

Approved

Ivan Sand
Date

MINUTES OF THE House COMMITTEE ON Local Government

The meeting was called to order by Representative Ivan Sand at
Chairperson

1:30 ~~xxx~~ a.m./p.m. on March 21, 1983 in room 521-S of the Capitol.

All members were present except:

Committee staff present:
Theresa Kiernan, Revisor of Statutes Office
Mike Heim, Legislative Research Department
Jeanne Mills, Secretary to the Committee

Conferees appearing before the committee:
Senator Gaar
E. A. Mosher, League of Kansas Municipalities
Senator Winter
Buford M. Watson, Jr., City Manager

Chairman Ivan Sand called the meeting to order.

Sub SB 265 - Registration of bonds; compliance with federal law.

Theresa Kiernan of the staff gave a brief overview.

Senator Gaar appeared to give background and intent. The substance of the bill is included in the first ten sections and makes a number of technical amendments to bond statutes. The Committee of the Kansas Investment Bankers has asked for a grace period before the Committee takes action so to see if the legislation is workable. The Chairman agreed to wait before taking action. Information on municipal bonds was presented to the members (See Attachment I). Senator Gaar responded to questions from the members.

Representative Moore made the motion, seconded by Representative Nichols, to amend Sub. for SB 265 so to become effective on publication in the Kansas Register. Motion carried.

Representative Roper made the motion, seconded by Representative Johnson, to amend Sub. for SB 265 by inserting the language found on page 6, line 206 beginning with subsection (c) through line 208, into page 11 on line 390 after the word "registered" and renumber. Motion carried.

Representative Nichols made the motion, seconded by Representative Moore, to amend Sub. for SB 265 by inserting the language found on page 6, line 206 beginning with subsection (c) through line 208, into page 103 on line 996 after the word "registered" and renumber. Motion carried.

E. A. Mosher, League of Kansas Municipalities, appeared in support of Sub. for SB 265.

The Chairman announced action would be postponed until later in the week.

Sub. for SB 286 - AN ACT concerning public improvements; relating to the assessment of the costs thereof; amending K.S.A. 12-6a08 and repealing the existing section.

Senator Winter appeared to give background and intent. This bill deals with assessment plans under the city General Improvement and Assessment Law to add that this section shall not be construed to limit the adoption of any assessment plan for any improvement that recognizes varying benefit levels and imposes assessments in relation thereto.

Buford M. Watson, Jr., City Manager, Lawrence, appeared in support of the bill. A copy of his testimony is attached (See Attachment II).

E. A. Mosher, League of Kansas Municipalities, appeared in support.

CONTINUATION SHEET

MINUTES OF THE House COMMITTEE ON Local Government

room 521-S, Statehouse, at 1:30 ~~a.m.~~/p.m. on March 21, 1983

SB 296 - AN ACT concerning municipal courts; relating to sentencing; amending K.S.A. 12-4509 and repealing the existing section.

Staff gave a brief overview. The bill concerns sentencing by municipal courts to require reparation or restitution be a part of the conditions of probation unless compelling circumstances make this unworkable.

E. A. Mosher, League of Kansas Municipalities, expressed the thought that every case before the municipal court would have to be decided by the judge if there were compelling circumstances.

SB 297 - AN ACT concerning park districts; repealing K.S.A. 19-2879. No conferees appeared.

Representative Schweiker made the motion, seconded by Representative Acheson, to report SB 297 favorable for passage. Motion carried.

Buford A. Watson, Jr., City Manager, Lawrence, appeared in support of SB 301 that will be heard on March 22, 1983. See the minutes of that day for a copy of his testimony.

Representative Nichols made the motion, seconded by Representative Roper to report Sub for SB 286 favorable for passage. Motion carried.

Representative Rezac made the motion, seconded by Representative Fry, to approve the minutes of the March 3, 1983, meeting as printed. Motion carried.

Representative Fry made the motion, seconded by Representative Turnquist, to approve the minutes of the March 17, 1983, meeting as printed. Motion carried.

Meeting adjourned.

