MONEY

Investors look for future guidance ; As earnings roll in, one key is: What's next?

Matt Krantz
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Investors are starting to get clues about whether recent optimism about stocks is justified. So far, they like what they see.

Stocks jumped Wednesday as the Dow Jones industrial average rose 76 points to 11,096, following strong third-quarter results from computer-chip maker Intel, financial firm JPMorgan Chase and railroad CSX. This pivotal earnings season hits full steam next week and could show whether the stock market rally has any fundamentals behind it.

Companies in the Standard & Poor's 500 are expected to post 31% growth during the quarter, vs. a year ago, which is well above the median 9.6% growth since 1988. Still, the third quarter's growth is down sharply from the 51.3% and 91.7% rates of the first two quarters of the year, says Howard Silverblatt of S&P.

That would mean third-quarter growth would be lower than the previous quarter's for the first time since fourth-quarter 2008. Even so, stocks are on a tear: The Dow is up 70% from its March 2009 low and just 1% below its 2010 high, largely because of a strong September rally.

In parsing companies' earnings results, investors will be:

*Listening about the future. Investors can look past the third- quarter slowdown as just a moderation from the first half's blistering growth, says Dirk van Dijk of Zacks Investment Research. What's critical, though, is guidance. Analysts expect earnings to set a record in the fourth quarter of 2011, Silverblatt says.

*Looking for companies going beyond cost cutting. Much of the deceleration in earnings growth is a sign that the benefits of cost cutting are running out. Revenue is expected to grow only 5.5% in the third quarter. Investors will search for companies growing faster than that.

*Monitoring surprises. The wild card is whether companies top estimates, as 70% of them did in the second quarter, says John Butters of Thomson Reuters. If so, earnings growth may not slow as much as expected.

With so many unknowns, there's "potential for disappointment," says Doug Sandler of RiverFront Investment Group. The last two quarters investors expected slow growth and got medium growth. But now, they "are expecting medium growth and might get slow growth," he says.

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MONEY

Title issues could slow home sales ; Lack of title insurance could hold up loans on foreclosed properties

Stephanie Armour
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Foreclosed homes could get harder to buy now that one of the nation's largest title insurance companies has stopped insuring titles to homes foreclosed by JPMorgan Chase and GMAC Mortgage.

Old Republic National Title Insurance said last week that it will no longer insure title to any property foreclosed by Chase or GMAC after both mortgage servicers halted foreclosure sales in 23 states and said they are reviewing legal filings that may not have been properly verified or notarized.

Most lenders won't issue a mortgage without title insurance, which ensures buyers have clear title to the property and protects theirs and lenders' financial interests if ownership disputes arise.

Old Republic's action is the latest twist in a growing controversy that has called tens of thousands of foreclosure cases into question in the 23 states that require court approval. Bank of America said Friday that it, too, will stop foreclosures in those states while reviewing its records for the same problems tying up JPMorgan and GMAC foreclosures.

Representatives of the three servicers have given sworn statements in lawsuits that they signed thousands of foreclosure affidavits without signing them in a notary's presence or verifying the supporting documents, as the law requires.

Questions about whether foreclosures were done legally could lead to evicted homeowners claiming they still own their houses after someone else buys them in foreclosure sales, says Mark Stopa, a Florida lawyer representing homeowners.

"The bank forecloses on a property, sells it to a legitimate third party," Stopa says. "Two weeks later, the former homeowner says the paperwork was wrong and the judgment has to be set aside. The (new) owner is out."

Adds Rafael Castellanos, managing partner at Expert Title Insurance Agency in New York, "It is possible for a homeowner to come back and stake a claim to their property."

The American Land Title Association (ALTA), which represents title insurers, says possible flaws in foreclosure documents should have little impact on buyers of foreclosure-sale homes because they can argue they bought the home in good faith and the law protects them.

"It is unlikely that a court will take property from an innocent, current homeowner and return it to a previous homeowner who failed to make payments on the loan subject to the foreclosure," the ALTA said in a statement.

But if other title insurance companies do follow Old Republic's lead, that could prevent or delay more foreclosure sales. More than 151,000 bank-owned properties were sold in the second quarter -- 15% of all home sales, according to RealtyTrac.

PHOTO, Color, Joe Raedle, Getty Images

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MONEY

Ohio officials join call to investigate foreclosures ; Paperwork processing at JPMorgan, GMAC cited

Stephanie Armour
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Two of Ohio's top state officials Thursday waded into a rapidly growing number of examinations into possibly improper foreclosures affecting tens of thousands of homeowners around the country.

Secretary of State Jennifer Brunner said she has asked federal prosecutors to investigate possible defects in legal papers supporting thousands of foreclosures in Ohio by JPMorgan Chase.

A day after JPMorgan suspended some 56,000 foreclosures in 23 states because of possible legal flaws, Brunner said she had asked the U.S. attorney in Cleveland to investigate admissions by the lender's employees in sworn depositions that documents were not properly notarized.

"For too long thousands of homes have been taken from consumers without proof that the foreclosing party actually has that right. ... As the officer in Ohio who licenses notaries, I cannot stand idly by and watch financial institutions concoct a chain of title they never had by abusing the notary process," Brunner said.

JPMorgan and the U.S. Justice Department declined to comment on Brunner's action.

Separately, Ohio Attorney General Richard Cordray said he has asked courts to examine foreclosures involving Ally Financial's GMAC.

Last week GMAC suspended evictions in 23 states while it reviews affidavits related to foreclosures that may have been signed and notarized improperly. JPMorgan cited similar reasons when it said it is reviewing supporting affidavits submitted to courts to repossess delinquent borrowers' homes.

Attorneys general are launching inquiries into potentially flawed GMAC foreclosure documents in Connecticut, Texas, Iowa, North Carolina and Illinois.

Freddie Mac and Fannie Mae have suspended foreclosures where GMAC was a servicer. Fannie Mae also said it is contacting servicers to ensure they're accurately reviewing documents.

John Walsh, chief of the Office of the Comptroller of the Currency, told a Senate hearing Thursday that his office has asked JPMorgan Chase and other large mortgage servicers to review their foreclosure processes.

Greater scrutiny of foreclosures by courts and regulators could lead to further delays in a process that already grinds slowly.

Economist Mark Zandi, with Moody's Analytics, says the delays over flawed foreclosures could push resolution of the foreclosure crisis from seven years to 10.

"The scale seems to be ballooning," Zandi says.

PHOTO, B/W, Joe Raedle, Getty Images

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MONEY
Trials drag on for loan help ; Many 3-month plans are hitting 6 months

Stephanie Armour
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Bank of America and JPMorgan Chase service the mortgages for half the homeowners who have been awaiting decisions on permanent mortgage modifications for three months or more, according to a government report.

Through July, the government's mortgage-aid program had a backlog of 118,000 borrowers whose trial plans have run at least six months - - three months past the typical duration for determining if they qualified for a permanent modification, the government said Friday. Bank of America and JPMorgan Chase, the two biggest banks, account for about 59,000 of the cases.

Under the government's Home Affordable Modification Program (HAMP), borrowers are supposed to get permanent modifications if they keep up their adjusted payments for a three-month trial.

But the program has been dogged by controversy.

Servicers blame delays on borrowers who don't provide necessary documentation and on the government's frequently changing requirements. Borrowers complain that the servicers repeatedly lose the paperwork they send and don't return calls.

Friday's report said the number of borrowers who have been in trials for six months or more had dropped from 166,000 in June and that servicers indicate decisions on those remaining should be made in August.

Bank of America expects to make decisions on most of them in August and September, says spokesman Rick Simon.

BofA's total number of customers in trial modifications dropped from 121,000 in June to 85,000 in July as decisions were made on who qualified for permanent modifications, he says.

JPMorgan Chase declined to comment on whether it will resolve all of the older trial modifications this month.

"We're reducing the number of aged trials each month, and we'll continue do that," says spokesman Tom Kelly.

Homeowners are not subject to foreclosure sales while decisions are being made on their eligibility for permanent modifications. But some economists question whether the administrative delays are only postponing the inevitable.

"The delays in trial modifications aren't a good thing," says Dean Baker of the Center for Economic and Policy Research.

The government's report also shows nearly half the 1.3 million homeowners enrolled in the program since March 2009 had been dropped by the end of July.

About 630,000 homeowners had seen their trial modifications canceled, while about 435,000, or roughly a third of those who enrolled, had moved into permanent modifications.

Those in permanent modifications are guaranteed lower payments for five years and then fixed terms at current rates for the life of the loan.

The median monthly payment decrease for those in permanent modifications was $513, or 36%.

About 256,000 homeowners were in active trials in July, the report showed.

"It looks like HAMP is running out of steam. Only a quarter of a million are in active trials," says economist Mark Zandi of Moody's Analytics. "The plan as originally constructed is not up to the task. There are some new programs, such as principal reduction, that may give it new life."

TEXT OF INFO BOX BEGINS HERE

Extended trial plans

Mortgage servicers with the largest percentages of active trial modifications in the federal program that have run six months or more -- instead of the typical three months -- at the end of July.

PNC Mortgage 68%

Saxon 66%

CitiMortgage 65%

JPMorgan Chase 63%

Aurora 52%

OneWest 49%

Wells Fargo 49%

Ocwen 41%

Bank of America 41%

American Home 31%

Source: Treasury Department

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MONEY

No bank? No problem. Phone apps let you deposit checks ; More banks are offering new service to their customers

Sandra Block
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Correction ran 7/15/2010: A story Wednesday on smartphone bank deposits should have said Chase has 5,100 branches.

Busy people who use their smartphones to check their bank balances, transfer funds and pay bills have a new reason to bypass banks and ATMs: They can use their phones to deposit checks.

Earlier this month, JPMorgan Chase updated its iPhone app to allow customers to electronically deposit checks. To make a deposit, customers photograph the front and back of the check with the phone's built-in camera, then transmit the image to their account.

USAA has offered a deposit app since last August. Customers have used it to deposit 1.5 million checks worth more than $900 million, spokesman Paul Berry says.

Bank of America has tested a mobile deposit app but hasn't set a launch date, spokeswoman Tara Burke says.

USAA, which serves members of the military and their families, had a strong incentive to offer the mobile deposit: It has only one branch, located in San Antonio. Customers outside San Antonio can use other banks' ATMs for cash withdrawals, but in the past, they had to deposit checks by mail.

Chase customers can deposit checks at any of the bank's 1,500 branches or 10,000 ATMs. The bank's decision to offer mobile deposit reflects customer demand, spokesman Tom Kelly says.

"We know some iPhone users are passionate about using their iPhones for anything possible, and we are happy to help," he says.

Chase's decision to offer mobile deposit will force other banks to seriously consider offering their own app, says Bob Meara, senior analyst at Celent, a research firm. Because of its non-traditional structure, "a lot of banks were dismissive of USAA," he says. "They can't be dismissive of Chase."

USAA and Chase say they've installed several features to protect app depositors from fraud.

The innovation comes as the use of checks is declining. From 2007 to 2009, the number of checks handled by the Federal Reserve fell 14%. The Fed processes about a third of the USA's checks.

Still, even the most tech-savvy consumers sometimes need to deposit old-fashioned paper checks. Daniel O'Leary, 27, of Long Beach, Calif., uses USAA's app to deposit checks he receives from his grandparents on his birthday.

O'Leary, a content manager for a software company, says he'd use the deposit app even if USAA had a branch in his area.

"Going to the bank is not a fun experience," he says.

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MONEY
Bear Stearns execs blame 'market forces' ; Ex-CEOs say they couldn't have foreseen meltdown

Paul Davidson
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The firm whose demise marked the first salvo in an epic financial crisis isn't taking much blame for the tailspin.

Bear Stearns' former top executives told officials investigating the meltdown Wednesday they did not foresee the housing bust that doomed the venerable investment bank and there was little they could have done to head off its failure.

Although the company held big stakes in risky mortgages that were plunging in value, they blamed "unfounded rumors" and "overwhelming market forces" for the firm's March 2008 collapse. That culminated in its takeover by JPMorgan Chase for $10 a share.

In light of the market turmoil, "I do not believe there were any reasonable steps we could have taken, short of selling the firm, to prevent the collapse," James Cayne, CEO from 1993 to January 2008, told the Financial Crisis Inquiry Commission in Washington.

Skeptical commission members suggested the firm should have reduced its exposure to an imploding mortgage market, or at least beefed up its capital cushion.

"It does seem that your firm and other firms were participating in a range of activities that put the system at risk as a whole," said commission Chairman Phil Angelides.

It was the first of two days of hearings by the panel, which is investigating the causes of the Wall Street meltdown that dramatically accelerated the recession.

Bear Stearns was the fifth-largest investment bank but the first to be pummeled by the plunge in home prices and resulting mortgage crisis. The slide began in summer 2007 with the collapse of the firm's two hedge funds, which invested in securities tied to subprime mortgages.

Bear Stearns itself held $46 billion in mortgage-backed securities, many of which were less than prime-rated, and other complex instruments. As the subprime mortgage crisis spread to less- risky home loans, investors questioned the value of the securities. Creditors balked at renewing loans whose collateral was mortgage- backed securities. Customers began withdrawing their investments.

Ultimately, JPMorgan Chase acquired the firm but only after the Fed provided billions in financing.

Former senator Bob Graham, a commissioner, suggested executives should have foreseen the collapse of the mortgage market.

Cayne had a different view. "You're basically saying you see something coming that 99.9% of the rest of the people on Earth don't see coming," he said.

Commissioners said the firm at least should have had more capital to offset potential losses. Angelides noted that despite Bear Stearns' high exposure to mortgages, it had only about $1 in capital to cover each $40 or so in mortgage-related securities. "You didn't see going into turbulent water it was necessary to build a higher levee?"

"That was really industry practice," Cayne said, though he added in hindsight, leverage was "too high."

Alan Schwartz, the firm's last CEO, added that the company "had very strong capital ratios" compared with its competitors in light of the relatively stronger securities on its balance sheet. Rather, he blamed "unfounded rumors" that "Bear Stearns was in the midst of a credit liquidity crisis."

Schwartz said the firm's highly rated securities were solid. But he said rating agencies erroneously gave high ratings to other bad securities in the market. Because the instruments were privately traded, all were suspect. He said he supports a provision of the financial reform bill that would require derivatives to be traded on exchanges or clearinghouses, giving more information to investors.

By the end of the hearing, Schwartz conceded, "There's certainly a whole lot of people who participate in creating something that turned out bad and certainly we were part of that."

PHOTO, B/W, Andrew Harrer, Bloomberg News

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MONEY
6 financial gaps still lacking plugs ; Chris Dodd takes a 2nd shot at a thankless job

Paul Wiseman
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Trying to fix the broken U.S. financial system is no way to win a popularity contest.

Standing by himself, Christopher Dodd, chairman of the Senate Banking Committee, on Monday announced his second attempt to plug loopholes in financial regulation and find ways to prevent a repeat of the crisis that overtook Wall Street in late 2008. His first attempt was declared dead on arrival last fall by his Senate colleagues.

The House of Representatives passed its version of financial reform in December.

Dodd's new plan on Monday faced an immediate barrage of criticism. The American Bankers Association said it imposed too much regulation; consumer groups said it imposed too little. "It's a far distance from what we had hoped for," says John Taylor, president of the National Community Reinvestment Coalition.

Political observers expressed doubts that the plan would become law, considering that Dodd, D-Conn., would need to win over Republican votes to get the 60 required to break a filibuster and ensure passage in the Senate.

Brian Gardner, who follows regulatory issues for investment firm Keefe, Bruyette &Woods, gives it a 40% chance of passage. "It's going to be tough," he says.

But Dodd, who has announced his retirement next year, made an impassioned plea for reform in the wake of a financial crisis that sent the economy tumbling into recession and required a $700 billion taxpayer bailout.

Americans have "lost faith in our markets," he said. "And they wonder if anyone is looking out for them."

The crisis exposed the weakness of a patchwork regulatory system with different agencies monitoring different types of institutions - - and plenty of leeway for banks and other lenders to shop around for the laxest regulation.

Dodd's bill aims to clarify the regulatory apparatus, making the Federal Reserve responsible for bank holding companies with assets exceeding $50 billion and for policing the entire financial system for risk. The Fed would also house a new consumer financial protection bureau.

The Fed's enhanced role is a switch. Dodd originally wanted to end the Fed's bank regulatory duties.

Before unveiling the bill Monday, Dodd had tried to work out a bipartisan compromise with Sen. Richard Shelby, R-Ala., and then with Sen. Bob Corker, R-Tenn. When the talks broke down, he went it alone, hoping to win bipartisan support in the Senate.

On Monday, Shelby sounded a conciliatory note, telling CNBC that there was agreement on 85% to 90% of the bill.

Some observers expect the Senate to ditch the most contentious parts of the legislation -- beefing up consumer protection and regulating the murky market in derivatives -- and pass a narrower bill.

"No one, regardless of party, is going to want to face the electorate without having passed financial reform," says Rob Johnson, former chief economist of the Senate Banking Committee, and now with the Roosevelt Institute. "No matter how weak it is, in terms of its real structure, the cosmetic ritual is something these guys will want to pass."

Consumer abuses

Problem: No regulatory agency has sole responsibility for protecting consumers from predatory lending and other financial abuses. In the absence of single-minded oversight, home buyers were steered into mortgages they couldn't afford, and consumers were fleeced by hidden fees and high interest rates.

Why it matters: Fannie Mae has estimated that up to half of subprime borrowers could have qualified for prime mortgages, but many were sold higher-interest loans by unscrupulous mortgage brokers looking for higher commissions. But many regulatory agencies have put consumer protection on the back burner -- or have seen it as a threat to banks' financial health. The Office of the Comptroller of the Currency, for instance, went to court to stop state regulators from investigating allegations of abuse at the national banks it oversees.

Proposed solutions: Dodd's bill would create a Consumer Financial Protection Bureau, housed within the Federal Reserve, to protect consumers. His plan falls short of the independent, stand-alone agency that the Obama administration wanted and that the House included in its bill.

Critics note that the Fed has a lackluster record for protecting consumers. Dodd argues that the new agency's address matters less than the power it gets. Under his plan, the consumer watchdog would have an independent leader picked by the president and confirmed by the Senate; get its own budget, paid by the Fed; and have independent rule-writing authority. However, the vast majority of banks -- those with assets below $10 billion -- would be exempt from the watchdog's examinations in both Dodd's bill and the House bill. The House version also exempts auto dealers. In a statement, President Obama said he would work with Dodd to make the bill stronger.

"I will not accept attempts to undermine the independence of the consumer protection agency, or to exclude from its purview banks, credit card companies or non-bank firms such as debt collectors, credit bureaus, payday lenders or auto dealers," he said.

The financial services industry argues that consumer protection should be handled by the regulators responsible for keeping banks safe and sound.

Compensation

Problem: Bankers, traders and mortgage brokers are compensated in ways that let them enjoy big paydays when things go well and stick shareholders or the taxpayers with losses when they don't.

Why it matters: "Heads I win, tails you lose" is the way critics describe Wall Street's pay policies. Executives who drove their banks into the ground could walk away rich.

Lehman Bros. CEO Dick Fuld, for instance, received a $22 million bonus a few months before his firm went bankrupt in September 2008. Harvard Law School researchers found that senior executives at Lehman and Bear Stearns (merged into JPMorgan Chase with the government's financial help in March 2008) pulled $2.4 billion out of the doomed companies between 2000 and 2008 in cash bonuses and stock sales.

A year ago, insurer American International Group paid $165 million in bonuses to 400 employees of the unit that drove the firm to the brink of failure.

The problems aren't only in the executive suite: Loan officers were often paid for churning out loans, regardless of whether they were likely to be repaid. And traders could -- and sometimes did -- put their entire firms at risk in attempts to hit the jackpot.

Proposed solutions: Regulators are going further than Congress in trying to rein in destructive pay practices. Dodd's bill and a bill passed in December by the House of Representatives would give shareholders only a non-binding vote on top executives' compensation.

The Federal Reserve has proposed expanding its oversight of pay. Two dozen unidentified banking giants would be required to submit compensation policies to the central bank. The Fed would inspect them and approve the ones that do the best job of making sure employees aren't encouraged to take on excessive risks. The rules would apply to top executives, to traders who can gamble billions, and to groups of employees, such as loan officers, whose collective decisions can put a firm at risk.

Legal authority

Problem: Federal policymakers lack clear authority to shut down non-bank financial institutions, leading to an inconsistent policy of bailouts, bankruptcies and forced mergers.

Why it matters: Banking regulators have the power to shut down troubled banks, sell their assets and pay insured depositors from the Federal Deposit Insurance Corp.'s fund. But federal policymakers did not have clear-cut options to shut down failing non-bank institutions such as brokerages and insurance companies. Simply putting big financial firms, which often have complicated dealings with other banks and firms, into bankruptcy might put the entire financial system at risk.

So when the meltdown in subprime mortgages started threatening large financial firms in 2008, policymakers were forced to make a series of ad hoc decisions that ended up causing confusion and panic.

When investment firm Bear Stearns faced collapse in March 2008, the Federal Reserve stretched its authority to the limit to finance a takeover by JPMorgan Chase. But when Lehman Bros. was on the brink in September 2008, the government let it fail, triggering panic on Wall Street. Ultimately, the Treasury Department asked for -- and got -- $700 billion from Congress to restore calm, helping finance a government takeover of American International Group.

But critics have lambasted the government's inconsistent decision- making, and the public is outraged about the bailout. Fed Chairman Ben Bernanke has said the government needs "the tools to restructure or wind down a failing systemically important firm in a way that mitigates the risks to financial stability and the economy and thus protects the public interest."

Proposed solutions: Dodd's bill is similar to the House's. He would set up an orderly process to shut down non-bank firms such as Lehman or Bear Stearns, forcing shareholders and unsecured creditors -- not taxpayers -- to absorb losses. Additional losses would be borne by a fund financed by big financial institutions. Big financial firms would be required to write their own funeral plans, detailing how they would be shut down.

Too big to fail

Problem: Some financial institutions are so big and so interconnected that letting one of them fail can bring down others, threatening the entire economy.

Background: Federal regulators decided they had no choice but to rescue insurance giant American International Group with $180 billion in taxpayer money. If AIG went under, they feared, it might drag down big financial firms that AIG owed money to and risk toppling the financial system.

But labeling some firms too big to fail creates big distortions in the financial marketplace. Investors and creditors are more willing to put their money in financial giants they believe won't be allowed to fail. That means big banks and financial institutions can raise funds on more favorable terms than smaller ones that would never be rescued by Uncle Sam. The Center for Economic and Policy Research estimates that the too-big-to-fail subsidy is worth up to $34 billion a year.

Managers of firms deemed too big to fail also have an incentive to take big risks -- and earn potentially big returns for the firm and bonuses for themselves -- if there's a government safety net to break their fall.

Proposed solutions: Dodd and the House would create a regulatory council to identify big financial firms whose collapse would threaten the entire system. Those firms would face stricter regulation and possibly be required to set aside more capital as a buffer against losses.

Under Dodd's plan, big financial firms could be forced to break up if their size posed a risk to the financial system, provided the Fed and two-thirds of the council agreed. If the big firms failed, shareholders and secured creditors would absorb the losses first; additional losses would be taken by an emergency fund financed by assessments on big financial institutions.

As Washington has debated the issue, the biggest banks have gotten even bigger. A report in January by the think tank Demos found that the five biggest banks have doubled their share of the nation's deposits to 40% since 1998 and increased their share of banking assets to 48% from 26% a decade ago.

Credit-rating agencies

Problem: The credit-rating agencies gave their seal of approval to securities that turned out to be virtually worthless, misleading investors and regulators.

Why it matters: Three companies -- Moody's, Standard &Poor's and Fitch -- dominate the business of rating the risk of bonds and other forms of debt. Federal regulations have required banks and other institutions to rely on the agencies' ratings when deciding how much capital to set aside to cover potential losses on bonds or other investments.

The agencies are paid by the companies that issue the debt, not by the investors who must decide whether to buy them.

During the housing boom that ended in 2007, critics say, the rating agencies loosened their standards to build business.

The Securities and Exchange Commission has released e-mails in which an employee at one rating agency (whose identity was not made public) joked that securities written by "cows" would get a clean bill of health, and another called the whole system a "house of cards."

The ratings of mortgage-backed securities proved worthless when the U.S. housing market collapsed. For example, Lehman Bros. debt was rated investment grade the morning the investment firm filed for bankruptcy protection.

Proposed solutions: Dodd's bill would create an office in the Securities and Exchange Commission to regulate rating agencies.

The House bill would make it easier for investors to sue rating agencies; require agencies to release more information about how they reach their decisions; force agencies to put more independent directors on their governing boards to police conflicts of interest; and drop references to rating agencies in financial regulations, so that banks and other institutions would no longer be required to rely on the agencies' judgments.

Lawrence White, economics professor at New York University, worries that new regulations will backfire, discouraging new competitors from entering the ratings market. He says less, not more, regulation would reinvigorate the business.

Derivatives

Problem: Over-the-counter derivatives are an unregulated black hole that sowed confusion and panic at the height of the crisis. Derivatives are contracts whose values are derived from an underlying asset such as stocks or bonds. They nearly brought down insurer American International Group, triggering a $180 billion taxpayer bailout.

Why it matters: Derivatives allow farmers, business managers and speculators to protect themselves against or to bet on changes in the value of everything from corn to jet fuel to mortgage bonds. For years, most derivatives were traded on public exchanges such as the Chicago Mercantile Exchange. Over-the-counter (OTC) derivatives are negotiated between two parties out of public view. In 2000, Congress declared them off-limits to regulators. They mushroomed in the darkness, reaching a worldwide value of $605 trillion.

AIG began issuing a type of OTC derivative called a credit default swap that amounted to insurance against the risk that mortgage securities or other forms of debt would go bad. But AIG's unregulated derivatives operation was never required to back up the contracts with capital. When mortgages started to default in large numbers, AIG couldn't meet its obligations; AIG, and its counterparts, faced financial oblivion until the government rescue.

Proposed solutions: Dodd's bill -- and the bill passed by the House in December -- aims to push OTC derivatives onto exchanges for regulators and investors to see. But the bills also contain what critics call loopholes that might allow speculators to avoid scrutiny. "Most of it is just codifying current behavior through loopholes," says Rob Johnson, of the Project on Global Finance at the Roosevelt Institute.

Dodd's version isn't final: He's asked Sens. Jack Reed, D-R.I., and Judd Gregg, R-N.H., to produce a bipartisan version.

Johnson doubts Congress will pass meaningful reform. "Banks are going to dig in hard on derivatives," he says. "They make so much money." Former commodities regulator Michael Greenberger, now a University of Maryland law professor, is worried about loopholes, but says Dodd's bill might give regulators enough clout to police derivatives.

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MONEY

Wall Street risk-takers could be doomed to repeat history ; Pattern of excess by company executives is long, author says

Richard Eisenberg
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Wall Street's reckless appetite for risk may have nearly brought down the financial system last fall, but nothing like that will ever happen again, right?

In The Sellout, CNBC on-air editor and longtime Wall Street reporter Charlie Gasparino, says: Don't be so sure.

Gasparino argues that the disaster was just the latest in a 30- year pattern of executive excesses, unsustainable leverage, massive hidden losses and unreliable computer models.

And he's not optimistic that something similar won't happen again.

"Trading risk through leverage or esoteric investments and trades has become the mother's milk of Wall Street," he writes.

Gasparino's brutal history of Wall Street from the 1980s through today offers damning evidence that this is one movie we've seen before.

In the '80s, Wall Street's bond cowboys created the collateralized mortgage obligation (CMO). The firms leveraged up to boost profits, then lost millions when rates rose. By pricing bonds "aggressively" (translation: for more than they were really worth), they hoped to avoid showing losses until the market recovered.

In the '90s, gunslingers began running Wall Street. By 1996, Lehman Bros. and Bear Stearns were borrowing $32 for every $1 they had in capital.

In 1998, the massive Long Term Capital Management hedge fund collapsed because risk models failed. Wall Street sputtered; Lehman Bros. nearly folded. The government ordered Wall Street to pony up hundreds of millions to bail out the hedge fund.

A decade later, Wall Street leveraged again, this time using subprime and Alt-A mortgages, collateralized debt obligations and other risky debt wrapped in AAA-rated packages. Citigroup embarked on "one of the greatest binges of risk and leverage in Wall Street history."

What really happened: A fire sale purchase of Bear Stearns by JPMorgan Chase; Lehman Bros.' bankruptcy; a hurried Merrill Lynch- Bank of America merger; the $85 billion AIG bailout; and the government's industrywide TARP bailout.

Gasparino cites four culprits for the history of Wall Street calamities:

*Sleepy regulators. Although Gasparino is tough on Treasury Secretary Henry Paulson for his ad hoc approach to the recent crisis, he skewers the Securities and Exchange Commission.

"We should have been getting information on the risk they (investment banks) were taking, but we didn't because we didn't know what to ask for," says Harvey Goldschmid, an SEC commissioner under George W. Bush.

*Clueless (at best) CEOs. Often, they didn't know how much trouble they were in. Bear Stearns' James Cayne thought his firm had $20 billion in risky hedge funds, when it actually had $45 billion.

*Docile boards and managers. "Yes men" (and women) were the norm, partly because CEOs wouldn't tolerate dissent. Why didn't Bear's board step in when the firm's hedge funds were overleveraged?

*An out-of-touch culture. A Lehman executive took a helicopter to work every Monday from Long Island.

Under CEO Stanley O'Neal, Merrill Lynch served guests thousand- dollar bottles of wine. Successor John Thain spent $131,000 on office rugs.

Gasparino knows the Wall Street characters well, and the fly-on- the-wall anecdotes prove it. Many came from interviews with current and former CEOs, including Morgan Stanley's John Mack, JPMorgan Chase's Jamie Dimon and Merrill's O'Neal.

A self-described "economic libertarian," Gasparino calls for the elimination of the SEC and bond-rating agencies, which is a bit excessive.

Surprisingly, he suggests mandatory clawbacks penalizing CEOs for excessive risk-taking.

Without such a disincentive, Gasparino believes, you might as well start buying popcorn for the next sequel to Wall Street's horror film.

Richard Eisenberg is a freelance writer based in New Jersey

The Sellout

By Charles Gasparino

HarperCollins, 499 pages, $27.99

PHOTOS, B/W (2)

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MONEY

Dimon bio is a fun read that's flattering, but not gushy ; Book tells it like it is, just like the man himself

Kathryn Canavan
857 words
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USA Today
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English

What do you call a banker who refuses to promote the boss's daughter, lets loose with F-bombs in haute banking circles, and shows up at a black-tie event in Manhattan wearing a business suit?

A new biography calls him "the world's most important banker."

Jamie Dimon, the unorthodox chairman and CEO of JPMorgan Chase, has been called a moral compass, a force of nature, the Seven- Billion-Dollar Man and Wall Street's Mr. Fix-It.

Last Man Standing: The Ascent of Jamie Dimon and JPMorgan Chase, the meticulously researched new book by Duff McDonald, quilts together Dimon anecdotes from more than four dozen first-person sources. The result is a business bio that's flattering but not fawning.

Two glimpses of a young Dimon at Harvard Business School foreshadow how his modus operandi would change Wall Street:

On his second day of class, Dimon found himself surrounded by Type A students competing for the professor's attention because they'd been told that half their grade would be based on class participation. When another student began anxiously waving a hand while Dimon was speaking, he turned around and said, "Put your ... hand down while I'm talking."

Dimon himself was so obsessed with achievement that he asked a student who outdid him on a midterm if he could read the student's exam answers to gauge why he hadn't done as well.

The book is dotted with details of Dimon's youth and family life: The third-generation stockbroker grew up in affluent Larchmont, N.Y., and in a Park Avenue apartment. His twin brother, Ted Jr., is a Harvard-trained educator who studies a mind-body discipline called the Alexander Technique. Their older brother, Peter, earned a doctorate in physics.

Dimon married a Harvard classmate, Judy Kent, the daughter of a real estate entrepreneur and the first in her family to go to college. She paid for their first date because he had no money, McDonald writes. On their 15th wedding anniversary, he would hand her a rolled-up stock certificate, formally giving her one-third of his net worth and saying, "You deserve this."

Upon graduating from Harvard, Dimon declined job offers from Goldman Sachs, Morgan Stanley and Lehman Bros. to work with family friend Sandy Weill for less pay so he could learn the investment business. McDonald calls it one of the greatest mentor-protege relationships in the history of American business.

The duo rose from an unglamorous commercial credit operation in Baltimore to the top ranks of Citigroup. The relationship started to crack when Dimon passed over Weill's daughter, Jessica Bibliowicz, for promotion at Citi, even though the two had grown up together. While Weill surrounded himself with yes men, McDonald writes, one colleague described Dimon as "the guy who would say what everyone else was thinking."

The cracks widened when news stories began to focus on Dimon's accomplishments rather than Weill's. In 1998, Weill dumped Dimon.

Less than a decade later, after a detour to Bank One in Chicago, Dimon ascended to CEO of JPMorgan Chase, the oldest banking institution in the U.S., which traces its roots to Aaron Burr. The pistols from Burr's 1804 duel in which he mortally wounded Alexander Hamilton, valued at $25 million, are displayed on the 50th floor of the bank's Park Avenue headquarters.

While other bankers looked at the upside of every deal, Dimon studied the possible downside, insisting on a "fortress balance sheet." When unemployment rates were low, he modeled what the financial landscape might look like if the jobless rate hit 10%.

By the time the Wall Street meltdown began, Dimon and his bank stood tall in the Wall Street group picture. With the acquisition of Bear Stearns and Washington Mutual, it stood taller.

Before JPMorgan Chase bought Bear Stearns at the government's behest, Dimon, who rarely calls staffers in during off hours, got key executives out of bed to spend the night slicing Bear Stearns' financials until they came up with a purchase price that would work. In an interview with the author, Warren Buffett lauded Dimon's ability to make a gut decision with limited information: "You don't have to understand it perfectly. You just need to know the outer limits. A guy can walk into a room, and you might not know whether he weighs 300 or 350 pounds, but you know he's fat."

Fresh first-person comments such as Buffett's make McDonald's book a good read. Patricia Crisafulli's The House of Dimon, published in April, and Last Man Standing are both good behind-the- scenes business primers and valentines to Dimon. The details in McDonald's book make it more entertaining.

Kathy Canavan is a Wilmington, Del., writer who covers family finance

Last Man Standing: The Ascent of Jamie Dimon and JPMorgan Chase and

by Duff McDonald

Simon & Schuster

340 pages, $28

PHOTO, B/W

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MONEY
Zombie stocks just refuse to die ; Some have made impressive gains, albeit dubiously

Matt Krantz
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Halloween is weeks away, but on Wall Street, it's already like a night of the living dead.

A number of the stocks at the center of the financial crisis that had been practically left for dead, including Lehman Bros., Washington Mutual (WaMu), American International Group (AIG), Fannie Mae and Freddie Mac, have posted strong percentage gains amid the stock market's recovery.

Lehman and WaMu, for instance, were booted from stock exchanges and filed for bankruptcy protection. Yet on the lightly regulated Pink Sheets markets, this year their stocks are up 500% and 1,050%, respectively.

Meanwhile, AIG, Fannie and Freddie are still listed on the New York Stock Exchange, but must repay massive debts to the government. Even so, the shares are up 41%, 88% and 134%, respectively.

While it's impossible to lump all the stocks together, market observers say the jumps are a sign of rampant speculation and false hopes creeping into corners of the market that investors are better off avoiding.

"These gains are like the white static noise in the background that I tend to let go," says Robert Maltbie of research firm Singular Research. "People are playing these as the next penny stocks."

Fans of these stocks point to many reasons why the rallies are justifiable. But experts who study financial stocks and severe economic distress call the moves questionable and a case of dead stocks walking because:

*Severely battered stock prices magnify gains. It's easy to be dazzled by the percentage gains in these stocks, but they're exaggerated by their low levels.

For instance, WaMu's more than 1,000% gain this year is just a function of the stock trading on the Pink Sheets for 23 cents, says George Putnam, publisher of The Turnaround Letter, who tracks corporate bankruptcies.

Some less-informed investors figure large stock moves by beaten- down stocks such as AIG and Fannie Mae that still are listed on major exchanges, mean firms such as Washington Mutual and Lehman that have filed for bankruptcy protection must surge, too.

"With stock prices so low, you have speculative buying," he says. Christopher Whalen, at banking research Institutional Risk Analytics, says, "It's not unusual for bankrupt things to flop on the floor of the boat for a while."

*Companies face pending legal action. One big reason behind speculation in shares of WaMu is pending lawsuits. While the bank WaMu was sold to JPMorgan Chase for $1.9 billion in September 2008, the WaMu holding company is suing both the FDIC and JPMorgan to reclaim assets. JPMorgan declined to comment.

Speculating over whether the WaMu holding company will win the lawsuits and reclaim money is a popular pursuit for bulls on the stock. WaMu "is far from being a zombie stock," says Hans Brost, founder of Washington Mutual Equity Group, which operates a website to compile pending legal action with the company. Brost, who invested in WaMu stock after the JPMorgan deal, says he expects the courts to find the deal wasn't handled properly. "It was a travesty what happened to WaMu," he says. "There could be a significant recovery," he says. "I am betting on it."

*Artificial buying has a big impact. Much of the buying in the zombie stocks is caused, ironically, by investors who bet against them, says Frederick Cannon, analyst at Keefe, Bruyette & Woods.

In something known as short covering, investors who made huge gains betting against these stocks must purchase them in order to realize their gains, he says.

Investors who lack sophistication may confuse short covering for real buying, he says. The stock in WaMu and Fannie Mae are worthless, yet traders are trying to make profits off daily moves, Cannon says. "You're getting guys in pajamas that are day trading this stuff," he says.

*There's a shortage of credible information. As the companies faltered, the number of analysts following them has dropped off, too. Gradient Analytics' Donn Vickrey, who closely covered the financials of AIG, for instance, no longer follows the company or stock.

This void of information gives the speculators even more influence, thanks to online chat boards where they congregate.

Investors who are trading in the zombie stocks are forgetting the level of duress the financial system and the companies were under when the government took action, says Patricia McCoy, a law professor at the University of Connecticut. The moves taken by the government to save the system as these companies failed cost stockholders their stakes. "When the reckless loans crashed, shareholders should be wiped out," she says.

But the fact investors are willing to gamble on the stocks, and feel there might be a recovery, is a dramatic sign of the very nature of speculation. The run-up in the zombie stocks "shows hope springs eternal," McCoy says.

TEXT OF INFO BOX BEGINS HERE

Dead stocks walking?

Shares of several of the financial firms at the epicenter of the financial crisis have posted strong percentage gains this year.

Company Listed on exchange? Dec. 31, 2008 Oct. 9, 2009 Pct. chg.

Washington Mutual No $0.02 $0.23 1,050%

Lehman Bros. No $0.03 $0.18 500%

Freddie Mac Yes $0.73 $1.71 134%

Fannie Mae Yes $0.76 $1.43 88%

American Int'l. Group Yes $31.40 $44.22 41%

Source: USA TODAY

PHOTO, B/W, Michael Caronna, Reuters; PHOTOS, B/W, Jason Reed, Reuters (2); PHOTO, B/W, Nicholas Roberts, AFP/Getty Images; PHOTO, B/W, Andrew Harrer, Bloomberg News

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MONEY

Despite all the rhetoric, bankers still raking it in ; Billions in pay, bonuses flow into pockets on Wall Street

Pallavi Gogoi
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Public outrage has boiled over as billions of dollars in bonuses have been handed out on Wall Street, the center of the 2008 financial storm that contributed to the worst recession in generations and left millions of people jobless.

Even President Obama joined in, labeling the $18.4 billion in bonuses "shameful" and calling on Wall Street to "show some restraint." Seizing on the populist anger, lawmakers put together a compensation-reform bill that passed the House of Representatives on July 31 and will be brought to a vote in the Senate after the summer recess.

Still, despite all the apparent momentum building to rein in runaway pay, it looks as if Wall Street's compensation practices will largely emerge unscathed. Critics say the bill's key proposals, though well-intentioned, are non-binding, so companies can choose to ignore them. And Wall Street executives, seemingly unconcerned about further antagonizing an already agitated mob, are gearing up to boost pay. Some top firms that just last year received billions in government bailout money are thriving again and appear undaunted by the widespread criticism of big paychecks. Consider:

*Flush from two quarters of profits and having repaid the government its bailout money, Goldman Sachs has set aside $11.36 billion for compensation and benefits in the just first six months of the year, a 33% increase from last year.

*JPMorgan Chase, which also has paid back taxpayer money, reported record second-quarter revenue and has carved out $14.5 billion for pay in the first half of the year, up 22%.

*While Morgan Stanley, too, has repaid the government, the bank recorded its third-consecutive loss in the second quarter. Despite that, the bank has set aside $6 billion so far this year for compensation expenses, and $3.87 billion just in the second quarter, which represents 72% of its revenue.

"The Wall Street community is not particularly plugged into the public sentiment," says Peter Cappelli, management professor at Wharton business school. "It's a culture that hasn't cared very much about the political realities elsewhere."

Little correlation between pay, performance

Officials have blamed Wall Street's pay structure for making the financial crisis worse. Treasury Secretary Timothy Geithner said the compensation practices "encouraged excessive risk-taking." Lured by big bonuses, increasingly large numbers of bankers took risks that led the U.S. to the brink and a $700 billion government bailout for the industry.

Wall Street banks typically set aside more for compensation than other industries -- about 50% of revenue to pay employees. However, the largest companies that make up the S&P 500 spend less than 22% of revenue on all indirect costs, which includes salaries, commissions and other overhead, according to a USA TODAY analysis of data from Standard & Poor'sCapital IQ.

Bankers say they have to pay more to retain top talent. In Morgan Stanley's annual report, it says: "In order to attract and retain qualified employees, we must compensate such employees at market levels. Typically, those levels have caused employee compensation to be our greatest expense." The banks also say that pay is directly linked to performance and that if they don't retain qualified employees, performance could be affected.

However, studies have found that there is little correlation between pay and performance on Wall Street, and bankers win no matter which way the market goes. On July 30, New York Attorney General Andrew Cuomo released results of a nine-month investigation of the first nine banks that received bailouts from the government's Troubled Asset Relief Program (TARP). His report found that banks paid out bonuses even while running at a loss, and at those that did post positive income, annual bonuses exceeded the entire year's profit.

At Citigroup, despite the $27.68 billion in losses last year, the bank paid out $5.33 billion in bonuses, of which about 738 employees each received $1 million or more. JPMorgan earned $5.6 billion in the year and paid out $8.69 billion in bonuses. The bank also had more seven-figure earners than any of its competitors -- 1,148 employees received $1 million or more. Goldman earned $2.3 billion and paid out $4.8 billion in bonuses, with 212 employees earning $3 million or more.

Cuomo says his analysis makes it clear that "there is no clear rhyme or reason to the way banks compensate and reward their employees. ... Compensation for bank employees has become unmoored from the banks' financial performance."

Throughout this year, there have been plenty of other revelations about Wall Street excesses. One example that only seemed to get uglier as more details emerged was what happened at Merrill Lynch before and after it was forced to sell itself to Bank of America to avoid collapse.

In the final three months of 2008, as BofA was trying to close the purchase, Merrill lost $15.3 billion -- bringing its losses for all of 2008 to a record $27 billion. Yet, Merrill CEO John Thain pushed through $3.6 billion in bonuses to Merrill employees days before the merger with BofA closed on Jan. 1, 2009. The merger cost American taxpayers $20 billion in cash and an agreement by the government to share in losses that totaled $118 billion.

It also damaged the reputation of BofA CEO Kenneth Lewis. He had to relinquish the title of chairman in April and since then has faced calls to step down as CEO. The bank is being investigated by Cuomo and by Congress because of the Merrill bonus payments and losses that weren't disclosed to shareholders. Last week it paid a fine of $33 million to the Securities and Exchange Commission to settle a court complaint that BofA had misled shareholders about what it knew about the bonuses.

Lawmakers don't want to rock economy's boat

Even as Wall Street is increasing its compensation and lawmakers are criticizing it for doing so, Washington, too, seems to be shying away from imposing harsh curbs on pay. The key reason is that lawmakers are fearful that tough pay curbs might get in the way of the financial services industry helping foster an economic recovery.

"It is a nightmare situation -- nobody wants these firms to fail, which would lead to a bigger economic and political disaster; on the other hand it's embarrassing that they are already deciding to pay themselves more for doing well," says Alan Johnson of compensation consultant Johnson Associates.

Critics say the compensation-reform bill lacks teeth. Sponsored by Rep. Barney Frank, D-Mass., the Corporate and Financial Institution Compensation Fairness Act of 2009 has provisions that affect all publicly traded companies, and there are special provisions for financial institutions.

The bill doesn't place any caps on pay. Rather, it requires that shareholders vote on compensation of senior executives. That's because, as Frank notes, the amount of compensation at banks is not "a public decision, rather it's up to shareholders." However, the votes are non-binding, and boards of directors at the companies can choose to ignore them. At least one prominent shareholder is already saying that it would be impossible for it to be effective.

The pension fund of The United Brotherhood of Carpenters and Joiners of America has assets of $40 billion and holds shares of 3,603 companies. Douglas McCarron, the fund's president, says it would be a "challenge" to undertake a level of research and analysis required to vote on the pay plans of all the companies in which it owns shares. He says the fund might end up voting at thousands of the companies it invests in based on a simple checklist.

"Such an action will undermine the goals that motivated the work to improve compensation disclosure," says McCarron, in a letter to the SEC.

Opponents of the bill say there are a lot of unanswered questions that they hope the Senate will address when it debates the legislation. "Part of the problem is that I don't recall any expert testimony on any of the pieces of the bill, nor have we held any hearings on compensation specifically," Rep. Scott Garrett, R-N.J., says.

Bankers win no matter what happens

It's also unclear how, exactly, banks that still have TARP funds will see their compensation affected. The government has appointed Kenneth Feinberg as pay czar to monitor pay at banks and auto companies that have not repaid government bailout money, and he has yet to publicly take any action.

The Treasury has proposed that executives at these firms get no bonuses or retention and incentive awards, and in some cases they might even have to pay back past bonuses. Seven companies have until Thursday to submit proposed compensation details for the 100 highest-paid employees within the firms. While Feinberg has the power to make sure pay doesn't reward risky behavior and to even take back pay that was undeserved, it is unclear what he will do with the information.

"Feinberg has broad authority to make sure that compensation at those firms strikes an appropriate balance," says Treasury spokeswoman Meg Reilly. "Obviously, we all have a shared interest in ensuring that those companies can return to profitability as soon as possible so that taxpayers can recoup their investment."

But neither Feinberg's appointment nor the bill that awaits the Senate addresses the fundamental problem that fueled the anger, which is that traders and executives at these firms end up winning both ways. As Cuomo said in his report, Wall Street compensation is a proposition in which "heads I win, tails you lose."

Most of the biggest banks declined to comment. But at Goldman Sachs, "The correlation between our net revenue and compensation has been 99% since the firm went public in 1999," says spokesman Lucas Van Praag. "This is hard proof that pay is directly linked to performance."

Criticism is focused on more than the industry's big players. An Aug. 4 report from compensation consultants Presidio Pay Advisors analyzed 115 banks that received TARP funds. The report, like Cuomo's, found no correlation between pay and performance at the banks in the last three years.

"Wall Street's economic well-being is totally based on taxpayers' money saving them from disaster, and they've already forgotten that," says Stephen Lerner, who directs the financial-reform campaign at union group SEIU. "Americans lost trillions of dollars in wealth from the economic collapse, and while Wall Street got bailed out, it will take years for workers on Main Street to get jobs and work their way out of this economic catastrophe."

Contributing: Matt Krantz

"Folks on Wall Street ... (need to) show some restraint and show some discipline and show some sense of responsibility."

-- President Obama after news of the $18 billion of Wall Street bonuses in 2008

"Compensation practices encouraged excessive risk-taking."

-- Treasury Secretary Timothy Geithner

"There is no clear rhyme or reason to the way banks compensate and reward their employees."

-- New York Attorney General Andrew Cuomo

TEXT OF INFO BOX BEGINS HERE

Wall Street bonuses

Wall Street firms didn't cut bonuses even when they posted huge losses. And at those with positive income, bonuses exceeded the entire year's profit. (In billions):

Earnings\loss Bonus pool

Citigroup -$27.7 $5.3

Goldman Sachs $2.3 $4.8

JPMorgan Chase $5.6 $8.7

Merrill Lynch -$27.6 $3.6

Morgan Stanley $1.7 $4.5

Source: Bank bonus report, Office of the New York Attorney General

PHOTO, Color, Nicholas Kamm, AFP/Getty Images; PHOTO, Color, Jay Mallin, Bloomberg News; PHOTO, Color, Andrew Harrer, Bloomberg News; PHOTO, B/W, Richard Drew, AP; PHOTO, B/W, Jeremy Bales, Bloomberg News; PHOTO, B/W, Chris Hondros, Getty Images; PHOTO, B/W, Daniel Acker, Bloomberg News; PHOTO, B/W, Douglas C. Pizac, AP

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MONEY
Dimon's capital obsession pays off ; JPMorgan Chase stakes claim as a front-runner as CEO steers it through crisis

Pallavi Gogoi
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NEW YORK -- Five years ago, Jamie Dimon and his three daughters picked up an RV in Grand Teton, Wyo., and drove through Yellowstone, Idaho, Nevada and Yosemite, and finally into the Beverly Wilshire hotel in Los Angeles, where his wife was meeting them. Arriving at the wheel of an RV, unshaven and in shorts, he was waved to a stop by the guard, who told him he couldn't park there.

