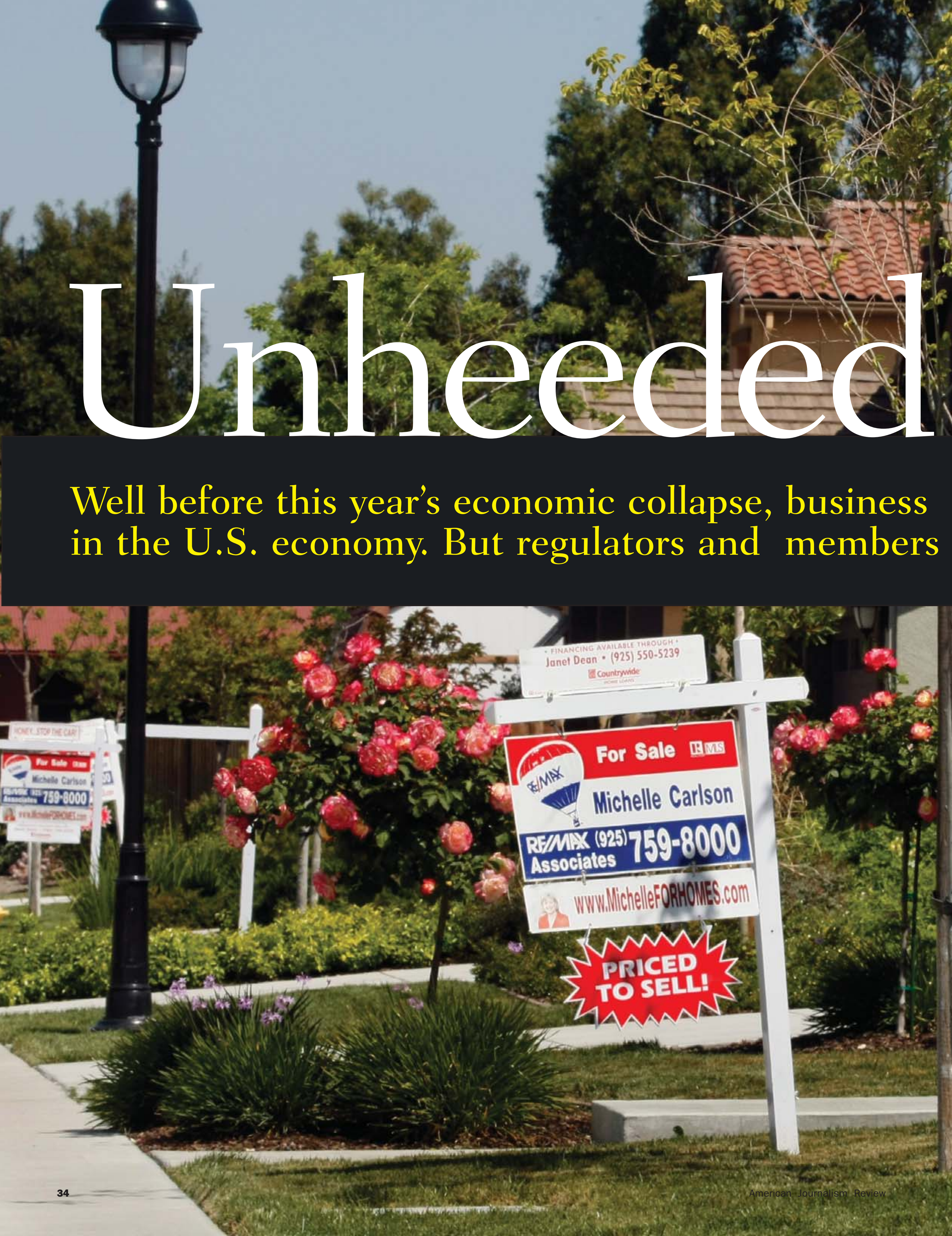
Unheeded

Well before this year's economic collapse, business in the U.S. economy. But regulators and members



Warnings

By Chris Roush

journalists shined a spotlight on serious problems of the public didn't pay much attention.

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In the early weeks of October, as the American financial crisis intensified, everyone from former Lehman Brothers CEO Richard Fuld to Advertising Age media critic Simon Dumenco took shots at the business press, pummeling its reporters and editors for failing to anticipate the looming economic collapse.

"Of course, just as we're getting more self-pity than humility from Wall Street these days, we're not exactly getting much in the way of mea culpas from the financial press," Dumenco wrote on September 29. "Nobody's really been stepping up to the plate to say, 'With our woefully incomplete and often shamefully gullible reporting on the murky financial underpinnings of the real-estate bubble, we let our readers and/or viewers down.'"