2/23/83

SPECIAL FEATURES

ATTACHMENT I

Municipal Bonds in Registered Form: What It Means, How It Works

by John E. Petersen*

Amid the sound and fury that accompanied passage by Congress of the Tax Equity and Fiscal Responsibility Act (TEFRA) in August, 1982, little notice was paid generally to the provisions in the new federal tax law that mandate registration of tax-exempt bonds. With the bond registration requirement now in place as federal law and scheduled to take effect in January, 1983, the government financial manager is afloat on a sea of procedural questions to be answered and decisions to be made quickly. The local policymaker is asking: What does a registered bond look like and how is it traded? Who will promulgate regulations governing the registration of new bond issuances and when? Will our outstanding bonds have to be registered? How will the registration requirement affect interest rates that we can expect on our next bond issue? Can and should our city (or state) go to the market with an issue before mandatory registration takes effect? Where can we get objective advice on these questions?

The purpose of this article is to briefly explain the new federal requirements that all state and local bonds issued after December 31, 1982, be in registered form. It will review the nature and scope of the new requirement, penalty provisions, how the new requirement may be satisfied, and general implications of the requirement for the marketing of municipal bonds in the future.

The reader is cautioned that the relevant regulations from the U.S. Treasury have not yet been promulgated and, moreover, that many operational details involving the registration process have not been conclusively decided upon by key market participants. Furthermore, certain state and local laws regarding bond issuance appear to be in conflict with the federal requirement. At least, they may make the registration process awkward and cumbersome for issuers. Governments planning to sell bonds next year are strongly advised to check with bond counsels, financial advisors, and underwriters regarding (1) how the new registration requirements may be met in an efficient and economical manner and (2) what specific changes are needed in the issuance process to conform with the new requirements.

The Municipal Finance Officers Association (MFOA) will hold two seminars late this November that will examine the registration requirements, how they may be satisfied, and other important features of the new tax law that will affect the issuance of state and local securities. More information on these seminars is provided in the box below.

The Registered Form Bond Requirement

Under the 1982 federal tax act all state and local obligations issued must be in registered form.¹ Only three exceptions are

- provided, those being if the obligation—
1. is not of a type offered to the public;
 2. has a maturity (at issue) of 1 year or less; or
 3. fits within a particular exception for bonds that are sold only to foreign persons.

"Registered Form" is not specifically defined in the act. However, under existing regulations and according to the Conference Report² language, an obligation is in registered form if its ultimate ownership is registered as to both principal and interest and if transfer between owners must be effected by the surrender of the old instrument and either the reissuance of that instrument by the issuer to the new owner or issuance of a new instrument by the issuer to the new owner. This process is in distinction to the unregistered ("bearer") obligations, currently used in the municipal bond market, whereby the transfer may be effected only by the physical delivery of the instrument to the purchaser (or its agent) and a record of ownership need not be kept.

The registered form security is not entirely new to municipal bonds. Many issuers have provided the option to register bonds if investors so wish, and in the case of certain obligations relating to housing or energy programs, registered bonds must be used if the interest on the obligations is to be exempt from federal income tax. But, overall, an estimated 97% of tax-exempt bonds currently are sold as bearer form instruments.

Compliance with the Requirement

The Conference Report provides additional guidance as to satisfaction of registered form requirement. It indicates that an obligation is registered if the right to principal and interest is transferable only through a book entry consistent with regulations by the Secretary of the Treasury. Such a book entry requirement will be satisfied by entries, on the books of any person holding an obligation in a street name or safekeeping the obligation for another, when the ultimate beneficial owner of the obligation is determinable by the system.

The Conference Report anticipates, for example, that a system of entries comparable to that used for U.S. Treasury bills would satisfy the registration requirement. An issuer could choose, use an agent to maintain its book entry system. The Report notes that if local law requires the issuer to maintain its own registry, the issuer could issue a single registered obligation (commonly known as a "jumbo") to its agent which could re-issue the obligation in such form that the ultimate beneficial owners can be identified. The controlling fact as to acceptable systems appears to be that the Secretary of the Treasury be

*Dr. Petersen is Director of the Government Finance Research Center of the Municipal Finance Officers Association.
¹The new requirements pertain to all issuers, including the U.S. government. In this analysis we will focus only on their application to state and local governments.
²The Conference Report is one of the legislative documents detailing and explaining the provisions of a bill and, as such, serves as a major tool for understanding the intent of Congress. It is issued by the Conference on the bill—the group of legislators appointed from each house of Congress who negotiate the differences between the House and the Senate versions of a bill and recommend a final form for adoption by the Congress.