"I got off and said, 'You do valet parking here, don't you?' " says a grinning Dimon, gleefully recounting the exasperated look on the face of the hotel guard. Little did the guard realize, but that scruffy hotel guest at the wheel of the RV would a few months later strike a deal to merge Bank One with JPMorgan Chase, a step on his way to being CEO of one of the oldest blue-chip financial institutions in New York.

The image of Dimon, 53, barreling around the country in an RV is hardly one that matches with Wall Street CEOs, who have in the past year been vilified as greedy financiers who took the country to the brink with their risky appetites.

But RVing has been one of Dimon's favorite ways of vacationing with his kids. In a way, it almost seems an appropriate pastime, given that his acquisition last year of the failed Washington Mutual has catapulted JPMorgan from a primarily New York/Chicago-centric bank to one with a very broad national footprint. As WaMu signs come down, Chase signs are going up on about 2,000 bank branches and 4,500 ATMs that JPMorgan got from the acquisition.

Today, JPMorgan has emerged as a front-runner among the survivors of one of the most harrowing periods in the nation's financial history, which led to the collapse of large investment banks such as Bear Stearns and Lehman Bros. and commercial banks such as Wachovia and Washington Mutual, the largest bank to fail in history, with $307 billion in assets. Of those, JPMorgan acquired Bear for $1.5 billion and WaMu for $1.9 billion.

The largest bank by market capitalization, JPMorgan is the only large financial institution that posted a profit during the financial crisis. This month, it posted its 20th-consecutive quarterly profit: $2.7 billion, a 36% increase from a year earlier, with record revenue of $27.7 billion. Its stock price is up more than 150% from its bear market low in March.

Dimon's reputation as a ruthless negotiator remains intact with his latest acquisitions, and he admits to being a tough manager. But his handling of the firm during the crisis has drawn praise from several quarters, including the highest in the land: President Obama, who commended Dimon "for doing a pretty good job."

"JPMorgan was conservative going into the downturn, and that strong financial position is enabling it to weather the current downturn better, and even be aggressive where required," says Tom Kersting, financial services analyst at Edward Jones.

Indeed, in one closely watched gauge on Wall Street, JPMorgan was No. 1 in investment-banking revenue in the first half of 2009, says Dealogic.

Fortress balance sheet

Among the four largest banks that received $25 billion each from the U.S. Treasury last fall as part of the Troubled Asset Relief Program (TARP), JPMorgan is the only one that has repaid the government. Citigroup and

Bank of America went back to the trough, taking an additional $20 billion each, while Wells Fargo still hasn't been cleared to repay.

Dimon says he didn't need the TARP funds and took the taxpayers' money at the behest of former Treasury secretary Henry Paulson. Other former investment banks, such as Goldman Sachs and Morgan Stanley, which each were given $10 billion, also have paid it back.

A key reason behind JPMorgan's reputation for solidity can be attributed to Dimon's obsession with capital and a "fortress balance sheet," a phrase he's been using for almost a decade. That fixation with capital turned out to be prescient when the government stress tests this year focused on capital levels as the crucial gauge for banks' ability to handle a worsening economy.

Dimon likens it to being prepared for war. "If you have the 82nd Airborne, you're able to go to war and handle battle," he says, referring to the U.S. Army's most combat-ready military unit.

JPMorgan's strong capital levels played a key role in the bank's ability to pay back the government before any of its rivals and was why Dimon was able to strike deals such as WaMu and Bear when others couldn't.

Dimon now is trying to make sure that the coming tide of government regulation doesn't squash JPMorgan's chances of thriving, either. He has become one of the most vocal bank CEOs, speaking out against any regulation that he believes will hamper JPMorgan's ability to prosper.

For instance, Dimon says that a provision in the new law on credit card reform that won't allow banks to charge more for some sorts of defaults will force banks to reduce credit and charge more. Ultimately, he says, such laws increase the cost for all consumers. He also dislikes a proposal to require derivatives -- complex financial instruments that are structured as agreements between an investment bank and a corporation that hedges risk -- to trade on exchanges.

"Corporations around the world hedge their foreign exchange, interest rate and oil risk, and putting everything in an exchange would be cookie-cutter standardization. A lot of people couldn't get what they wanted," he says.

Still, JPMorgan has made mistakes.

One that Dimon regrets most is hiring third-party mortgage brokers. Not wanting to lose out during the real estate boom, the bank aggressively courted business from outside brokers, who originated 30% of all of its home loans. Credit losses in the broker- originated loans were two to three times worse than that of JPMorgan's directly originated business, says Dimon, who has since shuttered the broker business.

Poorly written mortgage loans, including home equity and subprime loans, contributed to loan losses totaling $6.4 billion in the past year. The bank has put aside $30 billion in reserves for future losses, more than double the figure a year ago.

Despite those losses, the potential is huge for JPMorgan when the U.S. emerges from the recession. It acquired WaMu's assets at a bargain-basement price. Just before WaMu failed last year, the bank ran a TV ad blitz showing happy consumers whooshing past the screen in fast cars shouting "woo hoo" from the thrill of having banked there. But the reality was different. In the last 10 days before its demise, its customers withdrew $16.7 billion, the Federal Deposit Insurance Corp. says.

Chase, JPMorgan's retail banking division, by contrast, has a staid image more suited to people looking for a stable place to park their money. Compared with WaMu's narrow line of products, such as free checking accounts and high-rate CDs, Chase hopes to wring more profits by offering more products.

"People need loans, credit and debit cards, or investment products and retirement savings," says Charles Scharf, head of the retail bank and financial services division.

Chase also plans to grow its middle-market business, hoping to swipe market share from regional banks that now are suffering from the weight of massive losses in the commercial real estate sector.

Chase defines its middle-market customers as businesses with annual revenue from $20 million to $1 billion that need services including 401(k) plans for employees and commercial credit cards for customers. Chase's trump card is its mergers-and-acquisitions unit.

"M&As are technically challenging, and for most of these companies, probably the most important transaction that the family will do is an acquisition or sale of the business," says Todd Maclin, head of commercial banking at JPMorgan.

Anger management

Dimon's reputation is hard-won. His grandparents emigrated to the U.S. from Greece and settled in New York, where Dimon was born. Dimon's father, Theodore, or Ted, worked as a stockbroker for years, and still does at Merrill Lynch.

Dimon rose to prominence when he worked closely with his mentor Sanford "Sandy" Weill. He joined Weill at American Express. They both left AmEx in 1986 and moved to Commercial Credit, a small consumer lending operation.

The Weill-Dimon team worked closely to build a financial services giant. Their string of mergers and acquisitions, including insurer Travelers and brokerage Salomon Smith Barney, culminated in what became one of the largest of its time, the merger of Travelers with Citicorp in April 1998.

Soon, Dimon clashed with his boss and in November 1998, he was famously fired. In the months after that, Dimon took up boxing, which he has since given up after tearing both his rotator cuffs. "I was fired, and out of a job. I got in shape and burned off the excess anger and energy," says Dimon.

But in 2000 he landed the top job at Bank One in Chicago and four years later merged with JPMorgan, where he was named CEO in December 2005. Last year, when the government reached out to Dimon to help buy Bear Stearns and avoid a meltdown, many were reminded of the bank's heritage and the role played by its founder, John Pierpont Morgan, the financier who helped rescue the U.S. financial system during the panic of 1907.

"You test someone's mettle in bad times, and how Jamie Dimon has conducted himself during these times would earn him high grades from a conservative financier like J.P. Morgan," says Richard Bove, banking analyst at Rochdale Securities.

This has, indeed, been a breakout year for Dimon. First, Obama. Then, billionaire investor Warren Buffett, whose annual letter to shareholders is one of the most widely read in investing circles worldwide, told the 35,000 shareholders attending Berkshire Hathaway's annual meeting that they needed to read Dimon's letter.

In the letter to his shareholders, Dimon goes beyond the customary two pages penned by other CEOs about the performance of the company. His is a 28-page explainer of the unfolding of the financial crisis, how "the gathering storm arrived with a vengeance" and how JPMorgan faced it.

Dimon, a history buff, quotes Albert Einstein and Abraham Lincoln. He praises the government for acting quickly and boldly, exhorting readers to remind themselves of Theodore Roosevelt, who said people who dare to fight deserve praise even if they fail, for they "shall never be with those cold and timid souls who know neither victory nor defeat."

Despite being at loggerheads with the administration on various issues today, Dimon believes that the government's "bold" steps saved the financial system and the economy from a much worse fate.

It also puts him comfortably in the driver's seat at JPMorgan, where his vision is to build a fortress of a business "for the next 100 years."

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About Jamie Dimon

Chairman & CEO of JPMorgan Chase

Age: 53

Family: Three daughters, ages 20, 22 and 24, with wife, Judith. His father, Theodore, or Ted, still works as a stockbroker for Merrill Lynch.

After hours: Plays tennis with his kids. Started playing tennis with them when they were 9, 7 and 5.

Tennis tip for parents: Find someone to teach them for you; otherwise it's only a matter of time before you lose patience.

Lineage: Second-generation American; grandparents emigrated from Greece.

Recent disappointment: Found Congress' rule barring TARP-funded companies from hiring non-Americans "disgraceful. It wasn't a proud moment for me as a second-generation American."

Hobbies: Picked up boxing after being fired from Citi in 1998. Burned off excess anger and energy and tore both rotator cuffs. Switched to running.

Personal hero: Nelson Mandela. "He spent 27 years in prison and, instead of being angry, came out magnanimous to his captors and saved his nation. What an amazing reaction."

Favorite TV show: Everybody Loves Raymond. "He makes me laugh."

Favorite musician: Frank Sinatra.

Home: Upper East Side, New York City.

Weekend home: Westchester, N.Y.

Education: Tufts University, BA. Harvard Business School, MBA.

GRAPHIC, Color, Julie Snider, USA TODAY, Source: CSI (line graph);
PHOTO, Color, Jennifer S. Altman for USA TODAY; PHOTO, B/W,
Jennifer S. Altman for USA TODAY

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MONEY
Paulson endures tough day on Hill ; He admits he pressured to get Merrill deal done, and that it wasn't perfect

Paul Davidson
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WASHINGTON -- A congressional hearing Thursday on former Treasury secretary Henry Paulson's hard-nosed efforts to push through Bank of America's takeover of Merrill Lynch turned into a contentious inquisition into the government's emergency measures to rescue the financial system last fall and Paulson's leading role.

Some lawmakers suggested Paulson's handling of the BofA-Merrill deal was emblematic of overzealous government maneuvers last fall to rescue an armada of failing financial giants at the expense of taxpayers and besieged homeowners.

"Last year, at the height of the financial crisis, major decisions were made about who was going to live and who was going to die," said Rep. Edolphus Towns, D-N.Y., chairman of the House Committee on Oversight and Government Reform. "Lehman (Bros.) went down, but AIG was saved. ... In a way, the Bank of America-Merrill Lynch deal illustrates the danger of concentrating enormous power in only one or two individuals."

It was the committee's third hearing on Bank of America's acquisition of one of the country's largest investment banks, a deal that has become a lightning rod for congressional criticism of the government's handling of the financial crisis since last October's creation of a $700 billion fund to rescue financial firms.

Bank of America CEO Kenneth Lewis and Federal Reserve Chairman Ben Bernanke testified last month.

The hearings come at a pivotal time, with the Obama administration proposing to broaden the Fed's powers to head off future financial crises.

Paulson acknowledged pressuring Lewis last December to complete the planned acquisition of Merrill Lynch, despite Lewis' concerns about Merrill's unexpectedly deep fourth-quarter losses, because of the potential damage to the financial system if Merrill failed as Lehman had in September. The former Treasury secretary said he reminded Lewis that the Federal Reserve, as the bank's regulator, could remove Lewis and the board if the bank backed out of the Merrill merger.

Bank of America received $45 billion in federal aid, including $20 billion after it acquired Merrill Lynch to help it withstand Merrill's losses.

But Paulson denied he was acting at the behest of Bernanke or that he withheld vital information about Merrill's worsening financial status from the public and regulators.

"Our responses were not perfect," said Paulson, who often spoke haltingly. But they "were substantially correct" and "saved this nation from great peril."

Yet, several committee members were even more intent on grilling Paulson about his role in last fall's unprecedented Wall Street rescue. They accused him of hoodwinking Congress by using the bailout money to inject capital into flailing financial titans after promising to buy their toxic assets. The government is now beginning a joint program with private investors to purchase those assets.

Lawmakers demanded to know why Paulson and Bernanke decided to let Lehman fail -- an event that spooked credit markets and worsened the crisis -- while saving Bear Stearns and insurance giant AIG.

They suggested Paulson's ties to Goldman Sachs, which he headed before becoming Treasury secretary, influenced key decisions during the crisis. And they asked how a Republican free marketer could engineer such an extensive government initiative to meddle in private enterprise.

Better than alternative

Paulson said government officials had little choice but to take a series of extraordinary steps to avoid financial calamity. Those steps included the takeover of Fannie Mae and Freddie Mac and bailouts of AIG, Bear Stearns, Citigroup and BofA-Merrill as part of the $700 billion bailout plan.

"I came to the job believing in markets and free enterprise," he said. "We ended up doing things many of us found abhorrent, but they were better than the alternative."

The merger was announced in September as Merrill foundered. But by December, Lewis had learned that losses at Merrill would exceed $12 billion, far more than anticipated, and he told Bernanke and Paulson he wanted to invoke a legal clause to back out of the deal. In the end, he went ahead with the merger after the government cash infusion and other guarantees.

Lewis told the committee in June that government officials threatened to fire him and the board if he tried to scuttle the merger.

Lawmakers have said officials should not force a firm to hobble itself to save the financial system.

On Wednesday, Paulson conceded he pressured Lewis. "I don't characterize it as a threat," he said. "I told him the Federal Reserve could replace him and the board" if he tried to get out of the deal. "I intended to give a very direct, strong, clear message," he said.

In a letter to Congress, New York Attorney General Andrew Cuomo said Paulson told him he made the threat at Bernanke's request. Bernanke told the committee he never told Paulson to threaten Lewis.

On Thursday, Paulson said he "had no recollection of Ben Bernanke having ever talked to me directly about" removing BofA management. Noting he participated in several calls with Fed officials, he said, "I don't know whether someone in those conversations expressly said it or my understanding came from the tone or forcefulness."

Said Rep. Dan Burton, R-Ind.: "You're a very smart man, and I don't think anybody's buying what you're saying."

Lawmakers also criticized Treasury's failure to inform other regulators of Merrill Lynch's deteriorating financial condition.

"You kept the (Securities and Exchange Commission and the Office of Comptroller of the Currency) in the dark," said Rep. Jim Jordan, R-Ohio.

Paulson said that was the company's responsibility, not his or Bernanke's. "It's not a Treasury secretary's job to get between a company and the SEC, for instance," he said.

October promises

Other lawmakers reserved their sharpest arrows for Paulson's broader handling of the financial crisis. Several said he deceived lawmakers by persuading them to create the $700 billion bailout fund by saying the money would be used to buy troubled mortgage-backed securities that were languishing on financial firms' ledgers and clogging credit markets. Ten days later, officials decided to use the funds to invest in the companies.

"If you had said, 'I've got a plan to take $800 billion of taxpayer money and give it to nine of my biggest pals in Corporate America,' you would not have gotten a dime," Rep. Stephen Lynch, D- Mass., told Paulson.

Paulson said the plan evolved.

He said the distressed assets could not be purchased quickly. Many banks have been loath to sell their troubled assets at a steep discount.

Others asked Paulson why the government allowed Lehman to fail, dramatically deepening the crisis, while rescuing AIG and Bear Stearns. "We did not have the legal authority to do something in the Lehman Bros. case," Paulson said.

He said the government did not yet have the bailout money to provide Lehman and was unable to find a buyer for it.

Rep. Cliff Stearns, R-Fla., said Paulson's Goldman Sachs ties influenced his decision to bail out AIG -- which resulted in a $13 billion payment to Goldman -- and allow Goldman rival Lehman to fail.

"I find your statement outrageous," Paulson said.

Some cited the crisis' human toll. Rep. Elijah Cummings, D-Md., said Wall Street firms that caused the chaos got bailed out, while "people in my district lost their homes."

"The thing that bothers you bothers me," Paulson said, "because the people that are paying the price had nothing to do with the problem. But the sad truth is, if these companies had gone down, they would be paying a bigger price."

Contributing: Michelle Walbaum

TEXT OF INFO BOX BEGINS HERE

BofA, Merrill Lynch timeline

Sept. 15, 2008: Merrill Lynch agrees to sell itself to Bank of America for around $50 billion.

Oct. 14: Bank of America receives $25 billion in bailout funds.

Dec. 5: BofA shareholders approve purchase of Merrill Lynch.

December: BofA's top executives learn Merrill Lynch's fourth- quarter losses are greater than they say were expected.

Jan. 1, 2009: BofA officially takes over Merrill Lynch.

Jan. 16: BofA receives $20 billion more in federal bailout funding to help with Merrill Lynch's deep losses. Both report fourth- quarter losses: BofA, $1.79 billion; Merrill Lynch, $15.3 billion.

June 11: BofA CEO Kenneth Lewis tells Congress that he didn't feel threatened by regulators, but was warned the government could remove him if he canceled the Merrill Lynch deal.

June 27: Federal Reserve Chairman Ben Bernanke testifies he did not threaten to fire Lewis.

Thursday: Former Treasury secretary Henry Paulson tells Congress he did pressure BofA to acquire Merrill Lynch and warned Lewis that the Fed could remove management if BofA backed out.

PHOTO, Color, Jonathan Ernst, Reuters; PHOTO, Color, Kevin Wolf, AP;
PHOTO, Color, Garrett Hubbard, USA TODAY

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MONEY

Buy and hold can be a big downer ; Even top companies' stocks can fall, and investors sink with them

Matt Krantz
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Buy shares of good companies and hang on. That's the way millions of investors have been trained to almost religiously invest for the long haul. Even Warren Buffett likes to say his favorite holding period is forever.

But this seemingly common-sense approach, which has worked remarkably well over the decades for patient investors, proved extremely treacherous during the bear market. Investors holding onto some well-known stocks saying "they will come back" often found themselves holding onto stocks with next to no value.

Since the start of the decade, shares of 25 U.S. companies that had market values of $4 billion or more are now trading for $2 or less, according to a USA TODAY analysis of data from Standard & Poor'sCapital IQ. Half of those were even booted from a major stock exchange and now trade on lightly regulated markets.

General Motors was the most recent example. Shares of the hallmark of American enterprise traded for nearly $73 a share on the New York Stock Exchange in 2000. Now, GM trades for less than $2 on the Pink Sheets market.

That's what makes this twist so shocking. Household-name companies, several with massive market values, seemed to be exactly the kinds of stocks to safely hold long-term. But many of these well- known stocks ended up crashing like fly-by-night penny stocks. The list of other stocks investors rode down to practically nothing includes financial firms American International Group, Fannie Mae, Freddie Mac, Washington Mutual and E-Trade, technology stocks including Level 3 Communications and Conexant Systems, and retailer Circuit City.

The market's vicious kicking the life out of stocks has been a brutal wake-up call for investors who long held out faith that holding on is the only way to go.

A painful lesson to learn

John Canelake, 88, long taught his children that patient, long- term investing was the way to go. As the founder of candy store Canelake's Candies in Virginia, Minn., Canelake has watched the value of his stocks rise and fall but found sticking with them through the ups and downs almost always paid off.

Not this time. Canelake invested in Great Western in 1980 and saw his holdings hit $80,000 after the bank was bought by Washington Mutual. Now it's worth just $200. "I was in the habit of (buying and holding stocks)," Canelake says. "I don't think it's so good now."

In many ways, riding a stock down as it plummets is part of human nature, says Robert Shiller, finance professor at Yale. Humans dread facing regret over a bad decision. People will go to great lengths to avoid or postpone the feeling that they made a mistake, he says. "People are highly motivated by avoiding the pain of regret," he says.

"The problem with selling stocks when they're going down is you're forced to confront the fact you were wrong," he says. "You can avoid the pain of regret, or postpone it, hoping a stock will come back."

The implosion of banks such as Washington Mutual was especially hard for many individual investors to take. Not only have bank stocks been traditionally relatively stable, but some investors had the added comfort of being the banks' customers.

Wilma and Dennis Patzkowksi, 68 and 70, knew stock investing was gambling. But they felt good about holding Washington Mutual -- also owning it through an original investment in Great Western. They'd been Golden West and Washington Mutual customers for 35 years. They'd even visited employees at their local Washington Mutual branch when the stock was falling to see if there was a problem. They walked away reassured. "You buy what you know," Wilma says. "You figure they'll go back up."

But Washington Mutual crumbled from $17.25 a share in early 2000 to 10 cents now, shredding $21,000 of the Patzkowski's nest egg. Wilma says she'll never have such faith in a stock and, in fact, is all but swearing off the stock market. "I don't trust any stock anymore," she says.

Mutual funds are less risky

Investment professionals worry investors will confuse the prudent strategy of buying and holding a diversified mutual fund, which owns many stocks, with the dangerous practice of buying and holding individual stocks. Individual stocks are much riskier than diversified baskets of stocks because they are subject to company-specific risk, says Mark Hebner of Index Funds Advisors.

The risk of believing too much in an individual stock was a lesson learned by Ken MacGarrigle, a government worker based in the Washington, D.C., area who lost nearly all his investment in Lucent. Lucent was one of the most widely held stocks in the early 2000s, and was considered a symbol of American ingenuity. "I figured, hey, I don't even have to monitor this," says MacGarrigle, who declined to give his age or size of his loss in the stock.

Lucent, though, crashed more than 98% and no longer trades in the U.S., so it doesn't count in the list of 25 stocks in the USA TODAY analysis. Now the stock is Alcatel-Lucent trading for 1.81 euros, down from nearly 90 euros on an adjusted basis in 2000, Capital IQ says.

MacGarrigle still hasn't sold the stock, but rather just looks at it languishing on his brokerage statement waiting to take the tax loss. "It was always, you buy these big stocks and they will always make you money," he says. "That's not true anymore."

That leaves many investors looking at brutal losses and unsure how to get back to even.

Richard Ley, a 52-year-old social worker in Columbia, Tenn., lost nearly $30,000 on his investment in General Motors. He bought the stock thinking it was "a stock that paid a dividend and will be around," he says.

What's Ley's plan to get back to even? Buy and hold. This time, though, he's planning on holding onto shares of software maker Microsoft, figuring that company has staying power.

But the GM experience has renewed his memory of the risk of investing. "Yes, GM was an unusual case," he says. "But this market is an unusual case, too."

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Some big names that took the plunge

Company

Market cap (billions, 1999)

Close 12/31/99

Close Fri.

Pct. loss from '99

AIG $167.4 $72.08 $1.46 v 98%

Fannie Mae $64.1 $62.44 $1.34 v 98%

General Motors $46.5 $72.69 $1.16 v 98%

Freddie Mac $32.8 $47.06 $0.53 v 99%

Level 3 Comm. $27.9 $81.88 $1.40 v 98%

Washington Mutual $14.9 $17.25 $0.10 v 99%

Calypte Biomedica $14.4 $42.19 $0.01 v 100%

Conexant Systems $13.0 $663.75 $1.30 v 100%

XO Holdings $11.1 $41.53 $0.30 v 99%

Lehman Bros. $10.2 $21.17 $0.04 v 100%

Source: Standard & Poor'sCapital IQ

GRAPHIC, B/W, Web Bryant, USA TODAY (illustration)
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MONEY

Overhaul aims to corral financial mavericks ; Obama proposes sweeping changes giving regulators a chance to rein in future crises

David J Lynch
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President Obama unveiled a stem-to-stern overhaul of financial industry regulation Wednesday, promising dramatic changes for banks, consumers, hedge funds and even the inner workings of the Federal Reserve. The ambitious proposal is designed to strengthen a ramshackle system of government oversight that failed to either prevent or mitigate the current financial crisis.

The administration rolled out its 88-page plan amid a full-scale public relations offensive culminating in a 13-minute presidential statement in the East Room of the White House. Addressing an audience that included Fed Chairman Ben Bernanke, members of Congress, and representatives of the financial industry and consumer groups, Obama called for "a sweeping overhaul of the financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression."

Under the Obama plan, the Federal Reserve would get new authority to police all financial institutions -- not just banks -- whose failure could threaten the financial system. And the government would have new powers to wind up the affairs of financial institutions other than banks, such as insurance companies. Hedge funds would be compelled to register with the Securities and Exchange Commission and a new agency would be created to safeguard consumers against overly complex or fraudulent financial products. The new regulatory blueprint would "protect America's consumers and our economy from the devastating breakdown that we've witnessed in recent years," Obama said.

The sweeping proposal marks an emphatic end to an era during which top policymakers, notably including then-Fed chairman Alan Greenspan, celebrated the ability of market participants to largely police themselves. Now, smarting from the collapse of major institutions such as Bear Stearns and Lehman Bros., the costly government bailouts of insurer AIG and the worst U.S. recession since the 1930s, the pendulum has swung back toward an ethos of robust government oversight.

"Millions of Americans who have worked hard and behaved responsibly have seen their life dreams eroded by the irresponsibility of others and by the failure of their government to provide adequate oversight," the president said. "Our entire economy has been undermined by that failure."

The Obama plan also breaks with the pre-crisis period by attempting to head off financial bubbles before they form. Greenspan maintained that central banks could not "definitively identify" bubbles until after they had burst. Rather than attempt to prick bubbles before they grew dangerous, it was better, he said, to clean up after they popped.

"The president does not accept the judgment that it's best to let the market forces rip and then when there's an accident, to clean up after. He believes the last two expansions have, to an extent, been bubble driven, and it's important the next expansion rest ... on a new foundation and a much stronger foundation," Larry Summers, director of the National Economic Council, told reporters Wednesday afternoon.

Pulling back

Still, the far-reaching initiative fell short of what some sought. The administration backed away from merging the SEC and the Commodity Futures Trading Commission, fearing a turf battle between affected congressional panels. Obama also opted to eliminate just one agency -- the Office of Thrift Supervision -- from a sprawling regulatory network widely regarded as excessively fragmented. The OTS had hardly distinguished itself during the financial crisis; last year's two biggest banking failures occurred in institutions it regulated: IndyMac and Washington Mutual.

Administration officials, convinced of the need to act while memories of the crisis are fresh, will begin their sales pitch today when Treasury Secretary Timothy Geithner testifies on Capitol Hill. Rep. Barney Frank, D-Mass., chairman of the House Financial Services Committee, which will take the lead in considering the regulatory revamp, wants to pass legislation this year. But Rep. Spencer Bachus of Alabama, the panel's ranking Republican, wasted no time Wednesday in criticizing the president's road map.

"The administration's plan continues the cycle of bailouts for 'too-big-to-fail' financial institutions, furthers the government's role in picking winners and losers, complicates rather than streamlines the current regulatory structure, and keeps taxpayers on the hook for losses caused by imprudent risk-taking on Wall Street," he said in a statement.

Increased powers for Fed

Among the most controversial elements are expanded powers granted the Fed. The central bank, which controls the nation's money supply and supervises the banks, would become the financial system's uber-regulator. The Fed missed the housing and credit bubbles while they were inflating, badly underestimated their costs when they did pop and already has a full plate, critics say. With the Fed already engaged in numerous unconventional interventions in financial markets, some worry that adding a new role could backfire.

"I'd rather that the Fed stick to its knitting of conducting monetary policy and be the lender of last resort, as opposed to take on the role of supervision of individual institutions. ... In this role, the Fed will be thrust into the center of controversy," said Hal Scott, a professor at Harvard Law School and director of the influential Committee on Capital Markets Regulation, a private- sector body.

But administration officials say they carefully considered alternatives before opting to task the Fed. Countries that place key supervision authority outside the central bank don't operate well in crisis situations, Geithner said.

"I do not believe there's a plausible alternative that would create the necessary degree of confidence, accountability, responsibility and authority for protecting us against some of the risks we faced in this crisis," he said.

A key target of the plan: financial institutions so large and interconnected, their failure could ricochet around the economy with catastrophic results. These "systemically important' companies would be subject to more scrutiny and would need to hold more capital in reserve than under current standards. The government also would win new authority to handle "the orderly resolution" of them if they suffer fatal wounds.

"After this crisis, it's clear that there are a number of financial institutions that are capable of being the domino that causes the rest of the financial system to fall over," said Douglas Elliott, a former JPMorgan investment banker.

But some worry that investors will view any financial institution the government labels "systemically important" as effectively government-backed.

That could enable such firms to borrow at lower interest rates, since they would seem better credit risks than smaller rivals not vital to the financial system, says the Brookings Institution's Martin Baily, who chaired President Clinton's Council of Economic Advisers.

Stronger controls

At the heart of the current crisis were sophisticated financial products known as derivatives, securities whose values depend upon the performance of another asset. In the years leading to the credit crisis, unregulated derivatives markets mushroomed. Banks relied on them in an ill-conceived effort to control risk. But when the derivatives' values plunged amid unusually turbulent markets, the banks suffered huge, unexpected losses.

The administration now wants to impose for the first time record- keeping and reporting requirements on all over-the-counter derivatives trades.

After repeated financial crises and investment bubbles, the proposed regulatory overhaul seeks to make the financial system more stable. But that objective might be attained only at some cost. By requiring banks to maintain higher capital reserves, for example, the amount of credit flowing through the economy could be pinched. Likewise, new limits on the ability of banks to package their loans into securities that are sold to investors could crimp an important channel of credit formation.

Small businesses, in particular, might feel the efforts, Fed Governor Kevin Warsh suggested Tuesday in a speech to a bankers' association. "Then we might find ourselves with lower growth and diminished economic potential," he said.

But after the turmoil of the past 18 months, the political tide is running against such sentiments. U.S. households have seen $12 trillion in wealth disappear amid deflating housing and credit bubbles. Unemployment has soared to 9.4% with more than 6 million Americans added to the jobless rolls since the crisis began.

John Taylor, president of the National Community Reinvestment Coalition, backed the president's proposal. "There are a lot of powerful interests in Washington that have an allergic reaction to any type of regulation. ... They've had their shot at having loose or no regulation," he said. "Let's try having some regulation."

Contributing: Pallavi Gogoi in New York and Paul Davidson in Washington

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Plan at a glance

A look at President Obama's plan to improve oversight of the financial industry:

Closer market scrutiny

Calls for regulation of "over-the-counter derivatives," such as the insurance-like contracts that felled American International Group. The plan leaves in question who would regulate them.

Consumer protection

Establishes a Consumer Financial Protection Agency to protect consumers from deceptive practices by such companies as credit card lenders and mortgage brokers.

Crisis management

Creates a system to dismantle a troubled firm. Once the Fed and the Treasury Department decide an institution is a threat to the economy, the Federal Deposit Insurance Corp. would step in to break it down and sell its assets with minimal impact on investors.

Regulatory standards

Creates an office within the Treasury Department to review the regulation of insurance companies, now done primarily by states.

Stronger supervision

Creates a council of regulators called the "Financial Services Oversight Council" to monitor risk across the financial system. The council will be chaired by the Treasury secretary and include the heads of existing federal financial

regulators, the Federal Reserve among them, and representatives of new regulators.

Gives new authority to the Federal Reserve to supervise firms considered so big or influential, a failure could topple the economy.

Establishes a National Bank Supervisor to monitor all federally chartered banks and federal branches of foreign banks. The Fed and FDIC would retain their existing roles in helping to supervise state- chartered banks.

Eliminates the Office of Thrift Supervision. Critics say the office's oversight of AIG and IndyMac was too lax, contributing to their demise.

Retains the Securities and Exchange Commission and Commodity Futures Trading Commission as market regulators. However, the SEC would no longer have a role in supervising large holding companies as it did in monitoring Lehman Bros. and Bear Stearns. That role would belong to the Fed.

Gives the SEC oversight of hedge funds and other private pools of capital, including venture capital funds.

Requires financial institutions to retain more capital when making risky investments.

Aims to deter lenders from writing bad mortgages and passing the risk off to investors by requiring that lenders retain a 5% stake in all asset-backed securities.

Requires that shareholders get an advisory vote on compensation packages for financial executives.

Calls on the Treasury Department and the Housing and Urban Development Department to make recommendations on the future of government-backed mortgage lenders Fannie Mae and Freddie Mac and the Federal Home Loan

Bank system.

Source: Associated Press

GRAPHIC, Color, Alejandro Gonzalez, USA TODAY (illustration); PHOTO, B/W, Pablo Martinez Monsivais, AP; PHOTO, B/W, Kevin Lamarque, Reuters

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MONEY
Banks rake in $56B in capital ; Stress test helped restore confidence

Pallavi Gogoi
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Banks are raising money at a torrid pace from private investors, a clear sign that the government's stress test results have been a success in restoring confidence to the financial markets.

"This review is helping to increase confidence in the financial system," said Timothy Geithner, Treasury secretary, at a Senate Banking Committee hearing Wednesday. "To date, more than $56 billion in funds have been raised or announced by the 19 banks."

In the two weeks since the results were released, the largest U.S. banks -- Bank of America, JPMorgan Chase, Wells Fargo and Citigroup -- have either sold shares or issued debt to raise large amounts of money.

"It would've been unthinkable two months ago that these banks would be able to raise these large sums of money," says Sung Won Sohn, an economics professor at California State University. "The key is that banks are being recapitalized without additional government help."

Bank of America raised $13.5 billion by selling shares after the markets closed Tuesday. The Charlotte-based bank needs an extra $33.9 billion cushion to prepare for any adverse turn in the economy, according to the government. Citi sold 10-year bonds to raise $2 billion, while Wells Fargo raised $8.6 billion selling shares. Citi needs an additional $5.5 billion, while Wells needs to raise $13.7 billion as a result of the stress test.

Even those that don't need to raise capital, such as JPMorgan, American Express and State Street, have been actively raising cash. These firms are doing so not to boost capital, but to repay the government's bailout money. "It's an opportunity smart banks are taking advantage of," says Walter Todd, portfolio manager at Greenwood Capital Associates.

State Street, for instance, raised $2.3 billion in a stock offering and $500 million selling five-year bonds. JPMorgan, too, sold five-year bonds to raise $2.5 billion, and American Express raised $3 billion from five-year and 10-year bonds. The bonds are not guaranteed by the government.

The Treasury has set a requirement that any bank that wants to repay bailout money must show its ability to raise capital by issuing five-year debt not backed by the Federal Deposit Insurance Corp. It's being done partly to ensure that they don't come back to the government for even more money in the future.

PHOTO, B/W, Jason Reed, Reuters

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MONEY
JPMorgan reports boffo earnings ; 3rd rosy report in a row has industry looking up

Pallavi Gogoi
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NEW YORK -- Despite a near-death experience just six months ago, banks now seem pretty healthy. Thursday, JPMorgan Chase became the third bank to report stellar first-quarter earnings.

Mortgage refinancing has picked up sharply, and robust fixed- income trading helped JPMorgan report a first-quarter profit of $2.1 billion, which although down 10% from a year earlier was better than the 25% drop expected, Thomson Reuters says. That followed Wells Fargo's surprise early announcement last week that it posted a record $3 billion profit, and this week's report by Goldman Sachs of its $1.7 billion profit in the first quarter.

While banks' results so far have pleased some analysts, they remain worried about the strength of the broader economy. "Fixed- income trading and refinancing were strong, but I'd like to see GDP grow, and the unemployment pace slow," says Jason Goldberg at Barclays Capital.

Since Wells Fargo's surprise on April 9, bank stocks have rallied sharply, with Wells Fargo up 30%, JPMorgan up 22% and Goldman up 6%. The big question now is if Citigroup and Bank of America also will do better than expected. Today, Citi reports its first-quarter earnings, and CEO Vikram Pandit has set expectations high, announcing in March that the bank made a profit in the first two months of 2009. Its stock is up 48% since last week. BofA, which reports next week, is up 46%.

A closer look at each bank's earnings reveals the pockets of strength and weakness so far:

*JPMorgan. The Good: Bond trading and underwriting brought in $8.3 billion, and the Washington Mutual acquisition helped attract more deposits, which were up 62%.

The Bad: The credit card business lost money for the second quarter in a row, and losses could accelerate as defaults grow. Commercial real estate loan losses could also pick up. The bank has increased its loan loss provision by $4.2 billion to $28 billion.

*Goldman Sachs. The Good: Revenue from fixed-income, currency and commodities trading was a record $6.6 billion.

The Bad: If mergers and acquisitions or new securities issuance don't pick up, profit could be hurt as new growth is harder to come by.

*Wells Fargo. The Good: There were $100 billion in mortgage originations, double the rate of the previous quarter, and there's a strong pipeline for the current quarter. The Bad: Buying Wachovia Bank brought in billions of dollars in questionable loans. Wells Fargo today has a big portfolio of mortgages in California and Florida, two states with some of the highest home foreclosure rates.

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MONEY

JPMorgan experts reacted first to slump ; Mellman and Kasman didn't expect it to be this bad, though

Barbara Hagenbaugh; Barbara Hansen
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WASHINGTON -- JPMorgan senior economist Robert Mellman tried to be optimistic in 2008, hoping the United States would avoid a deep recession. But once Lehman Bros. failed in September, he knew the economy was in for a rough ride.

Mellman and his partner, chief economist Bruce Kasman, quickly cut their forecasts for the economy for the rest of the year, predicting sharp interest rate cuts from Federal Reserve policymakers, who sliced their target for short-term rates to near zero in December. The Fed is expected to keep rates at historic lows at the conclusion of their two-day meeting today.

Mellman and Kasman also predicted big drops in consumer and business spending and rising unemployment at the end of 2008. The deterioration turned out to be much larger than they thought, with gross domestic product, the broadest measure of the economy, tumbling at a 6.2% annual rate, the biggest drop in 26 years, in the October-December quarter.

But no one on USA TODAY's panel of economists saw such a rapid drop coming. And Mellman and Kasman's quick acknowledgment of the downturn helped make them the most accurate forecasting team in 2008 among the 36 teams and individuals who filled out the survey each quarter.

That makes the JPMorgan economists' predictions for 2009 worth paying attention to. They say the recession will end in the second half of the year as fiscal and Federal Reserve stimulus kicks in. But it won't be pretty. Unemployment will continue to rise, lending is expected to remain constrained, housing will be slow to improve with a glut of unsold homes, and exports will be soft, given economic woes worldwide.

"For the person on the street, it will still feel like a recession," Mellman says. "I don't think it will be a joyful recovery. It will be pretty slow from here. It will be tough to get jobs for some time."

Mellman predicts the unemployment rate will hit 9.5% at the end of 2009, up from 8.1% in February. The jobless rate will likely top 9% until the end of 2010, Mellman predicts.

"We won't recover the jobs we lost for some time," predicts Mesirow Financial chief economist Diane Swonk, who came in sixth. "When you dig yourself into a hole as deep as we are likely to see, it takes awhile to dig your way out of it."

All but one of the economists who placed in the top 10 based on their 2008 forecasts predict the recession will end in 2009. Merrill Lynch's David Rosenberg doesn't expect a turn until the beginning of 2010.

Gloomy in banking

Second-place winner and Wachovia chief economist John Silvia says he thinks his team, which also includes Mark Vitner and Jay Bryson, did well forecasting last year, because it was hard not to be gloomy while working at a bank.

"I've always thought economists somewhat reflect the problems of their own industry," Silvia says. "As we saw the problems evolve in our own industry, it led us to be on the pessimistic side. ... That, I think, helped us a lot."

About the winners:

*Mellman has been at JPMorgan for more than 20 years. Prior to that, he worked for an economic consulting group in Boston. He has a Ph.D. in economics from MIT.

*Kasman joined JPMorgan in 1994. He previously worked at Morgan Stanley and the Federal Reserve Bank of New York. He has a Ph.D. in economics from Columbia University.

TEXT OF INFO BOXES BEGINS HERE

Benchmarking the economists

For the sixth year, USA TODAY enlisted the help of the Federal Reserve Bank of Atlanta to determine the most accurate forecasters among the economists surveyed for the newspaper's quarterly survey on the U.S. economy.

Atlanta Fed economist Tao Zha and Fed programmer Eric Wang analyzed the 2008 quarterly predictions to determine the most accurate forecasters. Zha and economists Robert Eisenbeis and Dan Waggoner had previously developed the methodology.

The Atlanta Fed economists did not know the identities of those they were evaluating.

JPMorgan, Wachovia economists top USA TODAY's 2008 forecasting panel

Top economists, based on last year's forecasts, and their predictions for 2009:

Economist(s)

Company

When will the recession end?

December jobless rate will be...

Robert Mellman and Bruce Kasman JPMorgan 3rd quarter 9.5%

John Silvia Wachovia 4th quarter 9.5%

Allen Sinai Decision Economics 4th quarter 9.5%

David Seiders National Association of Home Builders 4th quarter 9.1%

Robert Shrouds and Robert Fry DuPont 3rd quarter 9.4%

Diane Swonk Mesirow Financial 4th quarter 9.4%

Richard Moody Forward Capital 4th quarter 9.8%

David Rosenberg Merrill Lynch 1st quarter 2010 10.0%

Scott Anderson Wells Fargo Bank 4th quarter 9.5%

Martin Regalia U.S. Chamber of Commerce 4th quarter 9.5%

PHOTO, B/W, Jennifer S. Altman for USA TODAY
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MONEY
Experts wait out cheap bank stocks ; They may look like bargains, but pros are too nervous to buy

Pallavi Gogoi
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NEW YORK -- Portfolio manager Eric Boyce of Hester Capital Management talks about great stock-buying opportunities every morning when he meets with his fellow investment professionals in their Austin offices. But they aren't lured by bank stocks, even though once blue-chip institutions, including Citigroup and Bank of America, are trading like penny stocks.

If there's a new wave of credit losses, Boyce says, "The government might take some of these banks over, just like it did Fannie (Mae) and Freddie (Mac)."

Lots of people share Boyce's aversion to banks, even though the sector has fallen 66% over the last 12 months. "Investors are concerned that their shares will be diluted further," says Samuel Hayes, professor of finance emeritus at Harvard Business School.

Several banks hold assets that are made up of complex securities - - including home mortgages -- that have either plunged in value or are too hard to assess. And the likelihood of additional consumer and commercial loan losses at these severely weakened banks rises as the U.S. recession deepens, putting millions of people out of work.

Citi stock, at $3.55, is off 86% in the last 12 months to levels not seen since the early 1990s. And BofA, at $6.50, is down 84% and close to a 16-year low.

What's more, the banks cut dividends to a penny per common share when each issued preferred stock to the government for its cash infusions of $45 billion each. The government collects annual dividends of 8% and 10%.

"A classic reason why people invest in bank stocks is for the dividends, and now that's gone," says Cassandra Toroian, chief investment officer at Bell Rock Capital.

Now there's a growing view that federal officials will have to take control of Citi or BofA if either needs additional capital from the government. That could drive the stock price to zero.

One telltale sign is the value that shareholders have put on the banks. Citi has a market capitalization of $18 billion, and BofA's at $30 billion -- in both cases, less than the amount of the government's investments.

"It reflects that the market doesn't believe these banks are solvent, despite all the cash that has been injected into them," says Thomas Cooley, dean of the New York University's Stern School of Business.

The recent stream of devastating losses from financial companies contributes to the fear that the worst is not over yet. General Electric, which has a huge financial arm, said on Friday that it wrote off $10 billion in bad loans in 2008.

"We expect both the commercial and the consumer delinquencies to continue to get worse in 2009," CFO Keith Sherin told analysts in a conference call.

PNC Financial Services also sounded downbeat last week when it said that charges related to its recent purchase of National City contributed to a loss for the fourth quarter. PNC has set aside as much as $500 million to cover credit losses.

Almost all banks -- from giants JPMorgan Chase to comparative small fry including SunTrust Bank and KeyCorp -- are doubling the amount of cash they're holding to cover losses.

"Last year, we saw the de facto bankruptcy of the largest mortgage broker, Countrywide, and the largest buyer of securities, Fannie and Freddie," says Sean Egan, managing director of ratings agency Egan-Jones. "Now the train wreck is moving through the rest of the financial sector."

Many investors fear that even comparatively solid banks such as JPMorgan Chase and Wells Fargo will be hit with additional asset problems following their marriages with, respectively, Washington Mutual and Wachovia.

"The assets are made up of complex securities distributed internationally, which are impossible to unwind, which is what makes this financial crisis so knotty," says Egan.

Treasury Secretary Timothy Geithner said last week that President Obama's administration plans to "stabilize the core of the financial system."

Geithner said that dealing with the so-called toxic assets was key to solving the financial mess. He also plans to help banks expand lending for car and student loans, credit cards and small businesses.

However, critics say that could drive consumers to borrow more than they can handle. "It's like force-feeding Twinkies to somebody who is on a diet," says Peter Schiff, president of Euro Pacific Capital.

Meanwhile, Hester Capital's Boyce says that he will wait. "There's no doubt that banks look cheap, but we're waiting for a catalyst."

TEXT OF INFO BOX BEGINS HERE

Bailout money goes in, but losses pile up

Despite getting $328 billion in federal bailout money, the top 10 recipients of TARP funds have lost a combined $736.4 billion in market value from their 52-week highs.

Top 10 TARP fund recipients

TARP funds received (billions)

Stock drop, 52-wk. high

Market value loss, 52-wk. high (billions)

AIG $150 -98% -$140.5

Bank of America $45 -87% -$161.5

Citigroup $45 -89% -$129.7

JPMorgan Chase $25 -60% -$87.8

Wells Fargo $25 -67% -$67.3

Goldman Sachs $10 -69% -$46.2

Morgan Stanley $10 -71% -$31.7

PNC Financial $7.7 -70% -$15.1

U.S. Bancorp $6.6 -68% -$43.4

Capital One $3.6 -67% -$13.2

Total $327.9 -$736.4

1 - includes Merrill Lynch

Sources: Capital IQ, USA TODAY research

PHOTO, B/W, Brendan McDermid, Reuters; PHOTO, B/W, Craig Ruttle, AP

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MONEY
Banks restore some confidence ; Financial stocks recover a bit as execs buy shares

Pallavi Gogoi
452 words
22 January 2009
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English

NEW YORK -- Bank stocks came surging back from the brink Wednesday as several top financial companies took various steps to restore confidence.

Shares of industry leaders Citigroup, JPMorgan Chase and Bank of America soared more than 25%, spearheading a broad financial industry rally that helped propel the benchmark Standard & Poor's 500 index 4.3%. After weeks of seemingly unending bad news from the industry, the three companies each gave investors some reason for optimism.

At Bank of America, CEO Kenneth Lewis bought 200,000 shares on Tuesday at prices ranging from $5.98 to $6.06, according to a Securities and Exchange Commission filing. Other board members also jumped in -- Temple Sloan, lead director of the Charlotte bank, bought 41,800 shares, while another director, Robert Tillman, bought 200,000 shares. Directors Jacquelyn Ward, John Collins and William Barnet III also picked up shares. BofA shares climbed 31% to $6.68.

It was welcome relief for investors shocked Friday when BofA took $20 billion from the government to help absorb brokerage Merrill Lynch, which it had agreed to buy in October. It reported that Merrill had a record loss in the fourth quarter of $15.3 billion. BofA along with Merrill had already taken $25 billion from the government bailout fund. Tuesday, its shares hit an 18-year low as they plummeted 29% to $5.10.

Adding to angst from the BofA news, normally staid investment management firm State Street stunned investors Friday when it announced $5.5 billion of unrealized after-tax losses on its investment portfolio. And Citigroup reported $8.3 billion in fourth- quarter losses. "These results are forcing people to realize that we're not out of the woods," says Matt McCormick, portfolio manager at Bahl & Gaynor Investment Counsel.

But Wednesday, instead of massive losses, investors heard about stock purchases by executives and leadership changes.

JPMorgan Chase CEO Jamie Dimon also entered the market, spending $11.5 million to purchase 500,000 shares on Jan. 16 for $22.93 each, according to an SEC filing. Wednesday, its shares soared 25% to $22.63.

Citigroup, which has been criticized for its snowballing losses, also saw its shares rise 31% to $3.67. It named Richard Parsons as its new chairman Wednesday, succeeding Win Bischoff, who will retire. Parsons, who will take over the chairmanship on Feb. 23, is a current board member and was formerly the CEO of Time Warner. He also is widely respected for his knowledge in banking and his role in turning around Dime Bancorp, where he served as CEO.

PHOTO, Color, 2003 AP photo

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MONEY
Worry tanks bank stocks ; Investors fear more help will be needed

Pallavi Gogoi
432 words
16 January 2009
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FIRST
B.3
English

NEW YORK -- Shares of large banks plummeted Thursday as investors grew fearful that asset values at several are declining and that they can survive only with additional cash from the federal government.

