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Don't Expect Fed To Limit Banks' Bad Behavior

By Steven Pearlstein

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How many financial scandals does a banking company have to be involved in before the Federal Reserve will finally conclude it isn't up to the task of taking control of yet another big bank?

We still don't know the answer to that question, given the Fed's boneheaded decision last week to approve Bank of America's purchase of FleetBoston, creating a behemoth with nearly \$1 trillion in assets. In a single stroke, the Fed managed to reinforce its reputation as a patsy for the banking industry while undermining efforts of other regulators to get tough with corporate wrongdoers.

Yes, this is the same Bank of America that agreed this week to pay \$375 million, and reduce fees by \$80 million, to settle civil charges that it defrauded mutual fund investors by helping a big hedge fund engage in illegal trading.

It is the same Bank of America that last week agreed to pay a \$10 million fine for withholding and destroying documents requested by the Securities and Exchange Commission. That's in connection with an ongoing investigation into whether B of A's securities unit engaged in illegal trading based on inside information about its upcoming analysts reports.

It's the same Bank of America that helped Enron structure one of its infamous off-balance-sheet entities, then helped beat back an accounting reform that would have forced disclosure of such scams.

The same Bank of America that was so proud of the one-stop service it provided to Adelphia Communications -- loans, securities underwriting, strategic advice and positive analyst reports -- that it actually detailed it in a case study it used with its new employees.

The same Bank of America that helped dairy giant Parmalat place more than \$1 billion in public and private debt, and now has three former employees under investigation by Italian authorities.

Confronted with this embarrassing rap sheet, and a requirement that it consider the bank's compliance history and management competence, the Fed's opinion approving the FleetBoston purchase is a model of sophistry. Rather than focus on the past, the Fed's six governors lavish praise on Bank of America for cooperating with investigators and taking steps to make sure it doesn't happen again. They also reiterate their faith in the Fed's nifty new system for monitoring financial giants, which, as far as I can tell, consists of reading Eliot Spitzer's press releases.

As is their wont, Fed officials declined to discuss their FleetBoston decision. But I certainly got a different take yesterday from another regulator who has spent months digging into Bank of America: "They've been very cooperative and done a good job in dealing with this mess. But even now there's a striking absence of a coherent compliance culture."

Given the fact that the Fed has disapproved only three of more than 350 bank mergers since 1996, the FleetBoston decision hardly comes as a surprise. The Fed reserves its regulatory zeal for cases like the 2002 proposal from Northern Star Financial, the 417th largest depository institution in Minnesota, when it apparently threatened the integrity of the entire U.S. financial system with its proposal to buy the much larger First Federal Savings, the state's 174th largest.

But for big guys who have always looked to the Fed for political protection and regulatory coddling, the message from the FleetBoston decision is clear: Mergers are too important to let a few instances of corporate fraud stand in the way. All you have to do is launch an internal investigation, blame a few rogue employees, pay a fine that shaves a few pennies off quarterly earnings and promise not to let it happen again.

Next up: J.P. Morgan Chase. Thanks to its leading role in Enron and other scandals, Morgan is already required to check in with its Fed probation officer every quarter. But look for the Fed to lift that inconvenient "supervisory order" just in time to give the green light for its purchase of Bank One later this year.

Steven Pearlstein will host a Web discussion at 11 a.m. today at www.washingtonpost.com. He can be reached at pearlsteins@washpost.com.