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able to require that the systems, however they be administered, be maintained in a manner that will permit examination of entries in connection with the enforcement of Internal Revenue laws. Furthermore, in the case of the above-mentioned exemptions from the registration requirements, the Secretary is given authority to require registration of short-term and non-public obligations if, with respect to certain types of obligations, he determines that they are used frequently to evade federal taxes. The law does not apply retroactively.

Outstanding municipal securities issued before ^{July 1} January 1, 1983, may continue to exist in bearer form. However, if a bond is in registered form prior to January 1, 1983 and carries privileges for its conversion into bearer form, whether or not such a conversion to bearer form will be permitted after the effective date of the registration requirement is not clear. Last, the date of delivery of the bonds and payment for them is considered to be the date of issuance of the obligations. Consequently, bonds sold during 1982, but where the closing does not take place until January 1983, must be issued in registered form.

The reader is cautioned, however, that until Treasury regulations are promulgated, no one is certain as to the details of compliance. Several groups are attempting to establish when the Treasury regulations will be released and what will be the specifics of their content.

Penalty Provision

The major penalty for state and local government issues that fail to comply with the registered obligation requirement is that interest income on the violating security would not be exempt from federal income tax. Additional penalties include the loss of capital for gains treatment and the denial of loss deduction when such violations are sold or exchanged. Moreover, it appears that the Act would impose on issuance of an unregistered security an excise tax on the issuer equal to one percent of the principal amount of the obligation multiplied by the number of years in the term of the obligation.

Operational Considerations with Registered-Form Bonds

The design and implementation of a comprehensive registered-form bond system for the municipal securities market by January 1, 1983, presents numerous problems. At present, the vast majority of state and local securities (97%) are sold as bearer-form instruments. Some municipal bonds have been sold where registration of principal and interest or principal only is optional; and for one class of securities—those for housing and energy-related activities—the registered form is required as a matter of federal law. But, overall, the new requirements regarding the recording of ownership and related matters in the issuing and trading of municipal securities will present new organizational challenges for market participants. Corporate bonds, as opposed to municipal securities, are typically sold in registered form. As a practical matter, registration of the owner means that either the issuer or his agent must keep a registry wherein is recorded the name of the investor in the securities. The bonds may be held on behalf of the investor for safekeeping in a "street name" (broker-dealer) or a "nominee" (special administered trust). But that agent, in turn, must then keep books whereby the ultimate owner in whose interest the security is being kept is recorded.

Since ownership is a matter of bookkeeping record, the bond documents and instruments in the corporate market have become highly standardized in order to accommodate rapid exchange and precise identification. When bonds are traded among owners, the transfer is accomplished by an agent, called a "transfer

agent," who cancels the old document, authenticates a new document, and sends it to the owner whose name is then entered in the registry. Subsequently, interest payments are sent to the new owner without its having to return a coupon as is the case with the bearer-form coupon bond.

In order to implement such a system in the municipal securities market, a high degree of standardization will be required. For one thing, the individual securities will need to be precisely identified. This presents a problem in municipal securities because of the multiplicity of issuers and issues. It has been estimated that there are more than 2 million separate municipal issues outstanding, as opposed to approximately 40,000 cor-

Highlights

This special feature took its final shape as *Resources in Review* went to press the third week in October 1982 and it reflects the status of legislation, regulation and opinion at that time. More precise and authoritative information on implementing municipal bond registration is expected early in November when the U.S. Treasury Department announces detailed compliance procedures. It is also anticipated that municipal market participants will mount efforts to delay or derail the registration requirement. The reader is cautioned that such events will undoubtedly alter the validity of the information presented here. The most prominent points to be emphasized at this time are summarized below from Mr. Petersen's text.