In an October 6 story titled "Press May Own a Share in Financial Mess," Washington Post media writer Howard Kurtz added, "As in the savings-and-loan scandal of the late 1980s, the press was a day late and several dollars short."

And Marketwatch.com media columnist Jon Friedman, a longtime business journalist, complained about recent business coverage, particularly during a press conference announcing Bank of America's purchase of struggling Merrill Lynch. Friedman wrote: "With all the carnage, you might expect to see a pinstripe lynch mob of sorts encounter the two chief executives. But the media were so polite and deferential to the two CEOs, they behaved as if the press conference were a victory lap for the financial services industry."

The business media in 2008 serve as a welcome scapegoat for those who simply want to ignore their own culpability in the financial meltdown. But it's a bad rap. Gone since the tech bubble burst in 2000 are the flattering CEO profiles and the touting of Internet companies with no revenue. The business media have done yeoman's work during the past decade-plus to expose wrongdoing in corporate America. In fact, a review of the top business publications in the country shows that they blanketed the major issues, from subprime loans to adjustable-rate mortgages to credit derivatives, that caused so much economic pain.

"I take umbrage at the notion that financial journalists have let us down," says Sarah Bartlett, who runs the urban and business journalism programs at the City University of New York's Graduate School of Journalism. "It's just not true," adds Bartlett, a former assistant managing editor at BusinessWeek and business reporter at the New York Times.

The problem isn't that the business media were dazzled by soaring real-estate prices and Wall Street profits and failed to see rot beneath the surface. Rather, it was that government regulators and the general public weren't paying attention.

And the warning signs were plentiful:

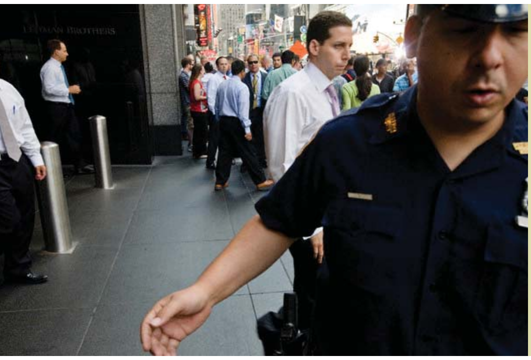
- As far back as 1994, Fortune magazine's Carol Loomis predicted that derivatives could be "a villain, or even *the* villain, in some financial crisis that sweeps the world." The complicated investments she mentioned are those we've seen unravel this year.
- The Wall Street Journal's aggressive coverage of government-based lenders Fannie Mae and Freddie Mac dates back nearly a decade. In 2004, one piece in the Journal compared Fannie Mae to Enron and WorldCom, two companies that crashed and burned the last time business journalists were blamed for an economic downturn.
- Back in 2007, under the headline "Mortgages May Be Messier Than You Think," Gretchen Morgenson of the New York Times wrote, "As is often the case, only after fiery markets burn out do we see the risks that buyers ignore and sellers play down." Her colleagues Diana Henriques and Floyd Norris exposed shady lending to military personnel and shaky accounting practices, respectively, in the past five years.
- Washington Post columnist Steven Pearlstein has been warning of financial trouble for years. On August 1, 2007, in a column titled "Credit Markets' Weight Puts Economy on Shaky Ground," Pearlstein wrote, "This financial engineering has encouraged debt to be piled on debt, making the system more susceptible to a meltdown if credit suddenly becomes more expensive or unavailable."
- Investigative business journalist Gary Weiss, who now writes for Portfolio, exposed nefarious behavior on Wall Street in his 2007 book, "Wall Street Versus America: A Muckraking Look at the Thieves, Fakers and Charlatans Who Are Ripping You Off." The title pretty much sums it up.

Although business news coverage often struggles to explain the complexities of the field to average citizens, writers such as Morgenson and Pearlstein avoid the jargon found elsewhere. They made it clear that serious trouble was brewing in the economy and on Wall Street.

Here's the issue that financial journalism faces: No one likes a nattering nabob of negativism, especially when the stock market is climbing and all of our 401(k) plans are tied to it. So we shut out what we don't want to hear because it conflicts with what we'd like to happen.

To be sure, the business media haven't been perfect. Both Fortune and Forbes, for example, sang the praises of Merrill Lynch CEO John Thain in 2008, shortly before the company was forced to sell itself to Bank of America or risk going under. Forbes went so far as to say the financial house was in "damn good shape." And the personal finance magazines that tout the best stocks and mutual funds can be maddening because they rarely, if ever, outperform the market. Do they really think they—or the so-called experts they're interviewing—know?

