

Municipal Bond Offerings: SEC Charges State of New Jersey for Fraudulent Municipal Bond Offerings

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On August 18, 2010, the United States Securities and Exchange Commission (“SEC”) issued a cease-and-desist order ([the “Order”](#)) in settlement of SEC proceedings against the State of New Jersey (the “State”) alleging violations of federal securities laws in connection with the issuance of over \$26 billion in bonds from August 2001 through August 2007.

[Click here to view the complete Order.](#)

The Order finds that, over the period in question, the State engaged in a pattern of inadequate and misleading disclosure relating to two state-funded pension plans. The facts of the New Jersey case, as described in the Order, suggest a significant disregard for adherence to fundamental principles of fair and accurate disclosure, and one could easily dismiss this matter as having little relevance to municipal issuers who have implemented and follow basic policies and procedures when preparing offering materials for a securities offering. However, we think that it is instructive (i) to note that the SEC placed blame for the State’s disclosure violations on “a lack of disclosure training and inadequate procedures relating to the drafting and review of bond disclosure documents” and (ii) to carefully examine the New Jersey disclosure deficiencies criticized by the SEC.

Specifically, the SEC observed that

- “various divisions and offices within the New Jersey Treasury updated their sections of the State Appendix. They viewed the updating of the pension funding sections as a routine process, requiring the insertion of new numbers or facts into an existing document.” (¶ 14)
- during the period of inadequate disclosure, the various State Treasurers, or their designees, signed Rule 10b-5 certificates certifying as to the adequacy of the disclosure, however “the Treasurers did not read official statements, and relied on their staff to ensure the accuracy of information contained in the documents.” (¶ 15) (Note: The SEC’s pointed criticism of the Treasurers for failing to read the official statements should be considered in tandem with the SEC’s criticism of the lack of disclosure training of Treasury staff and the absence or inadequacy of disclosure procedures.)

- “The New Jersey Treasury had no written policies or procedures relating to the review or update of the bond offering documents. In addition, the State Treasury did not provide training to its employees concerning the State’s disclosure obligations under accounting standards or the federal securities laws. Accordingly, the State’s procedures were inadequate for ensuring that material information concerning [the State’s pension plans] or the State’s financing [of the plans] was disclosed and accurate in bond offering documents.” (¶ 16)

It might also be instructive to note that in agreeing to settle the SEC’s proceedings against the State, the Order states that the SEC considered the following remedial acts taken by the State (¶ 51):

- “the State hired disclosure counsel to advise the State on an on-going basis regarding its disclosure obligations under the federal securities laws.” (¶ 44)
- “the State has reviewed, evaluated, and enhanced its disclosure process by instituting formal, written policies and procedures” including the establishment of a “committee comprised of senior Treasury officials, representatives from the Attorney General’s Office, and disclosure counsel to oversee the entire disclosure process and to review and make recommendations regarding the State’s disclosure and disclosure practices.” (¶ 45)
- “In addition, the State has implemented an annual mandatory training program conducted by disclosure counsel for the State’s employees involved in the disclosure process to ensure compliance with the State’s disclosure obligations under the federal securities laws.” (¶ 45)

It is likely that the Order and the SEC’s critique of the State’s disclosure practices will be the subjects of much discussion over the coming months.

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