.

ASSEMBLYMAN R. SMITH: Okay. If we in the State of New Jersey have made a conscious decision that we want to see the financial house of New Jersey receive some kind of preference -- New Jersey-based companies, etc. -- and we made that a public policy determination, that is within our realm of discretion, is it not?

MR. McBRIDE: I would assume it is within your discretion, sure.

ASSEMBLYMAN R. SMITH: You don't know of anything that would make that illegal?

MR. McBRIDE: No, not at all, sir.

ASSEMBLYMAN R. SMITH: All right. If we decided we wanted to give some preference to minority- or women-owned firms, that is certainly within our discretion, as far as you know? There is nothing illegal about that?

MR. McBRIDE: No, sir, not at all.

ASSEMBLYMAN R. SMITH: Okay. When a negotiated rate is negotiated, is it a valid-- Is it reasonable that one of the considerations given to the financial group that is servicing you is that you will allow them to reinvest the short-term proceeds of the bond sale, and for them to receive the proceeds? Is that a consideration that can be used legally in the negotiated rate?

MR. McBRIDE: Sure, legally it can. Certainly.

ASSEMBLYMAN R. SMITH: All right.

MR. McBRIDE: There is nothing illegal about that.

ASSEMBLYMAN R. SMITH: Is there anything immoral about it, unethical, to your knowledge -- through the Chairman?

MR. McBRIDE: Not that I know of.

ASSEMBLYMAN R. SMITH: Okay. I would assume that, in allowing that as a consideration, the flip side of that is that the issuing authority would get some consideration in return, either a lower spread, or some other consideration in return for that. Is there anything in that context that you view as illegal?

MR. McBRIDE: Based on the way you're stating it, no, sir.

ASSEMBLYMAN R. SMITH: Okay. Are there other states in which states, authorities, government entities have utilized that as a consideration, to your knowledge?

MR. McBRIDE: Well, my only confusion with your question is when you say, "have utilized that as a consideration." You mean negotiating the--

ASSEMBLYMAN R. SMITH: Yes, in a negotiated rate situation.

MR. McBRIDE: Okay, but the reason I asked you to restate it was-- When you said "consideration," I'm thinking of remuneration. Okay. You're--

ASSEMBLYMAN R. SMITH: Well actually, that is the context in which-- I mean, obviously it is a benefit to the

servicing agent. You are allowing them to receive some short-term revenue.

MR. McBRIDE: Right.

ASSEMBLYMAN R. SMITH: And the assumption in any negotiated situation is that you receive something for something.

MR. McBRIDE: Right.

ASSEMBLYMAN R. SMITH: All right. We obviously did very well. The State of New Jersey did very well in the spread in terms of those bonds, looking at the average spreads across the country. I mean, we had a spread that was \$1.78 less per \$1000 of bonding. That is a very significant difference. I don't know if that was the Treasurer's consideration, but what I am asking you is: Under normal circumstances in which there is a negotiated agreement on rate with your servicing agents, is it a valid consideration to say, "I will allow you to receive the short-term interest in exchange for other considerations"?

MR. McBRIDE: Yes, it is; it's valid.

ASSEMBLYMAN R. SMITH: Have you studied this particular bond issue?

MR. McBRIDE: Yes.

ASSEMBLYMAN R. SMITH: Is there anything in that negotiated arrangement that strikes you as out of the ordinary or unnatural?

MR. McBRIDE: I cannot respond to that completely, because I studied it from a market standpoint, but not from an inside standpoint. I was not part of that financial--

ASSEMBLYMAN R. SMITH: All right. Well, from a market standpoint, is there anything unnatural, out of the normal with regard to that bonding arrangement?

MR. McBRIDE: Which aspects of the bonding arrangement are we talking about?

ASSEMBLYMAN R. SMITH: The marketing end of it that you were discussing.

MR. McBRIDE: None that I knew of.

ASSEMBLYMAN R. SMITH: The State of New Jersey, in the last three years -- again, this is according to the Treasurer's report, Exhibit 2 of the Treasurer's report--

ASSEMBLYMAN FRELINGHUYSEN: Could you speak up, Assemblyman?

ASSEMBLYMAN R. SMITH: Yes, yes, Mr. Chairman; certainly through you, as well.

Exhibit 2 of the Treasurer's report, which was presented to the Chairman of this Committee, which is entitled, "Comparisons of Underwriting Spreads--"

ASSEMBLYMAN FRELINGHUYSEN: This report is the-- The first report, or the second report that we recently received?

ASSEMBLYMAN R. SMITH: The first report.

ASSEMBLYMAN FRELINGHUYSEN: The first report.

ASSEMBLYMAN R. SMITH: There is an Exhibit 2 attached to it which says, "Comparison of Underwriting Spreads, New Jersey vs. all 50 U.S. States (\$ per \$1000 of Bonds)." In 1990, it indicates that the average spread for the 50 U.S. states was 11-- In 1990, the average for all the 50 U.S. states was \$11.36 per \$1000 of bonds. New Jersey was \$10.79, which was a 57-cent lower spread, on average. In 1991, New Jersey-- Oh, I'm sorry, in the United States of America -- the 50 states -- the average was \$10.51. In New Jersey, the spread was \$8.48, the difference being \$2.03 less in spread for New Jersey bonds. In 1992, the average for the United States of America -- all 50 states -- was \$9.28, and in New Jersey it was \$8.18, a difference of \$1.10 less per \$1000 of bonds.

- Am I reading this incorrectly, or does it appear that in the last three years New Jersey seems to have done particularly well with its spreads?

MR. McBRIDE: I don't know whether you are reading it incorrectly, but basically from the numbers you read back to me it seems like they are doing well.

ASSEMBLYMAN R. SMITH: And, if the Committee will take a look at the rest of the years -- the years prior, 1983 through 1989, which -- one, two, three, four, five, six, seven years -- four out of those seven years New Jersey paid significantly higher than the national average for spreads on bonding: \$1.06 higher; \$3.05 higher; \$.86 higher; \$.15 higher.

Not being an expert in this field, it would seem to me that somebody in New Jersey seems to know what they are doing when it comes to bonding, at least with respect to the spreads. Is that a fair statement?

MR. McBRIDE: That's a fair statement.

ASSEMBLYMAN R. SMITH: That's all, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman.
Assemblyman Lance?

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman.

The spreads that Assemblyman Smith has pointed out, they deal with the refinancing, do they not? I am not an expert in this area either. They do not deal with the temporary reinvestment once the refinancing has occurred.

MR. McBRIDE: Well, I am not so sure that the numbers that Assemblyman Smith was reading deal only with refinancings, because he-- I think he was reading numbers that were a collection from all of the spreads. This one particular issue, which I think exacerbated this hearing, was a refinancing, or a refunding. So there is a difference. The numbers I think Assemblyman Smith read to me were a collection of all financings, whether they be--

ASSEMBLYMAN FRELINGHUYSEN: Which I may add, pertain to the short-term as well as long-term borrowing.

MR. McBRIDE: And it may be refinancings plus new money, so I-- Assemblyman Lance, I can--

ASSEMBLYMAN FRELINGHUYSEN: There are no longer requests for new money terms. There is no distinction on material to the best of my knowledge, Assemblyman Smith.

Assemblyman Lance?

ASSEMBLYMAN R. SMITH: Mr. Chairman, just by way of your own information, the bottom of the chart (indiscernible) includes all negotiated, long-term bond sales by State and State authorities. It doesn't say combined--

MR. McBRIDE: So it may not be-- Assemblyman Lance, it may not be just refinancings; it may be new money and refinancings.

ASSEMBLYMAN LANCE: Well, yes. That's very helpful, for that matter. Regardless of whether it is refinancings or new paper issued, my point is that, as I understand it, it is not included for temporary investment in Treasury notes short-term and then used later for projects. That is my principal focus, as I have stated several times. I just wish to make the point as I understand it, and I wish to be corrected if I am wrong, that the figures the Assemblyman cites relate to reinvestment or the initial sale of paper -- a combination of the two -- but not to the temporary reinvestment of that money short-term. Is that accurate?

MR. McBRIDE: That is accurate; that is correct.

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman. Anything further for Mr. McBride? Assemblyman Kamin?

ASSEMBLYMAN KAMIN: Thank you. Mr. McBride, Mr. Smith asked you about being able to assess the fairness of this issue we are reviewing. It is difficult for you to make an assessment without knowing, in fact, what fees the working papers are putting together -- the syndicate. It is difficult for you to make an assessment other than just a market assessment without knowing that inside data. Is that correct?

MR. McBRIDE: That's correct, Assemblyman, yes.

ASSEMBLYMAN KAMIN: Now, how much of a cost could, in fact-- How much could the cost of an issuance be affected by the inner workings of that snydicate putting together the fee structure?

MR. McBRIDE: That's very difficult to answer. I really don't know--

ASSEMBLYMAN KAMIN: But it could have significant effect.

MR. McBRIDE: It could, and then again it could not. It would depend on how the senior manager and the other co-senior or comanagers related to one another. I mean, it is a competitive field, and sometimes people help and sometimes people do not help.

ASSEMBLYMAN KAMIN: You mentioned in responding to an earlier question of mine that it was most unusual for a firm without a market capability to be involved in a deal, in the role in which it played. Can you think of any other example of a firm of similar capabilities being involved at a significant level in an issuance without, in fact, having a sales force?

MR. McBRIDE: Again, it must be stated that to be involved to receive bonds of proceeds from the issue itself--

ASSEMBLYMAN KAMIN: Yes?

MR. McBRIDE: In that capacity, no, I cannot think of any other time that that has happened.

ASSEMBLYMAN KAMIN: Thank you very much for your testimony, Mr. McBride.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Mr. McBride. Any other questions for Mr. McBride? (affirmative response) One final question from Assemblyman Smith, and then--

ASSEMBLYMAN R. SMITH: I didn't get the response to Assemblyman Kamin's question concerning the fairness, etc., of the fees. Again, the Treasurer was kind enough to provide a list of the fees associated with the \$1.8 billion refinance. The total takedown on that refinance was \$11,625,000, and the list of fees-- With the Chair's indulgence, I would like to just pass those over.

While they are being passed over to you to take a look at, and to put some things in context and respectfully answer Assemblyman Kamin's question, you can make some comparisons.

If you look at 1985, if you look at the Turnpike Authority's '84-'85 bond sale, at that time, including underwriters, lawyers, printers, etc., \$67 million was spent by the Turnpike Authority to refinance \$2.5 billion in bonds. And at that time one firm, Smith Barney, made over \$30 million in gross revenue from the sale of those bonds in 1985. The total takedown of these on that list is \$11 million -- and I don't have the figure in front of me. If you would--

MR. McBRIDE: It's \$12,813,000.

ASSEMBLYMAN R. SMITH: If you would take a look at that list of the fees paid to the underwriters, etc. -- the \$12 million -- is there anything on that list that jumps off that page as something that would be excessive or out of the norm on a \$1.8 billion bond issue?

MR. McBRIDE: Yes, sir.

ASSEMBLYMAN R. SMITH: What is that?

MR. McBRIDE: My firm's name does not appear here.

(laughter)

ASSEMBLYMAN R. SMITH: Please note that for the record. Anything else that jumps off the page?

MR. McBRIDE: No, sir.

ASSEMBLYMAN R. SMITH: Okay. Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman.

Let me say for the record, I have to take exception to Assemblyman Smith's characterization that the Treasurer has been kind in providing this Committee with the information we have been seeking for the last eight or nine months. While you may not know it, Mr. McBride, our Committee has been seeking information that, quite honestly, the Treasurer should have gotten to us soon after this bond deal was put together. One of the focuses of this Committee is to find out why it has taken so long for this kindness to be bestowed upon the Legislature.

Thank you very much for being with us.

The Chair would like to recognize Mr. Carmello Montalbano and swear him in. He has had a number of years of experience in sales trading and public finance. He has a MBA from Columbia. He has worked at Bankers Trust, Dillon Reed, and Lazard Freres before forming his own investment counseling firm and another company which created the first expert system to aid portfolio managers of municipal bonds, that now has \$25 billion in bonds in the system.

Before welcoming this gentleman, I would like, if I could, to read the questions for witnesses under oath. Did you receive a subpoena from this Committee compelling your attendance at this hearing today? Did you receive a subpoena from this Committee compelling your attendance?

C A R M E L L O M O N T A L B A N O: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: You did not. Do you understand that the Chairman of this Committee has the authority to administer an oath of affirmation to a witness in any matter now pending before this Committee?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Have you received a copy of the Code of Fair Procedure here today before testifying before this Committee?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: The Code of Fair Procedure gives you certain rights as a witness testifying under oath here today before this Committee. For example, you have the right to be accompanied by counsel who may advise you of your rights during the proceeding. Do you have counsel here present today?

MR. MONTALBANO: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: Do you agree to testify here today without having counsel present here with you?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Under the Code of Fair Procedure you have the right, at the conclusion of your examination by this Committee, to file a brief sworn statement relevant to your testimony for incorporation in the record of this investigatory proceeding. You are advised that we are making a tape recording of this proceeding, and you are entitled to receive a copy of your testimony. You also have the right to request a copy of the resolution authorizing this investigation.

Do you have any questions concerning the Code of Fair Procedure or your rights under the law?

MR. MONTALBANO: No, I do not.

ASSEMBLYMAN FRELINGHUYSEN: Do you have any questions about the proceedings today?

MR. MONTALBANO: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: If you don't, would you please raise your right hand? Do you solemnly, sincerely, and truly declare and affirm that the testimony that you will give in these matters now pending before this Committee shall be the truth, the whole truth, and nothing but the truth?

MR. MONTALBANO: Yes, I do.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that if statements you make today are willfully false you will be subject to penalties under the law, including monetary penalties and incarceration if you fail to answer pertinent questions or commit perjury, which is making a false statement under oath in an official proceeding such as this?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand this?

MR. MONTALBANO: Yes.

ASSEMBLYMAN FRELINGHUYSEN: Is the testimony you are providing today given of your own free will?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Have you been directed or required by anyone to testify here today?

MR. MONTALBANO: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: Again, welcome. Thank you for being here. We appreciate your patience. Do you have any opening comments or perspectives?

MR. MONTALBANO: No. I would just like to explain to the Committee that I would like to basically try to reduce, perhaps, some of this complication of the different areas of bond trading, new issue securities, and so forth; try to reduce it to a level where maybe it will be a little bit more understandable so that the intricacies of it can be appreciated also.

ASSEMBLYMAN FRELINGHUYSEN: I believe Assemblyman Russo has some questions. Assemblyman?

ASSEMBLYMAN RUSSO: I asked this question a few seconds ago of Mr. McBride: Why have these underwriting spreads and profit margins gone down tremendously? In my notes it looks like they have gone down from something like \$19 per 1000 to eight-and-a-half, approximately, in about nine or ten years. What is the reason for that?

MR. MONTALBANO: There are a lot of reasons for it. The previous speaker spoke of competition, but take a look for just a moment, please, at the supply and demand situation. The interest-- Spreads are a function of how much risk an underwriter takes in the marketplace. When you are in a period of high interest rates, you take more risk. When you are in a period of high volatility, as we were in 1986, you take more risk. That builds up the spreads.

Then, over time-- Today we have a period of low rates and low volatility, which is an offsetting factor. The biggest single factor, though, was the 1986 Tax Act. This is very important, please, to understand. It reduced the supply of municipal bonds, but it also reduced them in such a way so that the lesser quality issues, which represent the BAA of lower

market -- the nonrated market -- they no longer could come to market any longer. If they wanted to come to market, they had to come as AAA securities by getting insurance.

So what happens is, the AAA rates-- There became more AAA bonds around, and very few nonrated and BAA rated securities. So what you ended up with-- It was everything starting to trade in a tighter and tighter range than they had before.

But to continue on, a lot of municipal securities were taken out of the market as long bond issuances and turned into variable rate demand notes, the State of New Jersey being one of them. Many forms of industrial development revenue bonds -- which I am sure you are all familiar with -- had been taken out of the market. What I am saying is, the supply dried up greatly. At the same time, the ability of dealers to hedge themselves in the future's market and the ability of dealers with growing capital -- as these firms went public and raised capital, and the great new supply of capital is minority firms, women firms, just small firms throughout the country -- did quite a bit, really, to reduce the -- to increase the general amount of capital available for municipal bonds.

Most importantly, though, is the fact that we -- I would say overall, is just the general level of volatility and interest rates. Someday it will go back up again.

ASSEMBLYMAN RUSSO: It has been indicated that negotiated issues have fallen to a rate that was actually lower in the first part of this year than competitively bid bonds. Now, is that correct? The difference is supposed to be about 65 cents. That's the spread. That is just the functioning of the market?

MR. MONTALBANO: Well, if you look at that number -- it is a first quarter of '93 number, I believe -- it is a hard number to go by because, again, it is only one quarter. It is unusual to have seen that happen. On the other hand, the types

of bond issues that are in the marketplace these days tend to be more, as you heard, the project financing bonds and more insured bonds; whereas the competitive issues tend to be A-rated paper, the paper of small municipalities, which have greater spreads to them.

For example, New Jersey-- We just spoke about New Jersey GOs yielding something on the order -- the spread being on the order of about \$7.50, or \$7.60. I don't know. If Whitehouse, New Jersey came to market, the spread would probably be \$12, and it could have the same rating. It is just a function of the size of the issue.

I can't comment beyond that. There is just not enough data to analyze it.

ASSEMBLYMAN RUSSO: Are you familiar with the Executive Order that came out about May with regard to the bond situation in New Jersey?

MR. MONTALBANO: Yes, sir, I am.

ASSEMBLYMAN RUSSO: Okay. In essence, it bans negotiated bidding for State bonds, except in certain circumstances. Could you give us your professional opinion on that, and should there be any exceptions?

MR. MONTALBANO: Okay. The portion of municipal bonds -- the practice that you heard about today -- was really -- if you think about Mr. Cobbs' testimony -- was really about preparing for the deal; deciding what it is you want to sell. Do you want to sell, for example, prison bonds? Do you want to sell it as a project financing? Do you want to sell it with -- get a lower rate, sell it as a general obligation bond guaranteed by the State of New Jersey?

What you are doing is-- The financial adviser at that point is like your spec man. He specs out the deal for you the same way as a steelmaker would spec out a, you know, a cast for something that was going to be built. Then what you do is, you call up all your bidders, and then you bring it to market and you make it available after they study the specifications.

Executive Order 92 doesn't answer the first part of that, and that is really the key to the way you have been issuing your securities. The second part of the order-- Or if it does, I don't understand it. But the second part of the order creates the potential for a market problem. Remember, no other state in the 100-year history of municipal bonds has ever had this order before. I mean, something unique must be going on to need it, particularly in light of what we heard were just very good rates.

The key, really, is the procedures. If we have very good procedures, then these things really shouldn't come up. If our current procedures are corrupted, then maybe we do need them.

What I am trying to say to you is, I don't know how 92 can be implemented. In theory maybe it is a great idea. I think it has so many flaws that I don't think it can be implemented.

ASSEMBLYMAN RUSSO: It has been stated that negotiated sales can actually bring the interest rate down by doing what is called the "successful presale." Can you briefly talk about what a presale is, and is that true that it could bring the interest rates down?

MR. MONTALBANO: Sure. I can give you a very good example of that: In 1980, I was at Dillon Reed and we underwrote the first MTA issue -- the New York City MTA issue -- and in that issue it was the first time that revenues were based on the collection of subway fares. People said that was impossible to do; it would have to come from a guarantee of the City of New York.

Now, what we did was, we put together a very large syndicate after the financing was done. We knew how we wanted to finance it. In other words, we had done our spec work, and we talked to all the underwriters and they understood the stories. Some underwriters began commercials, and some

underwriters called their customers in advance to get indications of what yield would clear the market with the securities. At the time it was a very large issue; it was \$400 million. We achieved entry into the market -- which is very important -- for the first time ever, and the estimate was that we saved somewhere around 25 to 30 bases points by doing it this way. On \$400 million, we saved somewhere around -- on the order of \$8 million.

May I spend one second explaining something that I think it is very important to understand? All the talk here today has been about the spread: the spread functions, the spread relationships over time. I don't mean to demean them, but what is really, really important when you are wanting to look at a bond issue, is the spread-- Think about it as you, the State of New Jersey, the issuer. The State issues bonds and what do they get? They get back money. Now, they get back the price of the bonds minus the spread.

But suppose I said to you, "Assemblyman Frelinghuysen, I want to sell your bonds for you at a yield of 610; that is, 6.1 percent," and to Assemblyman Kamin, at 6 percent, the difference being you are in one state, and you are in another state, let's say. That difference-- Excuse me. The difference is in State structure. We are going to use Structure 1 on you, and Structure 2 on you, sir. The difference on \$100 million of that 610 to 6 percent, is a million dollars. It is 1 percent of the issue price. So when you say-- If you are trying to prove that there was or was not a problem with the underwriting, that we were tied to the underwriters, you've also got to look at the fact that, how does the market receive your securities? Because if your financial underwriter gives bad advice -- as I did in situation one here, we'll say, he is going to pay a higher interest rate.

Now, the trouble is we can't measure that very easily. It is a real problem. What you can measure is the

spread. Everybody knows what the spread is. It is a number, you look it up, and there it is. But it doesn't tell you what it costs you in addition. Again, if the spread is \$9 in a deal, or the spread is \$2 in a deal, and I am selling my securities a little bit -- 10 bases points cheaper, one tenth of a percent cheaper, to the second party-- It overwhelms the spread. It is like increasing the spread by 50 percent or 100 percent. It depends on what the number is. So it is not just spreads. Spreads is not really the thing we want to be concentrating on exclusively.

ASSEMBLYMAN RUSSO: Have you reviewed the Turnpike bond report in May and the Treasurer's first report, I believe, of August 27? Have you looked at those documents?

MR. MONTALBANO: Yes, I have.

ASSEMBLYMAN RUSSO: Okay. Maybe we will start with the Turnpike bond report. Could you make some comments, or help--

MR. MONTALBANO: Let me step back and say that I am going to try to explain this just chronologically what I, as a reader, have problems with, because I have access to no other materials other than those two reports, I think. Maybe some press clippings or something.

Once there was the allegation of wrongdoing, or potential wrongdoing -- I don't know the real term they have ever given it -- but concern about how things were handled both to the detriment of the State and others -- and the Governor, perhaps, what I would want to know-- What is called for in that report is an explanation of how business was conducted. That is how I think the problem-- That is how I look at the problem.

Now, you have all seen the Kentucky report. What that really is is a log of how business was conducted. They were able to turn around and put their notes together and come up with what was really a very, very good report. What could not

be done, unfortunately, was the same thing here. The report that first came out was just-- It was a general statement about the '86 to '93 change in underwriting spreads. And unfortunately, I think when you look at the data, if you do a statistical impression on the data, I think if you notice how those averages are made, it is not going to hold up.

So, going back to the Turnpike report, the fact that there weren't a lot of conditions-- It wasn't like a banker's report; it was more of a, like a public information piece. So, when the May 25 report came along -- or the September report came along -- I noticed they had finally drawn divisions between public underwriting and national underwriting and State underwriting. They had drawn divisions between the different types of securities that were being underwritten, and, generally speaking, the approach I could agree with.

The section on the description of municipal bonds should be copyrighted and sold, because it is a very good description on how underwritings work. I really urge everybody to take a good look at that section. But then what I found out was-- I put these things on a spread sheet, and I started playing around with the numbers. Then as I looked at the numbers, I had trouble making things work. I then looked at the exhibits. Now, everybody seems to be turning their attention to Exhibit 2. Okay? And then also, I guess, Exhibit -- I don't know if this is 5 or 6 -- Exhibit 6--

ASSEMBLYMAN RUSSO: This is in the August 27 report?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN RUSSO: Sure.

MR. MONTALBANO: I'm sorry if I jumped ahead. It was just--

ASSEMBLYMAN RUSSO: No, that's okay.

MR. MONTALBANO: To me it is a--

ASSEMBLYMAN FRELINGHUYSEN: For transcript purposes, we would like to include copies of those exhibit pages. That's Exhibit 2 and--

MR. MONTALBANO: Two and I guess it is page 2 of Exhibit 6.

ASSEMBLYMAN FRELINGHUYSEN: Page 2 of Exhibit 6 is in the first report issued by the Treasurer on what date?

ASSEMBLYMAN RUSSO: August 27. Exhibit 2 would be the one that Assemblyman Smith just referred to, which is titled, "Comparison of Underwriting Spreads, New Jersey vs. all 50 U.S. States" -- or, I guess, 49 maybe -- "U.S. States." And then Exhibit 6 you're talking about, Mr. Montalbano?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN RUSSO: Okay. That would appear to be one page: "Comparison of Underwriting Spreads, New Jersey vs. Neighboring States."

MR. MONTALBANO: No, this is the sheet.

ASSEMBLYMAN RUSSO: Oh, okay. Hold on. What is the title of that one, sir?

MR. MONTALBANO: "Gross Spreads 1984 through 1993."

ASSEMBLYMAN RUSSO: Do you know what exhibit that is?

ASSEMBLYMAN ROMANO: It's the big thick one.

ASSEMBLYMAN WATSON: That's not what we have here.

MR. MONTALBANO: Sir, I have been through this so many times that I am sure my pages are confused.

ASSEMBLYMAN RUSSO: Just for the transcript so we have the right exhibit, did we figure that out on the second exhibit yet -- which one that is?

ASSEMBLYMAN R. SMITH: Actually, Mr. Chairman, a point of order: I would suggest to the Chairman that rather than including just the individual exhibits in the transcript of the hearing, that we enclose the entire Treasurer's -- both Treasurer's reports of September 10 and August 27.

ASSEMBLYMAN FRELINGHUYSEN: I don't have any objection to that as long as it can be logistically handled. For the record, we need to specify the pages and from what report. We will do that before the transcript is put together.

Assemblyman Russo?

ASSEMBLYMAN RUSSO: Yes. Why don't you proceed, and start with the -- if you would like to deal with both, or Exhibit 2 especially, the one we just dealt with a couple of seconds ago with Assemblyman Smith?

MR. MONTALBANO: Well, my point really was, in calculating these spreads -- and if I remember correctly from page 1 or 2 of the initial letter that accompanied the report-- In the first paragraph of page 2, "New Jersey underwriter costs," they mention \$4.79 billion in bonds sold by negotiated sale in 1992. There they compare '92 to '83 as if the underwriting fees had been the same.