But anybody who's been paying attention has seen business journalists waving the red flag for several years. "The fact that housing was a bubble was printed millions of times," says Allan



The business media have done yeoman's work during the past decade-plus to expose wrongdoing in corporate America.

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Sloan, a Fortune columnist and arguably the country's preeminent business journalist. "This is one time that we did what we were supposed to do."

Don't just take the business journalists' word for it. Their effectiveness in naming the scoundrels is supported by academic research. In 2003, then-Harvard Business School professor Greg Miller studied more than 260 cases of accounting fraud. He determined that nearly a third of them were identified by the business media before the Securities and Exchange Commission or the company said they were targets of investigations. "In each of these articles, it is the reporter making the case for accounting impropriety based on analysis of public and private information," wrote Miller, who now teaches at the University of Michigan. "No other information intermediaries (i.e. analysts, auditors, or the legal system) are cited."

In other words, business journalists, who have no regulatory power over the companies and the economy, have been proactive in their coverage.

The current economic crisis and Wall Street turmoil have been caused by developments in the housing market. Lenders, in a bid to continue growing, extended credit to homebuyers who previously might not have qualified for a loan. They then sold many of those dubious loans to investors to get them off their books, allowing the lenders to make yet more questionable loans. The packages of loans purchased by the investors are called credit derivatives. The investors thought they were buying loans that had been properly vetted—but they hadn't been.

Meanwhile, many homebuyers were unaware of the terms of the contracts they were signing. Others were speculating in the real estate market, purchasing homes they simply wanted to flip to another buyer for a higher price.

A market based on rickety credit, fraud and speculation can grow for only so long. Regulators from the Federal Reserve Board to the SEC kept it going for as long as possible by relaxing some of their regulations on lending and debt. When real estate prices started to fall in the spring and summer of 2007, loans that had been sold to investors began to sour, and derivatives that lenders such as Fannie Mae had purchased as investments to protect themselves against higher interest rates led to more risk on their balance sheets than they could handle. These derivatives were no longer worth their purchase price because of the decline in the value of the real estate that backed them.

That created the current unpleasantness, with the federal government pumping $700 billion into the economy and billions more into endangered companies to avert another depression like the massive one of the 1930s.

The powerful players in business journalism include the Wall Street Journal, the business sections of the New York Times and the Washington Post, and business magazines such as BusinessWeek and Fortune. These are the news outlets with the power to direct the conversation. Readers who care about business and the economy—from investors to regulators to company executives—read these publications.

An examination of their work before spring 2007, when the first cracks began to appear in housing and investments, reveals ample coverage of the dangers that lay ahead.

And it wasn't just the business media elite. A number of smaller news organizations distinguished themselves by spotlighting the rampant problems. The Charlotte Observer, for example, ran a series in March 2007 about an unscrupulous homebuilding firm that caused the company to stop making loans and leave the area. In fact, 11 winners in the most recent Society of American Business Editors and Writers' Best in Business contest—for material published in 2007—focused on the mortgage mess or credit problems. Regional and metro papers, for the most part, covered the housing and credit issues well, but did so from a local angle and didn't convey the broad perspective that the national business media provided.

Let's start with the Wall Street Journal, considered the top business newspaper in the country, if not the world. Marcus Brauchli, now executive editor of the Washington Post, returned to the United States at the end of 1999 after reporting from China to become the Journal's national editor. He immediately took an interest in the Journal's coverage, then overseen by Constance Mitchell-Ford, of government-backed housing lenders Fannie Mae and Freddie Mac, two of the largest lenders in the country. The first page-one story questioning the lenders' practices ran on July 14, 2000. Brauchli was called to Fannie Mae's headquarters in 2001 to meet with CEO Franklin Raines, who was upset about the tone of the articles. "He felt we were unduly critical," Brauchli remembers. "We were just reporting the facts."

The Journal published numerous stories about the lenders, hammering away at the excesses it uncovered—often on the front page. On January 2, 2002, reporters Jathon Sapsford and Patrick Barta wrote about the dramatic increase in consumer lending. On August 6 of that year, Barta followed up with a 2,400-word examination of Fannie and Freddie that asked, "With homeownership already so high, are Fannie and Freddie running out of room to grow?" In the fifth paragraph, he wrote, "The huge size and rapid growth, coupled with their concentration in a single industry, has brought concern about possible risk to the U.S. economy should one of them ever fail."

