VEDDER PRICE

Financial Services Report

A report designed to provide news and analysis of recent legal and regulatory developments in the financial industry

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SURPRISE–SURPRISE: WAL-MART WANTS A BANK

Wal-Mart Stores, Inc. ("Wal-Mart" or the "Company"), the company that revolutionized the retail industry, wants to extend its market dominance to financial services. Over the past three years, the world's largest retailer has attempted to expand its already broad menu to include banking services and has filed three separate applications with federal regulators as part of this effort. However, the retail giant has met resistance from Congress, state legislators, community banks and regulators.

Currently, Wal-Mart indirectly provides financial services to its customers through percentage lease arrangements with community banks. As of September 2001, Wal-Mart leased space to bank branch offices in approximately 600 of its 2,700 U.S. stores.[1] The Company, however, desires to directly offer its own banking products and services. The question is whether Wal-Mart may do so in a manner consistent with the law.

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The greatest obstacle facing Wal-Mart's entry into banking is the legislative barrier precluding affiliations between banks and commercial companies. Even though the Gramm-Leach-Bliley Act of 1999 ("G-L-B" or the "Act") significantly broadens a bank's ability to affiliate with any financial company and engage in virtually any type of financial activity, the Act reinforces the legislative prohibition against mixing banking and commerce. The gradual breaching of the barrier between banking and commerce is nowhere more clearly evidenced than in Wal-Mart's recent attempts to enter the banking industry. This article will discuss the background to Wal-Mart's attempts to enter the financial services industry, describe its strategies to become a financial services provider and comment on the likelihood of the success of its most recent attempts.

Why Wal-Mart wants to sell financial services

As the world's largest retailer, Wal-Mart is constantly looking for ways to maximize the value of its space and provide worthwhile services to its customers, which includes 92% of U.S. shoppers.[2]

Banking and financial services would provide an additional merchandise category and expand the increasingly popular notion of "one-stop shopping."

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According to Thomas Schoewe, Executive Vice President and Chief Financial Officer of Wal-Mart, "[f]inancial services are a top request of our customers and this initiative will allow us to help meet that customer demand across a greater number of stores."[3]

By utilizing its size and strategy of competitive pricing and customer service, Wal-Mart is also hoping to tap into a previously untapped market. Wal-Mart officials have stated that almost 20% of its customers do not have any banking relationship, and 13% of Americans do not have a checking account.[4] In some cases, those who do have a banking relationship have little choice, because they live in remote rural areas. Entering the financial services industry and expanding on its in-store banking strategy would give Wal-Mart, with its dominant presence in rural areas, the opportunity to provide these unbanked or underbanked individuals with more options and flexibility and permit the Company to capitalize on its network of more than 3,000 stores.[5]

Wal-Mart's attempts to enter the financial services industry

This section of the article will briefly discuss Wal-Mart's three attempts to enter the financial services industry.

Unitary thrift charter. At the same time Congress was looking to close the unitary thrift loophole, Wal-Mart was trying to purchase an Oklahoma savings bank, Federal BankCentre. This long-time loophole allowed a commercial company, regardless of its primary business, to own and operate a single thrift. Sears Roebuck, Ford Motor Company and State Farm Insurance are three of the prominent commercial companies which own or owned thrifts by virtue of this statutory provision.

If successful in obtaining the charter, Wal-Mart planned on spending the first year of ownership learning the banking business and then, in the second year, opening test locations in five Wal-Mart Supercenters where Wal-Mart would provide its own brand of financial services.

However, Wal-Mart's plans were derailed by the passage of G-L-B. Following intense lobbying by community banks and fearing the blurring of the barrier between commerce and banking, Congress closed the unitary thrift loophole by requiring companies wishing to establish a unitary thrift charter to apply by May 4, 1999. Wal-Mart submitted its application in June 1999 and, consequently, was denied the unitary thrift charter.