"The banks are broke, and each day their capital requirements skyrocket, but there's no place to raise capital," says Sean Egan, managing director of ratings agency Egan-Jones.

Bank of America fell 18.4% to $8.32, Citigroup lost 15.5% to $3.83, Wells Fargo dropped 12.6% to $20.16, and JPMorgan Chase slipped 6.1% to $24.34.

The sell-off followed reports that BofA wants billions of additional dollars from the Treasury Department's bailout fund.

BofA needs the cash to complete its acquisition of Merrill Lynch and to help make up for a deterioration of assets at the brokerage firm, according to industry and government sources who are familiar with the talks but declined to be named because discussions are ongoing.

The government gave $15 billion to BofA in October, while Merrill got $10 billion.

"The government is caught, because to let them fail now means the first round of cash would be flushed down the toilet," says Peter Schiff, president of Euro Pacific Capital.

Investors also are anxious about what they'll hear today when Citi discloses its fourth-quarter financial results.

The banking giant could report a loss of about $10 billion for the period, says Richard Bove of Ladenburg Thalmann. Citi CEO Vikram Pandit is expected to outline plans to sell assets equal to a third of the bank's balance sheet. Citi said this week that it will sell part of Smith Barney for $2.7 billion to Morgan Stanley.

"Citi is obviously in dire need of capital, and the government can't give any more, so it had to sell the most liquid of its assets," says Matt McCormick, a portfolio manager at Bahl & Gaynor Investment Counsel.

Citi will follow JPMorgan Chase, which reported a $702 million profit for the fourth quarter, beating the consensus estimate of zero profit from analysts surveyed by Thomson Reuters.

Still, the profit was down 76% from the same period in 2007. The bank marked down $2.9 billion in leveraged loans and mortgage- related securities.

Banks also were in the spotlight as a group of former central bankers and finance ministers led by Paul Volcker, an adviser to President-elect Barack Obama, released a report calling for tighter regulation of banks, insurance companies and hedge funds.

Document USAT000020090116e51g0000h

MONEY
A look at the biggest losers

John Waggoner
991 words
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English

You don't know who has been swimming naked until the tide goes out, Warren Buffett once wrote. Well, the tide went out last year, and many funds and managers were caught -- shudder -- without their Speedos. The top three sights that would make you go blind at the financial beach last year:

*The Reserve fund. The nation's oldest money market mutual fund collapsed Sept. 16, allowing its share price to fall below $1 -- "breaking a buck," as it's known in the industry. It was a staggering blow to the money market industry, which has long held itself out as a bastion of safety.

Bruce Bent, chairman of the Reserve funds, was an outspoken critic of other money funds, often arguing that they took too much risk. "A lot of money funds lost their way," he told USA TODAY in August. "Just follow the rules. Don't get clever."

If only he'd listened to, um, Bruce Bent. The Reserve fund collapsed because it had owned securities issued by Lehman Bros., the large investment bank that had filed for Chapter 11 bankruptcy the day before Reserve broke the buck.

*Ultrashort income funds. You can count on some small, hapless stock fund posting an appalling loss each year.

But you don't expect those kinds of losses from a bond fund, especially one that sold itself as a mildly risky alternative to a money fund.

Unless, of course, it's Schwab YieldPlus, which plunged 35% last year. The fund, like many ultrashort funds, invested in bonds that matured in one year or less. In theory, that means the fund should have relatively small price fluctuations, while sporting yields somewhat higher than money funds. Unfortunately, some of those short-term bonds in the Schwab fund were backed by subprime loans, the market that collapsed completely last year.

Schwab's wasn't the only ultrashort bond fund to suffer last year: The entire category fell 6%, and ultrashort funds offered by Fidelity, Dreyfus, JPMorgan and Legg Mason all produced below- average results. Nevertheless, Schwab's offering was the worst of the lot.

*Legg Mason Prime Value. Manager Bill Miller has been lauded, deservedly, for beating the Standard & Poor's 500-stock index for 14 consecutive years.

All good things come to an end, though, and Miller's streak ended terribly: The fund posted a 58% loss last year, mainly because of his large holdings in financial services stocks, such as Bear Stearns, the now-defunct investment bank, and Freddie Mac, the mortgage giant now under government receivership.

ETF deathwatch

In 2007, fund companies rolled out exchange traded funds at a record pace. Now they're disappearing at a record clip.

ETFs are mutual funds that trade on the stock exchanges, just like shares of IBM or Apple. A complex redemption mechanism makes sure that the funds' current share prices accurately reflect the value of their holdings. Investors love ETFs because they're easy to trade, and because they're easy to sell short -- a bet on falling prices. Fund companies love ETFs because they generate management fees.

Because ETFs are usually index funds, however, they don't generate juicy fees -- unless the ETFs get really large. Those that don't become large tend to go away.

It's doubtful how much investors will miss some of these funds, which had limited appeal. The HealthShares Ophthalmology ETF, for example, specialized in stocks of companies that combat eye problems. The Bear Stearns Current Yield fund failed because, well, it had "Bear Stearns" in its name.

Fund companies shuttered a record 60 ETFs last year, and, given current market conditions, many more may be on the way. Ron Rowland, a contributor to seekingalpha.com, has 139 funds on his ETF Deathwatch. All are new, small and rarely traded.

Treasury blues

If you're looking to invest in a money fund that invests only in Treasury securities, you're going to have to start looking much, much harder. Many funds are starting to restrict access to Treasury- only money funds, and some are shutting them down entirely.

Evergreen Institutional 100% Treasury Money Market fund, for example, closed to new investors Dec. 1. And defined-contribution plans that don't already offer Vanguard's Treasury Money Market fund won't be able to do so in the future.

Why are funds becoming so cautious with Treasury funds? The average three-month Treasury bill yields 0.13%, and most money funds need to charge more than 0.13% for expenses. Although many fund companies absorb expenses, few are happy about it. As of last week, the average Treasury-only money fund yielded 0.18%. Ten funds yielded exactly zero. Given the programs the government currently has to prop up money market funds, it makes little sense to take a zero yield in a fund that's not particularly safer than most others.

Fund news ...

Evergreen investments is shuffling off to Palookaville. The funds will become part of Wells Fargo's fund family. ... Templeton Foreign Companies (ticker: FINEX) and Templeton Global Smaller Companies (TEMGX) reopened to new investors last month, according to Morningstar. Other reopenings of note: Matthews Asian Growth & Income (MACSX), Oakmark Equity & Income (OAKBX), Calamos Convertible (CCVIX), Fidelity Low-Priced Stock (FLPSX), and Fidelity Contrafund (FCNTX). There will be neither Bjurman nor Barry at the Bjurman Barry Microcap Growth fund. It will be merged into Gamco Westwood Mighty Mites. ... Maureen Pettirossi has left MFS Massachusetts Investors Growth Stock. Jeffrey Constantino continues as a sole manager, according to Fundalarm.com. ... Looking for a way to turn $10 into $650? W. Atlee Burpee & Co., the seed company, is making no promises, but says its Money Garden packet, $10 at www.burpee.com, could grow up to $650 worth of vegetables. Past garden performance, of course, is no guarantee of future produce.

PHOTO, B/W, 2006 Bloomberg News

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MONEY

Regulator ousted over backdating at IndyMac ; Treasury official: Dochow let bank fudge its books

Pallavi Gogoi
383 words
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English

The banking regulator in charge of overseeing two of this year's largest failed banks -- Washington Mutual and IndyMac Bancorp -- was removed from his job Monday.

In what could be the first head to roll at a government regulatory agency from the financial turmoil, the Office of Thrift Supervision removed Darrel Dochow from his job as director of its western region.

In his review of IndyMac's failure, the Treasury Department's inspector general, Eric Thorson, found that Dochow allowed the bank to show it was in better financial health in the first quarter of this year than it really was. IndyMac was seized just four months later, on July 11, by the Federal Deposit Insurance Corp., which has since incurred $8.9 billion in losses related to the bank.

The inspector general found the bank had backdated a capital infusion after reviewing papers from IndyMac's auditor Ernst & Young. The backdating allowed IndyMac to show its capital ratio above 10%. A ratio below that means banks lose the "well- capitalized" status and need an FDIC waiver to accept deposits from brokers.

Thorson says Dochow knew that IndyMac couldn't meet its capital requirements and allowed it to record a capital infusion six weeks before it occurred. The IndyMac holding company made a $50 million capital contribution on May 9, of which $18 million was recorded on March 31, 2008. Dochow didn't return a call seeking comment.

"The impact of Western Director Dochow's approval to record the capital infusion in the quarter ending March 31, was that IndyMac was able to maintain its 'well-capitalized' status," Thorson said in a preliminary report. Thorson said he found that the OTS had also allowed other thrifts to record capital before it had been received. The OTS wouldn't identify the other thrifts.

Sen. Charles Grassley, R-Iowa, said he was worried that the findings weren't isolated. "What does that mean about the real financial condition of other banks?"

John Reich, OTS director, said E&Y had determined that the adjustments weren't material. Reich also says the issue uncovered by Thorson was a relatively small factor in IndyMac's failure.

PHOTO, Color, Reuters

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MONEY
More bank customers think small these days ; Community banks see huge cash infusions

Pallavi Gogoi
2,023 words
22 December 2008
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English

A tiny bank in Happy, Texas, is a century old but hasn't before seen the kind of deposit growth that it's seen in the last three months.

By any measure, it's been an extraordinary year for anyone in the U.S. banking industry. But Happy State Bank, with headquarters in a town with an irresistible name, has been the face of steadfast calm during a period of intense global financial turmoil, drawing $30 million in deposits since September into its 20 branches in the Texas Panhandle, double the rate of deposit growth in a similar period in recent years.

"It's our 100th-year anniversary, and it's a nice way to celebrate," says Pat Hickman, CEO of Happy State Bank, which has $960 million in assets and was established in 1908 in Happy, a town with just over 650 residents in northwest Texas.

This year's financial chaos hit its peak in September when investment bank Lehman Bros. collapsed, the government seized insurance giant American International Group, Washington Mutual became the largest bank failure in U.S. history, and an ailing Wachovia was acquired by Wells Fargo.

But as the top tier of the financial services industry faltered, small and regional banks, as well as credit unions, started seeing their cash deposits rise dramatically as nervous Americans shied away from big banks. Some of these smaller financial firms saw an increase in small businesses knocking on their doors. And despite rampant headlines about a credit freeze and plunging housing market, they have even been writing more home loans this year than last year.

In her 18 years as a banker, Sebrina Verburgt hasn't seen anything like this: new customers with cash in hand, streaming in through the doors of the 11 branches of the United Heritage Credit Union, where Verburgt is senior vice president of operations. Many of them had the same story to tell: They were moving cash from larger banks, afraid that they would fail.

Just ask Clay Strange, a lawyer in Lakeway, Texas, who decided to move $20,000 into United Heritage from his Charles Schwab money market account, after reading that some of the money market funds were unstable because they had invested in bad debt securities of firms such as Lehman Bros.

"I wanted to move my money into something that was clearly insured," says Strange.

In September, United Heritage, in Austin, saw a 52% increase in new checking accounts from a year earlier. That came after 35% growth in July and 43% in August.

"This is unprecedented," says Verburgt, who is seeing the most growth in one of her checking account products that offers an annual yield of 5.01%, far more attractive than the nationwide average of 0.22% on bank checking accounts, according to Bankrate.com.

An October survey by the Independent Community Bankers of America reveals that 70% of community banks saw an uptick in deposits in the past year. Nationwide, these higher-interest checking accounts saw an 11.6% rise in new accounts in the third quarter this year, vs. the previous year, according to BancVue, which helps set up technology at community banks nationwide.

"People are scared of large, national names, because of the spectacular failures this year," says Joshua Siegel, managing principal of StoneCastle Partners, a New York-based private-equity firm that invests in community banks.

Smaller banks fail, too

It's not as if only large banks failed in 2008. In fact, as the mortgage crisis intensified and home foreclosures surged, some smaller banks also buckled. Of the 25 bank failures this year, 16 have been banks with less than $1 billion in assets. Several were either based in the states with the worst real estate downturns -- California and Florida -- or had opened loan offices there. Still, compared with Washington Mutual's $307 billion in assets, the rest of the failed banks had a combined total of $65 billion in assets.

Of course, given that the Federal Deposit Insurance Corp. has decided to insure deposits up to $250,000 from $100,000 previously, it's not as if many people will lose their deposits. Rather, the fears on Main Street reflect how shaken the public has become from the financial turmoil. And the government's efforts to save the financial system from collapse by investing in some of the country's largest banks have only spooked Americans further.

Such faith in smaller banks, though, isn't necessarily flawed. The larger banks, with an average size of $10 billion in assets or more, today control more than $10 trillion in financial assets -- even though there are only 115 of them.

However, a lot of their assets are made up of toxic financial securities that have lost a lot of value -- whether it's the $2 trillion in collateralized debt obligations that are based on subprime mortgages and low-grade bonds, or the $2 trillion in asset- backed securities that are based on car and student loans and credit card debt.

In contrast, there are 8,278 banks that have less than $10 billion in assets and only $3 trillion in assets combined. However, according to StoneCastle Partners' review of FDIC data, these smaller banks have 50% more capital than the larger banks as a percentage of loans, so their ability to absorb losses is higher, a key distinction during a recession.

Smaller banks also have most of their loans secured by real assets such as property, equipment, receivables and even personal guarantees from senior management, which makes for better loan recovery in case of failure. So these banks have had less than half the rate of charge-offs in the last 15 years, compared with their larger, undercapitalized counterparts.

"Most community banks just didn't make subprime loans or get involved in exotic loans," says Burton Zwick, a business professor at Fairleigh Dickinson University.

Happy Bank CEO Hickman, for instance, points out that out of 8,881 loans outstanding, only 17 were 30 days past due. For now, the banks that people trust in their communities are attracting dozens of new customers. Consider:

*First Arkansas Bank & Trust started running ads in the Arkansas Democrat-Gazette and other local newspapers touting its conservative philosophy and safe reputation. Larry Wilson, CEO of the 28-branch Jacksonville, Ark., bank, also publicized his new high-interest checking account, which was offering a 4.4% annual yield. The ads helped boost new accounts more than 900% since last year. "People want higher rates but want to get it from a place they can trust," says Wilson.

*Regional bank Hudson City Bancorp is one of the few banks whose stock price hasn't fallen this year. Hudson City, with assets over $50 billion, is by no means a community bank. However, it has a very localized, community approach with its 127 branches in the tri- state area of New Jersey, New York and Connecticut. "Our loan production is at record levels," says CEO Ronald Hermance Jr.

The Paramus, N.J., bank accepted more mortgage applications during the first nine months of 2008 than in all of 2007, originating $4 billion of mortgage loans, compared with $2.65 billion for the comparable period in 2007. In the same period, deposits grew by $2.14 billion.

*Yakima Valley Credit Union, based in Washington, the state were WaMu was headquartered, saw 433 new members in September, a 57% jump from the same month last year, and 416 new members in October, a 22% jump. "On average, the balances in these accounts are also higher," says CEO Mina Worthington.

*Happy State Bank, too, has made gains in more ways than one this year. Hickman, who had been on the lookout to grow his business, fielded a call earlier in the year from Citibank, which was unloading some of its branches in

Texas to focus on its core operations as it worked to shore up its balance sheet. Hickman was offered eight Citibank branches in his area, which he promptly bought in June for about $20 million.

*Red Mountain Bank in Hoover, Ala., also saw a 23% increase in deposits in three months, compared with a 19% increase for all of last year. "We are also seeing small and medium-size businesses seeking us out for loans," says CEO Mike Washburn.

One is Clyde Tillman, president of Press Access, a printing- press business in Atlanta with annual revenue of $30 million. After banking with Wachovia in recent years, Tillman says he was tired of "being just a number" at the large bank, where he had to explain his business each time to a different loan officer.

Making the switch

Tillman says that he runs a profitable company and should be a desirable account. His business sometimes demands large amounts of upfront investments to buy large printing machines, and then weeks go by when he doesn't have to draw on his $6 million credit line at all.

"It's feast or famine for our loans, which is why we need someone to understand our business," he says.

So he took his account to Red Mountain, where the loan officer visited his business to understand his goals and structured a loan program accordingly. "Now I tell people to change to a local bank," he says.

It is these sorts of ties and deep connections that bankers have woven in many communities that is bearing fruit in a year marked by tremendous tumult in banking. People all around the USA have lost trust and are flailing around looking for security. "In some local communities, the two most important people are the mayor of the town and the president of the bank, who sponsors most local charity work and events," says Siegel of StoneCastle Partners.

Happy State Bank's Hickman could pass as just one of those people. Besides sponsoring almost all the athletic teams and activities in the town's one school district, his bank is also the main sponsor of the town's largest celebration of the year, called Happy Days, which starts with a Western dance on a Friday night in August and is celebrated through the next day with a parade and a barbecue.

The bank's six Volkswagen Beetles cruise in the parade that ends with a rodeo at the end of the day. Hickman and his bank's employees are active participants, serving the town's residents barbecue, coleslaw and potato salad.

It might not be a surprise that practically the entire town banks at Happy State, and now folks from nearby towns are joining in.

TEXT OF INFO BOX BEGINS HERE

2008 bank failures by size

Banks with more than $10 billion in assets (in billions):

Washington Mutual Seattle $307.0

IndyMac Bank Pasadena, Calif. $32.0

Downey Savings and Loan Association Newport Beach, Calif. $12.8

Total$351.8 billion

$1 billion to $10 billion in assets (in billions):

Franklin Bank SSB Houston $5.1

PFF Bank & Trust Pomona, Calif. $3.7

First National Bank Nevada/Reno $3.4

ANB Financial Bentonville, Ark. $2.1

Silver State Bank Henderson, Nev. $2.0

Integrity Bank Alpharetta, Ga. $1.1

Total $17.4 billion

Less than $1 billion in assets (in millions):

Columbian Bank and Trust Topeka $752.0

The Community Bank Loganville, Ga. $681.0

Haven Trust Bank Duluth, Ga. $572.0

Security Pacific Bank Los Angeles $561.0

Alpha Bank & Trust Alpharetta, Ga. $354.1

Freedom Bank Bradenton, Fla. $287.0

First Priority Bank Bradenton, Fla. $259.0

First Heritage Bank Newport Beach, Calif. $254.0

First Georgia Community Bank Jackson, Ga. $237.5

Ameribank Northfork, W.Va. $115.0

Main Street Bank Northville, Mich. $98.0

Douglass National Bank Kansas City, Mo $58.5

First Integrity Bank Staples, Minn. $54.7

Meridian Bank Eldred, Ill. $39.2

Sanderson State Bank Sanderson, Texas $37.0

Hume Bank Hume, Mo. $18.7

Total$4.4 billion

Source: FDIC

GRAPHIC, Color, Sam Ward, USA TODAY (illustration); PHOTO, B/W;
PHOTO, B/W, Michael Lemmons

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MONEY
Rescue revamp ; Where will what's left of the bailout plan's $700 billion go?

Barbara Hagenbaugh; Sue Kirchhoff
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WASHINGTON -- With the economy falling into what could be the deepest recession in decades, the government is struggling to find a coherent way to quickly help homeowners and businesses -- and the clash of politics and economics is hitting a fever pitch.

The administration is still working on the best way to deploy the remaining money in the $700 billion financial rescue plan passed last month. Treasury Secretary Henry Paulson said Wednesday that the government will no longer buy troubled assets from bank balance sheets, the original intent of the legislation, and will mainly focus on injecting money into the financial sector.

Congress and the administration are debating several approaches, including a new round of economic stimulus and an all-encompassing approach to help people who are facing foreclosure stay in their homes. Wednesday, the dispute about help for automakers intensified as Paulson suggested Treasury would not be open to directly aiding the industry through the $700 billion program, while lawmakers said they would force the government to step in.

Such issues are being complicated by the fact that the administration has just a little more than two months left. President-elect Barack Obama has made it clear that he favors supporting the auto industry and more economic stimulus, while the Bush administration has been leery of further government involvement.

All this is leading to more politics at a time financial markets need more, not less, clarity.

"It seems the dominos are falling rapidly and in more than one direction," Charles Crane of Scotsman Capital says.

Paulson, however, said the government was forced to change its approach because of the rapid deterioration in the economy. "My focus has been how to get the maximum bang for the buck," he told USA TODAY, noting the government couldn't snap its fingers and make everything all better. "There's only so much government can do."

Investors had no shortage of reasons to sell stocks, but the flagging confidence in the government's actions to fix the economy was a big one Wednesday, says Peter Cardillo of Avalon Partners.

The Dow Jones industrial average fell 411.30 points, or 4.7%, to 8282.66, stringing together three-straight days of losses and declines in five of the last six sessions. Roughly $1 trillion in shareholder wealth has been destroyed in the last three trading days, according to the DJ Wilshire 5000.

"The fear is out there that the government doesn't have a handle" on a solution, says Cardillo, who added that he disagrees and thinks the measures will eventually kick in.

Fight could be brewing

Paulson, who met Monday with two members of Obama's economic transition team, said in an interview Wednesday that he would not propose anything new before the next administration takes office unless he feels it is absolutely necessary for the economy. "We're not going to go to big lengths to do things that could be done later," he said.

Paulson also said he still expects that $700 billion will be enough. But with Treasury's commitment earlier this week to buy $40 billion in stock of ailing insurance giant AIG, $290 billion of the $350 billion first installment is already spoken for. Either the Bush administration or the Obama administration will have to survive a congressional vote on the second $350 billion funding installment.

Such a request will likely set up a fight, with lawmakers trying to steer the use of the money.

"It's conceivable use of the remaining funds could come with more congressional strings attached," Goldman Sachs said in a note to clients.

A number of lawmakers, such as Sen. Charles Schumer, D-N.Y., have complained banks are hoarding money they're getting from the Treasury, rather than lending. In a statement timed to coincide with Paulson's announcement, the Federal Reserve, the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency and the Office of Thrift Supervision on Wednesday pressed banks to expand lending.

Stimulus plan debated

Another economic debate could hit Capitol Hill next week. The House and Senate may debate stimulus legislation that could provide aid to the staggering auto industry, funds for infrastructure improvements to boost jobs and an extension of unemployment benefits to laid-off workers.

"We need a stimulus," Schumer said in a conference call with reporters. "It's the ideological opposition of the administration" that's blocking action. He said there is still a chance Congress could pass a bill during the lame duck session but that odds are "smaller than I'd like."

Automakers are lining up for aid.

Paulson on Wednesday said the intent of the $700 billion package was to aid the financial industry, suggesting he opposed aid to automakers from the pot of money. But House Financial Services Committee Chairman Barney Frank, D-Mass., is drafting legislation that would allocate $25 billion from the $700 billion package to aid automakers.

Sen. Barbara Mikulski, D-Md., says she will propose an amendment next week that would allow consumers to deduct the interest on auto loans, as a way to boost auto sales.

"We will send a message to Paulson to include the auto industry in the $700 billion," Mikulski, speaking at a Chevrolet dealership in Bethesda, Md., said. "So far, he's said no. We'll say yes."

New vehicle sales in the USA last month were at an annual rate of 10.6 million, the worst since right after World War II, adjusted for population growth. Financial reports show that GM, Ford and Chrysler all could run out of cash in the first half of next year.

What about homeowners?

Also left unanswered is how -- or even if -- the government will create a wholesale approach to help homeowners facing foreclosure hold onto their homes.

Paulson said the government is considering a number of plans, including a model used by FDIC Chairman Sheila Bair to modify the loans owed by customers of failed IndyMac Bank, one of the nation's largest subprime lenders, which the FDIC took over this year.

Paulson expressed concern that Bair's plan and others to make wide-scale mortgage modifications would "require substantial government subsidies."

The foreclosure numbers continue to rise. Foreclosure filings, which include default notices, auction sale notices and bank repossessions, were up 5% in October from the previous month. At 279,561, the number of filings is up 25% from October 2007, according to RealtyTrac.

Meanwhile, the Department of Housing and Urban Development said it's moving forward with controversial rules aimed at helping borrowers avoid the kinds of risky mortgages that exacerbated the subprime mortgage crisis.

HUD officials said the rule change will lower the average borrowers' closing costs by $700.

The rules will require lenders to provide a standard, three-page good-faith estimate, outlining the terms of the loans and approximate costs. While lenders have been required to provide a good-faith estimate for years, a standard document will make it easier for consumers to shop around, HUD Secretary Steve Preston said.

The rules will also require lenders to provide more information about the way mortgage brokers are compensated. Mortgage brokers say the requirement is unfair, because HUD isn't requiring direct lenders -- such as banks -- to disclose how they're compensated.

HUD is giving lenders and mortgage brokers until Jan. 1, 2010, to adopt the new good-faith estimate. That gives opponents plenty of time to lobby the new administration and Congress to overturn the rule change.

Contributing: Sandra Block, Matt Krantz, James R. Healey, Sharon Silke Carty, Anna Bahney, Richard Wolf, Kathy Kiely, John Waggoner.

TEXT OF INFO BOX BEGINS HERE

Financial rescue chronology

Sept. 16: Government announces $85 billion emergency loan to insurance giant AIG in return for 79.9% stake in company.

Sept. 19:

Bush administration announces plan to let government buy bad mortgages and other toxic debt at a cost of up to $700 billon.

Sept. 25:

JPMorgan Chase buys Washington Mutual assets after FDIC seizes failed WaMu.

Sept. 28:

Congressional leaders and White House agree to $700 billon rescue of financial industry.

Sept. 29:

House rejects bailout plan, 228-205. Dow posts largest single- day point drop in its history, nearly 800 points. Citigroup agrees to buy Wachovia for $2.2 billion. The deal later falls through.

Oct. 1:

Senate passes, 74-25, revised bailout package that contains $110 billion in tax breaks for businesses and middle class. It also raises the FDIC insurance cap to $250,000.

Oct. 3:

House approves revised bailout bill, 263-171; President Bush signs it into law. Wells Fargo agrees to buy Wachovia for $15.1 billion in stock.

Oct. 8:

Government lends AIG another $38 billion.

Oct. 14:

Treasury Department agrees to let government buy stakes in banks.

Monday: Federal Reserve and Treasury revamp AIG's aid package to keep insurer afloat, agreeing to invest $150 billion, including $40 billion for preferred shares paying an annual dividend.

Wednesday: Government changes plans, says it won't buy risky assets of banks, but will continue to focus on buying stock in banks.

Sources: Associated Press, Bloomberg News, USA TODAY research

PHOTO, Color, Sam Ward, USA TODAY; PHOTO, Color, Susan Walsh, AP

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MONEY

A costly crisis of confidence ; When depositors lose faith, financial institutions lose out

Kathy Chu; Sandra Block
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The exodus of money from the stock market and troubled banks is reshaping the financial industry as quickly as any government bailout.

Amid unrelenting economic turmoil, investors are pulling billions of dollars out of the plunging stock market. They're also withdrawing money en masse from banks perceived as troubled and putting it into others deemed in better shape. And, in a sign of just how nervous Americans have become, some have even started to hoard cash outside of banks.

"People are panicked, and they want something as close to the mattress as they can find," says Mark Zandi, chief economist at Moody's Economy.com. "What we're experiencing now is something we have not seen since the Depression era."

This whirlwind migration of funds is shoring up the balance sheets of comparatively healthy institutions. The problem is, it's also weakening the financial condition of more stable institutions - - making them vulnerable merger targets -- and tipping troubled ones into insolvency.

Complicating matters, the government's injection of up to $700 billion in the financial system has stoked confidence in some institutions while breeding uncertainty about the survival of others that aren't getting this financial lifeline.

David Walerstein, of Brooklyn, N.Y., says he's moving a chunk of his money to a local bank because he can't get a straight answer from his midsize institution about its financial condition.

"There are hundreds of chaps like myself and my missus who have worked all our lives, been fairly respectable citizens, who have money in banks and are anxious about it," says Walerstein, 82. "I want to know if that money is safe."

The government has urged consumers to remain calm and is hoping that new increases in deposit insurance limits -- to $250,000 for most bank accounts -- will stem the panic.

Yet many consumers remain wary. Some are diversifying their money among multiple banks. Others are poring over complex financial statements to determine whether their bank will be the next to fail. In recent months, Veribanc, a bank-rating company in Woonsocket, R.I., has gotten "hundreds of requests" for information from consumers worried their banks will fail, says President Michael Heller.

Nearly one in three consumers in a recent Nielsen Claritas survey said they were concerned about their personal savings accounts. More, though, were worried about the financial markets or their retirement accounts than their bank accounts.

Of the 3,000 consumers polled, one in five said they were likely to move at least some of their funds to another institution in the near future, with nearly one in 10 likely to move all their money.

The withdrawals reflect consumers' widespread distrust of financial institutions and of government actions, analysts say. And until banks and the government regain investors' trust, withdrawals will continue.

"The movement of money has enormous implications for our economy, for individual companies and their viability," says Mary Beth Sullivan, managing partner at Capital Performance Group, a financial industry consultant. "It says something about the American consumer and about confidence."

Boon for some banks

The financial upheaval is benefiting large banks and community banks most, says economist Zandi: "The losers are the midsized institutions, who can't operate in as many markets as the big guys and don't cater to the niches as much as the small guys."

JPMorgan Chase, considered one of the healthier players, saw its deposits jump 9% from the second to the third quarter to $969 billion. Including the deposits of Washington Mutual, which it recently acquired, deposits jumped 34%.

By contrast, midsize banks such as Sovereign have seen deposits plunge in recent months, raising concerns about their viability. Last month, Sovereign agreed to sell itself to Santander.

As the financial meltdown spreads globally, consumers are also taking refuge in community banks, long known for their personal service and hand holding.

Coda Hale, 27, a software engineer for Wesabe, a website aimed at helping consumers manage their money, moved his savings from Washington Mutual to Mechanics Bank, in Richmond, Calif., in mid- September. Small banks, he says, "are less focused on creating these bizarre derivatives."

An October survey by the Independent Community Bankers of America, a trade group, reveals that 70% of community banks saw an uptick in deposits in the past year. More than a quarter of the banks surveyed saw deposits grow by at least 11%.

"I don't think we've had this kind of movement of money since at least the Great Depression," says Cam Fine, chief executive of the Independent Community Bankers of America. "It's historic."

Even during the savings and loan crisis of the 1980s, consumers weren't as panicked -- and prone to moving money -- as today, says James Chessen, chief economist of the American Bankers Association, a trade group.

In a market ruled by investor fear, banks of all sizes worry that they could be the next victim of the downturn.

"A rumor festers into fact, and people react accordingly," says Scott Talbott, senior vice president of the Financial Services Roundtable, which represents large banks.

Indeed, the cascade of rumors -- and news -- about banks can nudge even the most steadfast consumers to take their money and run.

Ngan Adams, 34, opened a checking account at Partners Federal Credit Union the week that Lehman Bros. declared bankruptcy and she heard rumors that Washington Mutual might be next. Adams says she likes that the credit union is "very conservative. I thought I should put my money in an institution that has the same ethics."

Similarly, the troubles at Pasadena-based IndyMac, which was closed by the FDIC in July, contributed to a pickup in business at Wescom Credit Union, also based in Pasadena, says Wescom Chief Executive Darren Williams.

Overall, bank deposits are rising -- by more than $158 billion from August to September -- as investors yank money out of stocks, bonds and other investments and put it in banks.

In September, investors withdrew $56.2 billion from stock funds, according to the Investment Company Institute, a trade group for investment firms. It was the fourth consecutive month that stock funds lost money.

Corporate bonds and muni bonds are also losing money in the "broadest market downturn that we've seen since the 1970s," says Brian Reid, chief economist of the investment group.

Robert Cantwell, 57, pulled hundreds of thousands of dollars -- his entire investment portfolio -- from the stock market last year when he heard loan defaults could cripple bank earnings.

"We decided," says Cantwell, of Flower Mound, Texas, "that this was the time to sit out the market." Cantwell put his money into bank CDs instead.

Stock market woes, however, aren't benefiting all financial institutions.

A recent survey by the Credit Union National Association found that a fourth of credit unions have had above-average growth in deposits the last six weeks, but 40% said deposits were growing at a weaker rate than a year earlier.

Bill Hampel, the trade group's chief economist, attributes the slowdown to confusion over whether credit union accounts are federally insured. Most credit union deposits are federally insured for up to $250,000. But because credit unions are insured by the National Credit Union Administration, not the FDIC, that message is sometimes lost on consumers, credit union officials say.

Diversifying bank portfolios

The government's temporary boost in deposit insurance has given more consumers confidence to keep their money at one institution. But despite such protection, some consumers still seek out multiple banks, banks and analysts say.

"We are definitely seeing some customers trying to rationalize and diversify their portfolio," says Gary Perlin, CFO of Capital One. "There is more consumer uncertainty in this environment than we've seen in a long time."

Lingering fear about the safety of bank funds may also be a factor, says Sullivan, of Capital Performance: "Having a lot of your eggs in a single basket has felt like an unsafe thing to do lately, no matter what the government says."

Still, as long as funds are federally insured, depositors should not worry about losing their money, says Stephen Brobeck, executive director of Consumer Federation of America, an advocacy group: "There's no way the government won't meet its federal deposit insurance guarantees."

FDIC spokesman David Barr says the agency has a "flawless track record" of protecting consumers' life savings. "In our 75-year history, not a single customer has ever lost a penny of insured funds as a result of a bank failure," Barr notes.

These assurances provide little comfort to Walerstein, of Brooklyn. He says the collapse of the mortgage market, along with the use of taxpayer money to prop up the financial system, has made it hard for him to trust the government.

"If there's a major run (on the banks), I worry that there's a lot of us that will be out in the cold," Walerstein says.

In Decatur, Ind., Joe Obringer, 43, says he's taken a chunk of money out of banks and is holding onto it until the markets calm down, in case he can't get access to his money. "All we've got left is our savings," Obringer says.

"If we lose that, because we've got family to support, that would be tough."

TEXT OF INFO BOX BEGINS HERE

Where the money's going

Amid the Wall Street crisis of the past year, nearly 70% of community banks have seen their deposits grow.

Increased More than 20% 10.4%

11% to 20% 15.8%

1% to 10% 43.5%

Stayed about the same 12.8%

Decreased 1% to 10% 15.8%

11% to 20% 1.2%

More than 20% 0.6%

Source: Independent Community Bankers of America survey of 336 community bankers conducted Oct. 15-21.

GRAPHIC, Color, Karl Gelles, USA TODAY, Source: Nielsen Claritas October 2008 survey (Pie chart); PHOTO, Color, Danny Moloshok, Reuters; PHOTO, B/W, Jamie Rector, USA TODAY

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MONEY
Bank strife likely to spark mergers, asset sales ; Foreign banks sniffing around for good deals

Edward Iwata
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The unrelenting financial crisis is pounding U.S. commercial banks, transforming the industry landscape and likely leading to a rising wave of bank mergers and fire sales in the coming months.

A clear harbinger of the turbulent times ahead for retail banks came last week, when Wells Fargo beat rival banking titan Citigroup to win over troubled Wachovia in a stock-swap deal brokered by the Federal Reserve that's now valued at about $12billion.

Also sure to shake up the industry is the Treasury Department's sweeping plan to buy billions of dollars of stock in ailing financial firms. The move will give banks badly needed cash, while aiming to free up credit for consumers and businesses.

"We've never seen such uncertainty over the economy and the banking and brokerage industries," says Michael Flanagan, an independent brokerage analyst at Securities Industry Analytics in Philadelphia.

Federal Deposit Insurance Corp. numbers tell a stark story:

*Fifteen banks, led by Washington Mutual, have failed this year, and the FDIC has added 117 banks to its problem list, including banks facing severe threats to their financial viability.

*Total second-quarter assets of the 8,451 U.S. banks and savings- and-loans fell by $69billion -- the largest quarterly drop since 1991.

*Bank loan charge-offs in the second quarter hit $26billion -- triple the same period in 2007.

Despite the turmoil, a flood of banking mergers and asset sales is anticipated soon, as the value of U.S. bank stocks has plummeted in recent months, say analysts such as Bart Narter at Celent, a financial services consulting firm.

Already, foreign banks are hunting for good deals. Potential acquirers include Toronto-Dominion Bank in Toronto, HSBC in London, Royal Bank of Scotland in Edinburgh and Banco Santander in Madrid. All have bought U.S. banks in recent years, and Banco Santander reportedly was an avid suitor of Wachovia. "The U.S. banking industry is up for sale, and it's a Kmart blue-light special," says analyst Robert Patten at Morgan Keegan. "A lot of stronger banks are looking very closely at a lot of weaker banks."

The merger frenzy is likely to strengthen large U.S. "money center" banks that already wield plenty of financial firepower. The Wells Fargo-Wachovia deal will create a superbank -- boasting $1.4 trillion in assets and 48 million customers -- that will rival Bank of America, JPMorgan Chase and Citigroup.

At the same time, thousands of small local banks, blessed with niche markets and loyal customers, will keep thriving.

"There will be a few very large institutions, many smaller community banks -- and virtually nothing in the middle," says Nancy Bush of NAB Research, an investment advisory firm.

The entry into commercial banking by Wall Street giants Goldman Sachs and Morgan Stanley also will rock the industry. With the Federal Reserve last month allowing them to operate as bank holding companies, Goldman

Sachs and Morgan Stanley -- each boasting $1 trillion in assets -- can seek stable, federally insured deposits from customers.

That poses a huge competitive threat to commercial banks, especially if the Wall Street firms buy retail banks to bolster their presence on Main Street.

Retail bank branches haul in 60% to 80% of commercial bank revenue, Narter says. Even with the growth of investment firms and online banking in recent decades, bank branches remain the best way to draw new deposits and build customer loyalty.

Amid the upheaval in banking, consumers should win in the short run. Big banks, fiercely competing for millions of consumers and business clients, are likely to lower prices on products and services. But with less competition and fewer choices for consumers, prices will rise in the long haul, Flanagan predicts.

Barring an economic rebound, consumers, homeowners and businesses in the coming months also won't find it easy to land loans and tap credit lines from cautious banks.

And if credit stays frozen, banks are likely to get more visits from regulators seeking to free up cash and capital. The FDIC, as it did with Wachovia, is pressuring more troubled banks to find prudent, well-run merger partners, Bush says.

"There has to be dramatic and fundamental change in the banking industry," she says. "We can't let this happen again."

TEXT OF INFO BOXES BEGINS HERE

Analysts say Wells Fargo and Wachovia are a near-perfect match in terms of branch locations, except for big overlaps in California and Texas. Number of branches{+1} in their dominant states:

Wells Fargo States Wachovia

0 Alabama 141

265 Arizona 16

1,010 California 176

150 Colorado 34

0 Florida 731

0 Georgia 286

180 Minnesota 0

125 Nevada 6

0 New Jersey 321

0 New York 86

0 North Carolina 323

128 Oregon 0

0 Pennsylvania 309

0 South Carolina 153

566 Texas 228

136 Utah 0

0 Virginia 295

159 Washington 0

1 -- as of June 30

Sources: Celent, FDIC

Biggest U.S. banks

Leading commercial banks, number of offices nationwide, and total domestic deposits, in billions, as of June 30:

Bank Offices Deposits

Bank of America 5,738 $642.3

JPMorgan Chase 3,175 $461.0

Wachovia 3,338 $397.8

Wells Fargo 3,369 $276.3

Citibank 1,073 $224.3

Washington Mutual 2,213 $183.5

U.S. Bank 2,596 $127.9

SunTrust 1,730 $114.3

National City 1,568 $97.8

Regions 1,924 $86.2

Source: Federal Deposit Insurance Corp.

GRAPHIC, B/W, Kieth Simmons (map)
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MONEY
The Fed has had to get a little creative ; Dealing with credit crisis has taken fancy footwork

Sue Kirchhoff
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The Federal Reserve has used all its traditional tools -- and some new ones -- as it grappled with a spreading credit crisis. Among them: deep interest rate cuts. Low-cost lending to banks and investment banks. Credit swaps with other central banks. And providing financing sources for the shutdown of investment bank Bear Stearns and the rescue of troubled insurer AIG.

The rescue package moving through Congress is designed to help financial regulators to a more systemic approach. It would let the Treasury Department buy up to $700 billion in distressed assets, which would help set a floor under asset prices and help financial firms rebuild capital and confidence.

The Fed may still have to lean on its existing array of tools even if Congress approves the bill. Some of the Fed's efforts over the past year:

*Cutting the key federal funds rate, which is what banks charge each other for overnight loans. The rate is used as a benchmark by lenders for business, auto and other consumer loans.

*Cutting the interest rate the Fed charges banks that want to take out direct loans.

*Pumping cash into financial markets through a variety of mechanisms including so-called repurchase agreements, which are essentially short-term collateralized loans.

*Creating auction programs to provide funds to commercial banks and financing to investment banks.

*Offering a loan to insurance giant American International Group to stave off a potential bankruptcy that could have had widespread impact throughout the system.

Timeline of Fed's moves

Aug. 10, 2007: Fed says it will provide extra liquidity to keep credit markets functioning orderly.

Aug. 17: Cuts the discount rate by half a percentage point to 5.75% from 6.25%. Allows financing for as long as 30 days.

Sept. 18: Cuts the federal funds rate to 4.75%. Cuts the discount rate to 5.25%.

Oct. 31: Cuts the federal funds rate to 4.5%. Cuts the discount rate to 5%.

Dec. 11: Cuts the federal funds rate to 4.25%. Cuts the discount rate to 4.75%

Dec. 12: Creates a special facility to auction funds to banks against a wide range of collateral. Sets up special lines to provide needed dollars to foreign central banks.

Jan. 22, 2008: Cuts the federal funds rate to 3.5%, discount rate to 4%.

Jan. 30: Cuts the federal funds rate to 3% and the discount rate to 3.5%.

March 16: Grants $29 billion loan to facilitate the sale of failing investment bank Bear Stearns to JPMorgan Chase. Announces special programs for financing to investment banks.

March 18: Cuts the federal funds rate to 2.25%; discount rate to 2.5%.

April 30: Cuts federal funds rate to 2%; discount rate to 2.25%.

May 2: Increases swap arrangements with foreign central banks. Expands collateral that can be used at its term lending facility auction.

July 13: Gives Federal Reserve Bank of New York the authority to lend to troubled mortgage giants Fannie Mae and Freddie Mac.

July 14: Approves nationwide rules governing all mortgage lenders. Rules bar unfair, abusive or deceptive home mortgage lending practices.

Sept. 14: After refusing to bail out investment bank Lehman Bros., Fed, along with Treasury and SEC, announces steps to deal with possible disruptions, including broadening collateral for loans to investment banks and increasing the number and dollar amount of auctions.

Sept. 16: Authorizes Federal Reserve Bank of New York to lend up to $85 billion to troubled insurer American International Group.

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MONEY
SEC scrutiny of short selling zeroes in on rumors

Kevin McCoy
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A Securities and Exchange Commission investigation into whether traders spread misinformation in a bid to drive down shares of financial firms focuses in part on a series of midsummer Wall Street rumors, according to an SEC subpoena.

The SEC also extended the temporary ban on short sales of stock of more than 900 financial firms. The ban would have expired tonight.

Served on numerous hedge funds, the subpoena identifies two former investment banks -- Bear Stearns and Lehman Bros. -- that the SEC believes may have been subject to short-selling manipulation aimed at generating trading profits as share prices in the two firms dropped.

The subpoena, reviewed by USA TODAY, seeks internal trading data, personnel information and e-mail and other communications relating to June and July market rumors that:

*Lehman would get access to the Federal Reserve Bank's discount window.

*British bank Barclays would buy Lehman for $15 a share (its market price was near $20).

*Major investment firms SAC Capital and Pimco had stopped trading with Lehman.

Other SEC subpoenas issued in the investigation cite similar rumors involving Bear Stearns, according to a person with direct knowledge of the investigation who declined to be identified because the case is ongoing.

The SEC subpoenaed the information to investigate if traders originated or spread the rumors to profit from short selling Bear and Lehman shares.

Lehman filed for bankruptcy protection earlier this month and subsequently sold its core trading operation to Barclays. JPMorgan Chase acquired Bear in March.

The SEC this month broadened the investigation by ordering dozens of hedge funds to provide similar trading data and communications about trading in the stocks of insurance giant AIG, Goldman Sachs and other firms, according to the person with direct knowledge of the case.

The SEC declined to comment.

It is legal to sell short by borrowing shares and selling them in the hope of profiting by replacing the shares with equivalents bought later at a lower price. But it is illegal to spread false rumors to try to drive down the share price while short selling.

Several financial executives have complained that their companies' share prices were driven down by short sellers spreading rumors seeking to profit from this year's financial crisis.

Along with communications related to market rumors, the SEC subpoena seeks all trading positions for Bear and Lehman from June1 through early July. It also seeks names of officials responsible for approving trades, details of all client relationships with Lehman and Bear, plus information about any changes in those relationships.

Separately, the FBI launched preliminary investigations of possible fraud involving Lehman, AIG and mortgage giants Fannie Mae and Freddie Mac, the Associated Press reported last week.

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MONEY
Citigroup and FDIC save Wachovia ; Concerns about regional banks continue to spread

Del Jones
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Worldwide banking remained in turmoil Monday as Wachovia became the latest giant to topple, agreeing to sell most of its operations to Citigroup in a deal brokered by the Federal Deposit Insurance Corp.

All deposits in Wachovia are protected, even those with accounts in excess of the $100,000 FDIC insurance.

"Today's action will ensure seamless continuity of service from their bank and full protection for deposits," FDIC Chairman Sheila Bair said. "There will be no interruption in services, and bank customers should expect business as usual."

Citigroup will acquire most of Wachovia's assets and liabilities, but Wachovia will continue to own brokerage A.G. Edwards and investment manager Evergreen Investments. Charlotte-based Wachovia will also continue as a publicly traded company.

Concerns about Wachovia's financial health have hammered the company's share price. Friday, Wachovia closed at $10, off 81% from its 52-week high. By Monday's close, Wachovia had slumped to $1.84.

Wachovia's financial problems can be traced to its 2006, $24billion acquisition of Golden West Financial. Wachovia inherited a deteriorating $122billion portfolio of loans that let borrowers skip some payments. Wachovia posted a $9.1billion loss for the second quarter, slashed its dividend and announced plans to cut 11,350 jobs, mostly in its mortgage business.

Havoc across the Atlantic

Wachovia may be the last big bank considered to be in immediate trouble, but fears continue to spread among the next-tier regional banks.

Havoc also reached across the Atlantic Monday, where Britain nationalized Bradford & Bingley, Britain's ninth-largest mortgage lender. It was the second U.K. bank to be taken on by the British government. Also, Belgium, the Netherlands and Luxembourg pumped $16.4billion into Fortis to stabilize Belgium's largest financial services firm, taking on a 49% stake.

Elsewhere:

*Morgan Stanley said it would sell a 21% stake to Japan's Mitsubishi UFJ Financial Group for $9billion to shore up its finances. Even so, Morgan Stanley stock closed down 15% to $20.99.

*Lehman Bros., which became the largest bankruptcy filing in U.S. history on Sept.15, said it would sell its investment management business to private-equity firms Bain Capital Partners and Hellman & Friedman for $2.2billion.

The Wachovia deal came just four days after the FDIC brokered the sale of Washington Mutual, the nation's largest savings and loan, to JPMorgan Chase.

"Citigroup passed over Washington Mutual because they were focused on a bigger target: Wachovia," says Bart Narter of Celent, a Boston-based financial research and consulting firm. He says the deal makes Citigroup an instant player in the Southeast and Mid- Atlantic states. It will add 731 branches in Florida, 323 in North Carolina, 320 in New Jersey and 309 in Pennsylvania, Narter says.

Citigroup, in an effort to shore up its capital position, said it will sell $10billion in common stock and cut its quarterly dividend 50%, to 16 cents a share. Citigroup paid $2.1billion for Wachovia and agreed to absorb $42billion in losses from Wachovia's $312billion loan portfolio, with the FDIC covering any remaining losses. Citigroup will issue $12billion in preferred stock and warrants to the FDIC.

Citigroup lost 12% to $17.75.

Continuing consolidation leaves four giant banks: Bank of America, JPMorgan Chase, Citigroup and Wells Fargo. Going forward, they will press their advantage with new products and services, says Jim Eckenrode, an executive at TowerGroup, a research and advisory services firm for the financial services industry.

Donn Vickrey, chief analyst at Gradient Analytics, a stock research firm in Scottsdale, Ariz., says that as the country is left with few large banks, consumers can expect lower yields on savings and higher fees.

Banks will likely offer expanded services to big customers such as managers of large assets. "For the average consumer, it's going to be a bad deal," Vickrey says.

Consolidation could create opportunity for small and midsize banks, which focus on community and small-business banking, says Jay Sidhu, former CEO of Sovereign Bancorp, which runs Sidhu Special Purpose Capital out of Reading, Pa.

Sidhu says smaller banks are now poised to prosper, and he intends to invest at least $250million in them in upcoming months. "Capital and superior management will be the keys for survival and growth in this environment," he says.

Regional bank stocks slammed

Whatever their prospects, regional bank stocks sank in the broad market's Monday slide.