- Under the 1982 federal act, all state and local obligations issued must be in registered form; only three exceptions are provided.
- The date of delivery of the bonds and payment for them is considered to be the date of issuance of the obligations. Consequently, bonds sold during 1982, but where the closing does not take place until January, 1983, must be issued in registered form.
- Until Treasury regulations are promulgated, no one is certain as to the details of compliance with the Act.
- Penalties for noncomplying issues include loss of tax exemption from federal income tax and, possibly, the imposition of an excise tax on the issuer.
- Implementing a system for bond registration in the securities market will require a high degree of standardization regarding questions of identification, authentication, printing and formatting, and transfer procedures.
- State laws in some states will have to be amended in order to permit compliance with anticipated Treasury regulations.
- Altered payment procedures plus additional recordkeeping requirements may affect the amounts and forms of compensation for the services of transfer agents.
- Questions concerning the extent to which the issuing government should pre-specify depository, paying agent, transfer agent, etc., arrangements remain to be fully explored.
- Issuers are advised to stay on top of the developing situation with several specific caveats.

porate security issues.³ There does exist the CUSIP system⁴, which seeks to provide a unique identification of all securities, including state and local issues, but complete identification for the latter group has yet to be accomplished. A major problem with the current CUSIP system is, according to transfer agents, the inability to designate bonds by purpose within multi-purpose issues. This problem is currently under study by a CUSIP committee.

* Another problem with implementing registered-form securities in the municipal market is the frequent legal requirement for authentication by an officer of the municipality using original signatures. In the corporate area, the transfer agent is empowered in the event of transfer of ownership to create new certificates of ownership through affixing its signature, without requiring an original signature by an officer of the issuing corporation. It appears that in many cases, state laws would need to be amended to allow municipalities and state entities to have transfer agents do the authentication of the security in lieu of original signatures by public officials. Although continuation of original signatures would be theoretically possible, the need for that would considerably slow down the transfer process and increase its cost.

Another municipal market problem involves the preprinting of sufficient bond forms to permit ease in the transfer process. With the widespread use of the serial bonds in state and local offerings, transfer agents would need a large inventory of blank bonds, were these to be preprinted for each maturity. It has been suggested that transfer agents should have the power to enter new serial numbers on "universal" bond certificates that would be good for any maturity in a given serial issue. This would greatly reduce storage and printing costs.

Added operational problems have to do with the selection and relationship of the transfer agent to the market. In many cases, local governments keep their own registry books or appoint local banks or officials to act as transfer agents. Those individuals and entities that transfer only municipal securities are not regulated by the Securities and Exchange Commission nor do they have to comply to its standards regarding transfer activities. Such standards generally require that a transfer be accomplished ("turned around") within 3 days of an order to transfer. In the case of unregulated and infrequently used agents, the performance of transfer agents (particularly in the turn-around time on transfers) may be unsatisfactory and unacceptable to other participants in the market. Transfer fees and who sets them may become a problem.

The physical form of the instrument, itself, is a matter of considerable concern. Under the present bearer-form, bonds frequently carry large sets of semi-annual coupons as part of the document (which tends to be large, colorful, and on heavy paper). The corporate registered-bond, on the other hand, does not have the coupons and is a much smaller, simpler evidence of ownership. The corporate certificate is frequently immobilized (held for safekeeping), and it is important that it be eligible for deposit in a national depository. This requires that the instrument comply with certain standards regarding size, information and format as set forth by the American National Standards Institute Committee (ANSI). The ANSI Committee is currently working on standards that would be applicable to municipal securities, generally based on those used for corporate bond certificates. Such standards must be quite precise in order to allow for large-scale, computerized handling of certificates.

Municipal Securities Rule Making Board Conference

Municipal market participants gathered for a two-day meeting in Washington, DC, to discuss the requirement mandated by the "Tax Equity and Fiscal Responsibility Act of 1982" that municipal obligations be issued in registered form after December 31, 1982.

The conference, held October 18-19, 1982 and sponsored by the Municipal Securities Rulemaking Board (MSRB), was attended by bond dealers, bond counsels, underwriters, depository representatives, issuers, and federal agency and congressional staffs.

The first day was devoted to the effect the new registration requirement would have on the issuance of obligations. Several key areas of concern were identified, such as the significant changes required in state laws to accommodate registered issuance of bonds, the need for a standardized instrument and transfer process, the development of a book entry system, and questions as to how and by whom the additional costs created by the law would be absorbed.