Joint venture with TD Bank. Despite failing in its first attempt to enter the financial services industry, Wal-Mart was not deterred. In September 2001, Wal-Mart announced that it would enter a joint venture with TD Bank USA ("TD Bank"), a subsidiary of Toronto-Dominion Bank of Canada, under which the two entities would offer banking services in approximately 100 Wal-Mart stores across the country.

While the precise details of the partnership have not been made public (despite numerous attempts by us to obtain such details under the Federal Freedom of Information Act), reports indicate that TD Bank would have utilized banking terminals at Wal-Mart store check-out lanes, and that Wal-Mart employees would have assisted in providing banking services to customers.[6] Reports also indicate that TD Bank and Wal-Mart would have shared in profits derived from the partnership.[7]

Unlike the purchase of a thrift, a joint venture between a commercial company and an existing bank is permissible as long as the venture is approved by the Office of Thrift Supervision ("OTS"). However, the OTS summarily rejected TD Bank's application in "the shortest letter [the OTS] ha[s] ever written" on the grounds that the proposed partnership breached the barrier between commerce and banking established by G-L-B.[8] According to the OTS, Wal-Mart would have had control over TD Bank and, therefore, would have been deemed a savings and loan holding company. Second, pursuant to the Home Owners' Loan Act, a company engaged in commercial activities is precluded from becoming a savings and loan holding company. In addition to an unacceptable level of control over the operation of the bank branches by Wal-Mart employees, the purported profit-sharing arrangement between TD Bank and Wal-Mart also prevented the plan's approval. Officials from TD Bank and Wal-Mart, however, have vowed to modify their plan in hopes of developing an arrangement acceptable to the OTS.

In light of the legal restrictions on commercial-banking relationships and the limited profit potential of supermarket branches, it remains to be seen how Wal-Mart and TD Bank can structure a profitable partnership within the bounds of G-L-B. Wal-Mart and TD Bank perhaps included employee sharing and other resource sharing arrangements in the original application in an effort to cut costs.[9] Thus, it is doubtful that Wal-Mart would be interested in a nationwide percentage lease initiative in which it would construct segregated branch kiosks in Wal-Mart stores across the country, because start-up and ongoing staffing costs could prove to be cost-prohibitive.

The OTS has expressed its willingness to entertain a revision to the September application,[10] and Wal-Mart and TD Bank officials have vowed to resubmit the application. Just where the middle ground lies between segregated supermarket branches and fully integrated check-out lanes/bank customer service counters is uncertain. The fact that Wal-Mart is once again pushing the limits of banking law and blurring the barrier between commerce and banking, however, is quite certain.

The in-store kiosk model appears to have little appeal to Wal-Mart. We wonder if the sheer size of their Super-Stores makes the kiosk format impractical. Allowing check-out clerks to become bank tellers would be a huge leap for bank regulators, considering previous guidance issued by regulators emphasizing that, within bank premises, sales of nondeposit investment products should be conducted in physical areas distinct from areas where retail deposits are taken.[11] We are not aware of any financial services organization where a salesperson can sell both a socket wrench and a certificate of deposit.

"The in-store kiosk model appears to have little appeal to Wal-Mart."

Industrial loan company charter. While Wal-Mart has yet to submit a revised application to the OTS, its full-out attempt to enter the financial services industry has taken on a new form, as it recently bid on Franklin Bank, a small industrial loan company in California. This bid, however, could quite possibly be history repeating itself.[12] Similar to Wal-Mart's attempt to purchase a thrift in 1999, this recent development is taking place at the same time Congress is considering controversial legislation that could prevent Wal-Mart from following through with the acquisition.

