The Role of the Financial Institutions in Enron's Collapse – Part II

PSI Hearing

Senator Joe Lieberman

July 30, 2002

Thank you, and I want to again commend you, Senator Levin, and you, Senator Collins, and your staffs, for your continuing and very insightful work on the Permanent Subcommittee on Investigation into the role of financial institutions in Enron's collapse. As Chairman of the full Senate Committee on Governmental Affairs, I'm proud of and grateful for the work that you are doing.

Today, we will examine another set of very troubling transactions between Enron and one of the nation's leading financial institutions – Merrill Lynch.

We're going to be talking about a number of technical issues today – about highly complex agreements and partnerships that improved the appearance of Enron's financial statements but kept investors in the dark about what was really happening at that company before it was too late for most of them to save their security. But there are, of course, beyond these details, much larger questions at stake – and I want to talk about them now.

For weeks now, the markets have seemed like a mountain climber sliding down the slope of a mountain, searching for a foothold. Now, it appears that they may have grabbed onto a ledge and begun to climb back up – but it's too early to say for certain.

Our markets are still suffering, and the reason, as I think we all now know, is simple: investors don't know who or what to believe.

We Americans are great risk takers. That's what gives capitalism its great vitality, its seemingly endless supply of new ideas and of ambitious people to turn those ideas into opportunities and wealth, to grow the middle class. But Americans are also great pragmatists. We don't part carelessly with our money. We work hard to understand the difference between intelligent investing and reckless gambling – and that practicality is aided, we hope, by the honesty and transparency of our markets. It's this critical blend of hard-charging risk and hard-won trust that gives our unique brand of capitalism its strength and its stability. Without risk, our economy couldn't accelerate. But without trust, it couldn't stay on the road.

That delicate balance has clearly been upended since September 2 when Enron declared bankruptcy, and since then with the scandals at WorldCom, Global Crossing, and other corporations. It's now troubling to see truly venerable firms like Merrill Lynch drawn into this web, with the evidence being presented today that the company helped Enron in its effort to obscure its financial statements, undermining market integrity in the long term, all for profit in the short term.

This subcommittee investigation has revealed that Merrill Lynch facilitated many of Enron's most questionable dealings. Today, we'll hear about Merrill's willingness to finance Enron CFO Andrew Fastow's special purpose entities, LJM II and III, and to help Enron manipulate the purchase of equipment so that Enron could book additional revenue.

Today's hearing also echoes several of the concerns raised during the Full Committee's hearing on February 27th, when we examined the role of Wall Street analysts. We'll hear evidence that strongly suggests the existence of a quid pro quo for Merrill to change its rating of Enron from "hold" to "buy" in exchange for Enron investment banking business being directed to Merrill.

The findings presented by the Subcommittee today regarding this corruption of the analyst ratings process are all too consistent with the findings of New York Attorney General Eliot Spitzer's investigation into Merrill's equity research practices in general, completed earlier this year. As a result of that investigation, Merrill Lynch agreed to a $100 million penalty and promised to reform its practices. Hopefully, such practices will now wane at Merrill and at other firms as a result of the very strong bill sponsored and written by Senator Sarbanes.

Finally, I think it's important to remember again that today, as a result of a remarkable revolution in this country that's occurred over the last two decades, in which capitalism has truly been democratized, more than half of Americans have a stake in our capital markets, or at least did before the recent crisis in investor confidence. My guess is, they still do. That money is underpinning people's hopes for funding a secure retirement, for sending a child to college, or for buying a house or starting a new business. Just talk to your friends and neighbors and co-workers, and you'll be able to measure the very personal impact of the issues we'll be discussing here.

So while the talk may get technical today, the stakes here couldn't be more real for millions of American families.

Once again, Mr. Chairman, I want to thank you and your staff again for your outstanding work in these investigations, which have told and will continue to tell such riveting stories of corporate fraud and negligence. I am confident they will help bring about not just the corrective legislation, but the business self-regulation that will help restore confidence in our markets and help millions of Americans pursue and achieve their economic dreams.

I look forward to hearing from today's witnesses.