

State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
CN 290
TRENTON, NJ 08625-0290

March 14, 1995

Chairman Arthur Levitt
Securities and Exchange Commission
450 Fifth Street
Washington, DC 20549

Dear Chairman Levitt:

I would like to reiterate the profound sense of gratitude that I expressed to you and your staff at our recent meeting regarding the municipal bond investigations that your agency has been conducting in New Jersey.

I am a professional Civil Servant with 20 years of experience in the Treasury Department of New Jersey, and I believe that my sense of gratitude is widely shared among other Civil Servants in my State. Of course, like other citizens of New Jersey, I am shocked and saddened by the recent revelations regarding the ethical conflicts of a senior official in the last administration. However, the conflicts cited are only a part of the harm that was done to public integrity at that time. Not only are such officials guilty of sins of commission, but they are also responsible for sins of omission. During such an administration, all decisions regarding money matters are referred to the Governor's Office, and all other decisions are ignored. This creates an atmosphere of inaction and incompetence, as personal and political issues take precedence over the proper fulfillment of public duties.

I hope that your investigations go further, to other states and jurisdictions and to matters of ethical as well as criminal conflicts. I am very concerned that many conflicts are not properly addressed in the law, but, nevertheless, are unethical and detrimental to the public good. For instance, on at least one occasion, a New Jersey authority issued bonds, and, over the advice of its financial advisors, the Governor's Office mandated a generous underwriting spread to compensate an underwriting syndicate which included political favorites with limited underwriting capabilities. In effect, these favorites were being generously paid for doing little, if anything. It can easily be assumed that such political favorites repaid this generosity through political contributions or other favors.

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In another instance, the State itself refunded outstanding general obligation bonds and allowed the managing underwriter to reinvest the proceeds of the issue without competitive bidding. Again, this was dictated by the Governor's Office over the objections of senior Treasury officials, and it is likely that the substantial benefits of the non-competitive investment program were repaid in personal or political favors. On occasion, these transactions are publicized, and The Wall Street Journal did do an article on the refunding issue mentioned above.

A particularly pervasive and pernicious conflict in municipal finance involves the less-than-arm's-length relationships of some financial advisors to underwriters, and of both to fund raising political committees. The result can be an unspoken complicity to provide a generous underwriting spread and weak pricing terms for a bond offering. Such cases serve the interests of all parties but the public. The underwriter sells the bonds easily; the financial advisor ingratiate himself to both the underwriters and the politicians; and the politicians receive political contributions from all parties. These practices are undetectable to the media and well-intentioned public officials, absent some authoritative primer or guidelines provided by an independent third party. I would hope the Commission will assume that role over time, by continuing to take action against individual transgressors and by publicizing the pervasive conflicts so alarmingly common to the industry.

To my knowledge, no law would directly address any of the conflicts listed above, which would normally fall under broad business judgment rules. It would be a valuable public service if your commission could continue to take action against individual transgressors and could publicize such ethical conflicts, even though they may be beyond the reach of law, because they are the breeding ground of public corruption. An exposition of the possible areas of conflict would be a valuable public document and a useful guide for the press and responsible public officials.

Once again, I want to thank you and your staff for this necessary and valuable initiative.

Very truly yours,

Roland M. Machold
Director

RMM cae