My point, though, is this: When I first did it, I couldn't get the \$4.79 billion. Then what I noticed was, when you use Exhibit 7, which is the one that breaks out in great detail securities data information about how these securities are ranged, they include the note issues in there. Now, this says that it does not include the notes -- that securities data did not include the notes in their calculations. So I take that at face value, and I assume that Exhibit 7 eliminates these securities.

Now, the average price of these securities, since they are short-term notes due in a year or less, is only about \$2. When we add those \$2 in with the other underwriting -- with the other securities that have been included, the true cost of issuance for bonds-- Remember, the report says, "bonds." It doesn't say, "bonds and notes." It says, "bonds." The cost of issuance of bonds probably flips over to the other side. Now, I say probably because I can't figure out the numbers. Why? Because I used the securities data information myself yesterday, and I was able to do it just for one group of securities -- New Jersey Economic Development. When I did that, I found six securities in there that weren't even listed in the report, or if they are listed, they are listed under another name.

That being the case, frankly, I stopped at that point, but then I realized something else. In 1986, New Jersey used to give a letter of comfort to every hospital -- to almost every hospital that was issued, so they could help themselves with the underwriting issuance. It would look like they were closer to the credit of the State of New York, and as a result would get lower interest rates. Today, though, the New Jersey Health Care Finance Authority is simply a name by which -- under which bonds are issued. There is no State guarantee for any one of those issues. Seventeen or 19 of those 32 bond issues are guaranteed by an insurance company. When that is the case, why should the State be including them when there is no State risk to them? There is no State liability whatsoever to those bond issues. When you do that, then it occurred to me, maybe somehow these three or four groups of securities have been changed. And finally I said, "I don't know what the list really looks like, but all I know is, you can't judge by the prices we've got here."

Then I would just like to back up to the comparison point. We're talking about New Jersey State. Look at the national figures. You've got 15-- Excuse me, you've got approximately from here-- Every one of these categories--

ASSEMBLYMAN FRELINGHUYSEN: Let me say for the record, you are again referring to--

MR. MONTALBANO: Gross spreads 1984 to 1993.

ASSEMBLYMAN FRELINGHUYSEN: Which will be included as a part of the record, if it isn't already included therein.

ASSEMBLYMAN R. SMITH: Where is that from, Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: I assume it is securities data, and if we can get a copy of that--

MR. MONTALBANO: My papers mixed them up, I have had these so long. They are in one of the two dated reports, I believe.

ASSEMBLYMAN R. SMITH: You're saying it is from the Treasurer's report?

MR. MONTALBANO: Yes, they are definitely from the Treasurer's, right, because they are dated the same date as this information. No, he didn't put the date on this one. It's securities data for 1983.

ASSEMBLYMAN R. SMITH: Why is the--

ASSEMBLYMAN FRELINGHUYSEN: If you would continue, please.

MR. MONTALBANO: In any case, what I found when you go through the report there is, some issues in there are not mentioned, for example, under-- For example, the New Jersey Economic Development Authority has issues in there for both hospitals and universities -- small deals, nonrated deals. I think that is what the purpose is. I can't tell exactly because all I have to go by are a few lines of data. But if that is the case, I don't even know how they could have calculated them into here, because they wouldn't fall down into the right categories, and so our cost of issuance is going to be skewed there also.

All I'm saying is: I think really concentrating -- and I know it has been a focus because of the reports and because of the information -- but this is not the way to get at what the problem is. I really think that you have to take another look at what has gone on, and say, "Go back to a Kentucky type of report and understand where things broke down on an individual basis -- on a deal-by-deal basis." Because some of these deals are just fine; some of these deals are not very good. Some of the underwriting practices are very, very weak.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Russo?

ASSEMBLYMAN RUSSO: Yes. I was going to ask another question in a minute, but Assemblyman Lance wanted to ask something, if that is okay with the Chair.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Lance is recognized. Is there anyone else who wants to be recognized? And Assemblyman Smith.

ASSEMBLYMAN WATSON: The only question I would like to ask is--

ASSEMBLYMAN FRELINGHUYSEN: Excuse me. Assemblyman Watson, Assemblyman Lance is recognized, and I will recognize--

ASSEMBLYMAN WATSON: But before we go to the exhibit he was holding up, I want to ask a question.

ASSEMBLYMAN FRELINGHUYSEN: A question on the--

ASSEMBLYMAN WATSON: Can you hold it up so that we can see it? What is crossed out at the top there?

MR. MONTALBANO: Well, it is the words "New Jersey." I wrote it in the wrong place. Here.

ASSEMBLYMAN FRELINGHUYSEN: We will get a copy of this.

Assemblyman Lance, you have some questions?

ASSEMBLYMAN LANCE: Yes.

ASSEMBLYMAN WATSON: This is not from the Treasurer's report.

UNIDENTIFIED MEMBER OF COMMITTEE: I don't know where it is from.

ASSEMBLYMAN FRELINGHUYSEN: Well, if we can get a copy of whatever you have and include it in the record, please.

Assemblyman Lance.

ASSEMBLYMAN SMITH: It is kind of a radical concept, but I would like to know what we are including in the record. I mean, we have a chart. There is no source of it. The title has been crossed out. We can't find it in the Treasurer's report. I mean, it is a minor point, but I would like to know what it is we are including in the public record, and who calculated it.

MR. MONTALBANO: It's securities data, sir. The same people who did all of the other calculations. It was calculated on April 8, 1993.

ASSEMBLYMAN R. SMITH: Where is it from?

MR. MONTALBANO: I had it in the papers with me. I have used it all along. I can't imagine that I didn't get it from a package I was sent. But, to be honest with you, it is not really that relevant. You can draw the same calculations from your-- I think it's Exhibit 2. It just gives you the data going back for a longer period of time, and it breaks it out by component category.

ASSEMBLYMAN FRELINGHUYSEN: Assembly Lance, if you could continue the questioning.

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman. Mr. Montalbano, I would like to change the topic for a moment, if I might?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN LANCE: Regarding the reinvestment of the bond proceeds, short-term--

MR. MONTALBANO: Yes, sir?

ASSEMBLYMAN LANCE: By Lazard.

MR. MONTALBANO: Yes, sir?

ASSEMBLYMAN LANCE: After Lazard was the lead underwriter initially-- I am talking about after the bond refinancing occurred.

MR. MONTALBANO: We're talking about New Jersey, not Kentucky or--

ASSEMBLYMAN LANCE: No, sir, we're talking about New Jersey. The general bond refinancing that occurred in New Jersey in 1992, with Lazard taking the lead. My questions relate specifically and exclusively to the reinvestment of those proceeds, short-term.

MR. MONTALBANO: Yes, sir?

ASSEMBLYMAN LANCE: You're following me and where I am?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN LANCE: As I understand it, Lazard reinvested those proceeds temporarily without a competitive bid. This is the first time in the history of New Jersey that

that was done without a competitive bid, against the recommendations of two experts within our own State government, Messrs. Lurie and Machold.

My question to you, based upon your experience, is: What are the financial and fiduciary problems with such an arrangement?

MR. MONTALBANO: Well, there is a fiduciary responsibility that the financial adviser has to his customer, and it is hard for me to understand how the financial adviser can therefore do something that would oppose, or might potentially oppose, the interests of the issuer. That happens in this case very clearly, because Lazard Freres, knowing that they were going to get the securities, or that they might get the securities, had an advantage in setting up the spread -- the trade that gets put on to absorb all those securities into the Treasury market, or to prepare to sell the securities.

Now, as a result of that transaction there may or may not be large profits. I don't know what the words "excess profits" mean, but there could be very large profits. And my response is, as a banker, that either those profits should be remitted back to the bank -- or, excuse me, the profits should be remitted back to the issuer, or at least the responsibility for taking over -- for taking competitive bids, or breaking up the size of the issue, had a cost to it, and that cost had to be weighed against letting Lazard do it. There is no reason for letting Lazard, by themselves, undertake that issuance. It is contrary to the purpose of the financial adviser's responsibility to the issuer.

Now, you could argue that the financial adviser wasn't willing to forego his responsibility at that time, and the relationship ended. I don't know the details of the relationship between Lazard and the State.

ASSEMBLYMAN LANCE: Through you, Mr. Chairman-- I do not know how much Lazard made on the temporary reinvestment of

the bond proceeds. I cite The Wall Street Journal article of May 2, 1993, a page 1 article.

ASSEMBLYMAN FRELINGHUYSEN: A copy of which we would like included in the record.

ASSEMBLYMAN LANCE: A copy which I would like to include in the record, written by Laurie Cohen and Michael Siconolfi, where it is quoted: "Lazard earned more than \$10 million as lead manager of a \$1.8 billion New Jersey State bond issue last December, according to individuals with knowledge of the fees."

I am the first one to recognize that that is pure speculation on the part of The Wall Street Journal and would be hearsay in a court of law. But I intend to ask State officials this afternoon precisely how much money Lazard earned on the temporary reinvestment, and I hope they can provide me with that information. I believe it is the right of the taxpayers of this State, and of the Legislature, to know how much money was made. I recognize -- and certainly Assemblyman Smith will point this out -- that the newspaper account is hearsay, but I do want to know how much Lazard made.

Number two, I understand Lazard is not a primary dealer, which is a Federal Reserve designation.

MR. MONTALBANO: Yes, sir. To the best of my knowledge, it isn't.

ASSEMBLYMAN LANCE: What is the significance of this designation as it relates to Lazard's reinvesting of the bond proceeds?

MR. MONTALBANO: The designation refers to the fact that the Federal Reserve has approved, through capital commitment, through sales force, through general effort in the area, an individual firm to be a recognized dealer, which means they have a direct wire to the Federal Reserve Board, to a Federal Reserve bank borrowings, and that they are expected to

be market-makers all the time. There are over 40 of these dealers in the banking community, and I believe Lazard is not one of them.

ASSEMBLYMAN LANCE: And then, Mr. Montalbano, this is for the purpose of purchasing "T" bills, or whatever.

MR. MONTALBANO: Treasury bills, Treasury bonds, Treasury notes.

ASSEMBLYMAN LANCE: And it is your professional judgment that those who are "primary dealers" under the designation of the Federal Reserve are better able to handle the purchase of Treasury securities than would otherwise be the case?

MR. MONTALBANO: Right. Furthermore, I don't believe they have a derivative desk, and if the transaction was to be handled through interest rate swaps or anything like that to achieve the most effective rate, that could not have been done either.

ASSEMBLYMAN LANCE: I am not aware if the short-term temporary reinvestment included swaps, which, as I understand it, is more sophisticated. Perhaps we can ask the officials this afternoon, so I will not pursue that at this time.

Thank you, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Lance. I believe Assemblyman Smith had some questions.

ASSEMBLYMAN R. SMITH: We're still having difficulty finding that chart in the Treasurer's report.

ASSEMBLYMAN FRELINGHUYSEN: If the Chair can try to clarify, all I read at the bottom of the sheet that has been given me, which the witness has been good enough to provide, is that the source is the Securities Data Company, dated 4/8/93. I may have led, or maybe the witness may have led the Committee to believe it was--

ASSEMBLYMAN R. SMITH: Part of the Treasurer's report.

ASSEMBLYMAN FRELINGHUYSEN: --included as part of the Treasurer's report. If, in fact, it isn't, I presume there must be some verifiable source, and if we can provide the Chair--

ASSEMBLYMAN R. SMITH: I don't doubt that the information is probably accurate, but Mr. Montalbano offered it to say that the Treasurer's figures don't add up.

MR. MONTALBANO: Only these are not the numbers.

ASSEMBLYMAN R. SMITH: These are not the Treasurer's figures.

MR. MONTALBANO: These are not the numbers I used either. Exhibit 7's were the numbers I used.

ASSEMBLYMAN FRELINGHUYSEN: Excuse me, gentlemen, through the Chair. Assemblyman Smith, you wanted to--

ASSEMBLYMAN R. SMITH: The point I am trying to make, Mr. Chairman, is that for whatever disregard, and I thought he said, "I am offering this as a-- It came from the Treasurer's report. I used it to analyze the Treasurer's numbers, and the Treasurer's numbers--" I wrote it down: "I had trouble making things work with regard to these exhibits." He then took this out and said, "The numbers don't add up." This is not part of the Treasurer's report. I don't think the Treasurer should be held responsible for something he didn't prepare. Whatever Mr. Montalbano said about this not concerning the Treasurer's number, I think is basically irrelevant. It has nothing to do with what we are doing today.

I would also note--

ASSEMBLYMAN FRELINGHUYSEN: Excuse me, Mr. Smith. I think the witness obviously has the ability to react to that. He can make his point again. I think he was saying, in fact, that the figures that have been submitted to the Committee in this voluminous report are, at best, questionable if, in fact, the basis for the figures that we were given do not include all the types of securities and bonds and whatever that may have,

in fact, been included in the overall statistics, and in some cases they may not have been included.

ASSEMBLYMAN R. SMITH: Well, I listened to it. I listened to the testimony; I looked at the chart. I noticed this was a fax. Who was this fax from?

MR. MONTALBANO: I think everything I received was faxed.

ASSEMBLYMAN R. SMITH: Faxed from whom?

ASSEMBLYMAN FRELINGHUYSEN: Mr. Smith, this isn't some sort of a court of law; again, let me just remind you.

ASSEMBLYMAN R. SMITH: It might help to identify where the chart is from.

ASSEMBLYMAN FRELINGHUYSEN: The witness is making a point. If he--

MR. MONTALBANO: Okay. Sir, I guess it was faxed from Securities Data.

ASSEMBLYMAN FRELINGHUYSEN: Gentlemen, the witness has provided some information. We are going to try to verify the source. If, in fact, he makes his point using this as a source, with or without it--

ASSEMBLYMAN KAMIN: The source has been identified.

ASSEMBLYMAN FRELINGHUYSEN: Yes.

ASSEMBLYMAN R. SMITH: Well, let me ask Mr. Montalbano: On the witness list, they have listed as your title-- It says: Fourth speaker, Mr. Carmello Montalbano, Former Public Finance Professional. What is your current affiliation?

MR. MONTALBANO: I have my own company.

ASSEMBLYMAN R. SMITH: What is the name of that company?

MR. MONTALBANO: I actually have two. BHN is the first.

ASSEMBLYMAN R. SMITH: That is a corporation in the State of New Jersey?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN R. SMITH: Okay. And what does that corporation do?

MR. MONTALBANO: The company has built the largest expert witness -- full bond training program in the country.

ASSEMBLYMAN R. SMITH: Expert?

MR. MONTALBANO: Excuse me, expert user program.

ASSEMBLYMAN R. SMITH: What does that mean?

MR. MONTALBANO: It means anybody, including anybody at this desk, who has never traded municipal bonds, can walk up to the desk under the name of "Securities" and evaluate the securities -- evaluate its effect on your portfolio; evaluate it by any one of these categories or any other categories I have. Should I go on? There is \$25 million under management, sir.

ASSEMBLYMAN R. SMITH: Investment oriented. I understand it. The second corporation?

MR. MONTALBANO: Carmello Montalbano & Company.

ASSEMBLYMAN R. SMITH: And what does that do?

MR. MONTALBANO: It is an investment advisory business.

ASSEMBLYMAN R. SMITH: For whom?

MR. MONTALBANO: For myself.

ASSEMBLYMAN R. SMITH: Yes, but what clients do you service?

MR. MONTALBANO: Basically, right now, it is like a stock trade for my own account and a couple of close friends.

ASSEMBLYMAN R. SMITH: So it is a personal financial investment firm?

MR. MONTALBANO: Correct.

ASSEMBLYMAN R. SMITH: Have you advised the government-- Have you been hired by any government -- State of New Jersey, township, county, etc. to do any of their public financing?

MR. MONTALBANO: I did advisory work-- Let me explain something: Most of my time was spent-- I did four things: I was in charge of the Derivative Products Group--

ASSEMBLYMAN R. SMITH: Where are we talking about now?

MR. MONTALBANO: Dillon Reed.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Smith, I think I read in my introduction that the witness had established business credentials. He has worked for a variety of firms. He, in fact, appears to be involved in two firms that he heads up and that have considerable assets that they manage.

ASSEMBLYMAN R. SMITH: Not to be disputatious with the Chair--

ASSEMBLYMAN FRELINGHUYSEN: I knew that. It is not your nature, Assemblyman, I know.

ASSEMBLYMAN R. SMITH: However, both of the enterprises that Mr. Montalbano has described -- the first an advisory firm and a firm that is involved in trading bonds -- do not provide him with any credentials to provide advice with regard to government or public financing.

MR. MONTALBANO: Sir, may I answer that?

ASSEMBLYMAN FRELINGHUYSEN: I am going to let the witness respond. Thank you, Assemblyman.

MR. MONTALBANO: Sir, as a Vice President and Senior Vice President of Dillon Reed, I made many, many calls on customers, including the New York City MTA, New York City--

ASSEMBLYMAN R. SMITH: Okay. Let me ask you a question on that. You worked for Dillon Reed?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN R. SMITH: How long did you work for them?

MR. MONTALBANO: Nine years.

ASSEMBLYMAN R. SMITH: And you said you called on customers. What was your function?

MR. MONTALBANO: I would accompany the public finance people in explaining the marketing and the trading and the promotion of public finance deals. I also gave them several marketing ideas, which would then be turned into public finance ideas. There is not a strong separation between marketing and public finance, sir.

ASSEMBLYMAN R. SMITH: Okay.

ASSEMBLYMAN FRELINGHUYSEN: I need specific questions of the witness, Assemblyman.

ASSEMBLYMAN R. SMITH: Yes. If I might, I would like Mr. Montalbano to take a look at Exhibit 7 of the Treasurer's report, which is the finance--

MR. MONTALBANO: Look at what?

ASSEMBLYMAN R. SMITH: Exhibit 7--

MR. MONTALBANO: Okay.

ASSEMBLYMAN R. SMITH: --of the Treasurer's report, which is the overview of the \$1.8 billion refinancing, the subject of this hearing.

MR. MONTALBANO: Can you tell me what page you're on?

ASSEMBLYMAN R. SMITH: What's that?

MR. MONTALBANO: Which page?

ASSEMBLYMAN R. SMITH: Exhibit 7 of the August 27 transmittal.

MR. MONTALBANO: Okay.

ASSEMBLYMAN R. SMITH: It's page 28.

UNIDENTIFIED MEMBER OF COMMITTEE: Page 28?

ASSEMBLYMAN R. SMITH: Yes.

MR. MONTALBANO: Okay.

ASSEMBLYMAN R. SMITH: Okay. As I understood your testimony, basically it seemed to account for three areas where you thought this might have an interest on this refinancing, or at least there were three areas where I have an interest; that is: Number one, with regard to the spread and the fees paid to the underwriters-- On page 28 you have a list of all the managers/underwriters and the fees that they have received. Have you had a chance to take a look at that exhibit?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN R. SMITH: Okay. Is there anything on that page that is untoward or not normal with regard to any bond financing of \$1.8 billion?

MR. MONTALBANO: I think I might have examined the possibility of issuing this as three sets of competitive bond deals, if that were possible to do at the time. If you did that you could reduce the spread to maybe just over \$6.

ASSEMBLYMAN R. SMITH: Say that again slowly.

MR. MONTALBANO: You should have been able to reduce-- You might have considered-- You are asking me, anything untoward? Perhaps not. It is a call by the banker. But you see a spread per bond of \$7.54.

ASSEMBLYMAN R. SMITH: What you are saying is that hypothetically maybe something could be done, but on its face you see nothing wrong with those fees. Is that correct?

MR. MONTALBANO: Right.

ASSEMBLYMAN R. SMITH: Okay. With regard-- You said, "The Committee shouldn't focus all its attention on spreads"--

MR. MONTALBANO: Right.

ASSEMBLYMAN R. SMITH: --and secondly, "You might want to take a look at interest rates, that there may be -- that bases points could be some incentive to the underwriters in the transaction." Was that your testimony?

MR. MONTALBANO: What do you mean "incentive"? No, no, no. I'm saying it is out of their hands as a result of bad decision making. It can result in higher interest rates. They are not doing it on purpose. They can't benefit from--

ASSEMBLYMAN R. SMITH: Okay. Do you have any knowledge that in this bond transaction -- the \$1.8 billion refinancing -- that there was any bad decision that resulted in higher interest rates?

MR. MONTALBANO: That is an impossible question to answer, sir.

ASSEMBLYMAN R. SMITH: Yes, but that is what you put on the table before. You said that could have happened. I'm asking you, "Did it happen?"

MR. MONTALBANO: What do you mean, "that could have happened"?

ASSEMBLYMAN R. SMITH: Your earlier testimony, as I understood it, was that if bad decisions are made, the issuing authority may pay higher interest rates.

MR. MONTALBANO: Okay, but you referred to, and the way you used "interest rates" as the nominal interest rate that floats throughout the country--

ASSEMBLYMAN R. SMITH: What did you--

MR. MONTALBANO: I'm saying-- I'm talking about the relationship of the cost of doing business in New Jersey -- the interest rate premium that comes over and above or underneath an interest rate.

ASSEMBLYMAN R. SMITH: Whichever interest rate you want to talk about.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Smith, through the Chair, please.

ASSEMBLYMAN R. SMITH: Through the Chair, do you have any specific knowledge that the people of New Jersey suffered an adverse interest rate of whatever type you described in this bond transaction?

MR. MONTALBANO: No, sir.

ASSEMBLYMAN R. SMITH: All right. Your last comment was with respect-- The last area that I thought was germane to the discussion was in response to Assemblyman Lance's question with regard to the financial adviser having the ability to reinvest the short-term proceeds of the bond sale. That apparently is where we are focusing now our attention today. Perhaps that--

ASSEMBLYMAN LANCE: Well, that is where I am focusing.

ASSEMBLYMAN R. SMITH: Yes, all right. With respect to that, were you a party to the negotiations between the Treasurer and the financial adviser?

MR. MONTALBANO: Of course not.

ASSEMBLYMAN R. SMITH: Okay.

ASSEMBLYMAN FRELINGHUYSEN: May I say, also for the record, that this Committee was not party--

ASSEMBLYMAN R. SMITH: Right.

ASSEMBLYMAN FRELINGHUYSEN: --and, as a matter of fact, had to wait nine months to even be party to it.

ASSEMBLYMAN R. SMITH: I am anxiously awaiting the Treasurer's arrival so we can find out exactly what was said and what the considerations were. But the hypothetical that was--

ASSEMBLYMAN FRELINGHUYSEN: Excuse me, Assemblyman. It is a sad commentary that we have had to wait for so long, even after voluminous materials, to get satisfactory testimony hopefully coming out of oral testimony.

ASSEMBLYMAN R. SMITH: Chairman, as you know, we have different views on that.

That being said, your earlier testimony in response to Assemblyman Lance's question, as I understood it, was that that act allowing the financial adviser to reinvest the short-term funds was a breach of fiduciary duty. Was that your statement?

MR. MONTALBANO: Whose fiduciary responsibility?

ASSEMBLYMAN R. SMITH: The financial adviser's.

MR. MONTALBANO: No. I think I said there was a conflict of interest.

ASSEMBLYMAN R. SMITH: I thought you went further and said, "breach of fiduciary responsibility," but I will take conflict of interest.

MR. MONTALBANO: Wait, wait, wait, wait, wait. I am not a lawyer. That is very, very important to understand here. I am not making claims as a lawyer. I'm saying that certainly it would be an ethical consideration. It is a point that had to be considered ethically, perhaps legally, perhaps morally. I don't know.

ASSEMBLYMAN R. SMITH: Do you know whether or not the financial adviser may have been able to offer to the State of New Jersey anything of value to the public of the State of New Jersey, with regard to allowing him to reinvest the short-term proceeds?

MR. MONTALBANO: What?

ASSEMBLYMAN KAMIN: Wouldn't that be a question for Mr. Crane, Assemblyman?

ASSEMBLYMAN R. SMITH: Yes, it really would, but I think what I am trying to point out-- Maybe I can just say it as opposed to a lengthy interrogation.

Mr. Montalbano is not in a position to say, in response to Assemblyman Lance's question, that allowing the short-term proceeds to be invested and the proceeds to go to the financial adviser is, in and of itself, an act that is either a conflict of interest, immoral, unethical, or illegal, because we really don't know what the considerations were in the Treasurer's mind. That particular set of testimony on the record is, I think, something that has to be challenged. That was the point of this.

ASSEMBLYMAN KAMIN: And how nice it would be, Mr. Smith, to see--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Kamin?

ASSEMBLYMAN KAMIN: How nice it would be if we, in fact, had that information from the Treasurer.

ASSEMBLYMAN R. SMITH: Well, we are going to get that shortly.

ASSEMBLYMAN KAMIN: I mean, that is exactly why there is a Federal inquiry into what is going on in New Jersey.

ASSEMBLYMAN WATSON: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: Gentlemen--

ASSEMBLYMAN R. SMITH: Mr. Chairman, while I know that is true--

ASSEMBLYMAN WATSON: Mr. Chairman, we are not going to--

ASSEMBLYMAN FRELINGHUYSEN: Gentlemen, gentlemen. Assemblyman Smith, Assemblyman Watson--

ASSEMBLYMAN WATSON: I would just like to be-- On the same question--

ASSEMBLYMAN FRELINGHUYSEN: The Committee witnesses, as well--as the people on this Committee, obviously, as Assemblyman Smith so stated-- We all have our right to--

ASSEMBLYMAN R. SMITH: Right.

ASSEMBLYMAN FRELINGHUYSEN: --our opinions. Obviously, this gentleman's perspective comes from his line of work and experience. We can weigh that, as we will what we hear from the Treasurer later this afternoon.

ASSEMBLYMAN WATSON: Mr. Chairman, could I just--

ASSEMBLYMAN LANCE: Mr. Chairman?

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Watson?

ASSEMBLYMAN WATSON: Yes, thank you.

ASSEMBLYMAN R. SMITH: I think the last comment I will make, Mr. Chairman--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman, your good colleague wants just to be recognized -- Assemblyman Watson.

ASSEMBLYMAN R. SMITH: Oh, I'm sorry.

ASSEMBLYMAN WATSON: Yes, if you don't mind, Assemblyman Smith. You know, I think what we are after here--

ASSEMBLYMAN FRELINGHUYSEN: Use the mike.

