"All the News That's Fit to Print"

The New York Times

Late Edition

Today, sun mixed with some clouds, slightly cooler, high 60. **Tonight,** mostly cloudy, some rain late, low 46. **Tomorrow,** some rain, cool, high 53. Weather map is on Page D8.

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Banks Shared Clients' Profits, But Not Losses

Asset-Lending Strategy Backfired on Funds

By LOUISE STORY

JPMorgan Chase & Company has a proposition for the mutual funds and pension funds that oversee many Americans' savings: Heads, we win together. Tails, you lose — alone.

Here is the deal: Funds lend some of their stocks and bonds to Wall Street, in return for cash that banks like JPMorgan then invest. If the trades do well, the bank takes a cut of the profits. If the trades do poorly, the funds absorb all of the losses.

The strategy is called securities lending, a practice that is thriving even though some investments linked to it were virtually wiped out during the financial panic of 2008. These trades were supposed to be safe enough to make a little extra money at little risk.

JPMorgan customers, including public or corporate pension funds of I.B.M., New York State and the American Federation of Television and Radio Artists, ended up owing JPMorgan more than $500 million to cover the losses. But JPMorgan protected itself on some of these investments and kept millions of dollars in profit, before the trades went awry.

How JPMorgan won while its customers lost provides a glimpse into the ways Wall Street banks can, and often do, gain advantages over their customers. Today's giant banks not only create and sell investment products, but also bet on those products, and sometimes against them, putting the banks' interests at odds with those of their customers.

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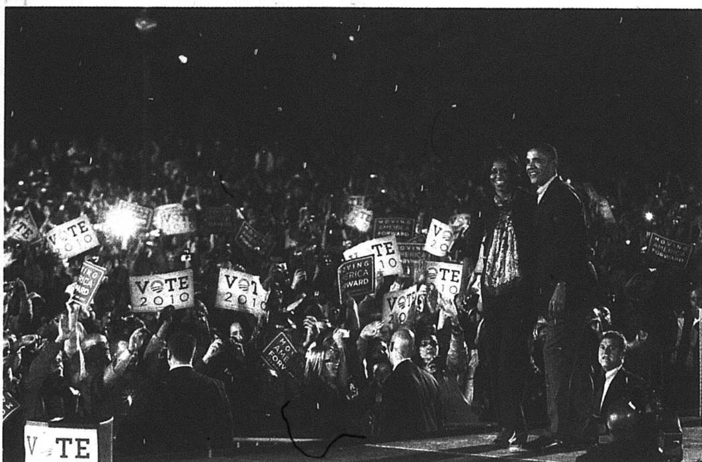
HOUSE ADVANTAGE
The Sure Thing



DOUG MILLS/THE NEW YORK TIMES

President Obama, whose wife joined him on the campaign trail for the first time this year, at a rally at Ohio State on Sunday.

Weary of Debris, Haiti Finally Sees Some Vanish

By DEBORAH SONTAG

PORT-AU-PRINCE, Haiti — Wearing a Nike visor, sunglasses, a crisp linen shirt and pressed jeans, Randal Perkins of Pompano Beach, Fla., watched with satisfaction as his $400,000 hydraulic excavator clawed into a towering pile of concrete chunks in the shattered heart of this city.

"This is what the people have been waiting for," Mr. Perkins declared in his booming voice, sweeping his arm to take in a crowd of bystanders mesmerized for hours by the demolition and removal of a collapsed funeral home.

Mr. Perkins had been waiting, too, with increasing impatience, for the cleanup of Haiti to begin. Chief executive of a Florida-based disaster recovery firm, he had made a $25 million gamble that he could capitalize on the Jan. 12 earthquake. He had partnered with a Haitian conglomerate, imported a dozen shiploads of heavy equipment and set up a state-of-the-art base camp here — but then, nothing.

It has been obvious since January that clearing the wreckage is the necessary prelude to this country's reconstruction, physically and psychologically. But the problem was so dauntingly big and complex that the government and donors got stuck in visionary mode, planning the future while the present remained mired in rubble.

It was easier, in a way, to conceive ambitious projects that would, someday, address Haiti's longstanding issues, like its weak educational system or its crumbling roads.

