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SEC Had 'Window Dressing' on Radar for Years

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Federal regulators were aware of and concerned about potentially questionable accounting of short-term trades on Wall Street long before Lehman Brothers' collapse raised the issue, a report indicates.

Since 2004, the Securities and Exchange Commission has questioned 115 transactions by 102 different companies to assess if they accounted properly for repurchase agreements, or "repos," among other short-term trades, according to AuditAnalytics.com. The research firm reviewed more than 115,000 comment letters the SEC sent to companies asking questions about their securities filings.

An SEC spokesman declined to comment on the report.

In March, a bankruptcy examiner said Lehman improperly moved $50 billion off its balance sheet by misclassifying short-term trades as "sales," when they should have been classified as borrowings. The strategy, dubbed, "Repo 105," triggered an SEC inquiry.

The new report suggests that the SEC has for years been concerned about potential Wall Street "window dressing"—finding ways to shed debt before reporting finances to the public. Since the financial crisis, window dressing has increased, according to a Wall Street Journal analysis, as banks have grown more sensitive about showing high levels of debt and risk.

"The SEC at least knew of this issue and tried to inquire when they could," said Don Whalen, AuditAnalytics.com's director of research.

Though window dressing isn't illegal, intentionally masking debt to deceive investors violates regulatory guidelines. In recent weeks, Bank of America Corp. and Citigroup Inc. have said they mistakenly booked some repo trades as sales when they should have been borrowings, but said the amounts were immaterial.

The SEC's questions don't indicate the companies did anything wrong, or that the SEC took any action against them, except for a few instances in which the regulatory request apparently prompted companies to restate earnings.

Among the 102 companies to which the SEC posed such questions are Bank of America and Citigroup. The BofA and Citi transactions the SEC questioned that are part of the new report's figures apparently were accounted for properly, and the SEC didn't take any action against the banks.

A BofA spokesman didn't provide any comment. A Citi spokesman declined to comment.

In one instance cited in the report, Lehman itself in 2007 told the SEC that a group of trades involving subprime mortgages the SEC had inquired about didn't meet the requirements for sale treatment.

The SEC never asked about Lehman's Repo 105s in a comment letter. But given its focus on the accounting issue, "it seems reasonable to assume" that the commission would have done so if it had been aware of them, the report said.