ASSEMBLYMAN WATSON: Oh. You were sure-- You implied there could be something wrong here in your statement in regard to what has taken place. I think what the Assemblyman is asking you is: In what areas are you implying there was something wrong?

MR. MONTALBANO: Okay. Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Watson. Do you care to respond to that?

MR. MONTALBANO: Could I just have a short-- When I first came up, the point I was really trying to make was, I think the type of questions and the focus so far isn't really the focus that is going to answer what I have read might be the problem. I don't know-- I know places to look; I know what I have read; I know what some numbers look like to me. All I am saying is, it is just the wrong path to go down.

The questions here are questions of judgment and people; they are not questions of structure. And structure, frankly-- If you want to improve everything right away, I think one thing you could do very quickly would be to empower all the boards of all the different authorities to have something more-- Let them have some liability in the structure that is being developed, so that if there is a problem with it, they will be on top of it and somebody will say something to someone else.

Maybe that is for another time. But I feel very strongly that my presence here was not meant to be particularly valuable, but to try to raise as many of the issues as I could find reading those documents, writing them down on a piece of paper, and I would be glad to share them with anybody. I am not out to make political points.

ASSEMBLYMAN FRELINGHUYSEN: Thank you for your response.

Assemblyman Smith?

ASSEMBLYMAN WATSON: Mr. Chairman, could we have that-- The document he has, would he like to share it with us, and could we make that part of the record?

ASSEMBLYMAN FRELINGHUYSEN: I think what he is referring to is not only the document that we have a copy of, but also the reports that have been submitted -- both of those reports.

Assemblyman Smith, and then Assemblyman Russo.

ASSEMBLYMAN R. SMITH: By way of a concluding comment on Mr. Montalbano's testimony, if Mr. Montalbano in his last testimony is now saying that he is not suggesting that there was a conflict of interest, but rather a question of judgment, that is certainly less offensive. It is saying that the Treasurer of the State of New Jersey acted -- or hired someone in a fashion that presented a conflict of interest to the people of the State of New Jersey. I would point out that Mr.

Gerald McBride, the gentleman who preceded Mr. Montalbano, said exactly the opposite with regard to the reinvestment of the proceeds -- the short-term proceeds. That absolutely could be a consideration in the negotiations -- in a privately negotiated transaction for which the State of New Jersey may have received consideration.

I look forward to the Treasurer being present, as well.

ASSEMBLYMAN FRELINGHUYSEN: Okay. Thank you, Assemblyman.

Assemblyman Lance, a point of order. Then Assemblyman Russo.

ASSEMBLYMAN LANCE: I certainly do not intend to ask the Treasurer this afternoon, nor did I imply in any way in my remarks, whether or not it was immoral. I can't imagine that it was. My questioning will focus on how much it cost us, \$10 million -- the taxpayers -- \$2 million, \$1 million. And second, whether this is the first time it happened in the history of the State -- it appears from the records so far, over the objections of Messrs. Lurie and Machold.

There may be legitimate answers to all of these questions, but I certainly am not implying the immorality of anyone.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman.

Assemblyman Russo, do you have some questions of the witness? Thank you for your patience.

ASSEMBLYMAN RUSSO: Yes, just a few more in one particular area. What I would like to do is direct your attention to the August 27 report of Treasurer Crane, Exhibit 10, which is a three-page enclosure. It is really a copy of a fax from Lazard Freres, who was the lead underwriter in the December \$1.8 billion refunding. To quicken this, I would say to just focus on page 1 -- and that goes for the entire Committee -- which deals with about 99 percent of the

allotment. This is entitled, "Total Designations and Allotment," of the refunding bonds. Do you have a copy of that? If you need one, I'll hand you one.

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN RUSSO: Okay.

ASSEMBLYMAN FRELINGHUYSEN: For the Committee's purposes, would you again highlight that section so we have that--

ASSEMBLYMAN RUSSO: It's Exhibit 10 in the August 27 report called, "Total Designations and Allotment," of the refunding bonds, Series D, December '92. Okay? Three pages. The first page deals with about 99 percent of the allotment, so we are going to deal with the first page.

Now, if you can help with this, fine; otherwise, I will ask the Treasurer directly. The first thing: In the report, the Treasurer talks about holding back, or, he calls it a pool. In fact, the final column is, "Pool Allocation." Of about the 15 percent of fees derived from the institutional orders -- and it says that this back pool of fees was allocated to specific bond dealers.

Now, what I don't understand, and maybe you could explain, is: What is the difference between your first group here, which are seniors and co-seniors; then you have these three tiers; then those percentages, which I think I understand, as opposed to the pool allocations? What is a pool allocation, and what do these numbers correspond with?

MR. MONTALBANO: Okay. What you see in each one of those categories -- senior, co-senior, comanager, Tiers 1, 2, and 3 -- is the percentage of risk -- underwriting risk that each is going to take. That is their percentage of the deal that they are underwriting.

ASSEMBLYMAN RUSSO: So underwriting participation is the first column, I guess, or part underwriting share?

MR. MONTALBANO: Underwriting participation, yes, sir.

ASSEMBLYMAN RUSSO: Okay. So Lazard was 30 percent of the entire deal, meaning they had 30 percent of the bonds, I guess?

MR. MONTALBANO: Yes. The senior and co-seniors is not-- Those are fairly typical, I would guess.

ASSEMBLYMAN RUSSO: Okay. That was 70 percent for those senior and co-seniors, it looks like, under that bracket?

MR. MONTALBANO: Yes, sir.

ASSEMBLYMAN RUSSO: Then the next bracket is Tier 1, what they call comanagers here. It is 15 percent in that next bracket, even when distributing 2 percent each about. Is that right?

MR. MONTALBANO: Correct.

ASSEMBLYMAN RUSSO: Okay. Tier 2, about 7.5 percent, meaning half of Tier 1, about 1.50 each; Tier 3, half again, 7.5 percent. Okay.

What is this pool? What is pool allocation? Have you ever heard of it, or retention, and if you have, I would like you to explain it?

MR. MONTALBANO: Okay. Retention is simply-- It is one of the reasons to have negotiated deals. If a deal-- Let's suppose you buy -- you bring an issue for the State of New Jersey and immediately the market interest rates skyrocket. People are not going to be selling their bonds in panic to get out of their positions. What they can do is, the manager will control the situation by now making them free to trade. But what happens also in retention is, when the new issue comes, to get the deal started-- Let's say I am the senior manager on a deal like this and I tell each of you, "At the outset of the deal you are going to have 10 million bonds each to work with." A mutual fund likes to know that when he is buying bonds, he is buying bonds that you, the broker, really have. That is a retention bond.

The advantage of having a retention bond is, you don't really pay your money until the deal closes, but you have the risk for it -- but you know up-front how much risk you are going to have, and you are going to know that some portion of the bonds have been given to you, and you can go out and sell them now. Because it is possible that even though you are in a deal for 30 million bonds, you might only get three million or four million of the bonds and you don't want to be caught short. I won't say anymore about that.

What also happens is, when there are sales-- When the manager makes sales, let's say, to a Fidelity, Fidelity actually credits everybody in this account, or whoever they want to in this account, with some portion of the sale. In other words, Lazard wouldn't have gotten credit for 30 million bonds; they would have gotten credit for, maybe, five million bonds, and First Fidelity would get two million, and Paine Webber would get two -- anyway Fidelity wanted to do it.

But what started to happen was, the fellows in the lower tiers weren't getting any designations. So to make it more fair, if there was, let's say, \$6 in the selling concession, \$1 of the selling concession would be bundled, or added up, and then split equally among all the managers and members of the underwriting.

Then New Jersey took it a step further. I don't know who else has done this. I haven't found anybody. I did ask a friend of mine if he knew of anybody who did it. New Jersey then took that bundle of money and then started giving it to whoever they wanted to give it to. As you can see, they didn't give it to all the-- They didn't pool allocate among all the managers and comanagers. They only allocated among those they chose. And the result is as appears on the paper.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Russo?

ASSEMBLYMAN RUSSO: Yes. Should the pool allocations have some kind of coordination with the underwriting percentage?

MR. MONTALBANO: You would expect them to, yes.

ASSEMBLYMAN RUSSO: Okay. In the senior and co-senior, I see Lazard has a pool allocation of about 134,000 and no one else has anything. Is that right?

MR. MONTALBANO: That's what it says.

ASSEMBLYMAN RUSSO: Yes. Now, what I can't understand is, if in the next three tiers, which total 30 percent of the transaction, roughly -- those three tiers-- You have in Tier 1, under the comanagers, 610,000, as opposed to 100,000 in Tier 2, meaning six times that, and three times that in the next two tiers. Am I reading this correctly?

MR. MONTALBANO: That is correct.

ASSEMBLYMAN RUSSO: Okay. And in Tier 1, you have two companies having, in my view just looking at the numbers, numerically much larger shares. In fact, Cypress Securities here has nearly triple what Lazard, as the lead, does, and Cypress is a company -- if I read the other column right -- with 2.1 percent of the deal. Is that the way to say it?

MR. MONTALBANO: Right.

ASSEMBLYMAN RUSSO: Now, in that same bracket I see First American-- I mean, I see 27 companies, if I just added them right here, on this page -- 27 firms, and I have two companies in Tier 1 getting more than all the rest combined virtually. Now, can you see--

Now again, from your point of view as someone in the business, you understand, I guess, these middle columns -- "Allotment," "Designation," "Total Bonds," and "Total Revenue." What I am asking you is: Do you see anything that would lead you to look at these 27 companies and wonder why one would far outstrip all the others under the pool? I mean, can you see anything from this sheet?

MR. MONTALBANO: No, sir.

ASSEMBLYMAN RUSSO: Have you ever seen anything like this before in your experience where you have retention of maybe 11 percent or 15 percent, as the State Treasurer put in

the report? You've got the bulk of it going to one company. I see underneath that the second largest figure for retention going to somebody, and it looks like -- and again, correct me -- the allotment of bonds is zero. Can you tell from here what was sold, what bonds actually were sold, or do you need the order tickets when you buy stock? Because I don't see any listing of the order tickets, and I have asked the State Treasurer for the order tickets on all these securities. I have gotten no answer.

But I am asking you: Is there any way you, as an expert, could figure this out from this chart?

MR. MONTALBANO: No, sir. All I can--

ASSEMBLYMAN RUSSO: Yes?

MR. MONTALBANO: I don't know Cypress Securities; I don't know Enright & Co. Enright may have put in for securities or may not have put in for securities and they got none. Somebody knew they were around, because they got designations. That means that some institution wanted to give them \$500,000 worth of bonds. So their total sales were \$500,000, and they received about \$2600 on it.

I will skip the pool allocation for a moment. Cypress Securities received \$17 million in bonds. Now, I don't know what their capital requirement is, but if you have \$17 million in bonds when you settle on that trade, I believe you are supposed to have \$17 million to pay for it. I don't know what the arrangement is here. All I can say is, this is extraordinary. Let me say this: If they were a great marketing house, it's possible, slightly possible, though \$350,000 is what you make on a major deal.

ASSEMBLYMAN RUSSO: Right. I mean, have you ever seen a situation where a Tier 1 comanager--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman, through the Chair, please.

ASSEMBLYMAN RUSSO: I'm sorry.

ASSEMBLYMAN FRELINGHUYSEN: Go ahead with the question.

MR. MONTALBANO: What is the question?

ASSEMBLYMAN RUSSO: Have you ever seen a situation where, if the term is a Tier 1, they get comanager whether it is tiers or not -- would have three times what the senior would, or co-senior, on a pool allocation?

MR. MONTALBANO: Well, I would think in a pool allocation-- A pool allocation, if the purpose is similar to that of the retention--

ASSEMBLYMAN RUSSO: Right.

MR. MONTALBANO: --nobody in the senior or co-senior would get very much.

ASSEMBLYMAN RUSSO: Okay.

MR. MONTALBANO: But with regard-- No. I mean, obviously this doesn't make sense.

ASSEMBLYMAN RUSSO: It doesn't make sense.

MR. MONTALBANO: I mean, particularly if-- I mean, you have to ask yourself this question, and this is a little bit like the question I was trying to make about the financial adviser: Is it in the best interest of the firm to pay somebody that you're paying them? In other words, if Cypress didn't have any real marketing ability, but Cypress had great, say, financial skills and they figured out a way to make the deal work a lot better, maybe you would want to pay them something. That is a big number to pay them, \$350,000, but you might want to do it. But if they don't have marketing and they don't have financial acumen, I don't know. I couldn't explain that payment, sir.

ASSEMBLYMAN RUSSO: Okay. Because what bothered me-- That chart behind the Chairman is a chart of that tier. If you looked at 2.1 percent, those companies would have all had equal -- I'll use the term "pieces of the pie." That is the way it ends up, that tier, with regard to the pool. Fifty-seven percent one company, which is Cypress; 22 percent another; and the rest is 21 percent cut up that way.

MR. MONTALBANO: Okay.

ASSEMBLYMAN RUSSO: That is to demonstrate, because I couldn't understand it. I have looked at this. I have asked for this fax for four months, but I found it in this report finally.

If the answer is that you can't answer, that's fine. Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Anything further, Assemblyman? Any other questions for the witness?

ASSEMBLYMAN R. SMITH: Just a point to be helpful to the Assemblyman.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Smith?

ASSEMBLYMAN R. SMITH: On page 3 of the summary, the last two paragraphs of Section II, I think, answer your question.

ASSEMBLYMAN RUSSO: On this fax, Bob?

ASSEMBLYMAN R. SMITH: No, on the Treasurer's report of the 27th.

ASSEMBLYMAN RUSSO: Page 3 of the--

ASSEMBLYMAN R. SMITH: Page 3, the last two paragraphs of that-- It looks like Section Roman numeral II. I think that is the answer to your question.

ASSEMBLYMAN RUSSO: Okay. Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Thank you very much, Mr. Montelbano, for your testimony this afternoon.

We now anticipate the Treasurer, who is on his way up.

If the members will take their seats, we will continue this public hearing. The Chair would like to thank Treasurer Crane, Mr. Lurie, and I believe Mr. Machold may be here, for their participation in this segment.

If we could have your attention, we would like to start the hearing.

Mr. Treasurer, there are a number of questions that Counsel have asked that I ask for witnesses under oath. The first question being--

If the members will take their seats, and please give the Chair their attention-- Thank you. Assemblyman Smith, Assemblywoman?

Mr. Treasurer, good afternoon. Did you receive a subpoena from this Committee compelling your attendance at this hearing?

TREASURER SAMUEL F. CRANE: No.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that the Chairman of this Committee has the authority to administer an oath or affirmation to a witness in any matter now pending before this Committee?

TREASURER CRANE: Yes, I do.

ASSEMBLYMAN FRELINGHUYSEN: Have you received a copy of the Code of Fair Procedure here today before testifying before this Committee?

TREASURER CRANE: Yes, I think-- Let me check. Yes, I did.

ASSEMBLYMAN FRELINGHUYSEN: The Code of Fair Procedure gives you certain rights as a witness testifying under oath here today before this Committee. For example, you have the right to be accompanied by counsel who may advise you of your rights during the proceeding. Do you have counsel present here today?

TREASURER CRANE: No, I don't.

ASSEMBLYMAN FRELINGHUYSEN: Do you agree to testify here today without having counsel present here with you?

TREASURER CRANE: Yes, I do.

ASSEMBLYMAN FRELINGHUYSEN: Under the Code of Fair Procedure, you also have the right, at the conclusion of your examination by this Committee, to file a brief sworn statement relevant to your testimony for incorporation in the record of this investigatory proceeding. You are advised that we are making a tape recording of this proceeding, and you are entitled to receive a copy of your testimony, at my expense, which may be considerable by now.

TREASURER CRANE: That's a refreshisng thought, Mr. Chairman, that you are going to pay for it.

ASSEMBLYMAN FRELINGHUYSEN: Yes. You also have the right to request a copy of the resolution authorizing this investigation. Do you have any questions concerning the Code of Fair Procedure or your rights under the law?

TREASURER CRANE: No, I don't, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Do you have any questions about the proceeding today?

TREASURER CRANE: No.

ASSEMBLYMAN FRELINGHUYSEN: If you would be good enough to raise your right hand, Mr. Treasurer?

TREASURER CRANE: I do have one question, Mr. Chairman. I would like to just take a minute to make a brief statement before being placed under oath.

As you know, I am appearing before the Assembly Appropriations Committee today voluntarily and in keeping with this administration's commitment to cooperate fully with you in this inquiry. Notwithstanding yesterday's Assembly discussion about the exercise of subpoena power, there was no need to compel me to appear before you. Nor, Mr. Chairman, is there any need to place me under oath.

I have testified fully and honestly in my previous appearances before this Committee and other legislative committees, and intend to do so today. I want to let you know that I deeply regret, and strongly resent, the suggestion that placing me under oath is necessary for the Committee to receive truthful and responsive testimony from me.

Mr. Chairman, I think you realize that the oath is unnecessary, and I can only conclude that the purpose of swearing me has more to do with theater than substance. Despite those feelings, I will agree to be sworn so as to avoid yet another distraction in what I hope will be a hearing that deals fairly with the facts.

ASSEMBLYMAN FRELINGHUYSEN: Thank you for your comments. If you would please raise your right hand? Do you solemnly, sincerely, and truly declare and affirm that the testimony that you will give in these matters now pending before this Committee shall be the truth, the whole truth, and nothing but the truth?

TREASURER CRANE: I affirm.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that if the statements you make today are willfully false you may be subject to penalties under the law, including monetary penalties and incarceration if you fail to answer a pertinent question or commit perjury, which is the making of a false statement under oath in an official proceeding such as this?

TREASURER CRANE: Yes, I do.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand this?

TREASURER CRANE: Yes.

ASSEMBLYMAN FRELINGHUYSEN: Is the testimony you are providing today given of your own free will?

TREASURER CRANE: Yes.

ASSEMBLYMAN FRELINGHUYSEN: Have you been directed or required by anyone to testify here today?

TREASURER CRANE: No.

ASSEMBLYMAN FRELINGHUYSEN: Counsel advises me we should also swear in Mr. Lurie, and I presume it would be probably advisable to swear in Mr. Machold. Mr. Machold is here, too?

ROBERT F. LURIE: I believe he is on his way. He has been notified to come.

ASSEMBLYMAN FRELINGHUYSEN: All right. I will have to, I guess, swear him in separately. May I ask Counsel-- I should run through the identical set of questions of Mr. Lurie. Did you receive a subpoena from this Committee compelling your attendance at this hearing today?

MR. LURIE: No, I did not.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that the Chairman of this Committee has the authority to administer an oath or an affirmation to a witness in any matter now pending before this Committee?

MR. LURIE: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Have you received a copy of the Code of Fair Procedure here today before testifying before this Committee?

MR. LURIE: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: The Code of Fair Procedure gives you certain rights as a witness testifying under oath here today before this Committee. For example, you have the right to be accompanied by counsel who may advise you of your rights during the proceedings. Do you have counsel here present today?

MR. LURIE: No, I do not.

ASSEMBLYMAN FRELINGHUYSEN: Do you agree to testify here today without having counsel present here with you?

MR. LURIE: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Under the Code of Fair Procedure you also have the right at the conclusion of your examination by this Committee to file a brief sworn statement relevant to your testimony for incorporation in the record of this investigatory proceeding. You are advised that we are making a tape recording of the proceeding, and you are entitled to receive a copy of your testimony. You also have the right to request a copy of the resolution authorizing this investigation. Do you have any questions concerning the Code of Fair Procedure or your rights under that law?

MR. LURIE: Not at this time.

ASSEMBLYMAN FRELINGHUYSEN: Do you have any questions about the proceedings today?

MR. LURIE: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: Is Mr. Machold here yet?
(no response) If not, I have some opening comments.

The second portion of this public hearing of the Assembly Appropriations Committee--

MR. BASARAB: Swear him in.

ASSEMBLYMAN FRELINGHUYSEN: Oh, yes, excuse me. I will swear you in.

Mr. Lurie, please raise your right hand. Do you solemnly, sincerely, and truly declare and affirm the testimony you shall give in the matters now pending before this Committee shall be the truth, the whole truth, and nothing but the truth?

MR. LURIE: Yes, I do.

ASSEMBLYMAN FRELINGHUYSEN: Is the testimony you are providing today given of your own free will?

MR. LURIE: Yes.

ASSEMBLYMAN FRELINGHUYSEN: Have you been directed or required by anyone to testify here today?

MR. LURIE: No.

ASSEMBLYMAN FRELINGHUYSEN: Thank you for being sworn in.

The second portion of this public hearing of the Assembly Appropriations Committee will continue as we move forward with our ongoing practice of examining and scrutinizing the State's bonding practices. The public record will show that this Committee has an established public track record in reviewing the State's debt issuances, a process which the Treasurer, his staff, and other members of the administration have participated in in the past. But these special hearings, and others which are likely to follow, became necessary after repeated requests for details about the State's \$1.8 billion bond refinancing deal were ignored for many months.

Some have suggested that our mission is political. It isn't. The citizens have a right to know if Governor Florio's appointees have acted in their best interest. The truth, even

at this late date, is necessary if the public's confidence in its State government is to be restored.

The process by which the State and its authorities issue bonds may be imperfect in many respects, but never in so many quarters where bonding is a common practice -- whether it be the Treasurer's Office, the New Jersey Turnpike Authority, the Sports and Exposition Authority, or the Health Care Facility Financing Agency -- have there been so many rumors of self-dealing, personal gain, and centralized management of both the fiscal and political details of bond issuances.

Last December you, Mr. Treasurer, on behalf of Governor Florio, had the bipartisan Joint Budget Oversight Committee take action on a highly complex Bond Refinancing Plan. This action was taken after weeks of badgering and suggestions that delays would be bad for New Jersey. For many of us who tried to slow down that scheme and the review process to allow the Legislature to fully understand the Plan you urged us to rush into, it is especially frustrating to be here today. Many of us thought back to when, late last fall, you had to be asked several times for additional information about those plans. But instead of coming forward with all the information we requested, you expected us to vote on trust and faith alone.

At that transcribed hearing you promised full disclosure after your office completed the deal. You gave us your word and, acting in good faith, we accepted your word. We even adopted, at my insistence, particular language in the Joint Budget Oversight Committee resolution reflecting this agreement. Almost nine months have passed, with at least four formal requests for data having gone unanswered by your office. Now at this late period in time we are finally getting some answers. But frankly, you did not keep your word to this Legislature or the citizens of New Jersey. In the meantime, the media has widely reported that probes have been launched

into the bonding practices of the Turnpike Authority, and documents have been subpoenaed from the Sports and Exposition Authority. It is also seen that the Federal Justice Department, specifically the Southern District Court of New York, the FBI, and the Securities Exchange Commission launched their own investigations into New Jersey's bonding practices on a variety of governmental levels. But, most disturbing, are those that the State Treasurer has a fiduciary role in.

This hearing, and others that follow, will attempt to get the answers to questions and inquiries that we have been making for several years about the State's bonding practices. We hope this public hearing will succeed in obtaining information where more routine and conventional requests for information have failed. The recent report which you submitted to the Legislature on bond underwriting fees, which was prepared, and I quote -- "which was prepared at the request of the Chief of Staff" -- unquote -- former or present I do not know which -- is wholly inadequate. Both that report and the one which followed raised more questions and provided very few answers. While comparisons between administrations are valuable, neither report does anything to remove the cloud of scandal that has plagued this administration for many months now.

The time has come to address specifically the issue of last year's Bond Refinancing Plan and the State's bonding practices in general. This discussion and examination will be conducted in this open forum. The people of New Jersey and the Legislature want and deserve answers to the questions which have been repeatedly asked of this administration.

Mr. Treasurer, I hope today is the beginning of a concerted effort by your office and the entire administration to clear the air about the numerous allegations and rumors relating to our State's bonding practices. The citizens of this State deserve nothing less from their government.

I believe you have a statement, Mr. Treasurer?

TREASURER CRANE: I do, Mr. Chairman.

Mr. Chairman, members of the Committee: Before I begin my formal testimony, I would like to make some personal observations about today's hearing.

During my years in Trenton, I have had the honor and privilege to work for and now work with members of this Committee. And while we may have disagreed, our dealings in the past have been conducted in an atmosphere of mutual respect and consideration.

I hope, Mr. Chairman, as we proceed today, that this same spirit will prevail. I would deeply regret being drawn into a series of exchanges which could damage our working relationship --solely for the purpose of advancing an agenda that's driven by the pressures of the current political season.

Let me begin. My testimony today addresses four issues:

- * The reports made public by this administration which outline our performance in reducing the cost of selling bonds.

- * The process and success of the Governor's Executive Order 92 reforms.

- * A history and discussion of the general obligation refinancing which took place last December.

- * And some recommendations for legislative actions on the subject of bond transactions.

This administration and Legislature have utilized capital investment to create jobs and spur economic activity through the Economic Development Authority, the Transportation Trust Fund, and other State programs, including programs to assist people to buy their homes and to rehabilitate schools.

In undertaking these capital investments, this administration has saved the taxpayers money by reducing underwriting costs. In addition, we have been successful in our efforts to include firms which have invested in New Jersey and firms that are owned by women or minorities.

These facts were documented and substantiated in the report I submitted to the Governor's Chief of Staff on August 27. In addition, on Friday I submitted another report on bond counsel and other fees. As far as I know, these public reports are the most comprehensive and public analysis of bond transactions that has ever been done by any state or any government entity.

The reports clearly show that this administration has responsibly managed State bond transactions, and that we have selected financial underwriters that are qualified to execute their particular roles in these transactions.

These reports show that this administration has saved the taxpayers \$72.8 million by reducing underwriting fees from an average of \$23.39 for every \$1000 in bonds in 1983, to an average of \$8.18 in 1992.

A striking example of this turnaround is evident at the New Jersey Turnpike Authority, which spent \$67 million in fees in issuing \$2.5 billion in bonds in 1984-'85, in contrast to the \$27 million that was earned by underwriters on the refinancing of \$2.9 billion in 1991-'92. In fact, one firm, Smith Barney, made over \$30 million on that transaction under the previous administration, which dwarfs the largest fee of \$3 million earned in the more recent transaction.

Our performance when compared to national and regional figures further demonstrates this administration's success. Since Governor Florio took office, New Jersey underwriting fees have been below the national average -- a reversal from prior years when the State paid more than average costs nationally. New Jersey also outperforms our neighbors by paying much less in underwriting fees than New York and Pennsylvania.