These questions were explored by working groups on the following day. In the final plenary session the following recommendations were approved:

- American National Standards Institute (ANSI) bond form should become the industry standard.
- Model state legislation should be developed that would correct existing constitutional and statutory impediments to a registered obligation system.
- Changes to bond issuance procedures and requirements should be made that would expedite transfer such as printing of ample certificates at time of the original issue to permit subsequent transfers, use of facsimile signatures, and adherence to the Securities and Exchange Commission's (SEC) 72-hour turn-around rule for transferring securities.
- Standard date of record and payment should be adopted and securities should be delivered in denominations of \$5000.
- Securities should be immobilized through the use of depositories or a book entry system.
- U.S. Treasury regulations should define and clarify the status of the term "obligation not of a type offered to the public."
- A delay of the effective date of the requirement to January 1, 1985 should be requested of Congress.

There was a majority view by the securities industry representatives that the issuer be responsible for registration and transfer fees. A strong dissenting view was expressed by the issuers and issuer public interest groups who suggested that the subject needs further study, with the possibility that the investor, underwriter, or broker-dealer may have to share in the burden.

The official conference proceedings will be published early in November and will be available to the public through the Municipal Securities Rule Making Board, 1150 Connecticut Ave. NW, Suite 507, Washington, DC 20036. (202) 223-9347.

³It has been estimated that there are more than 1.2 million separate tax-exempt bond issues in existence (in contrast to the 30,000 to 40,000 corporate securities). A major reason there are so many is that a separate number needs to be assigned to each rate and/or maturity for each issue of bonds. Thus, a serial bond having 40 maturities would be assigned 40 different numbers because each maturity is, in fact, a distinct security having its own price and life.

⁴CUSIP stands for Committee for Uniform Securities Identification Procedures.

The need for standardization is clearly evident in the case of municipal securities, since the number of certificates in that market is many times larger than that of the corporate markets.

In the case of at least six states, local governments are not allowed to issue securities in registered form. These state laws will need to be amended in order to permit compliance with Treasury regulations. By the same token, there is a strong possibility that the Treasury regulations may be open to various options that will accommodate a smoother transfer from the bearer-form to registered-form bond. One such option would be the issuance of "global" issues in bearer-form that would be acquired in the name of a nominee, which could then be broken down into smaller registered-form denominations.

In fact, under a pure book entry system certificates could be done away with altogether. Brokerage firms would simply buy shares of the master security which is held for safekeeping in a depository and credit their customers' accounts as they retailed participation to individual customers. Ownership would be evidenced by the confirmation slip and the monthly statement of customer accounts. Trades could be reconciled among the firms' accounts on the books of the depository.

But one problem with this approach is that for weak credits, the depositories or security firms may not want to be identified with a bond that might go into default. Moreover, small issues that seldom trade in the secondary market may prove to be more trouble (and cost) than they are worth to retain in such a system.

At present, a major unknown revolves around the relative merits and costs of the alternative systems. In the past, paying agents have gotten at least part of their compensation by holding balances (the float) while awaiting the presentation of matured bonds and coupons. Registration will eliminate the delay in payment since it originates with the borrower. This fact, along with the added recordkeeping duties, will raise questions about the appropriate amounts and forms of compensation for services. Furthermore, the appropriate mix of activities—depository, paying agent, transfer agent, etc.—and the extent any should be done by the governmental unit or, by private firms, remain open to question. Last there remains the question of the extent to which such arrangements should be pre-specified by the government, or left to others to decide.

Key Questions for Issuers

Hopefully, useful criteria soon will be developed to guide market participants in their decisions regarding how to handle registered-form municipal bonds. At this point, issuers are best advised to stay on "top of the situation" and to be mindful of the following:

- What laws (state statute, local ordinance, etc.) need to be changed to implement a registered-form system?
- How will issuers need to adjust the timing on their schedule of sales and to amend notices for sale or other documents as a result of the registration requirement? What new parties need to be contacted in conjunction with sales and who is responsible for such notice?
- What registration-related services should be specified or selected by the issuer? What decisions regarding paying agent, transfer agent, bond printer, and the specific dimensions and form of security need to be made?
- What factors go into deciding if governments should keep their own registry or have an agent do it for them? If the latter course is followed, how does one decide which firm to use?

- How much will the cost of issuance be affected and who will pay the bill? Who will absorb the on-going costs of registration in the monetary market? What legal and operational steps can be taken now (or later) to make the entire system most efficient?

Summary

Change often brings confusion and costs, and the requirement to move the municipal bond market into registered-form securities is a good example of this phenomenon. No one would defend the use of municipal bonds in bearer form for tax evasion or illicit transactions and few would argue against the market moving toward more efficient issuance and operations procedures, and, ultimately, to a pure book entry.