Sovereign Bancorp tumbled 72% to $2.33. Fifth Third Bancorp sank 44% to $9.11; FirstFed Financial dropped 25% to $7.50; and KeyCorp slumped 33% to $9.80. The Financial Select Sector SPDR (ticker: XLF), a fund that holds 85 large-company financial stocks, dropped 13%.

There were 117 banks and thrifts in trouble during the second quarter, the highest level since 2003, the FDIC says, but that number could climb. "There are a number of regional banks which may need help, either because of the weakening mortgage market or simply because of the weakening economy," Michael Sheldon, chief market strategist of RDM Financial Group, told the Associated Press.

This year, 13 banks have failed. Aside from Washington Mutual, two others failed this month: Ameribank and Silver State Bank. Only three banks failed in 2007, and none failed in 2005 and 2006, the FDIC says.

Contributing: Paul Davidson

TEXT OF INFO BOX BEGINS HERE

How Citigroup and Wachovia compare

CitigroupWachovia

2007 revenue (billions) $159.2 $56.7

2007 net income (billions) $3.6 $6.3

Assets{+1} $2.2 trillion $8.1 billion

Headquarters New York Charlotte

Fortune 500 rank 8 38

Employees 387,000 120,000

1 -- as of March 31; Sources: Hoover's, Fortune, Citigroup, Wachovia

PHOTO, B/W, Joe Raedle, Getty Images

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MONEY
If your cash is FDIC insured, you can relax ; No one has ever lost a dime of protected money

Sandra Block
902 words
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Old photographs of Depression-era bank runs are popping up all over the place, and that raises a couple of questions. Why don't people wear hats anymore? And, more important, could this happen to your bank?

Concerns about bank safety and soundness have been exacerbated by the recent downfall of two of the nation's largest financial institutions. Thursday, the Federal Deposit Insurance Corp. seized Washington Mutual, the nation's largest savings and loan, and brokered a sale to JPMorgan Chase for $1.9 billion. On Monday, Citigroup said it will acquire Wachovia's banking business, a deal that was also negotiated by the FDIC.

The FDIC emphasized that Wachovia didn't fail and that all depositors were protected. Likewise, none of Washington Mutual's depositors lost any money, and customers have experienced no disruption in service.

No one has ever lost a dime of FDIC-insured deposits. Still, the prospect of a bank failure unnerves a lot of people, particularly in light of ongoing mayhem in the stock market.

The FDIC maintains a list of troubled banks but doesn't publicly disclose it because regulators don't want to trigger a run on those banks. There are, however, other ways to check on your bank's financial health. Bankrate.com assigns a "Safe & Sound" rating to banks, thrifts and credit unions, based on profitability, liquidity, asset quality and other criteria. Veribanc, an independent ratings agency, will provide a financial rating for any bank, thrift or credit union, for $10 per institution. Go to www.veribanc.com, or call 800-837-4226.

While closing accounts at a bank that appears to be on shaky ground could give you peace of mind, it could also cost you money. If you withdraw funds from a certificate of deposit before it has matured, you'll have to pay an early-withdrawal penalty.

A better option: Make sure all of your deposits are insured. No customer has ever lost a dime in insured deposits in a bank failure. But not all bank customers have that protection. The FDIC estimates that about 37% of all bank deposits are uninsured. Some of those accounts belong to businesses that keep more than $100,000 in the bank to pay bills, but other accounts may belong to people who don't understand the deposit insurance limits.

In the Washington Mutual and Wachovia transactions, all deposits were included in the deal, so no depositor lost money. But it doesn't always work out that way. When the FDIC took over IndyMac in July, about 10,000 customers of the California-based mortgage lender had uninsured deposits of about $1 billion. Those customers received an "advance dividend" of 50% of their deposits. Additional payments won't be made until the FDIC sells IndyMac's assets, which hasn't happened yet, says FDIC spokesman Andrew Gray. If your deposits are uninsured, you may have to wait months or years to get your money back, if you get it at all.

The FDIC insures up to $100,000 for individual accounts, $200,000 for joint accounts and up to $250,000 for retirement accounts. But when a bank fails, some customers discover that they have inadvertently exceeded the limits. Here's what you need to know:

*Joint accounts are covered for up to $200,000 if both account holders have equal withdrawal rights. If one account holder needs the other's permission to take withdrawals, it's not considered a joint account for insurance purposes.

*If you have deposits at two banks that merge, you could end up exceeding deposit insurance limits. As the banking industry becomes increasingly concentrated, this could become an issue for more savers. When two banks merge, the FDIC provides full coverage for six months after the merger, or in the case of CDs, until maturity. After that, depositors need to move some of their money to an unaffiliated bank to maintain full protection.

*You can significantly increase your coverage with revocable trust accounts, typically known as payable-on-death or living-trust accounts. The FDIC will cover up to $100,000 per beneficiary for these accounts. In the past, the coverage was limited to "qualifying beneficiaries," defined as spouses, children, grandchildren, parents and siblings. But last week, the FDIC voted to eliminate this requirement. Now, deposit insurance will cover any beneficiary named in the trust.

The FDIC provides an online tool to help you calculate your coverage for all of your bank accounts. Go to www.fdic.gov and search for the Electronic Deposit Insurance Estimator.

To suggest columns, e-mail: sblock@usatoday.com.

Bank failures in 2008

Bank Assets Closing date

Washington Mutual $307 billion Sept. 25

Ameribank $115 million Sept. 19

Silver State Bank $2.0 billion Sept. 5

Integrity Bank $1.1 billion Aug. 29

Columbian Bank and Trust $752 million Aug. 22

First Priority Bank $259 million Aug. 1

First Heritage Bank $254 million July 25

First National Bank of Reno $3.4 billion July 25

IndyMac $32.0 billion July 11

First Integrity Bank $54.7 million May 30

ANB Financial $2.1 billion May 9

Hume Bank $18.7 million March 7

Douglass National Bank $58.5 million Jan. 25

Source: FDIC

PHOTO, B/W; PHOTO, B/W

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MONEY
Top executives' pay takes a hit ; Bailout plan seeks to rein in compensation, exit packages

Del Jones; Edward Iwata
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The draft of the government's controversial $700 billion financial rescue plan released Sunday makes it clear that CEOs of firms seeking the bailout are about to have their pay packages capped.

The proposal seeks to rein in compensation at participating companies by limiting their tax deduction on executive salaries exceeding $500,000. It allows officials to recover bonuses that have been paid out based on financial statements that later prove to be inaccurate. And it curbs exit-pay packages, or golden parachutes, at those companies.

The provisions may be some of the easier for politicians to agree on. They already appear to have support from some CEOs and taxpayers. A recent USA TODAY/Gallup survey of 1,019 people found that 63% think setting limits on executive compensation at companies that participate in the bailout is very important.

Golden parachutes typically pay ousted CEOs three times annual pay, bonuses and pensions and often include perks lasting well into retirement. They've long been a sore point for investors at underperforming companies, where many exiting executives have shared little of their pain.

Parachutes have been particularly gilded at the same financial firms that are now struggling. Merrill Lynch CEO Stanley O'Neal left in 2007 with an exit package valued at $161 million. Washington Mutual CEO Kerry Killinger's golden parachute is valued at $44 million, while Citigroup CEO Charles Prince left last year with $105 million in compensation, says compensation consultant James Reda.

It's highly unlikely that lawmakers will try to extend curbs on financial CEO compensation to other industries. "Congress should nudge the free market, not bludgeon it," Reda says.

Current regulations and industry guidelines on executive pay are complex and don't need meddling from Congress, says Frank Glassner, CEO of Compensation Design Group, a pay consultant. Moreover, the last time Congress tried to limit executive pay, it resulted in 1993 tax-code changes that capped corporate deductions for executive salaries over $1 million. But corporate boards found new ways to lavish executives with stock-based compensation and perks ranging from private use of corporate aircraft to financial advice and country club memberships. Coupled with rising stock prices, CEO pay packages soared.

Perhaps nowhere has excessive pay been more pervasive than at many of the financial firms now foundering. David DeBoskey, a San Diego State University professor, estimates Lehman Bros., American International Group, Fannie Mae and Freddie Mac -- all reportedly under FBI investigation because of the mortgage crisis -- paid their top executives a total of $1.4 billion in salaries, bonuses and stock-related pay from 2003 to 2007. Last year alone, top executives at Wall Street investment banks Goldman Sachs, Merrill Lynch, Morgan Stanley, Bear Stearns and Lehman received a combined $613 million, or an average of $123 million at each firm, says pay expert Graef Crystal, author of The Crystal Report on Executive Compensation.

"The enormous sums of money being paid to them is far above any other industry. It's obscene," Crystal says. "Wall Street is whacked out."

But the crisis has cast a spotlight on a wider universe of corporate compensation, particularly golden parachutes. (CEOs at Fannie Mae and Freddie Mac already were denied their golden parachutes, and when the government took over AIG, CEO Robert Willumstad voluntarily forfeited his $22 million exit package.)

"This may be the kind of wake-up call that boards need, because investor anger and regulatory action haven't woken them up," says Broc Romanek, a former Securities and Exchange Commission chief counsel and editor of CompensationStandards.com.

To some pay critics, many boards have long been asleep at the wheel. "We have been calling attention to out-of-control CEO pay for the last dozen years," says Mike Lapham, project director of the Responsible Wealth project at United for a Fair Economy, which favors paying CEOs no more than 25 times what their lowest-paid worker receives.

Lapham's efforts have gotten little traction. Criticism over executive pay has often fallen on deaf ears during bull markets that enrich investors. Even now, it's hard to prove that excessive CEO pay has had much to do with the underlying problem.

Yet the current financial meltdown has made placing curbs on executive compensation more acceptable even among current and former CEOs.

CNX Gas CEO Nicholas Deluliis notes that government intervention into financial markets is generally bad for taxpayers and financial markets and that capping executive compensation is inconsistent with capitalism. "However, if direct government intervention into the markets is a reality, then the taxpayer takes the place of the shareholder. That means that as taxpayers we should have the power to structure or limit compensation for executives any way we see fit," Deluliis says.

Jay Sidhu, former CEO of Sovereign Bank and now head of private- equity firm Sidhu Holdings, backs pay for performance, but "that means when performance is poor, CEOs should be held accountable and must lose perks and compensation.

"Unfortunately, some boards have not done their job, and Congress has to step in," Sidhu says. "Rubber-stamp boards must end."

Some already have. In May, insurer Aflac became the first U.S. company to let shareholders vote on the compensation of CEO Dan Amos. Of those casting votes, 92% approved Amos' $12 million package. But it was largely symbolic, because the vote was non- binding.

David D'Alessandro, CEO of John Hancock Financial Services from 2001 to 2004, says limiting pay, or even ending golden parachutes, isn't as key as time. CEOs should not get big paydays when they leave but should wait for five years so that shareholders can assess if any of their decisions resulted in long-term damage, he says.

Departed financial chieftains at some of the firms caught in the mortgage meltdown didn't have to wait for golden parachutes to collect eye-bulging compensation, says Equilar, a compensation- consulting firm. According to senior analyst Andrew Gordon and research manager Alexander Cwirko-Godycki, total 2005-2007 pay for executives heading troubled financial firms:

*Angelo Mozilo, former CEO of ailing mortgage lender Countrywide Financial, made $362 million in salary, bonuses, stock-option gains and perks ranging from country club fees to personal use of corporate aircraft.

*AIG CEO Martin Sullivan received $25.4 million, including $322,000 for private use of corporate aircraft, $153,000 for car and parking, $160,000 for home security and $41,000 for financial planning.

*Former Lehman CEO Richard Fuld got $187 million.

*O'Neal of Merrill Lynch received $66 million, including $357,000 for car services and personal use of aircraft in 2007.

*Prince of Citigroup made $42 million, including $180,000 for corporate aircraft, ground transportation and security services.

*Goldman Sachs CEO Lloyd Blankfein made $76.2 million, including $233,000 for car and driver services and $61,000 for financial and benefits counseling services.

Still, while its unclear how much -- if any -- impact the financial crisis will have on overall executive compensation, it's probable that the luster of golden parachutes will be dulled, experts say.

"There's a lot of room to downsize the exit pay for executives," says Reda. "They don't need that much money to find their next jobs, or to figure out what they want to do with their lives."

TEXT OF INFO BOX BEGINS HERE

Million-dollar exit amounts for CEOs

Exit pay packages (cash, pension, benefits, accelerated stock and options and other compensation) for CEOs of financial firms and mortgage lenders:

Company CEO Date Total

Merrill Lynch Stanley O'Neal Oct. 28, 2007 $161,000,000

Citigroup Charles Prince Nov. 4, 2007 $105,000,000

Washington Mutual Kerry Killinger Sept. 8, 2008 $44,000,000

Wachovia Ken Thompson June 1, 2008 $42,000,000

Lehman Bros. Richard Fuld Sept. 17, 2008 $24,000,000

Washington Mutual Alan Fishman Sept. 25, 2008 $19,000,000

Freddie Mac{+1} Richard Syron Sept. 8, 2008 $16,000,000

Bear Stearns James Cayne Jan. 8, 2008 $13,000,000

Merrill Lynch John Thain Sept. 14, 2008 $9,000,000

Fannie Mae{+1} Daniel Mudd Sept. 8, 2008 $8,000,000

AIG{+2} Robert Willumstad Sept. 17, 2008 $22,000,000 (declined)

1 -- CEO will receive only part of exit package; 2 -- AIG was taken over by the government; CEO Robert Willumstad voluntarily forfeited his $22 million exit package Source: James F. Reda & Associates

PHOTO, B/W, Jim Sergent, USA TODAY; PHOTO, B/W; PHOTO, B/W, AP;
PHOTO, B/W, AP; PHOTO, B/W, Bloomberg News; PHOTO, B/W, Bloomberg
News

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MONEY

What's next for failed WaMu's customers? ; Not much change at first as JPMorgan takes over

Sandra Block
624 words
29 September 2008
USA Today
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These are nail-biting times for bank customers. On Thursday, the Federal Deposit Insurance Corp. seized the assets of Washington Mutual, the nation's largest savings and loan, and brokered the sale of the company to JPMorgan Chase. The collapse of Washington Mutual - - often called WaMu -- is the largest bank failure in U.S. history.

The WaMu failure sparked renewed worries that more big banks would fail. Shares of Wachovia plunged 27% Friday on concerns about its financial health. On Sunday, The Wall Street Journal, citing unnamed sources, reported on its website that Wachovia is talking to several potential buyers, including Wells Fargo, Citigroup and Banco Santander of Spain.

Wachovia spokeswoman Christy Phillips-Brown said in an e-mail Sunday that the company doesn't comment on merger rumors. Phillips- Brown said the company is "aggressively addressing" its challenges.

Here are answers to some questions about what Washington Mutual's failure and the sale to JPMorgan Chase will mean for savers, credit card borrowers and mortgage holders:

Q: I have a bank account with Washington Mutual. How will the merger affect me?

A: For WaMu customers, it's business as usual. You'll have the same account numbers, passwords, branches and ATMs. Sometime in the future, you'll see the JPMorgan Chase name on your bank statements and credit cards, and you'll receive new debit cards bearing the Chase name.

Q: What about my insured deposits with WaMu?

A: They're still fully covered by the FDIC, up to $100,000 for individual depositors, $200,000 for qualified joint accounts and $250,000 for retirement accounts. And because JPMorgan Chase bought all of WaMu's deposits, WaMu customers with uninsured deposits won't lose any money, either.

Q: I bought one of WaMu's one-year certificates of deposit with a 5% rate. Will I still receive that rate until the CD matures?

A: At a press conference call on Friday, Charlie Scharf, head of JPMorgan Chase's retail business, said rates for WaMu products will remain the same "as we figure out how to merge the companies." But it's unlikely that Chase will honor the rate on WaMu's 5% CD through maturity, says Greg McBride, senior analyst for Bankrate.com. Last week, the average rate for a one-year CD was 2.45%, according to Bankrate.com.

If Chase decides to lower the rate on WaMu CDs, customers will have the option of holding on to their lower-paying CDs until maturity or redeeming their CDs without paying an early-withdrawal penalty, McBride says.

Q: I have CDs with JPMorgan Chase and WaMu. How will this merger affect me?

A: You won't have to do anything right away. WaMu CDs will be separately insured for six months after the merger, or until maturity. But if your combined deposits with WaMu and JPMorgan Chase exceed federal deposit insurance limits at the end of that period, you'll need to make some changes to maintain full coverage. The easiest way to do this is to move some of your funds to another bank.

Q: I have a WaMu credit card with a low interest rate. Will that change?

A: Over time, McBride says, JPMorgan Chase probably will streamline some of its products with WaMu products, and terms of WaMu credit cards could change. "But that's not going to happen overnight," he says.

Q: What about my WaMu mortgage?

A: All WaMu mortgages and other loans have been acquired by JPMorgan Chase. The terms of your mortgage won't change, so continue to make your monthly payment by the due date.

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NEWS
Distasteful as bailouts are, the alternative is worse

484 words
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English

After the bailout of American International Group on the heels of Fannie Mae, Freddie Mac and Bear Stearns, many Americans are no doubt wondering why the government appears to be coming to the aid of fat cats who mismanaged large corporations. Some economists ask a related question of whether it would be better to let these companies fail to send a message to future managers that they had better be prudent.

To those who would like to see more punishment and less help meted out by Washington, we say: Be careful what you wish for.

Executives who won fat bonuses by behaving in colossally stupid ways, investing in junk mortgages and willfully ignoring risks, deserve neither help nor sympathy. But that is not the point.

Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson are not in charge of law enforcement, ideological purity or consistency. Nor should they pass judgment on the few in ways that could harm the many. Their job is to prevent a dramatic drop in lending, which would threaten the entire economy.

Failure of the Fed to act as a lender of last resort in the early 1930s is widely seen as one reason that the stock market crash of 1929 became the Great Depression of the 1930s. Bernanke is a student of the Depression and knows full well how important it is to keep the financial system operating.

By that measure, these bailouts are cheap. In fact, some, most notably the loan of $85 billion to AIG in return for taxpayer ownership of much of the company, might turn a profit. Even if not, they are a worthwhile investment to keep the economy from going into free-fall.

Many critics of bailouts talk of generating "moral hazard" -- the danger of people and institutions acting in reckless ways because they believe they are shielded from risk (including from potential government rescues).

Moral hazard is real. It can be seen in areas as diverse as the 1980s' savings-and-loan crisis to the rash of development on hurricane-prone coastlines. But it's hard to see how Lehman Bros.' bankruptcy filing, and the near total losses to shareholders of the four rescued companies, invite moral hazard.

The government's fault here is not in helping companies through a crisis, but rather that it let the crisis develop in the first place. The institutions that are failing have been operating outside the regulatory rules devised in the Depression. So far, most institutions covered by the rules -- tightened after the savings- and-loan debacle -- appear to be less at risk.

Washington needs to fix its outdated regulations. It needs to regard bailouts as a last resort. For now, though, its job is simply to keep the financial system running -- not for the financiers but for everyone else.

PHOTO, B/W, Mark Lennihan, AP

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NEWS

Markets in turmoil ; Investment firms' fall sends Dow down 500, forcing mergers and shaking confidence *Is your money safe? See 3 pages in Money

John Waggoner
1,729 words
16 September 2008
USA Today
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FINAL
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Lehman Bros. Merrill Lynch. Fannie Mae. Freddie Mac. Countrywide Financial. Bear Stearns.

In staggering succession, some of Wall Street's oldest and biggest firms have been seized, failed outright or merged into other companies.

"It's the worst news out of Wall Street since I've been alive," says Steve Romick, manager of FPA Crescent fund.

The credit crunch, which began in the real estate market, has emerged as a full-blown financial crisis threatening the global credit markets. Thanks partly to nimble emergency moves by the U.S. government, the financial system has avoided a full-scale collapse. There is widespread concern, however, that other financial institutions could be brought down by the sliding home mortgage market.

In the short term, it will be harder for people with shaky credit to get loans, particularly mortgages. And if you're investing in stocks for retirement, your savings have shrunk by 20% or more in the past 12 months. For most others -- even those invested in brokerage accounts at Lehman or Merrill -- the developments are likely to have little immediate effect because of government safeguards that protect individual investors with up to $500,000 in their accounts.

On Wall Street, though, the hurt runs deep and broad. Two Wall Street icons are about to vanish as independent companies. Lehman Bros., which began 158 years ago as Alabama cotton traders, filed for bankruptcy protection. And Merrill Lynch, whose bull mascot has been Wall Street's iconic symbol of optimism since 1970, agreed to be absorbed by Bank of America.

"It took my breath away," says Jim Dunigan of PNC Wealth Management. "I don't think anyone would have come up with that scenario."

The stock market, still reeling from the government takeover of mortgage giants Fannie Mae and Freddie Mac, plunged Monday.

The Dow Jones industrial average sank 504 points, or 4.4%, to 10,918 in the biggest point drop since Sept. 17, 2001, the day stock trading resumed after the Sept.11 attacks. Monday's sell-off wiped out $700 billion in shareholder wealth.

As bloody as Monday's market trading was, the carnage was less than some had expected. "It wasn't pretty, but it wasn't a catastrophe," says Bill Gross, manager at the Pimco mutual funds.

Even so, the danger isn't over. Analysts say too many companies have borrowed too much to buy high-risk assets -- mainly securities backed by subprime mortgages, which are loans made to borrowers with poor credit.

Now, companies that own those securities must write off their losses and raise fresh cash. That means fewer consumer loans and stricter loan standards, says Hugh Johnson of Johnson Illington Advisors.

More cautious lending

The unfolding financial crisis means that banks -- those that do not fail -- likely will become much more cautious about how much they lend, and to whom, than they were from 2004 to 2007. "It's back to basics," Johnson says.

The stock market was spared an even steeper fall Monday because the government had moved to make sure Lehman's collapse didn't spark the immediate failures of dozens of other financial institutions.

It was a vital step. Lehman is an investment bank. Unlike a traditional bank, which makes loans, an investment bank arranges financing for commercial banks, companies, cities and states. Should a city, say, need to issue bonds for a new bridge, an investment bank will arrange the terms of the financing and sell the bonds to interested investors.

But Lehman also arranged many other types of financing, including debt backed by subprime mortgages and complex financial arrangements called derivatives. On a given day, many of those notes come due or are renewed. The government assured those who might have trouble with their Lehman trades that they could receive short-term loans until matters can be sorted out.

To make sure that companies weren't caught short, the Federal Reserve made it easier for troubled institutions to raise cash. Meanwhile, a group of 10 major banks cobbled together a $70 billion emergency loan pool.

The crisis could spread. American International Group (AIG), an insurance giant, is scrambling to raise cash. Shares of Washington Mutual, the nation's largest savings and loan, have plunged more than 90% during the past 12 months. Both have been damaged by heavy subprime mortgage holdings.

Before they can resume normal operations, the companies must sell off their bad holdings and raise more money. "Until some entity with a checkbook steps up to buy those assets, instead of the government financing them, then we have a problem," Pimco's Gross says.

That will be difficult. For one thing, AIG and Washington Mutual are only the most visible companies trying to raise capital and sell problem investments. Other large holders, such as hedge funds and sovereign wealth funds, are scrambling to unload such securities, too.

But few investors want to buy subprime-mortgage-backed securities. And those who are willing to do so will buy them for just pennies on the dollar. So not only are those troubled securities nearly impossible to sell, they're worth far less than their holders would like.

"They're marked to the low-ball bid," says Ron Muhlenkamp, portfolio manager of the Muhlenkamp fund. So even if the institutions don't sell their holdings, the assets they count as capital have been marked down drastically. That, in turn, reduces the institutions' ability to operate.

Financial institutions seldom suffer alone. When banks take losses, or fail entirely, fewer loans are available for homes and businesses. A $1 billion loss at a major bank could mean that as much as $10 billion is no longer available to lend, says FPA's Romick. (Bank loans are often deposited in other banks, giving those banks the ability to borrow more.)

Fewer loans mean companies will have less money to borrow to expand. That could spell further weakness in the economy.

For financial services companies, even a best-case scenario could mean huge stock losses. When a company raises fresh capital, it dilutes the value of existing shares. And many financial services companies need capital.

Politicians and market participants are calling for reforms. Some argue that accounting rules are forcing banks to mark down their holdings too sharply.

"Real estate in a lot of areas is down 20% to 25%, but banks are being forced to mark down their portfolios 60% to 70%," says former FDIC chairman William Isaac. Those sharp markdowns severely limit the amounts banks can lend, making an already sluggish economy even weaker.

"Someone has to stop this nonsense," Isaac says.

Others worry that offering too much aid to failing institutions encourages reckless behavior, a type of risk called "moral hazard." That's one reason the government didn't bail out Lehman Bros., as it did Bear Stearns. Federal officials decided that giving government backing to two major investment banks would be worse, in the long run, than doing so for just one.

"Moral hazard is something I don't take lightly," Treasury Secretary Henry Paulson said Monday.

But Jon Faust, director of the Center for Financial Economics at Johns Hopkins University in Baltimore, says people shouldn't read Lehman's trip to bankruptcy protection as a sign that the Fed won't ever step in again to prevent an investment bank's failure.

So far, at least, investors aren't panicking. Calls to the Vanguard Group, the big mutual fund company, "surged at the beginning of the trading day and subsequently subsided," says spokesman John Woerth. There was no increase in stock fund redemptions, he says.

"We're stressing that the fundamental benefit of a mutual fund is that you're broadly diversified," Woerth says.

Vanguard Total Stock Market Index, Vanguard's largest fund, has only 0.02% of its assets in Lehman stock and 0.19% of its assets in Merrill Lynch, Woerth says.

T. Rowe Price also saw a jump in calls from investors Monday morning, but by afternoon, "It had leveled off a bit," says spokeswoman Heather McDonold.

"Investors are more inquisitive than jittery," she says. T. Rowe doesn't disclose information about fund redemptions.

If you're an investor, taking a few steps can help you weather the storm. Try to pay off any high-interest loans. Repaying a credit card with a 19% interest rate is equivalent to earning 19% on an investment.

If you don't have an emergency fund, start one. Ideally, you should have enough in the bank to pay at least three months' worth of bills. If you're laid off, you'll need your emergency fund to tide you over while you're looking for a new job.

FPA's Romick remains cautious about investing in stocks in general and financial stocks in particular. The Standard & Poor's 500-stock index is down about 20% from its October peak (assuming dividends were reinvested), Romick says.

These are no ordinary times, he says. When banks and investment banks fail because they borrowed too much to buy bad assets, "It doesn't end with the market being down just 20%."

A silver lining?

Optimists point out that the recent failures can be a positive because the financial system finally will measure the size of its problems and work to fix them, says Jonathan Merriman, CEO of investment bank Merriman Curhan Ford.

"You're talking about the guys with the most exposure to the toxic paper," he says. "You're coming to the end of the list."

The fact that Bank of America is willing to buy Merrill Lynch in what seems to be the depth of the turmoil shows that at least one bank sees a recovery coming, says Keith Stock, CEO of investment management firm First Financial Investors.

Portfolio manager Muhlenkamp is anxious about the economy and the market but is fairly sanguine. "Have we been there before? Yes," Muhlenkamp says. "Is the flavor different? Yes. Will we survive? Yes."

Contributing: Sandra Block, Sue Kirchhoff, Matt Krantz and Barbara Hagenbaugh

GRAPHIC, Keith Simmons, USA TODAY, Source: CSI (Bar graph); GRAPHIC, B/W, Alejandro Gonzalez, USA TODAY, Sources: BankruptcyData.com, Bloomberg (Bar graph); PHOTO, Color, David Karp, AP; PHOTO, B/W, Joshua Lott, Reuters

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NEWS
Herd mentality leads Wall Street off a cliff

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What's the difference between the collapse of companies such as Enron and WorldCom and the failure of venerable Wall Street institutions such as Bear Stearns and, now, Lehman Bros.?

From the perspective of a wiped-out shareholder or laid-off employee, the answer is: Not very much. One total (or near-total) loss brought on by bad management is pretty much the same as another, regardless of whether people go to prison. Like the con artists who ran Enron and WorldCom, today's humbled Wall Street bosses vastly overstated their companies' prospects and understated their risks.

The key difference is that the former group was aware of the deceptions, accomplished through accounting tricks. The latter group appears to have been more clueless than venal. In their quest for ever-higher profits and bonuses, the executives violated the first rule of investing, which is to know what you're getting into.

Perhaps it's time to reconsider the "greed is good" sentiment of the 1987 movie Wall Street, which has served as a mantra for the unfettered capitalism, financial market deregulation and bull markets of the past quarter-century or so.

Greed has its uses. But more recently it has blinded and deceived. It has caused smart people to behave in stupid and destructive ways, to put their companies at risk and to jeopardize the national and world economies in the process.

Wall Street chieftains -- at Bear Stearns, Lehman, Merrill Lynch and elsewhere -- acted this way because, for a while it least, it would confirm their status as financial geniuses and justify their big compensation. (Lehman CEO Richard Fuld collected a $35 million bonus last year, part of a $9.5 billion bonus bonanza for Lehman staff. Stanley O'Neal, who presided over much of Merrill's demise, was paid $161 million last year when he was forced out.) And they did it because no one in Washington said they couldn't.

They poured money into portfolios of dubious loans, ensuring the housing collapse that is at the root of today's problems. They borrowed massively to boost their profits. And they invented an endless series of risky new financial instruments that supposedly mitigated their risk but did more to hide it. Five years ago, no less a figure than Berkshire Hathaway Chairman Warren Buffett called derivatives "financial weapons of mass destruction." Now, those weapons are exploding.

The urgent need, obviously, is to contain the damage. More companies will fail, but to protect the public that must happen in a slow, orderly way. Longer term, the regulatory structure over financial institutions has to be overhauled.

Treasury Secretary Henry Paulson, who outlined a plan in March, said as much Monday as he tried to reassure a nation shaken by the bankruptcy filing of 158-year-old Lehman, the shotgun sale of Merrill to Bank of America and a cash crunch at American International Group, the nation's largest insurer.

It makes little sense to have traditional banks under state and federal regulations designed to prevent the worst excesses and then permit an alternative and unregulated universe on Wall Street.

Whether this week's roiling economic rapids will lead to a waterfall or to calmer waters ahead remains unclear. The Dow Jones industrial average dropped 504 points Monday -- a bad day, to be sure, but not as awful as some had expected given the magnitude of the upheaval. The scariest part is that no one seems to know the full extent of the financial toxic waste, or how far it has spread. People know only that there is more.

The lesson of Wall Street's meltdown is that the financial services industry needs more transparency, oversight and accountability. Even more, it needs leaders who demonstrate less greed and more prudence and humility.

TEXT OF INFO BOX BEGINS HERE

Lehman Bros.' Chapter 11 is by far the largest corporate bankruptcy case in U.S. history. The top 15 and their assets before filing for protection (in billions):

* Lehman (2008): $639

* WorldCom (2002): $103.9

* Enron (2001): $63.4

* Conseco (2002): $61.4

* Texaco (1987): $35.9

* Financial Corp. of America (1988): $33.9

* Refco (2005): $33.3

* Global Crossing (2002): $30.2

* Pacific Gas & Electric (2001): $29.8

* United Airlines (2002): $25.2

* Delta Air Lines (2005): $21.8

* Adelphia Communications (2002): $21.5

* Mcorp (1989): $20.2

* Mirant (2003): $19.4

* Delphi (2005): $16.6

Sources: The Associated Press; New Generation Research Inc.

PHOTO, B/W, Jin Lee, AP

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MONEY
Treasury's Paulson says future bailouts aren't off the table

Sue Kirchhoff; Barbara Hagenbaugh
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WASHINGTON -- U.S. Treasury Secretary Henry Paulson said Monday that he "never once considered" using taxpayer dollars to bail out investment bank Lehman Bros. but emphasized he'll act as needed to protect the economy.

Paulson commented at a White House press briefing after Lehman filed for protection from creditors in bankruptcy court. That action followed a series of weekend meetings in which no taxpayer-backed plan emerged for saving Lehman.

"Don't read (this weekend) as no more (support from the government). Read it as that it's important ... for us to maintain the stability and orderliness of our financial system," Paulson said.

The move over the weekend to let Lehman fail was a sharp break from recent, dramatic market interventions, including the federal takeover of mortgage giants Fannie Mae and Freddie Mac and a $30 billion Federal Reserve loan for the March sale of troubled investment bank Bear Stearns.

Federal Reserve Chairman Ben Bernanke has been among those worrying that the efforts, though justified, encourage firms to take undue risks. "Lehman seemed the appropriate place to draw the line," says Vincent Reinhart, former director of the division of monetary affairs at the Fed.

Unlike Bear Stearns, Lehman had been rumored to be struggling for months, meaning its fall was less likely to spark a financial panic. And Lehman has had access to funds from the Fed under a lending program set up after the sale of Bear.

The Fed and Treasury will likely be tested again, given the line of companies in financial straits, from insurer American International Group to savings-and-loan Washington Mutual.

Jon Faust, a former Fed economist now at Johns Hopkins University, says what happened this weekend doesn't mean the Fed won't step in again. "They don't want to bail out somebody if they don't have to." But, "If something came up today that they thought threatened the stability of the financial system as much as Bear Stearns did, I would think they would make a similar decision."

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NEWS
Carmakers seek cheap loans from Bank of Uncle Sam

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The federal government has swooped in to rescue Bear Stearns, Fannie Mae and Freddie Mac. Over the weekend, regulators were busy trying to broker an acquisition -- without taxpayers' money -- of Lehman Brothers, the troubled investment bank.

So it's hardly surprising that other industries might start making me-too arguments. First in line are automakers. They're in Washington, hubcap in hand, seeking $25 billion to $50 billion in loan guarantees.

The case for such a move is unconvincing, premature and has more to do with politics than economics.

The loan guarantees are designed to aid the Big Three -- Ford, General Motors and Chrysler -- which are in much worse shape than the likes of Honda and BMW. Detroit's predicament stems from decades of bad decisions, ranging from excessive benefits packages to over- reliance on gas-guzzling large pickups and SUVs.

The foreign-based carmakers, which build many of the cars for the U.S. market here in America, have largely avoided these mistakes. Their U.S. employees should not be put at a disadvantage because the government has decided to aid their competitors.

At the very least, for both practical and political reasons, any decision should be put off until next year.

Practically speaking, none of the Big Three is facing imminent demise. At the end of June, they had combined cash reserves of $60 billion. Industry analysts say Chrysler is in the worst shape but would not likely be forced into crisis management mode until some time next year. Ford and GM are in a better position to weather the storm and perhaps even turn a profit in 2010.

Politically, the move to rush through a bailout now is a cynical ploy to use the presidential election to mute opposition. Defenders of limited government and free markets are fearful that vigorous opposition would doom John McCain's chances in battleground states such as Michigan and Ohio.

The carmakers say taxpayer backing would help them borrow money more cheaply to retool their factories to produce more fuel- efficient cars. That might be true. But any industry could make a case for all the nifty things it could do with government help.

Government bailouts should be a last resort, used only when a business collapse threatens the public in general, not just the companies in question. The failure of Fannie Mae and Freddie Mac, for instance, could have been a crushing blow to the already reeling housing market.

In contrast, the economy has survived bankruptcies of companies such as Enron, WorldCom and numerous airlines. It survived the collapse of steel companies, whose predicament was very similar to that of auto companies today.

Failure of a top U.S. automaker would no doubt be painful to workers and shareholders and could leave the government with large pension liabilities. Even so, presidential campaign season is no time to make hasty decisions that would tilt the competitive playing field and expose U.S. taxpayers to billions of dollars in new risks.

GRAPHIC, B/W, Adrienne Lewis, USA TODAY, Source: Company reports
(Chart)

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MONEY

No white knight emerges to rescue Lehman Bros. ; Intense negotiations end on sour note as feds refuse to offer Bear Stearns-like help

Adam Shell, Matt Krantz, Sue Kirchhoff, John Waggoner, Kathy Chu
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NEW YORK -- Six months of pent-up anxiety over the fate of the financial system exploded into chaos on Wall Street this weekend, as the deepening credit crunch threatened to put a second major Wall Street firm out of business and had top government officials and bankers scrambling to avert a more serious crisis.

It was a wild weekend, full of intense negotiations at the offices of the Federal Reserve Bank of New York, one that drove home just how difficult it will be for the nation's banks and financial institutions to return to health.

The weekend ended on a sour note: Lehman Bros., one of Wall Street's oldest and most-storied investment banks that had run into trouble by investing too riskily in real estate, failed to strike a deal with a number of potential bidders.

Barclays, Britain's third-biggest bank, was the last of the potential white knights to nix a deal. Reports by Bloomberg News and others said Sunday night that Lehman was preparing to file for bankruptcy protection.

The failure to get a Lehman deal was due largely to the federal government's refusal to provide interested buyers such as Barclays with the kind of support that JPMorgan Chase received when it bought troubled investment bank Bear Stearns.

In that controversial deal, the Fed extended what amounted to a $30 billion loan to JPMorgan that reduced some of the risk. This time, the Fed put none of taxpayers' money on the line.

Also Sunday, several news organizations reported Bank of America was in talks to acquire Merrill Lynch, the nation's third-biggest investment bank, which has been facing questions about its survival as well.

Plus, insurance giant AIG was reported by Bloomberg News to be seeking capital from buyout firms Kohlberg Kravis Roberts and J.C. Flowers. Bloomberg cited an unnamed source. Shares of both Merrill and AIG tumbled Friday as investors speculated on the next potential victims of the spreading credit crunch.

USA TODAY was unable to independently confirm either report.

"We are in a hysteria," says Richard Bove, banking analyst at Ladenburg Thalmann.

And that hysteria is creating concerns that today's market action may be turbulent.

The simple fact that the Lehman rescue didn't occur "will send shivers down the spines of investors," says Jack Ablin, chief investment officer of Harris Private Bank.

How severe is the crisis? Former Federal Reserve chairman Alan Greenspan, appearing on This Week with George Stephanopoulos, said: "It's a once-in-a-century type of financial crisis." Greenspan said he expects other financial institutions to fail.

Weekend negotiations

The attempted rescue plan for Lehman -- along with wider discussions with many banking leaders about shoring up the financial system -- was debated in New York over the weekend in high-level meetings that began Friday and included top government officials from the Federal Reserve, Treasury and the Securities and Exchange Commission, as well as top executives from all of Wall Street's top investment banks.

The biggest stumbling block was the government's reluctance to contribute financially to a rescue package. Potential suitors wanted the government to protect them against potential losses surrounding Lehman's so-called bad bank assets. These assets include toxic real estate securities, which have a face value of about $77 billion, and about $53 billion if write-offs are taken into account.

Buyers were comfortable with buying Lehman's so-called good assets, such as its investment management division and equities business.

Questions about Lehman's ability to survive have been swirling ever since a bank run on Bear Stearns led to its demise and government-engineered shotgun marriage to JPMorgan Chase in mid- March. Lehman was deemed vulnerable because it was the smallest of the major investment banks still standing and because it had massive investments in troubled real estate and mortgage-related securities.

Lehman's hopes of remaining independent were squashed last week when talks with a sovereign wealth fund from South Korea, which was considering injecting much-needed capital into Lehman, broke down.

Lehman's hopes were dashed for good when Wall Street gave a thumbs down to a plan the firm rolled out Wednesday to try to fix its problems. The plan, which investors thought was too late, included selling a majority stake in its asset management division, slashing its dividends and spinning off toxic real estate assets.

Lehman's troubles morphed into a crisis late last week due in large part to the sharp decline of its stock price and a sharp increase in its borrowing costs.

The stock plunged 77% last week to $3.65, and its borrowing costs ballooned to 8 full percentage points above a comparable government bond. The combination of higher costs to access capital, coupled with the loss of collateral value of its stock, put Lehman in a vulnerable position.

Investors are also afraid Lehman would announce bigger losses in the quarters ahead, beyond the nearly $7 billion in write-downs it's suffered the past two quarters.

"It was a run on confidence," says Chris Whalen, managing director at Institutional Risk Analytics.

Whalen says Lehman is now being hurt by fears that other financial companies will cease doing business with it.

The endgame for Lehman comes after a turbulent week on Wall Street, where the spotlight on troubled financial firms spread to a wider number of players. Jittery investors fear that the steep stock price declines in the firms could make it more difficult for them to raise capital.

It also follows on the heels of the Treasury Department's historic seizure last week of the nation's two mortgage giants, Freddie Mac and Fannie Mae. Both were reeling from bad housing investments caused by falling home prices and failed mortgages.

In that bailout, the Treasury Department committed to injecting up to $200 billion into the financially troubled giants in an effort to help stabilize the sagging real estate market. The government's plan is designed to help keep the cash spigot open for mortgages and push mortgage rates lower.

Despite massive government intervention over the past six months, fears of credit problems infecting the broader financial system are still palpable.

Wall Street is still having problems valuing toxic real estate assets, which makes big investors leery of putting more capital at risk and investing in troubled financial companies.

Financial institutions around the globe have already booked losses totaling more than $473 billion, according to Bespoke Investment Group. And while they have been able to raise more than $350 billion to offset those losses, it is getting more and more difficult for battered institutions to raise much-needed cash, notes Paul Hickey of Bespoke.

The government's decision not to put taxpayer money at risk is a departure from its prior interventions in the crisis. Debate has been raging on Wall Street as to which institutions are "too big too fail."

But in the case of Lehman, Treasury Secretary Henry Paulson has made it clear that the government does not want to use taxpayer money to rescue the firm.

Unlike in the case of Bear Stearns, the market has had ample time to prepare for troubles at Lehman. What's more, unlike Bear, Lehman has direct access to short-term funds from the Fed. When it announced the Bear deal, the Fed also created a special facility that enables investment banks for the first time to access the Fed's cash for short-term needs.

Fallout and confidence

Many critics of early government bailouts say it would be a mistake for the government to send the message that it will bail out everyone. Anthony Sabino, a law and business professor at St. Johns University, says the bailouts must stop. "The government is keeping the free in free markets," he says. "And free means free to succeed and free to fail.

"If you bail out Lehman, then you have to bail out everyone. Who's next? Does it go beyond the next financial institution? The automakers? Do you bail out Wendy's because it's not selling more burgers than Burger King?"

Critics of CEO Richard Fuld's strategy to save Lehman say he waited too long to strike a deal with a deep-pocketed suitor.

Because Lehman's banking business is geared mainly to institutional investors and not mom-and-pop investors depositing money in the bank, its fallout on Main Street is likely to be more of a confidence issue.

But the messier the company's death, the greater the effect it will have on Wall Street and Main Street.

What worries federal authorities is not the collapse of Lehman, but the effects of its possible demise on the rest of the financial system.

"They're worried about the daisy chain," says Seattle money manager William Fleckenstein. "They're worried about the problems that Lehman might create for someone who did business with Lehman."

One type of ordinary American it does affect is Lehman's roughly 25,000 employees. They got a sizable chunk of their compensation in Lehman stock. Employees reportedly own up to 25% of the shares, which on Friday closed 95% off their 52-week high. That means employees have suffered losses of $11 billion since Nov. 14, when shares traded at $67.73, their highest level in the past year.

Shell and Chu reported from New York, Kirchhoff from Washington, and Waggoner from Northern Virginia.

Contributing: Barbara Hagenbaugh in Washington

TEXT OF INFO BOXES BEGINS HERE

Key events

March 16: JPMorgan Chase announces it is buying Bear Stearns in a deal supported by the Federal Reserve.

March 18: Lehman reports $489 million in net income for its first fiscal quarter. "Our results reflect the value of our continued commitment to building a diversified platform and our focus on managing risk," says CEO Richard Fuld.

June 12: Lehman ousts CFO Erin Callan, four days after announcing it would report a $2.8 billion loss for the prior quarter.

Sept. 7: Federal takeover announced of Fannie Mae and Freddie Mac, the nation's largest buyers of mortgage loans.

Sept. 10: Lehman announces an expected loss of $3.9 billion in the quarter ended in August. Outlines plan to raise capital by selling its asset-management business, slashing its dividend and selling commercial mortgage holdings.

Sources: Company reports, FirstAmerican Loan Performance, USA TODAY research

Largest U.S. investment banks

Lehman's market capitalization slipped to sixth-largest based on Friday's stock prices.

Company Stock price

Friday

YTD change Market cap. (in billions)

Latest 12 mos.

total revenue

(in billions)

Goldman Sachs $154.21 -28.3% $60.7 $40.8

Morgan Stanley $37.23 -29.9% $41.3 $22.3

Merrill Lynch $17.05 -68.3% $26.1 NA

Raymond James $31.16 -4.6% $3.7 $2.8

Jefferies Group $17.23 -25.3% $2.8 $1.3

Lehman Bros. $3.65 -94.4% $2.5 $4.3

Source: Standard & Poor'sCapital IQ

Wall Street losses

Write-downs and losses, and capital raised, by leading banks and securities firms since the mortgage-financing crisis began a year ago, in billions:

Firm Write-down & loss Capital raised

Citigroup $55.1 $49.0

Merrill Lynch $52.2 $29.9

UBS $44.2 $27.1

HSBC $27.4 $5.1

Wachovia $22.7 $11.0

Bank of America $21.2 $20.7

Washington Mutual $14.8 $12.1

Morgan Stanley $14.4 $5.6

IKB Deutsche Industriebank $14.4 $11.8

JPMorgan Chase $14.3 $9.5

Lehman Bros. $13.8 $13.9

Source: Bloomberg News

About Lehman Bros.

Lehman's key business segments and gross revenue for the fiscal year ended November 2007 (in billions).

Capital markets: $51.9

Fixed income: Includes municipal bonds and mortgagerelated securities

Investment banking: $3.9

Advises and raises capital for corporations and governments worldwide.

Investment management: $3.2

Private investment management: Provides advice and trades for wealthy individuals and companies.

Asset management: For individuals and institutions.

Private equity: Privately negotiated transactions

Source: Lehman Bros.

PHOTO, Color, Chris Hondros, Getty Images; GRAPHIC, B/W, Alejandro Gonzalez (line graph); GRAPHIC, B/W, Robert W. Ahrens (pie chart)

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MONEY
Markets need more regulation, Fed told ; Economists study issues at annual conference

Sue Kirchhoff
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JACKSON HOLE, Wyo. -- Financial markets need to be more tightly regulated to prevent financial crises and quash perceptions that some firms are too big to fail and will be rescued by the government, central bankers and economists suggested at the Federal Reserve's annual policy conference.

Major changes are probably years away. In the meantime, as Fed Chairman Ben Bernanke noted, businesses and consumers are feeling the impact of the current financial crunch as economic growth softens and unemployment rises. The Treasury Department faces a possible bailout of mortgage giants Fannie Mae and Freddie Mac, and the Fed is continuing emergency lending to strapped banks.

"The crystal ball at this stage is unusually unclear, given that we are a year into this (financial) crisis," Stanley Fischer, governor of the Israeli central bank, said in closing remarks Saturday.

Policymakers tried to do several things at the conference, which focused on financial stability. One was to get a better understanding of the specific factors that caused credit markets worldwide to seize up a year ago as the U.S. housing market, and mortgage-backed bonds, started to sour.

Another was to examine the impact of central bank actions since the crisis began. The Fed has cut a key interest rate to 2% from 5.25% to bolster the economy, made a $30 billion loan to aid the sale of investment bank Bear Stearns to JPMorgan Chase and created special lending facilities.

The conference also looked at proposals for reform, including Bernanke's suggestion that the Fed take a broader, systemwide approach. Another plan by University of Chicago economist Raghuram Rajan and others would create a special insurance fund for banks that would be triggered at times of systemic distress, infusing capital to lenders.

Debate was sometimes heated.

Willem Buiter, a professor at the London School of Economics, argued that the Fed had been a sort of bumbling giant during the crisis, too eager to bend to the desires of Wall Street. In a thick paper, Buiter also suggested the USA needed an economic downturn to clear the financial toxins out of its system and get back on a stable footing.

"The Fed listens to Wall Street and believes what it hears," Buiter argued. Fed actions, including the Bear Stearns intervention, have sent the wrong signal to the markets and in the process the "likelihood and severity of future crises have been heightened ... we shall pay the price for that."

Other economists countered that the Fed moves had been essential in stabilizing markets and preventing broader financial distress. Princeton economist Alan Blinder called the Fed's performance "pretty good" given the circumstances.

Bernanke acknowledged that Fed emergency actions posed long-term risks, citing the Bear Stearns episode as a reason for tighter regulation. Without tighter oversight, the markets could conclude that the government will bail out more institutions "possibly resulting in excessive risk-taking and yet greater systemic risk in the future."

Harvard economist Martin Feldstein said the economy was sliding toward a recession and that federal tax stimulus checks hadn't provided much boost. Columbia University professor Charles Calomaris argued that the economic threat of falling home prices had been overstated and the Fed should concentrate on tackling inflation.

PHOTO, B/W, Bradly J. Boner, Reuters
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MONEY
Mortgage losses at JPMorgan hit stocks

Greg Farrell
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NEW YORK -- Two days of hopeful news for the USA's embattled financial industry evaporated Tuesday after JPMorgan Chase announced reduced earnings for the second quarter and warned that it had already taken $1.5 billion in mortgage-related losses so far in the third quarter.

The disclosures sent its stock down $3.97, or 9.5%, to $37.92.

The news also weighed heavily on other financial stocks, which had benefited from a recent drop in oil prices and resurgence in the U.S. dollar.

