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Settlement Ends Nasdaq Price Probe; Brokerages to Let U.S. Tape Traders' Calls
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Wall Street's most prestigious and powerful firms -- including Merrill Lynch & Co., Goldman Sachs & Co. and Morgan Stanley & Co. -- have agreed to allow the government to randomly monitor and tape record the telephone conversations of their stock traders as part of settling the Justice Department's two-year investigation of suspected price-fixing on the Nasdaq Stock Market.

The Department of Justice yesterday announced the settlement with two dozen Wall Street firms in what has been the most sweeping federal investigation into a major stock market since the 1930s. The brokers agreed to the settlement without admitting or denying guilt.

The Justice Department believes the monitoring agreement will end what it saw as the industry-wide practice of manipulating prices so that individual investors pay a few pennies a share more when they buy Nasdaq stocks, and receive a few cents less when they sell, than they would in a more competitive market.

The government found that the "industry convention" was enforced by peer pressure in the form of harassing phone calls to those firms that wanted to narrow the spread that customers paid.

"We found substantial evidence of coercion and other misconduct in this industry," said Attorney General Janet Reno at a press conference. "By providing for the random monitoring of traders' telephone calls, we expect to deter future price-fixing on Nasdaq."

"Having traders fear that someone from the Justice Department is listening in on the phone should be a pretty big disincentive to the head of a major firm to allow a trader to behave in this fashion again," said Rep. Edward J. Markey (D-Mass.), ranking minority member of the House telecommunications and finance subcommittee.

The Securities and Exchange Commission is nearing the end of a similar examination of Nasdaq and the National Association of Securities Dealers (NASD) , the Nasdaq parent organization that is responsible for regulating brokers.

The Nasdaq Stock Market is the largest securities market in the world after the New York Stock Exchange and last year traded $ 2.4 trillion worth of stock. Unlike the NYSE, where prices are set by competing bids posted for all to see on a trading floor, stocks are traded by Nasdaq firms by telephone and computer at Prices that the public cannot always see.

The government investigations have come at a time when more people than ever are investing in stocks -- particularly the kind of successful technology companies that list with Nasdaq, such as Netscape communications Corp., Microsoft Corp. and MCI Communications Corp. On Tuesday, Nasdaq set a record volume for trading of 877 million shares.

Anne K. Bingaman, assistant attorney general in charge of the antitrust division, noted that the Wall Street firms that are party to the settlement account for 70 percent of the Nasdaq market's trading volume. Bingaman declined to put a number on how much money the government's investigation and settlement will save U.S. investors. But she noted that since mid-1994, when the investigation began, consumers have been paying consistently smaller markups to dealers on Nasdaq stocks. In fact, dealer spreads have declined 30 percent, she said.

As part of the government order, the Wall Street firms also have agreed to hire "antitrust compliance" officers in addition to their compliance staff that watches for securities laws violations.

These in-house cops have the right to tape the conversations of their Nasdaq traders and must listen to those tapes. The antitrust compliance officers must report possible violations to Justice as well.

Finally, the settlement establishes fines and prison terms for traders who conspire to fix prices in the future.

Joseph Hardiman, president of the NASD, called the resolution "a positive step for all participants in the nation's financial markets."

But some stock watchers said that yesterday's settlement did not go far enough.

"They spent two years studying something, announced they were going to require the industry to record a bunch of phone calls and report to a brand new federal agency . . . then patted themselves on the back and went home," said Junius Peake, a former Wall Street executive who teaches at the University of Northern Colorado.

William Christie of Vanderbilt University, who along with Paul Schultz of Ohio State University first brought the price-fixing issue to public attention in the summer of 1994, gave the government better marks. "In terms of the root problem -- that the big firms made it difficult for other firms to compete to make a market in a Nasdaq stock by offering a better quote -- you have solved much of it," Christie said. " . . . The settlement agreement opens up opportunities for market makers to offer better prices without the threat of retaliation."

But it does not solve all of the problems, according to Christie. "A lot of the orders on the Nasdaq are spoken for. There are informal agreements among firms to channel orders to each other in exchange for reciprocal business considerations."

That may soon be addressed by the SEC, which has issued several proposals for changing a number of Nasdaq trading rules, including these informal reciprocal arrangements.

Gerri Detweiler, policy director of the National Council of Individual Investors, said the Justice Department action is "a victory for investors to see things moving in the direction of narrowing the spreads."

Staff writer Jerry Knight contributed to this report.