Merrill Aides Could Face SEC Charges

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The Securities and Exchange Commission staff has notified two senior capital-markets executives at **Merrill Lynch** & Co., including the head of the brokerage firm's fixed-income group, that it is prepared to recommend charging them with civil securities-law violations stemming from the 1994 collapse of Orange County, Calif.'s investment pool.

People familiar with the continuing investigation say that Richard Fuscone, a managing director who heads Merrill Lynch's global debt markets and also runs the firm's derivatives unit, and Robert Simonson, a managing director who at one time was the firm's top money-markets trader, both received so-called Wells notices from the SEC staff regarding their involvement in securities dealings with the county's ill-fated investment pool. At issue is the adequacy of disclosure in public offerings of securities whose proceeds were earmarked for the county investment

Please Turn to Page A6, Column 1

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9/25/96 *Continued From Page A3* A6

pool.

Orange County and its $20 billion investment pool filed for bankruptcy-court protection in December 1994 after the fund incurred $1.7 billion in losses from a risky investment strategy. Merrill has been the focal point of regulators' interest, because it sold the county fund $14 billion in securities, many of these hard-to-value structured notes, even as the firm underwrote hundreds of millions of dollars of municipal-notes issues for the county.

The SEC's interest in individuals at the firm, however, shows for the first time how high within Merrill the probe has reached. The SEC staff's notice is part of a standard procedure that gives potential defendents a chance to argue before the commission that it shouldn't follow the staff's recommendations. While the Wells notices won't necessarily lead to formal charges, the SEC's staff is signaling the seriousness of its case by naming individuals in the Orange County matter.

Neither Merrill executive could be reached for comment. A Merrill spokesman said that neither man had any comment. "As we have previously stated, we are very confident that our work on the Orange County note offerings was done professionally and properly. All the risks were appropriately disclosed," the firm said in a statement yesterday.

The SEC refused to comment.

The staff's notice turns the spotlight for the first time to the firm's powerful money-market desk, which not only sold securities to the county pool, but also sold securities issued by the county. In all, Merrill underwrote $875 million of short-term notes, whose proceeds went into the investment pool.

At the center of the inquiry is Mr. Simonson, a former college-baseball star who helped build Merrill's powerful money-market operation under Mr. Fuscone, who at that time was co-head of fixed income. Mr. Simonson pushed Merrill to the fore of the medium-term note market, a malleable form of debt that today represents about half the high-grade bond market. In 1994, Merrill underwrote $21 billion of U.S.-issued medium-term notes, a 60% increase over 1990 when the business took off, according to an estimate provided by the firm.

These notes were a low-margin business until traders like Mr. Simonson figured out how to append exotic derivatives to them in order to tempt buyers. Derivatives are financial intruments whose value fluctuates with changes in interest rates, commodities, stocks or bonds.

Critical Role

Orange County's massive purchases of these securities were critical to the growth of that business at Merrill. As early as 1992, well before problems surfaced in the pool, Orange County's purchases accounted for a large chunk of the profits from such securities, according to a former Merrill trader. Merrill declined to comment on its Orange County business.

Both Mr. Simonson and Mr. Fuscone were involved in the sale of those securities to Orange County. They were both listed as recipients of copies of a March 1992 letter from Merrill broker Michael Stamenson to Orange County Treasurer Robert Citron that outlined some advantages of medium-term notes the county already owned. Orange County followed a strategy of leveraging its securities portfolio in order to generate above-market returns.

Messrs. Fuscone and Simonson remained intimately involved as Orange County's huge purchases began to prompt concerns within Merrill in 1992. Both men were copied on an internal memo from Merrill's risk manager to Mr. Stamenson in September 1992 that outlined the investment pool's sensitivity to changes in interest rates. That memo recommended, in part, that the firm "explore with the county ways of reducing their overall leverage."

88