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Wrist slap a joke for these crimes

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So this is how it ends. More than $7 trillion (U.S.) in shareholder value goes up in smoke, and the perps get a nice slap on the wrist.

This week's "landmark" settlement by 10 leading Wall Street firms of accusations of gulling investors during the Internet and telecom boom will see no jail time for peddlers of shoddy stock. And it imposes laughably modest fines and trivial reforms on an industry that is culpable in the biggest misallocation of capital in history.

A recap: In the late 1990s, Wall Street's most prominent firms pumped out flattering "research" reports on virtual firms (no profits, but a hot concept and fancy offices and free lattes all around) that helped drive the market to previously uncharted heights of speculative delirium. This sage advice was often known to the authors of the reports to be utter fantasy or outright lies.

The intent was to drum up underwriting business from the companies touted by this research, churned out by hopelessly compromised brokerage analysts.

Brokerages also rewarded chief executive officers of their underwriting clients with shares in high-demand initial public offerings, stock that was promptly sold for a handsome windfall — a practice known in the industry as "spinning" and by prosecutors as "virtual commercial robbery."

So what punishment did the U.S. Securities and Exchange Commission, state prosecutors and market regulators tailor to fit the activities of these latter-day "malefactors of great wealth," so described by Theodore Roosevelt many crashes ago?

William Donaldson, chairman of the SEC, boasted that the $1.4 billion settlement with the 10 firms unveiled Monday is the biggest in history. It opens, he said, "an important new chapter in our ongoing efforts to restore investors' faith and confidence in the fairness and integrity of our markets."

Actually, we've been here before. In 1993, a single firm, Prudential Securities Inc., paid out $1.5 billion or so in restitution to buyers of its worthless limited-partnership investments. Later in the 1990s, dozens of dealers in Nasdaq stocks collectively shelled out some $1 billion to settle price-fixing charges. Then came the new economy, our latest reminder that mass credulity didn't die with the Klondike days.

In the boom years of 1998 to 2000, Merrill Lynch & Co. Inc., Citigroup Inc., J.P. Morgan Chase and Co. and the seven other firms named in this week's settlement harvested a total of nearly $100 billion in profits.

The tiny fines assessed to these firms in the settlement unveiled on Monday basically sanction the status quo. In the case of Merrill Lynch, the crushing penalty of $200 million it has agreed to pay equals 2.6 per cent of its total profits of $7.7 billion in the boom years.

In no case does the fine agreed to this week come to more than 4 per cent of any of the 10 companies' profit haul during the boom.

Playing the roles of Bernie Cornfeld and Michael Milken in the latest Wall Street scandal to end all scandals are Jack Grubman and Henry Blodget, mania-market analysts whose mistake was to chronicle their misadventures in smoking-gun e-mails. And to acknowledge—in confidence, they thought—that much of what they were promoting to Main Street investors was crap.

Grubman, 49, a compulsive BlackBerry user, blundered by writing to a workmate that with many of his favoured stocks "going to zero" as the bubble burst, he now recalled that "I wanted to downgrade them months ago, but got huge pushback" from his investment banking colleagues.

For his troubles in helping generate more than $1 billion in investment banking revenue for Citigroup's Salomon Smith Barney brokerage, Grubman was paid $67.5 million in 1999-2002, plus more than $30 million when he quit the firm last year — unheard-of compensation for an analyst toiling in what had been the industry's most obscure function. In Monday's settlement, Grubman was nicked for a $15 million fine.

Blodget, 36, erstwhile *Harper's* proofreader and unlikely senior Internet analyst at Merrill Lynch, erred in leaving a pixel trail of epithets to describe fallen stars he came to be ashamed of — "dogs," "powder kegs" and "pos" (pieces of s---), which he eventually threatened to downgrade "no matter what the ancillary business consequences are."

Blodget's $20 million in boom-era earnings was trimmed by $4 million in Monday's settlement. His having avoided criminal prosecution, the proceeds from his planned hardcover expose of the Internet mania are sheltered from the Son of Sam law.

Mary Meeker, the "Queen of the Internet" stock picker at Morgan Stanley Co. who kept "outperform" ratings on at least a dozen stocks even after they'd lost 70 per cent or more of their value, was either a true believer or BlackBerry-challenged. Investigators could find no evidence of Meeker apostasy.