By late summer, however, the need to tackle the earthquake damage directly became so glaring that some initial steps were taken. The government tendered its very first cleanup contract to Mr. Perkins's Haiti Recovery

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JAKE PRICE FOR THE NEW YORK TIMES

Rubble was removed in Port-au-Prince, and later scavengers picked through the remains.

Obamas Rally For Democrats In Final Push

By CARL HULSE and JACKIE CALMES

WASHINGTON — President Obama on Sunday sought to rally anxious Democrats for the final two weeks of the midterm election campaign, traveling to the heart of the electoral battleground to urge them not to be discouraged — "Don't let them tell you that change isn't possible" — even as resurgent Republicans continued to expand their sights with the help of deep-pocketed allies.

Campaigning for the first time since the 2008 election with his wife, Michelle, the president visited Cleveland and Columbus to try to build support for Gov. Ted Strickland of Ohio, one of the embattled Democratic candidates for governor, and to raise money while making the case for Democrats nationwide. The stops followed trips to Massachusetts on Saturday and Delaware on Friday — the start of two intensive weeks of campaign travel leading up to the Nov. 2 elections.

"The biggest mistake we could make right now, Ohio, is to go back to the very same policies that caused all this hurt in the first place," Mr. Obama, his voice hoarse, exhorted to an enthusiastic crowd of an estimated 35,000 people at Ohio State University in Columbus.

"I know it gets discouraging sometimes," he added. "But don't let anybody tell you this fight

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IN POLL, VOTERS CONVEY WARINESS ABOUT PALADINO

A BIG LEAD FOR CUOMO

New Yorkers Gloomy on Economy but Leery of an Outsider

By NICHOLAS CONFESSORE and MARJORIE CONNELLY

New York voters are profoundly pessimistic about the state economy, worried that they or someone in their household will be laid off in the coming year, and convinced that Albany is rife with corruption.

But in the race for governor, they are rallying not around the gruff outsider who has promised to take a baseball bat to Albany, but around an insider who has spent much of his adult life working in government: Attorney General Andrew M. Cuomo.

A New York Times poll found that Mr. Cuomo had opened a big lead over Carl P. Paladino, drawing 59 percent of likely voters, to his Republican rival's 24 percent.

New Yorkers' embrace of Mr. Cuomo stands in vivid contrast to many races around the country, where establishment candidates face steep climbs to re-election, and insurgents backed by Tea Party activists appear poised to win a significant number of seats in Congress.

Mr. Cuomo's popularity appears to be fueled in part by widespread doubts about Mr. Paladino's temperament and qualifications.

Some 59 percent of voters in the poll said that Mr. Paladino did not have the right temperament and personality to be a good governor, while 55 percent said that Mr. Paladino, a novice candidate who made millions as a real estate developer, did not have the right kind of experience.

Only 11 percent of voters in the poll had a favorable view of Mr. Paladino.

And when asked what comes to mind when they hear his name, voters who were surveyed offered a collection of negative personality traits, like "angry,"

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TED S. WARREN/ASSOCIATED PRESS

A Tossup in Washington

In Washington State, where Senator Patty Murray is in a tight race, most voting is by mail, making predictions difficult. PAGE A13

A Seven-Headed Debate

A debate among New York's candidates for governor on Monday invites unpredictability. PAGE A26

A New Wave of Ads

Interest groups are increasingly using "express advocacy" advertisements. PAGE A10

New Spy Game: Firms' Secrets Sold Overseas

By CHRISTOPHER DREW

Huang Kexue, federal authorities say, is a new kind of spy.

For five years, Mr. Huang was a scientist at a Dow Chemical lab in Indiana, studying ways to improve insecticides. But before he was fired in 2008, Mr. Huang began sharing Dow's secrets with Chinese researchers, authorities say, then obtained grants from a state-run foundation in China with the goal of starting a rival business there.

Now, Mr. Huang, who was born in China and is a legal United States resident, faces a rare criminal charge — that he engaged in economic espionage on China's behalf.

Law enforcement officials say the kind of spying Mr. Huang is accused of represents a new front in the battle for a global economic edge. As China and other countries broaden their efforts to obtain Western technology, American industries beyond the traditional military and high-tech targets risk having valuable secrets exposed by their own employees, court records show.

