



CORPORATE SCANDALS LEAD TO CHANGES IN FINANCIAL INDUSTRIES

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Last week a jury in New York found Frank Quattrone, an investment banker who first sold the stock of such companies as Amazon.com and Netscape to the public, guilty of trying to obstruct an investigation into the activities of his firm, Credit Suisse First Boston. His crime? Quattrone sent out an e-mail in December 2000 urging coworkers to "clean out" their files -- in violation of the ongoing investigation.

The jury's verdict comes just a few weeks after another guilty verdict. This time it was Martha Stewart convicted of lying to investigators who were looking into whether she illegally sold shares of Imclone, a company owned by her friend.

In both cases, it was the cover-up, not the actual crime, that brought the convictions. More importantly, the verdicts sent the signal that life in corporate America may be getting a lot tougher for those who break the rules.

"Clearly we are in a different world now," Georgetown University professor Donald Langevoort told The Washington Post. "Anyone who plays that game anymore is risking serious jail time."

Indeed, several other cases -- against Dennis Kozlowski, the former chief executive of Tyco International, several executives of Enron Corp. and Bernie Ebbers, the former CEO of Worldcom -- are set to go to trial and dozens of additional investigations are underway. Allegations of wrongdoing range from using illegal accounting tricks, stealing money from the person's own company (one CEO bought a \$6,000 shower curtain) to lying to investigators.

The stock market boom

What happened to change the fortunes of these former high-flying CEOs and flashy investment bankers? The common thread through all these scandals is the alleged criminal activity occurred during the stock market boom of the 1990s.

Stock markets -- like the New York Stock Exchange and the NASDAQ -- are where shares of stock in thousands of companies are bought and sold. Each share represents a small percentage of ownership, and a company can have billions of shares outstanding. Between 1983-1999, stock prices increased 16 percent a year -- their fastest growth in more than 75 years.

All that growth and the millions of dollars it represented made many rich and some people greedy. And there were several factors that made it a lot easier for some to bend or break the rules to get richer.

Stock options

First, there were stock options. Stock options are agreements between the company and its top executives that allow the executives to buy the company's stock at prices far below what the public pays. Companies don't pay anything to issue stock options, making it a sort of "free money."

In 1993, the government's stock regulating agency, the Securities and Exchange Commission, and the nation's accounting authority, the Financial Accounting Standards Board, tried to change the rules to make sure companies paid for the options they were issuing. Congress blocked their attempt and the use of stock options exploded.

Soon, many CEO salaries were mostly made up of stock options, with more given if the company's stock price went up. This meant that some CEOs would do anything to make their company's stock price rise, even if they had to falsify how the company was doing.

Banks getting into business

Another factor was the repeal of the Glass-Steagall Act in 1999, which had kept banks out of other businesses, like selling stock or insurance. The repeal created a slew of conflicts of interest -- like bank analysts recommending the stocks of companies that were customers of the bank -- which would later plague those who bought stock.

Meanwhile, the quickly growing Internet became an important way for Americans to buy stocks -- many for the first time. By 1999, almost half of the households in the country had some money in the stock market, either by buying stocks on their own or through a retirement plan where they worked. As all this new money drove stock prices higher and higher, more and more Americans wanted in. That made it easy for crooked executives and bankers to take advantage of naive investors.

In April 2000, all this came to an end. Stock prices began to fall very quickly as people became nervous about high prices. It became worse when it was discovered that companies like Enron, HealthSouth, Worldcom and others were using accounting gimmicks to make themselves look more profitable or hide problems, like high debt. Even as companies faltered and collapsed, the top executives at many businesses were collecting huge salaries -- sometimes hundreds of millions of dollars.

It was also learned that investment bankers and stock analysts had indulged in bad behavior, such as rigging the selling of stocks to favor investors willing to kick back money to the bank, or falsely telling the public such stocks were good investments when they knew they weren't.

When the smoke cleared, millions of people across the country had lost money, several large companies had gone bankrupt, and thousands of employees had lost their jobs.

The Sarbanes-Oxley Act

Outraged government regulators -- those people whose job it is to oversee stock markets and companies -- began investigating those involved and started prosecuting some of those who caused such a scandal. And in July 2002, Congress and President Bush created a new law, the Sarbanes-Oxley Act, that contained several new rules designed to keep such behavior from ever harming investors again.

For example, CEOs must now swear in writing that the financial reports filed every three months with the SEC are truthful. Also, the rules banned companies from making loans to executives, and made it tougher for CEOs to sell their company's stock for a profit. The law also created an accounting oversight board to supervise corporate bookkeepers. A later settlement with ten large Wall Street investment banks funded a new industry of independent stock pickers, whose recommendations the government hopes will not be as tainted as Wall Street's.

Whether all these new rules will bring Americans back into the market is hard to tell -- the market's been going up over the past several months and more people are again buying stocks, but all that could change quickly, especially if any new scandals emerge.

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