Goldman Sachs, which, like JPMorgan, had avoided much of the mortgage-related carnage of 2007, was caught in the downdraft, falling $10.70, or 6.0%, to $167.30.

Goldman's drop was spurred in part by negative reports from analyst ratings. Deutsche Bank downgraded Goldman because the firm's exposure to stocks at a time when stock prices were slumping would likely result in lower-than-expected earnings for the third quarter.

Shares in Lehman Bros., Merrill Lynch and Citigroup fell, while a $5.1 billion write-down from Switzerland's UBS also contributed to the rout.

But JPMorgan's surprise seemed to be the primary cause for the weakness in bank stocks. For the second quarter, the bank announced net income of $2.0 billion, down from its first-quarter earnings and less than half of the $4.2 billion it earned in the second quarter of 2007.

And in a discussion of the outlook for the next year, JPMorgan disclosed that less than halfway through the third quarter, it had already incurred $1.5 billion in losses related to investments in mortgage-backed securities (MBS). During the entire second quarter, MBS accounted for only $1.1 billion in losses.

Richard Bove, analyst at Ladenburg Thalmann, says the "basic concept of the company had broken down."

Bove recalls that when JPMorgan acquired Bank One several years ago, the goal was to create a financial services company that could thrive when the capital markets were strong, which leads to increased earnings in investment banking and related areas, or when consumer markets were strong. The problem today, Bove says, is that both sectors are weak.

David Beim of Columbia Business School says the banking sector's problems are rooted in the weak economy. "We have come to the bottom," he says. "The downturn in the real economy due to lack of consumer demand has yet to be absorbed by the markets and fully realized," he says.

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MONEY

Why the crisis of confidence? ; Big worries surround mortgage giants Fannie Mae, Freddie Mac,

John Waggoner, Sue Kirchhoff and Anna Bahney
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Just a decade ago, mortgage packagers Fannie Mae and Freddie Mac were the gold-plated giants of the home loan industry. Their stocks soared, and no blue-chip portfolio was complete without them.

Now, in the clearest sign yet of the nation's deep financial troubles, investors fear that Fannie Mae and Freddie Mac -- which exist to keep the mortgage market running smoothly -- are sinking into the same credit crisis that claimed the corporate lives of Countrywide Financial, Bear Stearns and dozens of other institutions.

The latest victim: IndyMac Bank, which regulators closed late last week in one of the largest bank failures in U.S. history.

And Sunday, the Treasury and the Federal Reserve announced extraordinary support for the beleaguered mortgage giants, an indication of how troubling their collapse would be.

"These are very perilous times -- more serious than the events leading up to the collapse of Bear Stearns," says Henry Kaufman, former chief economist at Goldman Sachs. "It's unfortunate for the economy and for the financial institutions that finance housing, business and other activities."

As speculators bet on whether Fannie or Freddie will survive, regulators are planning for the worst: the need for an emergency infusion of capital or perhaps an outright takeover of the two government-sponsored companies -- at taxpayers' expense.

Whatever the outcome, fateful questions remain: Why has there been such a loss of faith in the mortgage system, and how can it be restored?

Shares of the two companies endured a bloodbath last week on Wall Street. Fannie Mae's stock closed at $10.25 Friday, plunging 22% from Thursday and about 80% from a year earlier. Freddie Mac's stock sank 3.3%, to $7.75, Friday.

It was a savage week for two of Wall Street's former darlings. Investors feared that both companies had too little money to cover their monumental losses. Fannie Mae lost $2.2 billion in the first three months of 2008; Freddie Mac lost $151 million.

On Wall Street, though, investors worry even more about future losses. And they still have plenty to fear. The big unknown is this: Do Freddie and Fannie have enough capital -- money available -- to withstand the losses they face or to continue to buy mortgages from banks in the same huge volume?

No one is sure of the answer. Fannie and Freddie combined have about $81 billion in capital -- enough to cover only 1.6% of the mortgages they insure. And if there are doubts about Fannie and Freddie's ability to guarantee their mortgage-backed securities, says Paul Kasriel, chief economist for Northern Trust, then there are also questions about companies that hold Fannie and Freddie's mortgage-backed securities as assets on their books.

Fannie Mae and Freddie Mac serve a vital role: They buy mortgages from banks, reselling many of them with the guarantee that those who buy these loans will be repaid. In return, banks receive a fresh supply of money to make more loans. Fannie and Freddie ensure that the mortgage market can function properly.

Both companies maintain fairly stringent requirements for the mortgages they buy. They don't touch subprime mortgages or many of the exotic types of loans that helped fuel the real estate bubble. But as the mortgage market has soured, even prime borrowers -- the kinds of borrowers whose loans Fannie and Freddie guarantee -- have begun to default.

In packaging the loans they buy, Freddie and Fannie create mortgage-backed securities. Institutional investors like these securities because they pay higher yields than Treasury securities do. And because Fannie and Freddie guarantee timely interest and principal, investors in mortgage-backed securities know they'll be paid even if borrowers default.

As long as the housing market soared in the first part of the decade, so did Fannie and Freddie. Demand for mortgages -- and mortgage-backed securities -- surged. And the companies churned out ever-higher earnings. It seemed as though Fannie and Freddie enjoyed a near-perfect business model -- one bolstered by the widespread faith that the government wouldn't let them fail.

From the end of 1990 until the end of 2003, the combined portfolios of Fannie Mae and Freddie Mac catapulted from $135 billion to $1.56 trillion, according to the Federal Reserve. Together, the two companies issued nearly $3 trillion in debt.

Once the housing market deteriorated, though, Fannie and Freddie ran smack into two problems. First, demand for mortgages slowed, which meant that the companies' earnings sputtered, too. More ominously, mortgage defaults began to mount, eating into the two companies' capital.

Both companies insist they have enough capital to cover their losses. So does the Office of Federal Housing Enterprise Oversight, which regulates them. But what would happen if Fannie or Freddie were to run out of capital?

"Fannie and Freddie are too important to fail," Sen. Charles Schumer, D-N.Y., said last week. "The market's over-reaction over the past few days is more based on psychology than reality."

Still, many suspect that the government will have to take some bold steps to shore up Freddie and Fannie. "I think there is going to have to be some government intervention with Fannie and Freddie," says Chris Mayer, a professor of real estate at Columbia Business School. "I don't see how we could avoid that."

Rumors of various bailout schemes have swirled around Wall Street, adding to the volatility in the companies' shares and the market.

At one point Friday, the stock market rallied sharply on rumors that the Fed would let Fannie and Freddie borrow at the Fed's discount window -- lender of last resort for troubled banks. Friday, the Fed said it had had no discussions with either company about using the discount window. Sunday it said it will lend to them if necessary, although it considers its role as a backstop to Treasury.

Other suggestions range from an outright takeover of Fannie and Freddie by the government to plans to raise more capital through stock offerings or from private investors.

The Senate on Friday passed the latest version of a bill that contains some changes backed by regulators. The measure must be reconciled with an already passed House version, but the market turmoil makes it likely that Congress will forge a deal.

The legislation would create a stronger regulator for Fannie and Freddie and allow them to buy pricier mortgages to help home buyers in more expensive areas who are having trouble securing loans because of tightened credit markets. The measures would also create a fund, financed by Fannie and Freddie, for affordable housing.

And today, the Federal Reserve is expected to issue new rules to protect home buyers from questionable mortgage-lending practices.

Frightening litany

The litany of recently failed financial institutions is frightening. People can dismiss subprime lenders as a typical casualty of a lending mania. But Countrywide was the biggest non- bank lender in the nation. Bear Stearns was the fifth-largest investment bank.

And when the Office of Thrift Supervision closed the $32 billion IndyMac Bank on Friday, after an 11-day deposit run that saw investors yank $1.3 billion from their accounts, it was a fittingly grim end to an unsettling week. (A successor institution, IndyMac Federal Bank, is to open for business today and be run by the FDIC.)

"What we've learned is that when entities spiral down like this, they go to zero," says Seattle money manager William Fleckenstein. "When you're operating with 2%, 3%, 5% equity, it doesn't take much of a move to wipe you out."

A collapse of Fannie and Freddie would deal a body blow to the reeling U.S. housing market, says Susan Wachter, professor of real estate at the Wharton School of the University of Pennsylvania.

"Fannie and Freddie, which have been a big part of the security of this market, are under threat," she says. "Subprime is no more. Jumbo loans are under pressure. We're ticking off one at a time."

One fear is that a collapse of either would, in the long run, send mortgage rates up. More broadly, it would lead to the further deterioration in confidence in the U.S. financial system and threaten the overall U.S. economy.

"The efforts to stabilize the markets haven't stabilized the markets," says Kaufman. And, Fleckenstein adds, any deal that stabilizes Fannie and Freddie won't shore up Lehman Bros., which has been beset by rumors about its solvency.

Somewhat ominously, yields on Treasury securities rose Friday. Normally, when the financial system is shaken up, investors rush to the safety of Treasuries. But this time, investors were selling Treasuries -- perhaps on fears that any bailout would strain the federal budget deficit even more.

"People," Northern Trust's Kasriel says, "are beginning to realize that there's no such thing as a free bailout."

Contributing: Ramya Gopal

TEXT WITHIN GRAPHIC BEGINS HERE

July 3: Investors become alarmed about Freddie Mac's ability to raise $5.5 billion in capital. By June, Freddie Mac and Fannie Mae had a combined loss of more than $11 billion.

July 7: Freddie Mac and Fannie Mae stocks fall after a report by Lehman Bros. suggests the mortgage companies may need to raise $75 billion combined.

Friday: Together, Freddie Mac and Fannie Mae own $5 trillion worth of mortgages, half of the U.S. total debt. Rumors swirl about a variety of options to bail out Freddie Mac and Fannie Mae, including access to emergency Federal Reserve lending, a government takeover and placement into conservatorship where taxpayers would finance mortgage loss, or a government guarantee on the debt.

TEXT OF INFO BOXES BEGINS HERE

How Freddie Mac funds home loans

Freddie Mac and Fannie Mae make sure that there is plenty of money available for making home loans. How Freddie Mac operates:

1. Borrower applies for loan.

2. Lender evaluates application.

3. Lender lends money to borrower.

4. Lender sells loan to Freddie Mac.

5. Freddie Mac pays lender, giving it money to make new loans to other borrowers.

6. Freddie Mac packages its loans to create mortgage-backed securities, then sells them to investors.

Source: Freddie Mac

About Freddie Mac

1970: Congress creates the Federal Home Loan Mortgage Corp. to provide liquidity to the mortgage market using private capital.

1971: Freddie Mac creates the Mortgage Participation Certificate, now the conventional mortgage-backed security.

1984: Freddie Mac distributes 15 million shares of participating, preferred, non-voting stock to individual member savings institutions. It also tops $100 billion in home financing.

1989: Freddie Mac becomes listed on the New York Stock Exchange. The Financial Institutions Reform, Recovery and Enforcement Act also establishes a new governing structure for the company.

1997: Freddie Mac becomes official name.

2002: Freddie Mac is required to register stock with the Securities and Exchange Commission for the first time.

2003: Freddie Mac enters into a consent order with the Office of Federal Housing Enterprise Oversight and pays a $125 million civil money penalty for understating its 2002 earnings by $5 billion.

2004: Stock price reaches a record $70 a share in December.

2006: Freddie Mac pays a penalty of $3.8 million to the Federal Election Commission for donating money to candidate Michael Oxley, chairman of the Financial Services Committee, who was running for federal government offices.

About Fannie Mae

1938: The National Mortgage Association of Washington is chartered to increase the liquidity in the mortgage market by creating a secondary market.

1949: Fannie Mae begins to buy and sell loans guaranteed by the Veterans Administration.

1954: The association is converted into a mixed ownership corporation, partly owned by private stockholders.

1968: The association is split in two: Fannie established as privately owned, while the Government National Mortgage Association (Ginnie Mae) is created within the Department of Housing and Urban Development.

1970: Fannie Mae joins the New York Stock Exchange and is authorized to buy conventional mortgages.

1982: Fannie Mae funds one out of every seven U.S. mortgages.

1992: Fannie Mae becomes the largest issuer of mortgage-backed securities, surpassing Freddie Mac and Ginnie Mae.

1996: Fannie Mae marks its 10th-consecutive year of record earnings.

2001: Stock price peaks at about $87.

2006: Securities and Exchange Commission fines Fannie Mae $400 million for accounting manipulation from 1998 to 2004. In this period, executives allegedly received more than $90 million in bonuses. SEC asked Fannie Mae to restate its earnings from 2001, resulting in corrections of $11 billion. Fannie Mae also violated two accounting regulations regarding costs of prepayment on loans and derivatives the company used to lower its portfolios risk.

GRAPHIC, Color (line graph); GRAPHIC, B/W, Julie Snider (line graph)

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MONEY

Inflation may be biggest obstacle to economic rally ; Interview: Gary Stern, president, Federal Reserve Bank of Minneapolis

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MINNEAPOLIS -- Gary Stern has been president of the Minneapolis Federal Reserve Bank since 1985, making him the longest-serving top official in the Fed system. Stern, 63, a Ph.D. economist, is an expert on banking regulation and co-author of a 2004 book, Too Big to Fail: The Hazards of Bank Bailouts, that foreshadowed the Fed's March decision to broker the sale of tottering investment bank Bear Stearns.

The book, which Stern wrote with Minneapolis Fed colleague Ron Feldman, warned that the growth and complexity of large banks can force the government to intervene to limit spillover to the broader markets when big institutions get in trouble. Stern has called the Fed's Bear Stearns intervention justified, but has said that it underscores the need for tougher oversight.

Stern is a voting member of the Federal Open Market Committee, the policy-making arm of the central bank. The FOMC in June voted to hold a key interest rate steady at 2%, ending months of aggressive rate cuts to buoy the economy.

USA TODAY economics writer Sue Kirchhoff interviewed Stern this week. The interview has been edited for clarity and length.

Q: What's your assessment of the economy?

A: This is a difficult, challenging environment. Headline inflation is running above anything I would consider to be acceptable, largely because of energy and food and some other commodity prices. Core inflation (a measure that excludes food and energy prices) has been better behaved, but the persistence of the run-up in food and energy prices raises at least questions about how long core will hang in there. Inflation risks have increased.

Q: What's the bigger threat now, slow growth or inflation?

A: There are risks on both sides. My own view is we're reasonably well positioned to deal with the downside risks to growth. I could be surprised. On the inflation issue, that may perhaps turn out to be the bigger challenge.

Q: Has the Fed contributed to the commodity price run-up by cutting interest rates and weakening the value of the dollar?

A: I'm not aware of any good evidence that suggests that Federal Reserve policy has had a significant effect on commodity prices. I think it's fundamentally demand and supply.

Q: Is the housing market near the bottom?

A: Until we work our way further through inventory, I think there will be downward pressure on housing prices. I would expect this will continue into next year.

Q: Some economists have compared this period to the 1970s stagflation: high inflation and slow growth. Agree?

A: This doesn't seem much like the '70s to me and I hope I'm right. In the '70s, and certainly into the early '80s, the rates of inflation and interest were way above everything we're experiencing now. But part of it is (Fed) policy has changed a lot. People shouldn't lose sight of that.

Now, I think if you talk to central bankers around the world, talk to Fed people, we all realize that at the end of the day, it's our mandate to provide for a stable, low-inflation environment.

Q: What's a comparable period?

A: The 1990-91 episode and its aftermath is not a bad yardstick. We had significant financial headwinds. Even though the recession of '90-'91 turned out to be brief, though not altogether mild, the distinctive characteristic was that the subsequent recovery, for a year to perhaps three years, was quite modest.

Growth is going to be modest perhaps for some time while the financial sector recovers. To me that remains a relevant parallel.

Q: Should the Fed have broad new regulatory powers?

A: If you're going to expect us to try to maintain or restore (market) stability, you have to give us appropriate authority.

Q: What changes are needed?

A: The first thing is try to identify the potential for spillovers (from the failure of a large institution). That's scenario planning and preparation. The second part is what I would call enhancement: prompt corrective action. Finally, you want to make sure you are communicating all these efforts very clearly so that everybody in the financial market understands the regime is changing.

People are clearly moving in this direction. Back in 2004, (our) book kind of fell on deaf ears. I would not have preferred to have a crisis to sort of revive the relevance of the suggestions.

Q: After the collapse of the technology and housing bubbles, does the Fed have to be more attuned to inflated asset prices?

A: At least in the equity markets, it does seem possible to identify what a lot of people like to call asset bubbles.

That doesn't mean to me that we should therefore make asset prices a target of monetary policy. What it means is we need to be as careful and comprehensive as we can be in analyzing the implications of asset prices for the economic outlook, and therefore, for policy.

PHOTO, B/W, Dawn Villella, Bloomberg News

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NEWS
Homeowners fight for their mortgage rights ; Lawsuits target loan servicers' billing practices

Kevin McCoy
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Beset by financial problems in 2002, Eunice Anderson fell months behind in the mortgage payments on her four-bedroom ranch in Redford Township, Mich., near Detroit.

Anderson, 48, a medical insurance auditor, says she was unable to refinance or negotiate a relief plan with her lender, Countrywide Financial. Facing foreclosure, she filed a Chapter 13 bankruptcy petition that let her keep her home while she paid more than $11,000 in debt.

She emerged from bankruptcy three years later with a court-filed certification that she had paid in full. But weeks later, Countrywide notified Anderson she still owed more than $10,000 in late payments and other fees, and threatened to foreclose.

"I thought when I came out of bankruptcy, I was paid up and current," says Anderson, who felt her only option was to seek bankruptcy protection for a second time. "I think it's kind of unfair."

She's now a plaintiff in a federal lawsuit that seeks class- action status and alleges that Countrywide, the nation's largest home lender, disregarded bankruptcy-court rules by billing for unwarranted fees.

The case, being fought amid what the Mortgage Bankers Association says is the highest level of foreclosures since 1979, is among scores of lawsuits accusing the lightly regulated companies that collect mortgage payments of violating borrowers' rights, a USA TODAY review of court and government records shows.

The lawsuits typically include allegations that mortgage- servicing firms mishandle borrower payments, triggering unwarranted late charges or defaults; bill homeowners for more than they owe; charge for unneeded and expensive property insurance; and disregard bankruptcy-court rules.

Countrywide, whose shareholders on Wednesday approved an expected July takeover by Bank of America, is a prominent defendant in some of the litigation. The attorneys general of Illinois and California sued the company Wednesday for alleged deceptive practices, including mortgage-servicing abuses. But cases across the nation also focus on other mortgage-servicing firms, including some owned by major investment banks.

"We see huge numbers of problems with this industry," says Tara Twomey, an attorney for the National Consumer Law Center, which represents low-income clients.

Countrywide and other mortgage servicers reject any notion that their practices have been improper. "Reports alleging that mortgage servicers are systematically charging excessive fees and using the bankruptcy process to push borrowers into foreclosure, or abusing the process more generally, are inaccurate," Steve Bailey, Countrywide's loan administration chief, wrote in testimony submitted at a May congressional hearing.

But homeowners nationwide say the firms have violated housing laws, bankruptcy rules or both:

*In a Pennsylvania bankruptcy case similar to Anderson's, Judge Thomas Agresti in May dismissed a proposed settlement of a case that included allegations Countrywide used fabricated letters in its bid to foreclose on the home of Sharon Hill in Monroeville, Pa. The letters contained purported notifications of increases in Hill's mortgage payments during the bankruptcy process. But Countrywide never sent them to Hill, court records show. They were "misrepresented as bona fide payment-change letters," a bankruptcy trustee alleged in a June9 court filing.

Agresti called that a sign "something is not right in Denmark."

*In New Hampshire, Michael Dillon, a handyman and former freelance stage technician, won a 2005 state court decision upholding his allegations that Fairbanks Capital improperly tried to foreclose on his Manchester home.

Judge Gillian Abramson issued a contempt ruling after concluding Fairbanks had "created a predatory scheme of penalties," in part by billing him for fees for which Dillon "did not receive any notice." The ruling ordered the firm to give Dillon a chance to reinstate the mortgage "without penalties." The litigation is continuing.

*In Louisiana, a bankruptcy-court review of accounting by Wells Fargo Home Mortgage found the firm's servicing arm collected nearly $25,000 more from Michael Jones than he owed on his Mandeville home. Judge Elizabeth Magner ordered a refund and told Wells Fargo to pay more than $67,000 in sanctions and damages. The firm has appealed.

*And in Illinois, a lawsuit that consolidated 18 cases from 10 states accuses Ocwen Financial of engaging in a "nationwide scheme of illegal, unfair, unlawful and deceptive business practices" involving improper fees, costs and other charges. The case is in settlement negotiations, court records show.

Separately, EMC Mortgage and its former parent, Bear Stearns, notified investors in March that the Federal Trade Commission staff believes the firms "have violated certain federal consumer protection statutes" with their mortgage-servicing practices. JPMorgan Chase acquired the servicing firm in May with its purchase of Bear Stearns. EMC said it expects negotiations to avoid a federal lawsuit.

This month, the firm also agreed to settle a federal lawsuit filed by Excel and Annie Ward, said Kenneth Mayfield, the lawyer for the Mississippi homeowners. They accused EMC of failing to refund more than $4,100 they were owed from an insurance settlement.

Along with the EMC investigation, the FTC is assessing whether other mortgage servicers and lenders "are making deceptive claims," agency Chairman William Kovacic wrote in a June4 letter to Sen. Chuck Schumer, D-N.Y.

'Abuse' of bankruptcy process

The FTC action comes five years after it reached a $40 million settlement with Fairbanks Capital to resolve allegations the company failed to post borrowers' mortgage payments on time, charged unauthorized fees and used dishonest or abusive debt-collection practices.

Fairbanks subsequently changed its name to Select Portfolio Servicing. The renamed company, now owned by Credit Suisse, has been the subject of similar complaints to the FTC since the settlement.

The Executive Office for U.S. Trustees, the Justice Department agency that oversees bankruptcy cases, has intervened or filed actions in 16 cases involving Countrywide, GMAC Mortgage Loans, NovaStar Mortgage or Washington Mutual Bank. The cases were filed in eight states.

Similar action could come in more than 30 other cases, agency director Clifford White said at the congressional hearing.

He said most of the cases involve people who fell behind on their mortgages and filed for Chapter 13 bankruptcy protection, a process designed to help debtors repay what they owe over months or years.

"Countrywide's failure to ensure the accuracy of its claims and pleadings has resulted in an abuse of the bankruptcy process," U.S. Trustee Donald Walton alleged in a Georgia bankruptcy-court complaint filed in February.

The action accuses the firm of "engaging in bad faith conduct" in the bankruptcy of John and Robin Atchley by accepting payments made on the couple's behalf even though they "had already paid Countrywide's claim in full." The complaint said Countrywide's alleged actions were "not an isolated incident." The firm moved to dismiss the case in May.

In a similar conclusion, a November research study by Katherine Porter, a University of Iowa law professor, found mortgage and servicing companies "frequently do not comply with applicable law."

Fees charged to borrowers "are often poorly identified, making it impossible to verify if such charges are legally permissible or accurate," concluded the report, which analyzed 1,700 recent Chapter 13 bankruptcy cases.

Struggling homeowners who have avoided bankruptcy may have it worse, Porter concluded, because they lack bankruptcy-court safeguards.

"I am also concerned that ... the practices of these companies may not be limited to bankruptcy cases," said Sen. Russell Feingold, D-Wis., at the May hearing.

Incentives to overcharge?

A generation ago, home buyers often got a mortgage from a local bank, which serviced the mortgage by sending monthly statements, collecting payments and assessing penalties for late or missed payments.

Today, however, home borrowers may get mortgages through a bank, a mortgage corporation, a mortgage broker or a financial institution. The original lender frequently sells the loan. And mortgages often are packaged into Wall Street securities backed by the income from borrower repayments.

The mortgage-servicing function also has changed. Servicing companies, some owned by mortgage firms or investment banks, handle the monthly notices, collections and late-fee assessments and other penalties. They also manage foreclosures when borrowers default.

Mortgage servicers typically receive fees ranging from 0.25% to 1.375% of the note's principal for each loan, Porter found. The servicers also keep part or all of late charges and other default fees, her analysis showed.

That gives mortgage servicers "a financial incentive to impose additional fees on consumers," a process that could result in foreclosures, Porter concluded.

Countrywide President David Sambol stressed the importance of servicing fees in the company's third-quarter earnings conference call last year.

Referring to the increased operating costs caused by mortgage delinquencies, Sambol said those expenses "tend to be fully offset by increases in ancillary income in our servicing operation, greater fee income from items like late charges" and from "our businesses involved in foreclosure trustee and default title services and property inspection services."

As Sambol addressed Wall Street analysts, Countrywide reported $764 million in operating earnings from mortgage servicing, up from $518 million for the third quarter in 2006. The earnings have since declined amid lower interest rates and faster mortgage prepayments, Countrywide says.

Borrower grievances about mortgage servicing account for about one-third of all mortgage-related complaints received by the U.S. Department of Housing and Urban Development. HUD has received more than 1,000 mortgage-servicing complaints during the last five years.

FTC records contain similar consumer complaints about alleged abuses.

For example, a November 2006 complaint states Select Portfolio Servicing notified one homeowner she was four payments behind, an allegation the woman, whose name was redacted from the complaint, said was untrue.

She also alleged in the FTC complaint that the servicing company placed insurance on her property "when she had insurance already."

Some recent court rulings have sided with homeowners who accused servicers of abuses.

In a March5 opinion, Bankruptcy Court Judge Jeff Bohm criticized Countrywide and a law firm representing the mortgage giant for filing a motion that misrepresented the payment history of Texas homeowner William Parsley. Responding to court questions about the error, Countrywide's lawyers withdrew the motion. But the firm gave no assurance Parsley wouldn't be billed for related legal costs, court records show.

"What kind of culture promotes payment histories that are so confusing to the vast majority of persons, including attorneys and judges -- not to mention borrowers -- that it becomes necessary for legal assistants to 'simplify' them, leading to more errors and confusion?" Bohm asked.

The judge urged Countrywide to "re-evaluate its policies and procedures" to ensure that it doesn't "undermine the integrity of the bankruptcy-court system."

'My last resort'

The ruling addressed the same issue raised by Eunice Anderson.

She bought her home in 1999 for $129,000, put 5% of the purchase price down and got a Countrywide mortgage for the balance. Her monthly payment, including taxes and insurance, totaled $1,205, Anderson says.

Her grandmother's death and unexpected family expenses landed her in financial trouble in 2002. Unable to work out a solution with Countrywide, Anderson filed a Chapter 13 petition.

"Bankruptcy was my last resort. I was pretty stressed out," she says.

Through the court, she worked out a financial plan expected to cover the missed payments and penalties she owed Countrywide while simultaneously paying current mortgage bills.

The court confirmed the plan in January 2003. And, in January 2006, the bankruptcy trustee reported that Anderson had paid more than $11,700 in pre-bankruptcy mortgage and related debt and $46,287 for mortgage bills after the bankruptcy petition.

Anderson was discharged from bankruptcy in April 2006. Soon afterward, Countrywide notified her she still owed nearly $11,743 in mortgage payments, escrow bills and other fees, court records show.

Anderson's attorneys allege in court filings that Countrywide misapplied payments she made during the bankruptcy proceeding and assessed "fictitious charges" not included in the repayment plan approved by the court.

Countrywide, in a June3 court filing, said the loan charges challenged by Anderson were included in the claim the company submitted in her bankruptcy case. The company argued that because she did not challenge the charges during the bankruptcy court's confirmation proceedings, her claim should be dismissed.

In a similar case in Kansas involving EverHome Mortgage, Bankruptcy Court Judge Robert Berger ruled in May that the company violated the rights of borrowers Willie and Valerie Payne by not advising them of nearly $13,000 in costs and fees that allegedly accumulated during a bankruptcy proceeding. He ordered EverHome to pay $2,500 in punitive damages.

"When a lender silently accepts payments for over three years without notifying the borrower the payments are insufficient, when the borrower believes his taxes and insurance are being paid by his monthly payments to his lender, and when the borrower has no reason to know the lender is advancing taxes and insurance and thereby increasing borrower's indebtedness, the lender waives his right to recover the advances from the borrower," Berger wrote.

EverHome appealed the ruling, arguing that it was "contrary to the totality of evidence."

Berger denied the appeal on June6.

Anderson hopes for a similar outcome in her battle.

"The only thing I look forward to is coming out of the bankruptcy and not being faced with another nightmare," she says. "It's frustrating, but I work through it."

PHOTO, Color, Kyle Keener for USA TODAY; PHOTO, B/W; PHOTO, B/W,
Alex Wong, Getty Images

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NEWS

How rising home values placed your finances at risk ; Banks urged owners to borrow more, based on 'phantom equity' that has vanished

Kathy Chu; Byron Acohido
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At the peak of the housing boom, April Lewis-Parks' three- bedroom house in Fort Lauderdale doubled in value. To her surprise, her credit card limits soared even more.

One card issuer more than tripled her spending limit, to $17,000. Another increased her limit 60%, to $16,500. Lewis-Parks' income hadn't risen. Nor had her credit score changed much. "The only thing that went up," she says, "was the equity in the house."

That pop in her credit card buying power was no accident.

During the housing boom, from mid-2001 to early 2006, banks raised card limits at a blistering pace across the nation, in part because of a surge in home equity, much of it now vanished. As home prices ballooned, banks also plied customers with a record number of offers to open new card accounts. Then they guided card borrowers to tap into rising home equity to pay off card balances with artificially inflated home equity, putting their homes at risk.

Today, the mix of high-rate debt and meager home equity has squeezed consumers -- and threatens to prolong the economic slowdown. Those are the findings of a USA TODAY investigation, based on analyses of credit card data from Equifax credit bureau, Moody's Economy.com, Synovate Mail Monitor and Mintel Comperemedia.

The consequences are visible. Foreclosures are at record levels. And credit card delinquencies are nearing a six-year high as millions of borrowers struggle to keep up with a record load of revolving debt, mostly on credit cards.

Card issuers extended too much credit, too quickly because of the "phantom equity" in people's homes, says William McCracken, CEO of Synergistics, a financial services research firm.

In turn, this "reckless extension of credit is contributing to the financial vulnerability that many families are facing," says Travis Plunkett of the Consumer Federation of America.

USA TODAY's analysis of credit card data found that during the housing boom:

*The average credit card spending limit rose a cumulative 17%, to $8,158, after adjusting for inflation, as median pay was declining and living costs were rising. Cardholders have an average of five cards.

*Banks doubled the amount of new credit cards issued to "subprime" customers -- those with tarnished credit. They could least afford to sink deeper into debt yet were most likely to tap additional credit.

*Banks encouraged customers to use their inflated home equity to pay off mounting card balances. In doing so, borrowers converted unsecured revolving loans into debt secured by their homes, which they now stand to lose if they can't pay their bills. Many financially squeezed borrowers ran up more card debt.

Now, even with the economy ailing, banks have continued to expand credit limits. They're also raising more borrowers' interest rates to as high as 30% -- at a time the Fed is cutting rates -- and collecting a record amount of penalty fees.

Banks are "hoping that in an atmosphere of tight credit, these people will have nowhere to go and be forced to pay high interest on their card balances," says Elizabeth Warren, a Harvard law professor. "It's a straightforward profit calculation."

Banking officials dispute any notion that they exploited swelling home values to expand credit limits. They contend that higher card limits from 2001 through 2006 simply made good business sense.

James Chessen, chief economist for the American Bankers Association, says rising home values and a booming stock market made banks willing to lend. "There was rising equity in houses, growing wealth, and the economy was growing quickly," he says.

Joe Belew, president of the Consumer Bankers Association, argues that home value was just one factor -- and not the most important one -- banks used in deciding how much to expand consumer credit. In raising card limits, Belew says, banks look first to a borrower's ability to repay a loan.

It's "perfectly reasonable" for lenders to look at home equity to decide how much credit to extend, says Mark Zandi, chief economist at Moody's Economy.com, because "The home is the most important asset many households have."

Yet the industry's eagerness to issue mortgages -- and to boost card limits simultaneously -- created a "double financial bubble," says Robert Manning, author of Credit Card Nation: The Consequences of America's Addiction to Credit.

As home equity and card limits rose in unison, consumers overextended themselves. Banks encouraged consumers to take on "unrealistic levels of credit card debt," Manning says, and then to pay it off with home equity loans.

Kenna and Richard Baker of Des Moines say that as their home's value rose, they were barraged with offers for home equity loans and credit cards. They opened up new credit cards. They also refinanced their mortgage twice and withdrew cash to pay off existing card bills and make home improvements.

But as the economy weakened and Richard's pay as a delivery driver fell, they used their cards again -- for necessities. "We had to pay the gas bill on cards one month or we'd get cut off," says Kenna Baker, 44.

Today, the Bakers owe $30,000 on credit cards and $105,000 on a home worth only $63,000. They blame themselves but also say lenders share responsibility for "making it so easy" to borrow.

Tripled limits

The seeds of the mortgage crisis -- and the emerging credit card crunch -- were planted as housing values began rising at an accelerated clip in 2001. Loose lending standards fueled demand for real estate, driving home prices sky-high in many cities, says Paul Bishop, director of research for the National Association of Realtors.

Consumers tapped into a new wellspring of home equity to pay for home improvements, medical costs, even education. And they began using proceeds from lower-rate home loans to pay off higher-rate credit card balances.

As the shift to home equity loans gained traction, card debt slowed. Revolving debt, which had grown at a sizzling 12% annual rate in 2000, slowed to a meager 3% rate in 2005, near the peak of the boom.

Banks moved quickly to shore up their sagging card business. They blanketed consumers with a record 25.5 billion credit card offers from 2001 to 2005, partly to "compete with home equity loan (offers) in the mailbox," says Andrew Davidson, vice president at Synovate Mail Monitor, which tracks such data.

Banks also sent existing cardholders approvals for huge step-ups in their spending ability. Banks know "you don't make money unless you get (consumers) to transact more, and one way to do that is to raise the credit card limits," says John Ulzheimer, who's worked as a manager at Equifax and Fair Isaac, creator of the FICO credit score.

Lewis-Parks, of Fort Lauderdale, says Chase and Bank of America raised her credit limits in 2006, shortly after she took out a larger mortgage on her home and extracted cash to pay off credit card bills and other debt. Banks, she argues, should first ask consumers if they want the additional credit before raising their credit limits.

Chase and Bank of America say they don't comment on individual situations, citing privacy concerns. Bank of America spokeswoman Betty Riess says that generally, "Customers like the fact that their credit line is increased" if the bank considers them a good customer. Chase spokeswoman Tanya Madison says the bank tries to "anticipate our customers' credit needs" by raising limits, but customers can always request less credit.

Pending legislation from Rep. Carolyn Maloney, D-N.Y., and Sen. Chris Dodd, D-Conn., seeks to give consumers more control over their credit limits. The bills would restrict banks' ability to approve charges beyond consumers' card limit and then assess a penalty. But they wouldn't require banks to ask consumers before raising their limits.

When banks extend more credit, younger consumers and the financially inexperienced are more likely to take on debt, a 2002 study by Amar Cheema, of Washington University in St. Louis, and Dilip Soman, of the University of Toronto, found.

Subprime borrowers, many of whom have little experience with credit, tend to use more of their available credit than others do. "Generally, these are consumers who have (greater) need for credit," says Myra Hart, a senior vice president at Equifax.

During the boom, banks focused on getting more plastic into these borrowers' hands: New cards issued to subprime consumers rose 137% from 2003 through 2006, Experian data show.

Banks focused on these consumers because they "don't have five cards already," says David Robertson, publisher of The Nilson Report, an industry newsletter. "They thought they could manage the risk."

Rising delinquencies and defaults suggest otherwise. Overall delinquencies reached 4.9% in the first quarter of 2008, a level not seen since 2002. Card write-offs -- which occur when banks give up on recouping the debt -- have been rising since the second quarter of 2007.

'Hamster wheel'

Major lenders such as Citibank, Washington Mutual and American Express also sent offers in the mail urging credit card borrowers to use home equity loans to pay off card debt or renovate their homes. One offer in 2006 says: "If you're currently paying more than 13.99% on any personal loan, you should ask yourself, 'Why?' With an American Express Bank home equity credit line, you could easily consolidate those balances to a rate below Prime Rate with no closing costs."

Citibank and Washington Mutual declined to comment. American Express spokeswoman Kim Forde says the offer was sent to "a relatively small population of card members" with strong credit.

Such cross-selling, analysts say, was necessary to keep rivals from luring card customers away with their own offers.

"The deeper the relationship runs, the less likely the consumer will go to another bank," says Lisa Hronek, senior analyst at Mintel Comperemedia, which tracks direct mail and print advertising.

The strategy worked. From mid-2001 through early 2006, consumers extracted a record $538 billion from homes to pay off card and other non-mortgage debt, according to estimates by Federal Reserve economist James Kennedy, based on a paper he wrote with former Fed chairman Alan Greenspan.

In Pevely, Mo., Dan Blanton's credit limits rose from $3,500 to $7,500 during the housing boom. Last year, it jumped an additional $4,000, after he paid off his credit card with a home equity loan.

"I don't plan to run it up," says Blanton, 50. "But I think credit was way too loose" in the past few years.

By raising credit limits to encourage borrowers to pile up more debt and then urging them to pay that debt off with home equity, banks put card customers on a "lucrative hamster wheel," says Joseph Ridout, a spokesman for Consumer Action, an advocacy group.

In theory, paying off high-rate card debt with lower-rate home equity is wise, says Gail Cunningham, a spokeswoman for the National Foundation for Credit Counseling. But the reality, she says, is that many who did so during the boom just "re-debted," running up more card and mortgage debt.

Industry analysts, consumer advocates and lawmakers are starting to fear that some of the $461 billion in card debt that the Fed says was sold as securities to Wall Street investors could unravel, just as a sizable chunk of the $6.5 trillion in mortgage-backed securities is now doing.

"We cannot allow the credit card problem to become the next foreclosure crisis," says Sen. Robert Menendez, D-N.J. Backed by 11 consumer groups and labor unions, he's introduced the Credit Card Reform Act, which would restrict banks' lending practices.

Banks say there's nothing wrong with urging people to shrink their card balances with proceeds from home equity loans. It's up to borrowers, they say, to be responsible.

"It makes sense to be able to consolidate debt at a lower interest rate," says Chessen of the ABA.

But paying off unsecured debt with a loan secured by a principal residence is risky because if you can't pay your bills, you could lose your home, says Ellen Schloemer, director of research at the Center for Responsible Lending.

This strategy could have played a role in foreclosures, says Zandi, of Moody's Economy.com, because homeowners tapped equity to pay off their credit cards when housing values were high, only to see their equity shrink as prices slid.

With the economy slumping and the job market tightening, more people are getting stuck with debt they can't afford.

"If you have a lot of credit open to you, then if something bad happens, you might jump to use it when it's not the best option," says Lewis-Parks, a publicist for a debt-counseling agency.

Home equity a fading option

Borrowers are turning back to cards because "the spigot has been turned off on home equity lending," says Mark Lauritano of Global Insight, a research firm.

In a recent USA TODAY/Gallup Poll, one in five consumers said they'd been using their credit cards more in the past year. Within this group, 44% are paying for necessities they couldn't otherwise afford. The survey of 845 credit card holders was conducted in late May. Its margin of error is plus or minus 4 percentage points.

"A lot of the clients we have work in the construction field, and there's not a lot of construction going on," says Diana Navarro, a housing counselor in Sacramento. "They've been using their credit cards for (everyday) expenses."

Credit card limits, after falling in 2006 along with the housing market, began climbing again in mid-2007, according to Equifax data. In the USA TODAY/Gallup Poll, 43% of consumers said the limit on their most-used credit card had risen in the past year. An equal percentage reported no change; 12% either were unsure or didn't answer. Only 2% of consumers reported a decline in their credit limit.

Low-income consumers, who tend to be riskier borrowers, are getting the bulk of the credit-limit reductions, Synergistics Research says. Banks, at the same time, are likely extending more credit to higher-income borrowers, causing an overall increase in average card limits, says McCracken, CEO of Synergistics.

Banks are also raising rates and fees on a growing number of card borrowers -- even creditworthy ones -- making it more expensive to carry debt.

In March, Bank of America as much as tripled card rates for some borrowers -- even those who'd paid bills on time and had solid credit, according to USA TODAY's research. And Washington Mutual has told some credit card customers that it's raising their rates by up to 100%, USA TODAY has found.

Both banks say they raise rates as borrowers become riskier.

The danger, says Warren, the Harvard professor, is that the rate increases could push struggling consumers to default on their bills. These defaults, in turn, could exacerbate the economic downturn, she notes.

Borrowers with adjustable-rate mortgages at least knew the rates would eventually jump, Rep. Maxine Waters, D-Calif., said at a recent hearing. But credit card agreements are "land-mine loans, because it is not at all clear to consumers if, how and when their rates are going to increase," she said.

Marvin Weatherspoon, a supervisor in the Chicago Convention Center's linen department, says a sudden rate increase on his Bank of America credit card last year -- from 16% to 25% -- has made it nearly impossible to keep up with his other bills. He owes about $12,000 on his credit cards.

"I'm sacrificing all over the place, food, gas and necessities," he says. "It's a real struggle."

GRAPHIC, Color, Web Bryant, USA TODAY (Illustration); GRAPHIC, B/W, Adrienne Lewis, USA TODAY (Line graphs); PHOTO, B/W, Gary Fandel for USA TODAY

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MONEY

Lehman investors get reassurance ; CEO's damage control indicates investment bank won't be acquired

Greg Farrell
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English

NEW YORK -- Lehman Bros. CEO Richard Fuld seemed to reassure shareholders about the investment bank's future Monday after he took responsibility for its $2.8 billion loss in the second quarter and added his belief that the firm can continue to "go it alone."

Lehman shares closed at $27.20, up 5.4%, after a conference call with analysts to discuss the company's first quarterly loss since going public in 1994.

Last week's pre-announcement of the loss in the quarter ended May31 led some investors to question whether Lehman could survive as an independent entity. But Fuld's efforts to contain the damage mean that "They're not going to be acquired," says Richard Bove of Ladenburg Thalmann. "There's no reason for them to give up their independence."

Lehman reported that revenue in the second quarter was negative $668 million -- compared with $5.5billion in the same period last year. The unusual negative number for revenue reflected the company's trading losses.

The $2.8 billion net loss contrasted with a $1.3 billion profit last year.

Fuld last week removed two top members of his management team: CFO Erin Callan and COO Joseph Gregory. Fuld told analysts, though, that he wouldn't pass the buck for Lehman's dismal second-quarter performance.

"I am very disappointed with these financial results," he said. "We lost $2.8 billion. That's just totally unacceptable. This is my responsibility."

Investors have watched Lehman closely since Bear Stearns collapsed in March. Bear fell after its trading partners began to fear that it didn't have enough liquidity to withstand the economic downturn.

Like Bear, Lehman was highly leveraged, its balance sheet weighed down with mortgage-related assets that have declined in value.

When Bear Stearns ran out of capital, the investment bank was forced into a bargain-basement sale to JPMorgan Chase at $2 a share, a price that was eventually raised to $10 a share.

But unlike Bear, Lehman has access to the Federal Reserve's discount window.

In addition, Lehman moved aggressively in the second quarter to shed its mortgage-related assets. The firm reported it had sold $147 billion worth of assets in the second quarter, putting it in a stronger position than Bear Stearns was in during its final months.

Fuld says that Lehman's "core business and our strategy are sound. ... I believe in the model."

Several analysts agree.

"They're big enough to be independent," says Jeff Harte of Sandler O'Neill. "That's not to say that if the right opportunity came along, they wouldn't take it."

Brad Hintz of Sanford Bernstein, who used to work for Fuld at Lehman, says, "It would take a very callous board of directors to forget what he has achieved at the firm and force Dick out."

Fuld has headed Lehman since it was spun off from American Express in 1994 and turned what was considered a weak player into a financial powerhouse.

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MONEY
Bear Stearns interns learn about business the hard way ; Summer posts get cut after JPMorgan deal

Erin Kutz
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For much of this school year, Fabienne Bruneau spent three hours a day compiling summaries of major financial news stories, preparing for a competitive recruiting process for internships at major Wall Street banks.

After a 4 1/2-hour interview with Bear Stearns earlier this semester, the New York University junior landed a summer position in its global equities division with the sales and trading team. This month, she was notified she had lost her internship, a casualty of JPMorgan's recent purchase of Bear Stearns to prevent it from going bankrupt.

"You feel like you won the lottery, and now someone stole it away from you," she says.

Bruneau is just one of hundreds of Bear Stearns hires questioning their futures after the fire sale of the country's fifth-largest investment bank and deep cutbacks at other banks. At least 105,000 financial jobs have been lost since March 2007, according to the Bureau of Labor Statistics. The U.S. banking industry could drop another 150,000 to 200,000 jobs in the next 12 to 18 months, estimates financial consulting firm Celent.

Because JPMorgan hired its own summer interns, it can only absorb Bear Stearns' intern hires in areas where the two firms' operations didn't overlap. Those businesses include prime brokerage, commodities, asset management and merchant banking. Bear Stearns hired about 300 full-time employees and 300 interns this year. JPMorgan has taken on roughly 60% of them, says JPMorgan spokesman Brian Marchiony.

Non-profit opportunities

Those who don't work at JPMorgan this summer won't necessarily lose out on paychecks, though. JPMorgan is coordinating internships for Bear Stearns hires at non-profit organizations in strategy, finance, marketing and project-management positions and will pay them the same summer salary they were promised by Bear Stearns, Marchiony says. Those interns will also be among the first round of external applicants considered for full-time jobs in the fall. The company has no figures yet on how many hires will take non-profit offers.

On Wall Street, undergraduate investment banking interns typically make about $13,000 to $14,000 a summer, while MBA interns make around $20,000 a summer.

Bruneau has not been officially placed with a non-profit internship and is unsure if she will even decide to go that route. She's still hoping to gain experience with a financial company this summer. Bruneau says she's trying to remain positive.

Students who accept JPMorgan's non-profit offers may lose out on hands-on Wall Street experience and an express ticket to a job after graduation, as investment banks frequently hire their best summer interns for full-time jobs, says Trudy Steinfeld, executive director of New York University's Wasserman Center for Career Development.

"They really counted on having that banking experience this summer," she says. "Now some of them are not sure where that job is going to materialize."

That's what concerns Gabe Marans, an NYU junior who planned to work as an intern at Bear this summer.

"The loss of the Bear Stearns offer took away a potential opportunity for full-time employment in an increasingly hostile job market for college graduates," Marans said in an e-mail.

Business students can still draw relevant skills from an internship at non-profit organizations, says Patricia Rose, director of career services at the University of Pennsylvania.

"There will be opportunities to work with a non-profit on business plans or a branding strategy," Rose says. "I think the experience will be very good, but it will not be banking experience."

Bonuses to keep

Those who were full-time hires by Bear Stearns are also more likely to be retained by JPMorgan if the division they were to work for at Bear Stearns doesn't overlap JPMorgan's operations. Those whom the company can't take on can still keep their signing and relocation bonus and access to JPMorgan's career services for one year, Marchiony says.

University of Pennsylvania senior Yashoda Khandkar was hired to work full time for Bear Stearns upon graduation next month, a direct result of her internship last summer in its investment banking department, she says. That offer was rescinded on April 2.

Much of the full-time recruiting for financial firms is completed in the fall, leaving Khandkar in a difficult position. She would like to stay in investment banking, but the skills she learned in her internship could benefit her in a variety of jobs.

"When you work in such a specific part of a bank, you learn the skills you need to be successful there," she says. "That will be useful for me wherever I am."

For students struggling to find jobs in investment banking, corporate finance positions provide an alternative, particularly in the health and technology fields, says Al Cotrone, director of career development and student affairs at the University of Michigan's Stephen M. Ross School of Business. The best barometer of job prospects in financial services will come at the end of the summer, when firms offer their best interns jobs after graduation, says Patrick Perrella, senior associate director of MBA career development at Notre Dame's Mendoza College of Business.

"If students don't come back with offers in their back pocket, we'll know the firms are being very, very cautious in their economic outlook," he says.

TEXT OF INFO BOX BEGINS HERE

Converting internships to jobs

Percentages of interns at surveyed companies who received job offers and percentages of those who accepted offers:

2004 2005 2006 2007 2008

Interns receiving offers 57.6% 52.3% 72.6% 64.9% 69.6%

Interns accepting offers 77.6% 68.1% 73.0% 72.9% 72.5%

Source: National Association of Colleges and Employers' 2008 Experiential Education Survey of 310 employers

PHOTO, B/W, Photos by Rebecca McAlpin for USA TODAY; PHOTO, B/W

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MONEY
JPMorgan increases Bear Stearns bid to $10 a share

Adam Shell
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NEW YORK -- In a move aimed at easing shareholder backlash and boosting the odds that its buyout of wounded investment bank Bear Stearns closes quickly, JPMorgan Chase raised its offer to $10 a share from its initial bargain-basement price of $2 a share.

In exchange for sweetening the deal, JPMorgan negotiated the purchase of a 39.5% equity stake in Bear Stearns, as well as assurances from its board that it will vote in favor of the new deal, announced Monday.