Rather than relying on dead

Continued on Page A3

'Culture of Poverty,' Long an Academic Slur, Makes a Comeback

By PATRICIA COHEN

For more than 40 years, social scientists investigating the causes of poverty have tended to treat cultural explanations like Lord Voldemort: That Which Must Not Be Named.

The reticence was a legacy of the ugly battles that erupted after Daniel Patrick Moynihan, then an assistant labor secretary in the Johnson administration, introduced the idea of a "culture of poverty" to the public in a startling 1965 report. Although Moynihan didn't coin the phrase (that distinction belongs to the anthropologist Oscar Lewis), his description of the urban black family as caught in an inescapable "tangle of pathology" of unmarried mothers and welfare dependency was seen as attributing self-perpetuating moral deficiencies to black people, as if blaming them for their own misfortune.

Moynihan's analysis never lost its appeal to conservative thinkers, whose arguments ultimately succeeded when President Bill Clinton signed a bill in 1996 "ending welfare as we know it." But in the overwhelmingly liberal ranks of academic sociology and anthropology the word "culture" became a live grenade, and the idea that attitudes and behavior patterns kept people poor was shunned.

Now, after decades of silence, these scholars are speaking openly about you-know-what, conceding that culture and persistent poverty are enmeshed.

"We've finally reached the stage where people aren't afraid of being politically incorrect," said Douglas S. Massey, a sociologist at Princeton who has argued that Moynihan was unfairly maligned.

The old debate has shaped the new. Last month Princeton and the Brookings Institution released a collection of papers on unmarried parents, a subject, it noted, that became off-limits after the Moynihan report. At the

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INTERNATIONAL A4-8

Fraud in Afghan Elections

Afghan and Western officials say fraud was common in September's parliamentary elections, and nearly a quarter of the votes might be thrown out. PAGE A4

NEW YORK A23-32

Informing on an Informer

An ex-terrorist's new life in an Atlanta suburb may come to an end, in part because of the testimony from a prostitute whom he had befriended. PAGE A23

BUSINESS DAY B1-8

Calm Is Urged on Foreclosures

The Obama administration again deflected calls for a national moratorium on housing foreclosures, saying it would do more harm than good. PAGE B1

SPORTSMONDAY D1-8

Keeping Their Streaks Alive

The Jets won their fifth straight game, beating the Denver Broncos, 24-20. The Giants won their third straight, beating the Detroit Lions, 28-20. PAGES D1, D5

EDITORIAL, OP-ED A34-35

Paul Krugman PAGE A35

WE PLAY IN SOMETHING NEW, TOO.
PROUD TO FLY THE NEWEST JET FLEET.
Official Airline
ny
continental.com
Continental Airlines
A STAR ALLIANCE MEMBER
Work Hard.
Fly Right.
Continental Airlines flies the newest jet fleet among global airlines based in the U.S.

Banks Willingly Shared Fund Clients' Profits, but Not Their Losses

From Page A1

ers. The banks and their lobbyists also help fashion financial rules and regulations. And banks' traders know what their customers are buying and selling, giving them a valuable edge.

Some of JPMorgan's customers say they are disappointed with the bank. "They took 40 percent of our profits, and even that was O.K.," said Jerry D. Davis, the chairman of the municipal employee pension fund in New Orleans, which lost about $340,000, enough to wipe out years of profits that it had earned through securities lending. "But then we started losing money, and they didn't lose along with us."

Through a spokesman, JPMorgan's chairman and chief executive, Jamie Dimon, declined a request for an interview. The spokesman, Joseph Evangelisti, said that JPMorgan had a long record of success in securities lending, and that the losses represented only a small fraction of the funds in the program.

Moreover, Mr. Evangelisti said, all of the investments had been permitted under guidelines negotiated with the bank's clients. JPMorgan, he said, did not take undue risks.

"We have powerful incentives to take only prudent investment risks," Mr. Evangelisti said. If customers lose money that they have entrusted with the bank, he said, that "can lead to a loss of clients and can affect the reputation of the business."