An industrial loan company is an institution organized under state law and, unlike a bank, can be owned by commercial entities. In order to qualify as an industrial loan company, the entity must be an institution organized under the laws of a state which, on March 5, 1987, had in effect or under consideration a statute which required or would require the institution to obtain FDIC insurance and which:

- does not accept demand deposits or transaction accounts, or
- has total assets of less than $100 million, or
- the control of which is not acquired by any company after March 5, 1987, or
- does not directly or indirectly or through an affiliate engage in any activity in which it was not lawfully engaged as of March 5, 1987.[13]

California's industrial loan charter originated in the early 1900s and was designed to provide consumer loans to blue-collar workers.[14] Over time, the powers under the industrial loan charter have expanded, putting the charter on nearly equal grounds with state-chartered commercial banks.[15] Two primary distinctions remain, however, as industrial bank companies cannot accept demand deposits and the industrial loan company and its holding company are not regulated by the Federal Reserve Board.[16]

Even though the industrial loan charter will not allow Wal-Mart to accept demand deposits, the charter will be a step towards Wal-Mart's long-term goal of entering the financial services industry. With the charter, Wal-Mart will be able to sell certificates of deposit and NOW accounts.[17] The charter would also allow Wal-Mart to act as its own merchant-acquirer on signature-based debit card transactions, which would

eliminate some of the fees presently paid by Wal-Mart to other third-party intermediaries between Wal-Mart stores and card issuers for processing these transactions.[18] Acquisition of the Franklin Bank charter would also reduce Wal-Mart's check-clearing costs by allowing Wal-Mart to use its own bank to process checks instead of paying a third party to do so.[19]

Wal-Mart's future in the financial services industry

Similar to its attempted thrift acquisition in 1999, Wal-Mart's current attempt to acquire Franklin Bank is encountering stiff resistance from legislators, community banks and regulators, because many fear that Wal-Mart is attempting "to circumvent the prohibitions against mixing commerce and banking."[20] For example, the chairman of the California Assembly's Banking and Finance Committee has asked the state's banking committee to delay consideration of Wal-Mart's application because he believes Wal-Mart "is using the state of California and…the industrial bank charter to accomplish that which it could not otherwise achieve if it attempted to acquire another California chartered financial institution."[21]

Wal-Mart, however, insists that there is no connection between the charter and its attempts to enter retail banking. Rather, it states it is obtaining the charter solely for the purpose of reducing its transaction processing expenses.[22] However, given Wal-Mart's previous attempts to enter the financial services industry, some observers find it difficult not to view this statement skeptically.

To compound matters for Wal-Mart, Congress is currently reexamining the existence of the industrial loan charter and deciding whether such institutions should be given more bank-like powers. Many believe that Wal-Mart's bid for Franklin Bank makes this congressional initiative more controversial and that Congress is likely to "kill it."[23] Others have suggested that the recent focus on industrial loan charters calls into question this exception to the banking-commerce barrier and could lead Congress to eliminate the charter altogether.[24]

"…critics argue that a Wal-Mart-owned bank is less likely to reinvest deposits in the community, because it has a nationwide network through which it can reinvest the funds."

While history does not always repeat itself, in this case some observers believe that Congress will respond the same way it did when Wal-Mart attempted to acquire the thrift in 1999. Others believe Wal-Mart will be permitted to acquire the industrial loan charter and Congress will not eliminate the charter due to its limited utility and scope.

One of the primary concerns of Congress in closing the unitary thrift loophole was the foreseeable unfair competition that could have arisen in the rural communities where Wal-Mart's presence is the strongest. Wal-Mart's critics have repeatedly accused the retailer of engaging in "predatory" pricing tactics that have put out of business smaller, local hardware, grocery and drug stores.[25] Wal-Mart's critics also contend that, along with possibly driving small banks out of business, businesses that compete with Wal-Mart could see their credit evaporate because a Wal-Mart-owned bank would have little incentive to lend to businesses that directly compete with the parent company.[26] Further, critics argue that a Wal-Mart-owned bank is less likely to reinvest deposits in the community, because it has a nationwide network through which it can reinvest the funds.[27]

Wal-Mart has responded by reminding its critics that both big and small business across the country successfully compete with Wal-Mart every day.[28] In addition, Wal-Mart stated that the discrimination in lending that its critics were prophesying is illegal.[29] Finally, Wal-Mart's stated intention for acquiring Franklin Bank is to reduce its credit transaction processing costs. Thus, the Franklin Bank acquisition could ultimately benefit consumers if Wal-Mart passes these cost savings along to its customers.