Both concessions were key for JPMorgan, as it lowers the hurdle needed to get shareholder approval. The deal needs more than 50% approval. JPMorgan would have 45% yes votes under the amended deal. It's likely to get the needed 5% from Bear bondholders.

"It appears it was a trade," says David Trone, analyst at Fox- Pitt Kelton. "It virtually guarantees a yes vote at $10 per share, vs. an almost certain no vote at $2."

The board of directors at both banks and the Federal Reserve signed off on the new terms. "The amended terms are fair to all sides," JPMorgan CEO Jamie Dimon said in a statement, adding that it would bring more certainty to the market. Dimon hopes the deal will close promptly. Alan Schwartz, Bear Stearns' CEO, said the terms "provide greater value to our shareholders."

Shares of Bear Stearns soared $5.29, or 89%, to $11.25. The fact that shares closed above the $10 deal price suggests some traders are betting JPMorgan will have to raise its bid again to cement a deal or will be trumped by another party, notes Jon Najarian of OptionMonster.com. But Najarian says the most likely end game is for JPMorgan to complete the deal, perhaps at a slightly higher price. JPMorgan rose 1.3% to $46.55.

The sweetened deal comes a week after a last-ditch effort to rescue Bear Stearns from bankruptcy and head off a broad financial meltdown resulted in a fire-sale price. Under new terms, JPMorgan will bear the first $1 billion of losses associated with Bear Stearns' assets, and the Fed will fund the other $29 billion.

The initial low-ball bid, which came before the Fed's decision to make credit lines available to broker dealers such as Bear Stearns for the first time, was greeted with a backlash from Bear shareholders and employees. The $2 bid, for a stock that traded at $160 within the last year, wiped out investors and employees.

The deal is scheduled to close April 8. One potential glitch is that only in "exceptional" cases does the New York Stock Exchange let a firm sell more than 20% of its shares without shareholder approval. Brad Hintz, an analyst at Sanford C. Bernstein, isn't convinced Bear's case is extreme, given that it already had a guarantee from JPMorgan and has access to the Fed's cash. "My guess," says Hintz, "is this issue will be determined in a courtroom. Bear's stock rally means ... the continuing saga of Bear and JPMorgan isn't over yet."

GRAPHIC, Color, Julie Snider, USA TODAY, Sources: S&P's Capital IQ;
Investor.com (BAR GRAPH)

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MONEY
Can other firms avoid same fate? ; Confidence in rest of financial firms melts, fairly or not

Greg Farrell; Matt Krantz
986 words
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English

NEW YORK -- In the wake of Bear Stearns' shotgun marriage to JPMorgan Chase at $2 a share, investors might want to know how a financial institution with nearly $400 billion in assets and $12 billion in shareholder equity went from normalcy to near bankruptcy in just seven days.

While some experts blamed Bear's fall on "opaque assets," "notional derivative exposure" and "liquidity demands," the answer is as old as the industry itself: a "run on the bank" is impossible to survive. "If the market is driven by an irrational fear, then it's very difficult to come up with a strategy that can quell that," says Kris Niswander of SNL Financial.

The key element in Bear's collapse is not the assets listed on its balance sheet, which totaled $395 billion at the end of 2007, but the portion of those assets that was in cash or cash equivalent: $34 billion.

When Bear's customers and clients started taking their cash out of the firm early this year, or demanding better terms on financing, Bear found itself in a classic fix: It needed to sell assets to raise more cash, but the assets it held on its books -- many of which consisted of mortgage-backed securities -- were difficult to sell.

According to Peter Schiff, president of Euro Pacific Capital, Bear found itself in a situation comparable to a beleaguered homeowner.

"You have a mortgage of $400,000, and one day you get a call from the bank and they say, 'We need all our money back.' If they say, 'Give me your money or we're taking your home,' you're in trouble," Schiff says. Bear found itself in just such a situation last week.

In January and February, a smattering of the 900 hedge funds that used Bear for prime brokerage services made inquiries at other firms, putting out feelers about whether they could shift their business there on short notice.

Early last week, a number of major hedge funds took their cash and business out of Bear and shifted to Bear's primary competitors in the area, Morgan Stanley and Goldman Sachs. The sudden departure of those hedge funds and word of their flight sparked a "run on the bank" for the firm, stripping it of much-needed cash.

It also spread fear among Bear's trading partners, making it prohibitively expensive for the firm to raise short-term cash.

The situation got so bad that by Thursday night Bear executives reached out to JPMorgan Chase for help accessing additional funds. The Federal Reserve provided help, allowing the firm to access its discount cash window via JPMorgan, but the announcement of the bailout Friday only confirmed the rumors of a liquidity crisis that had been swirling around Bear all week.

Bear management had no choice over the weekend but to submit to any reasonable offer they could find, and JPMorgan Chase turned out to be the best suitor, in terms of business needs. As a result, Bear Stearns CEO Alan Schwarz -- who had emphatically denied that the firm had any liquidity problems just last week -- was forced into a deal late Sunday, agreeing to sell the 85-year-old firm to JPMorgan Chase for $236 million.

Tough times

With a lack of clear information about how widespread the problems are, investors are just selling. "Confidence continues to be in question for all the other firms out there," says Larry Adam, U.S. chief investment strategist at Deutsche Bank.

Investors may get more information this week as several of the investment banks report earnings. Still, Adam doesn't expect the financial system to steady itself until housing prices stabilize, as real estate values are the basis of the problem. He's hoping the Fed's aggressive moves can limit the problems to Bear. "If you go back in history, these tend to be isolated cases," he says. But investors aren't taking much comfort in that, he adds. "This could continue to be isolated, but there is no way to say that with 100% certainty."

Bear's woes spread and inflicted damage on other brokerages and investment banks. Lehman Bros. fell $7.51, or 19%, to $31.75; Merrill Lynch $2.33, or 5.4%, to $41.18; and Citigroup $1.16, or 5.9%, to $18.62.

Investors are "knocking the heads off everything having to do with financial services, even if they have nothing to do with mortgages," says Ken Winans, president of money management firm Winans International. What happed at Bear has "shaken people's confidence in what's usually a bastion of strength." While part of the selling smells of panic, there are some plausible worries that the problems that took down Bear could spread, Winans says. Those worries include:

*Ripple effect and length of recovery. More firms could also struggle. Winans "would be shocked" if Bear were the last. "When this begins to happen, it takes awhile for Wall Street to recover."

*Confusion about the industry. Not only are many of the troubled assets not clearly disclosed, there's concern that financial experts tracking the industry are in the dark.

Investors will shift toward companies people can understand, with good histories with credit and dividend payments. The pressure will not end anytime soon. "People are shifting away from financials, not just today, but for the rest of the year," Winans says. He thinks investors may be being overly hasty. "I question the thought of selling today at any price. What you'll look back in a month and regret," he says.

Krantz reported from Los Angeles

GRAPHIC, B/W, Karl Gelles, USA TODAY, Source: Bloomberg (LINE GRAPH); GRAPHIC, B/W, Julie Snider, USA TODAY, Source: CSI (LINE GRAPH); PHOTO, B/W, Don Emmert, AFP/Getty Images

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MONEY
Aramark OKs $6.3B offer to go private

Theresa Howard
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NEW YORK -- Aramark, the USA's No.3 food-service company in revenue, is going private, again.

The board on Tuesday approved a $6.3billion deal to sell Aramark to CEO Joseph Neubauer, 65, and a consortium of private equity groups including GS Capital Partners, CCMP Capital Advisors, JPMorgan Partners, Thomas Lee Partners and Warburg Pincus.

Neubauer said he would contribute up to $250million to the buyout.

The group will get a company with food and beverage contracts for thousands of venues nationwide including executive suites, prisons, schools, hospitals and stadiums.

The agreement to pay $33.80 in cash for each Aramark share tops the group's $32 offer in May. That represented a 20% premium over the closing price the day before they made the initial bid.

As part of the deal, the group will assume about $2 billion in debt. The transaction is expected to close by early 2007 if it is cleared by federal regulators and shareholders. Although Neubauer owns 41% of Aramark's stock, he agreed to have his voting power restricted to 5% of the total.

By going private, Aramark can try to revive the business without worrying about Wall Street. The company warned last month that its profit for the quarter that ended in June, which it will report today, would be about half of what analysts expected.

"You have more flexibility when you are out of the public marketplace," says Fentress Seagroves, a partner in PricewaterhouseCooper's private services practice. "You don't have to be beholden to the quarterly earnings pressures."

Aramark, which generated $10.9 billion in revenue last year, would be the sixth-largest U.S. company bought this year by private equity investors. Private equity firms have spent $205 billion so far in 2006, up 700% since 2001, according to financial research firm Dealogic.

"Everybody is going private," says Jay Anand, a professor of corporate strategy at Fisher College of Business at Ohio State University. "Money is being poured into private equity. At the top end it's performed well." The stock market, he says, "hasn't been performing that well."

In 1984 Neubauer took the company private, in a management buyout, in response to a hostile takeover bid. It went public again in 2001.

He said in a statement that the group of private equity firms are "committed to working with us in building long-term solutions that deliver the most value for our clients and customers."

Aramark shares closed at $32.58, down 47 cents.

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MONEY

JPMorgan, Bank of New York swap branches, trust units in $3.1B deal ; Chase hopes trade helps broaden its market share, retail presence

Elliot Blair Smith
548 words
10 April 2006
USA Today
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FINAL
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English

In a deal the New York Yankees might have made, JPMorgan Chase traded its corporate trust business and $150 million in cash Saturday to the Bank of New York for the smaller institution's lucrative consumer banking business in the USA's largest financial market.

That makes it New York banking's Sultan of Swat.

Under the $3.1 billion swap of assets and cash, Morgan Chase acquires 338 Bank of New York branches serving 700,000 households and businesses in the hard-fought New York Metropolitan Statistical area.

Charlie Scharf, head of Chase's Retail Financial Services business, said in an interview Sunday the transaction is "a very attractive way to build (our) competitive position in the most important marketplace in the country." The USA's No. 3 bank in assets thus adds to its home-market lead over rival Citigroup and pre-empts potential inroads by two aggressive national competitors, Bank of America and Wachovia.

With a 23.8% deposit share in the New York market already, Morgan Chase snaps up Bank of New York's 5.8% share, expanding its lead in the local market over No. 2 Citibank, with a 16.5% share, according to June 2005 Federal Deposit Insurance Corp. data.

"They've created significant concentration of market share that they didn't have," said bank consultant Richard Speer, chief executive of Speer & Associates. "We think they made a brilliant decision. It gives them distribution points that they can leverage their retail engine through that would be difficult to replicate."

Morgan Chase values the business it is acquiring at $2.3 billion over book value, and the corporate trust business it is selling at $2.15 billion over book value, resulting in its added $150 million cash payment.

Bank of New York, the USA's oldest bank, founded in 1784 by Alexander Hamilton, is a major player in the trust business, offering asset management, private banking and securities services to wealthy individual and corporate clients. But it is a minor player in the consumer banking business, where Morgan Chase is emerging as one of the consolidators.

Morgan Chase CEO James Dimon, who took the company's helm in January, is moving to expand the institution's retail presence under the Chase mantle while growing its traditional investment banking business under the white-shoes Morgan nameplate.

The Bank of New York deal follows a string of acquisitions that includes the purchase of Bank One, completed in July 2004, and the earlier rollups of former New York banking powerhouses Chase Manhattan, Chemical and Manufacturers Hanover.

Last month, in a letter to shareholders, Dimon expressed frustration the company was "underperforming financially in many areas" and signaled his intent to "focus resources where we can succeed and win."

Much of that focus appears to be in consumer banking and credit cards, which recorded combined operating earnings of about $5.3 billion last year, according to the company's 2005 financial results, compared with $3.7 billion in the investment bank, $1.2 billion in asset management, $1 billion in commercial banking and $1billion in its treasury and securities services.

Document USAT000020060412e24a0003i

COVER STORY
MONEY
Dimon adds sparkle to JPMorgan Chase ; Ousted at Citigroup, banker fights his way back to top

Greg Farrell
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English

NEW YORK -- On his first trip to JPMorgan Chase's London office last year, Bank One CEO Jamie Dimon had a full schedule: He had just announced the merger of his Chicago-based retail bank with Chase, and agreed to work under Chase CEO Bill Harrison for two years before taking the reins.

Now he had to introduce himself to some future colleagues: the men and women who headed the bank's most important international office.

Instead of planting himself in the heart of London to schmooze with those executives, Dimon zipped out of town for a 90-minute drive to Bournemouth on England's southern coast, where JPMorgan's operations center is located. There, he spoke to a town hall-style gathering of 550 employees and immersed himself in the details of how Chase's back-office operations work in Europe.

If his new colleagues didn't know it before, they soon realized that Dimon, who takes over as CEO of JPMorgan Chase on Jan. 1, is a guy who pays attention to details.

"Sometimes, all that matters are the details," says Dimon, in his first extensive interview since his promotion was announced. "Sometimes, details will sink you. CEOs should drill down."

Dimon, 49, got his start in the 1980s as a "details" guy, apprenticing under legendary dealmaker Sandy Weill, with whom he worked for 15 years before Weill fired him from Citigroup in 1998.

In 2000, Dimon was recruited to be CEO of Bank One, then a troubled financial institution. He slashed costs, replaced a hodgepodge of different technology systems with one unified platform, and achieved profitability.

In 2004, he agreed to merge with JPMorgan Chase, itself a fusion of multiple banks. As chief operating officer, he would work under Harrison until July of 2006. But last month, after Chase reported strong third-quarter earnings, Harrison announced that he would step aside six months earlier than scheduled.

"Once you announce a successor, you have a certain power shift," says Harrison, who will remain chairman. "It should flow naturally. He never pushed me or suggested I do that. I felt no pressure."

But when Dimon takes the helm, he's likely to feel plenty of pressure. The company's stock has been lagging largely because the bank's many operations seem to add up to less than the sum of their parts.

"Strategy and vision are necessary," says Dimon, a Queens native who can't seem to spit out his words quickly enough to keep up with his thoughts. "But it doesn't work if other things don't work. Execution is the only thing right now. Running the businesses well and making them shine. That will create its own destiny."

Analysts who follow the company say Dimon is the right man to improve order and efficiency in the array of banks put together by Harrison, 62. In revenue, JPMorgan Chase now ranks behind only industry leader Citibank.

"Jamie Dimon is reining in what the visionary has done," says Richard Bove of Punk Ziegel. "I have never come across a CEO who understands a financial conglomerate as well as this guy."

"He stepped into a company -- JPMorgan and Chase -- that was not well integrated itself," says David Stumpf, a bank analyst at A.G. Edwards. (JPMorgan stock is down 14.4% since the merger closed at the end of 2000, while the Standard & Poor's select financial SPDR, an exchange-traded fund that tracks financial services stocks, is up 9.5%.) "People have high hopes. Whether or not you think he's the greatest financial services CEO in the world, it's got to be better managed than before. Whether you buy into the Jamie hype or not, all the evidence points in that direction."

Hype history

The "Jamie hype" stems from Dimon's first career, as right-hand man to Weill. Dimon joined Weill at American Express' Shearson Lehman division in 1983 as a 26-year-old graduate of Harvard Business School. He came to Weill's attention through his father, Ted Dimon, who was a top Shearson broker.

After Weill was ousted in a power struggle with American Express CEO James Robinson in 1985, Dimon stuck with his boss and new mentor, helping him evaluate opportunities for getting back into the finance business.

Weill eventually took control of Commercial Credit, a floundering consumer loan company. Dimon became his point man in the drive to slash excess costs and rebuild the business. They succeeded, then acquired the brokerage firm Smith Barney, Travelers Insurance and ultimately, Salomon Bros.

But the crowning achievement of Weill's career was the merger with Citibank in 1998 to form the largest financial services company in the world. The merger also led to the lowest point in Dimon's career.

Having worked for Weill for 15 years, the younger executive felt comfortable questioning Weill's decisions. Dimon was so self- assured that he rebuffed the attempts of Weill's daughter, Jessica Weill Bibliowicz, to get on the executive fast track at Travelers. Bibliowicz, a highly experienced financial executive, eventually resigned.

After the merger to form Citigroup, Dimon clashed with his opposite numbers from the Citi side. Weill had enough. He convinced co-CEO John Reed that Dimon -- the heir apparent -- wasn't fitting in. They fired him. (Weill and Reed did not return calls for comment.)

Asked if he learned anything from the firing, which caught him by surprise, Dimon leans back in his chair and thinks a moment. At 49, his hair may be graying, but he still has a youthful enthusiasm for answering questions. The lesson: Never shy away from a problem.

"We all avoid things," he says. "But problems don't age well. I try to see the real truth and act on it. On weekends, I'll ask myself, 'What is it I might be avoiding?'"

If a question occurs to him on a Saturday, Dimon will call a colleague to talk it over. Or if he thinks back to a meeting with a subordinate and senses there might be an underlying problem, he'll act on it the following week. "It may just be taking somebody out for a drink, but I'll talk to them," he says.

'Jamie socialism'

Seven years after his firing at Citigroup, Dimon is back to where his early career had been leading: a corner office at one of the world's biggest financial conglomerates. But instead of wallowing in feelings of triumph or revenge, he says he's focused on growing his business.

"I feel tremendous obligation rather than personal triumph," he says. "I was happy at Bank One. I didn't have a dying need to go back to New York. I had a dying need to do the best thing for Bank One."

Dimon says his challenge right now is to keep doing what he's been doing for more than a year: improving efficiency. At Bank One, he canceled the company's policy of issuing cellphones to staffers. Instead, he told employees to pay for their own cellphones and bill the company for any bank-related calls.

In the USA, many companies reward their highest-paid executives by picking up all costs of their health care plans, even if it means rank-and-file employees have to pay more for comparable coverage.

At Chase, Dimon adopted a different arrangement. Investment bankers and traders who make millions of dollars a year pay higher health care premiums so that employees at the low end of the spectrum, such as tellers, can pay less.

"That's 'Jamie socialism,'" says Heidi Miller, a top Chase executive who worked with Dimon at Citigroup and followed him to Bank One. "It's the right approach."

Miller recalls that when Dimon arrived at Bank One, he had a contract that guaranteed him a $1 million bonus. But when he started laying people off to cut expenses, he gave up his bonus. His lieutenants did the same. "He's not afraid of putting himself in the same boat as everybody else," she says.

Dimon's greatest strength, says Miller, is his ability to be both a keen analytical manager and a good people person. "He has a high degree of charisma," she says. "At a large town hall meeting with hundreds of people, they all feel he's talking to them."

Surgeon General's warning

When the merger with Bank One was announced last year, investment bankers at JPMorgan Chase thought Dimon would focus on merging the retail operations of the two organizations, a huge task in itself, and steer clear of their division.

Dimon's strength was in improving operations. The investment banking unit of Chase was generating solid profits. There was some surprise when Dimon began showing up unannounced at meetings among the highflying rainmakers.

Steven Black, who worked with Dimon at Citigroup and is now co- head of JPMorgan Chase's investment banking unit, says he was amused by the thought that Dimon would leave his division alone.

"They thought this was going to be a retail merger, right?" he says. "It should have come with a Surgeon General's warning: For every single thing we do at the entire company, there will be a level of discipline brought to bear that no one has ever seen before. And it will be different."

Black says Dimon's work ethic is beyond compare. "It's a combination of inquisitiveness, of wanting to know every single part of how something works and being willing to go look in every nook and cranny for every bit of efficiency you can get," he says.

Sometimes, Dimon's insistence on inserting himself into every issue sparks heated debate.

"I'm not going to say he's perfect, or that he doesn't step on toes, but you can tell him something, and he's perfectly willing to say, 'You're right. I didn't pay attention,'" says Black. "When you're yelling and screaming and sticking your fingers in each others' eyes, you're treating Jamie as one of your partners, not as the CEO."

"He's not a saint," adds Miller. "He makes mistakes, but he lets you talk back." She acknowledges that she sometimes yells at her boss, a practice Dimon encourages. "The yelling is never personal," she says, adding, "He doesn't yell that much anymore."

If Dimon succeeds in improving JPMorgan Chase's operations, the stock price -- which has been mired in the $35-$40 range for more than a year -- should start rising. If that happens, it will validate Harrison's grand plan of bringing all these banks together and finding a successor with the energy and acumen to make it all work. "Jamie is going to be the best CEO in the business," he says. "He's a great operations guy and a visionary."

TEXT OF INFO BOX BEGINS HERE Comparing companies How JPMorgan stacks up against the competition. All dollar figures in billions:

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CompanyRevenue   Market capitalization   Total deposits
Citigroup$46.7   $250.5   $581.1 JPMorgan Chase$33.3   $136.0
$535.1 Bank of America$26.4   $188.7   $626.5 HSBC Holdings$24.2
$189.3   $841.1 1 -- latest quarter Source: Capital IQ
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TEXT OF BIO BOX BEGINS HERE About Jamie Dimon Age: 49

Born: Queens, N.Y.

Current residence: Chicago

Personal: Wife Judy, three daughters

Recreation: Running, tennis ("I don't play golf.")

Recent books read: Guns, Germs, & Steel: The Fates of Human Societies by Jared Diamond; A Short History of Nearly Everything by Bill Bryson.

PHOTO, Color, Mikki K. Harris, USA TODAY; PHOTO, B/W, Jan. 15, 2004
AP file photo by Mary Altaffer

Document USAT000020051129e1bt0000j

MONEY
CIBC agrees to pay $2.4 billion in Enron settlement ; Deal shows stakes rising

Greg Farrell
456 words
3 August 2005
USA Today
USAT
FINAL
B.3
English

In a sign that the stakes in the Enron civil case are growing by the month, the Canadian Imperial Bank of Commerce agreed Tuesday to pay an eye-popping $2.4 billion to settle charges that it helped Enron inflate its earnings.

CIBC's settlement is larger than what Citigroup and JPMorgan Chase agreed to pay in June even though those two, as Enron's primary banks, were more deeply involved in the energy company's efforts to mask its true financial condition.

On June 10, Citigroup agreed to pay $2 billion to settle shareholder charges that it helped Enron deceive investors. Four days later, JPMorgan Chase agreed to pay $2.2billion to settle similar charges. Although neither bank admitted any wrongdoing, the Securities and Exchange Commission extracted settlements of $120 million and $135 million from them, respectively, two years ago for their roles in Enron's collapse.

By contrast, in December 2003 CIBC paid $80 million to settle SEC allegations that it helped Enron fool investors.

"This is a huge sum of money," says Thomas Ajamie, a Houston attorney who has followed the case closely. CIBC "is not paying this amount of money just because they believe it is a nuisance."

In a statement, CIBC noted that there was no admission of any wrongdoing on its part. Rather, the bank said it "agreed to the settlement solely to eliminate the uncertainties, burden and expense of further protracted litigation."

The implosion at Enron wiped out about $60 billion in shareholder value. The three big bank settlements, along with a series of smaller ones in the past year, bring the total recovery in the class- action lawsuit to $7.1 billion. That makes it the biggest settlement in class-action history, exceeding even the $6.1 billion pledged so far in the WorldCom lawsuit.

The lead plaintiff, the University of California Board of Regents, and its attorney, William Lerach of Lerach Coughlin Stoia Geller Rudman & Robbins, said in a conference call Tuesday they were pleased with the settlement but that there was still lots of work to be done.

The CIBC settlement "builds on the earlier settlements announced over several weeks and sets the stage for important additional progress," said James Holst, general counsel for the Board of Regents. Lerach noted that there were still seven other large banks - - including Credit Suisse, Deutsche Bank and Merrill Lynch -- that face exposure in the case.

A trial is scheduled in Houston for October 2006 if the remaining parties don't settle. Lerach said that CIBC paid more than Chase or Citigroup in part because it waited for them to settle first.

Document USAT000020050803e1830005o

MONEY
JPMorgan settles Enron case for $2.2B ; Payout biggest yet in fraud; bank does not admit guilt

Elliot Blair Smith
431 words
15 June 2005
USA Today
USAT
FINAL
B.1
English

JPMorgan Chase said Tuesday that it will pay $2.2 billion to settle investor allegations that it helped former energy giant Enron prop up its share price through a series of sham loans. The payout is the largest to date in Enron-related litigation, with more Wall Street settlements likely.

The lawsuit led by the University of California brings Enron shareholder recoveries to $4.7 billion but empties the litigation reserves JPMorgan had established for this and other investor complaints related to its allegedly fast-and-loose investment banking practices that prevailed on Wall Street in the late 1990s. Enron's collapse shaved more than $40 billion from its market capitalization.

Plaintiff's attorney William Lerach, who last week hammered out a $2 billion settlement with Citigroup in the Enron case and previously won payments from Bank of America, Lehman Bros. and the defunct accounting firm of Andersen Worldwide, continues to negotiate with the remaining defendants: Merrill Lynch, Credit Suisse First Boston and Deutsche Bank, among others.

"When we are done here this will be the largest recovery, in absolute dollar terms, ever for victims of securities fraud, and it will represent a significant recovery of their potential losses," Lerach said. He estimated shareholders will pocket "more than 90% of the recovery." But that would leave substantial earnings for the class-action lawyers who filed the claims.

JPMorgan, Citigroup and the other defendants faced going to trial next year after the pending criminal cases in Texas against former Enron CEOs Kenneth Lay and Jeffrey Skilling. Former Enron financial executives are expected to testify against their bosses, testimony certain to have implications for the Wall Street banks. In July 2003, JPMorgan paid $135 million to settle a related complaint by the Securities and Exchange Commission.

JPMorgan's settlement of the Enron-related case, made without admitting or denying the allegations, follows its $2 billion settlement in March of investor claims related to its work for telecom giant WorldCom, now known as MCI. Those and other legal claims tapped the $3.7 billion in reserves the bank had established in the second quarter of 2004 followed by a $900 million addition early this year.

JPMorgan CEO William Harrison Jr. said the bank would now add $2billion to its reserves to cover its remaining legal liability, producing a $1.25 billion after-tax charge to earnings this quarter.

Harrison said, "We are working hard to put the uncertainty of litigation risk behind us."

Document USAT000020050615e16f0007f

COVER STORY
MONEY
Struggling airlines can stay aloft for years ; Government, creditors, assets, labor all play roles

Dan Reed
2,215 words
4 May 2005
USA Today
USAT
FINAL
B.1
English

How in the world do these guys stay in business?

The USA's big airlines have lost $35 billion since 2000, yet not a single one of them has gone away.

No.2 United continues in its third year of operating under bankruptcy protection. No.7 US Airways, likewise, is operating under bankruptcy-court protection and is seeking a merger with a more solvent, but struggling, America West. No.3 Delta registered a record loss of $5.2 billion last year -- a staggering $41.07 a share -- and continues to slide toward a liquidity crisis.

Yet the USA's roster of big airlines continues nearly unchanged since the beginning of a devastating industry downturn that began nearly five years ago, and accelerated with a plunge in travel following the Sept.11 terrorist attacks. Not even the most financially fragile carriers appear to be in imminent danger of shutting down. No large U.S. airline has simply ceased operations since Pan American World Airways shut down in December 1991, although TWA disappeared after American bought it in 2001.

"It takes a lot and a very long time to kill an airline," says Tom Plaskett, who as Pan Am CEO from 1988 until 1991 juggled furiously to keep the grand dame of the U.S. airline industry afloat.

He compares it to the way many people manage their own finances: "They live from paycheck to paycheck, always scrambling to find a little extra cash here or there."

But airlines don't face the same limitations as people. They don't even face the same limitations as most failing businesses. If they did, the industry would look more like Big Steel, where changing economics have washed away former industry stalwarts such as Bethlehem, LTV and Weirton.

Big airlines can't simply close their doors when the losses pile up. Creditors, government, employees, politicians and the public have too much at stake. The result: For terminally ailing airlines, the demise can be played out over years, maybe decades.

"This business has extremely high barriers to exit," Continental President Jeff Smisek complained at an investors conference in February. Smisek said essentially failed carriers are permitted to hang on, dragging down the rest of the industry with their excess capacity and too-low fares.

1 Government An army of powerful and wealthy outside parties is dedicated to keeping even the most economically dysfunctional big airline alive. Foremost among them is Uncle Sam.

The federal government now has at least $9.5 billion directly invested in the survival of the nation's big airlines in grants, loan guarantees and tax waivers. An additional $30 billion-plus in underfunded airline pensions could also fall to the government.

Congress and executive agencies have shown a willingness to absorb even more of the load. Their motivation: the need to maintain the USA's far-flung air service, workers' retirement security and the one in 12 U.S. jobs tied to commercial aviation.

Rather than allowing airlines to go broke after 9/11, Congress delivered $7.5 billion in emergency aid. It also waived collection of certain taxes and fees for four months in 2003 to help the airlines survive, saving them about $350 million. The Air Transportation Stabilization Board, the industry support agency created after 9/11, has issued about $1.6 billion in loan guarantees to carriers.

In 2003, for example, the ATSB backed a $900 million loan guarantee that helped US Airways emerge from Chapter 11 bankruptcy. Then, last September, when the carrier entered Chapter 11 a second time, the ATSB agreed to allow it to use some of the cash it had pledged as collateral for that first loan to keep it flying.

"US Airways has the very best lender-of-last-resort known to man - - the U.S. government," Smisek says. "Your and my tax dollars are being (frittered) away daily there."

Nor is the ATSB the only government agency with a stake in the airlines' survival. The Pension Benefit Guaranty Corp., the federal agency that insures corporate defined-benefit retirement plans, already has been stuck with the $2.3 billion bill for US Airways' failed plans.

And Tuesday, a bankruptcy judge in Chicago is scheduled to consider a tentative deal for PBGC to assume $6.6 billion in liabilities from four underfunded United pension plans. The deal would relieve United of $645 million a year in pension costs.

And it could get worse for the PBGC as rival carriers seek to level the playing field with United by dumping their pension plans on the government insurer. Already facing a $23 billion deficit, PBGC could end up covering an estimated $31 billion in underfunded airline pensions if United rivals dump their plans too.

2 Labor Three times since 9/11, US Airways workers have agreed, after great outcries, to big pay and benefits cuts, the outsourcing of thousands of jobs and the shutdown of their pension plans. In some cases, workers approved concessions only to pre-empt more painful concessions that might have been imposed by a bankruptcy judge.

That was the case in November, when Delta's pilots, long the highest paid, took a 32.5% cut to save the carrier $1billion a year and, for a time, keep it out of bankruptcy reorganization.

In March, Continental pilots and ground workers approved $249 million a year in concessions that management said were necessary to avoid a cash crunch, shrinkage and a potential bankruptcy filing. Combined with management and non-union worker pay and benefits cuts, Continental has cut employee costs by $418 million a year and wants to push that to $500 million.

Flight attendants there narrowly turned down a similar concessions package. But the pilots and ground workers unions, who had the right to walk away from the deal if any of the unions rejected it, waived that right, to keep Continental from defaulting on loan covenants. Management has resumed negotiations with flight attendants.

Two years ago, American's employees voted at the last minute to accept concessions worth $1.6billion a year to keep it out of Chapter 11.

In bad times, "Labor nearly always comes to the table with concessions to lower your costs," Plaskett says. Many -- especially those like pilots and mechanics with highly specialized skills -- have few good career alternatives.

The last time of note when that didn't happen was in 1989. Machinists union workers refused to grant concessions sought by Eastern Airlines. A strike put the carrier into Chapter 11 and, two years later, out of business. It's a lesson that labor, much to its dislike, has taken to heart, says Adam Pilarski, head of aviation consulting firm Avitas.

"If I'm a pilot who ... was earning $300,000 a year and living a very comfortable lifestyle, I would be angry over a 20% pay cut. That's $60,000. I'd scream," he says. "But if the other option is making zero, what choice do I have?"

The pattern is likely to continue. Sometime soon, perhaps this month, the bankruptcy judge handling United's case is expected to impose cuts that mechanics there have been resisting -- unless their union agrees to such cuts first.

Also, Northwest is turning up pressure on all its unions. The pilots already have taken a temporary cut and are urging other unions to share the pain. In recent weeks, the sense of urgency has increased, with management demanding that deals be reached this year.

3 Creditors Banks, aircraft-leasing companies, airplane and engine makers and other vendors have lots of skin in the game, too. To protect their investments, they've been accommodating to struggling airlines.

In the current downturn, General Electric has been the most accommodating of all. GE makes about half of the commercial jet engines in use. Another GE unit provides major maintenance and aircraft overhaul services to airlines. And its General Electric Commercial Aviation Services is the world's largest aircraft- leasing company, with about 1,300 jets. A shutdown of a major carrier could create a sudden glut of planes on the leasing market.

That's largely why GE has lent more than $8billion to struggling airlines since 9/11. It has propped up, among others, US Airways -- to which it has $2.9 billion of exposure on leases, loans and services contracts -- Delta and Air Canada.

"Having lots of liquidity is great, but owing GE lots of money is even better," says UBS analyst Robert Ashcroft. "If GE is significantly involved, it is likely to act" to keep an airline in business.

The airlines, with their huge debts, have a ton of leverage on the largest of their lenders, says David Butler, an Atlanta attorney and former U.S. bankruptcy trustee. When an airline owes hundreds of millions, lenders "are not creditors, they're partners," Butler says.

In another key concession to a struggling airline, American Express paid Delta $750 million in advance for frequent-flier miles it buys from the airline for its SkyMiles charge card users. A Delta failure could drive loyal AmEx customers to rivals' mileage cards. That gives the credit card company strong incentive to keep the cash flowing to the airline even before payment is due.

"That card is a hugely valuable franchise for American Express," Butler says.

Partly because Bank One had a similar credit card deal with United, its investment banking arm in December 2002 stepped in with more than $300 million in financing to allow the No.2 airline to operate while in bankruptcy protection. Through various business relationships, Bank One had more than $1.4 billion in financial exposure to the carrier at the time of its 2002 Chapter 11 filing. Bank One since has merged with J.P. Morgan Chase, which is maintaining the relationship with United.

4 Assets Even the most cash-poor airlines have one big, additional source of potential financial help: assets to sell.

Pan Am went repeatedly to the pawn shop. Among assets sold, prolonging its time in business: its namesake Manhattan skyscraper, its Intercontinental Hotels unit, its subsidiary that serviced the Space Shuttle, its lucrative rights to serve London's Heathrow Airport, its European division, its Latin American routes, even its crown jewel -- the historic Pacific Division.

Chronic money-loser TWA, acquired out of Chapter 11 by American in 2001, survived for 20 years in much the same way. It sold itself twice, once to investor Carl Icahn, and then back to the public. In an arrangement dubbed "the light bulb deal," TWA once raised $300 million in cash by selling bonds secured by spare airplane parts, mechanical equipment and office furnishings, right down to the light bulbs at its headquarters.

"People think airlines run on jet fuel, but they're wrong," Plaskett says. "They run on cash, and as long as they can keep raising cash, they can stay in business."

Big airlines today are reluctant to do that, says consultant Jon Ash of InterVistas-ga2. It would "start a downward spiral toward the ultimate liquidation" of the enterprise.

But the temptation may build as they continue losing money. Consider that Pan Am manufactured 20 years of extra life by selling assets, and TWA bought perhaps 15 extra years. Assuming buyers could be found, Ash estimates that:

*United could raise up to $2billion through the sale of its Pacific Division, bought from Pan Am nearly 20 years ago.

*Northwest, likewise, has Pacific and Asian routes worth as much or more.

*Delta's two regional carriers, ASA and Comair, could net perhaps as much as $1billion total.

*American's Latin American division and its rights to serve Heathrow might fetch $3billion or more.

Plus, most carriers have real estate, airport-gate leases, service subsidiaries, spare parts and equipment, and, yes, even light bulbs, that can be used to generate cash.

Ultimately, Pilarski says, the big airlines have shown they don't have to make actual profits to remain in business.

Through most of industry history, they've survived downturns by finding ways to generate the cash that is their lifeblood. They then repaired their balance sheets during cyclical peaks.

But this downturn is the deepest and longest ever, and it is accompanied by a fundamental shift in industry economics toward low everyday pricing. The big carriers' cash-generating capabilities are being strained like never before. And oil prices continuing at $50- plus a barrel may be what "puts them over the edge," Pilarski says.

Even now, Pilarski adds, most of the big carriers have well over $1billion in cash.

"If they can't pay their employees, or for their fuel or airplanes, then they will shut down. Not before."

TEXT OF INFO BOX BEGINS HERE: GE's aircraft leasing With more than 700 planes leased to U.S. carriers, General Electric Commercial Aviation Services and its corporate parent have been key to keeping struggling airlines flying. The number of planes leased by GE to big U.S. carriers as of mid-February: Airline Full-size jets Regional jets American 24 0 Continental 99 0 Delta 32 0 Northwest 12 84 Southwest 5 0 United 15 0 US Airways 94 30 Sources: Airclaims CASE, UBS Investment Research

Document USAT000020050504e1540007k

MONEY
J.P. Morgan settles WorldCom claims for $2 billion

Thor Valdmanis
495 words
17 March 2005
USA Today
USAT
FINAL
B.1
English

NEW YORK -- J.P. Morgan Chase agreed Wednesday to pay $2 billion to settle claims of thousands of investors who lost money in the collapse of WorldCom, becoming the last major bank to reach a deal.

The surprise announcement by New York Comptroller Alan Hevesi, the court-appointed lead plaintiff in the class-action lawsuit, came a day before trial.

"Given recent developments, we made a decision to settle rather than risk the uncertainty of a trial," J.P. Morgan Chase CEO William Harrison said in a statement.

J.P. Morgan lost a series of rulings before U.S. District Judge Denise Cote, including a decision Monday that could have doubled the bank's potential liability to $10 billion. The settlement wipes out about five years of fees for underwriting investment-grade bonds.

A total of 16 banks involved in the underwriting or sale of billions of dollars of WorldCom bonds have agreed to pay more than $6 billion -- eclipsing the $3.2 billion Cendant deal five years ago as the biggest securities class-action settlement.

Unlike most class-action awards that largely enrich plaintiffs' lawyers, about 95% of the proceeds are set for former WorldCom investors, mostly bondholders.

"We insisted on the lawyers accepting a reasonable fee arrangement," Hevesi said. "We are talking about millions of dollars at stake."

J.P. Morgan's board met to approve the settlement as news broke Tuesday that a jury found former WorldCom CEO Bernard Ebbers guilty of orchestrating the $11 billion accounting fraud at the company, which imploded in 2002, leaving thousands of investors and employees empty-handed.

Lawyers for Hevesi say they are also close to a renewed settlement with 11 former WorldCom directors, who are expected to pay about $18 million, or more than 20% of their collective net worth. Director's insurance will add $36 million, bringing the total to about $54 million. That would leave former WorldCom board member Bert Roberts and failed auditor Arthur Andersen as the last holdouts.

"Considering we were dealing with a bankrupt telecom company, a defunct auditor and banks with a due-diligence defense, we are pretty pleased," said Bernstein Litowitz partner Sean Coffey, an outside lawyer on Hevesi's team.

J.P. Morgan Chase, which last year rejected a $1.37 billion settlement, plans to take a charge of $900 million. The shares closed unchanged at $36.25.

TEXT OF INFO BOX BEGINS HERE

How much banks are paying

J.P. Morgan was the last of 14 banks to settle, bringing the total to $6.0 billion. Settlements (in millions):

Citigroup$2,600

J.P. Morgan $2,000

Bank of America$461

Deutsche Bank Securities$325

ABN Amro$278

Mitsubishi Securities$75

WestLB$75

Lehman Bros.$63

BNP Paribas Securities$38

Caboto Holding$38

Mizuho International$38

Credit Suisse First Boston$13

Goldman Sachs$13

UBS Warburg$13

Source: Office of New York State Comptroller

Document USAT000020050317e13h0004c

MONEY
Painful year for funds in scandal ; Untainted funds see large gains

John Waggoner and Christine Dugas
424 words
3 September 2004
USA Today
USAT
FINAL
B.01
English

Mutual fund companies have felt the pain of fines since New York Attorney General Eliot Spitzer uncovered the trading scandal one year ago today. But investors have administered the harshest punishment.

Spitzer stunned the industry when he charged Canary Capital Partners with illegal trading practices at Bank of America, Bank One, Strong Financial and Janus Capital. Nearly a dozen other fund companies have been implicated since.

The Securities and Exchange Commission and state regulators hit the miscreant funds with fines, but investors have administered brutal punishment by yanking billions from them. Lipper, the mutual fund tracker, says that scandal-tainted funds watched $155.6 billion flee from September 2003 through July, the latest figures. Untainted funds gained an estimated $128.6 billion.

Financial Research, which tracks fund flows, says that the biggest losers the 12 months through July have been:

* Putnam Investments, which saw $38.5 billion in stock and bond fund assets flee. Putnam paid $55 million in April to settle an enforcement action with the SEC. The charges: that the Boston-based firm let favored investors, including some of its own fund managers, make rapid, in-and-out trades in its funds. That's not illegal, but Putnam's prospectus forbids it.

* Janus Capital saw an estimated $22.6 billion outflow. Denver- based Janus paid $100 million last month to settle market-timing charges with the SEC.

* Strong Financial watched an estimated $6.9 billion bolt. The SEC fined Strong $140 million and barred Richard Strong, the company's CEO, from the industry. Wells Fargo agreed to buy the Menomonee Falls, Wis., company in May.

Brokers and advisers probably yanked the most money from scandal- tainted funds, says Don Cassidy, research analyst at Lipper.

"What we've seen over the last year is that the sector that had the reputation for being the safest, the most secure, the most honest, had significant problems," Spitzer says.

Fear of being hit by waves of redemptions could help keep funds from straying, says Harold Evensky, a financial planner in Coral Gables, Fla. "At least in the short term, it's sobering for them."

The fund scandal is noteworthy for another reason: profound stupidity. The profits the funds made from allowing market timing are dwarfed by the business they have lost. "It looks like the worst business decision of the decade," says Roy Weitz, publisher of FundAlarm.com, an Internet site that follows the industry.

See related story: 06B

Document USAT000020040903e0930000u

Investing
MONEY
Spotting a merger early is a tough nut

John Waggoner
731 words
20 February 2004
USA Today
USAT
FINAL
B.03
English

Spring is just around the corner, and it's not just the wildlife that has the urge to merge. Being on the right side of a merger deal can mean a quick profit.

But predicting which company will be bought is harder than getting a rabbit to take a chastity pledge. If you want to capture the profits of merger mania, consider the matchmakers: investment bankers. And if you don't want to buy an individual stock, make a date with a financial services fund.

Several big mergers and merger proposals have been in the headlines recently. Cable giant Comcast wants to marry Disney. Cingular Wireless bid $41 billion for AT&T Wireless. Investment bank J.P. Morgan will merge with Bank One.

The irony is that many mergers turn out to be dreadful business decisions. Ask an AOL shareholder how the merger with Time Warner worked out.

The Boston Consulting group conducted a study in 2002 of larger U.S. mergers from 1995 to 2001. They found that 61% of the mergers didn't add value for shareholders of the acquiring company.

But strong economic growth tends to get the merger juices flowing. In a recession, companies look for earnings improvements through cost-cutting.

In a recovery, "Companies become more outwardly focused," says Chris Perry, portfolio manager of Turner Financial Services fund. "CEOs become more comfortable with combining companies." And interest rates are still low if they need to borrow to buy.

Investors love mergers because the stock of the company being bought usually rises when the deal is announced -- or beforehand, if speculation is rife. Investors figure that the purchaser will pay a high price for the company. The stock of the company that's buying usually falls, for the same reason.

Companies may be bought for a number of reasons. They may have production capacity or customers that another company covets.

They may have several divisions that, if the company were hacked apart and the pieces sold, would return more than the purchase price.

Or the acquirer may argue that the two companies are stronger together than they are separately.

Spotting a takeover candidate isn't easy. For many investors, buyouts are a happy accident -- a side benefit to buying cheap, down- and-out companies. "I don't chase takeovers," says David Ellison, manager of FBR Financial Services fund. When a takeover happens, "It's like a blind squirrel finding a nut," he says.

But if you're looking for takeovers, the financial services industry offers a double-barreled play:

* Regional banks are a fertile field for takeovers, says Turner's Perry. Many have reported fat earnings from mortgage refinancing fees. As the refinancing boom cools, many will see earnings growth dwindle. "They will have to acquire to grow in 2004," Perry says.

* Investment banks, which earn fees for arranging mergers, should also benefit. At Lehman Bros., for example, earnings jumped to $1.71 per share the fourth quarter of 2003 from 69 cents the fourth quarter of 2002. Investment banking revenue rose 19%. Merrill Lynch's Global Markets & Investment Banking division saw pretax earnings rise 16% last year, to $3.9 billion.

"The prospects for (the investment banks) are pretty bright for 2004," says Mike Holton, portfolio manager for T. Rowe Price Financial Services fund. Initial public offerings of stock -- a profit center for investment bankers in bull markets -- are heating up.

During the bear market, many companies reaped profits underwriting bonds and continue to do so. Holton favors (and owns in the fund) Merrill Lynch, Goldman Sachs and Lehman Bros.

Nothing's a sure bet, of course. Derek Rollingson, manager of Icon Financial Fund, thinks the investment banks are fairly valued now. He thinks there's more money to be made in property-casualty insurers and consumer lenders and has no investment banking firms in his fund.

A sharp rise in interest rates could hurt all financial services stocks, although FBR's Ellison argues that modest rate increases will simply enable banks to increase rates -- and profits -- on loans. But if you want to cash in on merger mania, a financial services fund may be the best way to get your money to multiply.

John Waggoner's column appears Fridays. E-mail: jwaggoner@usatoday.com.

GRAPHIC, B/W, Source: Lipper (CHART)

Document USAT000020040220e02k0003v

COVER STORY
MONEY
J.P. Morgan, Bank One to join ; Ousted Citigroup exec Dimon poised for comeback in $60B deal

Thor Valdmanis, Christine Dugas and Adam Shell
1,577 words
15 January 2004
USA Today
USAT
FINAL
B.01
English

NEW YORK -- Little more than five years after being cast into exile, Jamie Dimon is returning to Wall Street on a chariot.

Dimon, a protege of Citigroup chief Sandy Weill before his abrupt firing in 1998, is set to lead the blockbuster $60 billion banking combination of J.P. Morgan Chase and Bank One, announced late Wednesday amid a whirlwind of market speculation.

Set to take over as CEO in 2006 under a sensitive and detailed power-sharing arrangement, Bank One CEO Dimon hopes to build a colossus that glues J.P. Morgan's volatile investment banking and trading concerns with the more predictable consumer and credit card businesses of Bank One.

J.P. Morgan Chase, as the combined company is to be known, would be the nation's second-biggest bank, with $1 trillion of assets and 2,300 branches in 17 states centered in the Midwest and Northeast. Only Weill's Citigroup, with its huge global reach, would be larger.

"I don't think Citi is going wake up in a panic at this news," says Brock Vandervliet, the banking analyst at Lehman Bros. who proved prescient with a note last week trumpeting potential benefits of a J.P. Morgan-Bank One deal. "Sandy will likely say: 'Good luck in getting the integration right, and we'll see where you are in two years.' "

The deal could usher in more consolidation. Banking mergers are back in vogue, most notably with the October $49.3 billion deal that ties together Bank of America, the nation's third-largest bank, and FleetBoston Financial, the seventh-largest. Regional banks such as Wells Fargo and Wachovia are likely to come under intense pressure from shareholders to grow through acquisition.

Although the wheeling and dealing has yet to pay significant dividends for consumers in improved service or reduced fees, securities regulators are unlikely to block any proposed mergers, analysts say. Several thousand banks still operate in a highly competitive environment.

J.P. Morgan and Bank One say they are aiming for cost savings of $2.2 billion over three years and are determined to build on their top-tier positions in retail banking and lending, credit cards, investment banking and asset management. Merger-related costs are expected to be $3 billion. The companies expect to eliminate 10,000 jobs, or about 7% of their combined workforce.

The merger's success or failure will likely hinge on how well the respective businesses mesh and how well the hard-driving senior executives get along. William Harrison, J.P. Morgan's chairman and chief executive, will keep those jobs in the combined company, while Dimon becomes chief operating officer before taking the reins two years after the deal is closed.

In interviews late Wednesday, both Harrison, 60, and Dimon, 47, stressed that they are determined to make the partnership work.

"We've known each other for years," Harrison says. "We've already made management decisions three levels down. We've both been through enough mergers to know that is of critical importance."

Under the terms of the deal, Bank One shareholders would receive 1.32 J.P. Morgan shares for each Bank One share, valuing Bank One at $51.77 a share, a 14.5% premium over its Wednesday closing price of $45.22. As the deal began to leak in late afternoon, investors pushed up the shares of both banks, with J.P. Morgan increasing 32 cents to $39.22 and Bank One gaining 61 cents to $45.22. In after- hours trading, J.P. Morgan shares dropped $1.40 to $37.82. Bank One fell 7 cents to $45.15.

The merger would allow Dimon to go head-to-head with Weill, Citigroup's chairman. Friends say the pair have patched up differences but remain highly competitive.

A comeback role

"It is a Horatio Alger story," says Richard Bove, managing director at brokerage Hoefer & Arnett. "He (Dimon) got booted out of Citigroup, was out of the industry. (He) becomes CEO of Bank One and spends three tortuous years to turn the bank around. And now he has engineered a blockbuster."