The financial regulation bill that Congress just passed, after fierce lobbying by banks, is aimed at curtailing some of the practices that caused the financial crisis. But much of Wall Street has mostly gone back to business as usual. Nowhere are the potential conflicts more apparent than on the trading floors, where executives must balance their pursuit of profits and their duty to customers.

In addition to losing money for New Orleans workers and others, securities lending also played a central role in the near-collapse of the American International Group. Through securities lending, pensions and mutual funds borrow money to make trades, adding to the risks within the financial system.

Lawsuits are flying against JPMorgan and others, including Northern Trust. Clients say that they were not warned of the risks associated with this practice and that the banks breached their fiduciary duty. Wells Fargo lost such a suit over the summer and was ordered to pay four institutions a combined $30 million. The State Street Corporation, which took a $414 million charge in July to cover some of its customers' losses, faces suits from other clients.

Representatives for these banks said the companies had acted appropriately and that they intended to fight the suits.

Despite such troubles, the securities lending business has rebounded after plummeting during the crisis. Today shares with a combined value of $2.3 trillion are out on loan, according to SunGard, which provides technology services to financial companies. In 2007, before the bubble burst, the total on loan was worth $2.5 trillion.

The quick revival of securities lending raises concerns about whether banks and their pension customers have learned any lessons.

"What happened was the banks got greedy and they looked at the return they were getting on the collateral and said, 'Why don't we go further with this?'" said Steve Niss, the managing partner at the NFS Consulting Group, an executive search firm specializing in investment management. "But the clients got greedy right along with the banks."

Quiet Growth

James Wilson entered the securities lending business in the 1990s, when it was still a backwater. The financial industry was then in the midst of a transformation that was threatening some of its traditional sources of earnings. Stock brokerage commissions were being squeezed, and profits from making loans were dwindling.

So at Chemical Bank, which was later absorbed into the JPMorgan empire, Mr. Wilson ratcheted up securities lending.

Though he was ambitious, former colleagues say Mr. Wilson had an unassuming way that won the confidence of clients. He was well-known at industry conferences, and he often stepped up to the microphone as a master of ceremonies.

Moreover, he saw the growth potential in securities lending and stayed in it longer than many of his peers and competitors, who moved on to more prestigious banking departments.

Mr. Wilson, 55, retired after the 2008 losses. He declined to comment last month when reached by phone at his home in New Jersey.

The idea behind securities lending is simple: it allows big investors like pension funds to make extra money on their investments, without having to sell them. In a typical transaction, a pension fund or other institution lets a bank like JPMorgan lend some of its stocks or bonds to other investors, like hedge funds or banks. In return, those investors put up a cash security deposit, in case they are unable to return the securities. The pension funds and other institutions then authorize JPMorgan traders, like Mr. Wilson, to use that cash deposit to trade.

To pension fund managers, this is an attractive proposition. That is because eking out marginally higher returns on investments — even just another quarter or half of a percentage point a year — can make a difference over time.

At Chemical Bank and later at

LEE CELANO FOR THE NEW YORK TIMES

"They took 40 percent of our profits, and even that was O.K. But then we started losing money, and they didn't lose along with us."

JERRY D. DAVIS

Chairman of the municipal employee pension fund in New Orleans

JPMorgan, Mr. Wilson pushed the trading linked to securities lending to new heights, according to former colleagues. He urged his customers — funds like the one for New Orleans workers — to let him put the cash into longer-term investments. The bigger risks led to bigger rewards, and more pensions signed on.

"If you can throw around a billion or two and make a million and then you take half of it, that's not a bad day's work," said Evan Wolk, who worked with Mr. Wilson from 1993 until 2002 and now runs his own financial advisory firm in Florida.

Securities lending also fostered the rapid growth of hedge funds, which often borrow shares from pension funds to bet against those stocks. The practice also helped spur the creation of some of the arcane investments that eventually threatened the nation's financial system.

Today, institutions around the world have about seven trillion shares worth a total of $20 trillion that they are offering to lend out. That is roughly twice the market value of every corporation included in the Standard & Poor's 500-stock index. Only about a tenth of those shares are out on loan at any point in time, depending on which ones hedge funds and others want to borrow, according to SunGard.