A month later, on September 17, a Barta story on the front of the Journal's Money & Investing section pointed out the increased risk on Fannie's financial statements because of falling interest rates. On August 19, 2003, Barta and fellow reporter Ruth Simon wrote a front-page story on the hidden closing costs for mortgages.

And a month later, a 3,000-word bombshell on Freddie, written by Barta, John D. McKinnon and Gregory Zuckerman, appeared on the Journal's front page. They wrote: "Far from the sleepy mortgage company of its carefully cultivated reputation, Freddie Mac in recent years has evolved into a giant, sophisticated investment company, running a business laden with volatility and complexity. That change has sent risks soaring, not just for investors but for U.S. taxpayers, who likely would be on the hook if the federally chartered company stumbled."

Stories about the increasing uncertainty in the real estate market appeared regularly in the Journal for the next several years until the market imploded. A May 2005 front-page story focused on homeowners who took on too much debt while buying real estate. An August 2005 front-page story examined the fact that lenders were selling more mortgages because investors wanted the securities that backed them. James Hagerty wrote a front-page story on March 11, 2006, about the dangers of adjustable-rate mortgages. In December 2006, a front-page article about the increase of delinquent subprime mortgages appeared, noting, "If late payments and foreclosures continue to rise at a faster-than-expected pace, the pain could extend beyond homeowners and lenders to the investors who buy mortgage-backed securities."

Another Journal reporter, Jesse Eisinger, wrote extensively during this period about the risks posed by derivatives. And since joining Portfolio in 2006, Eisinger has repeatedly written about how derivatives might cause turmoil on Wall Street, going as far as to predict in a November 2007 cover story that Bear Stearns and Lehman Brothers would struggle to remain independent.

Nikhil Deogun, a former editor of the Journal's Money & Investing section and now deputy managing editor, says the coverage was intentionally repetitive to hammer home the point. "People may not have heard you, so you have to explore different angles to tell the same story a different way," he says. "I'm kind of curious as to…why is it that people were shocked, given the volume of coverage."

Meanwhile, the New York Times and the Washington Post were sounding warnings of their own. In the Times on October 3, 2004, in a story headlined "A Coming Nightmare of Homeownership?" Morgenson wrote, "The most damaging legacy of Fannie Mae's years of unchecked growth may not be evident until the next significant economic slump." Alongside Morgenson's story that day was another on Fannie Mae, by Timothy L. O'Brien and Jennifer 8. Lee, that said, "If the company encounters serious setbacks, the impact on homeowners and the world's financial markets could be unpleasant."

When she wasn't writing about housing, Morgenson was detailing the continued excesses of executive compensation and the credit markets.

The Times' Henriques wrote a series of articles exposing instant lenders who preyed on military households, pushing high-cost loans with interest rates much higher than the norm. Unlike many other pieces, her reporting set off a firestorm. Congress held hearings on the practice and passed laws to ban it.

Henriques believes she knows why regulators paid attention to her stories but ignored others about lending practices that were far worse because they were hurting investment portfolios. A friend who works for a big institutional investor was called to Washington, D.C., to speak to lawmakers before the first vote on the Bush administration's bailout plan in September. The friend noticed that all of the televisions in Congressional offices were tuned to coverage of Capitol Hill on C-SPAN, not to CNBC or Fox Business Network. "He said nothing had struck him so powerfully about how lawmakers had been cut off from what was happening on Wall Street," Henriques says. "As a business journalist, we were talking to a glass window. They were sealed off from what we were writing."

Also exploring the dangers on the horizon was the Times' Floyd Norris, whose coverage of creative accounting during this period was prescient. Time after time, he wrote about how companies, including Fannie Mae, were pushing regulators to relax standards and stretch the rules as far as they could, just a few years after Enron's manipulation of accounting regulations helped push the company into bankruptcy court.

The Post's Pearlstein also shed light on the economy's pitfalls. At least someone noticed his work: Pearlstein won a 2008 Pulitzer Prize in commentary—the first ever given to a business columnist—for a series of columns about the impending economic turmoil.

These reporters weren't alone. Their colleagues at business magazines burrowed into the dangerous financial landscape and unearthed alarming stories as well.

Shawn Tully at Fortune raised serious questions about the housing market as far back as October 2002, when he wrote, "U.S. housing prices are stretching the outer limits of what's reasonable and sustainable. Instead of cooling down, prices keep hurtling upward, defying the laws of economic gravity just as grievously as those unmentionable dot-coms once did."