But the capabilities of technology do not always comport with institutional and political circumstances and complexities. The large public issuers (many of which were created with borrowing and management flexibility in mind) will likely encounter relatively few obstacles that they cannot overcome and may appreciate subsequent economies of operations. Small governments (and the dealers and banks that serve them) have the greatest risk of loss and delay and possible obsolescence in the new operations environment. Similar tensions exist elsewhere, as traditional paying agents, printers, and the like scurry to find roles in the registered-form process. Present estimates are that the transition will be strenuous in the near term, and will reward the larger, stronger and more sophisticated entities over the longer term.

MFOA Seminars on Municipal Bond Registration

The Municipal Finance Officers Association has scheduled two seminars dealing with mandatory bond registration, new industrial revenue bond (IRB) restrictions, and other major impacts of the 1982 tax reform act. They will be held on November 23, 1982, in San Francisco and on November 30, 1982, in Washington, DC.

The major emphasis of the seminars will be the new federal requirement that all new municipal bonds, starting January 1, 1983, must be issued in registered form. Some observers say big paperwork headaches may lie ahead. Failure to comply with the new law will mean loss of tax exemption.

The seminar will discuss other provisions of the 1982 tax reform act which are of major interest to finance officers and market professionals. Tax-exempt IRBs will be subject to new restrictions, including public hearings, elected official approval, and reporting of new issues to the Internal Revenue Service. Several other restrictions, including purposes that can be financed, combining of issues, maximum maturity, and depreciation treatments will affect the use and design of private-aid financing. A panel will review these and other changes affecting tax-exempt leasing and municipal mortgage bonds, stressing what to do and what to watch out for when issuing these securities in the future. Finally, an overview will be provided of how the new tax provisions regarding commercial banks and insurance companies are likely to affect the institutional demand for tax-exempt bonds.

For a descriptive brochure with a registration form write to the MFOA Career Development Center, 180 North Michigan Ave., Suite 800, Chicago, IL 60601; or for further information call (312) 977-9700.



City of Lawrence KANSAS

Attachment II

BUFORD M. WATSON, JR., CITY MANAGER

CITY OFFICES 6 EAST 6th
BOX 708 66044 913-841-7722

CITY COMMISSION

MAYOR

MARCI FRANCISCO

COMMISSIONERS

DONALD BINNS

BARKLEY CLARK

TOM GLEASON

NANCY SHONTZ

March 21, 1983

Chairman Ivan Sand
House Local Government Committee
Kansas State Capitol
Topeka, Kansas

RE: Support of the Substitute for
Senate Bill 286

Mr. Chairman:

My name is Buford M. Watson, Jr., City Manager of Lawrence, speaking on behalf of the Lawrence City Commission. I appreciate the opportunity to speak to this committee in support of the Substitute for Senate Bill 286.

Ever since the tragic pedestrian accident of a school age child when crossing a major trafficway in Lawrence, our City Commission has sought ways to improve pedestrian safety along the trafficway. One of the proposed safety solutions is sidewalks. To date, a sidewalk improvement district has not been established because an insufficient number of adjoining property owners are willing to constitute the improvement district. Their two major objectives are that the sidewalk provides benefit to more than the abutting property and the assessments are larger than normal for some lots because their side yards front on the trafficway or the sidewalk is in their back yard.

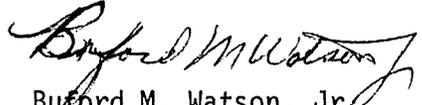
Because of losing a past lawsuit* concerning assessment of sidewalks on non-abutting property, the City Commission desires state legislation so sidewalk improvement districts may extend beyond the abutting property to include all properties reasonably benefited by the sidewalk improvement. We believe Senate Bill 286 accomplishes this objective by further clarifying the intent of the General Improvement and Assessment Law. The City of Lawrence utilizes the General Improvement and Assessment Law exclusively for public improvements.

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Chairman Ivan Sand
Topeka, Kansas
March 21, 1983
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I appreciate the opportunity of addressing your committee on behalf of the
City of Lawrence.

Respectfully,


Buford M. Watson, Jr.
City Manager

BMW/ed

* Davies v City of Lawrence, 218 Kan 551, 545 P 2d 115 (1976)