Mr. Chairman, I brought some charts with me today. They are included in the report. I know they were referred to earlier today in testimony, but I think -- and I have had an opportunity to listen to some of the earlier testimony today--

What is clear to me is that the cost of issuance in New Jersey has-- It has climbed nationally; I agree with the earlier testimony today. But we have, in the last two or three years, through what I think -- believe is very tough negotiating, gotten our fees below the national average. And frankly, when we started this particular project and started to look at our regional -- our neighbors, I was surprised. I thought that we would all be within the same range. I was pleased when I got this particular report, which shows how well we stack up against Pennsylvania and New York. I think it is a remarkable performance.

We have also been successful in opening up the business to New Jersey firms and those owned by women or minorities. Of the firms participating in negotiated bond sales between 1990 and August of 1993, 36 were New Jersey firms and 16 were owned by women or minorities. The business of public finance should not be limited to New York firms from Wall Street.

In and of itself, this is a sound record of achievement. However, this administration has gone one step further.

The Governor put in place the most aggressive reforms in the country through Executive Order 92. E.O. 92 requires competitive sales for all but a minority of uncommon bond transactions. It also has put into place the most competitive and open process for securing professional services for State bond work.

Mr. Chairman, I just want to review the process for a moment, because I heard some of the discussion and there seems to be some confusion about the operation in E.O. 92. So I think the Committee, in its consideration, ought to be taken right through the process.

The process, frankly, is rather simple. All bond transactions are to be done competitively, except when an

issuing authority asks for and receives from the Treasurer permission to undertake a negotiated sale.

I have granted some requests for negotiated transactions. The standards used to evaluate these requests are:

1. The transaction is particularly complex, or
2. The transaction is a low rated credit.

For both types of transactions, advance marketing is critical to their success.

Regardless of the transaction, whether it is a competitive sale or a negotiated sale, the bond counsels, financial advisers, and, in the case of negotiated sales, of course, the lead underwriters are selected by competitive bid.

The Department of the Treasury and the Attorney General's Office have requested prequalifications from all investment firms -- the Department of the Treasury did that -- and law firms -- from the Attorney General's Office -- that are interested in doing bond work in the State. Each firm's qualifications are evaluated for experience and expertise in particular kinds of transactions. When an authority or other issuer asks for a particular service to support a bond issue, all firms that may meet those needs are asked to bid.

The successful bidder is selected by a committee comprised of the issuing authority, the Treasury Department, and the Attorney General's Office. The decision process, therefore, weighs experience, ability, resources, and, finally, cost.

This process is fully competitive and completely open. In fact -- and I invite all the members of the Committee to come and review them, if they would like -- if you want to see any of the reports of the transactions completed under this system, they are available for public inspection.

The results have been dramatic. While I expected costs to be reduced further by instituting this competitive

process, the savings have been greater than I anticipated. For example, bond counsel costs have declined by about 50 percent. I have included a report on the first three months of this reform process for your review. This is our first and only report after three months under this process. I am very pleased with the success of it so far.

This report demonstrates that the Governor's Executive Order is being followed and is producing results. Before the Executive Order, 80 percent of the State's deals were negotiated and 20 percent were competitively bid. Since the Order took effect, this proportion has been reversed so that 85 percent of the deals have been competitively bid, with only 15 percent negotiated.

I am proud of this reform. I have also submitted to you a letter from a hospital which did its financing under the Executive Order 92 process. It speaks well for the effectiveness of this competitive process in selecting officials. I-- There was some-- I got that about two weeks ago, and I think that speaks for this.

While some people would prefer not to discuss E.O. 92, the simple fact is that no other jurisdiction anywhere has such an open and competitive process. The requirements of the Executive Order may even exceed MSRB standards.

Now let me turn to the next section of my testimony on the general obligation refinancing that took place last year. I know some on this Committee have questions about this transaction. So let me address those questions by retracing the history of the refinancing.

By September of 1992, the State had exhausted most of its capital funds. The legislative leadership and the Governor were rightfully concerned about constructing a capital program as a countercyclical measure against the continuing recession. In addition -- as many members, if not all members of this Committee know -- we did not have sufficient reserves. We did not have a Rainy Day Fund for emergencies.

These circumstances were of concern to me. I testified before the Joint Budget Oversight Committee during its consideration of this transaction about the need to create a capital program and a sufficient reserve, and to make a deposit into the Rainy Day Fund.

Another factor that was considered was the dramatic decline in interest rates.

For all these reasons, I revisited, in September, a proposal put forward by Lazard Freres to refinance State debt to fund a needed capital program, to rebuild our reserves, and provide a deposit for the Rainy Day Fund. I worked with Lazard to restructure their previous work on a refinancing proposal to match our then current needs. This resulted in an outline of a proposal for consideration by the administration and by the Legislature.

The first conversation I had with the Legislature on this specific proposal was on November 6, 1992. Mr. Chairman, you will no doubt remember a meeting was held in your district office with Senator Littell. I think on that occasion you also bought us lunch. The purpose of that meeting was to discuss the FY '94 budget and how to meet the State's fiscal obligations. During the course of that meeting, I outlined the refinancing proposal. You both agreed to take it under consideration.

This transaction required the approval of the Legislature. It required the approval of the Joint Budget Oversight Committee. The Chairman and Mr. Kamin are both members of that Committee, as well as Mr. Watson. All voted to approve the transaction.

In addition, the full Legislature approved legislation making the transaction possible. Those bills were sponsored by Assemblyman Bagger and Senator Littell. Every member of this Committee voted for that particular legislation.

The Chairman of this Committee and the Chairman of the Senate Appropriations Committee knew which professionals would be included as the principal underwriter and bond counsels in this transaction prior to the approval of the transaction by the Joint Budget Oversight Committee. I supplied this information in writing to them on November 25, 1992.

The lead underwriter, Lazard Freres, was selected because they brought the complex concept of this refinancing to the State. It has been an industrywide practice to grant business to those firms which develop new financing ideas the State chooses to pursue. It is both fair and appropriate to let the originator of a particular financing idea or product be the one to earn a commission from their work or investment in creating the concept or product. In addition, they had experience in these types of transactions. They were, and are, qualified to do this work, and no one has ever suggested otherwise.

The other firms participating in the transaction were selected according to the goals of this administration: qualified New Jersey-based firms and women- and minority-owned firms. Of the 27 firms participating in this transaction, 10 were New Jersey-based firms, five were firms with large New Jersey presence, and six were minority- or women-owned firms.

As part of the report I outlined at the beginning of my testimony, you and the public have all of the costs associated with the issuance of these bonds. You know every dollar paid out to underwriters, lawyers, and other costs associated with this transaction.

In addition, I would like to note that the report of August 27 and the one of last Friday provide not only for this transaction, but every transaction that has been undertaken in the last few years.

The Department of the Treasury's concern has been not who participates, but are they qualified to fulfill their roles

in the transaction. I believe all of the investment houses included in this transaction were qualified for the particular role they played in the transaction.

Let me address the role of the Department of the Treasury in the selection of participants in bond transactions.

First, Treasury evaluated the transaction. In doing so, we asked: Is it structured properly? Is it sound financially? Does the benefit of the transaction outweigh the cost? Are the costs of issuance reasonable and prudent?

Second, are the underwriters qualified to perform the work required in their roles in the transaction? As Treasurer, I was especially concerned with the lead underwriter and senior managers, and I wanted a strong legal counsel. These principal players are the keys to the success of any transaction.

Then I asked: Is the overall team balanced? Does it bring the creativity and have the experience to ensure a successful transaction?

Third, the policy objectives of this administration were to increase the representation of New Jersey firms and minority- and women-owned firms. In fact, in the transcripts of the previous hearings, Senator Littell exhorted us to include more New Jersey firms in the pursuit of our policy objectives. In that spirit, I reviewed the team to assure these representative goals were met.

Next, let me address the role of the Governor's Office in the selection process.

Historically, the Governor's Office in this State has been involved in the selection of professionals for bond transactions. Any suggestion that such an involvement is new or noteworthy is to deny history.

Prior to E.O. 92, the former Chief Counsel participated in the decisions about what firms were involved in bond transactions. To my knowledge, this participation by the Governor's Office is consistent with past practice in prior administrations.

But the measure of our success, ladies and gentlemen, is the bottom line, which is: I believe the participants in our transactions have been qualified. We have had a series of very successful transactions. You have heard that testimony from outside witnesses today. I'll just cite Mr. Cobbs, Mr. McBride, and others who have testified here today suggesting that the spreads we got were very good, and that they were successful transactions. And, as interest rates have declined, the State and its authorities have refunded high-interest bonds at lower cost to save almost a quarter of a billion dollars.

Some members of this Committee have raised concerns about the reinvestment of the proceeds of the bond sale. First, let me dispel any notion that Lazard was given all the work. In fact, the lead underwriter did not purchase all of the reinvestment instruments. Four firms -- Goldman Sachs, Merrill Lynch, Paine Weber, and Lazard Freres -- participated in the reinvestment. These firms are all recognized as large purchasers of Treasury securities.

I required the participation of three other investment firms with the lead underwriter in the purchase process. We required all of the purchasers to sign letters of certification that the purchases of the reinvestment instruments were made at a market price. We have checked some of the purchase prices of the securities against published prices for those securities on that particular day, and we found the prices consistent and fair.

We do not know what profit, if any, the four firms that purchased these securities made on the purchase. Similar to State purchases of any other items, we do not know the profit those firms make selling those items to the State. The measure of the transaction is the interest rate received.

The time frame for completing the transaction was very tight. You were absolutely right, Mr. Chairman. As you recall, we were attempting to take advantage of the market

prior to Christmas week in 1992, because we believed we could get the best interest rates. The Legislature had delayed passage -- I will not say the Assembly, although I should probably correct that later, Mr. Chairman -- delayed passage of the needed legislation. We wanted to save the \$50 million by completing the transaction before January 1.

I received conflicting advice on the best route to follow. Some in the Treasury Department -- you have called them today, Mr. Lurie and Mr. Machold -- thought that the reinvestment might have been done differently. The lead underwriter who was managing the deal believed it was best to have the reinvestment instruments purchased by them because of the size of the issue, and because the purchase needed to be done in a matter of hours.

The State had never done an issue of this size or complexity. There was an element of risk involved in the purchase of this number of securities, as well as the overall transaction. In this particular-- Seventy-six separate securities needed to be purchased -- an unprecedented number that needed to be handled in a very short period of time. My judgment was that this was the fastest and most secure way to complete the transaction.

Finally, some have raised the issue of campaign contributions by investment bankers and law firms. Until the recent reports in the press, I did not know who gives to the Democratic or Republican candidates and committees. When I entered the Treasurer's Office, I realized any campaign activities were out of the question. I have continued that practice to this day, and will continue it in the future.

The Governor has done his part in lowering underwriting costs and instituting reforms to State bond practices. He believes that these new standards should be made permanent. That is why he is calling upon the Legislature to follow his lead by enacting Senate Bill No. 2016 and Assembly

Bill No. 2730 into law. These bills implement the provisions of Executive Order 92 requiring bidding for the services of bond counsel, underwriters, architects, engineers, and other professionals.

That is why the Governor has called for the adoption of the same competitive bidding reforms at the municipal and county levels that he has put into place for the State. He would like to see speedy action on Senate Bill No. 2041, which would put his new standards in place for local government. As the revelations about underwriter selection in Jersey City point out, there is a crying need for reforms at the local level.

Finally, the Governor has supported a ban on political contributions by underwriters. That bill, which would make this the law of the State -- A-930 -- has yet to be considered by the Legislature.

I am here to answer any questions you may have, Mr. Chairman, members of the Committee.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Mr. Treasurer, for your remarks. The Chair recognizes-- If other legislators are interested in questioning the Treasurer or Mr. Lurie, would they please so indicate to the Chair? Recognizing Assemblyman Watson, Assemblyman Smith -- Assemblyman Bagger, I believe initially.

ASSEMBLYMAN BAGGER: Thank you, Mr. Chairman, and thank you, Treasurer, for your presence today and for your very thorough testimony.

I would like to discuss with you for a few minutes the refunding issue of December 1992 that we are all familiar with, and to review with you the steps that took place and the selection of Lazard Freres as lead underwriter. I think, as we all know, Lazard, which was a firm with no previous history in New Jersey, made quite a splash on the scene in 1992, receiving

about a quarter of all State bond work in 1992, and was involved, I think, in seven -- nine issues by this administration, earning fees of over \$6 million.

Treasurer, in terms of the decision-making process for selection of the lead underwriter, specifically for the refunding, was the final decision yours?

TREASURER CRANE: In this particular case, Lazard, as I have testified -- and I think I spoke, Assemblyman, directly to this point in my testimony-- If you would like me to reread that section, I will be glad to reread it.

ASSEMBLYMAN BAGGER: No, I have that page right here.

TREASURER CRANE: Okay. I think I responded to that question. I mean, they had brought the concept. I revisited it in September. The interest rates had declined dramatically, as you know. The market had gotten much better. And for all of the reasons I have outlined, I met with them because they had been pursuing this concept, as investment houses do. They bring ideas to the State; they bring new products to the State. We don't discourage that because if they come up with an idea that could save us money, we ought to avail ourselves of it. So sometimes they come with ideas that are less than desirable, or don't work in our particular circumstance, or we choose not to do. In this particular case, it was a complex undertaking. They had brought proposals, so I began to work with them in September of '92.

ASSEMBLYMAN BAGGER: Who in the administration makes the final decision to go with a particular firm as lead underwriter? Was that your call?

TREASURER CRANE: The decision on lead underwriter in this particular case? I began to work with Lazard because they had brought the concept, and, as my testimony says, they brought the concept to me. They brought it repeatedly under different terms, but as the interest rates got better and as our needs changed -- as I cite in my testimony -- to do a

capital program, and whatever, I started working with them in September of 1992 because they brought it, because I think we need to recognize and reward, if you will, those who have the creativity to bring us new ideas. Otherwise, they will stop bringing them, which would be a cost to the taxpayers, I believe.

ASSEMBLYMAN BAGGER: Is it correct, then, that you designated Lazard Freres as the lead underwriter for that deal?

TREASURER CRANE: Yes, they brought the concept.

ASSEMBLYMAN BAGGER: And the participation at the Governor's Office that you mentioned in your testimony, in that particular case was it just a notification of what was happening, or was clearance of anyone in the Governor's Office necessary for the designation of the lead underwriter?

TREASURER CRANE: I discussed it with the Chief Counsel. I discussed also, I mean, obviously, the concept of whether we should pursue it; whether we should go and get this idea to see if we would make some work. I was not discouraged from doing that. We were in the process of looking for capital funding -- a way in which we could increase our capital program, so I went to pursue it. I was not discouraged about going to do it. I went and explored the idea.

ASSEMBLYMAN BAGGER: If I understand it, it is your testimony that that decision made by you had absolutely nothing to do with any political contributions made by the firm of Lazard Freres?

TREASURER CRANE: Absolutely.

ASSEMBLYMAN BAGGER: Were Executive Order 92 in effect at the time that the 1992 refunding was done, would you have granted an exception for negotiating this particular transaction, or would it have been done competitively?

TREASURER CRANE: I have given that some thought, Assemblyman, as I have gone through the E.O. 92 process. I probably would have granted a negotiated transaction. It was

very big. We hadn't done it before. It probably would have been my judgment to do a negotiated.

ASSEMBLYMAN BAGGER: And, in accordance with your prior testimony, even in that case the designation of the lead underwriter would have been done on a competitive basis?

TREASURER CRANE: Well, one of the-- Assemblyman, one of the things that we have been struggling with under E.O. 92 is, in the midst of this competitive process, Assemblyman, we have -- Mr. Lurie and myself -- struggled with the issue of how to reward people who come to us with new ideas, because-- For instance, someone comes forward in a RFP process. They have an idea that although the absolute cost of their fee may not be the best, they may not have the lowest fee, their idea for the transaction is so good and will save so much more money than their fee-- How do we reward that? How do we handle that particular kind of, you know, creativity, or whatever? So we have been working within the context of E.O. 92 to deal with that particular phenomenon. I don't know how we would have handled it there. Every time you start a reform, every time you start a new process, you have to work to refine it as you go through.

I am very pleased with E.O. 92. This is one of the things that I really, frankly, think we have to work on, because-- Now, there is a case where somebody will come and say, "Okay, it is going to cost us. Their fee is \$5000 higher, but their structuring of the deal saves you \$2 million." Do you choose the low bidder, or do you choose the structure that saves you \$2 million? My inclination is you take the \$2 million. I mean, obviously, that is a much bigger savings, if they bring a unique idea to the table.

ASSEMBLYMAN BAGGER: Well, I hope the Executive Order gives you and the professionals in your Department the flexibility to make those judgments.

Back on the 1992 refunding: I take it, then, that there wasn't any formal RFP process for lead underwriters or any formal procedure followed by you and Mr. Lurie for evaluating different proposals. Lazard came in with this refinance recommendation, and they were basically, after working with you, allowed to go on with it.

MR. LURIE: That is correct.

TREASURER CRANE: Right.

ASSEMBLYMAN FRELINGHUYSEN: Could you use the microphone, please, Mr. Lurie?

MR. LURIE: Oh.

ASSEMBLYMAN FRELINGHUYSEN: I'm sorry.

MR. LURIE: Yes, that is correct.

ASSEMBLYMAN BAGGER: On the refinancing and the refunding deal, who made the decision as to how many bonds each comanager or selling participant received out of the issue? Was that a Treasury decision, or Lazard Freres' decision?

TREASURER CRANE: Are you asking me, or are you asking-- You were looking at Mr.--

ASSEMBLYMAN BAGGER: I am asking you, Treasurer, in the first instance.

TREASURER CRANE: Oh, okay. You were looking at Mr. Lurie; I wasn't sure.

We don't decide. An issuer doesn't decide who buys the bonds through who. I think you heard testimony earlier today-- I think it was from Mr. McBride, who went through the process of a transaction where you had large purchasers designating certain buyers, or certain dealers to purchase bonds. So that is not a decision of us. It is a decision of the marketplace. There are big investors who put in priority orders -- and we know who they are, a CALPERS or a large purchaser of New Jersey bonds. There are people who invest in our bonds repeatedly, and then there are the dealers who buy them on behalf of their clients or their retail networks.

ASSEMBLYMAN FRELINGHUYSEN: Just a point of order here. I believe the Assemblyman is asking for information relative to the specific refinancing. I understand Mr. McBride's comments earlier today had more to do with the overall process, but I think your question had to do with the specific -- with this deal. Is that correct?

ASSEMBLYMAN BAGGER: Yes. It might be easiest to do it by reference to Exhibit 10 to your report, Treasurer, of the 27th of August, which has been discussed earlier today, and will probably be discussed later today. If you could, with reference to that exhibit -- particularly page 1 of that exhibit, which has a series of columns--

TREASURER CRANE: Exhibit 10?

ASSEMBLYMAN BAGGER: The Total Designations and Allotment. Do you have that?

TREASURER CRANE: Yes, I do.

ASSEMBLYMAN BAGGER: With reference to that exhibit, if you could just tell me, referring to the columns across the top of the page, starting "Underwriting Participation," "Allotment," "Designation," "Total Bonds," "Pool Allocation"-- There may be some more discussion of these issues later, but which of those columns and the figures under them are determined by the issuer, the State of New Jersey, and which are determined by either the lead underwriter or the marketplace?

TREASURER CRANE: The senior manager and the marketplace? All of the columns, except -- exclusively are done by the marketplace and the lead underwriter -- all the columns: "Underwriter Participation," "Allotment," "Designation," "Total Bonds," and "Total Revenue," because they are built one upon the other.

ASSEMBLYMAN BAGGER: Those are all determined by either the senior manager--

TREASURER CRANE: The lead underwriter or the marketplace.

ASSEMBLYMAN BAGGER: How about "Pool Allocation?" Who is that determined by?

TREASURER CRANE: Pool allocations generally are a function of the issuer and the lead underwriter.

ASSEMBLYMAN BAGGER: In this instance--

ASSEMBLYMAN FRELINGHUYSEN: Excuse me, Assemblyman. Specifically, we understand the general, and of course the general may have more applicability given the Executive Order. But what in regard to the specific period of time -- this particular deal? Excuse me, Assemblyman, but this is--

ASSEMBLYMAN BAGGER: No, I was going to ask the same question specifically with regard to this transaction. Was that a function of the issuer?

TREASURER CRANE: Did the State play a role in the pool allocation?

ASSEMBLYMAN BAGGER: Yes.

TREASURER CRANE: Yes.

ASSEMBLYMAN BAGGER: And, on behalf of the State, who would that have been?

TREASURER CRANE: I learned of this pool allocation on June 3, 1993. The allocation was supplied to me by the lead underwriter.

ASSEMBLYMAN BAGGER: And you approved it?

TREASURER CRANE: I learned of this pool allocation on June 3, 1993.

ASSEMBLYMAN BAGGER: After it occurred?

TREASURER CRANE: After the allocation had been done.

ASSEMBLYMAN BAGGER: So is your testimony that this pool allocation is not a function of the issuer?

TREASURER CRANE: It was not a function-- To my knowledge-- I had no knowledge of this pool allocation.

ASSEMBLYMAN BAGGER: Did anybody in State government?

TREASURER CRANE: Yes.

ASSEMBLYMAN BAGGER: Who was that?

TREASURER CRANE: I believe -- according to my information -- that Mr. DeCotiis had a conversation with Lazard on this allocation.

ASSEMBLYMAN FRELINGHUYSEN: So, did the administration direct this, or did the issuer direct it? I am somewhat confused.

TREASURER CRANE: I have no firsthand knowledge of what role Mr. DeCotiis might have played or what role the lead underwriter might have played.

ASSEMBLYMAN FRELINGHUYSEN: How about you, Mr. Lurie?

MR. LURIE: Same answer. I do not know how this allocation was made.

ASSEMBLYMAN FRELINGHUYSEN: Could you just tell the Committee what your job is; what your responsibilities are?

MR. LURIE: With respect to this transaction?

ASSEMBLYMAN FRELINGHUYSEN: In regard to what your job is with the State of New Jersey?

MR. LURIE: I am the Director of the Office of Public Finance, and in that capacity I, and my office, basically have two roles: One is to act as staff in the execution of State financings; that is, direct State financings, such as general obligation bonds, of which this bond issue we are discussing is one. And also indirect debts, such as lease financings that are paid by the State.

A second role is to act as in-house financial adviser to the State Treasurer with respect to any other types of financing that may be considered by this State through the authorities or through the State itself.

ASSEMBLYMAN FRELINGHUYSEN: Let me say I think you have excellent credentials. I am just wondering -- and this is made to the Assemblyman's line of questioning -- were you-- Did you have those responsibilities at this particular point in time?

MR. LURIE: Yes, sir.

ASSEMBLYMAN FRELINGHUYSEN: Okay. Excuse me, Assemblyman Bagger, for interrupting.

ASSEMBLYMAN BAGGER: No, that's quite all right, Mr. Chairman.

Just closing that line of questioning, who was it at Lazard Freres that the former Chief Counsel had that discussion with, do you know?

TREASURER CRANE: I have no knowledge of that.

MR. LURIE: I don't know either, sir.

ASSEMBLYMAN BAGGER: If I may turn for a second to both of your reports, Treasurer, Parts I and II, I noticed that the exhibits that reflect total underwriting fees earned by firms on all New Jersey business appear to differ with the second report having higher figures. I am doing this by reference to Exhibit 9 of August 27, and Exhibit 8 of September 10, the September 10 figures being higher. I note that Exhibit 9 of August refers to the takedown portion of these, and Exhibit 8 refers to takedown management fees. I wonder if that accounts for the difference?

MR. LURIE: Yes, it should account for the entire difference.

ASSEMBLYMAN BAGGER: Returning to the Lazard firm for a moment and its selection, I think many of us now know the Lazard firm has run into some criticism in some other states, including the State of Kentucky. Its Office of Financial Management and Economic Analysis prepared a report in October of 1992, which I will ask that in its entirety be added to the record of this hearing.

ASSEMBLYMAN FRELINGHUYSEN: So approved. May I ask either the Treasurer or Mr. Luirie, were you aware of this report?

TREASURER CRANE: Yes.

ASSEMBLYMAN FRELINGHUYSEN: Excuse me?

TREASURER CRANE: I am aware of it currently.

ASSEMBLYMAN FRELINGHUYSEN: Were you aware of it at that point in time?

TREASURER CRANE: No, sir.

ASSEMBLYMAN FRELINGHUYSEN: Okay. That will be included in its entirety. Excuse me, Assemblyman.

ASSEMBLYMAN BAGGER: No, that's quite all right.

That report, in its summary, itemizes some of the problems Kentucky experienced with the firm, including: difficult communications; attempts by Lazard to increase management fees and expense components after they had been previously agreed upon; Lazard representatives disregarding Kentucky's many efforts to conduct the reinvestment of funds in a predetermined and orderly fashion; and what the Kentucky representatives referred to as less than candid -- the representations by the Lazard firm -- and numerous misrepresentations.

Treasurer, you were not aware of this report at the time you made your designation of Lazard as lead underwriter?

TREASURER CRANE: No, I wasn't.

ASSEMBLYMAN BAGGER: Were you aware of criticism of the Lazard firm that had occurred in Florida, where Lazard was lead underwriter for a general obligation bond issue which ended up having issuing costs about three times what would have been standard?

TREASURER CRANE: No, I wasn't.

ASSEMBLYMAN BAGGER: Did you or your office, in making the designation of Lazard as lead underwriter, conduct any due diligence or consultations with other state treasurers or appropriate state officials as to whether they had had difficulties with the Lazard firm?

TREASURER CRANE: I didn't. As others have testified here today, they are a highly qualified firm. In addition, as others have testified today, and I have testified, the proof is in the final product. As I think either Mr. McBride or Mr.

Cobbs -- I have it in my notes here somewhere -- suggested -- and I will correct the record in a minute when I look at my notes -- we got a very good spread on that loan, so that indicates that we did very well in the marketplace. That is the proof and evaluation of the transaction.

ASSEMBLYMAN BAGGER: Do you think it is appropriate, or is it part of your procedures now under Executive Order 92, to consult other states where firms seeking appointment as lead underwriter have done work to get recommendations or reports?

