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HEADLINE: Inside Putnam: Reform or Damage Control?

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BODY:

THE day after Thanksgiving, Edward A. H. Siedle, a former compliance director at Putnam Investments, received a disturbing phone call. His lawyer described a heated conversation he had just had with Dennis Kelleher, an attorney at Putnam's outside law firm.

What were the two lawyers quarreling about? In late November, Mr. Siedle had received a subpoena from Eliot Spitzer, the New York attorney general, as part of his investigation into Putnam's practices. So he had his lawyer contact Mr. Kelleher to inform him that he intended to comply by providing information and documents to investigators about his years at Putnam, the nation's fifth-largest mutual fund company.

That is when Mr. Kelleher went ballistic, according to an account of the conversation relayed to Mr. Siedle by his lawyer that Friday. Mr. Kelleher warned Mr. Siedle's attorney about his client's agreement, signed in 2000, never to discuss his experience at Putnam with anyone; if Mr. Siedle went ahead with his plans, Mr. Kelleher said, the fund company would pursue him aggressively. At one point, according to the lawyer, Mr. Kelleher even said Putnam would go after Mr. Siedle's home if the former compliance director breached the agreement.

Such hardball tactics may seem difficult to reconcile with Putnam's efforts to put its problems behind it. In the six weeks since it was sued by regulators for securities fraud, the company has been attempting to cleanse the taint of its insider trading scandal. But behind the scenes, some current and former Putnam employees say, there appears to be a concerted effort to keep a lid on what went on at the firm during the reign of its former chief executive, Lawrence J. Lasser.

These former Putnam employees, who declined to be identified for fear of retaliation by the firm, spoke of a company that since the 1980's has allowed portfolio managers to trade actively for their own accounts, but conducted lax oversight of those trades. In one case, a portfolio manager was found to have created a false document to conceal improper personal trades, according to a former employee. Yet little was done about it.

What these former employees describe sounds much like the recent allegations state and federal securities regulators have made in their case against Putnam. That case identified two employees who profited by making improper trades in their own fund shares starting as early as 1998. When Putnam learned about the trades several years ago, the managers were neither punished nor asked to return their profits.

Now, Putnam says, it is dedicated to putting its shareholders first. And among the actions Putnam has taken to shore up investor confidence was to fire four fund managers for trading in their own fund shares and benefiting personally at the expense of their shareholders. The company has also reached a settlement with the Securities and Exchange Commission in which it admitted wrongdoing for the purposes of a not-yet-determined fine and agreed to institute restrictions on employee trading, as well as other reforms.

IN the meantime, Putnam's parent, the Marsh & McLennan Companies, the insurance brokerage,

jettisoned Mr. Lasser, the despotic, longtime head of Putnam, soon after the scandal broke. Charles E. Haldeman Jr. replaced Mr. Lasser as president of Putnam and A.J.C. Smith, a former Marsh chairman who is known as Ian, was brought out of retirement to become its chairman.

But some outsiders think Putnam has not done enough. "There are structures there that allowed these people to hold sway and allowed these practices to continue unabated for a considerable period of time," said Eli Gottesdiener, a lawyer in Washington who specializes in 401(k) and pension law. "There are more systemic problems with that organization than can be addressed by firing the bad apples. With Putnam, it's an organization that would need to be reformed from top to bottom before I would let any of my clients put their money there."

Many of Putnam's customers seem to agree. Clients continue to fire Putnam as a fund manager; just last week, the California State Teachers Retirement System pulled $312 million in stock assets from the firm. Putnam has lost $32 billion or 12 percent of its assets since it was sued by regulators.

The question some are asking is this: Is Putnam committed to aggressively uncovering misdeeds and the people who committed them or is it more interested in getting back to the business of running money and generating management fees?

Certainly, the fund company's decision to cut back on the disclosure of how many assets it has under management signifies an attitude of concealment rather than openness. By disclosing asset levels once a month rather than weekly, as had been its custom, Marsh may be attempting to take the focus away from client defections.

And to conduct the internal investigation into its questionable practices, Putnam chose Skadden, Arps, Slate, Meagher & Flom, its longtime law firm. That choice has won it few points with critics; Skadden has earned millions in legal fees from its relationship with the fund company and may not be considered an unbiased outsider. The Putnam Fund trustees have hired Ropes & Gray to investigate on their behalf.

Putnam has also hired Barry P. Barbash, a former director of the investment management division of the S.E.C.

"Mr. Barbash and his colleagues have been reviewing past trading activities and have been conducting an investigation without any restrictions. They will be ready to make a report on their findings shortly and to make recommendations regarding policies and procedures going forward," a spokesman said.

In an interview on Friday, Mr. Barbash said that while he is examining misdeeds, his role is more about preventing future problems.

One former Putnam official also questioned the company's decision to recall Mr. Smith to head its cleanup crew. After all, Mr. Smith knew about and approved the major management decisions made at Putnam by Mr. Lasser over the years, this former official said. He also blessed the lucrative employment contracts that made Mr. Lasser one of the highest paid executives in the mutual fund industry: in the past five years, he received an estimated $163 million in cash and stock.

"Smith should have been aware of the emphasis on creating products that could be sold in the marketplace instead of doing a solid investment job," said this former official, adding, "Smith endorsed what was going on."

