

# Wall Street broker rebuked for misleading investors

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Yet another darling of the financial markets has been dragged through the courts, after the financial scandals surrounding Equitable Life and Enron. Merrill Lynch, one of the world's largest stockbrokers, came to grief after its analysts were caught persuading customers to invest in Internet stocks they knew were "crap" to bolster the firm's revenues and their own commissions.

On May 21, Merrill Lynch agreed to pay \$100 million and reform its research department to settle claims that it was offering investors biased advice. The bank's unprecedented agreement with the New York State Attorney General, Eliot Spitzer, is framed so as not to trigger billions of dollars in claims against other Wall Street firms from shareholders who believe analysts misled them during the dot.com boom. This is because the agreement "represents neither evidence nor admission of wrongdoing or liability". It also does not create a restitution fund that could have helped efforts to seek civil penalties.

Under the settlement, Merrill will sever ties between the compensation of analysts and the firm winning investment-banking business. The bank will also create a committee to review the advice given by analysts and a compliance monitor will be appointed to ensure Merrill sticks to the agreement. A new system will be put in place to keep track of emails between departments.

But Merrill scored a strategic victory by moving Spitzer away from his earlier suggestions that the firm's research department be separated from its investment banking operations—a demand that would have involved the re-engineering of the modern full-services securities firm. More importantly, the \$100 million imposed by Spitzer is unlikely to damage the firm for long. In the first quarter of this year, the firm's net revenues totalled \$5 billion. At the height of the

Internet boom, the period that Spitzer was investigating, the firm's net revenues for the first quarter of 2000 reached \$7.5 billion, the broker's best performance in the last five years. There are no figures readily available to show how much investors may have lost on the back of Merrill's dubious advice.

The case against Merrill was based on emails in which analysts privately disparaged stocks they publicly recommended to investors. Spitzer asserted that these emails demonstrated how Merrill, the world's biggest securities firm, issued biased stock picks to gain lucrative investment banking fees. One email, written by star Internet analyst Henry Blodget—whose recommendations were often aired on US TV channels—described 24/7 Media as "a piece of shit". But the bank's public recommendation was for customers to "accumulate". From December 1999 to November 2000, Merrill's Internet research group was involved in investment banking deals that produced about \$115 million in revenue.

Merrill is not the only Wall Street firm hit by Spitzer's probe. The investigation has included most big investment firms. In April, Spitzer issued subpoenas to Credit Suisse First Boston, Salomon Smith Barney, Goldman Sachs, Morgan Stanley, Bear Stearns, UBS Warburg, Lehman Brothers and JP Morgan. They have been asked to turn over communications between their stock analysts, investment bankers and brokers.

In response, many banks are overhauling their research departments, cutting jobs, monitoring recommendations and reviewing compensations. Some are also facing lawsuits for failing to disclose potential conflicts of interests between analysts and corporate financiers. After its share price lost more than one-fifth of its value last month, Merrill apologised for "failing

to live up to the high standards that are our tradition”.

This is not the only spot of bother that the firm has recently been linked to. The firm’s fund management arm, Merrill Lynch Investment Managers (MLIM), has also recently admitted that its UK institutional business has seen a net loss of £3 billion since the start of the year. MLIM, one of the world’s largest fund managers with more than £500 billion of assets, is also fighting the threat of legal action. The firm is still reeling from last year’s landmark legal dispute with Unilever’s pension fund, which sued over poor investment performance.

Banking and insurance services provider, the Co-operative Group, is considering legal action against MLIM over its investment performance. The Co-op has also dropped MLIM as manager of £500 million of pension fund assets. Meyer International, the building materials group, Bath and Northeast Somerset Council, engineering manufacturer GKN and the Church of England are also reconsidering their involvement with MLIM.



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