MR. LURIE: In my view, Assemblyman, it would be very difficult to do any state-by-state search of officials that might have any knowledge of particular firms and what their experience had been with those firms. The best we can hope to do is have the staff of the Treasury Department have discussions with officials on a regular basis on these types of matters, and also to consult the industry periodicals and so forth in which these types of things may be reported.

There was nothing that was reported in the standard industry periodical "Bond Buyer" relating to the Kentucky matter or the Florida matter, and there was nothing that came to our attention from any other issuing officials in the country relating to any negative experiences with Lazard during that period of time. It wasn't until much later, in May of this year, that we became aware of any of these problems.

ASSEMBLYMAN BAGGER: The Lazard firm has also had difficulty in Massachusetts, where I understand the state has barred Lazard and Merrill Lynch from two particular bond issues, because the state found a failure to disclose a conflict of interest from fee splitting. Apparently Lazard there was serving as a financial adviser and chose Merrill Lynch to participate as an underwriter, and received a portion of Merrill Lynch's fee income in return.

I have concerns that I need to put to rest that we don't have the same situation in New Jersey. The Turnpike bond

issue-- My understanding is that Lazard served as the financial adviser and Merrill Lynch was the lead underwriter. Can you assure me, Mr. Treasurer, that there was not any fee-splitting arrangement involving Lazard or Merrill Lynch on the Turnpike deal, or on any other New Jersey bond issues?

TREASURER CRANE: Well, Assemblyman, first of all, I was not Treasurer at the time of the Turnpike transactions. You should know that. So let me make it clear that I became Treasurer when the last piece of the transaction was about ready to go priced in the market. I believe the transaction was effectively done. I only signed the final documents necessary for it. I have no knowledge, therefore, of any such arrangement in that transaction.

ASSEMBLYMAN BAGGER: Or any New Jersey transactions?

TREASURER CRANE: Correct.

ASSEMBLYMAN BAGGER: Are there procedures you have in place to review State bond deals to ensure that no such fee-splitting arrangements or conflicts of interest exist?

TREASURER CRANE: We are, to the best ability of any issuer, putting in place-- Remember, this Massachusetts-- I think, Assemblyman, to be fair, my source of information about Massachusetts was a copy mailed to me of the Boston Globe on this particular problem in Massachusetts. I guess it was two months ago that I first learned of this particular problem. But we will be vigilant and very careful, and will put in, to the best of our ability, all of our ability to make sure that that doesn't occur here.

This is a rather new revelation in another state, and I think for the record it ought to be noted, Assemblyman -- and I know in the past you have been very fair in these matters -- that this is something that is recent, as of two months.

ASSEMBLYMAN BAGGER: I understand and accept that, Treasurer.

On the same subject, as I think most of us know or have read, the Governor's former Chief of Staff has an ownership, or had an ownership in a financial consulting firm, about which The Trenton Times wrote, on May 20 of this year: "Armacon had no sales staff to sell the bonds, no clientele of retail customers to buy them, and little capital of its own to finance an inventory. In 1991, when it took in \$727,800 in underwriting fees, its total operating expenses were less than \$50,000."

Do you think there is even the potential for a conflict of interest in that situation as reported there, and whether it should be looked into by your office?

TREASURER CRANE: Assemblyman, when I learned through, I think, The New York Times about this particular one, Mr. Lurie and I, if I remember correctly, gathered in my office to figure out if Armacon had participated in any of our bond deals on any of the underwriting teams, either before I was Treasurer or after I was Treasurer. They didn't.

ASSEMBLYMAN BAGGER: Have you done a similar investigation to see whether Armacon was receiving any consulting fees from the firms that were participating as part of the underwriting syndicates, or that they might be participating in any fee-splitting or other arrangements?

TREASURER CRANE: This is a matter of investigation of the U.S. District Attorney's Office of the Southern District of New York. It would be a bit presumptuous of the State, or anyone else for that matter, to engage in an investigation of something that is under that investigation, so I didn't.

Understand, Assemblyman-- If you would just indulge me for a moment, I just want to spend a few minutes on what an issuer generally -- Mr. Chairman, generally -- knows and doesn't know, because I think it ought to be clear. I think I started before, in my testimony or in response to a question, Assemblyman, to talk about who buys our bonds. Dealers buy our

bonds; big institutional buyers buy them. Our bonds are then traded in the marketplace. As an issuer, we do not know who the dealers might sell them to. We don't know who those dealers might sell them to. Frankly, Assemblyman, you could purchase one as an investment for your kid's college, and we wouldn't know that. You don't know that.

So I think if you are going to discuss this, you ought to know what an issuer knows, which is the first part of the transaction, and not the rest.

ASSEMBLYMAN BAGGER: I will conclude, Mr. Chairman, just with a couple of policy questions, because we are here to evaluate legislative or other initiatives that this State can take. I very much appreciate and welcome your previously stated --and stated again today -- support for Assemblyman Russo's bill. It has been suggested by some that the conflict of interest law in New Jersey should be amended to prevent a State employee from having more than a 1 percent increase in a company that profits from State business. I am wondering whether you have any advice for us on a proposal such as that?

TREASURER CRANE: Assemblyman, I have looked at that, but if it is okay with the Chairman, I will send you a letter with my thoughts on that particular issue. I have no problem, as a general rule, with extending conflict.

ASSEMBLYMAN BAGGER: I appreciate that very much, and if you could add to that your views on the role of the Bureau of Securities in the Department of Law and Public Safety, and whether or not it should be an independent agency or commission, or remain part of the Division of Consumer Affairs?

TREASURER CRANE: Okay. Can I do that in concert with the Attorney General's Office, because--

ASSEMBLYMAN BAGGER: I am sure the Attorney General would appreciate that.

TREASURER CRANE: --when Treasurers' comment on the operations of another department-- You can take the phone call for me, Assemblyman.

ASSEMBLYMAN BAGGER: And I will ask the Attorney General, as well.

TREASURER CRANE: Okay, thank you.

ASSEMBLYMAN BAGGER: Mr. Chairman, thank you.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Kamin, a point of order.

ASSEMBLYMAN KAMIN: Yes?

ASSEMBLYMAN FRELINGHUYSEN: I am going to recognize Assemblyman Smith and then Assemblyman Lance.

ASSEMBLYMAN KAMIN: Mr. Chairman, I think it would be helpful, especially in the responses to some of the questions of the Treasurer, if we were also-- Mr. Lurie, if you have a different opinion or a different position than the answers given by the Treasurer, I would like to know that, as well. For example, the question of whether there was fee splitting between Merrill and Lazard; the question of whether there was fee splitting between Armacon and what knowledge the administration had. The Treasurer has indicated no knowledge, as I understood your answer.

TREASURER CRANE: That is correct.

ASSEMBLYMAN KAMIN: Is that the same answer from you, Mr. Lurie?

MR. LURIE: Yes, sir, that is correct.

ASSEMBLYMAN KAMIN: Thank you. And for other questions, as well, I would like to have your opinions as it goes along.

MR. LURIE: I understand that, although since I am under oath, I would prefer not to be held accountable for things that I am not asked, as well as things I am asked.

ASSEMBLYMAN KAMIN: I understand. For the benefit of the Committee, then, if we would try to make sure that as questioners we ask of both parties specifically.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman.

Excuse me, Assemblyman Watson. I somehow got Assemblyman Smith on my mind.

ASSEMBLYMAN WATSON: Thank you, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: It is my pleasure to recognize you, and then I will recognize Assemblyman Lance.

ASSEMBLYMAN WATSON: Thank you. Good afternoon.

Mr. Treasurer, could you explain to us why the proceeds of the 1992 refinancing had to be reinvested?

TREASURER CRANE: Do you mean why we bought Treasury securities?

ASSEMBLYMAN WATSON: Why, yes.

TREASURER CRANE: In order to achieve the savings, the way in which you do an advance refunding is that you buy Treasuries with certain maturities and certain interest rates that provide you with revenue to pay the debt service on the bonds that you are refunding. It is a classic purchase. We have done it -- how many times before?

MR. LURIE: Four times total.

TREASURER CRANE: Four times total in this State in a refunding purchase of securities. That is why we purchased them. It is all part of the process of an advance refunding.

ASSEMBLYMAN WATSON: Through you, Mr. Chairman, Mr. Treasurer, could something this complex be done in a sealed bid?

TREASURER CRANE: My judgment was that there was risk involved in this transaction. I think, Assemblyman, I so testified -- in this particular transaction. We were up against a deadline. This was part of the overall transactions and somewhat critical to carrying it off in the same day. We had not done a transaction of this size before. It was my judgment that it would be best to have a syndicate of people -- people participating in the underwriting group -- purchase this particular one.

As far as a sealed bid, we would have to be in the process of purchasing or setting up the purchase days earlier, because you are not talking about \$150 million or \$200 million

in Treasuries; you are talking about \$1.8 billion, a substantial number of securities. It is very complex; it is critical to the part of the transaction.

ASSEMBLYMAN WATSON: Mr. Chairman, through you-- So, Mr. Treasurer, if you were really guilty of anything, I would say that you were guilty of being too cautious that the "refinancing program" was going to succeed.

TREASURER CRANE: I wanted a successful transaction in the time frame we had in which to do the transaction. Yes, Assemblyman, there was risk involved all the way around on a transaction of this particular size. It was my judgment that we would use a mechanism that allowed us to successfully -- with as much guarantee as you can get in any transaction like this -- succeed in the time and on that particular day.

ASSEMBLYMAN WATSON: Mr. Chairman, through you-- Mr. Treasurer, I am a little surprised that the firm made \$10 million off the reinvestment. Is that your number -- \$10 million?

TREASURER CRANE: That is a number that I have read in the newspapers, Assemblyman.

ASSEMBLYMAN WATSON: Has any firm ever made \$10 million from a State bond contract?

TREASURER CRANE: Do you mean as a lead underwriter?

ASSEMBLYMAN WATSON: Yes.

TREASURER CRANE: I testified today one example of Smith Barney on a Turnpike transaction.

ASSEMBLYMAN FRELINGHUYSEN: Mr. Treasurer, I just -- I think--

TREASURER CRANE: Just a minute, let me make sure. You asked me a question.

ASSEMBLYMAN FRELINGHUYSEN: I am a little bit confused. Are you confirming the figure that the Assemblyman throws out?

TREASURER CRANE: No.

ASSEMBLYMAN FRELINGHUYSEN: You're not?

TREASURER CRANE: No. I said that I read the number in the newspaper. I believe -- if I understand the Assemblyman's question-- Maybe I can rephrase it, Assemblyman, and make sure that we are absolutely clear here. But you're saying, "Has any underwriting firm, or whatever, made \$10 million or more on a transaction?"

ASSEMBLYMAN WATSON: Ten million dollars.

TREASURER CRANE: What I am saying is, I know on a Turnpike transaction in the middle '80s, one firm made \$30 million. If I may consult with Mr. Lurie for just a minute to see if--

ASSEMBLYMAN KAMIN: Mr. Chairman, if I may--

TREASURER CRANE: I do not know of any other transaction. We do not know of any other transaction, Assemblyman.

ASSEMBLYMAN KAMIN: Mr. Chairman, on point of order.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Kamin on point of order, and then back to Assemblyman Watson.

ASSEMBLYMAN KAMIN: I'm a bit confused. In your prepared statement on page 18, you have indicated: "We do not know the profit those firms make selling those items to the State," talking about profits. Why is it that you have such wonderful knowledge about Smith Barney and no knowledge about profits related to these other issues during your term as--

TREASURER CRANE: Assemblyman, that is why I have been trying to clarify the question. The Assemblyman asked a question -- that is why I tried to clarify it here: Did any firm, on any transaction -- and if this is not the question -- make \$10 million or more on the transaction?

ASSEMBLYMAN WATSON: My question, Mr. Treasurer -- and I would like to restate it--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Watson is going to restate his question.

ASSEMBLYMAN WATSON: My question is not on the reinvestment, but on the underwriting: Has any firm made over \$10 million?

TREASURER CRANE: In response to that direct question, I am saying that the only instance I know of -- and I just consulted with Mr. Lurie here -- was the Smith Barney transaction at the Turnpike in the middle 1980s. That is the only one we know of.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman.

ASSEMBLYMAN WATSON: Through you, Mr. Chairman-- Mr. Treasurer, last month you released a report which showed that during the Florio administration it cost the taxpayers less money to issue bonds because fees paid to underwriters, etc. were lower. In a press release that day, Speaker Haytaian said, "The report missed the point. It is not how much money was paid." Do you agree with his statement?

TREASURER CRANE: Well, you are asking for my opinion, so I will give you my opinion.

ASSEMBLYMAN WATSON: I think we have been asking for opinions all day long here.

ASSEMBLYMAN FRELINGHUYSEN: Actually, opinions and a few facts, I hope. Right, Assemblyman Watson?

TREASURER CRANE: Well, Mr. Chairman, you can be assured that I have supplied the Committee with far more facts than any other legislative committee has ever had.

ASSEMBLYMAN FRELINGHUYSEN: It's been a long time in coming, but they have finally--

TREASURER CRANE: Fair shot, Mr. Chairman.

Yes, underwriting fees are down. Yes, we saved money. Yes, it is a fair comparison both between national and other states -- the charts I had up here before and whatever -- that the cost of issuance is down, and down below our neighbors and whatever. At a time when the cost of issuance is going down -- our charts verify that -- we thought it was important

to have -- that everybody have that. The point is how effective a measure of a transaction ultimately is. Was it successful, and did we get the best deal, the best possible transaction, with the best possible interest rate, at the lowest possible issuance costs, at that particular market, sometimes on that particular day or for that particular time afforded us?

This report shows that we have done exceedingly well on behalf of the taxpayers. As I said in my opening statement, through-- As interest rates went down, we have moved aggressively, not just the State, but its authorities -- and it is continuing out there, Asssemblyman -- to refund higher interest notes at lower interest costs that will save, not just in the first year, but in every year thereafter.

So that is, in my opinion, a fair measure of the success of any program.

ASSEMBLYMAN WATSON: Mr. Treasurer, I have but one more question.

ASSEMBLYMAN FRELINGHUYSEN: Okay, Assemblyman.

ASSEMBLYMAN WATSON: Mr. Treasurer, you repeatedly have said that the administration had some goals pending on the bond work, recruitment of certain firms, etc. What were those goals? Did you ever share these goals with the Legislature in testimony, or whatever?

TREASURER CRANE: As I said in my opening statement, outside of reducing the cost of issuance, we were particularly interested in including more New Jersey-based firms and firms that were making a significant investment in New Jersey. We have been fortunate over the last couple of years to have some of them move more of their operations into New Jersey. We have also made an effort to include minority- and women-owned firms in these transactions over the last three or four years. As those two reports demonstrate, particularly the report of the

27th, we have been successful in that regard. We have included them. It has been a public policy of this administration to include them, and we were successful.

I was, by way of expansion -- if you will, Assemblyman -- pleased that Mr. Cobbs this morning talked about his work with, I believe, Mayor Bradley in Los Angeles on a program to include that. That is what we have been trying to do here, and I think we have been successful in that regard.

And, to answer your last question, I have with me today this green book which has all of my testimony before this Committee on the policies and debt management, and transcripts of hearings by this Committee and others on various transactions the State has undertaken. In every single one of them you will find the same refrain: New Jersey firms, minority firms, women-owned firms reduce the cost of issuance. Those were the goals, and we achieved them.

ASSEMBLYMAN WATSON: Thank you, Mr. Treasurer. Thank you, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman. I am still a little bit confused. Those are admirable goals to have more women- and minority-owned firms. What, in fact, were the criteria that the former Chief Counsel used in terms of the decisions he made prior to the Executive Order you cited, Executive Order 92? Were those goals the same ones that he sought?

TREASURER CRANE: Absolutely. They are the goals of the administration.

ASSEMBLYMAN FRELINGHUYSEN: They have been the goals of this administration. At what point in time were those plans set into motion? I know the Executive Order set things into motion, but what published plan was there that set into motion that which you have described to the previous -- the former Chief Counsel?

TREASURER CRANE: You have an assumption in your question, Mr. Chairman, that I want to challenge so that the record is clear. The assumption is that the former Chief Counsel made all the decisions. I challenge that particular assumption.

I don't think we signed an Executive Order, or whatever, but, Mr. Chairman, I can, if you would like me to, go back to my very first testimony before this Committee and recite and read to you, if you want me to, where this Legislature was informed by the Treasurer, in writing -- because I always distributed written testimony to every single member of this Committee -- that that was the policy. From the time that I was Treasurer I have discussed that particular policy. I am consulting with Mr. Lurie to make sure that you have the full information you need that it was the policy, also, of the previous Treasurer because, as you can see, more New Jersey minority- and women-owned firms were participating during this particular administration.

You, Mr. Chairman, if you would like me to-- I mean, I will be glad to. It will take me a few moments to go through and read it.

ASSEMBLYMAN FRELINGHUYSEN: I think it is important to reiterate that the State has a longstanding commitment to firms owned by women and minority-owned businesses. But what I am referring to is the religion that seemed to be caught, as exemplified by the Executive Order. It didn't seem to be that high a level of commitment to the goals and objectives of that Executive Order until such time as problems surfaced that related to New Jersey's reputation for certain bond practices.

The Executive Order was in direct relation to things that were occurring in the public's mind, either real or imagined. That is why the Executive Order was issued. One might consider it to be damage control. That is the way I responded to the Governor when he challenged me to move ahead

with putting that proposal under legislation. Quite honestly, I said to him at that time that the Executive Order was too late, obviously, to correct things that appear to have been problems with the administration prior to that Order being issued. The reason is so people could actually see everybody.

(Slight tape malfunction at this point. Several words inaudible.) Is Mr. Machold here? Mr. Machold, I have a number of questions I am required by Counsel to-- You can leave your jacket off -- that's fine -- if you wish.

Did you receive a subpoena from this Committee compelling your attendance at this hearing today?

R O L A N D M. M A C H O L D: No, I did not.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that the Chairman of this Committee has the authority to administer an oath or an affirmation to a witness in any matter now pending before this Committee?

MR. MACHOLD: Yes, I do.

ASSEMBLYMAN FRELINGHUYSEN: Have you received a copy of the Code of Fair Procedure here today before testifying before this Committee?

HEARING REPORTER: Excuse me, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Yes?

HEARING REPORTER: I don't believe the microphones are picking Mr. Machold's statements up here. Could you ask him to come--

ASSEMBLYMAN FRELINGHUYSEN: Actually, I'm hoping you'll pick up his affirmative or negative answers as the transcriber.

HEARING REPORTER: We're doing the best we can, sir, but if the sound equipment doesn't get it, we're dead.

ASSEMBLYMAN FRELINGHUYSEN: You're doing a good job, and actually we will help you by having Mr. Machold take a seat.

Your answer to the first questions-- The first one was a no; the second one, I understand, was a yes. The third

one is a yes, and the next question, I understand, Mr. Machold, is: The Code of Fair Procedure gives you certain rights as a witness testifying under oath here today before this Committee. For example, you have the right to be accompanied by counsel who may advise you of your rights during this proceeding. Do you have counsel present here today?

MR. MACHOLD: No, I do not.

ASSEMBLYMAN FRELINGHUYSEN: Moving along, do you agree to testify here today without having counsel present here with you?

MR. MACHOLD: Yes, I do.

ASSEMBLYMAN FRELINGHUYSEN: Lastly, under the Code of Fair Procedure, you also have the right at the conclusion of your examination by this Committee to file a brief sworn statement relevant to your testimony for incorporation in the record of this investigatory proceeding. You are advised that we are making a tape recording of this proceeding, and you are entitled to receive a copy of your testimony, at your own -- at my expense. You also have the right to request a copy of the resolution authorizing this investigation.

Do you have any questions concerning the Code of Fair Procedure or your rights under the law?

MR. MACHOLD: No, I do not.

ASSEMBLYMAN FRELINGHUYSEN: Do you have any questions about the proceedings today?

MR. MACHOLD: No, I do not.

ASSEMBLYMAN FRELINGHUYSEN: If you would please raise your right hand-- Do you solemnly, sincerely, and truly declare and affirm that the testimony that you give in the matters now pending before this Committee shall be the truth, the whole truth, and nothing but the truth?

MR. MACHOLD: I so affirm.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand that if the statements you make today are willfully false, you may be subject to penalties under the law, including monetary

penalties and incarceration if you fail to answer a pertinent question or commit perjury, which is the making of a false statement under oath in an official proceeding such as this?

MR. MACHOLD: I do.

ASSEMBLYMAN FRELINGHUYSEN: Do you understand this?

MR. MACHOLD: Yes, I do.

ASSEMBLYMAN FRELINGHUYSEN: Is the testimony you are providing today given of your own free will?

MR. MACHOLD: Yes, it is.

ASSEMBLYMAN FRELINGHUYSEN: And, fifthly, have you been directed or required by anyone to testify here today?

MR. MACHOLD: No, I have not.

ASSEMBLYMAN FRELINGHUYSEN: On behalf of the Committee, thank you for being with us. I believe Assemblyman Lance has some questions.

ASSEMBLYMAN LANCE: Thank you very much, Mr. Chairman.

At the outset let me say that I do not believe in practicing law by surprise. I do not believe in public policy by surprise. I believe in liberal rules of discovery, and for that reason I have stated publicly several times over the summer, and repeated yesterday on the floor of the Assembly, that my principal concern regarding the outstanding issues before this Committee today relate to the temporary reinvestment of the bond proceeds following the 1992 sale of bonds. I hope you, Treasurer Crane, and your colleagues, recognize that. You have stated in your testimony that several members of this Committee have raised concerns about the reinvestment of the proceeds of the bond sale, and I assume you were alluding to me.

TREASURER CRANE: I just assumed, since I do read newspapers, that I was going to be asked the question, so I thought I would answer it for you.

ASSEMBLYMAN LANCE: You have provided, Treasurer Crane, the Committee -- I believe you have provided the

Committee -- with memoranda from your two colleagues, Mr. Lurie and Mr. Machold.

ASSEMBLYMAN FRELINGHUYSEN: If you would read those memoranda by title -- if you wish -- the Chair will incorporate them in the minutes verbatim.

ASSEMBLYMAN LANCE: Yes, Chairman. I am referring to a memorandum dated December 14, 1992 to the Treasurer from Director Lurie. It is a one-page memo. And a memo dated December 15, 1992 to Treasurer Crane from Director Machold, a two-page memo. With the request of the Committee, I would like these complete memos to be placed in the transcript.

ASSEMBLYMAN FRELINGHUYSEN: Yes. Those are the complete memos, Assemblyman?

ASSEMBLYMAN LANCE: Are they complete memos? Director Lurie, to you, is your memo a one-page memo?

MR. LURIE: Yes, sir.

ASSEMBLYMAN LANCE: And, Director Machold, the complete memo is a two-page memo?

MR. MACHOLD: Two pages with an attachment.

ASSEMBLYMAN LANCE: I don't have the attachment. Perhaps it was provided us, if staff could--

ASSEMBLYMAN FRELINGHUYSEN: If we can get a copy of that attachment and-- Having been assured by those present that those are the entire memos as they were sent to the Treasurer, we will include the attachment and the rest, verbatim, in the transcript.

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman.

I quote from an editorial in The Trenton Times of Sunday, September 12 -- two days ago: "State Treasurer Sam Crane gave Lazard Freres & Co., the lead underwriter, the exclusive right to handle the short-term reinvestment of the bond proceeds in spite of memos written by Roland Machold, Director of the Treasury Department's Division of Investment, and Robert Lurie, Manager of Public Finance, urging him to put

the reinvestment job up for competitive bid. Lazard directly earned \$3.5 million in underwriting fees, but haven't disclosed how much it made on the reinvestment work. Published reports put that figure at \$10 million."

Before I continue, I want to acknowledge, and certainly will give the Treasurer the opportunity to explain in further detail if this is apparently inaccurate, that Lazard Freres was not given the exclusive right to handle short-term investments. According to your testimony, there were three others.

TREASURER CRANE: Correct.

ASSEMBLYMAN LANCE: Is that accurate, Treasurer?

TREASURER CRANE: That is correct. The editorial was--

ASSEMBLYMAN LANCE: Incorrect?

TREASURER CRANE: Incorrect.

ASSEMBLYMAN FRELINGHUYSEN: How much -- just for the record -- did they get? Do we have the documentation that would verify what they did get?

MR. LURIE: The amount that was purchased by each of the three firms -- Merrill Lynch, Goldman Sachs, Paine Webber -- was a total of \$450 million; the principle amount, \$150 million each; and the balance of \$1.35 billion was purchased by Lazard Freres.

ASSEMBLYMAN LANCE: So in other words -- I can't do the math in my head -- but more than a majority, well more than a majority went to Lazard Freres, with more modest amounts -- significantly more modest amounts -- going to the other three firms. Is that accurate?

MR. LURIE: A fair characterization.

ASSEMBLYMAN KAVANAUGH: Seventy-five/twenty-five.

ASSEMBLYMAN LANCE: Assemblyman Kavanaugh, an engineer, tells me it's 75/25.

MR. LURIE: I haven't done the calculations.

ASSEMBLYMAN FRELINGHUYSEN: Mr. Lurie, you're referring to a document that substantially answers the question that Assemblyman Lance raises, and could we have a copy of that?

MR. LURIE: Yes, you may have a list--

ASSEMBLYMAN FRELINGHUYSEN: Or does it exist with the materials that have been given to the Committee?

MR. LURIE: I have a list of the securities that were purchased and the firms from which they were purchased, as well as the prices we paid for them. I believe that is information we could provide to the Committee. I have a copy of that, and we will provide it to the Committee.

ASSEMBLYMAN FRELINGHUYSEN: But, just for the record, the information you have responded to Assemblyman Lance from is not -- has not been provided the Committee prior to this meeting?

MR. LURIE: I don't know that for sure, so I prefer not to say it.

ASSEMBLYMAN LANCE: Let me say this: I have never received such information, and I was under the impression, mistakenly, that Lazard Freres got 100 percent of the short-term temporary reinvestment, and am informed now by the Treasurer in his written testimony, and by you, Mr. Lurie, in your additions thereto, that to the modest extent of 25 percent of this money, others were involved.

I certainly would appreciate that information.

ASSEMBLYMAN FRELINGHUYSEN: Mr. Lurie, if you are referring to a sheet, we would appreciate having a copy of that.

TREASURER CRANE: We will provide it to the Committee.

ASSEMBLYMAN FRELINGHUYSEN: Okay. Assemblyman Lance?