However, in 1999 Congress nonetheless decided in a hotly disputed political debate that the barrier between

banking and commerce should not be destroyed, because putting too many resources in the hands of one entity is not in the best interests of the consumer or the country.

The public policy reasons cited above were enough to convince Congress that Wal-Mart should not be allowed to take advantage of the unitary thrift loophole. Therefore, it is not certain whether Congress will backtrack and permit Wal-Mart to accomplish indirectly what it could not accomplish directly by acquiring the industrial loan company charter. We do expect, however, continued and aggressive persistence from Wal-Mart in its attempts to enter the financial services industry.

[1] Quote of Thomas M. Schoewe, Executive Vice President and CFO of Wal-Mart Stores, Inc. from TD Bank Press Release, Sept. 10, 2001.

[2] Andrew Edgecliffe-Johnson, *Wal-Mart Looks to Banking,* Fin. Times, July 1, 1999, at 16.

[3] Quote of Thomas M. Schoewe, Executive Vice President & CFO of Wal-Mart Stores, Inc. from TD Bank Press Release, Sept. 10, 2001.

[4] TD Bank Press Release, Sept. 10, 2001.

[5] Susan T. Port, *Wal-Mart Supercenter Planned for Stuart,* The Palm Beach Post, April 23, 2002, at 1A.

[6] Rob Blackwell, *Wal-Mart Joins TD in End Run on GLB*, Am. Banker, Sept. 11, 2001, at 1. Rob Blackwell, *Wal-Mart, TD Venture Hits Regulatory Wall*, Am. Banker, Nov. 5, 2001, at 1. Rob Blackwell and Laura K. Thompson, *OTS Chief: Wal-Mart's TD Deal is Fixable*, Am. Banker, Nov. 6, 2001, at 1.

[7] *Id.*

[8] Rob Blackwell and Laura K. Thompson, *OTS Chief: Wal-Mart's TD Deal is Fixable*, Am. Banker, Nov. 6, 2001, at 1.

[9] Rob Blackwell, *Wal-Mart, TD: Could They Make It Work?*, Am. Banker, Jan. 3, 2002, at 1.

[10] Rob Blackwell and Laura K. Thompson, *OTS Chief: Wal-Mart's TD Deal is Fixable*, Am. Banker, Nov. 6, 2001, at 1.

[11] Interagency Statement on Retail Sales of Nondeposit Investment Products, Feb. 15, 1994.

[12] Rob Blackwell, *Once Again, Wal-Mart Stirs Debate on Policy*, Am. Banker, May 30, 2002, at 1.

[13] 12 U.S.C. §1841(c)(2)(H) (2001).

[14] Laura Mandaro, *Will Wal-Mart Spur More California Industrial Banks?*, Am. Banker, June 17, 2002, at 1.

[15] *Id.*

[16] *Id.*

[17] Rob Blackwell, *Once Again, Wal-Mart Stirs Debate on Policy*, Am. Banker, May 30, 2002, at 1.

[18] Rob Blackwell, *Once Again, Wal-Mart Stirs Debate on Policy*, Am. Banker, May 30, 2002, at 1.

[19] Rob Blackwell, *Wal-Mart's Banking Play Stalling on Two Fronts*, Am. Banker, July 26, 2002, at 1.

[20] Rob Blackwell, *California Urged to Stall Wal-Mart*, Am. Banker, June 14, 2002, at 4.

[21] *Id.*

[22] Laura Mandaro, *Will Wal-Mart Spur More California Industrial Banks?*, Am. Banker, June 17, 2002, at 1.

[23] Rob Blackwell, *Once Again, Wal-Mart Stirs Debate on Policy*, Am. Banker, May 30, 2002, at 1.

[24] *Id.*

[25] Michael Markowitz, *A Banking Boom: Growth of Thrifts Gives Consumers More Choice*, The Rec., Aug. 29, 1999, at A1.

