# Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking

**FOR IMMEDIATE RELEASE**
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### Historic Settlement Requires Payments of Penalties of $487.5 Million, Disgorgement of $387.5 Million, Payments of $432.5 Million to Fund Independent Research, and Payments of $80 Million to Fund Investor Education and Mandates Sweeping Structural Reforms

## Joint Press Release

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*Washington, DC and New York, Apr. 28, 2003* -- Securities and Exchange Commission Chairman William H. Donaldson, New York Attorney General Eliot Spitzer, North American Securities Administrators Association President Christine Bruenn, NASD Chairman and CEO Robert Glauber, New York Stock Exchange Chairman and CEO Dick Grasso, and state securities regulators announced today that enforcement actions against ten of the nation's top investment firms have been completed, thereby finalizing the global settlement in principle reached and announced by regulators last December. That settlement followed joint investigations by the regulators of allegations of undue influence of investment banking interests on securities research at brokerage firms, and the enforcement actions announced today track the provisions of the December global settlement in principle.

The ten firms against which enforcement actions are being announced today are:

- Bear, Stearns & Co. Inc. (Bear Stearns)
- Credit Suisse First Boston LLC (CSFB)

- Goldman, Sachs & Co. (Goldman)
- Lehman Brothers Inc. (Lehman)
- J.P. Morgan Securities Inc. (J.P. Morgan)
- Merrill Lynch, Pierce, Fenner & Smith, Incorporated (Merrill Lynch)
- Morgan Stanley & Co. Incorporated (Morgan Stanley)
- Citigroup Global Markets Inc. f/k/a Salomon Smith Barney Inc. (SSB)
- UBS Warburg LLC (UBS)
- U.S. Bancorp Piper Jaffray Inc. (Piper Jaffray)

**Penalties, Disgorgement and Funds for Independent Research and Investor Education —**

Pursuant to the enforcement actions, the ten firms will pay a total of $875 million in penalties and disgorgement, consisting of $387.5 million in disgorgement and $487.5 million in penalties (which includes Merrill Lynch's previous payment of $100 million in connection with its prior settlement with the states relating to research analyst conflicts of interest). Under the settlement agreements, half of the $775 million payment by the firms other than Merrill Lynch will be paid in resolution of actions brought by the SEC, NYSE and NASD, and will be put into a fund to benefit customers of the firms. The remainder of the funds will be paid to the states. In addition, the firms will make payments totaling $432.5 million to fund independent research, and payments of $80 million from seven of the firms will fund and promote investor education. The total of all payments is roughly $1.4 billion.

Under the terms of the settlement, the firms will not seek reimbursement or indemnification for any penalties that they pay. In addition, the firms will not seek a tax deduction or tax credit with regard to any federal, state or local tax for any penalty amounts that they pay under the settlement.

Attached is a list of how much each firm is paying pursuant to the settlement. The individual penalties include some of the highest ever imposed in civil enforcement actions under the securities laws.

**Summary of the Enforcement Actions —**

In addition to the monetary payments, the firms are also required to comply with significant requirements that dramatically reform their future practices, including separating the research and investment banking departments at the firms, how research is reviewed and supervised, and making independent research available to investors. The changes that the firms will be required to make are discussed below.

The enforcement actions allege that, from approximately mid-1999 through mid-2001 or later, all of the firms engaged in acts and practices that created or maintained inappropriate influence by investment banking over research analysts, thereby imposing conflicts of interest on research analysts that the firms failed to manage in an adequate or appropriate manner. In addition, the regulators found supervisory deficiencies at every firm. The enforcement actions, the allegations of which were neither admitted nor denied by the firms, also included additional charges:

- CSFB, Merrill Lynch and SSB issued fraudulent research reports in violation of Section 15(c) of the Securities Exchange Act of 1934 as well as various state statutes;
- Bear Stearns, CSFB, Goldman, Lehman, Merrill Lynch, Piper Jaffray, SSB and UBS Warburg issued research reports that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts, contained exaggerated or unwarranted claims about the covered companies, and/or contained opinions for which

there were no reasonable bases in violation of NYSE Rules 401, 472 and 476(a)(6), and NASD Rules 2110 and 2210 as well as state ethics statutes;