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman. All of these questions are, of course, through the Chair.

ASSEMBLYMAN FRELINGHUYSEN: And that copy will be made a matter of the public record.

ASSEMBLYMAN LANCE: I think you stated, Mr. Lurie, that four times in the past -- or, I guess, a total of four times, three times in the past and then the 1992 refinancing -- we have had major refinancings in this State. Did I understand that correctly?

MR. LURIE: General obligation refinancings I was referring to.

ASSEMBLYMAN LANCE: General obligation. In the prior situations -- the prior three situations -- undoubtedly there was temporary reinvestment of the bond proceeds. Is that accurate?

MR. LURIE: Yes, sir.

ASSEMBLYMAN LANCE: That is accurate, Mr. Machold, from your point of view?

MR. MACHOLD: Yes.

ASSEMBLYMAN LANCE: By asking you both I do not mean to imply that I am looking for a different answer; I am just trying to put you both on record as having said the same thing.

So, is it fair to say that in the four general obligation refinancings in the State of New Jersey in modern times, that the reinvestment of funds temporarily has always occurred in competitive bidding, and this situation, this fourth situation involving Lazard Freres, has been unique?

MR. LURIE: I would agree that it is unique. However, I would not agree that all the other transactions were done by competitive bid. In the three previous transactions, the interest rate that the State was legally permitted to invest at by Federal tax law was restricted to the rate on the new bonds. Because of that restriction, we were legally obligated to purchase direct securities from the U.S. government, called State and Local Government Series Obligations, commonly called "SLGS."

ASSEMBLYMAN LANCE: SLGS.

MR. LURIE: Those securities, I believe, were the exclusive investments for those escrows on the three prior situations. That involved strictly a private purchase of direct obligations from the U.S. government, over which we have no decision-making power. So this last transaction was unique in that respect. That legal restriction was not relevant to that particular transaction.

ASSEMBLYMAN LANCE: And that is because the law changed at the Federal level?

MR. LURIE: No, it was because of the economic conditions in the marketplace, such that the interest rate -- the maximum interest rate we could get in the market on securities in the open market on that day was, in fact, less than the rate that we borrowed at on our tax-exempt bonds. That was a common occurrence during 1992, so it was common for issuers around the country to invest in open market Treasury securities purchased through brokers, instead of investing in SLGS.

ASSEMBLYMAN LANCE: Mr. Lurie, I refer to your memo of December 14, and with your permission, Mr. Chairman, I would like to read it. Is that possible?

ASSEMBLYMAN FRELINGHUYSEN: Please go right ahead.

ASSEMBLYMAN LANCE: "As part of the refinancing that we expect to price this week or next, the State will need to invest the proceeds, \$1.6 billion, in U.S. government securities. While there is a small chance we will buy SLGS, which are directly purchased from the U.S. Treasury, we think it is more likely that open market securities will be needed." That is precisely what you just said, Mr. Lurie.

"Lazard Freres has requested that they serve as sole provider of those open market securities. I believe that to allow that would cost the State a great deal of money, since Lazard is not a 'primary dealer' of U.S. government bonds, and has little capital necessary to cheaply purchase and hold securities.

"I also believe that Lazard's argument that in order to structure the bond issue, they must control the securities purchase, is without merit, and is manageable in other ways. The large majority of the securities should be purchased by competitive bid. A small portion (probably less than 20 percent) should be purchased by Lazard.

"Prior to joining the State, I worked at Lehman Brothers as one of two people responsible for all technical analysis on refundings. I am, therefore, very sympathetic to Lazard's argument that they need control over the investments in order to quickly and successfully structure the bond issue.

"Based on my experience, only a fraction of the securities purchased will need to be subject to substantial adjustment at the time of pricing. This is because the size of the bond issue changes about \$100 million for every change of .1 percent in interest rate. It is very rare for rates to change that much in a single day. Even if we assume a .25 percent change on pricing day" -- and you say parenthetically, 'impossible' -- "that means that \$1.35 billion of the \$1.6 billion portfolio cannot change. That portion of the portfolio should be competitively bid.

"The last \$250 million that is subject to last-minute change depending on interest rates should be negotiated with Lazard. The exact maturities contained in this portion can be determined easily in cooperation with Lazard and/or other potential bidders."

Is that an accurate and complete reading of your memo to the Treasurer on December 14?

MR. LURIE: Yes, Assemblyman.

ASSEMBLYMAN LANCE: And, Mr. Lurie, do you still agree with what you wrote on December 14?

MR. LURIE: Yes, I do. I would like to clarify a couple of points--

ASSEMBLYMAN LANCE: Certainly.

MR. LURIE: --that perhaps were not clear from the memo. My first advice to the Treasurer was to competitively bid the transaction in days leading up to December 14. Lazard had argued during that period of time that it made more sense, for various reasons, for them to be the sole provider of the securities, as I say in the memo, and I believe the suggestion that I lay out here was intended to be in the form of a compromise position that I was offering to alleviate the difference of opinion.

ASSEMBLYMAN LANCE: By compromise you meant you argued that 80 percent should be competitively bid--

MR. LURIE: That is correct.

ASSEMBLYMAN LANCE: --and 20 percent not. What happened ultimately was that none of it was competitively bid. Is that right, Mr. Lurie?

MR. LURIE: That is correct.

ASSEMBLYMAN FRELINGHUYSEN: What did you mean, Mr. Lurie, when you said in your memo that the State would lose a lot of money, and how much, and why did you make that statement?

MR. LURIE: I think what I was concerned about was that there would be the risk that-- There was the possibility that the State could pay more for the securities than what I would consider to be fair market value for the securities if they were purchased through a noncompetitive process, number one; and two, were purchased from a firm that was not a primary dealer in Treasury securities, and, therefore, in theory, would find it riskier to accumulate that volume of securities; that they would charge us for that risk.

ASSEMBLYMAN FRELINGHUYSEN: But is it fair to say -- excuse me, Assemblyman Lance -- that-- Will we ever know what Lazard paid, and how much the State could have made?

MR. LURIE: Well, that is a difficult question for me to answer. I mean, certainly you've got subpoena power that I don't have, and you can consider using that to find out

something that I would find it difficult to find out. However, it is not customary, in my view, for issuers to get that information. Just as the Treasurer said in his testimony, whenever the State purchases any other commodity, we don't ask for the underlying profits that went into providing us that commodity. I think that is my analogy.

ASSEMBLYMAN FRELINGHUYSEN: But by the Treasurer's own statement, he has made much of the fact that this company had particular qualifications and ingenuity and imagination. Surely the relationship that it had established to put forward such a complex deal perhaps would have resulted in this particular company being more forthcoming about sharing what, in fact, the true profit was.

MR. LURIE: I won't take issue with that. However, I feel that our responsibility, as issuers, is to determine that the State has gotten a fair and reasonable price when it has purchased anything. I believe that is what we did.

ASSEMBLYMAN FRELINGHUYSEN: Well, the job of this Committee is to weigh what you consider to be a fair and reasonable price with what some have speculated was an unreasonable profit that went to this particular company.

MR. LURIE: Well, those are--

ASSEMBLYMAN FRELINGHUYSEN: Some might say that the taxpayers might have lost out by the way this whole deal was structured.

MR. LURIE: There are two different questions, though, inherent in that statement: One is, did the State pay fair market price? And two, what was the profit earned in that provision of those securities?

In order to find \$1.8 billion, or even \$1.35 billion of securities, any firm will need to take a fairly lengthy period of time to accumulate those securities, and they purchase them over, say, a couple of days at varying prices. We shouldn't necessarily care about what they paid for them or

what their profit was. What we need to know is that on the day that we bought it, at the end of that accumulation period, was the price we paid fair and reasonable compared to what the going rate was for securities on the day that we bought them? That, I believe, was true.

Whether Lazard made-- Lazard could have gained money. It could have made a large profit or a small profit based on the price that they actually bought it for versus what they sold it to us for, and I don't know that.

ASSEMBLYMAN FRELINGHUYSEN: But, of course -- and I want to get back to Assemblyman Lance -- we don't know what other firms would have done in a similar position to Lazard, because there were no other firms that had been given this responsibility. Is that correct?

MR. LURIE: Well, no. I mean, as the Treasurer stated, it was split four ways. However, I would agree with your question that on the specific securities, it was divided up so that each firm provided a different list of securities. So in any particular package, there was no way to know.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Lance, excuse me.

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman. I appreciate your questioning.

I am certainly understanding of your point that fair market price is different from the profit Lazard or any of the others make. I understand that. It seems to me, philosophically, that the profit that Lazard or anyone else would have made would be less under a competitive bidding process than was the case without competitive bidding. I understand that you do not know how much Lazard made. And, Mr. Machold, you don't know how much Lazard made, do you, sir?

MR. MACHOLD: No, I don't.

ASSEMBLYMAN LANCE: And, Treasurer Crane, you don't know how much Lazard made? (Treasurer Crane nods his head in a negative manner)

It is my philosophical belief, based upon the way the competitive market works, that if this had been competitively bid, as it has always been competitively bid in the past, whatever profit was to be made would have been less than in a situation that was not competitive. And incidentally, does the Governor's new Executive Order extend to temporary reinvestment of bond proceeds?

MR. LURIE: I guess there are a couple of different statements there. I would like to react to one of them that was made.

First of all, there was a statement made that we have not -- that we have always competitively bid these types of purchases in the past. I don't believe that is true, because, first of all, the State has never done a refunding where it was necessary to purchase open market securities. I believe I said that already.

Second, some of the authorities of the State of New Jersey have done refundings where they have purchased open market securities, and the majority of those authorities have done that through someone other than the Division of Investments. Sometimes that is done by competitive sale; sometimes it is done by negotiated sale. It will reasonably vary, depending on the complexity and the size of the transaction. So it is not unprecedented in the State for this type of purchase to be done on a negotiated basis, and it has been done that way for many, many years.

ASSEMBLYMAN LANCE: Well, I think we can address it this afternoon, indeed the whole day with the GO situation.

MR. LURIE: Right. As I said, I don't believe there is any parallel to that transaction in the past.

ASSEMBLYMAN LANCE: Well, it has not been negotiated in the past. You say it has been directly through the State, through--

MR. LURIE: No, on GO refinancings, the escrows have been purchased directly by my office from the Federal government. We fill out a form and we get it.

ASSEMBLYMAN LANCE: And presumably therefore, Mr. Lurie, the taxpayer has been saved whatever the profit would be if it is not done that way.

MR. LURIE: Well, I don't think that is the question, sir, because we don't have a choice. We have to legally purchase them through the Federal government. They don't say, "You can decide."

ASSEMBLYMAN LANCE: But if you do it directly -- if you have done it directly in the past, there is no profit margin. You are not in the business of making a profit.

MR. LURIE: Certainly. My point was that this is the first time we have been faced with this issue.

ASSEMBLYMAN LANCE: Now, Director Machold, you wrote a memo to the Treasurer on December 15. I will read only a portion of it. If it does not fairly represent the whole memo, you will certainly be willing to elaborate on it:

"With respect to investments, the purchase of Treasury bills should be bid. This is the universal practice for these securities and any designated agents will be viewed by the investment community as being unduly favored. Bob Lurie tells me that the bond authorization does not contain the language to the effect that the funds shall be 'invested in the same manner as other funds in the custody of the Treasurer,' which would mean that the investment would be the responsibility of the Division of Investment under the rules of the State Investment Council. Consequently, Bob Lurie reports that the Attorney General's Office has said that the Issuing Officials have the authority to direct the investment of the bond proceeds." I guess the issuing in that case is by either the State or the Treasurer's Office. "I am not sure that this is an accurate reading of the law, since the authority of the Treasurer to

temporarily invest 'moneys of the State,' which is set forth under N.J.S.A. 52:18-25.1 was transferred to the Division of Investment under N.J.S.A. 52:18A-86.

"If this is the case, then the Division would be required to invest the proceeds of the refinancing. Furthermore, the Division is under the jurisdiction of the State Investment Council, which requires competitive bidding for all purchases of Treasury securities. The Council requires that all bidders for U.S. Treasury securities must be primary reporting dealers, which is the group of leading dealers who have qualified to do the U.S. government's own business. As it happens, Lazard Freres does not qualify as a primary reporting dealer, but if the securities are put to bid, I would be happy to poll the Council and permit them to bid."

Is that an accurate summary of what this memo says?

MR. MACHOLD: It is a precise reading of it.

ASSEMBLYMAN LANCE: And, Director Machold, is that still your opinion?

MR. MACHOLD: Yes, it is.

ASSEMBLYMAN LANCE: So you believe, Director, that the purchase of the Treasury bills should have been bid?

MR. MACHOLD: I recommended that as a cautionary consideration.

ASSEMBLYMAN FRELINGHUYSEN: If you could use, Mr. Machold, the microphone a little closer to you-- Thank you.

MR. MACHOLD: I did recommend that as a cautionary procedure. My concern, as you will note from that memorandum, was a very fine legal point as to whether, in fact, we were required to do the investment programs. I was satisfied on that point. I did have a subsequent discussion -- subsequent to that memorandum -- with Mr. Lurie. He had checked with the Attorney General's Office. The Treasurer was not bound to use the Division of Investment. So one of the reasons I wrote that

memorandum was to forewarn the Treasurer that there might be a small legal technicality which would, in effect, require those procedures to be used.

ASSEMBLYMAN LANCE: But it is now your opinion that it was not required that this money be reinvested through your Division?

MR. MACHOLD: I was satisfied by Mr. Lurie's investigations that it was not required that they had to be invested through our Division, yes.

ASSEMBLYMAN LANCE: And, Mr. Lurie, is that your recollection as well?

MR. LURIE: Yes. I did have a conversation with the Attorney General's Office on this point, since Mr. Machold did raise that as an issue. I was satisfied, based on that formal advice from the Attorney General's Office, that the Issuing Officials had the discretion to invest in the manner they saw fit.

ASSEMBLYMAN FRELINGHUYSEN: For the record, that advice was never written up; it was always oral.

MR. LURIE: That is correct.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Lance, back to you, please.

ASSEMBLYMAN LANCE: Thank you, Mr. Chairman, and through the Chair again-- Ultimately, Treasurer, you decided, in your capacity as State Treasurer and as a Cabinet officer, not to take the advice of Director Lurie and Director Machold on this matter. Is that accurate?

TREASURER CRANE: That's correct.

ASSEMBLYMAN LANCE: Perhaps it is in your written testimony, but could you summarize why you chose not to take their advice regarding this matter?

TREASURER CRANE: I think I have included it in my testimony, but let me preface my answer with a remark that -- and, Assemblyman, since you are so familiar with the executive branch, even though now you serve in the legislative branch--

ASSEMBLYMAN LANCE: Yes, I have been demoted. We all know that.

TREASURER CRANE: I just wanted to say that a Treasurer makes about 10 to 20 financial decisions a day. In all of those decisions, or almost all of them, there is a conflicting opinion between the Department and OMB; sometimes between the executive branch and the Legislature, sometimes between two legislative committees, sometimes between two legislators, etc., as I am sure you are familiar.

ASSEMBLYMAN LANCE: Absolutely.

TREASURER CRANE: And all of those, in the end, require a Treasurer to make a call in judgment. And on this particular one, I made the judgment that the overall transaction was so complex, and that there was an element of risk either way we chose to do this, and I chose the more secure way. I stand by that judgment, as I concluded in my testimony. I wouldn't tell you anything other than that.

So, I made the judgment that that was the best route, the safest and securest way to bring to a close a successful transaction. As others have testified today from outside the government, both outside the Legislature and outside the executive branch, indeed we had a successful transaction. It was successful; it was a good deal; and overall for the taxpayers of New Jersey, we met our objectives. That and bringing it to a safe and secure close was my primary objective.

ASSEMBLYMAN LANCE: And, Treasurer, why, in your opinion, was it more secure not to engage in competitive bidding than to do so?

TREASURER CRANE: Assemblyman, as you know, lead underwriters, regardless of who they might be, and others, want to control the transaction to bring it to a successful close. Remember that there is risk, not just on the part of the State; there is risk assumed by the marketplace, particularly lead underwriters and comanagers when they enter into one of these

transactions. I felt as if I took some of the risk of completing the transaction out by allowing the lead underwriter and, in addition, by requiring the inclusion of others in the transaction that we would get the best market price that we could get on that day and safely and securely complete the transaction, which we did.

ASSEMBLYMAN LANCE: Did you discuss with Lazard or -- and I will ask the others this as well-- Did you discuss with Lazard, before Lazard was awarded the lead work initially, the fact that Lazard would also be granted the ability of the temporary reinvestment later?

TREASURER CRANE: I think that evolved as we worked on the transaction, because when we started, Assemblyman -- as I have so testified today-- I started the exploration of doing this for the purposes I have outlined -- capital program, rebuild reserves, deposit in the Rainy Day Fund -- without any expectation that we would ever complete a transaction. It was an exploring, as we have done -- and I have so testified today-- We explore other ideas that people approach us with.

So, no, it wasn't discussed.

ASSEMBLYMAN LANCE: It was not discussed.

TREASURER CRANE: This was an evolving process when we were exploring an idea through the fall to present both to the administration and to the Legislature.

ASSEMBLYMAN LANCE: And, Mr. Lurie and Mr. Machold, you did not discuss this with Lazard?

MR. LURIE: No.

MR. MACHOLD: I never had any discussions with Lazard.

ASSEMBLYMAN LANCE: Therefore, it was not as if Lazard was in some way entitled, that you were morally obligated to give them the temporary reinvestment. It was an ongoing matter that occurred at the time of the reinvestment.

TREASURER CRANE: That's correct, as the transaction evolved. Assemblyman, as you know, these get done in one or

two days. I mean, it evolved over a period of time and continued to evolve, frankly, right up to the day we sold. As Mr. Lurie suggested, there is an adjustment on the day we sold.

ASSEMBLYMAN LANCE: Treasurer Crane, it was your decision to give Lazard \$1.35 billion and to divide an additional \$450 million, \$150 million each, to the three other firms. That was the decision you made?

TREASURER CRANE: I believe it was done by the lead underwriter.

ASSEMBLYMAN LANCE: The lead underwriter, and that would be Lazard.

TREASURER CRANE: Right. I required the involvement of the other firms in.

ASSEMBLYMAN FRELINGHUYSEN: If my memory serves me right, I thought somebody said earlier in testimony that the Chief Counsel made that decision.

TREASURER CRANE: No. We haven't been asked about this point.

ASSEMBLYMAN RUSSO: This is the reinvestment that was the allocation?

ASSEMBLYMAN LANCE: That was a different matter, I think, Assemblyman.

ASSEMBLYMAN RUSSO: That was the allocation.

ASSEMBLYMAN LANCE: So that I am clear, you left with Lazard--

TREASURER CRANE: I required the inclusion of other people in the purchase, as I have so testified. I also required every single one of them to deposit -- to write a letter of certification that they bought at market value. I have received a letter of certification for everybody who has participated in this particular transaction. As I so testified, we have checked the prices, and we got fair market value that day, against the prices of that particular day.

ASSEMBLYMAN LANCE: Could Lazard have chosen other firms -- four or five other firms, or two or three other firms? It was they who chose Merrill Lynch, Goldman Sachs, and--

TREASURER CRANE: I specified the firms, because I think if you look at the transaction, Assemblyman, if memory serves-- All of these firms were already participating in the transaction, and, therefore, we had already assembled a team, and it only made sense to continue with the team that was bringing the transaction to market.

ASSEMBLYMAN FRELINGHUYSEN: A point of order, Assemblyman Kamin?

ASSEMBLYMAN KAMIN: Yes, Mr. Chairman. In the reinvestment of the proceeds, that is not a complicated process. And, quite frankly, when the decision was made on this to go ahead with not a primary dealer, in fact, put the investments of New Jersey at greater risk because they are not a primary dealer, and, in fact, to go ahead and have Lazard have the inside track-- I think that is much different. Quite frankly, I think the real question is: How much money did we lose by not going to competitive bidding? Mr. Lurie could respond to that, since the Treasurer went ahead, going against the advice of two key people.

MR. LURIE: Okay. Again, as--

ASSEMBLYMAN FRELINGHUYSEN: Mr. Lurie, if you could respond to the Assemblyman, and then back to--

MR. LURIE: First, I would disagree with one of the statements you used leading up to that question, which was that this was not a complicated transaction or purchase of securities. Having done a lot of these before in my prior life as an investment banker, the reinvestment of these proceeds in open market securities can get very complicated, in that there has to be an adjustment, many adjustments, in the portfolio's securities on the day of the pricing of the bonds reacting to

the change in the market for the tax-exempt bonds we are trying to sell; that is, the size of the issue may change based on the change in interest rates, which could result in a significant restructuring of the portfolio.

In this case, there were 76 separate securities purchased for that portfolio, which is a huge amount of securities, much larger than any one I had ever seen in my experience. I don't think there is any question that it was particularly complex, more so than usual.

ASSEMBLYMAN KAMIN: I'm talking -- Mr. Lurie, if I may interrupt you-- The point is the reinvestment of the proceeds.

MR. LURIE: Yes, that is what I am talking about.

ASSEMBLYMAN KAMIN: Just that part.

MR. LURIE: That is exactly what I am talking about. There were 76 separate Treasury securities purchased for the reinvestment portfolio, which was extremely difficult to accomplish.

ASSEMBLYMAN KAMIN: And that is why you had, in fact, recommended competitive bid.

MR. LURIE: I was going to go on to say that, notwithstanding that, I felt it could be accomplished by competitive bid. But I just wanted to take issue with the premise that it was not complicated, because it certainly was. I thought it was extremely complicated.

ASSEMBLYMAN KAMIN: My question then further was, how much money did we lose by not going with competitive bid, in your opinion? And one other question: Did you ask the Attorney General's Office about the propriety of going for the nonprimary dealer to handle it?

MR. LURIE: Let me answer the second question, since that is simpler. No, I did not ask them that question. Mr. Machold and I may have had some discussion about that point, but that was always understood in my mind to be a policy issue, not a legal issue.

With regard to how much the State paid for the securities, I don't think necessarily that the State lost any money as a result of purchasing it by negotiated sale. It is arguable that -- and I believe Mr. Cobbs today testified to this opinion that he had -- it can become extremely unwieldy to have a competitive bid among many firms for this large of a portfolio, and that a negotiated sale may, in fact, yield a lower interest rate.

Our responsibility, as I stated before, was to check that we got fair market value for the securities, and I don't think there is any way to know whether we could have done better by some other process. I think my suggestion that it be done by competitive sale was based on my judgment that it is appropriate in these types of transactions that, whenever possible, we try to introduce competition to the process. There is no question that there are cost benefits to both approaches, but my judgment was that I came down on the side of keeping the process as open as possible. The Treasurer obviously had a different judgment.

ASSEMBLYMAN KAMIN: Can you point--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Kamin, if--

ASSEMBLYMAN KAMIN: My final question.

ASSEMBLYMAN FRELINGHUYSEN: Okay.

ASSEMBLYMAN KAMIN: Can you point to any other transaction that you are aware of where, in fact, this procedure was followed where the reinvestment of the proceeds was not put out competitively in New Jersey, respective--

MR. LURIE: In my tenure here in New Jersey? Well, the largest example of that was the '85 Turnpike transaction, where all of the funds were invested through Smith Barney in Fannie Mae securities. To this day I don't know how much they made on that. There are all kinds of rumors that they made many millions of dollars, but that was the largest example. There have been other smaller examples since then, some during

the past administration, some during this administration, that have been done by the authorities. I have not had any direct role in any of those, however. I can provide you with some examples after the hearing, but they don't jump to mind.

ASSEMBLYMAN KAMIN: But the answer is, there were no such transactions, right? It was always competitive bidding.

MR. LURIE: No, I believe there were some that were done by negotiated sale, but I don't have the list of transactions in front of me, so I would not want to be pinned down as to what they were.

ASSEMBLYMAN KAMIN: Thank you, Mr. Chairman. I will have more when you come back to me.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Lance?

ASSEMBLYMAN LANCE: I think I asked this question earlier: Does the Governor's Executive Order prohibit in the future a negotiated situation for the temporary reinvestment of bond proceeds? Treasurer?

TREASURER CRANE: Well, not having an attorney around to interpret it for me, my recollection is that at least the bond section of the Executive Order, with which I am the most familiar, does not address that point. There are other sections of the Executive Order that deal with the procurement of services that may deal with that point.

ASSEMBLYMAN LANCE: It has been touted today that the Governor's Executive Order stresses competition. There has been a debate whether we should have competition or negotiations on underlying bond issuance. Perhaps this is an area we should investigate.

I point out that I have legislation that would require a temporary reinvestment of bond proceeds to be accomplished exclusively by competitive bidding. It was introduced, but has not yet gone through committee. It is Assembly 2719. I believe, Mr. Lurie, you telephoned me about that several months

ago and indicated that it would need technical amendment. It would have to be modified in some sort of technical fashion in that effort.

MR. LURIE: Yes, I was concerned that it needed an exclusion for the purchase of SLGS from the U.S. government.

ASSEMBLYMAN LANCE: Yes, and let me say that I certainly understand that, and certainly would be acceptable to amending my legislation in that way. But I am of the belief, I believe philosophically -- and, Mr. Chairman, this is not a question; it is a statement -- that the public is better served if there is no appearance of impropriety; if temporary reinvestment occurs through competitive bidding. That was the advice of both Mr. Lurie and Mr. Machold in this situation. The Treasurer has indicated that he waived their advice and chose another route.

I believe, on balance, that it would be infinitely preferable to have competitive bidding for temporary reinvestment. I hope that in the future that can occur. If my legislation becomes law, that will be the statutory requirement in this State.

Thank you, Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblyman Lance. The Chair recognizes Assemblyman Smith, who hopefully will not evoke the equal time provisions. Otherwise, we will surely go beyond the 6:00 hour.

ASSEMBLYMAN R. SMITH: Equal time-- (remainder of comment indiscernible)

ASSEMBLYMAN FRELINGHUYSEN: I may have Assemblyman Russo on deck as well, Assemblyman, so--

ASSEMBLYMAN R. SMITH: Mr. Lurie, if we had had competitive bid for reinvestment, is there any guarantee that the State would have been better off?

MR. LURIE: I don't believe so.

ASSEMBLYMAN R. SMITH: Okay. The Legislature knew about this transaction in the fall. You had approval to move ahead with it. Why did it take so long to actually do the refinancing?