[26] Robert W. Dixon, *The Gramm-Leach-Bliley Financial Modernization Act: Why Reform in the Financial Services Industry was Necessary and the Act's Projected Effects on Community Banking,* 49 Drake L. Rev. 671, 683 (2001). Mr. Dixon is a co-author of this article.

[27] Kristal L. Kuykendall, *S&L Plan of Wal-Mart Draws 4th Foe*, The Ark. Democrat-Gazette, Aug. 18, 1999, at D1.

[28] Michael Markowitz, *A Banking Boom: Growth of Thrifts Gives Consumers More Choice*, The Rec., Aug. 29, 1999, at A1.

[29] *Id.*

ILLINOIS COURT APPLIES CREDIT ACT TO LETTERS OF CREDIT

On May 21, 2002, the Circuit Court of Cook County delivered an important victory for Illinois financial institutions in the case of *Stein Roe & Farnham, Inc. v. Mindbuilder Group, Inc. et al.* when it declared that the Illinois Credit Agreements Act (815 ILCS 160/0.01 *et seq.*) (the "Act") applies to letters of credit ("LCs") and bars any action against an issuer of a letter of credit by the purported beneficiary unless the credit agreement giving rise to the LC is signed by both the debtor (the "applicant") and creditor (the "LC issuer").

The plaintiff in the lawsuit, Stein Roe & Farnham, Inc. ("SRF"), subleased office space to the principal defendant, Mindbuilder Group, Inc. ("Mindbuilder"). Pursuant to the sublease, Mindbuilder was to provide two letters of credit to SRF as a security deposit. Northview Bank & Trust,[1] also named a defendant in the case, allegedly supplied both letters of credit. Mindbuilder later defaulted on its obligations under the sublease, and SRF attempted to draw on one of the letters of credit. Northview refused to honor the LC, however, because the LC was never issued and Mindbuilder did not sign the underlying credit agreement. SRF then sued Northview, alleging that Northview failed to honor a valid letter of credit. SRF's claim depended on the existence of a valid "credit agreement" between Northview and Mindbuilder under the Act.

The Act provides:

> A debtor may not maintain an action on or in any way related to a credit agreement unless the credit agreement is in writing, expresses an agreement or commitment to lend money or extend credit or delay or forbear repayment of money, sets forth the relevant terms and conditions, ***and is signed by the creditor and the debtor***.

815 ILCS 160/2 (emphasis added).

Illinois courts have previously broadly construed the Act to bar all actions by a debtor based on or related to a credit agreement that is not signed by both the debtor and creditor.[2] Prior to the *Mindbuilder* case, however, Illinois courts had not specified whether the Act extends to letters of credit. In this case, SRF unsuccessfully argued that the Act did not invalidate the credit agreement between Northview and Mindbuilder because the Act does not apply to letters of credit. The court dismissed this argument, however, and held that "the plain language of the statute and the relevant case law . . . indicate that the Act is applicable to letters of credit."

While the facts surrounding the letter of credit were disputed, both parties agreed that neither Mindbuilder nor SRF signed the LC application/credit agreement purportedly giving rise to the letter of credit. Accordingly, the court held that SRF could not maintain an action based on the unexecuted credit agreement, and entered judgment in favor of Northview.

The *Mindbuilder* decision confirms that the Credit Agreements Act applies to letters of credit. As a result, for a credit agreement to create an enforceable LC, the letter of credit application/credit agreement must be signed by both the applicant/debtor and the issuer/creditor in order for the applicant, its beneficiary, or any related party to have a cause of action against the issuer of the LC, or that is in any way related to, the instrument.

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[1] Vedder Price represented Northview Bank & Trust in these proceedings.

[2] *See, e.g., McAloon v. Northwest Bancorp, Inc.*, 274 Ill. App. 3d 758, 763 (2nd Dist. 1995).