In September 2004, Tully was back with a big story. The headline blared, "Is the Housing Boom Over? Home prices have gone up for so long that people think they'll never come down. But the fundamentals tell a different story—a scary one." And in July 2005, Tully offered advice for how people near retirement could get the most from selling their houses in the "overheated real estate market." In May 2006, Tully wrote about the beginning of the decline of the housing market.

Not to be outdone, Fortune's Bethany McLean—one of the first to expose Enron's problems—wrote two stories highly critical of Fannie Mae in early 2005. And then there's Loomis' prophetic 1994 story about derivatives—the magazine trotted it out in mid-2008 and posted it on its home page.

At BusinessWeek, banking and finance editor Mara Der Hovanesian chipped away as well. Her September 11, 2006, cover story, "Nightmare Mortgages," was illustrated by a snake slowly squeezing the life out of a home. It covered everything from deceptive loan practices to investors willing to buy risky loan portfolios. The previous year, Der Hovanesian wrote about derivatives, essentially warning about a pending credit meltdown. "Surprises similar to Enron and WorldCom—large, investment-grade companies that fall from grace overnight—could roil markets," she wrote in a May 2005 story.

Her colleagues hit Wall Street equally hard. An April 2006 piece titled “Mortgage Lenders: Who’s Most at Risk” exposed the subprime lending problems likely to face many finance companies. A June 2006 BusinessWeek cover story raised warnings about Wall Street’s enthusiastic embrace of risk. And the magazine regularly published shorter stories about potential economic problems on the horizon.

So if business journalists did such a good job sounding the alarm about the nation’s economic house of cards, why did its collapse seem to come as such a shock? Why wasn’t anyone listening?

Andrew Leckey, director of the Donald W. Reynolds National Center for Business Journalism at Arizona State University, compares the situation to an unwanted Christmas present wrapped in shiny paper and a bow: Nobody wants to open it up to see what’s inside. The reading public wants to read only what it wants to believe. Brauchli agrees: “The notion that the business press wasn’t paying attention is wrong, and the assertion that we were asleep at the switch is wrong. We were attentive. We were aggressive. We were aware. We wrote abundantly. But it is very hard to get the public’s attention for stories warning of complex financial risks in the middle of a roaring, populist bull market.”

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Leckey believes that one way to get readers to pay more attention would be for regulators to require greater transparency regarding the quality of loans that lenders are making and that investors are purchasing. That will allow business journalists to more fully investigate the loan market and inform readers of the true creditworthiness of homebuyers. He believes that will give stories the power they need to resonate with readers. “It wasn’t loud enough to alter anyone’s behavior,” Leckey says. “The information was out there, but I don’t think we knew the level of the subprime that some of these companies like Merrill Lynch had on their books.”

Henriques, who grades the print business media from B+ to A in the run-up to today’s crisis, agrees with Leckey, adding that business journalists can do one thing to raise the volume of their alarms: Connect more clearly the dots between Washington policy, or the lack thereof, and events on Wall Street. “To some extent, there will be lessons on both sides,” Henriques says. “On our side will be that business journalists will have to expand the notion of whom we’re writing for and more clearly enunciate the policy decisions.”

But Brauchli worries about journalists becoming overly negative in the wake of the subprime lending schedule. “You can’t scaremonger,” he says. “I’m not suggesting for a moment that journalists shouldn’t be aggressive. But journalists, like markets, tend to overshoot. You don’t want to go overboard and celebrate the downturn.”

Bartlett, the former business journalist who now teaches at CUNY, argues that the media could be at the forefront of educating readers on personal finance topics such as the value of long-term saving instead of promoting how to acquire more money as fast as possible. But, she says, “People don’t want to read it. The culture encouraged people to minimize risk. Nobody wanted to think about risk. We don’t celebrate thrift in this country.”

Deogun, the Wall Street Journal deputy managing editor, agrees with Bartlett about the need to better educate readers, noting the growing complexity of financial products such as adjustable-rate mortgages. “There is a tendency sometimes to get really caught up, particularly in personal finance journalism, to write about the latest product that a bank is selling,” he says. “These are products. They’re no different than Coca-Cola producing a new drink, or PepsiCo coming out with a new line of potato chips. It doesn’t mean that it’s good for the consumer.”

Deogun believes that some readers now understand that business journalists can give them the information they need. He points to the Journal’s September newsstand sales, which spiked 20 percent. “We’re selling out now,” he says. “There’s clearly a desire from readers to know what’s going on and to navigate their way through [the crisis]. Where were they earlier?” AJR

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