Banks often pressure pension funds to participate in securities lending, pension consultants say. If funds refuse, banks raise so-called custodial fees, the charge for holding a fund's securities.

"Whenever we say 'no securities lending,' then they say, 'well, we need to talk about your custodial fees,'" said Jay Love, a pension consultant with Mercer.

Still, Mr. Love said, he advised clients against securities lending. Participating in such programs amounts to borrowing money to make trades in the financial markets, he said. Ultimately, the cash has to be returned. He said the stocks the pensions lend out can be viewed as a security deposit in exchange for cash used for other investments.

"It's not a free lunch," Mr. Love said.

The Temptation

No one would take Jerry Davis for a financial hotshot. A former commander in the Coast Guard, Mr. Davis, 67, worked until 2002 as the employee training officer for New Orleans. In 1986, he joined the board of the city's pension fund. He has watched over the fund ever since. Along the way, he has also become something of a shareholder activist. He says he has led the pension fund in suing more than 30 companies or boards of directors that he believed failed in their duties to shareholders.

During the 1990s, Mr. Davis said he began bumping into Mr. Wilson at industry conferences, where JPMorgan's bankers espoused the benefits of securities lending.

To Mr. Davis, the practice sounded like a low-risk proposition. So New Orleans began lending out some of the securities in its portfolio, turning modest profits. For instance, in 2007, the fund earned $70,000 by lending out its securities and letting JPMorgan reinvest the cash deposits. To earn even such small amounts of money, pensions have to lend out substantial amounts of securities — $20 million on average for New Orleans that year.

But there were several aspects of the program that always bothered Mr. Davis. Not long after the New Orleans pension became a JPMorgan customer in 2004, Mr. Davis asked Mr. Wilson why the bank could not provide him with industrywide return data for securities lending, Mr. Davis recalled.

JPMorgan representatives said industry rankings were too difficult to come by, Mr. Davis recalled. And regarding Mr. Davis's other pet peeve, JPMorgan's practice of taking a 40 percent cut of profits.

"They told me we were too small to do any better," he said. That was in contrast to some giant pension funds, which share only 15 percent of investment gains with the bank.

JPMorgan declined to comment on its cut of profits and its discussions with Mr. Davis.

Still, Mr. Davis kept the New Orleans pension in the program. Securities lending helped the fund cover its operating costs, and unlike investing in, say, hedge funds, the fund officials did not consider securities lending to be risky.

It was, he said, "almost like free money."

Dangerous Investments

When Matthew B. Sarson arrived on the securities lending floor at JPMorgan in 2004, as part of the bank's merger with Bank One, Mr. Wilson and his team were hunting for new ways to expand their business.

Under Mr. Wilson, Mr. Sarson soon began managing a fund called CashCo, which pooled together the cash deposits that small pensions received for lending out their securities. One of those small pensions was the New Orleans fund.

Former colleagues described Mr. Sarson, 44, as a low-key Wall Street everyman. He invested his customers' money according to guidelines to which

House Advantage

Articles in this series will examine how Wall Street tries to gain an upper hand.

ONLINE: *An interactive graphic explaining how securities lending works.*

nytimes.com/businessday

the funds had agreed, according to former employees, and he adopted the don't-blame-us attitude that pervaded the department. JPMorgan's contract with the American Federation of Television and Radio Artists, for instance, stated that the customer bore the "sole risk" for the investments. It included a five-page appendix describing investments that were permitted. Among the requirements was that the investment carry a safe credit rating, of A or better.

That turned out to be a problem in 2008, as the financial crisis began to unfold.

Mr. Sarson bought a variety of investments that, while highly rated, turned out to be risky, including I.O.U.'s from Bear Stearns and Lehman Brothers, two Wall Street banks that foundered in the collapse.

As Bear Stearns hit trouble in March that year, the phones on the securities lending trading floor began ringing nonstop. Pensions and other clients were demanding to know why JPMorgan had left their cash in the plunging Bear Stearns investments, former JPMorgan employees said. JPMorgan's response: the Bear investments were allowed under the clients' guidelines.

The calls were particularly tense because JPMorgan had bought the stricken Bear Stearns on attractive terms. Some clients believed the bank should have known trouble was coming.