BOOK REVIEW: FAILURE IS NOT ALWAYS FATAL

When Genius Failed: The Rise and Fall of Long-Term Capital Management by: Roger Lowenstein

Reviewed by Mark J. Kosminskas, an attorney with Vedder, Price, Kaufman & Kammholz as appeared in *The Journal of Corporate Renewal*, December 2001

It was a financial dream team, the equivalent of the 1992 U.S. Olympic basketball team of Michael Jordan, Scottie Pippen, Larry Bird, Karl Malone and Magic Johnson. Long-Term Capital Management (LTCM) boasted a team of some of the world's brightest and most powerful minds in financial theory and most respected traders in the business.

Yet, in the autumn of 1998, LTCM crumbled almost overnight after a few years of enviable performance. *When Genius Failed: The Rise and Fall of Long-Term Capital Management* by Roger Lowenstein is an engrossing account of this dream team, its meteoric rise and its sudden and brutal collapse, which threatened the stability of the U.S. financial system.

The book takes the reader inside the complex and difficult negotiations of a business failure, the magnitude of which the U.S. financial world had not experienced since the collapse of Continental Bank in the 1980s.

LTCM was a hedge fund started in 1994 by John Meriwether, a revered trader who started and ran the arbitrage group at Salomon Brothers. Although he left Salomon to start LTCM under something of a cloud when an underling became entangled in a scandal with the U.S. Treasury Department, Meriwether had a reputation for being able to attract enormously talented professionals.

He brought that skill to LTCM, staffing it with an extraordinarily brilliant team that was fiercely loyal to him. The partners at LTCM were heavily credentialed, having trained at the Massachusetts Institute of Technology, Harvard University, the University of Chicago and the London School of Economics.

Two of LTCM's partners, Robert Merton and Myron Scholes, would win Nobel Prizes during their tenures at LTCM. With Fischer Black, Scholes developed the Black-Scholes option pricing formula, which is taught to virtually every finance student in the U.S. To round out his team, Meriwether added David Mullins, vice chairman of the U.S. Federal Reserve. The partners were smart and experienced. They possessed integrity and were committed to putting their own fortunes at stake in the venture.

'Spectacular' Returns

A hedge fund is a private investment fund, essentially a mutual fund that is limited to a small number of high-net-worth investors. Unlike a mutual fund, hedge funds have the flexibility to engage in short selling and to invest in more exotic financial instruments, such as options and derivatives.

Thanks in part to a roster of partners that included pioneers of modern finance, LTCM was able to raise $1.25 billion, an enormous amount of money for a start-up fund. Not only did investors pour money into the fund, but banks also lined up to extend credit to LTCM on very liberal terms, waiving normal margin requirements, granting unsecured credit and shaving their fees to win LTCM's business.

> ***"LTCM's basic strategy was to use its mathematical models to identify less-liquid bonds in different markets, going long on one, short on the other."***

LTCM's basic strategy was to use its mathematical models to identify less-liquid bonds in different markets, going long on one, short on the other. Theoretically, the spreads would always converge, and LTCM would profit, regardless of the direction of the market. By using leverage and taking on large trades, LTCM was able to turn miniscule spreads into a highly profitable business. Quantifying and betting on historic volatility was the company's touchstone. As a spokesman for LTCM proclaimed, "Risk is a function of volatility. These things are quantifiable."

It was a strategy that appeared to work exceedingly well at the outset. LTCM rewarded investors with returns before partner fees of 28 percent in 1994, its first year in operation; 59 percent in 1995; and 57 percent in 1996.

Despite these spectacular results, the author of *When Genius Failed* notes that there were hints of trouble from the outset. To generate large returns on tiny spreads, LTCM needed to use a great deal of leverage. While leverage can help magnify returns, it can be punishing in a down market.

Second, the partners at LTCM had unshakable faith in their financial models and in themselves. Lowenstein noted, "Given enough time, given enough capital, the geniuses from academe felt they could do no wrong."

Third, the partners were unchecked by any independent risk management system at LTCM. The culture of commercial banking is steeped in the credit approval process, with both independent internal risk managers and government regulators peering over management's shoulders. Hedge funds have no such mandated mechanisms for managing risk. The partners at LTCM more or less policed themselves.

