The Great Wall Street Ethics Crisis

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Introduction

My research paper is on Ivan Boesky and insider trading. My goal was to explain something about what has happened and give insight into what may happen as a result of the insider trading scandal. I chose this subject because it deals with current events that I am personally interested in.

Good, very currently

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Mrs. Miskiff

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THE GREAT WALL STREET ETHICS CRISIS

In the past four months Wall Street has been put into an ethics crisis that has affected a number of people in a number of ways. Magazine articles in the past weeks have read like a script for Dallas. The stars of this drama are Ivan Boesky and Drexel Burnham Lambert, Incorporated. Ivan Boesky was a risk arbitrager. Risk arbitrage is a strictly stock-exchange business consisting of the calculation of relative values of securities, stocks, and shares at different places at the same time, with the view of speculative profit, through differences in payments, favorable or unfavorable circumstances etc. Drexal Burnham Lambert is a Wall Street investment house that specializes in non-investment grade junk bonds. The company uses these bonds to raise funds for corporate takeovers. Ivan Boesky and Drexels are the two major players in a game called INSIDER TRADING.

Insider trading is trading based upon information that is not available to the general public. Congress has never passed a law specifically prohibiting insider trading, let alone defining it. Instead, the Securities Exchange Commission (SEC) has written rules about it under provisions in the Securities Exchange Act of 1934 that prohibit fraud in connection with the sale of securities. The rules are sufficiently broad that the SEC can brand almost any transaction it deems unfair to be illegal inside trading. As a result, the commission is constantly amending the

rules as it goes along, sometimes defining a new kind of insider trading after it brings a case. The SEC's verdict stands unless the culprit canpersuade the courts to overturn it. As SEC Chairman John Shad puts it, "We are judge, jury, and prosecutor" (Williams 36).

Thw laws are vague, so many people don't know what is legal and what is not. Ivan Boesky broke the law when he bought stocks of takeover targets on tips from an investment banker, Dennis Levine of Drexel Burnham Lambert. But Boesky did no wrong when he sold $440 million worth of securities before the Securities and Exchange Commission revealed its insider trading charges against him, knowing full well that the prices almost certainly would fall after the revelation. How could Boesky be guilty of a crime in the first case and innocent in the second? Because the SEC says so.(Williams 36)

Dennis B. Levine, the former Drexel's investment banker was charged with insider trading in May of 1986. Levine fed Boesky with information he gained as a mergers and acquisitions specialist for Drexel. Boesky paid Levine $70,000 for information on R.J.R Industries, Inc.'s takeover of Nabisco Brands. Boesky profited to the tune of $50 million on the Levine tips alone. For this he (Boesky) was fined $100 million and agreed to plead guilty to an unspecified felony charge. (Boesky Rocks Wall Street 19)

Some people on and off Wall Street think that Bosky got too sweet of a deal. A storm of protest erupted over news that Mr. Arbitrage was out of the game. (Glaberson 37) Business Week reported on December 8, 1986, that critics such as

Representative Charles E Schumer (D-N.Y.) slammed the agency. The SEC, said Schumer, "in effect sanctioned the reenactment of the crime" by allowing the November stock sales and generally "handled Boesky too leniently." Ira Lee Sorkin, until recently SEC regional administrator in New York: "This case takes you into the heart of corporate-takeover America. If it changes the takeover business and cleans up insider trading on the Street, it is the government who got the sweet deal, not Mr. Boesky." (37)

But why did Boesky, a highly respected arbitrager, trade securities illegally?

Boesky's actual performance in recent years has been so far from what was expected of him that only by cheating did he produce a decent return for his investors. (Rudnitsky, Sloan and Stern 38) When his funds were relatively small, Boesky did pretty well but lately he hasn't done much. In the year that ended March 31, 1985, Boesky's investors received a 7.7 percent rate of return on their money. Had these investors put their money in Treasury bills, they would have yielded a 3 percent higher gain. Dennis Levine, according to the Securities & Exchange Commission, approached Boesky in February of 1985, at a time when Boesky's results were dismal. Other arbs were earning three times what Boesky was. Is it so surprising that the King of Arbs was willing to do something to make his numbers better? (Rudnitsky, Sloan and Stern 39)

These recent events have led to a number of different questions. The first of these questions is: Can investors beat the market without cheating? For years, economists argued that the answer was

no. The received wisdom was that markets are "efficient" -- that is, all available information is fully reflected in stock prices, so there is no way to outguess the market and make super-normal profits. In recent years, though, some economists have wondered just how efficient markets really are. As Ivan Boesky recently proved, there's one sure-fire way to make money. Know something that virtually no one else does, and act on it first.*

The second question is: Is the turmoil generated by Boesky going to alter the takeover rules? House Energy & Commerce Committee Chairman John D. Dingell (D-Mich.) said he would hold the first of a series of hearings on insider trading and takeovers. But, added the congressman, "the actions of the Securities & Exchange Commission are also of some concern (Glaberson 37). In addition to Congressman Dingell's committee hearings, Senator William Proxmire, chairman of the Senate Banking Committee, wants to restrict the arbs' voting rights. He is considering a proposal that in effect would redefine when a shareholder becomes a full-fledged shareholder. In the event of an unfriendly tender offer, only those who owned the stock at least 30 days before the formal offer would be entitled to have their shares counted. Says Proxmire: "There's no reason to let the arbs vote in a takeover battle." (Worthy 28) While his proposal will get a better hearing in the new Democrat controlled Congress, it will be a tough sell. Many will argue that all shareholders should be treated equally. What's more, writing legislation affecting takeovers is extremely complex and is not made easier by the divided stances of various business lobbies. (Worthy 29)

* (Pennar 82)

The third question raised by the recent controversy is: Just who is an insider? The SEC has refused to come up with a clear cut definition. In the past, most investors have considered insiders as the officers and directors of a company, the people who file disclosure forms whenever they buy or sell their company's stock. In fact, anyone who is privy to important information about his or her employer can be an insider (Williams 37). In addition to people inside a company, people who work outside the company on trading deals can be held accountable. Moreover, people who buy information are in trouble.

No one really knows where its all going to end. The SEC will go on the information of Boesky and Levine and follow up on every lead. The SEC has already subpoenaed Drexel Burnham Lambert. Among the individuals said to have been subpoenaed are Michael Milkin, who runs the firm's big junk bond trading operation in Beverly Hills; Martin Siegel, a managing director in Drexel's mergers and acquisitions department; and Carl Icahn, a big-time raider and Drexel client. In the end, one thing we will know is who got the good deal - Boesky or the SEC.

Interesting

Good report, very current and sees hand in hand with what we are currently discussing —

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