Dimon relishes his comeback role. "I don't know about coming back on a chariot, but I did feel cast out," he says.

Fresh out of Harvard Business School at age 26, Dimon took a job with Weill and, through a series of acquisitions in the 1980s and 1990s, helped build insurance powerhouse Travelers Group. But by the time Travelers bought Citicorp in 1998 to create Citigroup, the world's biggest name in financial services, the relationship between Weill and Dimon had worn thin.

On Nov. 1, 1998, Weill fired Dimon, and Dimon spent more than a year reviewing his options.

When he took over an ailing Bank One in 2000, Dimon stressed that he did not take the job so he could get the $265 billion asset company in shape to be sold.

"I want to make the company strong so it's a predator, not the prey," he said at the time. He bought $58 million in his new employer's stock with his own money, at $28 a share as proof of his determination to resuscitate Bank One.

Moving his family from Manhattan to Chicago, Dimon succeeded in his turnaround effort. His investment in Bank One shares has paid off handsomely.

Now, as he contemplates his return to Wall Street, the big question is whether Dimon's brash and outgoing style will fit with Harrison's more reserved demeanor.

Harrison is a third-generation banker and an avid gardener who grew up in Rocky Mount, N.C., a cotton and tobacco town, where his grandfather founded Peoples Bank & Trust in 1931. He went to the University of North Carolina and played basketball for legendary coach Dean Smith, although he was not a Tar Heels starter.

After earning a degree in economics, Harrison joined Chemical Bank and quietly worked his way to the top. Harrison was instrumental in Chemical's $10 billion acquisition of Chase Manhattan in 1995, at the time the largest banking acquisition ever. He was named CEO of the combined company in 1999.

But less than two years later, Harrison faced a barrage of criticism after Chase's $34 billion merger with J.P. Morgan. Critics said he overpaid for an investment bank that was racked by bad loans, venture-capital losses and poor markets. Top bankers left the merged entity in droves.

But Harrison has turned the bank around in the past year, lifting its performance and its share price. That made a deal with Bank One palatable when he and Dimon first seriously broached the subject in early November. The deal was sealed in recent days. J.P. Morgan was advised by J.P. Morgan Securities and law firms Simpson Thacher and Sullivan & Cromwell, while Bank One used bankers Lazard and lawyers Wachtell Lipton.

'This blows me away'

Wall Street was abuzz at news of the merger.

"This blows me away," says Robert McKinley, CEO of industry tracker CardWeb.com. "In our business, it will make a new No. 1 credit card issuer. They will unseat Citibank."

Both credit card portfolios had been lackluster, McKinley says, noting that Bank One was just starting to improve at the end of last year.

The combined company will also be a powerhouse in retail banking, says Stuart Feldstein, president of SMR Research, a Hackettstown, N.J., consulting firm. Other recent mergers also have been about expanding retail banking presence across the USA.

"Bank of America bought Fleet because New England was a weak area for them," says Feldstein. "It's all about geographic spread."

Until now, J.P. Morgan hasn't had much of a retail banking presence outside of the greater New York area. Instead, J.P. Morgan built a national presence through corporate lending, securities business and asset management.

"This merger puts them more in the big leagues, in terms of their contact with ordinary folks through branch banking," Feldstein says.

"Both companies have a lot of experience in acquisitions," says Fitch Ratings analyst Sharon Haas. "So I think the likelihood of success is pretty good."

TEXT OF INFO BOX BEGINS HERE

J.P. Morgan Chase

Headquarters: New York

Ticker symbol: JPM (NYSE)

Chairman and CEO: William Harrison Jr.

2002 revenue: $29.6 billion

2002 net income: $1.7 billion

Third-quarter 2003 revenue: $7.5 billion

Third-quarter 2003 net income: $1.6 billion

Description: Second-largest financial services firm in the USA, with operations in more than 50 countries.

Bank One

Headquarters: Chicago

Ticker symbol: ONE (NYSE)

Chairman and CEO: James Dimon

2002 revenue: $22.2 billion

2002 net income: $3.3 billion

Third-quarter 2003 revenue: $4.1 billion

Third-quarter 2003 net income: $883 million

Description: Sixth-largest bank in the USA, with 1,800 branches in 14 states.

Sources: Hoover's, the companies, USA TODAY research

Contributing: Matt Krantz

GRAPHIC, Color, Karl Gelles, USA TODAY, Source: American Banker (BAR GRAPH); GRAPHIC, B/W, Adrienne Lewis, USA TODAY, Source: CardWeb.com (BAR GRAPH); GRAPHIC, B/W, Source:USA TODAY research (CHART); PHOTO, B/W, 200 photo Peter Mountain, Reuters; PHOTO, B/W, Ron Wurzer, Getty Images;

Caption: William Harrison Jr.: Chairman J.P. Morgan Chase. James Dimon: Chairman of Bank One.

Document USAT000020040115e01f0004v

MONEY
Southwest move puts low-fare airlines in direct competition

Dan Reed
493 words
30 October 2003
USA Today
USAT
FINAL
B.03
English

Southwest Airlines' May arrival in Philadelphia could be bad news not only for high-cost US Airways, but also for two rival discounters, AirTran and JetBlue.

It's the clearest sign yet that the competitive free ride that low-cost carriers have enjoyed the past couple of years is ending. Discount airlines are beginning to bump into one another as they grow. The big, high-cost carriers are starting to fight back.

Consumers will benefit. History shows that fares tumble when low- cost carriers enter markets. In the few markets where discount carriers face off, prices fall more. But that cuts into the discounters' profits.

Southwest is jumping into Philadelphia now partly to head off a costly battle later. Chief Financial Officer Gary Kelly told reporters last week that, "We don't want to wake up in five years and find that another (discounter) has established a strong presence in a market we want to enter."

Analyst Jamie Baker at J.P. Morgan Securities says Southwest's Philadelphia move is a "modest disappointment" for AirTran, which has higher costs than Southwest. It could face pressure to lower prices on its flights from Philadelphia to four Florida cities and to Boston if Southwest chooses to fly those routes. Any growth plans it might have had there now will be subject to what Southwest does.

For New York-based JetBlue, it is a "psychological negative," Baker says. "Hand-to-hand combat is likely years away." But the two are "one step closer" to a showdown.

Other examples of rising competition among discounters:

* JetBlue is withdrawing from Atlanta-Long Beach and Atlanta- Oakland in December, after six months. Delta and AirTran protected their Atlanta hubs by flooding the market with cheap seats.

* America West launched its first non-stop transcontinental flights Sunday from New York's Kennedy Airport to Los Angeles International Airport (vs. JetBlue's JFK-Long Beach service). Prices in the New York-Los Angeles market now go as low as $278 round trip, restricted; $299 one way, unrestricted.

* ATA, which competes with Southwest at Chicago's Midway Airport, has scratched out a couple of quarterly profits this year but not enough to meet a $300 million bond debt payment due in November. A debt-restructuring deal is in the works.

The high-cost carriers also are beginning to fight the discounters.

* US Airways CEO David Siegel says his carrier must defend itself in Philadelphia, where it gets 25% of its revenue.

* American CEO Gerard Arpey says discounters have had it "pretty easy" competing against high-cost airlines lately, but, "We are not running from these (discounters) anymore." American could announce a major simplification of its pricing and services by Thanksgiving.

* In the spring, Delta launched Song, a low-cost secondary brand, to compete against JetBlue and other low-cost carriers. United wants to launch a similar low-cost brand next year.

Document USAT000020031030dzau00041

MONEY
JetBlue gains on its competition ; Low-fare upstart advances in N.Y. area at rivals' expense

Dan Reed
1,105 words
13 August 2003
USA Today
USAT
FINAL
B.03
English

Three-year-old JetBlue likely will become the fourth-largest domestic airline in the hotly contested New York City area this year, and should pass both Delta and Continental airlines to become the biggest carrier in the heavily traveled New York-Florida market by the end of 2004.

While the upstart's everyday low fares business model is earning it profits, it also is helping to turn the Big Apple, once one of the major airlines' most lucrative markets, into a big headache for its high-cost competitors.

JetBlue has captured 10% of domestic-flight revenue in the New York market, just 3 1/2 years after it began flights, according to a recent J.P. Morgan report.

Its growth has come at a time when fewer travelers are flying in and out of the New York area. From the first quarter of 2001 to the fourth quarter of 2002, the number of domestic passengers traveling to and from the New York City area's three main airports -- LaGuardia, John F. Kennedy and Newark, N.J.-- fell by 9.7%, according to Department of Transportation data.

Even worse -- for the big airlines -- J.P. Morgan analyst Jamie Baker estimates that revenue from domestic air tickets to and from those three airports dropped 27%, to $1.6 billion from $2.2 billion during that same time frame.

JetBlue spokeswoman Fiona Morrison sticks to the company's standard explanation: "Our business model is the stimulation of flying; getting people to get up and do something they otherwise wouldn't do."

But the numbers show that much of JetBlue's success is coming at the expense of its major airline rivals. Not only are they selling fewer seats to and from New York these days, they're asking less for the seats to prevent the defection of even more customers.

JetBlue already has blown by US Airways, operator of the US Airways Shuttle in the Washington-New York-Boston corridor, and Northwest, both of which claim 5% of the domestic revenue in the New York area market. And by year's end it is expected to be ahead of United, which has lost 4.1 percentage points of revenue share in three years and is currently hanging on to an 11% share of the market. It's also closing in on Delta, which now has 16% of the market.

Continental and American remain New York's market leaders, holding domestic revenue shares of 25% and 24%, respectively. But both are losing share and profits because of JetBlue's presence in the market.

Of the two, American, a major player at LaGuardia and the biggest carrier at Kennedy Airport, JetBlue's home base, is suffering more. Its revenue share of the domestic New York market fell 2.7 percentage points from 2000 to 2002. Continental, which offers more domestic departures from the New York area than any other carrier, serves a somewhat different customer base from its Newark airport hub. As a result, its New York area revenue share was off a more modest 1.3 percentage points.

Still, Continental is not immune. In the New York-Florida air market, a point of emphasis for JetBlue, the newcomer now has nearly 20% of that large but notoriously price-sensitive market. Both Delta and Continental hover around 22%.

That's a big threat to Delta, where executives last winter told analysts that Florida was the second-biggest revenue generator in the Delta system, behind only its home state, Georgia.

Defending its Northeast-to-Florida turf against incursions such as JetBlue's was a primary factor in Delta's April launch of its low- fare subsidiary, Song. Delta recently began flying between Tampa and LaGuardia, proclaiming that it is the only low-fare airline serving all three New York airports.

"What really interests me is how far the low-fare model has come, and how fast," Baker says.

Consumers, he says, are responding to JetBlue's low fares and its perceived value, which includes comfortable seats and 24 channels of satellite TV at each of them. "Paying less and getting more is far preferable to the major airline alternative," Baker says. "It didn't take long for consumers to learn that paying less, and getting live TV is pretty cool."

"I can't lay all the deterioration in those other carriers' numbers at the feet of JetBlue," he adds. "The market has shrunk. There was a collapse in demand for business travel, a recession, and 9/11. But JetBlue is having a big impact."

The continued rapid growth of low-fare air service, both in the New York market and elsewhere, also will make a full revenue recovery by the major carriers nearly impossible, Baker says.

Business travelers may eventually come back in the kind of numbers seen prior to 2001, he says, but few will pay anything close to what they were paying for airplane seats in 1999 and 2000.

"If and when the business traveler emerges from hibernation, he'll likely find it fairly difficult to be gouged at the pump," Baker says. "In many domestic markets you simply can't spend more than $299 one way any more."

TEXT OF INFO BOX BEGINS HERE

As the domestic air travel New York market shrinks . . .

Domestic passengers, arriving and departing, at LaGuardia, Kennedy and Newark airports 2000-2002. In millions:

2000

2001

2002

'02 vs. '00

LaGuardia

22.3

20.1

19.4

-13%

Kennedy

14.1

13.3

14.5

3%

Newark

25.3

23.2

21.8

-14%

Total

61.7

56.6

55.7

-10%

. . . JetBlue is coming on strong

Share of revenue from domestic flights to/from LaGuardia, Kennedy and Newark airports, fourth-quarter 2002. Percentage point change from first quarter 2000:

'02 share

'00 share

Change

Continental

25%

26.3%

-1.3 points

American

24%

26.7%

-2.7 points

Delta

16%

15.9%

+0.1 points

United

11%

15.1%

-4.1 points

JetBlue

10%

1.0%

9.0 points

US Airways

5%

7.7%

-2.7 points

Northwest

5%

5.8%

-0.8 points

Others

4%

1.5%

2.5 points

Total

100%

100%

--

Source: J.P. Morgan estimates

PHOTO, B/W, Joe Raedle, Getty Images; PHOTO, B/W, Stephen Shernin, Getty Images;
Caption: Success stacks up: JetBlue planes line up at Kennedy International Airport in New York. The airline has made big inroads in the New York area. Another sale: JetBlue lead agent David Young issues a plane ticket in Fort Lauderdale.

Document USAT000020030813dz8d0000c

MONEY
Banks settle case for $289M ; 2 accused of helping Enron hide loans

Greg Farrell
435 words
29 July 2003
USA Today
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FINAL
B.01
English

NEW YORK -- Two banking giants agreed to pay $289 million Monday to settle allegations that they actively assisted Enron in its attempts to deceive investors by disguising billions of dollars in debt.

In an unusual twist, both banks -- J.P. Morgan Chase and Citigroup -- also promised the Manhattan District Attorney that they would reform their internal procedures to prevent any customers in the future from using Enron-style accounting chicanery to keep bank loans off their balance sheets.

From 1992 to 2001, the banks extended $8.3 billion in loans to Enron, while aiding in accounting maneuvers that allowed Enron to hide that debt from investors.

Without admitting or denying guilt, J.P. Morgan Chase and Citigroup pledged to pay $236 million into a fund organized by the Securities and Exchange Commission to help investors recoup something from Enron's $60 billion collapse. Merrill Lynch has already paid $80 million into the fund.

Citigroup will pay $19 million more into a fund for shareholders of Dynegy, for which it created Enron-style banking transactions.

Together, the banks also agreed to pay a total of $50 million to New York City and the state, and $3 million more to cover the costs of District Attorney Robert Morgenthau's investigation of their actions.

At a press conference, Stephen Cutler, the SEC's director of enforcement, said, "Financial institutions may not look the other way" when they enter into complicated loan schemes like the ones arranged for Enron.

"They may not hide behind the accountants and the lawyers, and they may not say, 'Everybody does it.' "

Morgenthau said he decided not to press criminal charges against individuals in the case because it would be difficult to prove that any one of them understood the comprehensive natures of Enron's fraudulent schemes.

"The people doing these things were looking at them as segments without seeing the whole picture," he said, adding bankers at Chase and Citigroup could be accused of "stupidity, maybe, but not fraud."

Both banks issued statements Monday pledging their commitment to reform and saying that under their new, more stringent guidelines, they would not enter into the same convoluted transactions as the ones they used to help Enron hide so much debt.

"This is extraordinary," says David Gourevitch, a former SEC attorney. "It's one thing to make the banks say that what they're doing is appropriate and aboveboard. It's another to make them say that what their customer is doing is appropriate and aboveboard."

See related story: 05B

Document USAT000020030729dz7t0001v

MONEY
Nuns, priests join crusade against sky-high exec pay

Matt Krantz
473 words
20 May 2003
USA Today
USAT
FINAL
B.01
English

Nuns and priests are hoping to put the fear of God into the hearts of high-paid executives.

Faith-based institutional investors -- longtime corporate activists on issues like the environment -- are taking on CEO pay for the first time at annual shareholders meetings this year.

At least 21 companies, including the likes of AOL Time Warner, J.P. Morgan Chase and Cisco Systems, face or have faced corporate governance proposals in the current annual meeting season from the Interfaith Center on Corporate Responsibility, the nationwide body that coordinates the efforts of religious groups. Because the ICCR doesn't own stock itself, it must count on its members who do, ranging from orders of sisters and priests to the General Board of Pension and Health Benefits of the United Methodist Church.

The share ownership allows ICCR members to put their proposals up for a vote at shareholders meetings, most being held this month and next. And in most cases, nuns and priests are leading the charge against lofty CEO pay.

The sudden interest in executive pay and other governance issues by religious groups is just the latest sign of how corporate scandals have been so deep and disturbing that more investors see it as their business to stop it.

Top executives appear ready to listen. "CEOs are afraid to be yelled at by nuns (at the shareholders meetings). It makes (them) look like bad guys," says Beth Young of the Corporate Library. In fact, drugmaker Pfizer has agreed to begin talking to a group of nuns about ways to reduce pay disparity.

Some unlikely CEO gadflies include:

* Nuns. Sisters have long lamented the high pay of top executives relative to rank-and-file employees but did not put proposals to curb it on the ballot until this year, says Susan Vickers, a nun and director of advocacy at Catholic Healthcare West, a hospital chain in California.

She says scandals at Enron and WorldCom and the losses to shareholders "rekindled interest." For that reason, Catholic Healthcare is leading the press on a vote to reduce the gap between the pay of top executives and lower-level workers at utility El Paso, one of its major holdings.

* Priests. The pay disparity effort by religious groups is being coordinated by Michael Crosby, a priest with the Province of St. Joseph of the Capuchin Order. His order has taken the lead with the proposal against AOL Time Warner, but he's also helping other orders that hold shares of J.P. Morgan, Alcoa, General Electric and Cisco press the issue there.

Being a priest helps Crosby be more effective, he says. "I only spend 25% of my time on these issues, but being celibate, 25% would be more time than other people could spend," he says.

Document USAT000020030520dz5k00021

MONEY
Cash flows out of blue chips into tech

Adam Shell
461 words
17 April 2003
USA Today
USAT
FINAL
B.04
English

NEW YORK -- Tech stocks were hot and blue chips were not Wednesday on Wall Street.

Investors who own techs like Microsoft and Intel that posted strong quarterly earnings were rewarded with higher stock prices Wednesday, but blue chips slid amid profit taking and concerns about the economy.

In a day reminiscent of the late '90s, when techs soared and Old Economy stocks stalled, investors favored riskier stocks over defensive names.

"We saw a market rotation," says Chuck Carlson, contributing editor of newsletter Dow Theory Forecasts. "Money flowed out of stocks like manufacturer 3M and into tech." Investors, he added, were also taking profits in stocks that have done well lately, such as financial services firms like J.P. Morgan, which fell 37 cents to $26.50, despite topping first-quarter profit forecasts by an impressive 19 cents.

The shift was fueled largely by earnings. After topping forecasts following Tuesday's close, Intel surged $1.03, or 6%, to $18.16, and Microsoft gained 30 cents to $24.91. Dow components IBM and Hewlett- Packard also benefited and finished higher.

But the 26 other members of the Dow fell. Roughly 40% of the Dow's 144.75-point, or 1.7%, decline to 8257.61 came from 3M and Coca-Cola.

The Nasdaq gained 3.71 points, or 0.3%, to 1394.72. The Standard & Poor's 500 fell 10.90 points, or 1.2%, to 879.91. The USA TODAY Internet 50 rose 0.54 points, or 0.7%, to 74.94.

3M fell $4.64, or 3.5%, to $129, after J.P. Morgan cut the manufacturer's profit estimates for 2003 and 2004 because of a soft global economy. And despite meeting analysts' earnings expectations, Coca-Cola plunged $2.63, or 6.2%, to $39.90 as investors fretted over a slowdown in future sales.

The sharp gains of the Dow's tech components could not overcome the steep loss suffered by 3M. The reason: The Dow is a price- weighted average, which means the highest-priced stocks carry the greatest weight. That's why the 3.5% drop in 3M, which closed at $129 a share, overshadowed the 6% gain of Intel, which closed under $20.

Highlights: Altria fell 75 cents to $31.70. The parent company of Philip Morris and Kraft Foods notched first-quarter profit that beat estimates but also temporarily suspended its share buyback program. Investors are also still leery of potential legal judgments against the cigarette maker.

* Gainers included Ford Motor, which surged 88 cents, or 10.5%, to $9.23 after the world's No. 2 automaker reported first-quarter earnings that handily beat estimates.

Markets Wednesday

GRAPHIC, B/W (CHART)

Document USAT000020030421dz4h0000w

MONEY

Enron examiner's second report blasts accounting ; Creditors may be entitled to $2.9B in disposed assets

Greg Farrell
579 words
7 March 2003
USA Today
USAT
FINAL
B.02
English

Former Enron chairman Ken Lay paid off more than $74 million in company loans with Enron stock at a time when the company was sinking in debt.

That's just one of several findings in a new report by a court- appointed examiner.

The 2,000-page report by Neal Batson of Atlanta law firm Alston & Bird is the second in a series requested by U.S. Bankruptcy Judge Arthur Gonzalez to determine how much Enron owes its creditors.

Batson suggests that creditors might be entitled to as much as $2.9 billion in assets that Enron transferred or sold before its Dec. 2, 2001, bankruptcy-reorganization filing.

He says Enron might be able to seek recovery of the more than $74 million lent to Lay in 2000 and $53 million paid to Enron employees in late 2001, when the company was presumed to be insolvent. The $53 million was from a deferred-compensation program, but retirees were rebuffed when they tried to reclaim their money.

The report also calls into question some $5 billion in loans disguised as transactions that Enron entered into with Citibank and J.P. Morgan Chase.

"Both Citibank and J.P. Morgan knew that Enron accounted for its obligations under the prepay transactions as liabilities from price risk management activities rather than debt," the report said. "They also believed that Enron reported the cash as cash flow from operating activities rather than financing activities. "

Other highlights from the report:

* Enron exploited tax loopholes to generate $800 million in reported income over a six-year period. The efforts of employees in the company's tax group, "went beyond normal tax savings techniques, and even beyond typical corporate 'tax shelter' transactions, to a new genre of transactions aimed largely at 'generating' accounting income from projections of future tax savings," Batson wrote.

In a footnote, Batson relates that Robert Hermann, former head of the company's tax group, said in an interview that Enron found the profits generated by the tax department to be "kind of like cocaine - - they got kind of hooked on it."

* Enron employed six accounting techniques, including its aggressive tax claims, to generate 96% of the company's $979 million in reported income in 2000. Without resorting to these unusual accounting techniques -- which Batson criticizes -- Enron's income would have been $42 million.

Those same accounting techniques, combined with Enron's reliance on special purpose entities, allowed the company to claim that its debt in 2000 was $10.3 billion. Without stretching the accounting rules to hide all its debt, Enron's liabilities would have been $22.1 billion for the year.

* Enron's quality of earnings were suspect. Batson's report describes one transaction, Project Nahanni, in which Citibank lent $485 million to a group of investors who added $15 million and purchased $500 million in U.S. Treasury bonds.

The Nahanni investors, who were not identified in Batson's report, then contributed the bonds to an Enron subsidiary called Marengo in exchange for 50% ownership of Marengo.

Marengo then sold the Treasuries for $500 million and lent the money to Enron. Enron subsequently reported that the $500 million was cash from operating activities for 1999. The entire transaction took place in December 1999. A month later, Enron repaid the loan without ever recording it as debt on its financial statements.

Document usat000020030308dz370000q

MONEY
Panel blasts Enron tax deals ; Senate committee raises shelter issues

Elliot Blair Smith
403 words
14 February 2003
USA Today
USAT
FINAL
B.01
English

WASHINGTON -- Before collapsing into bankruptcy in December 2001, Enron's lawyers and accountants helped the Houston energy company amass nearly $1 billion in questionable tax and accounting benefits, a Senate Finance Committee panel said Thursday.

In a disclosure likely to heighten the scrutiny of Congress and the IRS on tax-shelter promoters, the Joint Committee on Taxation raised substantial doubts about advice that Enron paid tens of millions of dollars for to such venerated firms as Deloitte & Touche, Deutsche Bank and J.P. Morgan Chase.

One suspect tax shelter, Tanya, named for a tropical storm, allowed Enron to report $65.8 million in profit and $65.8 million in tax losses from the same investment.

Another, Apache, named for a tax executive's favorite golf course, produced $50.7 million in profits and an equal amount of tax losses in a deal by which Enron apparently deducted interest payments on a loan it made to itself.

"Enron was a house of cards, and the cards were put together by these schemes," said Sen. Chuck Grassley, R-Iowa, the panel's chairman.

Sen. Max Baucus, D-Mont., said, "Enron repeatedly abused the tax code. And they had help from investment bankers, lawyers and accountants."

Most Enron advisers declined to comment. Deloitte & Touche's Deborah Harrington said her firm "abides by the highest professional, ethical and legal standards in all our practice areas, including our tax advisory services."

An Enron spokesman said his company cooperated in the probe.

Senate investigators said the Enron advisers generated $87.6 million in fees by creating financial ruses that served no economic purpose. But investigators stopped short of alleging criminal conduct.

From 1996 through 1999, Enron recorded $2.3 billion in financial profits while reporting $3 billion in tax losses.

Many profits and losses arose simultaneously from the same assets, investigators say.

Nevertheless, the IRS was unlikely to audit the company as long as the agency believed it unprofitable. Senate investigator Lindy Paull said Enron's complex tax strategies relied on a small circle of accounting firms, banks and lawyers whose "incestuous relationships" were self-serving.

Paull said Enron made "complexity an ally" -- its affiliates and subsidiaries produced 2,486 individual tax returns in 2000 -- while its deep pockets and professional advisers constituted "an inherent advantage over the IRS."

See related story: 06B

Document usat000020030214dz2e000c7

MONEY
Wall Street firms look to backup plans ; Most financial titans increasing security

Thor Valdmanis and Nicole Mucciolo
460 words
13 February 2003
USA Today
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English

NEW YORK -- As the threat of terrorism looms larger every day, major Wall Street firms are tightening security and testing backup systems to ensure that financial markets withstand another strike aimed at the heart of the U.S. economy.

Citigroup, J.P. Morgan Chase and other financial giants are beefing up security patrols, maintaining close contact with law enforcement agencies and distributing disaster plans to employees.

Senior Wall Street executives say privately that they are chiefly concerned about the possibility of a chemical or biological attack timed to coincide with the annual hajj pilgrimage to Mecca, a five- day Muslim holiday that ends today. But they add business continues as usual.

"We are prepared as best we can," says Robert Strang, executive vice president of SPX/Decision Strategies, a leading corporate security firm. "Since Sept. 11, the financial district in Manhattan has been working overtime to prepare for any type of terrorist situation to protect employees and avoid any major disruption to our markets."

While banking and securities regulators have taken steps to prevent future disasters from disrupting trading that costs billions of dollars, the General Accounting Office warned Wednesday that more needs to be done. In a lengthy report, Congress' investigative arm says many financial-market organizations that perform stock trading or clearing were still at risk of being disrupted by wide-scale terror attacks.

"There are some (firms) that are resisting building backup facilities" largely because of cost, says GAO director of financial markets Davi D'Agostino. "That could be a problem."

Regulators working on a disaster response plan for Wall Street, due next month, are expected to insist all firms have emergency backup offices but drop demands that the backups be hundreds of miles outside Manhattan.

Regulators remain concerned that many backup offices for critical technology systems and staff lie within a few miles of their Manhattan headquarters, in New Jersey or one of the outer boroughs.

After the Sept. 11 attacks, U.S. stock markets shut down for four days, the longest closure since the 1930s. Telecommunications infrastructure and trading floors at the New York Stock Exchange and American Stock Exchange, located blocks from the World Trade Center, were ruptured. There was also significant loss of facilities and personnel at many broker/dealers in and around the World Trade Center, which conducted 40% of normal market trading volume.

NYSE President Robert Britz told a House Financial Services Committee hearing Wednesday that the NYSE could "resume trading in less than 24 hours" after an attack on its headquarters. The NYSE and Nasdaq are also prepared to trade one another's stocks if one is disabled.

See related story: 02B

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MONEY
Stock markets ; Benefits may not be significant or long lasting

Adam Shell
540 words
7 January 2003
USA Today
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B.03
English

It's the economy -- and the stock market, stupid! Fearing a political backlash caused by economic discontent, President Bush is hoping a proposal to eliminate the taxes stock investors pay on dividends would entice people back into the stock market.

"Bush has made a calculation that the biggest problem facing the economy is the stock market," says Greg Valliere, managing director of Charles Schwab's Washington Research Group.

It's tough to find anyone on Wall Street who doesn't believe reducing taxes for investors isn't a plus. It's more difficult to find people who think it would be the catalyst for a 1990s-style bull market. "It's an unambiguous positive," says Carlos Asilis, U.S. equity strategist at J.P. Morgan Chase. But the benefits may not be long lasting or significant, he adds.

Seven out of 10 companies in the S&P 500 pay dividends. Since 1926, dividends have accounted for 4.3 percentage points of stocks' 10.2% average annual total return, Ibbotson Associates says.

Asilis says two of the plan's key assumptions may not pan out. First, fewer firms than expected would boost dividends substantially because they would direct profits and free cash to retiring debt instead. Second, he calculates that repealing the dividend tax would put $42 billion to $45 billion into investors' pockets -- less than the $200 billion in cash freed up last year via home refinancings. "Investors won't have a lot more money to spend," he says.

But there are short-term positives:

* A tax-free dividend is "equivalent to a dividend hike," notes Tobias Levkovich, institutional equity strategist at Salomon Smith Barney. There would be a "land grab for yield." People may even be willing to pay higher prices for stocks that boost payouts.

* It makes yields on stocks more attractive compared with fixed- income investments, says Muriel Siebert, president of Muriel Siebert & Co. Take drugmaker Merck. Its 2.4% yield is closer to 3% if you subtract taxes. That beats the 1% on money market funds and competes with the 4.06% yield on 10-year bonds.

What stocks would benefit most? "Look for companies with solid dividend yields that have grown earnings consistently over time," Siebert says. "And companies that have increased their dividend year after year." Don't just pile into the stock with the highest yield. Energy firm El Paso has the highest yield in the S&P 500 but fell 84% last year.

Making dividends tax-free; How plan could affect you; President Bush is expected to propose today eliminating taxes on dividends as a key part of his plan to jump-start the sluggish economy. While some have hailed the plan for the $300 billion; 10-year dividend tax cut as a plus for the economy -- especially in the long run -- Democrats are criticizing it as yet another bonus for the rich. That makes chances of the proposal's passage by Congress; at least in its full- strength form; unclear. Here's the potential impact on investors; the economy and corporations:

GRAPHIC, B/W, Marcy E. Mullins, USA TODAY, Source: Zacks Investment
Research (BAR GRAPH)

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MONEY

J.P. Morgan, insurance firms settle legal dispute ; Case involved company's link to dealings with Enron

Edward Iwata
461 words
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USA Today
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English

Hoping to cut loose the Enron albatross, J.P. Morgan Chase early Thursday settled a legal dispute with 11 insurance firms that had accused the Wall Street bank of engaging in sham financial deals with the collapsed energy-trading firm.

Later in the day, J.P. Morgan Chase said it will take $1.3 billion in fourth-quarter charges to cover losses on its dealings with Enron and to create a $900 million reserve for related but unresolved legal claims.

J.P. Morgan Chase had sued the insurers last year, after the companies refused to cover $1.1 billion in losses on several failed energy trades in the late 1990s involving Enron and Mahonia, an offshore company associated with J.P. Morgan Chase.

The insurers -- plus congressional investigators who have looked into Enron's ties with Wall Street banks -- alleged that the deals between Enron and J.P. Morgan Chase were fake accounting transactions designed to hide debt and boost revenue.

Under the complex settlement submitted in court, the insurance companies could pay from $520 million to $660 million to J.P. Morgan Chase.

Neither side admitted wrongdoing, and both claimed a legal victory.

John Callagy, an attorney at Kelley Drye & Warren in New York who represents J.P. Morgan Chase, says the settlement bolsters the bank's contention that the Enron deals were legitimate. "There was absolutely no evidence of fraud," he says.

Alan Levine, a lawyer at Kronish Lieb Weiner & Hellman in New York and the lead attorney for the insurers, says, "We're very satisfied with the economics of the settlement."

J.P. Morgan Chase's troubles relating to Enron haven't ended, though. The bank still faces the giant Enron bankruptcy case, a shareholders' class-action lawsuit against Enron and several Wall Street banks and federal investigations into the Enron scandal.

The insurers' settlement should have no legal impact on the other legal fights, says one attorney close to the cases. However, lawyers often use settlements as leverage in talks in related cases.

In the insurer's case, the settlement came early Thursday morning, near the end of a monthlong trial in New York before U.S. District Judge Jed Rakoff. The jury was ready to start its deliberations Thursday.

As part of the settlement, Travelers Property Casualty could pay up to $159 million; Chubb's Federal Insurance, $110 million; Lumbermens Mutual Casualty, $94 million; Allianz's Fireman's Fund, $93 million; St. Paul Fire & Marine Insurance, $80 million; CNA Financial's Continental Casualty and National Fire Insurance, $47 million; Safeco, $33 million; Hartford Financial Services, $25 million; and Liberty Mutual Insurance, $13 million.

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MONEY
IBM, J.P. Morgan in $5B tech deal

Jon Swartz
495 words
31 December 2002
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FIRST
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English

SAN FRANCISCO -- IBM signed its biggest technology deal in two years Monday and gained an early lead in what could be the next big wave in computing.

The computer giant and investment bank J.P. Morgan Chase signed a $5 billion contract that will transfer the bank's computing tasks, along with 4,000 employees, to IBM.

The seven-year contract -- IBM's biggest with a financial- services company -- is the largest of four outsourcing deals signed in the past month. Together, those contracts are worth about $9 billion.

The deal is crucial to Big Blue, which is banking future growth on so-called on-demand computing, in which information processing is treated like a utility. Corporations would plug into networks and use computing power as needed, paying only for what they use. Processors, software and storage, for example, would be turned on and off like electricity.

The market for on-demand computing is considered a potential gold mine for the tech industry as more companies farm out computing tasks to cut costs. Microsoft, Hewlett-Packard, Sun Microsystems and others are developing technology similar to IBM's.

IBM is increasingly focused on selling services rather than computers and other hardware. It gleaned 45% of its third-quarter revenue, or $8.9 billion, from the services business.

"IBM, for all intents, has become IBS, for International Business Services," says longtime IBM analyst Sam Albert. "With on-demand computing, as a customer's business grows, so does revenue for IBM."

Under the J.P. Morgan deal, IBM will take over most of the bank's computing operations. The two companies will create a pool of computing resources that will be accessed as needed, with most of the machines remaining in J.P. Morgan's buildings. IBM will maintain 16,000 servers worldwide and provide help-desk services to more than 100,000 people. The company's long-running history with the banking industry is likely to land it more deals, says tech analyst Bruce Caldwell of market researcher Gartner.

The contract "will create capacity for efficient growth and accelerate our pace of innovation, while reducing costs" and increasing quality, J.P. Morgan Chase Vice Chairman Thomas Ketchum said in a statement. J.P. Morgan has shaved about $500 million in computing costs since 2001.

"Customers literally want to pay only for what they use," says Paul Sweeny, general manager of IBM's financial-services sector. "They need to closely manage costs in a tight spending environment."

IBM bested rivals EDS and Computer Sciences for the deal. IBM's chief services competitor, Electronic Data Systems, in 2000 signed what is believed to be the biggest tech outsourcing contract -- a $6.9 billion deal with the Navy and Marine Corps.

The announcement had little impact on the companies' shares. Shares of IBM dipped 1% to $76.45, while J.P. Morgan improved 0.8% to $24.

Money extra

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MONEY
Senator: Banks helped Enron 'perpetrate a fiction'

Paul Davidson
484 words
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English

WASHINGTON -- A Senate committee chairman told Citigroup and J.P. Morgan Chase executives Thursday that they broke the law by helping Enron artificially inflate revenue, hide debt and avoid taxes in sham deals.

"You helped them perpetrate a fiction," Sen. Carl Levin, D- Mich., chairman of the Permanent Subcommittee on Investigations, told J.P. Morgan Chase executives at a hearing.

"I take exception to that," said J.P. Morgan Vice President Eric Peiffer.

Levin said after the hearing that he would refer the deals to the Securities and Exchange Commission and Justice Department for possible investigation.

The rancor marked the committee's third hearing spotlighting Wall Street's role in Enron's collapse.

Executives of both banks say their policies have been overhauled and they likely would not take part in such deals today. But they said they relied on assurances from Enron's executives and auditors, and they insisted they followed the letter of the law.

Levin, however, said the banks broke SEC rules that bar firms from "aiding and abetting a deception." He called on the SEC to more clearly apply those rules to banks, and on banking regulators to enforce those rules.

In the first deal, in December 2000, Enron sold its interest in an off-the-books pulp and paper trading business to a shell company it created called Caymus Trust. It booked $200 million in revenue and $112 million in profit.

To ensure it was recorded as a sale, Citigroup provided Enron a $194 million loan and $6 million equity investment. But former Enron CFO Andrew Fastow assured Citigroup it would recoup the investment. The committee released a raft of e-mails to show Citigroup effectively regarded the $6 million investment as more of a loan. If no independent investor had money at risk, Enron should have included the venture in its accounting records.

One document says "verbal guarantee 100%." Citigroup Managing Director William Fox told Levin, "(Fastow) did not give me a verbal guarantee. It was a businessman's understanding."

"You can split hairs, but it is hair-splitting," Levin said.

In the second deal, in June 2001, Enron and Citigroup set up a venture to pay off the $200 million.

Citibank put up $28.5 million in stock and cash. But in reality, its money was never at risk -- a requirement for Enron to keep the venture off its books -- investigators say. It was kept in a separate liquid account earmarked for Citigroup, and the bank could recoup it at will.

In an e-mail, a Citibank executive called it a "funky" deal, saying a colleague "is amazed that they can get it off balance sheet." Another executive said it was "unimaginable" that the bank would not recoup its money.

"This structure was presented to us by Enron executives in this form,' said Citigroup's Richard Caplan.

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MONEY
Hearing likely to link Enron deals with major banks ; Senate panel may allege execs knew transactions deceptive

Greg Farrell
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English

WASHINGTON -- More than a year after stumbling into bankruptcy protection, Enron continues to be an embarrassment for two of the nation's largest bank holding companies, Citigroup and J.P. Morgan Chase.

At a hearing Wednesday, representatives from the Senate's Permanent Subcommittee on Investigations plan to detail four deals Enron entered into from December 2000 through June 2001. The committee is expected to allege that the bank executives knew the transactions were deceptive.

The deals helped Enron book $112 million in phantom income for 2000 and would have saved it tens of millions of dollars in Canadian taxes. The deals include:

* Fishtail. On Dec. 19, 2000, Enron moved its pulp and paper- trading business into a joint venture dubbed "Fishtail." Although the book value of the business was $85 million, a J.P. Morgan Chase unit agreed with Enron that the business should be valued at $200 million.

* Bacchus. One week after Fishtail was formed, Enron sold its interest in the joint venture to Caymus Trust, a special-purpose entity named after a California winery. The purchase price was $200 million, which Enron recorded as revenue. Of that sum, Enron reported $112 million as profit.

Enron's banking partner in the Bacchus transaction was Citigroup, which supplied $194 million in loans to support Caymus Trust, and guaranteed the $6 million in equity that was required to make the transaction appear legitimate.

Bob Roach, the panel's lead investigator, is expected to unveil a batch of e-mail from Citigroup bankers describing verbal commitments they got from former Enron CFO Andrew Fastow guaranteeing Citigroup's money. Fastow's guarantees, if they were given, would indicate that Citigroup bankers knew the transactions would allow Enron to boost its earnings artificially for the year.

Citigroup said Monday it "would not approve these transactions today" because the bank has adopted tighter policies since last summer, when the Senate committee disclosed other transactions between the bank and Enron.

* Sundance. This joint venture, between Enron and Citigroup's Salomon Smith Barney unit, occurred in June 2001. Through its investments in Sundance, Enron paid off the $200 million it had borrowed from Citigroup for the Bacchus transactions.

Although Citigroup put up $28.5 million in cash for Sundance, Roach is expected to show that money was never at risk -- a requirement for Enron to keep Sundance off its books. On Nov. 30, 2001, two days before Enron sought bankruptcy court protection, the bank got its investment back, Wednesday's hearing is expected to show.

* Slapshot. This transaction involves a tax-avoidance program Enron purchased from J.P. Morgan Chase last year. Dubbed "Slapshot," it let Enron make use of a Canadian law allowing tax deductions for loan interest payments.

Sen. Carl Levin, D-Mich., said his committee's investigation "painted a deeply disturbing picture. Citigroup and J.P. Morgan Chase helped Enron deceive the investing public, as well as Enron employees and stockholders."

J.P. Morgan Chase spokeswoman Kristin Lemkau said the bank's tax program was approved by two Canadian law firms. "While we don't think we did anything illegal or unethical, from the standpoint of reputation risk, we would not do this transaction today," she said.

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MONEY

United expected to file Chapter 11 reorganization today ; Hopes to tap $1.5B in bankruptcy financing

Marilyn Adams
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English

United Airlines is expected to seek Chapter 11 protection from creditors today in its hometown of Chicago, ending a hard-fought, six-month battle to stay out of bankruptcy.

No disruption of operations is expected. Flights, reservations and frequent-flier miles won't be affected immediately.

United's lawyers are expected to ask a bankruptcy-court judge for permission to tap $1.5 billion in bankruptcy financing to pay for continued operations. Several lenders, including Bank One, Citigroup, CIT Group and J.P. Morgan Chase, are prepared to provide debtor-in-possession financing, which allows a company to operate in bankruptcy, people familiar with the talks said.

United will become the largest U.S. airline ever to go into bankruptcy. With 83,000 employees and about 560 jets, it is the world's second-largest airline by revenue. It will be the second major U.S. airline to seek bankruptcy protection since the Sept. 11 attacks. US Airways filed in August.

United officials had no comment Sunday night.

The filing isn't a surprise. Last Wednesday, United lost its bid to stay out of bankruptcy when a federal loan board denied its application for a $1.8 billion loan guarantee.

The Air Transportation Stabilization Board said the application wasn't financially sound enough to assure repayment.

Knowledgeable people said that United reached out to the Bush administration late last week in an attempt to determine what level of cost cuts could win approval. But federal officials declined to provide a dollar figure, and the appeal failed, those sources said.

Airline officials remain hopeful the loan board might grant a guarantee later for financing to help it emerge from bankruptcy protection.

Shares of UAL closed Friday at 92 cents as a bankruptcy filing appeared to be inevitable. Saturday and Sunday, the board of United parent UAL met to discuss a filing. A team led by bankruptcy specialist James Sprayregen of law firm Kirkland & Ellis has been preparing for months in case the loan application failed.

United applied for the loan guarantee in June. Shortly after the terrorist attacks, Congress established $5 billion in grants and the $10 billion loan guarantee program to bolster the airline industry, which shut down for three days. United lost two jets in those attacks.

United said it had no access to private financing because of its weak financial condition. The carrier has lost $4 billion since the third quarter of 2000, and $900 million in debt payments come due this week.

Employees own 55% of UAL and representatives of the pilots and mechanics unions sit on the board.

Employees, union and non-union, had pledged $5.2 billion in pay cuts over 5 1/2 years as part of United's loan application. In a bankruptcy, union leaders expect the airline to seek even deeper cost cuts to become profitable again.

Labor union officials were braced for the inevitable.

"No matter what happens, United Airlines will continue to fly our passengers," says pilots union spokesman Herb Hunter. "If it happens, it will be painful for employees, stockholders and vendors, but we'll come out stronger."

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MONEY
Wall Street reform: Stock research settlement taking shape ; Regulators, banks work out details

Noelle Knox
629 words
27 November 2002
USA Today
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English

Over the next few weeks, stock regulators and Wall Street are expected to complete an industrywide settlement that will change the way investors get information about stocks. While some aspects of the agreement could change, USA TODAY reporter Noelle Knox explains what is on the table now.

Q: Who is involved?

A: For the regulators: The Securities and Exchange Commission enforcement chief Stephen Cutler, New York Attorney General Eliot Spitzer and representatives of the National Association of Securities Dealers, the New York Stock Exchange and North American Securities Administrators Association.

On Wall Street: Bear Stearns, Credit Suisse First Boston, Deutsche Bank Alex. Brown, Goldman Sachs, J.P. Morgan Chase, Lehman Bros., Merrill Lynch, Morgan Stanley, U.S. Bancorp Piper Jaffray, Salomon Smith Barney, Thomas Weisel and UBS PaineWebber.

Q: What are the talks about?

A: Regulators have alleged that many stock analysts issued biased research to curry favor with investment-banking clients.

Regulators also maintained that some Wall Street firms gave executives of client companies special access to shares in initial public offerings (IPOs). Those shares, which often soared in the first days of trading, could be sold for a quick profit.

Q: What will the settlement mean for stock research?

A: Wall Street firms that want to cover a stock will be required to provide investors with side-by-side research from several independent research providers.

Q: What is an independent research firm?

A: A brokerage firm that generates all of its revenue from the sale of its stock research or from commissions for stock trading, or both. These firms do not provide investment-banking services for the companies they cover, so they avoid conflicts of interest for their stock analysts.

Q: What will the settlement mean for independent research firms?

A: Under the terms being discussed, Wall Street firms would be required to purchase independent research for five years and thus subsidize the independent research firms.

Q: What financial penalties will Wall Street pay?

A: Regulators are trying to assess fines ranging from $75 million to $500 million. The money will be divided between the SEC, the NYSE, the NASD and state securities regulators. Wall Street firms also are expected to spend hundreds of millions of dollars on independent research over the next several years.

Q: Will investors receive restitution?

A: Under the recently passed Sarbanes-Oxley Act, the SEC may put the money it collects into accounts that would be paid out to investors. The state securities regulators will make their own determinations about what to do with the money they collect from the Wall Street firms.

Q: What will the settlement mean for Wall Street firms that provide investment banking?

A: There will be a strict separation of research and investment banking. The SEC is expected to make this part of the settlement into new rules for the entire industry. Contact between stock analysts and investment bankers will be minimal and closely monitored.

Analysts will no longer be allowed to attend meetings with investment bankers trying to drum up business. Analysts' pay will no longer be linked to any investment-banking deals.

Q: Will Wall Street firms be allowed to give executives of client companies access to IPOs?

A: The current outline of the settlement would prohibit Wall Street firms from giving client executives, who have brokerage accounts with the firm, special access to shares in IPOs. This has been the subject of an investigation by the House Financial Services Committee, which criticized the practice.

Wall Street reform

PHOTO, B/W, Linda Spillers, ABC News, via AP; PHOTO, B/W, H. Darr
Beiser, USA TODAY;
Caption: Eliot Spitzer: Leading regulators finalizing reforms.
Stephen Cutler: Enforcement chief for the SEC.

Document usat000020021127dybr0001n

NEWS
White-collar sweatshops batter young workers

Laura Vanderkam
1,137 words
26 November 2002
USA Today
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FINAL
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English

Nancy Collins remembers when she hit rock bottom. She was in Australia for her investment-banking job at JP Morgan, trying to seal deals on two projects at once.

She thought she could handle the stress. After all, co-workers had dubbed her previous boss the "Prince of Darkness" for making people work until 3 a.m., and she knew she was good at what she did. But then, one night after weeks of 18-hour days and constant travel, she staggered home at 7 a.m. Not to sleep. To shower. As she stood in the water, she started crying. At age 25, she was having a midlife crisis. "I started thinking, there's got to be more to life than this," she says.

JP Morgan isn't the only firm driving its young employees insane. Salomon Smith Barney. Goldman Sachs. High-end consulting firms such as McKinsey and Boston Consulting Group and many tech companies do the same. All hire the brightest Ivy League grads and make them a deal: We will pay you $60,000 or more a year and give you glimpses of corporate luxury, from ritzy hotels to jaunts on the jet. In exchange, you must work 70, 80, 100 hours a week through the best years of your life.

Forget accounting, these white-collar sweatshops are corporate America's most successful scam. Give a kid a signing bonus and a $500 bottle of champagne, and he doesn't notice that he's working for $12 an hour. For years, exclusive firms have kept labor costs low by squeezing blood out of their hires. It's not exploitation. These kids are savvy enough to know what they're getting into. But they're also smart enough to wonder whether the lifestyle's worth the cost. As massive layoffs force the question, corporate bean counters should shiver at what the answer could do to their bottom line.

Since moving to New York a few months ago, I've marveled at Wall Street's and consulting companies' work-til-you-drop attitude. A friend still in a meeting at 10:30 p.m. asks whether we can reschedule drinks. A party moves from 9 p.m. to 10 p.m. on a Friday to accommodate late workers.

People complain. Oh, they complain. You worked 80 hours this week? Well, I worked 90. You slept four hours? I slept at the office and showered there, too! The dirty secret is, many sweatshoppers actually like it. This generation vied for status in college by comparing workloads. Many of them then dove like lemmings off the cliff into corporate America. A high-wattage job fills an almost religious need to be part of something bigger than yourself, and 16- hour days mean you don't have to deal with the messiness of life.