To make matters worse, they sequestered information about their trades and the firm's portfolio from investors and the banks and rationalized that this was necessary to keep banks from stealing their trades. Because of LTCM's clout and the competition for its business, the partners were able to shield information about their business from the banks and insulate themselves from the discipline and accountability to which "lesser" firms are subject routinely.

Finally, as profitable trades in their core business became more difficult to isolate, LTCM drifted from its core strategy and moved into other businesses, taking on directional exposure in equities and engaging in risk arbitrage.

"As in many restructurings, the outcome was determined in large part by the negotiating skills and leverage of strong personalities."

Reversal of Fortune

After three years of dazzling performance, the fund was rocked in the late summer and early fall of 1998 by a confluence of unforeseen events—devaluation of the ruble, weakness in Asian markets and the Monica Lewinsky scandal. Taken together, these events caused a sudden and persistent flight to quality in bond markets, and equity markets convulsed.

Unfortunately for its stakeholders, LTCM was premised around models that assumed a normal distribution curve. When these events pushed markets outside the curve, the firm stumbled and began to unravel with frightening speed.

Just as leverage magnifies gains, it exacerbates losses. LTCM began to hemorrhage capital as interest rate spreads widened beyond what the financial engineers could predict. LTCM's large positions in relatively illiquid securities, coupled with its leverage, gave it little room to maneuver. As the financial crisis worsened, the firm lost an astonishing 60 percent of its capital in one month, $550 million of that in a single day.

Even discounting its off-balance-sheet derivative exposure, the firm's leverage grew to 100 to 1. It was within days of collapsing and perhaps, as some feared, taking several banks down into the maelstrom with it.

While there are certainly many good technical books on corporate restructuring and several books on large corporate belly flops, few convey the drama, intensity and urgency of a large, important workout as well as Lowenstein does in *When Genius Failed*.

It is a process that all turnaround professionals have experienced, but rarely on so grand a scale. Lowenstein provides the reader with a seat in the conference room throughout the crisis; the reader is a voyeur through a failed attempt to raise additional capital, an aborted attempt to sell the fund to Warren Buffett and finally, a

negotiated restructuring and capital injection by the banks that was orchestrated by the Federal Reserve.

As in many restructurings, the outcome was determined in large part by the negotiating skills and leverage of strong personalities. William McDonough, president of the New York Federal Reserve Bank, and unflappable bankruptcy lawyer J. Gregory Milmoe of Skadden, Arps, Slate, Meagher & Flom forged fragile coalitions and made deals as the firm threatened to implode at any moment. Meanwhile, Goldman Sachs played the heavy, constantly making demands that threatened to derail the process at each turn.

Left to Debate

Lowenstein masterfully unfolds the tale like a Greek tragedy. While LTCM's competitive advantage derived from the enormous brainpower of its partners and their unwavering belief in their financial models, it was those attributes that led to LTCM's disintegration.

The author is, however, less skillful in drawing public policy conclusions from the debacle. He succumbs to journalistic reflex and, without much analysis, leaps to the conclusion that more government regulation of hedge funds is needed. He chides Alan Greenspan for his failure to support a tougher regulatory scheme and for not advocating more required disclosure of firms' derivative exposure.

Lowenstein also misses an opportunity to debate the scope of the too-big-to-fail doctrine. Should the Fed have intervened at all? At a time when the U.S. Government was urging other nations to permit the free market to work and allow financial institutions to fail, how could a private fund bailout be justified?

In retrospect, the Fed's intervention may well have been at an appropriate level and scope in the LTCM crisis. It helped engineer an orderly liquidation of LTCM, minimizing the risk of more widespread damage to the U.S. financial system as a whole, yet put no additional taxpayer dollars at risk. Although it does not detract from the story, Lowenstein neglects to debate these interesting questions in a serious way and fails to ground his case for more regulation.