MR. LURIE: I don't think that was an unusual period of time.

ASSEMBLYMAN R. SMITH: Only to legislators.

MR. LURIE: On a transaction of this size and complexity, it typically takes at least two or three months to put together all the financing documents and get the necessary approvals.

ASSEMBLYMAN R. SMITH: So it was a big, tough deal, is what you're telling me?

MR. LURIE: Yes.

ASSEMBLYMAN R. SMITH: Okay. Why do you describe it as being tough? Why is it being tough? Tell me why this is so difficult a thing for the State government.

MR. LURIE: Well, first of all, the sheer size of the transaction made it imperative that it be carefully structured and marketed to investors. It was, I believe, the second largest transaction ever done in the municipal bond market, second to the '85 Turnpike transaction.

ASSEMBLYMAN R. SMITH: Do you mean for the State of New Jersey or nationally?

MR. LURIE: Nationwide. It was the second largest nationwide. We happen to hold the distinction of having the two largest in the country.

In terms of the complexity, any refinancing, any advance refunding that involves the purchase of securities, as well as the issuance of a large amount of tax-exempt bonds, will typically be complicated, and will often require many mathematical computer calculations necessary to ascertain compliance with Federal law.

ASSEMBLYMAN R. SMITH: Why were we buying and selling bonds at the same time?

MR. LURIE: Well, we were selling bonds, again, to get money necessary to pay off some old bonds. However, those old bonds were not immediately due and payable. They became due and payable over a period of time.

ASSEMBLYMAN R. SMITH: Could they have called these?

MR. LURIE: Some of them were called, or were due to be called prior to maturity. What we did in this transaction was invest the money until such time as the call dates came or until the final maturity or interest payments came of the old bonds.

ASSEMBLYMAN R. SMITH: So we are really-- I have listened now to, I guess, about eight hours of testimony. It seems to me that we narrowed the issues-- One of the good things about the process is that we have narrowed the issues, at least in my mind, considerably. Nobody seems to be arguing that the State got a good interest rate; nobody seems to be arguing that the underwriters' fees appear to be quite normal, fair, etc. Nobody seems to be arguing that the spread wasn't a good spread; nobody seems to be arguing that the bottom line was a good line for the State of New Jersey.

It seems that we have focused on one issue, and that is the reinvestment. On the issue of the reinvestment, is the problem, in a nutshell, that while we took in \$1.8 billion, we could only retire bonds at certain dates? In other words, did we have surplus money that we had to do something with?

MR. LURIE: There is no question that the reinvestment was a critical component of this transaction; that it had to be done by the very nature of this transaction.

ASSEMBLYMAN R. SMITH: Okay. I am trying to understand why Treasurer Crane ultimately made the decision that placing the reinvestment as he chose to do was in the best interest of the State. Isn't there a complexity factor here

that has to be dealt with; the fact that whoever buys these bonds -- whoever sells us the Treasuries has to do so, that they will expire at a certain date so we can reuse the money to pay off the bonds that are called on a certain date, and that this is a fairly complicated time line?

MR. LURIE: I think the complexity relates to two factors: One, the sheer number and volume of the securities. Again, 76 separate securities for \$1.8 billion is a huge portfolio to manage at any given time.

ASSEMBLYMAN R. SMITH: Right.

MR. LURIE: And second, it related to the need for interaction and real time changes, as it were, in the portfolio, given changes in the bond issue pricing on that date. And Lazard's view was that that needed to be done by the same firm in order to have control of the process and not risk the entire transaction going forward.

ASSEMBLYMAN R. SMITH: All right. This is now over, to a certain extent, and you are now being hung by your own petard here in terms of an internal audit.

MR. LURIE: Well, I stand by my statements, so I would not say anything--

ASSEMBLYMAN R. SMITH: All right.

ASSEMBLYMAN FRELINGHUYSEN: Let's give him some credit, Assemblyman.

ASSEMBLYMAN R. SMITH: Nor is anyone asking you not to stand by your own statements. Your recommendation on December 14 to the Treasurer was that you thought there was a better way to do it.

MR. LURIE: That's right.

ASSEMBLYMAN R. SMITH: But the process is now over. The reinvestment was placed. As I understand the testimony from the Treasurer and yourselves, there was a check to see if it was done at market rate, and it appears that the

reinvestment was done at the market rate. And now, with 20/20 hindsight, have the taxpayers of the State of New Jersey been ripped off or not?

MR. LURIE: I don't believe so.

ASSEMBLYMAN R. SMITH: Mr. -- I'm sorry.

ASSEMBLYMAN FRELINGHUYSEN: Machold.

ASSEMBLYMAN R. SMITH: Mr. Machold, you similarly have a recommendation to the Treasurer that you thought there was a better way to do it. You credit that whole line of statements to Mr. Luria. Bottom line question: The process is complete. The reinvestment has been placed and appears to have been placed at market rates. Have the taxpayers of the State of New Jersey been ripped off or not?

MR. MACHOLD: I really don't know one way or the other. I don't see any evidence that they have been, but we don't know whether it could have been done another way. It's like Robert Frost.

ASSEMBLYMAN R. SMITH: It's a speculative type of thing.

MR. MACHOLD: It's speculative.

ASSEMBLYMAN R. SMITH: Okay. Mr. Treasurer -- and I know you have had some wonderful months in the newspapers-- Who knows what you might have done differently had you known what kind of fuss and focus has been attached to this bond issue. But you are now looking, in retrospect, at this transaction. Do you feel that you have a decision being made ultimately refounded to the best interests of the State of New Jersey and its taxpayers; that we have not suffered a loss as a result of your decision?

TREASURER CRANE: Yes. I believe we had a successful transaction and it benefited the taxpayers and does not cost them unduly.

ASSEMBLYMAN R. SMITH: And one question for all three of you: Suppose we had competitively bid the reinvestment

funds -- just suppose. People who would compete and bid-- When they compete and they bid, they have a profit margin in their bid, don't they?

MR. LURIE: Certainly.

ASSEMBLYMAN R. SMITH: They would make money.

TREASURER CRANE: No one is going to sell us something at a loss and stay in business very long.

ASSEMBLYMAN R. SMITH: Right. It is kind of like the basic law of the universe.

TREASURER CRANE: Yes.

ASSEMBLYMAN R. SMITH: So someone is going to make money, whether it is Lazard Freres and the other three or four underwriters that participated in the reinvestment, or if you had competitively bid it and had no guarantee that you would have a uniform process that conformed to your needs. Someone was going to make money. I don't know how much Lazard Freres made. You don't know either. Nobody has testified to that fact. Can anybody here tell me how much a competitive bond house or someone else bidding in a competitive outfit would have made, or is that also hypothetical and speculative?

MR. LURIE: It's hypothetical and speculative.

ASSEMBLYMAN R. SMITH: All right. Well, then respectfully, I am trying to-- I am not persuaded either way that you might have been better competitively doing it or whether the negotiated placement was done. I am trying to find something that is in violation of law or statute or regulation in this process. Can somebody tell me where that is?

TREASURER CRANE: There is none, Assemblyman.

ASSEMBLYMAN FRELINGHUYSEN: Point of order. Assemblyman Lance, do you have a point of information? And then Assemblyman Smith is going to continue.

ASSEMBLYMAN LANCE: The whole point of my questioning was that it was the conclusion of these two experts within the Treasury that the process should have been competitively bid,

and they stand by that testimony today. Mr. Lurie has stated to your question, Assemblyman, that he does not believe the taxpayers were ripped off, to use your phrase.

ASSEMBLYMAN R. SMITH: Right.

ASSEMBLYMAN LANCE: Mr. Machold says he doesn't know, and the Treasurer says that he agrees with Mr. Lurie. Personally, I don't know how we can answer that question without knowing how much Lazard had made, and I realize that none of these individuals can tell us.

ASSEMBLYMAN R. SMITH: What I don't understand, even about the statement and the assumptions -- the threshold assumptions of the question, no matter what Lazard made, how does that make what they did, or the decision that the Treasurer made-- Apparently, his crime is that he saw it differently than the people who made recommendations to him. No matter what Lazard made, how does that make a difference? How does that make this transaction illegal, unethical, immoral, or a conflict? It appears that nobody is saying -- nobody is giving any evidence that there is concrete damage to the State of New Jersey. Nobody can tell me that we lost a dollar or we gained a dollar.

ASSEMBLYMAN LANCE: First of all, let me say that I have never used this -- through the Chairman--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Lance, just one response, and then Assemblyman Smith is going to conclude his questions.

ASSEMBLYMAN LANCE: I am quite cautious in my language. I have never used the word "crime," or "immoral," or any of those words you used. That is not something that I would do. The \$10 million came from somewhere; their profit came from somewhere.

ASSEMBLYMAN R. SMITH: This is America. Companies make profits.

ASSEMBLYMAN LANCE: Absolutely, and in America, in my judgment, competition leads to the lowest level of profit and the greatest opportunity for all. That is why I have sponsored the legislation I have sponsored.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Lance, I am going to cut you off there, and, Assemblyman Smith, I appreciate your locking horns with Assemblyman Lance.

ASSEMBLYMAN R. SMITH: Well, I am not locking horns with Assemblyman Lance--

ASSEMBLYMAN FRELINGHUYSEN: Good. If you could wrap up your questions--

ASSEMBLYMAN R. SMITH: --but I would simply--

TREASURER CRANE: Mr. Chairman, if I could--

ASSEMBLYMAN FRELINGHUYSEN: Yes?

TREASURER CRANE: Assemblyman Lance-- With your leave, Assemblyman?

ASSEMBLYMAN FRELINGHUYSEN: Treasurer Crane.

TREASURER CRANE: I have been listening to this \$10 million number today, and I tried to source the \$10 million to an unnamed person speculating in a newspaper account that they might have made \$10 million. That has taken on, Assemblyman -- and I hope you will agree with me -- a life beyond -- a life of its own based on speculation.

ASSEMBLYMAN LANCE: Absolutely, that is why--

TREASURER CRANE: I read in the paper all the time speculation about this and that. I think it is only fair, Mr. Chairman, since that number was started to be discussed here, that it is fair that everyone understands that the source of that is a unnamed speculation by someone in a newspaper account. That is the authority for that particular number.

ASSEMBLYMAN FRELINGHUYSEN: I suspect that as this Committee continues its deliberations, we will have an opportunity to delve into that matter in a greater fashion.

I want to recognize Assemblyman Smith so that he can move toward conclusion, because I understand that Assemblyman Russo has some questions, as well.

ASSEMBLYMAN R. SMITH: Well, just to conclude that one thought, even if the \$10 million was a real number -- I don't know that it is, because it has the same -- near the same characteristics as so much of what we heard earlier today from some of our witnesses-- Even if it was true, in a competitive bidding process, people who competitively bid would be making a profit as well. Nobody can tell me that that profit wouldn't be \$14 million, or \$19 million, or \$27 million. Nobody has been able to show me today in any of this testimony that the State, the Treasurer, with the exception that he didn't listen to some recommendations from some of his staff -- that someone has done something wrong.

I am trying to find the smoking gun. That is the problem. There is no smoking-- After six-and-a-half hours, there is no smoking gun here of somebody doing something wrong. And listen, don't get me wrong. I am not hoping to find a smoking gun. If we can improve State processes, we want to do that, but I haven't heard anything today that tells me that we've done anything that we shouldn't have done, other than--

There is one thing that I think besmirches all of us, and that is this campaign contribution crap. That should be just totally eliminated, not just in the State of New Jersey, but across the country. All of our integrity and credibility and the credibility of our institution is at risk, because these bond houses, underwriters, and counsels make campaign contributions to either the State party or the leadership committees or to individual legislators, and that is what the real problem is. That is why nobody-- That is one of the reasons that people just think we are "politicians." That is what we should be doing something about.

I haven't heard anything about our processes so far. If we ultimately decide, as Assemblyman Lance suggests, that we should have competitive bidding on reinvestment, let's do a statute to say that. But, Mr. Treasurer, you had no statutory direction to do anything like that. This was a discretionary act on your part?

TREASURER CRANE: That is correct. It was my territory.

ASSEMBLYMAN R. SMITH: One in which you thought you were making a decision in the best interest of the State?

TREASURER CRANE: Yes.

ASSEMBLYMAN FRELINGHUYSEN: Okay. Anything further, Assemblyman Smith?

ASSEMBLYMAN R. SMITH: No, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: Thank you very much. I believe Assemblywoman Farragher has one short question, and then the Chair is going to recognize Assemblyman Russo.

ASSEMBLYWOMAN FARRAGHER: I don't guarantee that it will be short. There may be a follow-up.

ASSEMBLYMAN FRELINGHUYSEN: Assemblywoman?

ASSEMBLYWOMAN FARRAGHER: Thank you, Mr. Chairman.

We spent this day -- this morning -- getting very well educated into the process. Now, Mr. Treasurer, will you tell me, please, who was the financial adviser on the refinancing?

TREASURER CRANE: The financial adviser?

ASSEMBLYWOMAN FARRAGHER: The financial adviser on the refinancing.

TREASURER CRANE: There wasn't any.

ASSEMBLYWOMAN FARRAGHER: There was no financial adviser?

TREASURER CRANE: That's correct.

MR. LURIE: If anyone, Madam Assemblyman, I was the financial adviser.

ASSEMBLYWOMAN FARRAGHER: You were? Okay. Was it your recommendation to seek Lazard Freres?

MR. LURIE: No. As we have established today, it was my recommendation that it be done by competitive bid.

ASSEMBLYWOMAN FARRAGHER: You, as a financial adviser-- In that capacity, you-- Obviously, in your position-- It is inherent in your position, you have a fiduciary responsibility to the State of New Jersey. So in this amorphous situation there was nobody with the fiduciary responsibility to the State of New Jersey. Lazard Freres entered in and made a presentation. There was no one who was advising the State; no one that set up the deal. Lazard approached the State. Am I correct?

TREASURER CRANE: Assemblywoman, let me see if I can take the question apart and deal with it in its parts.

First of all, there is an assumption that this underwriter, or any other underwriter, comes in and says, "Have we--" You know, "Here is a transaction we think you ought to do. This is how you ought to structure it, and let us just go off and do it." I think Mr. Lurie started to say -- and I will not put words in his mouth; he can correct me if I am wrong-- We vented this idea with Mr. Lurie involved, and myself and others on the Treasury staff looking into this. The notion that they would bring an -- anyone, this firm, any other firm would bring an idea and we wouldn't test it, we wouldn't vent it, is incorrect, and should not be part of -- you know, left out there--

ASSEMBLYWOMAN FARRAGHER: I just want to know, through the Chair, did Lazard approach the State -- yes or no?

TREASURER CRANE: Lazard, as I have so testified--

ASSEMBLYWOMAN FARRAGHER: YES?

TREASURER CRANE: --had done some work and had done some proposals for the State of New Jersey on transactions very similar to the one that was ultimately done. I think my

opening statement clearly outlines the history of that and how we worked on this particular project. That is why I included it in the opening statement.

ASSEMBLYWOMAN FARRAGHER: So then, through the Chair, Lazard had the advantage of setting the spread?

MR. LURIE: I'm sorry, Assemblywoman, setting the spread on what?

ASSEMBLYWOMAN FARRAGHER: In other words, they set up the deal for the State. They gave the State-- They quoted the State an interest rate.

MR. LURIE: The way this worked, in a way -- the way I believed this worked, in a way similar to other transactions, is that the spread on the sale of the State's bonds was proposed by Lazard and subject to negotiation by the State. We did negotiate that spread so that it does not reflect their initial proposal.

ASSEMBLYWOMAN FARRAGHER: Through the Chair, what were the basis points?

MR. LURIE: I'm sorry, I don't understand the question.

ASSEMBLYWOMAN FARRAGHER: The basis points.

MR. LURIE: Of what, Assemblywoman?

ASSEMBLYWOMAN FARRAGHER: To gain the interest rate that was achieved on this deal, were there basis points involved?

MR. LURIE: I'm sorry, I don't understand how you are using the terminology. Basis points just refers to percentages of a point of interest rate.

TREASURER CRANE: Assemblywoman, could I help you? Are you asking the question-- Let me see if I can help you, Assemblywoman. Are you asking--

ASSEMBLYWOMAN FARRAGHER: I know where I want to go with it. I don't know how to get there, Mr. Crane.

TREASURER CRANE: That is what I am trying-- Assemblywoman, believe me, I am not challenging you. I think I

am trying-- Let me see if I can rephrase the question: Are you asking whether Lazard told us what the interest rate would be on the bonds--

ASSEMBLYWOMAN FARRAGHER: Yes.

TREASURER CRANE: --when we sold them?

ASSEMBLYWOMAN FARRAGHER: Yes.

TREASURER CRANE: That is a function of the marketplace at the time at which you sell.

ASSEMBLYWOMAN FARRAGHER: Right.

TREASURER CRANE: That interest rate changes daily--

ASSEMBLYWOMAN FARRAGHER: Yes?

TREASURER CRANE: --weekly, monthly, as we have all seen over the last 12 months. Interest rates have come down dramatically in the case of mortgages. Let me just use that example. We are at a 20-year low on mortgage rates. I read in the paper--

ASSEMBLYWOMAN FARRAGHER: I just refinanced my--
(indiscernible)

TREASURER CRANE: So I think, Assemblywoman, to be of assistance to you, the interest rate paid on the bonds is not something that the lead underwriter necessarily dictates. For instance, we could go market in the morning, and interest rates could go up during the day. Right, Mr. Lurie? I mean, it is a function of the market.

ASSEMBLYWOMAN FARRAGHER: I understand that. All right. Through the Chair--

MR. LURIE: Let me try to expand on that, because I think--

ASSEMBLYMAN FRELINGHUYSEN: Assemblywoman, do you want to ask a follow-up question?

ASSEMBLYWOMAN FARRAGHER: It isn't necessary to expand on it.

MR. LURIE: All right.

ASSEMBLYWOMAN FARRAGHER: We had testimony earlier today, Mr. Chairman, that indicated -- and I wrote it down -- that Lazard had the advantage of setting up the spread. There could be large profits. Profits should be remitted back to the issuer. Further, there was a statement made that there was no reason for Lazard, because of the size of this issue, to undertake the issuance by itself, and yet that was what was done. We keep dancing around and keep getting confused with other side issues. We have never, ever gotten today to the real issue: Why Lazard, why when it has been, as I understand it, the largest issuance in the country, why someone would be given all of that, when their profits they made that should have been remitted back to the State-- Did they come back to the State? Do we even know that they made profits that should have been remitted back to the State?

There are a lot of unanswered questions, Mr. Chairman, and I, quite honestly, look forward to the 30th. If I can find someone to help me phrase my question correctly, because I have been away from Wall Street for 28 years and I know things have changed, then I intend to do that. I will come back, Mr. Crane, with far better questions, I guarantee it.

ASSEMBLYMAN FRELINGHUYSEN: Thank you, Assemblywoman. Assemblyman Russo?

ASSEMBLYMAN RUSSO: Thank you. I will try to be brief.

The first question I wanted to ask concerned the date of June 3, Mr. Treasurer. My notes state that on that date you said you got for the first time this year -- '92 -- information on the allotment -- and if I am incorrect, please stop me -- I believe on the allotment of the original bond issue from '92 December -- the refunding. Is that correct?

TREASURER CRANE: What was included in the report of August 27, Assemblyman, is what I received on June 3.

ASSEMBLYMAN RUSSO: Okay. Maybe I should have asked it that way. That is a better answer.

I have in my hand Exhibit 10, which appears to me, Mr. Treasurer, to be a three-page fax transmission. It says, "Source: Lazard Freres." Maybe we should just wait a second until you get that.

TREASURER CRANE: Yes.

ASSEMBLYMAN RUSSO: Okay. Now, it looks like it's wholly typed on top -- Exhibit 10. That was in the August 27 report that your office issued.

TREASURER CRANE: Correct.

ASSEMBLYMAN RUSSO: Which I did receive, thank you. Now, it says-- It looks like it was typed, and it says: Page 1 of 3, 2 of 3, and 3 of 3, so I would assume that these three pages were received from Lazard Freres.

TREASURER CRANE: Correct.

ASSEMBLYMAN RUSSO: Thank you. Now, is this what you referred to Assemblyman Bagger, when on June 3 you received information with regard to the allotments? Is this the document?

TREASURER CRANE: Yes.

ASSEMBLYMAN RUSSO: Then that is the entire three pages?

TREASURER CRANE: That is correct.

ASSEMBLYMAN RUSSO: Okay.

TREASURER CRANE: That's the complete document.

ASSEMBLYMAN RUSSO: Thank you. The reason I asked that question at the outset is because it will save a great deal time, at least for me.

On June 2, I spoke to Peggy McNutt of your office, and that same day faxed her a letter asking her for information with regard to -- bond information on that issue. And of course, on that date-- Obviously, your testimony is that you did not receive it until June 3. She would not have had it on June 2. The reason I am asking you is, I would assume that you work quite closely with Ms. McNutt, because I know I called your office quite a few times, as you know.

TREASURER CRANE: Yes, you have called often.

ASSEMBLYMAN RUSSO: Often -- scores maybe.

TREASURER CRANE: Scores, yes.

ASSEMBLYMAN RUSSO: And Assemblyman Frelinghuysen has the phone bills to prove, not that it--

TREASURER CRANE: Is he going to pay them, Assemblyman? That's the question.

ASSEMBLYMAN RUSSO: Only the copy if he does; only the copy.

My question is that for the next several weeks-- I am just wondering, did you share this fax transmission with Ms. McNutt on June 3, or shortly thereafter?

TREASURER CRANE: No, I don't believe I did.

ASSEMBLYMAN RUSSO: Okay. Because I know that for approximately the next three weeks, the answer I received from her was that information was still being awaited from Lazard Freres.

Now, I know later I had received a telephone call from you. The reason I ask that is because this information was received by your office. Did you share it with anyone on June 3? Did you share it with Governor's Counsel? This is the allotment information.

TREASURER CRANE: On June 3, I am not sure I shared it with him.

ASSEMBLYMAN RUSSO: Well, shortly thereafter, would you have shared this type of information with Governor's Counsel -- Counsel to the Governor?

TREASURER CRANE: At some point I did, yes.

ASSEMBLYMAN RUSSO: Some point before the 4th of July, I would assume.

TREASURER CRANE: Assemblyman, this was the middle of budget negotiations, and if you have ever lived through those-- I am not sure. I invite you to come join us sometime. We were in the midst-- I am not sure what day. It might have been before July 4.

ASSEMBLYMAN RUSSO: Okay. So at some point in the month of June probably this was shared. Was this shared with the Governor?

TREASURER CRANE: I did not share it with the Governor, no.

ASSEMBLYMAN RUSSO: Did Counsel to the Governor share it with the Governor by telling you that?

TREASURER CRANE: He did not tell me he shared it with the Governor, no.

ASSEMBLYMAN RUSSO: No other officer of the executive branch told you that he shared it with the Governor at that time -- during the month of June?

TREASURER CRANE: That's correct.

ASSEMBLYMAN RUSSO: Okay. Now, you previously testified, I believe -- and again, correct me if I am wrong -- that with regard to the original allotment on this refunding it was your decision to select Lazard, although Lazard made the initial inquiry, let's say, as Mr. Lurie has stated. You made the decision to opt for Lazard. Is that correct? I want to make sure that I understand that, because I am not exactly sure.

TREASURER CRANE: Assemblyman, you have the note in the lead to the question -- the words "allot" and then "lead underwriter." Could you--

ASSEMBLYMAN RUSSO: Sure. Let me rephrase the question.

TREASURER CRANE: Not to be a technician, but I want to understand what you're asking.

ASSEMBLYMAN RUSSO: Did you make the decision, as Treasurer, to select Lazard as the lead underwriter in that particular issue of December '92 -- the refunding?

TREASURER CRANE: I testified as such, and it is in my written testimony, I think, if you will review-- I forget what page it is, but if you will review it, I testified to that fact.

ASSEMBLYMAN RUSSO: Okay. From that period -- I believe, I guess, the fall or late fall of '92 -- there was no discussion-- If I am correct here, there are 117 firms on these three pages. I know there are 27 on the first page, because I added them before. Your testimony was that, too, so we agree on the numbers.

The first page takes up about 99.5 percent of the issue. So my question is, until June 3 of '93 you, as State Treasurer, had no idea except for Lazard Freres, which is the number one firm here at 30 percent-- You had no idea as to the other 116 firms on these three pages. You weren't involved in that -- the selection of these firms?

MR. LURIE: I believe there are two questions here, and I want to make sure we understand them.

First, you're asking did the Treasurer or any one of us--

ASSEMBLYMAN FRELINGHUYSEN: Mr. Lurie, Mr. Lurie, you are responding to the questions?

MR. LURIE: Yes. Did the Treasurer or myself or anyone else understand that the firms on this list were in the transaction--

ASSEMBLYMAN RUSSO: Right.

MR. LURIE: --and secondly, did we understand what the allocations of bonds were in the transaction? Thus, there are the two different questions.

ASSEMBLYMAN RUSSO: The first question is: Did you know what other firms were involved to this prior to June 3?

MR. LURIE: Certainly.

TREASURER CRANE: Certainly.

MR. LURIE: Yes, they were on the official statement.

TREASURER CRANE: They were on the official statement when it was printed in December.

ASSEMBLYMAN RUSSO: Okay, okay. When did you know the allocation, only on June 3?

TREASURER CRANE: That's when I received the allocation from Lazard. Correct.

ASSEMBLYMAN RUSSO: And there were no discussions between you and Lazard with regard to the allocations before June 3?

TREASURER CRANE: No.

ASSEMBLYMAN RUSSO: No?

MR. LURIE: No.

ASSEMBLYMAN RUSSO: Who made the allocations?

TREASURER CRANE: Hold on, let's--

MR. LURIE: Again, in the spirit of Assemblyman Kamin's asking me to respond when I think it necessary, there was a transmittal in January from the administration to Lazard asking for this information. We did not receive it in the Treasurer's Office until June 3.

ASSEMBLYWOMAN FARRAGHER: From January to June?

ASSEMBLYMAN RUSSO: So your testimony is that, except for Lazard, you knew the firms but you did not know the division of the allotments?

MR. LURIE: That's correct.

ASSEMBLYMAN RUSSO: Now, I thought I heard before, and I want to make sure-- I know that page 6 of the August 27 report has a whole section clearly setting out the allotment. Maybe I should look at that for a second. But I know that in the next to the last paragraph on that page, it talks about the issuer. Now, the issuer is the State, right?

