Wall Street penalties pack little punch

Fines don't do much to deter wrongdoing

By Rob Wells
AP Business Writer

NEW YORK — America's fever for three-strikes-and-you're-out penalties has not spread to the bastion of pinstripes: Wall Street.

When the largest brokerages or their workers are caught cheating, they usually pay less in fines than the firms spend to throw the office picnic and softball game.

An Associated Press study shows a handful of firms and brokers have committed serious violations over and over in a system where they are largely responsible for disciplining themselves. The study included enforcement records of the 20 biggest brokerage firms from 1981 to 1994.

Year after year, thousands of investors call the cops on their brokers who may buy stocks without permission or pilfer accounts.

Despite increased enforcement and some high-profile fines of $1 million, the typical financial penalties are only a few thousand dollars per violation. That's less than a broker spends to park a car for a year in a Wall Street garage.

A review of enforcement records shows five firms had an average two or more serious violations a year: Prudential Securities, a total 77 cases; Paine Webber Group Inc., 48; Merrill Lynch & Co., 46; the former Shearson Lehman Brothers, 42; and Dean Witter Reynolds Inc., 36. Some large firms had less than half: the former Kidder Peabody & Co. Inc., 16; Smith Barney Inc., 14; and A.G. Edwards & Sons Inc., 11.

These serious violations range from insider trading and unauthorized trading to excessively trading a customer's account.

"When you have 5,000 brokers and you get a $10,000 fine, that's like shooting a pea at Godzilla," said Alan Davidson, former member of an industry self-policing panel and now president of Zeus Securities, a Jericho, N.Y., investment firm.

Houston widow Bettylou Horn said she lost about $15,000 when her Dean Witter Reynolds broker, Steven E. Johnston, engaged in unauthorized stock options trading in the early 1980s. The broker was fired and banned from the industry.

Johnston's attorney said he contested the charges and believes he didn't violate SEC rules.

Longtime investors aren't necessarily insulated. For Isadore and Bernice Fendelman, owners of a wholesale candy business in St. Louis, it meant the loss of their $200,000 life's savings following the 1987 stock market crash. They blamed the loss on Jerry Stein, a broker who managed their portfolio for 15 years.

Regulators barred Stein and fined him more than $200,000. Stein denies wrongdoing and is contesting the penalty.

The AP study found financial penalties amounted to $1.37 billion, less than 5% of the $29 billion these firms made over a period when the number of enforcement cases was rising continuously.

"I certainly think there's more money to be gained by defrauding people than there is to be lost by legal penalties at this time," said Leonard B. Simon, a San Diego attorney who has represented victimized investors.

One study by the General Accounting Office, the investigative arm of Congress, said only 2% of brokers have a disciplinary record.

"There are certainly violations that we don't catch and people we don't catch," said William McLucas, SEC chief of enforcement. "But we probably do a better job, the whole system does, I think, than what you would be led to infer" from the AP study.

Nonetheless, Prudential Securities and its brokers were cited 24 times and ordered to pay $1.6 million in cases concerning unsuitable investments in the early 1980s. Later, the brokerage was hit with nearly $1 billion in fines and settlements for the same infraction, this time over risky investments known as limited partnerships.

Prudential says it has strengthened oversight of brokers by hiring new compliance staff and scrapping financial incentives that tend to put a broker's own financial interest ahead of a client's.

The most common violation found was failure of brokerage bosses to supervise subordinates, a central element of some serious financial debacles such as the Barings bank collapse and bankruptcy of Orange County, Calif.

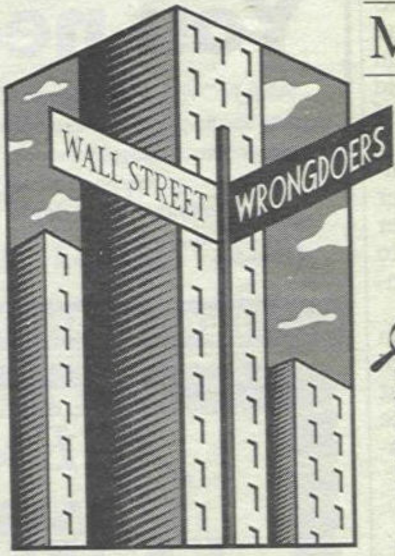
The number of insider trading cases has remained high — the SEC brought a record number of insider trading cases last year — even though Congress gave the SEC expanded powers to levy fines in 1984.

Critics say penalties must rise drastically.

"Unless you really levy a major fine, the hundreds of millions (dollars) type of fine, you really may not be having an impact," said John Perkins, a former Missouri state securities commissioner.

The SEC alone imposed fines and settlements of $340 million against the 20 firms and their brokers since 1990.

At Merrill Lynch, compliance director O. Ray Vass said its self-policing department has grown by 70% to 465 people since 1981. Financial penalties levied against brokerages, Vass said, are minuscule in "contrast to what we spend to try to prevent problems."



MAJOR FINDINGS

Key conclusions of an AP study on brokerage disciplinary history from 1981 to 1994

FINES AND SETTLEMENTS

Fines and settlements are part of the cost of doing business and represent only 4.7 percent of total profits of 20 firms reviewed between 1981 and 1994. Brokerages paid $1.37 billion in 1,257 cases. During the same period, the firms earned $29 billion.

VIOLATIONS

A handful of firms, including Prudential Securities Inc. and PaineWebber Group Inc. flouted securities laws they had previously been caught and penalized for breaking. Prudential was the top violator. Violations dropped at the nation's largest firm, Merrill Lynch & Co., due to increased internal enforcement.

INVESTOR COMPLAINTS

Newly hatched investment products promoted by brokerages, such as stock options in the early 1980s, often ran into regulatory trouble, arising in about 8 percent of the cases reviewed by The AP. The frequency suggests buyers weren't informed of the risks.

REGULATORS

Regulators are getting tougher. Of the $1.37 billion in fines and settlements against the firms, 95 percent were brought since 1990. Supervisors are held accountable more frequently for wrongdoing by subordinates.

AP/Bob Bianchini

Top regulators, fines and settlements from 1981-1994

Regulator	Total fines and settlements paid
JOINT	$562,560,000.00
SEC	$416,445,142.97
NASD	$9,736,339.85
NYSE	$7,416,500.00
MISC-ARB	$7,430,228.85
USA	$330,000,000.00
STATES	$34,102,511.89
TOTAL	**$1,367,690,723.56**

JOINT	Settlements and fines brought about by more than one regulator
SEC	Securities and Exchange Commission
NASD	National Association of Securities Dealers
NYSE	New York Stock Exchange
MISC-ARB	Arbitration, miscellaneous stock exchange cases
USA	U.S. Attorney's office
STATES	State regulators

AP

Total sales practice violations from 1981-1994

Company	
Prudential Securities Inc.	37
PaineWebber Group Inc.	19
Dean Witter Reynolds Inc.	18
Merrill Lynch, Pierce, Fenner & Smith Inc.	12
Shearson Lehman Brothers	10
Kidder, Peabody & Co., Inc.	8
Morgan Stanley & Co., Inc.	6
Smith Barney Inc.	6

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