Readers can ponder which factors ultimately led to LTCM's undoing: a fatally flawed business model, poor internal controls, the failure of investors and lenders to ask penetrating questions and provide appropriate external controls, excessive leverage, hubris or poor management. Or was the failure of LTCM, as Meriwether asserted, purely a case of bad luck—the financial equivalent of a 100-year flood. Lowenstein suggests that all of these factors may have been at work here.

There is another moral to the story of the failure of LTCM that would be easy to overlook, one that reflects a great strength of American business: as long as one's reputation for honesty remains intact, failure need not be fatal. After leaving Salomon under some controversy and soon on the heels of the spectacular failure of LTCM, Meriwether started a new fund with many of the same investors who lost money at LTCM. Decent players almost always get another turn at bat.

SELECTED SECURITIES OFFERINGS AND MERGERS/ACQUISITIONS

Included below is a listing of recent transactions reflecting significant activity in the financial institutions market.

Client	2002 Transactions
Big Foot Financial Corp.	Pending Sale to Midwest Banc Holdings, Inc. ($33.6 million)
Irwin Financial Corporation	Offering of 6.2 Million Shares of Common Stock ($88 million)
The Peoples State Bank of Newton	Pending Acquisition of Assets and Liabilities of First National Bank of Sumner ($2.42 million)
Bridgeview Bancorp, Inc.	Pending Sale of Bridgeview Bank, NA to Private Investor Group ($5.8 million)
Wintrust Financial Corporation	Offering of 1,362,750 Shares of Common Stock ($39 million)
Savanna-Thomson Investment, Inc.	Acquisition of Thomson Investment Company ($9.4 million)
Legg Mason Wood Walker	Offering of 1,200,000 Shares of Stifel Financial Corp. Trust Preferred Stock ($30 million)
American Bank and Trust Company	Pending Acquisition of Kaneland Community Bank (Undisclosed)

Client	2001 and Prior Transactions
MAF Bancorp, Illinois	Acquisition of Mid Town Bancorp, Inc. ($70 million)
Bridgeview Bancorp, Inc.	Offering of Pooled Trust Preferred Securities ($15 million)
Michigan National Bank	Sale of Home Equity Loans to Provident Bank
ABN AMRO North America, Inc.	Placement of Money Market Preferred Stock Custodial Receipts ($1.05 billion)

Client	Transactions
Success Bancshares, Inc.	Sale to BankFinancial Corporation ($48 million)
MFN Financial Corporation	Institutional Placement of Automobile Receivables Backed Notes ($301 million)
Michigan National Bank/LaSalle Business Credit	Acquisition of Asset Based Lending Business of Mellon Bank
ABN AMRO Bank, N.V.	Sale of European American Bank to Citibank, N.A. ($2.05 billion)
Hasten Bancshares, Inc.	Acquisition of Harrington Financial Group, Inc. ($40 million)
ABN AMRO North America, Inc.	Purchase of Michigan National Corporation ($2.75 billion)
Irwin Financial Corporation	Offering of Trust Preferred Securities ($90 million)
Private Bancorp, Inc.	Offering of Trust Preferred Securities ($20 million)
LaSalle Bank NA/Michigan National Bank	Creation of Merchant Bank Card Processing Joint Venture with National Processing Inc.
Private Bancorp, Inc.	Organization of a federal savings bank, Private Bank, St. Louis, Missouri ($8 million)
ABN AMRO North America, Inc.	Offering of Trust Preferred Securities (Fixed/Floating) ($510 million)
Lena Bancorp, Inc.	Acquisition by Foresight Financial Group, Inc. ($5.4 million)
Bridgeview Bancorp, Inc.	Acquisition of B&I Lending, LLC
Benchmark Bancorp, Inc.	Acquisition of Financial Institutions, Inc. and Private Placement of Common Stock ($8 million)
Mutual Federal Savings and Loan Association of Chicago	Reorganization to a Mutual Holding Company
Private Bancorp, Inc.	Acquisition of Johnson Bank Illinois ($20 million)

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