TREASURER CRANE: Correct.

ASSEMBLYMAN RUSSO: Okay.

MR. LURIE: I'm sorry, what page are you on?

ASSEMBLYMAN RUSSO: Can somebody help me out?

ASSEMBLYMAN KAMIN: Mr. Chairman, may I ask a question while you are looking?

ASSEMBLYMAN RUSSO: Yes, here it is.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Kamin, a point of order.

ASSEMBLYMAN KAMIN: In line with Assemblyman Russo's questions, you knew who the firms were that were involved, but did not know to what degree they were participating as far as their share. My question is: Was there any recommendations from the Treasurer's Office as to what level of participation a firm might take; for example, as comanagers, senior comanagers -- at what level they participated? So there are Tier 1, Tier 2, and Tier 3.

TREASURER CRANE: If you would-- Assemblyman, if you turn to -- I guess back to Exhibit 10--

ASSEMBLYMAN KAMIN: I am looking at the first page of Exhibit 10.

TREASURER CRANE: Oh, okay, fine. Then you've got what you need. Do you see the percentages in the first column?

ASSEMBLYMAN KAMIN: I do.

MR. LURIE: "Underwriting Participation" is the heading.

TREASURER CRANE: We participated in the construction of the underwriting participation by these firms -- the percentage.

ASSEMBLYMAN KAMIN: Okay. So then there was a determination as to what level of participation a particular firm might, in fact, have?

MR. LURIE: Well, let's be clear about what that column means. That column refers to the theoretical risk that each firm has in underwriting the transaction if, for some reason, the underwriting syndicate has to buy the bonds without having any purchasers at hand. In that respect, this was purely a theoretical number, and was not ever used for the allocation of bonds. So I want to be clear that that refers to the theoretical risk, not to the allocation of bonds or the allocation of fees.

ASSEMBLYMAN KAMIN: Not to the last column on the right?

MR. LURIE: Anything to the right of that column was separate and distinct from there, Senator.

ASSEMBLYMAN KAMIN: Okay. But the level -- whether you are a Tier 1, Tier 2, or Tier 3-- That part of the process is something that goes back -- that you, Mr. Treasurer, were involved with?

TREASURER CRANE: Through Mr. Lurie, yes.

ASSEMBLYMAN KAMIN: Through Mr. Lurie?

MR. LURIE: We assisted in determining the risk to each of the firms.

TREASURER CRANE: Right.

ASSEMBLYMAN KAMIN: Which is column one.

MR. LURIE: Sir?

TREASURER CRANE: I'm sorry?

ASSEMBLYMAN KAMIN: Which would be column one?

MR. LURIE: That is correct.

TREASURER CRANE: That if there was nobody in the market anyplace that would buy our bonds on that given day, these underwriters would buy them. This is the risk part of their participation.

ASSEMBLYMAN KAMIN: For which they are rewarded in column seven or eight -- seven, six.

MR. LURIE: No. If there was, in fact, an underwriting that needed to take place because there were not any bonds purchased by investors for at least a portion of the securities, there would be a separate fee negotiated with the underwriters on that portion of the securities. These fees that you see in the other columns on the page refer to the bonds that were actually purchased by investors, not the bonds that were not purchased by investors. There is a component of the underwriting spread called the "underwriting fee" that refers to any fee that is paid for bonds that are not purchased by investors. We did not have such an underwriting fee in this transaction, because there was no need for that type of

underwriting. That is why I say this brief is a purely theoretical number that is set before the deal in case it is needed. It was not needed in this case.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman Russo, following up, please.

ASSEMBLYMAN RUSSO: Yes. Now, with regard to especially the first page of that three-page fax, the light column is "Pool Allocation." If I heard previously correctly from the Treasurer, the pool allocation, or what I would call the "retention," that had involvement of the Governor's Counsel; not the allotment, but for the last column. That is what I wrote down before, and I want to confirm that. Is that correct -- the retention, or the pool allocation?

TREASURER CRANE: I testified that on June 3 I received this fax document from Lazard Freres, and the pool allotment had been done. I later learned that there was a conversation between the Chief Counsel and Lazard on that particular allotment.

ASSEMBLYMAN FRELINGHUYSEN: If you could lean a little closer to the microphone, Mr. Treasurer--

TREASURER CRANE: I have been sitting here for a while, and-- As I said, and as Mr. Lurie has testified, we in the administration sought this information from Lazard in January, and then we began by April with repeated calls from the Department of the Treasury seeking this information. I finally got the fax on June 3.

ASSEMBLYMAN RUSSO: And when did you have the conversation. Obviously, this fax does not say that the pool allocation was in any way influenced by Governor's Counsel, so was it that day or immediately subsequent that you spoke to Governor's Counsel and learned that?

TREASURER CRANE: After receiving it, and I don't remember what day.

ASSEMBLYMAN RUSSO: But at some point after that?

TREASURER CRANE: Some point after that.

ASSEMBLYMAN RUSSO: Have you discussed that particular issue with the Governor?

TREASURER CRANE: No.

ASSEMBLYMAN RUSSO: No. Now, inasmuch as this is the three pages you received and the first time you got them was June 3, was this the only piece of information whether you or Ms. McNutt or Mr. Lurie had asked-- Was this the major piece of information that you had wanted from Lazard since January -- this three-page enclosure?

MR. LURIE: We sent Lazard a letter to request information in the form of a spread sheet that we attached, which was blank as to its numbers, but just in a general form. This was in general accordance with that form.

ASSEMBLYMAN RUSSO: When I met with you, Mr. Lurie, I believe on June 18 with Mr. Kingston from the Assembly staff, I believe you said to me at that point that it might be likely that I could call Lazard Freres and speak to Mr. Paul with regard to the information which I guess was in this fax, which I didn't know at that time; and that also you had written a report. Was the report the same report that was set forth on August 27? Was that the report that was not complete at that time?

MR. LURIE: That's correct. It turned out to be, although it was not in that exact form.

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman, for the record, maybe from the Treasurer, who is Mr. Paul? Is that somebody that we dealt with?

MR. LURIE: Robert Paul is the Senior Managing Underwriter at Lazard Freres.

ASSEMBLYMAN FRELINGHUYSEN: Is this the individual that the Treasurer's Office, and you, Mr. Lurie, primarily communicated with?

MR. LURIE: With respect to the allocation of bonds and underwriting, that is correct, although primarily on the transaction we dealt with the Investment Banking Division, which was another set of individuals.

ASSEMBLYMAN FRELINGHUYSEN: And who in particular in that division, for the record?

MR. LURIE: Primarily John Tamagni (phonetic spelling) and Rick Poriae (phonetic spelling).

ASSEMBLYMAN FRELINGHUYSEN: Thank you. Back to you, Assemblyman.

ASSEMBLYMAN RUSSO: When you had just about, as you said, completed that report around mid-June, did it take-- Was there any more information you needed from Lazard to complete that report? Obviously, you had had this information since June 3.

MR. LURIE: Well, the report, as you have read -- you have no doubt read -- contains information that goes far beyond the information -- than just this one report. So therefore, I suppose the answer to your question is, no, the report required much more information than what was in this three-page fax.

ASSEMBLYMAN RUSSO: Treasurer, when I had put my request in, whether orally or in writing, numerous times, at one point you indicated to me in late June that your office -- and Mr. Lurie had previously confirmed it -- that there would be a report. Of course, I had never asked for the report; I had only asked for the fax transmission, which what became Exhibit 10. Was there any reason that it took another two months before that report was released on August 27?

TREASURER CRANE: Well, this report has gone through a number of reformatings as we tried to make it clearer and clearer and more usable as time went on. We made the decision--

First of all, you should know, Assemblyman, that you were not the only one who was requesting information about bond transactions.

ASSEMBLYMAN RUSSO: That's right.

TREASURER CRANE: I had members of the press asking for transactions separate and apart from this one. I had other legislators seeking information, if I remember correctly, and in the month of June, believe me, I get enough requests for information from the Legislature -- particularly pertaining to the budget -- and a lot of people.

We made the decision that we wanted to definitively and clearly put forth a report that showed all the expenses. On August 27, we put out the first phase of it. We said we still had some more to go get, and a scant two weeks later we put out the rest of it, because we believe it was important to put the whole of the transactions -- all of them -- out for-- Look at them all. I mean, we haven't even talked about some of the other successful ones.

ASSEMBLYMAN FRELINGHUYSEN: Mr. Treasurer-- Excuse me, Assemblyman--

TREASURER CRANE: And so we decided to put it into a total context, not to--

ASSEMBLYMAN FRELINGHUYSEN: Mr. Treasurer, let me say, relative to the period of time it took to get this information, I would not minimize the request of any legislator, but as one who participated and specifically requested, on a timely basis, this information, I am not sure I would want to be put in that category. I think the members of the Joint Budget Oversight Committee, when they approved this complex deal, fully anticipated that that information would be forthcoming a lot sooner than it did.

While there may have been some advantage for whatever reason to compare different administrations and their bonding practices, in fact, the Appropriations Committee Chair and those that I represent on this Committee, both Republicans and Democrats, deserve to get that information a lot earlier than we did.

Now, I know that we had the budget season; I know that there were other legislative requests. But if, in fact, this was an issue, by your own definition, of an enormous size in importance and complexity, if there was information, it should have been coming to us a lot earlier than it did.

TREASURER CRANE: Mr. Chairman, I won't address the timing of it. What I am trying to do for the Assemblyman, and for you, in a rather forthright way, is to suggest that we wanted to put into context, not just a single issue, but all of the issues.

ASSEMBLYMAN FRELINGHUYSEN: But for the Joint Budget Oversight Committee and the Republicans and Democrats who serve on that Committee, both as Senators and as Assemblymen -- and you know as a former staff to that Committee, a partisan staff -- that we, in fact, represent the Legislature. We represent certain responsibilities which are set out by our Committee's description. With all due respect, while there may be a high interest in other bond issuances, the Committee thought that you would be keeping your word in terms of getting the material to us on a timely basis. It did not have to appear as an amalgam of bond issuances and underwriting fees and legal expenses that came out in a number of reports from August 26 and following. It could have come out much earlier than that. It is unfortunate that this situation has occurred.

Assemblyman Russo?

ASSEMBLYMAN RUSSO: Thank you. With regard to the facts we received, Mr. Lurie, would you say this was a key factor in preparing that report?

MR. LURIE: Well, it was only one of many bits of information we had to gather for that report.

ASSEMBLYMAN RUSSO: Okay. Now, with regard to that chart -- and I will ask you this first, and possibly the Treasurer second -- that is a chart really of Tier 1 of this report, of the first page. Now, we have heard testimony with

regard to the last column, which is the "Pool Allocation," and we heard previous testimony, I believe, from you or the State Treasurer as to what pool allocation is, or retention. It is also on page 6 of the report.

My question is: When you look at column 1 with the risk, which is what you talked about -- Lazard at 30 percent, and you see them in tiers, Tier 1 is nearly 15 percent, I think you would agree; Tier 2, 7.5 percent; Tier 3, 7.5 percent. That first page adds up to 99 percent, roughly. What is the coordination, if any, with the retention, especially in Tier 1, where you have in the seniors and co-seniors \$134,000 being retained; Tier 1, 610 -- six times that; Tier 2, \$100,000; and Tier 3, \$205,000. With regard to the percentages, you don't even see each outfit, each firm receiving the same coordination, even within the tiers. How does that happen?

MR. LURIE: There are two things I want to say about the pool. First, the premise of your question, I guess, is that there should be a direct correlation between the pool allocation and the underwriting participation.

ASSEMBLYMAN RUSSO: Should there be?

MR. LURIE: Well, let me address that. You refer to page 6 of the report--

ASSEMBLYMAN RUSSO: Right, the next to the last paragraph.

MR. LURIE: That's right. I wanted to thank Mr. Montalbano today, by the way, for complimenting me -- he didn't know it was me -- on this section of the report. He said it ought to be copyrighted. But, be that as it may, this section of the report on page 6 does state the factors that are often used, that are commonly used to allocate these kinds of holdback pools, as they call them.

ASSEMBLYMAN RUSSO: I should also say I thought it was extremely well written.

My question is this: How do you come up with a situation -- when I say "you," I don't mean you in particular--

MR. LURIE: Let me continue to answer your question.

ASSEMBLYMAN RUSSO: --with that kind of divergence?

MR. LURIE: Well, let me get to the second part of the question -- the second part of my answer, which is: I do not know how this allocation was done. I did not learn about it until June 3, when the Treasurer shared it with me after the fact. Obviously, it had already been completed.

ASSEMBLYMAN RUSSO: Obviously.

MR. LURIE: Okay? So I cannot justify or explain how this was done, and I would, therefore, defer on that. I can only tell you that there are other factors commonly used.

ASSEMBLYMAN RUSSO: You mentioned, I believe -- excuse me -- four issues, I believe, when Assemblyman Smith asked you were there refundings. Was that refundings or--

MR. LURIE: Right, three allocations.

ASSEMBLYMAN RUSSO: Okay. When you had allocation sheets like this, have you ever seen allocations this out of kilter at any tier?

MR. LURIE: We include in the report the sum total of the pool allocations that occurred on any transactions, as far as I can determine, and I have tried to be as exhaustive as possible in determining that. We have never done this type of pool allocation on a refunding issue -- a GO refunding issue before, but it has been used on other issues in the State of New Jersey, and those are fully disclosed in the report.

ASSEMBLYMAN RUSSO: Now, Mr. Treasurer, what I just asked Mr. Lurie. I was pointing to that chart, which is a little bit of a blowup of Tier 1, and my question was-- Nobody answered one of the questions with regard to the pool allocation. That is why I asked that question, to try to enlighten myself.

Now the question: The "Pool Allocation" on the right side, or the retention, how can Tier 1 be that large next to the other tiers, and how can one or two companies, in

particular one, Cypress, receive 57 percent, and another one 130-- They are just not even close. There is virtually no relationship to the risk.

Now, can you answer that? I know Mr. Lurie had a hard time. He said he doesn't really know the answer to that.

TREASURER CRANE: As I testified--

ASSEMBLYMAN FRELINGHUYSEN: Mr. Treasurer?

TREASURER CRANE: Yes. As I testified, Assemblyman, when I received the facts on June 3 in my office, the allocation of the pool was done.

ASSEMBLYMAN RUSSO: It had been done, obviously. But can you explain-- I understand that you read it for the first time on June 3 and you shared it with Mr. Lurie. That is what he testified to while you were out for one second. We understand that. My question is: From your perspective as State Treasurer, can you explain, can you give any rational basis to someone why Cypress Securities is 2.1 percent risk, as everybody else in Tier 1, and they have three times -- my math is -- three times what Lazard has on a pool allocation, seven times and eight times and ten times what some of the other firms have in the same tier, and they have a 2.1 percent risk, as Mr. Lurie said, each company, in that bracket? There just doesn't seem to me to be any rational basis, but again, you are the State Treasurer. I'm asking you: Was there some kind of rationale after the fact that you see?

TREASURER CRANE: Would you turn to page 6 of the report?

ASSEMBLYMAN RUSSO: Sure.

TREASURER CRANE: You started there, Assemblyman.

ASSEMBLYMAN RUSSO: Yeah. No, we looked at that. Mr. Lurie had written that, and I understand that. But I'm saying, even with that lighting, how can it still be that out of kilter?

TREASURER CRANE: I'm trying to answer your question, Assemblyman.

ASSEMBLYMAN RUSSO: Sure.

TREASURER CRANE: On page 6, the next to last paragraph on that particular page--

ASSEMBLYMAN RUSSO: Right.

TREASURER CRANE: The holdback pools can also be used to compensate firms, especially small firms and minority firms, that were aggressive in placing orders for bonds, but for whatever reason did not receive allocations of bonds from the senior manager commensurate with their orders. That is one way -- and this has been in the written report--

ASSEMBLYMAN RUSSO: Right.

TREASURER CRANE: -- that you have before you -- that this holdback pool could have been allocated, to compensate those--

ASSEMBLYMAN RUSSO: They could? Okay.

TREASURER CRANE: You asked for one rationale -- there's one.

ASSEMBLYMAN FRELINGHUYSEN: Page 6 you are referring to, for our transcript purposes?

TREASURER CRANE: It is in the August 27 report, Mr. Chairman.

ASSEMBLYMAN FRELINGHUYSEN: All right. Thank you.

Assemblyman Russo?

ASSEMBLYMAN RUSSO: That would follow that paragraph. I appreciate that answer.

My question with regard-- Looking at those columns now on the "Allotment," column 2, the "Designation," column 3, "Total Bonds," if you look at Cypress, and then you go to Enright, right underneath it, now Cypress has the smallest allotment, except for Enright, which is zero. Both of those firms have the smallest designation by far, except that First American is close. And First American, which is right below Enright in the designation, has a very small number, but

they've got no retention. So their numbers are relatively small if you look at column 3 for the designation -- 435 to 500 to 250 -- very small mixed together numbers in that tier.

TREASURER CRANE: Assemblyman, I think I just read you a sentence. What this does not include are the orders.

MR. LURIE: Yes.

TREASURER CRANE: The bond orders. This is the result, if you will, of-- This is the final count, if you will, of this particular transaction. I mean, I don't know how many orders were placed by anybody -- Tier 1, Tier 2, Tier 3, Tier 4, whatever.

ASSEMBLYMAN RUSSO: You mean-- Now, last week, I believe you received it on Friday, because I had provided your office with a week, which is the 17th-- I called Ms. McNutt-- But I faxed you a letter. At that point, I had asked you, because I couldn't answer that question either-- What I asked you for was copies of the sales slips, which, if you don't have them, I know Lazard will. I asked for copies of all the sales slips for all the companies here, because I believe the only way you could answer that question -- anyone could answer that question-- Because if I ask you how many bonds did Cypress Securities sell, even though they had an allotment of \$350,000, is your answer-- You probably don't know. Would that be it?

TREASURER CRANE: I don't know what their orders were.

ASSEMBLYMAN RUSSO: But what do they actually do? What did they actually market? What did they actually sell?

MR. LURIE: That's listed on this page.

TREASURER CRANE: That is what is listed on this page. We don't know -- and I refer back to page 6 of the report -- we don't know what their orders were. I do not know, sitting here today. I don't know if Mr. Lurie knows what any of these firms placed in orders for bonds. Do you know?

MR. LURIE: No.

TREASURER CRANE: No. We do not know. I am not the fine technician that Bob Lurie is, but, I mean, we had on the day of this sale, Assemblyman-- We had orders in excess for some maturities -- correct?

MR. LURIE: Yes.

TREASURER CRANE: I mean, we had orders in excess of what -- of the number of bonds we were going to sell. People were wanting New Jersey paper. They wanted it that day. So, I don't know who placed orders here.

ASSEMBLYMAN RUSSO: Does Cypress have a sales staff? My understanding is that it doesn't. Mr. Lurie, would you know that?

MR. LURIE: I have never been to Cypress' offices. In discussions I have had with Dave Thompson of that firm, he represented to me that they did have somebody responsible for selling and underwriting bonds.

ASSEMBLYMAN RUSSO: Seventeen million dollars worth?

MR. LURIE: That's what this page says. I have no reasons to question it.

ASSEMBLYMAN RUSSO: Now--

ASSEMBLYMAN FRELINGHUYSEN: Assemblyman?

ASSEMBLYMAN RUSSO: Wouldn't they have to have capital of \$17 million to warrant--

TREASURER CRANE: No.

MR. LURIE: No. I mean, MSRB regulations have guidelines as far as capital that they must reserve, or set aside in order to underwrite certain amounts of securities. It is far less than a one-to-one relationship. It scales, you know, around 5 percent of the amount underwritten.

ASSEMBLYMAN RUSSO: With regard to the reinvestment-- Let me ask it this way: I believe, Mr. Treasurer, you answered -- you stated that you had gotten a letter from the various companies, or from Lazard, I'm not sure, stating that market prices were obtained for securities?

TREASURER CRANE: Yes.

ASSEMBLYMAN RUSSO: Okay. Was that for the reinvestment you were talking about?

TREASURER CRANE: Yes.

ASSEMBLYMAN RUSSO: Okay. Did they quote you prices for the securities in that letter? It is not in that report, is it?

TREASURER CRANE: No. It is a letter of--

ASSEMBLYMAN RUSSO: Okay. Did they quote you prices, or was it a one-paragraph that, "We bought at market. We just want you to know that"?

MR. LURIE: They did not quote us prices in that letter.

ASSEMBLYMAN RUSSO: They just made a statement?

MR. LURIE: They just, it was a--

ASSEMBLYMAN RUSSO: You will supply us with a copy of that letter, but I would assume that the letter is something to the effect that, "We bought at market."

MR. LURIE: That's right.

TREASURER CRANE: That is correct.

ASSEMBLYMAN FRELINGHUYSEN: The Chair would like to request a copy of that letter. Assemblyman Russo, it has become evident, I'm sure to everybody in this room since we are moving toward the 6:30 hour, that there is going to be a need -- and I have already announced it -- to have further hearings to call upon the Treasurer and perhaps Mr. Lurie and Mr. Machold, and others both in the public and private sectors to come before the Committee.

Yes?

ASSEMBLYMAN RUSSO: A final question.

ASSEMBLYMAN FRELINGHUYSEN: A final question.

ASSEMBLYMAN RUSSO: Did your office-- I didn't see the report; I asked Ms. McNutt, as late as last week-- Did the Treasurer's Office put in a written request to Lazard for copies of either the order tickets or for copies of the profits

or fees, meaning a listing of their profits and fees, especially from the reinvestment? I'm not saying you got it. I understand the answer was that you do not have the information.

TREASURER CRANE: On order tickets?

ASSEMBLYMAN RUSSO: Order tickets and/or profits and fees, because I did not see the report.

TREASURER CRANE: You have two questions there, Assemblyman.

ASSEMBLYMAN RUSSO: Okay.

TREASURER CRANE: Let me break it apart so I can respond to each one clearly and with--

ASSEMBLYMAN RUSSO: Profits and fees.

TREASURER CRANE: Profits and fees?

ASSEMBLYMAN RUSSO: Yes, sir.

TREASURER CRANE: No, I didn't ask them, and I will tell you why: It is like, for instance, the State buys State trooper cars. I do not know what GM or Ford makes on every one -- profit on every one of those State trooper cars. They don't disclose that. We go with the lowest bid. I required that. They could have lost money on some of these securities. They could have bought it the week before or three days before, and when they had to sell it to us at market, the market had moved away. They may have lost some money on the securities. I don't know if they made money on it or what the level of profit was. I don't know if they lost money through their investment.

ASSEMBLYMAN RUSSO: Are you aware, Mr. TreasureB, that the same firm in Kentucky, in essence, marked up the goods by nineteen/thirty-seconds by buying the goods, in essence, on the reinvestment -- by buying the securities two days early, and the end result is it cost taxpayers more? Was that question asked? That is why I am asking the question.

TREASURER CRANE: Assemblyman, I did not know -- and I think we have already testified to this point-- We did not

know about the Kentucky-- I think Assemblyman Bagger, earlier in the questioning--

ASSEMBLYMAN RUSSO: That's right.

TREASURER CRANE: --and I don't know if you were here -- asked us that question. We did not know about Kentucky until last week.

ASSEMBLYMAN RUSSO: No, I meant subsequently; I did not mean at that time. Obviously, you didn't know. I only meant subsequently.

TREASURER CRANE: Subsequently--

ASSEMBLYMAN RUSSO: Ms. McNutt told me that she couldn't answer the question. That is why I was wondering if there were copies of correspondence that had gone unanswered. That is what I am asking. I assume the answer is, "No."

Thank you.

ASSEMBLYMAN FRELINGHUYSEN: Thank you.

Assemblyman Russo, you are not driven to ask any questions, are you?

ASSEMBLYMAN ROMANO: Not Russo, Romano. You have it wrong. I am Romano.

ASSEMBLYMAN FRELINGHUYSEN: Romano, excuse me.

ASSEMBLYMAN ROMANO: I will be very brief. I am not looking to evoke any comments.

First of all, I want to compliment all my colleagues today. You know, the -- how shall I say it? -- deposition discovery was rather gentle. You make the point. We did have the whitewash line, you know, with the clothes dancing along the line, etc. That's fine.

I just want to make this comment to you: First of all, in terms of--

ASSEMBLYMAN FRELINGHUYSEN: Is this going to be in verse, Assemblyman, or is this going to be--

ASSEMBLYMAN ROMANO: No, no, not in verse. No. I'll tell you the truth, after six cups of coffee, I can't be here too long.

In terms of competitive bidding, you know, we heard that all today here. And, you know, you can bid almost anything when you are looking for the lowest responsive bid. The difficulty, however, Mr. Chairman, is to determine the responsible bidder. That is where I think the whole gist of this matter occurs.

You know, there is a basic definition of responsibility within contracting laws that talks about the experience, the moral integrity, the financial ability, and the qualifications of the bidder. I think that is something that we overlook when we talk about competitive bidding.

My own training was of a teaching order that was based on repetition or reinforcement, and I am not going to belabor the point by asking Mr. Lurie or Machold the question, but I just have one question for the Treasurer: Sans all the problems that we have had in the newspaper, sans all the problems of subpoena, go back to that time again. In your judgment as a Treasurer, as a professional administrator, would you have done that sale the exact same way?

TREASURER CRANE: Yes.

ASSEMBLYMAN ROMANO: Thank you very much. I have no other comments.

ASSEMBLYMAN FRELINGHUYSEN: Okay. Thank you, Assemblyman Romano.

The Chair and all the Committee members would like to thank the Treasurer for his time here this afternoon, as well as Mr. Lurie and Mr. Machold.

Mr. Treasurer?

TREASURER CRANE: If I may ask a housekeeping question?

ASSEMBLYMAN FRELINGHUYSEN: Yes?

TREASURER CRANE: If I am to appear again before the next hearing, will the transcript be made available prior to that date?

ASSEMBLYMAN FRELINGHUYSEN: We are going to do our level best to make sure that transcript is available in some form.

TREASURER CRANE: I appreciate it. After three-and-a-half or four hours, it would make some interesting no-doze reading.

ASSEMBLYMAN FRELINGHUYSEN: Yes.

We stand adjourned. I anticipate the other Committee hearings will be announced in the near future. Thank you all for your participation.

(MEETING CONCLUDED)