On top of all that, Mr. Smith was a trustee of the Putnam Funds during the recent years that the fund managers were conducting improper trades, which the company knew about and did not punish.

"Smith failed to do his job as a fund director, which makes it a little surprising that he is being put in that position at Putnam," said Mercer Bullard, a securities law professor at the University of Mississippi and president of Fund Democracy, a fund watchdog group. "Systems produce the results they are designed to produce, and when you have a total breakdown at the board level with respect to fund manager compliance you have to look at the system."

But a Putnam spokesman said in a statement, "Ian Smith is exactly the right person to serve as Putnam's chairman at this time. He is one of the most respected individuals in the industry with unimpeachable standards of integrity. Importantly, he knows both Marsh & McLennan inside out, has the respect and confidence of the organization at this difficult time, and can help bring about whatever change

is necessary."

In an interview, Mr. Haldeman said: "I have every expectation that I have free reign to change the company. If there's ever a time when I don't feel I have free reign, I would not tolerate it."

The incident involving Mr. Siedle, a former S.E.C. lawyer who now investigates pension fund managers for institutional investor clients at Benchmark Financial Services in Lighthouse Point, Fla., is particularly troubling. He said that Mr. Kelleher's warnings have made him fearful of complying with Mr. Spitzer's subpoena. Mr. Kelleher, a Skadden attorney, initially represented Putnam in an employee dispute and lawsuit involving Mr. Siedle a few years ago.

WHILE Mr. Siedle said he understands that he signed a contract requiring confidentiality, he considers Mr. Kelleher's comments unduly threatening. "I believe that threats of this kind are unacceptable and that nobody's family and home should be threatened in connection with responding to a subpoena," he said in an interview. "In my years of investigating money management abuses, I have never been threatened in this way, even when I referred hedge fund managers to law enforcement."

A spokesman for Skadden said the firm would not comment on the specifics of the conversation between Mr. Kelleher and Mr. Siedle's lawyer. "Neither Putnam nor its advisers are in the business of giving legal advice to Mr. Siedle or his advisers," the spokesman said.

In an interview last Thursday, Mr. Spitzer said: "We are very interested in pursuing the allegations that we are told would reflect adversely on Putnam's leadership. As a consequence, we are going to consider what legal recourse we have to obtain the information underlying these allegations."

Mr. Spitzer, who issued a subpoena to Mr. Siedle last month, is investigating Putnam as part of his inquiry into the fund industry. Although the company settled with the S.E.C, it remains under investigation by the commission, Mr. Spitzer and William Galvin, the secretary of the Commonwealth of Massachusetts.

By issuing a subpoena to Mr. Siedle, Mr. Spitzer may hope to learn what the former compliance director can tell him about practices of Putnam fund managers and executives going back to the late 1980's.

In a lawsuit filed against Putnam by Mr. Siedle in 1997 ~ under seal in federal court in Boston ~ the former compliance director alleged that senior fund managers at Putnam had asked colleagues to wait to make trades for clients so that the managers could first trade for their own accounts, according to a 1997 article in The Wall Street Journal. Such a practice is a type of front-running, an illegal practice in which a money manager buys a stock that is certain to go up because it will be purchased later in large quantities by a fund.

Both Putnam and Mr. Siedle declined to comment about the lawsuit and the front-running allegations. But a former fund manager who worked at Putnam from the late 1980's into the mid-90's said that he knew many of its managers were trading aggressively for their own accounts while they were managing money for clients.

Of course, such trades could have been entirely proper and made in stocks that were unrelated to portfolio holdings or executed well after a fund had traded the same shares. He said: "There were rules in place. If you were buying and selling individual stocks, you had to report it to the powers that be. But over time people don't watch things."

On at least one occasion, according to a Putnam employee who no longer works there, a portfolio manager created a false document to make it appear that he had complied with Putnam's code of ethics in his personal trading. The document was a memorandum detailing the manager's personal trades, as required under the firm's ethics code. But the memo had been improperly backdated so that the trades would appear to have followed the firm's rules.

The employee, who requested anonymity, said the incident occurred in the late 1980's and that it was unclear what occurred after the company's executives were alerted to the backdated document.

In 1997, Putnam conceded that it had reprimanded Thomas M. O'Neill, a stock fund manager identified by Mr. Siedle as conducting questionable trades, according to The Wall Street Journal article. A former fund manager who worked with Mr. O'Neill described him as a particularly active trader for his own account.

IN its reprimand, Putnam restricted Mr. O'Neill to 20 personal trades for 30 days and directed him to help rewrite Putnam's ethics code. Mr. O'Neill, who left Putnam in 1991 and later became chief investment officer at Fleet Financial Group's Fleet Investment Advisors unit, a position he has since left. He could not be reached for comment.

Mr. Lasser declined to comment for this article. John A. Hill, the chairman of the Putnam Funds board, declined to comment on whether the board was told of the front-running charges and what it might have done about it. He has been a trustee since 1985 and chairman since 2000.

"Putnam's taken some good steps," said Mr. Bullard, the head of Fund Democracy. "But it's hard to really characterize what they've done because part of it was in return for a deal with the S.E.C. You don't get credit for aggressively taking steps in return for a settlement agreement."

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GRAPHIC: Photo: Edward A.H. Siedle has been subpoenaed as part of an investigation of Putnam Investments. (Photo by Cindy Karp for The New York Times)(pg. 10)