Management & Trends

Top Of The News: Wall Street Gets Ethics

That Wall Street analysts, once touted as independent voices, are sharply biased in favor of their own self-interest hardly qualifies as news at this late date. The news is that they aspire to something higher--or at least to create that impression.

The big Kahunas on Wall Street--including blue-chippers like **Merrill Lynch** (nyse: MER - news - people), **Morgan Stanley Dean Witter** (nyse: MWD - news - people), **Bear Stearns** (nyse: BSC - news - people), and **Goldman Sachs** (nyse: GS - news - people)--yesterday endorsed voluntary guidelines for financial analysts designed to foster independence from their firms' investment banking interests and to keep research unbiased.

The guidelines or "best practices" were compiled by an ad hoc committee of the Securities Industry Association, lobbyists for Wall Street. They cover, among other things, analyst compensation and stock ownership, relations with investment banking units and disclosures.

The analysts are getting religion just as the U.S. House Financial Services Committee in Washington, D.C., is scheduled to hold hearings on the capital markets. "We're acknowledging there have been perceptions of problems," Marc Lackritz, president of the Securities Industry Association, a trade group, told *USA Today*.

Now they are struggling to create the perception of a solution. Measures include making sure analysts don't report to investment banking units and encouraging them to indicate not just when to buy but when to sell. Today, actual "sell" recommendations are as rare as Sen. James Jeffords at a Trent Lott family picnic.

This kind of advice was once considered obvious--average practices, not "best." That Wall Street needs to tell its best and brightest to look both ways before crossing the street is an indication of how untrustworthy the analysts have become. But despite the widespread incredulity about their persistent "buy" calls, the analysts are still widely followed and quoted. More important, whatever distrust exists about analysts' recommendations has not diluted the credibility of U.S. financial markets as a whole.

The report also does nothing about more profound issues such as the herd mentality among analysts themselves and the cozy relationships between analysts and the companies they cover. "The problem is very cultural," says Manuel Asensio of Asensio and Co. "The problem is they act as a group, and none of them do sufficient work to be independent." Asensio specializes in short-selling and is a persistent critic of Wall Street practices.

Analysts were once gray back-office types. In the Internet boom they became celebrities. Their compensation soared and was often tied to investment banking income that they openly generated. Underwriters used as a selling point the claim that their analysts were prominent and could "support" a company's share price after an initial public offering with a favorable report.

During the Internet boom especially, investors proved willing time after time to suspend disbelief and give credence to analysts' reports, even after conflicts of interest became widely publicized. The more "sophisticated" view was that a positive spin by a prominent analyst would give a stock momentum, and that the quick could then sell to the dumb. Beyond dispute is the fact that "buy" recommendations became reflexive if not actually dishonest.

"Within moments of receiving the new ethics code for analysts, Mary Meeker and Henry Blodgett went on CNBC to tell people to buy it," says Andy Borowitz, author of The Trillionaire Next Door.

Borowitz was kidding about the Merrill Lynch and Morgan Stanley stars. But Lackritz was in full sales mode when he said, in a statement, "Analysts play a very important role by providing thoughtful and independent analysis for investors."

It is because this is no longer true that some pension fund managers have urged legislation, not just voluntary restraints. Perhaps the best solution is neither guidelines nor legislation but a reliance on outside analysts, untied to the brokerage firms.

Or will analysts actually change their spots? Perhaps, but such beliefs are, as Dr. Johnson once wrote, the triumph of hope over experience.