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Watchdog Probe into 'Cover-Up' of Losses at Merrill

By Simon English

MERRILL Lynch's chances of facing huge lawsuits in the fallout from its subprime mortgage crisis increased today when it emerged regulators are looking into deals the bank cut with hedge funds over the summer.

The Wall Street giant wrote off \$8 billion (£3.85 billion) in bad mortgage debts last week, and ousted chief executive Stan O'Neal on Tuesday. Now the Securities and Exchange Commission is delving into suggestions it attempted to cover up the true size of the losses, reports the Wall Street Journal.

The watchdog is investigating how Merrill was valuing securities tied to mortgages and how it disclosed its exposure to investors.

The suggestion is that Merrill sold parcels of mortgage paper to hedge funds, on the understanding it would buy them back later at a fixed price. This allowed the bank to remove

debts from its balance sheet, albeit temporarily. Using off-balance sheet vehicles to hide debts was the tactic at the heart of the Enron scandal.

Accountants say such deals are problematic if there is an attempt to disguise which party holds the liabilities. Lawyers have already threatened to sue the bank if there are any signs it tried to sweep problems under the carpet.

Leading New York securities lawyer Jacob Zamansky said: 'If it turns out that Merrill played games in valuing their portfolio, there will be lawsuits.'

Analysts expect Merrill to write off at least another \$4 billion in the next quarter because of bad debts.

Merrill said it would not comment on individual transactions.