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October 15

August 18, 2010

Pension Fraud by New Jersey Is Cited by S.E.C.

By **MARY WILLIAMS WALSH**

Federal regulators accused the State of New Jersey of securities fraud on Wednesday for claiming it had been properly funding public workers' pensions when it was not.

The Securities and Exchange Commission said the action was its first ever against a state, and only its second against any government over the handling of a public pension fund. The first was the city of San Diego. More may be in store; the agency announced in January that it had a special unit looking into public pension disclosures. The S.E.C. has been trying to assume more authority over municipal securities.

The commission settled its suit with New Jersey by issuing a cease-and-desist order, which the state accepted without admitting or denying the findings. No penalties were imposed.

Nor did the S.E.C.'s order name any individual state officials, nor the bond underwriters and other professionals whose job it was to vouch for the state's financial statements. New Jersey's largest bond underwriters during the period in question include Citigroup, J. P. Morgan Securities, Morgan Stanley, Bank of America, Merrill Lynch, Goldman Sachs and Barclays Capital.

The S.E.C. said its action was meant to dissuade other governments and their advisers from hiding bad fiscal news in a fog of pension numbers. Actuaries, for instance, have been raising questions about the framework Illinois has laid out for bolstering its pension funds. In New York, California and other places, financial advisers have told lawmakers that benefits could be sweetened at virtually no cost, only to be proved wrong once those benefits were adopted.

“Hopefully, it will send a message to other states or local governments,” Elaine C. Greenberg, chief of the S.E.C.’s municipal securities and public pensions unit, said in an interview.

The commission said that from 2001 to 2007, New Jersey claimed to have money set aside in a “benefit enhancement fund” as part of a “five-year plan” to pay for new benefits for teachers and general state employees. In fact, the fund was an accounting illusion and no such money was available.

The misstatements began during the Republican administration of Gov. Donald T. DiFrancesco and continued under Democratic administrations, including those of James McGreevey and Jon Corzine.

“The State of New Jersey didn’t give its municipal investors a fair shake, withholding and misrepresenting pertinent information about its financial situation,” Robert Khuzami, director of the S.E.C.’s division of enforcement, said in a statement.

Because of New Jersey’s misrepresentations, the commission said, investors bought more than \$26 billion worth of the state’s bonds over six years without understanding the severity of its financial troubles. New Jersey’s pension fund — actually a family of funds for different groups of workers — is one of the biggest in the country, and when a pension plan of that size gets into trouble, its problems can dominate the finances of the whole state.

By the time Gov. Chris Christie took office this year, the pension funds had been deprived of contributions for so long that it had become near impossible to catch up. The state needs to come up with billions of dollars every year, something it cannot do without raising taxes, cutting public services or going even deeper into debt. Governor Christie has been forcing cuts in education spending and other areas in hopes of improving the state’s finances.

If things get worse, those who bought New Jersey’s bonds in years past could find themselves fighting with public retirees for the same limited pool of dollars.

A spokesman for the New Jersey treasury, Andrew Pratt, said the state had “never failed to pay a bondholder.”

The S.E.C. said the fraud began in 2001, when New Jersey increased retirement benefits for teachers and general state employees. New Jersey did not have the money to put behind the

new benefits, but every year after that, the state treasurer certified that the pensions were being funded according to the plan.

These statements continued until an article in The New York Times, in April 2007, described the accounting gimmick. New Jersey then brought in legal advisers and began correcting the six years of false statements.

Some commentators expressed disappointment that the S.E.C. had not named any of the treasurers who certified the misstatements or other professionals who helped New Jersey's bonds go to market during the fraud.

"Yes, they charged the State of New Jersey with fraud, but there's no price paid here," said Lynn E. Turner, a former chief accountant for the S.E.C. who helped with the pension investigation in San Diego. "There's no fine, and no accountability on the part of any individuals."