- UBS Warburg and Piper Jaffray received payments for research without disclosing such payments in violation of Section 17(b) of the Securities Act of 1933 as well as NYSE Rules 476(a)(6), 401 and 472 and NASD Rules 2210 and 2110. Those two firms, as well as Bear Stearns, J.P. Morgan and Morgan Stanley, made undisclosed payments for research in violation of NYSE Rules 476(a)(6), 401 and 472 and NASD Rules 2210 and 2110 and state statutes; and

- CSFB and SSB engaged in inappropriate spinning of "hot" Initial Public Offering (IPO) allocations in violation of SRO rules requiring adherence to high business standards and just and equitable principles of trade, and the firms' books and records relating to certain transactions violated the broker-dealer record-keeping provisions of Section 17(a) of the Securities Exchange Act of 1934 and SRO rules (NYSE Rule 440 and NASD Rule 3110).

Under the terms of the settlement, an injunction will be entered against each of the firms, enjoining it from violating the statutes and rules that it is alleged to have violated.

Today's enforcement actions will also reform industry practices regarding the relationship between investment banking and research and will bolster the integrity of equity research. Among other significant reforms included in these actions are the following:

- To ensure that stock recommendations are not tainted by efforts to obtain investment banking fees, research analysts will be insulated from investment banking pressure. The firms will be required to sever the links between research and investment banking, including prohibiting analysts from receiving compensation for investment banking activities, and prohibiting analysts' involvement in investment banking "pitches" and "roadshows." Among the more important reforms:

    - The firms will physically separate their research and investment banking departments to prevent the flow of information between the two groups.

    - The firms' senior management will determine the research department's budget without input from investment banking and without regard to specific revenues derived from investment banking.

    - Research analysts' compensation may not be based, directly or indirectly, on investment banking revenues or input from investment banking personnel, and investment bankers will have no role in evaluating analysts' job performance.

    - Research management will make all company-specific decisions to terminate coverage, and investment bankers will have no role in company-specific coverage decisions.

    - Research analysts will be prohibited from participating in efforts to solicit investment banking business, including pitches and roadshows. During the offering period for an investment banking transaction, research analysts may not participate in roadshows or other efforts to market the transaction.

    - The firms will create and enforce firewalls restricting interaction between investment banking and research except in specifically designated circumstances.

- To ensure that individual investors get access to objective investment advice, the firms will be obligated to furnish independent research. For a five-year period, each of the firms will be required to contract with no fewer than three independent research firms that will make available independent research to the firm's customers. An independent consultant for each firm will have final authority to procure independent research.

- To enable investors to evaluate and compare the performance of analysts, research analysts' historical ratings will be disclosed. Each firm will make its analysts' historical ratings and price target forecasts publicly available.

Further, seven of the firms will collectively pay $80 million for investor education. The SEC, NYSE and NASD have authorized that $52.5 million of these funds be put into an Investor Education Fund that will develop and support programs designed to equip investors with the knowledge and skills necessary to make informed decisions. The remaining $27.5 million will be paid to state securities regulators and will be used by them for investor education purposes.

In addition to the other restrictions and requirements imposed by the enforcement actions, the ten firms have collectively entered into a voluntary agreement restricting allocations of securities in hot IPOs — offerings that begin trading in the aftermarket at a premium — to certain company executive officers and directors, a practice known as "spinning." This will promote fairness in the allocation of IPO shares and prevent firms from using these shares to attract investment banking business.

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Remarking on the historic settlement, SEC Chairman Donaldson said, "The hallmark of our business and financial system is that the rule of law must prevail and when wrongdoing occurs, it must be confronted and punished. Today we do just that." Mr. Donaldson went on to say that, "These cases reflect a sad chapter in the history of American business — a chapter in which those who reaped enormous benefits from the trust of investors profoundly betrayed that trust. These cases also represent an important new chapter in our ongoing efforts to restore investors' faith in the fairness and integrity of our markets."

