Facebook IPO engulfed by insider trading scandal

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Multiple investigations and lawsuits have been announced following reports of deceptive practices and insider trading in connection with last Friday's $16 billion initial public offering of Facebook stock.

On Tuesday, Reuters reported that the social networking company and its bank underwriters downgraded their forecasts for the company's earnings shortly before they increased the number of shares and raised the offering price in advance of the IPO. Neither Facebook nor the banks publicly announced their downgrades. The major banks involved are Morgan Stanley, JPMorgan Chase, Goldman Sachs and Bank of America.

Morgan Stanley, the lead underwriter of the IPO, is specifically accused of informing institutional investors and favored clients of its downgrade of Facebook and not telling the investing public at large.

These revelations suggest that insider trading and deception played a role in heavy selling of Facebook stock that drove down the price to barely more than the $38 initial offering price at the close of trading Friday, and has since cut the stock to $32, down 16 percent from the offering price. While Facebook executives, early investors in the company and Wall Street insiders, including at least some of the underwriting banks, made a fortune selling shares, many thousands of small investors have suffered heavy losses in the biggest ever Internet IPO.

The stench of fraud is compounded by the frenzied media hype in the run-up to the IPO, which was instrumental in inveigling small investors into what appears to have been a trap laid by Facebook and the banks.

On Tuesday, Mary Schapiro, chairman of the Securities and Exchange Commission, said her agency would look into charges surrounding the Facebook public offering, and both the Senate Banking and House Financial Services committees said they would begin to investigate the deal.

William Galvin, the secretary of the Commonwealth of Massachusetts, on Tuesday subpoenaed Morgan Stanley's internal documents on the IPO. In addition, an official at the Financial Industry Regulatory Authority, Wall Street's own regulatory body, said the group would examine the private advisories by bank underwriters to big investors.

Facebook shareholders meanwhile filed suit in federal district court in New York against Facebook, Morgan Stanley and other bank underwriters charging that the defendants fraudulently concealed the company's weakened growth forecasts. A similar suit was filed in California.

Another suit was filed by investors against Nasdaq, which lists Facebook shares. The exchange was swamped last Friday by record trading volume in the new public stock and experienced delays and failures to confirm investors' trades.

On May 9, nine days before the IPO, Facebook filed an updated IPO prospectus with the Securities and Exchange Commission in which it said its revenue and earnings prospects were threatened by a disconnect between the growth of its user base and ads volume. Its users were growing much faster than its ads business, a problem the company attributed to the rapid growth of its mobile user base.

Facebook officials personally called stock analysts at its major IPO underwriters to advise them of these negative trends. Just days before the IPO, analysts at Morgan Stanley, Goldman Sachs, JPMorgan Chase and Bank of America lowered their forecast numbers for Facebook as a result. The banks then relayed the weaker forecasts to selected clients, one of whom

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reportedly was warned that second-quarter revenue could be 5 percent lower than earlier estimates.

At virtually the same time they were downgrading their business forecasts, Facebook and the underwriters decided to raise the price range of the initial stock offering from a high of $35 to a high of $38 and increase the number of shares being offered by 25 percent.

The *Financial Times* on Wednesday quoted Hugh Evans of T. Rowe Price, a big institutional shareholder of Facebook, as saying, “They raised the range on the offering literally two days after the underwriters called around saying, ‘lower your numbers for the second quarter.’ Those two things don’t go together, ever.”

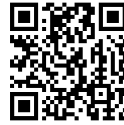
These facts may explain why Facebook executives, long-time shareholders and underwriting banks decided on the eve of the IPO to increase the shares they planned to sell. The *Wall Street Journal* reported May 17 that Goldman Sachs, Tiger Global Management and Facebook director Peter Thiel, one of Facebook’s first investors, had more than doubled the volume of shares they planned to sell.

The newspaper noted: “The change means that 57 percent of the offering will be coming from current holders, rather than from the company, an unusually high percentage for one of the most sought-after IPOs in years.”

Goldman Sachs entities sold some 50 percent of their shares, up from the 23 percent they had earlier planned to sell. Thiel upped his sale from 20 percent of his holdings to 50 percent. He stood to take in, according to the *Journal*, $847 million in one day.

Forbes magazine reported Wednesday that Morgan Stanley and the other big bank underwriters made $100 million of profit by “shorting,” i.e., betting against, the Facebook IPO. “That’s on top of the $175 million in IPO fees the underwriting banks received for selling the deal,” *Forbes* wrote. The magazine added that Goldman Sachs sold $1.09 billion of Facebook stock it owned for itself and on behalf of its clients.

These revelations underscore the parasitism and criminality that pervade the capitalist financial system. The Facebook IPO is an example of the financial manipulation that generates billions for Wall Street insiders at the expense of the productive forces of society and the living standards of the working class.



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