In the end, investors did not lose money on the Bear notes, but the tremors were a sign of trouble. Around that time, Mr. Sarson and other traders began to focus on another troubled trade: an investment vehicle known as Sigma.

JPMorgan had inside knowledge of Sigma, because the bank had helped finance it. But Sigma collapsed after JPMorgan pulled out to protect itself.

"They sensed there were problems with these investments, but they didn't tell the clients," said one of the former employees. "They knew all along: we've got the out — the losses are yours."

When Sigma collapsed, in September 2008, CashCo lost $99 million and other JPMorgan clients lost roughly $400 million more, according to JPMorgan client presentations. Sigma's notes have recovered a little since then and are now worth 4 cents on the dollar.

CashCo also invested in Lehman Brothers securities. When Lehman collapsed, JPMorgan's customers were on the hook. The value of those notes has plunged to 19.5 cents on the dollar.

Mr. Evangelisti, the JPMorgan spokesman, said the bank purchased Sigma and Lehman instruments "only after careful credit analysis." The investments were widely held by major money market funds, other securities lending programs and other conservative investment vehicles, he said.

JPMorgan also had insights into Lehman's health as one of Lehman's business partners. A court-appointed examiner concluded this year that JPMorgan may have helped to push Lehman over the brink by demanding cash from the faltering bank. JPMorgan has said in a court filing that it actually helped Lehman stay alive by providing financing as others in the industry would not.

Bearing Losses Alone

When the bottom fell out, the officials in New Orleans were stunned.

In January 2009, a representative from JPMorgan, Robert Bentz, visited to discuss the situation.

"These are not easy meetings," Mr. Bentz began, according to a tape recording from the meeting.

Mr. Bentz told the New Orleans officials that former workers from Citigroup created Sigma.

"So it was like Bernie Madoff!" one city official exclaimed.

Mr. Bentz replied: "I would like to think he was more of a crook, and these people were just smart."

But a deal was a deal, Mr. Bentz said, and he said JPMorgan did not plan to help the New Orleans workers cover their losses.

Mr. Sarson, who managed the New Orleans money, has been promoted at JPMorgan. JPMorgan did not make Mr. Sarson available for an interview.

There are few signs of change in the industry. Some pensions have begun asking banks whether they will agree to share not only potential profits but also potential losses. The Missouri State Employees' Retirement System, for instance, asked banks if they would promise to cover any such losses. All of the banks that replied declined to do so, according to Christine Rackers, a spokeswoman for that fund.

One of JPMorgan's current clients, the pension for employees of the State of Texas, solicited information from banks this fall, including whether they would cover such investment losses, according to Mary Jane Wardlow, a spokeswoman for the fund.

In late September, JPMorgan bankers paid another visit to the New Orleans fund, which decided not to sue the bank but stood to benefit if two class actions were successful. The conversation shifted to the Lehman and Sigma losses, the lawsuits against JPMorgan and the pension officials' belief that the bank had failed them. A JPMorgan banker mumbled apologies and rushed out.

Mr. Davis, the New Orleans official, said in an interview that the pension was considering looking for a new bank, even though leaving would mean his fund would have to immediately pay JPMorgan for its losses. He also said he was disappointed that regulators had not intervened on behalf of funds like his. He added, half-joking, that he wished his pension fund were a JPMorgan shareholder, rather than a JPMorgan customer.

"If I were a shareholder, I would say, 'I love Jamie Dimon to death because he's going to go out there and make money every way he can, no matter what happens to his customers,'" he said. "He's making money off of me."

How Pension Funds Became Tangled in Securities Lending

PENSION FUND'S PORTFOLIO

1. PENSION FUNDS hire banks like JPMorgan Chase to manage the stocks and bonds they own.
2. BANKS lend some of the assets to investors, including hedge funds or other banks.
3. INVESTORS provide a cash security deposit, in case they are unable to return those assets.
4. BANKS trade with the cash deposit until the investors return the borrowed assets and request their deposit back.

SECURITY DEPOSIT

IF THERE WAS A LOSS from the trading, the contract with the banks requires the pension fund to cover the loss on its own.

IF THERE WAS A GAIN from the trading, the banks share in the profit with the pension fund and the investor.

THE NEW YORK TIMES