Leave it to her supervisor, in Meeker's 2000 performance appraisal, to laud her for eluding the constraints of the so-called Chinese walls that supposedly insulate research analysts from investment bankers — a vaunted reform dating from ethical meltdowns of yore.

"You continue to drive our Internet business," Meeker's supervisor wrote, "and are very involved in M&A [mergers and acquisitions] assignments as they come up and as you can be brought over the wall on them ...."

Frank Quattrone, the investment banker at Credit Suisse First Boston who fills out the quartet of high-profile pied pipers of the new economy, is the lone bubble-era player to face criminal charges, in a separate action from this week's settlement. Quattrone miscalculated not by tainting research with the impure thoughts of investment banking, but by allegedly directing the destruction of evidence during an investigation into whether he did so.

Conspicuous in their absence from the prosecutorial limelight are the CEOs of the above-mentioned firms and the heavies from investment banking who leaned on their

analyst confreres to keep looking on the bright side of stocks like BoysToys.com, DietRehab.com and ReptileCenter.com, may they rest in peace.

Oh, and the reforms.

Yes, well, investment bankers may no longer commingle with analysts (see Chinese wall, above). They must disclose potential investment banking conflicts in their research reports (in bigger type, since they were already required to do this after an earlier reformation). And they must publish quarterly grades on their analysts' stock-picking prowess (saving investors the cost of a subscription to *Institutional Investor*, which, unlike the brokerages, has no motive for manipulating the performance criteria in its famous analysts rankings).

All of this is too much for Stan O'Neal, newly installed CEO of Merrill Lynch. That firm is still smarting from the failed mission of company envoy Rudy Giuliani, dispatched last year to meet with New York Attorney-General Eliot Spitzer, who spearheaded the investigation leading up to this week's settlement. The former hizzoner, latterly a corporate consultant, counselled Spitzer to pursue his Wall Street witch hunt with diminished vigour.

Giuliani reminded Spitzer that the thundering herd had not abandoned Manhattan after Sept. 11, 2001, acquainting Spitzer with the idea that patriotism comes with a price tag. The crusading prosecutor managed to live with this thought as he filed his first action against Merrill Lynch in New York State Supreme Court.

Discomfited by the inconvenient reforms about to be visited on his firm, O'Neal took after Spitzer in a Wall Street Journal op-ed piece last week. "If we attempt to eliminate risk — to legislate, regulate or litigate it out of existence — the ultimate result will be economic stagnation, perhaps even economic failure," O'Neal wrote, exhibiting a talent for usefully distractive alarmism that suggests the Merrill Lynch board might have slighted him in setting O'Neal's $15 million compensation.

Spitzer has a different take on the situation. "What your company did, and what we alleged about your company, is that you committed fraud," Spitzer said of Merrill Lynch this week.

"That's not risk," Spitzer said. "What you did was shift the risk to unknowing investors while you got your fees up front."

In a recent *New Yorker* piece on the investigation, Spitzer was sensitive to accusations that the lenient punishment he was negotiating with the Wall Street firms amounted to "premature capitulation" on his part.

True, there would be no criminal indictments. And no admission of wrongdoing by any of the firms.

But in opting for an out-of-court settlement with arguably the city's most powerful industry, Spitzer said he made the most of the hand he was dealt. When he decided to pursue the case, the investor-protection branch of his office counted a mere 10 lawyers on the payroll, compared with the hundreds of lawyers employed by the Wall Street firms.

While less satisfying than his investigation of the Gambino crime family a decade ago, Spitzer feels his more recent project has at least converted the securities industry to his premise that its "business model was rotten."

Well, it's all better now.

You have Dick Grasso's word on it. Grasso, head of the New York Stock Exchange, is the ubiquitous mascot who poses for portraits in the exchange gallery with the likes of Martha Stewart when their firms are listed on the Big Board.

Describing a preliminary version of this week's settlement last December, Grasso spoke for an industry that was about to dodge a big bullet. The settlement, he declared, will "restore public confidence in the finest system of enterprise that the world has ever known."

Additional articles by David Olive

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