New York Attorney General Eliot Spitzer said, "This global settlement is one of the largest effected by securities regulators to date. It fulfills our promise to help restore integrity to the marketplace and investor confidence in our system. The wide-ranging structural reforms to firms' research operations will empower investors to use securities research in a practical and meaningful way when making investment decisions."

"This case was a model for state-federal regulatory cooperation to benefit investors. As they did with microcap fraud and day trading, the states helped to spotlight a problem and worked with national regulators on enforcement actions and market-wide rule changes," said NASAA President, Christine Bruenn. "We're hopeful that the settlement announced today will help restore the faith and trust of wary and cynical investors." Ms. Bruenn added that, "If the Street follows both the spirit and the letter of this settlement, it will change the way business is done on Wall Street. Investors — not investment banking fees — will come first. And analysts will be beholden to the truth, not the IPO business."

NASD Chairman and CEO Robert Glauber said, "Today marks an ending, but even more, a beginning. Because in finalizing this settlement, we take a giant step on the road to restoring and renewing investor confidence. The final resolution we announce today is a good one for everyone, everywhere, who has a stake in the integrity of the U.S. capital markets."

"This historic settlement establishes a clear bright line -- a banker is a banker and an analyst is an analyst. The two shall never cross," said NYSE Chairman and CEO Dick Grasso. "The partnership between the SEC, state regulators, the SROs and our lawmakers remains the best and most effective system of market regulation and the global settlement reflects that. Our capital markets model is the most successful in the world and I am absolutely certain that we will come out of this period with a stronger system that puts the interests of the investing public first."

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To implement this global settlement, the SEC today filed separate actions against each of the firms in Federal District Court in New York City and, concurrently, the NYSE and NASD completed disciplinary proceedings pursuant to the disciplinary procedures of their respective organizations. At the state level, model settlement agreements have been finalized and the NASAA Board of Directors has recommended that all states accept the terms of the agreements. The proposed Final Judgments in the SEC actions are subject to Court approval.

**Payments in Global Settlement Relating to Firm Research and Investment Banking Conflicts of Interest**

| Firm | Penalty ($ Millions) | Disgorgement ($ Millions) | Independent Research ($ Millions) | Investors Education ($ Millions) | Total ($ Millions) |
|---|---|---|---|---|---|
| Bear Stearns | 25 | 25 | 25 | 5 | **80** |
| CSFB | 75 | 75 | 50 | 0 | **200** |
| Goldman | 25 | 25 | 50 | 10 | **110** |
| J.P. Morgan | 25 | 25 | 25 | 5 | **80** |
| Lehman | 25 | 25 | 25 | 5 | **80** |
| Merrill Lynch | 100* | 0 | 75 | 25 | **200** |
| Morgan Stanley | 25 | 25 | 75 | 0 | **125** |
| Piper Jaffray | 12.5 | 12.5 | 7.5 | 0 | **32.5** |
| SSB | 150 | 150 | 75 | 25 | **400** |
| UBS | 25 | 25 | 25 | 5 | **80** |
| **Total ($ millions)** | **487.5** | **387.5** | **432.5** | **80** | **$1,387.5** |

*Payment made in prior settlement of research analyst conflicts of interest with the states securities regulators.

April 28, 2003

***See Also:***

- Chairman Donaldson's Statement
- Commission Statement
- Fact Sheet
- Global Settlement Litigation Releases:
    - U.S. Bancorp Piper Jaffray Inc.
    - Morgan Stanley & Co. Incorporated
    - Lehman Brothers Inc.
    - Merrill Lynch, Pierce, Fenner & Smith Incorporated; Henry M. Blodget
    - J.P. Morgan Securities Inc.
    - Goldman, Sachs & Co.
    - UBS Warburg LLC
    - Citigroup Global Markets Inc., f/k/a Salomon Smith Barney Inc.; Jack Benjamin Grubman
    - Credit Suisse First Boston LLC, f/k/a Credit Suisse First Boston Corporation
    - Bear, Stearns & Co. Inc.
- Voluntary Initiative

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