So people bought in throughout the boom. They skipped love affairs to save time and caught cabs back from the beach on Saturdays because the client needed that report. Ryan Sawchuk, whose co-workers at Amazon.com had to remind each other to eat, watched people bring sleeping bags to the office. He worked 12-hour shifts in the warehouse during the holidays and then did his real job, too. It got to the point where, according to Sawchuk, CEO Jeff Bezos told the Amazonians that since the company was no longer a start-up, they didn't have to work 90-hour weeks. Seventy-hour weeks were perfectly acceptable. And 65, once in a while, were OK.

I can't comprehend working anywhere for 65 hours a week. It's doable, I suppose, if you know you'll climb the corporate ladder to three-martini lunches soon. You sacrifice your 20s to the company, believing it will make you rich and powerful later.

Or not. For thousands of white-collar sweatshop workers, these next few weeks will be their last. Last week, the financial media reported that Morgan Stanley would lay off 2,200 employees worldwide. Lehman Brothers is trimming 500 jobs. McKinsey recently decided not to keep any of its second-year analysts. These layoffs continue the past year's trend. Russell Eckenrod, 23, recounts working 80 hours a week for a consulting company during Christmas last year, only to be laid off three weeks later.

Talk about a reality check. Turns out the folks who took you on the corporate jet will shove you out on the street faster than you can recount missed autumn afternoons. I'll never cheer a layoff. But every cloud has a silver lining, and the job-shedding at sweatshop firms is forcing brilliant young people with a world of options to consider that maybe they'd be happier somewhere else.

Nancy Collins ultimately started her own company, Global Adrenaline, which leads adventure tours to Africa and the Arctic. She values her JP Morgan skills, but "I'm much happier," she says. When she works Saturdays now, the decision is all her own.

Sawchuk left the four-cups-of-Starbucks-a-day Amazon lifestyle for other pursuits. More will follow as people realize comparable money can be made elsewhere and that when you are young, time is the most valuable asset you have. Why sell it all for $12 an hour?

This complicates the sweatshop bargain. If people don't lust after glamour, these firms lose their lure. They can find less- savvy employees, but then they'll lose the brainpower that attracts clients in the first place. Or, the firms can accept shorter workweeks and pay for overtime. It won't be easy: On Wall Street, at least, worker compensation is 50% of expenses. Try throwing that into a third-quarter statement.

But so it goes. A deal offered doesn't have to be taken when you realize the emperor has no clothes. I remember a summer 2000 recruiting event for investment bank Donaldson, Lufkin & Jenrette, for instance, on a Hudson River cruise boat. We rising college seniors flocked to the open bar as the recruiters showed us the Manhattan skyline and the cruising DLJ lifestyle. Pursue that deal with us, the message went, and all this will be yours.

I thought of that cruise the other day as I took the No. 6 train to the Brooklyn Bridge. It was a beautiful fall morning, the kind too beautiful to miss. I walked toward the middle of the steel trusses and stared back at Wall Street's skyscrapers, imagining people laboring inside. It was the same view as from DLJ's boat.

Still stunning. And from here, absolutely free.

New York-based writer Laura Vanderkam is a member of USA TODAY's board of contributors.

The Forum

GRAPHIC, B/W, Sam Ward, USA TODAY (ILLUSTRATION)

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MONEY
Boardroom safeguards seem to be softening

Matt Krantz
212 words
25 November 2002
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FINAL
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English

The rise of price-fixing schemes in the industrial age caused the U.S. government to crack down on corporate boardroom inbreeding with the Clayton Act, which banned directors from sitting on the boards of rival companies. But over time, those safeguards seem to have dissolved.

Some companies indirectly share directors. Take rivals PepsiCo and Coca-Cola. No board member sits on both boards, but they come close: Robert Allen, a member of Pepsi's board, also sits on the board of Bristol-Myers Squibb with Coke board member James Robinson.

The Clayton Act was amended to exempt banks. That's one reason William Gray is able to be the director who shows up the most in The Corporate Library's database. He sits on the boards of two leading financial services firms, J.P. Morgan Chase and Prudential Financial. Gray's spokesman wouldn't comment. A Prudential spokesman says the bank doesn't compete directly with J.P. Morgan in any significant markets. A spokesman for J.P. Morgan says that as a bank it is exempt from the rule and adds that Gray would recuse himself from discussions where he would have a conflict.

See also related Cover Story on 1B.

Document usat000020021125dybp00010

MONEY

Bankers branch out to pamper rich ; They help with art, horses, even kids

Anne Tergesen
BusinessWeek
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Soon after Marty Sternberg and four partners purchased a 28-acre riding stable in Old Westbury, N.Y., they turned to Citigroup for help in managing the staff and equipment.

Turned to whom?

While offering advice on running an equestrian facility may seem a world away from traditional banking services, it is among the specialized products Citigroup offers clients of its private bank. "This will make the farm more efficient," Sternberg says of the daily, weekly and monthly maintenance and staffing schedules Citigroup devised.

In recent years, the private banks that cater to the superrich -- often defined as those with assets in excess of $5 million -- have piled on perks and expanded their expertise to include non- financial assets such as art, airplanes and thoroughbreds. Merrill Lynch recently helped a client navigate the adoption process.

Meanwhile, the private banks at both Citigroup and J.P. Morgan Chase have experts who scour the art world to locate treasures for clients.

Intense competition for customers is the driving force for these extra services. Despite the stock market's slump, the ranks of those worth $5 million or more rose from 578,000 in 2000 to 677,000 last year -- the latest available figures, according to the Spectrem Group consulting firm. Their accounts can generate fees of up to 1% a year, or $50,000 on a $5 million account, making this a lucrative business for banks.

Of course, private banks still cater mainly to clients' complex financial needs. Bankers spend most of their time shaping investment strategies and figuring out how to transfer money to the next generation while minimizing Uncle Sam's take. In the process, they offer access to hedge funds, derivatives and other sophisticated investments.

But private banking is all about pampering people, too. Bessemer Trust will take charge of your monthly bills. Merrill Lynch will score hard-to-get tickets to hit shows and sporting events.

Many now offer more than just go-fer services. J.P. Morgan and Citigroup have art experts who -- for undisclosed fees -- will educate neophytes or bid at auction for clients wishing to remain anonymous. The banks' advisers also help authenticate, insure and value pieces. If a client needs cash, they can arrange for a sale or a loan against the art.

Citigroup helps clients care for their farms -- and their homes. Sandra Stern, head of Citigroup Private Bank's Multiple Residence and Farm Advisory Group, compiled for free an inventory and maintenance schedule of the equipment, paddocks, fields, fences and barns at Sternberg's riding center. She also creates employee handbooks and performance appraisal forms to manage household staffs.

These days, private banks are taking a more active role in educating clients about both the nuts-and-bolts of money management and the special challenges that accompany wealth. J.P. Morgan sponsors conferences for the under-35 set featuring renowned finance professors. Its bankers also help families devise "mission statements," so they can agree on what they want to achieve with their wealth, says John Straus, who heads Morgan's U.S. private bank.

Meanwhile, Peter White, head of Citigroup Private Bank Family Advisory Practice, advises clients concerned about their kids becoming spoiled. He helps them address issues such as "whether to leave money to the kids, when, how much and how to raise them." Try getting answers to those questions from your regular banker or broker.

USA TODAY Business Week Special report

PHOTO, B/W, Brian Velenchenko;
Caption: Horse sense: Marty Sternberg gets help managing the staff and running the Old Westbury Equestrian Center from -- believe it or not -- Citigroup.

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MANAGING YOUR MONEY; Investing
MONEY
It may be time to dip a toe back into tech

John Waggoner
1,142 words
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Since the dawn of time, life has been marked by cycles. Geese fly south in the fall. Trout spawn in the spring. Technology stocks rise in winter. The bear market has disrupted the tech cycle, to put it mildly. Battered investors would gladly sacrifice a goat or two to restore harmony in the universe and get the tech season started again. A few tech stocks have shown signs of renewed life. And while few think the technology cycle will begin anew, it may be a good time for venturesome investors to start looking at tech stocks again.

An old rule of thumb -- at least until the bear market started -- was to buy tech stocks at the outset of the American Electronics Association conference in November, and to sell them at the Hambrecht & Quist Conference in April. (The conference is in early May this year, and the San Francisco investment bank is part of J.P. Morgan Chase.)

Consider the period from January 1988 through March 2000. Had you invested in the technology-laden Nasdaq 100 stock index at the start of each November and sold at the end of each April, you would have gained 620%. Had you invested only from May through October, you would have gained 224%.

Why the seasonal effect? Christmas buying is one explanation. And before the recession, many companies and government agencies upgraded computers and software at the end of the year, because if they didn't use their budgeted money, it disappeared on Jan. 1. Those two buying sprees were enough to keep tech companies humming until spring.

The bear market stopped the tech cycle cold. The Nasdaq 100 index fell nearly 83% from March 20, 2000, through the end of September 2002, not pausing at all during tech's traditional cycle. Some tech stocks have fallen so far that it will take decades before they reach their old levels -- if ever. Lucent, the AT&T spinoff, fell 99% from its bull market peak. Drkoop.com, the health care dot-com company, is now dead.Bargain hunting

But tech stocks have staged a modest rebound since their most recent pummeling in September. The average science and technology mutual fund rose 8.3% the four weeks ended Oct. 23, vs. a 3.3% gain for the Standard & Poor's 500-stock index.

Does this mean the technology cycle is returning? Probably not this year, most experts say. But it can be a good time for bargain hunting.

Don't look for a big bull market in tech, soon. "There are signs that things are still deteriorating," says Zachary Shafran, manager of Waddell & Reed Advisor Science and Technology fund. Telecommunications, for example, got whomped by too many new high- capacity fiber-optic lines -- and by new technology that lets users cram more voice and data traffic in them. The industry is still swamped with capacity, and the slack economy has slowed demand.

Companies that make semiconductors -- the chips that power computers -- are using about 60% of their manufacturing capacity, Shafran says. That doesn't bode well for semiconductor companies or the companies that make equipment for those plants.

Another argument against the cycle: Plenty of investors who bought tech in the past three years will be happy to sell their stocks or funds when the market rallies, cutting short any major moves in technology.

Shafran is bearish: About 30% of his fund is parked in money market securities, or cash. Many of his stocks are in health care and pharmaceuticals -- the science part of the fund's moniker.

Others say that you can find some value among the technology ruins. Dennis McKechnie, manager of Pimco Innovation, thinks two tech areas will fare well in the coming months:

* Cellphone manufacturers. Nokia, the Finnish leader in the field, has seen its stock soar 49% to $16.80 the past three months. New cellphones, which offer color, text messaging and better reception, have been hot sellers this year, and are likely to be next year, too.

* Computer storage companies. These companies make hard drives and other devices for saving data. Thanks to ultrafast Internet connections, computer users can download enormous audio and video files. That means they need larger hard drives for storage. Western Digital, one of the top makers of hard drives, has gained 45% to $6.19 the past three months. Earnings are expected to rise to 39 cents per share for the company's 2003 fiscal year, up from 36 cents per share for the past 12 months.

Jonathan Cohen, manager of Royce Technology Value fund, thinks some decent tech stocks have gotten pummeled beyond all reason. For example, United Online, the product of a merger between Internet providers NetZero and Juno, currently sells for $11.96 a share. Its market capitalization -- price times number of shares outstanding -- is about $482 million. But the company has about $3.50 per share in cash available for new acquisitions and expansion.

Another favorite, Verity, makes data-retrieval software, and sells for about $9 per share now. The company has $242 million in cash -- and it's making money, too. "It's too cheap," Cohen says.

If you're going to buy individual stocks, don't forget the lessons of Lucent and other crushed tech stocks. Set a sell price for your stock -- say, 9% below your initial investment -- so you don't ride the stock down to oblivion. And don't invest money you can't lose.

Most people are better off buying tech stocks through mutual funds, which at least offer some diversification. Bear in mind, however, that most diversified funds have plenty of tech. The Vanguard 500 Index fund, for example, has 17.6% of its assets in software, hardware or telecommunications, according to Morningstar, the Chicago investment research firm. So add technology sparingly.

What if you already own a tech fund, and it's causing you deep pain? If you still believe in tech, consider selling the fund before the end of the year. Then buy a tech fund from another mutual fund company. You'll be able to deduct the loss from your taxable income this year, and you'll still have a stake in technology.

If you want to get back even, though, you could have a long wait. The Nasdaq composite index now stands at 1330. It will have to almost quadruple to beat its high of 5049. And that could take many seasons to happen.

John Waggoner's column appears Fridays. Waggoner answers questions at www.usatoday.com. His e-mail is jwaggoner@usatoday.com.

Managing your money; Every Friday

GRAPHIC, B/W, Marcy E. Mullins, USA TODAY, Source: USA TODAY research (BAR GRAPH); GRAPHIC, B/W, Source: Lipper (CHART)

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MONEY
Stocks get smacked down again ; Dow below 8000 as search for market bottom drags on

Matt Krantz
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Wall Street is getting showered with so much bad news that even some of the most bullish investors are close to drowning in despair.

Each time it looks like stocks are finally starting to recover, they get violently slapped back down.

The latest blow came Thursday, when bad earnings news from Electronic Data Systems (story, 2B) helped send the Dow Jones industrial average down 230 points, breaking through 8000 to close at 7942. Meanwhile, the Nasdaq composite ended just 0.9% above its bear market low.

And now that the Dow has broken through 8000 again, "The retest of the summer lows will happen sooner rather than later," says Todd Clark, head of listed trading at Wells Fargo Securities.

Normally bad news from EDS, the No. 2 computer services company, wouldn't hurt the broad market so much. But after a week of warnings from companies such as McDonald's, J.P. Morgan Chase and Morgan Stanley, it was too much for investors to bear. The plunge in EDS shares -- down 53% to $17.20 -- added to problems already plaguing the market:

* Bad loans. Nearly three years after the tech bubble burst, the aftereffects are still causing problems. J.P. Morgan on Wednesday wrote off $1.4 billion in costs for bad loans, especially telecom. It, and other banks, may still need to write off billions of dollars more, says Reilly Tierney, bank analyst at research firm Fox-Pitt Kelton.

* Unrealistic valuations. Stocks have declined from their bubble peak, but there still appears to be air remaining. Even after the Standard & Poor's 500 fell 26 points to 843 Thursday, it still had a price-earnings ratio of 31.5 based on past 12 months' earnings. That's well above the 7.3 P-E the S&P had in the third quarter of 1974, after finally emerging from that bear market.

* Investor disgust. After suffering almost three years of losses, investors are having trouble coming up with reasons to hold on to stocks, let alone commit new money to the market.

"The biggest price we're paying for the bubble is investor confidence," says Al Goldman, strategist at A.G. Edwards. "Scars are so deep," he says.

And more investors are at least avoiding stocks: 55% of investors polled by Charles Schwab in July, its most recent poll, said they're "on the sidelines," up from 44% in November.

That includes investors like Paul Radovan, a telecom worker in Gurnee, Ill. Even after losing half his money when the tech bubble burst, Radovan bought more stocks this year, tempted by what seemed like bargain prices. But after getting hurt, again, Radovan this time is giving up and getting out. "I'm not putting anymore money in there," he says.

Contributing: Adam Shell

GRAPHIC, Color, Source: USA TODAY research (CHART)

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MONEY
Securities industry works on defense

Thor Valdmanis
530 words
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English

NEW YORK -- Eliot Spitzer appears to have Wall Street bankers in a quiet panic.

After downplaying, and even dismissing, the New York attorney general's probe into research-analyst conflicts, global investment banks in recent weeks have discretely launched internal probes to assess potential liabilities in a widening industry scandal.

According to people with knowledge of the situation, U.S. financial juggernauts such as Morgan Stanley and J.P. Morgan Chase, along with foreign banks such as UBS PaineWebber, have retained top Manhattan law firms to pore over potentially harmful e-mail and other documents dating back to 1999.

The goal: to determine whether there is evidence that research analysts routinely hyped company stocks to investors during the 1990s boom in order to gain investment-banking fees from those companies.

At the cost of tens of millions of dollars, blue-chip legal firms such as Skadden Arps and Wachtell Lipton are working overtime on warts-and-all investigations for their clients. By assessing possible liabilities, the firms hope to construct the best defense against a potential flood of fines, class-action lawsuits and even criminal prosecution growing out of conflict-of-interest probes initiated by Spitzer last year and followed up on by other state and federal regulators.

While law firms and banks involved declined comment or could not be reached Sunday evening, people familiar with the situation say that, for example, Deutsche Bank has recently retained law firm Fried Frank to conduct a search of e-mails, while Goldman Sachs has commissioned its longtime outside legal counsel Sullivan & Cromwell to do the same.

The securities industry's scramble to defend itself comes after the nation's largest broker, Merrill Lynch, was forced by Spitzer in May to pay $100 million and reform its research practices to settle claims of research-analyst conflicts. E-mails released by Spitzer showed that Merrill analysts publicly recommended stocks that they privately called "crap."

Citigroup's Salomon Smith Barney unit is the latest Wall Street heavyweight to come under fire.

As part of his ongoing investigation, say people close to the probe, Spitzer is examining how Salomon won a lucrative financing assignment from AT&T in a sequence of events that may have involved Citigroup CEO Sanford Weill. AT&T says it has received a subpoena from Spitzer's office.

In April 2000, Salomon earned nearly $45 million as one of three top underwriters of AT&T's $10.6 billion wireless phone unit spinoff. But Salomon was selected as a lead underwriter only after its telecom analyst Jack Grubman, who had been bearish on AT&T stock for years, upgraded his rating on AT&T to "buy." Grubman resigned Aug. 15 under pressure for his role in advising WorldCom.

Spitzer is looking into whether Weill, an AT&T board member, suggested to Grubman that he give AT&T another look, triggering the upgrade and helping to gain the investment-banking business for Salomon. AT&T Chairman C. Michael Armstrong serves on the Citigroup board, and he and Weill have maintained a close business relationship for years.

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MONEY
Banks face accusationsin Enron case ; Senate panel slams J.P. Morgan Chase, Citigroup

Edward Iwata
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English

WASHINGTON -- Lawmakers and Senate investigators charged Tuesday that J.P. Morgan Chase and Citigroup helped Enron engage in financial fraud before the energy-trading firm's collapse last fall.

"The financial institutions were aware that Enron was using questionable accounting," said Robert Roach, chief investigator for the Senate Permanent Subcommittee on Investigations, which is scrutinizing the role of Wall Street firms in the Enron scandal. "They actively aided Enron in return for fees and favorable consideration in other business dealings."

In a jammed hearing room, lawmakers blasted J.P. Morgan Chase and Citigroup, calling their behavior "a charade" and "a cancer" on the financial markets.

During the 10-hour hearing, the committee revealed document after document appearing to show the banks and their overseas law firms set up and ran secretive, offshore "shell" companies that funneled billions of dollars in financing to Enron over the past decade.

The 26 transactions, designed to look like legitimate energy- contract trades, were accounting trickery that served no business purpose, the senators said.

Lynn Turner, former chief accountant for the Securities and Exchange Commission, testified that the banks and Enron clearly set up the complex deals to disguise the debt from investors.

Heavier debt on Enron's balance sheet would have seriously hurt its credit ratings and hastened its meltdown, executives from Standard & Poor's and Moody's Investors Service testified.

Sen. Carl Levin, D-Mich., the subcommittee's chairman, said its findings would be turned over to the SEC and the Justice Department. The SEC reportedly is investigating the transactions.

Outside the hearing, Kristin Lemkau, a J.P. Morgan Chase spokeswoman, said Enron deceived the firm.

"It defies logic to say that we colluded with Enron to defraud ourselves," Lemkau said.

Lemkau also said the bank's use of an offshore company called Mahonia was legal and followed generally accepted accounting principles.

Citigroup spokeswoman Arda Nazerian said "the transactions (with Enron) were entirely appropriate at the time, based on what we were told by Enron."

Lawmakers said the suspect dealmaking would lead to even more public distrust of Wall Street. Stronger accounting disclosures and harsher sanctions against executives are needed, they said, pointing to reform bills moving through congressional committee this week.

The banks' stocks slid for the second straight day because of the committee's investigation. Citigroup fell 15.7%, to $27, while J.P. Morgan lost 18.1%, to $20.08.

See related story: 01B

PHOTO, Color, Tyler Mallory, AP;
Caption: Investors in this case were woefully misled." -- Lynn Turner, former SEC chief accountant

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MONEY

Banks defend e-mail about Enron ; Executives call exchanges 'inaccurate'

Edward Iwata
628 words
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English

WASHINGTON -- Call it a public bushwhacking. Seemingly with each denial of wrongdoing by Wall Street bankers at a congressional hearing Tuesday on Enron, lawmakers revealed damning documents to hammer home their point.

J.P. Morgan Chase and Citigroup executives deny any questionable or illegal behavior in at least 26 financial transactions with Enron from 1992 through 2001.

But a long trail of e-mails, letters and other documents disclosed by congressional investigators seems to show that the banks worked closely with Enron to help it hide more than $8 billion of debt.

"It appears Enron was not alone in its shady financial dealings," said Sen. Jim Bunning, R-Ky.

The Senate Permanent Subcommittee on Investigations believes that hundreds of pages of documents indicate the banks knowingly used secretive, overseas "shell" companies, with names such as Mahonia and Yosemite, to engage in the deals with Enron.

The subcommittee's seven-month investigation found e-mails showing that Enron and the banks set up complex financial transactions, known as "pre-pays," that appeared to be energy commodities trades but were really loans.

Lawmakers charge that the transactions should have been clearly recorded by Enron as debt, rather than cash flow from operations, on its balance sheet.

One e-mail, from J.P. Morgan Chase executive George Serice to another bank executive in November 1998, reads: "Enron loves these deals as they are able to hide funded debt from their equity analysts because they (at the very least) book it as deferred rev (revenue) or (better yet) bury it in their trading liabilities."

Another e-mail, from a J.P. Morgan Chase employee to Serice and dated October 2001, reads: "$5 (billion) in prepays!!!!!!"

The e-mailed reply from Serice: "Shutup and delete this email."

Sen. Carl Levin, D-Mich., the subcommittee's chairman, said the documents show clearly that "Enron saw (the deals) as a way to get cash without reporting liabilities." He also said, "Chase is clearly aware that one of Enron's motives is to classify the (financing from the banks) as liabilities."

J.P. Morgan Chase bankers who testified Tuesday said they were baffled by the e-mail exchanges. They called the e-mails "inaccurate" or "casual comments" that did not reflect the true nature of the deals between J.P. Morgan Chase and Enron.

"(The executives) were not fully informed as to Enron's interest or the full structure of the Mahonia transactions," said Donald McCree, managing director at J.P. Morgan Securities in New York. "I think it's an unfortunate statement."

Levin fired back, "Does that embarrass you?"

Replied Jeffrey Dellapina, a managing director at J.P. Morgan Chase: "It confuses me as well. I believe it to be inaccurate."

The lawmakers also grilled Citigroup executives about their questionable transactions with Enron.

Levin repeatedly asked Citigroup officials why they needed to design the Enron deals using an offshore entity, Yosemite, and a law firm, Maples and Calder, in the Cayman Islands.

"Why are you forming these in a secrecy jurisdiction?" he asked. "Why not do it in the daylight?"

Citigroup executives replied repeatedly that they believe they complied with accounting rules and that the use of offshore companies for financial deals was a common practice of many U.S. corporations.

"I don't think there's anything nefarious with doing it in the Cayman Islands," said Citigroup managing director Richard Caplan.

See related story: 01B

PHOTO, B/W, Dennis Cook, AP; PHOTO, B/W;
Caption: Questioned: Representatives of Citigroup and Salomon Smith Barney -- David Bushnell, left, Richard Caplan, Maureen Hendricks and James Reilly -- appear Tuesday on Capitol Hill. A Senate subcommittee is studying the role of banks in Enron's collapse.

Document usat000020020724dy7o0001r

MONEY

Did banks play role in Enron scandal?
; J.P. Morgan Chase, Citigroup execs face questions

Edward Iwata
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USA Today
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English

WASHINGTON -- Congressional investigators are expected to disclose today that Wall Street bank executives knew their deals with Enron were designed to hide billions of dollars in debt from investors.

The Senate Permanent Subcommittee on Investigations, which has been looking at Enron's collapse since December, will grill executives from Citigroup and J.P. Morgan Chase about the roles of their firms in the Enron scandal. Civil lawsuits allege that banks helped Enron defraud investors.

The Wall Street firms and Enron used "accounting tricks" and overseas "sham companies" to misstate Enron debt, keep its credit rating high and polish its financial statements for investors, according to congressional investigators.

"The maze of financial transactions that Enron constructed makes Rube Goldberg look like a slacker," said Sen. Carl Levin, D-Mich., the subcommittee chairman. "They couldn't have done it without Wall Street."

Enron received $8.5 billion in financing from Citigroup and J.P. Morgan Chase in 26 deals from 1992 to 2001, according to congressional investigators. Enron engaged in similar, smaller deals totaling $1 billion with several other investment banks.

Citigroup made at least $167 million from Enron in fees and other business over the past few years, congressional investigators say. It's unclear how much J.P. Morgan Chase received from Enron-related deals.

Many of the complex deals, called "pre-pays," were recorded by Enron as energy trades and contracts that strengthened Enron's cash flow, congressional investigators allege. But the transactions were really disguised loans that should have been accounted for as debt, they say.

For instance, if Enron had properly recorded the deals in fiscal 2000, its total debt would have been $14.4 billion -- not the $10.2 billion it posted, according to congressional investigators.

In one e-mail to be released today by the subcommittee, a J.P. Morgan Chase employee wrote: "Enron loves these deals as they are able to hide funded debt from their equity analysts."

Levin, whose subcommittee will hold another hearing next Tuesday on Enron, said that if the deals "had been true, pre-paid energy trades, they would have been legitimate transactions. But they weren't pre-pays. They were loans. The banks knew it, and Enron knew it."

Enron did not return calls for comment.

Citigroup said it relied on assurances that Enron's auditors approved the transactions' accounting. J.P. Morgan Chase said its accounting of transactions with Enron conformed with generally accepted accounting principles.

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MONEY

WorldCom's bad math may date back to 1999 ; Lawmakers dive into e-mails from former CFO and controller

Jayne O'Donnell and Andrew Backover
443 words
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English

WorldCom's accounting woes may go back to 1999 and were inspired by desires to keep profit margins up, lawmakers charged Monday.

Also Monday, WorldCom moved closer to a debtor-in-possession funding pact worth $2 billion to $3 billion that will give it money to operate under a possible bankruptcy reorganization, people familiar with the situation said. WorldCom is negotiating the deal with lead bank lenders Citigroup, J.P. Morgan Chase and GE Capital.

While WorldCom looks to its future, lawmakers are digging through its past. In e-mails dating to mid-2000, WorldCom's former CFO, Scott Sullivan, and ex-controller David Myers discussed with colleagues the accounting for excess network capacity as long-term investments rather than immediate expenses, say documents released by the House Energy and Commerce Committee.

WorldCom used such accounting methods to hide $3.9 billion in costs in 2001 and early 2002.

By early 2001, Myers and Sullivan were pressuring others to do something about declining profit margins. In an e-mail dated March 5, 2001, Myers refers to a recent dinner in which Sullivan and executive Tom Bosley discussed the need to "do whatever necessary to get Telco/Margins back in line." Ex-CEO Bernie Ebbers and COO Ron Beaumont were at the dinner.

WorldCom spokesman Brad Burns declined comment on the documents, saying: "We're providing documentation to all investigative bodies as we uncover it."

Rep. Billy Tauzin, R-La., says the committee will continue interviewing whistle-blowers in hopes of learning more. He says the panel may hold a hearing or report its findings to the Justice Department, which is also probing WorldCom.

Excerpts:

* An e-mail from WorldCom accounting executive Buford Yates in July 2000 confirmed the lack of accounting justifications for how WorldCom eventually treated the costs. That e-mail did not go to Sullivan but did go to Myers. "The bottom line is, people inside this company were trying to tell its leaders you can't do what you want to do, and these leaders were telling them they had to," Tauzin says.

WorldCom's Tony Minert, in a 2000 e-mail, floated the idea of capitalizing excess network capacity to Myers and others.

* Myers last month told auditors that capitalizing the line costs in the inappropriate matter was first done in the second quarter of 2001. While he said he was uncomfortable with the deeds, he added it was hard to stop them in subsequent quarters.

Contributing: Thor Valdmanis

See related story: 03B

Document usat000020020716dy7g0001s

MONEY
NASD investigates how Salomon divvied IPO shares ; Probe checks for client favoritism

Jim Hopkins
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15 July 2002
USA Today
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English

SAN FRANCISCO -- Wall Street giant Salomon Smith Barney has been added to a widespread investigation by regulators into alleged abuses in the market for initial public offerings.

The investigation by the National Association of Securities Dealers already included J.P. Morgan Chase, Robertson Stephens and other Wall Street firms.

Salomon disclosed its role in the NASD investigation in a letter to Reps. Paul Kanjorski, D-Pa., and Christopher Shays, R-Conn. The lawmakers last week requested a list of WorldCom executives who got shares in Salomon-managed IPOs. Salomon's letter says the NASD sought the same information in a "recent request." It declined to detail the timing or scope of NASD's request. NASD also declined comment.

NASD, the securities industry's self-regulatory agency for brokers and dealers, has been investigating whether Wall Street firms improperly gave favored clients bigger allotments of IPO stocks in 1999 and 2000, when the coveted shares --especially for dot-coms and other tech ventures -- were as good as gold. Its probe parallels a separate Securities and Exchange Commission inquiry into potential conflicts of interest among Wall Street analysts. The NASD has historically lacked the enforcement teeth of the SEC.

An early target of the probes, Credit Suisse First Boston, paid $100 million in January to settle SEC charges that it unfairly allotted IPO shares in exchange for kickbacks from investors. Credit Suisse did not admit wrongdoing.

Robertson Stephens, once a top underwriter for tech companies during the dot-com boom, abruptly closed Friday after owner FleetBoston Financial failed to find a buyer for the money-losing firm.

In its letter, Salomon confirms that it allocated IPO shares to WorldCom executives -- and says that it did so in ways "consistent with applicable laws, regulations and industry practice."

It did not say which or how many WorldCom executives received shares. It said it is "ready and willing" to provide the information to lawmakers. But it said federal privacy law prevents it from doing so without permission from investors. Salomon said the other way it could do so would be if it received a subpoena. Shays has not ruled that out.

The lawmakers question whether Salomon offered IPO shares to curry favor with WorldCom, which paid it about $80 million in investment banking fees in recent years. In a statement Friday, Kanjorski urged NASD "to examine whether Salomon tied its WorldCom investment banking business to its allocation of IPO shares" to WorldCom executives.

During last week's hearings, Kanjorski did not identify particular IPO shares he suspected were offered to WorldCom insiders. Speculation has focused on now-failed Rhythms NetConnections, a dot-com whose stock soared 229% in its first day of trading in 1999. It was the most successful IPO managed by Salomon since 1999.

Also Friday, Salomon -- facing scrutiny over the role its marquee analyst, Jack Grubman, played in the WorldCom scandal -- called for a stronger wall between investment bankers and research analysts, who recommend shares to investors.

In a letter to the SEC, the NASD and the New York Stock Exchange that Salomon made public Sunday, it said analysts should be prohibited from attending meetings with investment bankers seeking business from public companies. It also suggested investment bankers be kept from previewing research reports before publication.

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MONEY
Adelphia's filing postponed

Paul Davidson
291 words
25 June 2002
USA Today
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English

Adelphia Communications, the nation's sixth-largest cable TV company, postponed an expected bankruptcy filing Monday because financing arrangements were taking longer than anticipated.

Adelphia is ironing out the details of a deal to borrow $1.5 billion from banks led by J.P. Morgan Chase and Citigroup so the company can keep operating while it reorganizes.

The filing is now expected later this week, say people familiar with the matter. An Adelphia spokeswoman declined to comment.

The biggest Chapter 11 filing in cable history is designed to help Adelphia find a buyer for some or all of its systems, which serve 5.7 million subscribers.

Adelphia's troubles began in March when it disclosed off-the- books company-backed loans, later estimated at $3.1 billion, by the family of founder John Rigas. Adelphia, based in Coudersport, Pa., has said it plans to restate three years of financial results to show parts of the loans as liabilities.

The amount shocked analysts already troubled by the operator's $7 billion debt. The company, which now has missed interest payments on several of its bank loans, has tried to sell some of its cable system units.

The Securities and Exchange Commission and two grand juries are investigating its accounting practices. Rigas and sons Timothy, Michael and James had to give up their jobs and board seats.

The company's new leaders also revealed that the Rigas family used Adelphia to finance their rent-free New York apartments, build a golf course, help buy the Buffalo Sabres hockey team, subsidize a documentary film and create an investment firm.

Adelphia's shares, delisted by Nasdaq, fell 2 cents to 13 cents in over-the-counter trading Monday.

Document usat000020020625dy6p0001u

MONEY
Adelphia plans to file Chapter 11 ; Cable firm expected to seek bankruptcy protection today

David Lieberman
483 words
24 June 2002
USA Today
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English

NEW YORK -- The waiting should be over today. Adelphia Communications plans to file for bankruptcy protection, nearly three months after the once-proud No. 6 cable operator first disclosed dealings with the family of founder John Rigas that turned it into a symbol of corporate scandal.

The company is expected to announce that it has raised as much as $1.5 billion from banks led by J.P. Morgan Chase and Citigroup to keep operating while a bankruptcy judge decides how creditors will be paid.

A Chapter 11 filing -- the biggest in cable history -- could help efforts to find a buyer for some, or all, of Adelphia's systems, which serve 5.7 million subscribers. The court can protect an acquirer from unexpected liabilities, including those stemming from several shareholder lawsuits and investigations into Adelphia's finances by two grand juries and the Securities and Exchange Commission.

The company could pay off its estimated $19 billion in debt if it can sell systems for $3,500 per subscriber, roughly the industry norm. But stockholders could lose their entire investments. Adelphia shares closed Friday at 15 cents in over-the-counter trading.

And a sale may devastate Coudersport, Pa., where Adelphia is headquartered. It's by far the largest employer in the rural, mountain town of 3,000.

Meanwhile, Adelphia will try to reassure its subscribers. "Adelphia is committed to reversing its admittedly difficult present financial situation," it wrote last week to 3,500 franchise officials. "Most importantly, there should be no change in service to Adelphia customers as a result of these developments."

Adelphia's downfall began on March 27, when it disclosed that a Rigas family partnership had borrowed $2.3 billion using company assets as collateral. The amount has since been raised to $3.1 billion. That stunned analysts, who believed that the operator was already too deeply in debt.

Barraged with questions, Adelphia put off release of its 2001 annual report. More questions were raised when it was confirmed that the SEC was investigating.

As the stock plummeted, Nasdaq weighed delisting Adelphia shares. That took effect on June 3.

After acknowledging that it would have to restate its earnings, Adelphia put several cable systems on the block. The company defaulted on bank loans and failed to make interest payments on bonds. And Rigas and sons Timothy, Michael and James were forced to relinquish their jobs and board seats.

Then new interim CEO Erland Kailbourne stunned company watchers by disclosing a series of cases where the Rigas family allegedly used Adelphia for private gain. Among other things, the company paid for their apartments in New York, built a golf course on Rigas- owned land, helped the purchase of the Buffalo Sabres hockey team, created a Rigas-run investment firm and subsidized a documentary film.

Document usat000020020624dy6o00017

MONEY
Dow slips below 10,000 but rebounds

Gary Strauss
452 words
26 April 2002
USA Today
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English

A late rally prevented the Dow Jones industrial average from closing below the key 10,000 barrier Thursday. But the broad market closed mixed as a fresh series of lackluster earnings reports unnerved investors.

The Dow, down more than 100 points in early trading, closed up 4.63 points to 10,035.06 -- averting its first close below 10,000 since late February.

The Nasdaq broke a six-session losing streak, rising 0.36 to 1713.70. The Standard & Poor's 500 index slipped 1.66 points to 1091.48. The USA TODAY Internet 50 rose 0.49 to 79.83.

"The path of least resistance right now is still down," Christopher Wolfe, market strategist for J.P. Morgan Private Bank, told Reuters. "There are not a lot of catalysts, not a lot of expectations that the market's going to go up anytime soon."

Highlights: New York Stock Exchange volume leader Tyco International sank $5.15 to $20.75 after reporting a large second- quarter loss and lowered full-year earnings forecasts. The conglomerate also said it was scrapping plans to split itself into four separately traded companies. Instead, Tyco will spin-off its CIT Group financing subsidiary in an initial public offering. (Story, more earnings news, 6B.)

* Brokerage stocks plunged as the Securities and Exchange Commission confirmed that it is joining the New York Attorney General's probe of misleading investors. (Story, 1B.)

Merrill Lynch, the initial target of the probe, lost $2.15 to $42.50. Morgan Stanley slipped $2.86 to $48.13. J.P. Morgan Chase lost 86 cents to $35.03, while Goldman Sachs dropped $2.28 to $77.21.

* Dynegy plunged $8.09 to $19.21. The Houston energy trader, a former suitor of troubled Enron, said the SEC was conducting an inquiry into its accounting practices regarding natural gas contracts. Dynegy also said it would post a first-quarter loss.

* Bristol-Myers Squibb lost $1.11 to $29.89. The drugmaker said first-quarter earnings fell by more than 50%, and sales dropped 13%.

* Aetna surged $5.93 to $49.91. The insurer posted a big loss after taking a $3 billion charge, but earnings before charges surged to 44 cents from 10 cents in the year-ago quarter, well above analysts' estimates.

* Eastman Kodak eased 76 cents to $33.18. The photo-imaging giant topped first-quarter Wall Street estimates, but CEO Daniel Carp said future results depend on the rate of the economy's rebound. "We see a slow trajectory," Carp said. Given that economic climate, Kodak will continue to conserve cash and curb expenses.

Markets Thursday

GRAPHIC, B/W (CHART)

Document usat000020020426dy4q00011

MONEY
Complaint to link Wall Street banks with Enron woes

Greg Farrell and Edward Iwata
1,141 words
8 April 2002
USA Today
USAT
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B.05
English

Far from being innocent victims of Enron's collapse, Wall Street banks profited handsomely from transactions involving the Houston energy company and did everything they could to prop it up, even at the expense of Main Street investors, according to a complaint being filed in federal court today.

Until now, Wall Street's perceived role in Enron's collapse has largely been defined by the "buy" recommendations maintained by analysts as the company melted down last fall. Citigroup Vice Chairman Robert Rubin has been criticized for calling Moody's last November to urge the credit-rating firm not to downgrade Enron.

But a revised complaint by plaintiffs' lawyer Bill Lerach and his law firm, Milberg Weiss Bershad Hynes & Lerach, on behalf of the University of California system alleges that J.P. Morgan Chase, Citigroup, Credit Suisse First Boston and others were part of an effort to hide Enron's financial condition.

The complaint also names two law firms, Vinson & Elkins and Kirkland & Ellis, as participants in what it describes as Enron's fraudulent activity. Arthur Andersen was already a defendant, but the revised complaint names 24 Andersen partners, including former CEO Joseph Berardino and in-house attorney Nancy Temple.

The 485-page complaint is the result of a four-month investigation into Enron's collapse by Lerach's team of lawyers and investigators. Lerach would not respond to questions about his sources of information, but it is believed that former Enron insiders cooperated.

The banks

The revised complaint charges that J.P. Morgan Chase and Citigroup loaned Enron $5.3 billion but disguised the loans as commodity trades and swaps with offshore entities dubbed "Mahonia" and "Delta." Lerach says the banks disguised the loans because the investment community would have known Enron was in trouble if it had tried to borrow that much through traditional means. Lerach alleges that J.P. Morgan Chase and Citigroup charged 7% in interest vs. 4% for a normal loan.

Spokesmen for the banks and others mentioned in the complaint declined comment until they had a chance to look at the filing today.

The complaint says top bank executives put up $14 million in December 1999 so Enron could "sell" several businesses to LJM2, a partnership run by former Enron CFO Andrew Fastow. Executives from J.P. Morgan Chase, Citigroup, Credit Suisse First Boston, Canadian Imperial Bank, Deutsche Bank, Lehman Bros. and Merrill Lynch put their own money up and received fat returns within a few months, the lawsuit says.

But Enron's transactions with LJM2 hurt investors by keeping huge liabilities off Enron's balance sheet. Lerach charges that the bank executives knew what Enron was doing but took part anyway because it was so lucrative.

A team of CSFB bankers, led by Laurence Nath, often visited Enron's headquarters to help Fastow create special-purpose entities to keep debt off Enron's books. Nath's group concocted some of Enron's best-known financing vehicles, such as the Raptor partnerships. It was their unwinding last year that began Enron's tumble into Chapter 11.

"Although we can't comment on allegations because we haven't seen the complaint, we don't believe there is a basis for a lawsuit against CS First Boston," says company spokesman Pen Pendleton.

Wall Street banks have professed ignorance of Enron's problems, but in the complaint, an Enron executive describes a meeting with CSFB bankers in July. The subject was Enron's slumping stock price (then about $40) and how it could affect the company's special- purpose entities. CSFB bankers allegedly warned their Enron counterparts, "If this thing hits the $20s, you better run for the hills."

Andersen, Enron, the law firms

The lawsuit accuses two law firms, Vinson & Elkins and Kirkland & Ellis, of complicity in Enron's system of hiding debt. When Fastow formed Chewco investments in December 1997, both firms attested that Chewco was an independent business, with the requisite 3% of capital from outside parties. But officials who provided Chewco with 3% of its financing, Enron executive Michael Kopper and his domestic partner, were front men, the lawsuit charges. Their 3% was actually a loan from Barclays Bank, a fact the lawsuits allege both law firms knew.

Harry Reasoner, senior partner at Vinson & Elkins, said, "We remain confident that once the facts are known, it will be clear that we've fulfilled our professional obligation as Enron's legal counsel."

The complaint also states that Enron was Andersen's second- largest U.S. client and that David Duncan, lead partner on the account, sometimes made up to $2 million a year based on his ability to sell other consulting services to Enron. So important was Enron that Duncan was asked to serve on a special advisory panel at Andersen.

Finally, the complaint alleges it has found data about inside trading at Enron, saying that former chairman Ken Lay sold $184 million in stock from October 1998 to November 2001. Only $100 million of stock sales had been disclosed.

In October, after Enron announced a $1.2 billion loss in shareholder equity, Andersen's Houston office embarked on a frenzy of document destruction. When the document destruction was revealed in January, Andersen executives admitted that shredding had occurred after an in-house attorney, Nancy Temple, sent an e-mail to the Houston office reminding partners to comply with Andersen's document- retention policy.

"Such reminders about compliance were widely understood within Andersen to be a directive to destroy any incriminating documents at Andersen," the complaint says. Temple told Congress that her e-mail meant no such thing.

Chicago-based law firm Kirkland & Ellis apparently was a key player, receiving an unknown amount of legal fees "directly or indirectly" from Enron, the lawsuit alleges.

Fastow's longtime ties with Kirkland & Ellis precede his joining Enron, Lerach says.

Kirkland & Ellis worked closely with the Wall Street firms, Andersen and Vinson & Elkins to structure the off-balance-sheet partnerships, the lawsuit says. The law firm issued dozens of legal opinions on the entities and drew up loan and partnership agreements for LJM1, LJM2 and Chewco, the lawsuit alleges.

Kirkland & Ellis denies it played a role in the accounting meltdown. Laurence Urgenson, a partner at the firm, says: "Plaintiffs' counsel have apparently leaked in advance of filing a draft complaint that unfairly includes Kirkland & Ellis and several other major institutions as defendants. . . . The facts are that Kirkland & Ellis never represented Enron, and had no responsibility for the accounting judgments and related public disclosures that are at the center of the case."

Contributing: James Cox

PHOTO, B/W, Steve Yeater, AP; PHOTO, B/W, T. Kitamura, Reuters;
Caption: Bill Lerach Robert Rubin

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MONEY
Amended Enron lawsuit casts net across Wall Street ; Lawsuit says investment banks took active part

Edward Iwata and Greg Farrell
459 words
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A lawsuit being filed today casts the most widespread blame yet in the Enron debacle, alleging that leading Wall Street banks and others took an active part in the energy giant's collapse.

Until now, most of the attention has focused on the role of Enron's top executives and its auditor, Arthur Andersen.

But the amended class-action lawsuit outlines the roles allegedly played by others in the financial shell game that led to Enron's collapse. The original suit was filed late last year in federal court in Houston by Milberg Weiss Bershad Hynes & Lerach on behalf of the University of California, which lost $140 million, and other Enron shareholders.

The lawsuit names J.P. Morgan Chase, Citigroup, Credit Suisse First Boston, Canadian Imperial Bank of Commerce, Merrill Lynch, Bank of America, Barclays Bank, Deutsche Bank and Lehman Bros. as parties to the alleged Enron scheme that cost investors $25 billion.

It also names law firm Vinson & Elkins, which represented Enron, and law firm Kirkland & Ellis, which represented Enron-related entities. Sixty Enron and Arthur Andersen executives, directors and partners also are named.

Among the lawsuit's allegations:

* That J.P. Morgan Chase and Citigroup loaned Enron $5.3 billion but attempted to disguise the loans as commodities transactions and derivative swaps. The idea, the lawsuit says, was to allow Enron access to huge sums of capital without word spreading through the investment community that the company desperately needed so much cash. The lawsuit says the banks locked in rates of return approaching 7%, roughly twice the going rate. Spokesmen for both banks -- as well as others named in the lawsuit -- declined to comment.

* Executives from seven of the nine banks -- J.P. Morgan Chase, Citigroup, CSFB, CIBC, Merrill Lynch, Deutsche Bank and Lehman Bros. -- invested $14 million in LJM2, an Enron financing vehicle, in December 1999. They were guaranteed huge rates of return, says the complaint.

* Former Enron CEO Kenneth Lay and 27 other Enron executives and directors gained $1.2 billion, $171 million more than previously known, from insider trading, the lawsuit charges.

* Enron paid fees to Chicago-based law firm Kirkland & Ellis, which worked with the investment banks, Andersen and Vinson & Elkins to structure "the manipulative (entities) that formed the core of the scheme," the lawsuit alleges. The law firms deny being involved in any fraudulent scheme.

Legal experts predict it will be hard for Milberg Weiss to find the law firms and investment banks liable for fraud. "The odds are not in their favor," says John Coffee, a law professor at Columbia University.

See related story: 05B

Document usat000020020409dy480006y

MONEY
Financial stocks lead charge ; Dow climbs on their strength

Adam Shell
446 words
7 March 2002
USA Today
USAT
FINAL
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English

NEW YORK -- The stock market is romping again, and Wall Street's biggest financial powerhouses are out in front of the charge.

Buoyed by signs that the economy is on the mend, investors are plowing money back into the stock market. The Dow Jones industrial average, up 5.5% this year, has posted triple-digit gains three of the past four sessions and is at levels not seen since July.

And banks, brokerage firms and credit card companies have turned in even better gains:

* Merrill Lynch, the No. 1 U.S. brokerage, is up 11.2% this week.

* J.P. Morgan Chase, the nation's second-largest bank, is up 14.8%.

* MBNA, a leading credit card company, is up 10.4%.

"That bodes well for the market," says Marc Halperin, manager of Federated Global Financial Services fund. Financial stocks make up roughly 18% of the Standard & Poor's 500 index. So, "If the index is going to move up, financial stocks will have to be one of the leaders."

This week's gains may seem premature, given the sharp downturns suffered by financials due to the recession and bear market. And business has yet to pick up:

* Initial public offerings, a big moneymaker for dealmakers like J.P. Morgan, are still in the doldrums. In 2001, 83 companies went public, down 80% from 2000, Renaissance Capital says. In 2002, there have been only 10 IPOs.

* Mergers and acquisitions also have dried up. Since Sept. 11, deals valued at $270 billion have been announced, less than half the amount during the same period a year ago, says Rich Peterson, strategist at Thomson Financial.

And a record number of consumer bankruptcies last year and rising debt loads don't bode well for credit card companies or banks.

But investors are shrugging off the bad news. Instead, they are banking on profits improving as the economy gains momentum.

Bank and brokerage stocks have room to go higher, says Tom Goggins, manager of John Hancock Financial Industries fund: "IPO and M&A activity will pick up."

Brokers also will benefit from higher trading volume and greater fee income, says Anna Dopkin, manager of T. Rowe Price Financial Services fund. The credit quality of banks also will improve as the job market firms and consumers get their balance sheets in order. "They won't have to write off so many bad loans," she says.

What could derail financials? Dopkin says another accounting scandal, an unexpected rise in interest rates or more weak earnings.

GRAPHIC, B/W, Karl Gelles, USA TODAY, Source: USA TODAY research (BAR GRAPH)

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MONEY
Congress grills stock analysts ; How could they push Enron shares?

Greg Farrell
393 words
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English

In its effort to figure out what went wrong with Enron, Congress turned its attention to another group deemed partially responsible for the energy company's inflated stock price: Wall Street analysts.

Wednesday, the Senate Committee on Governmental Affairs grilled analysts from J.P. Morgan Chase, Credit Suisse First Boston, Salomon Smith Barney and Lehman Bros. about how they could keep recommending Enron stock into late October of 2001, even after Enron disclosed the sudden write-down of $1.2 billion in shareholder value.

"You have an appearance problem," Sen. George Voinovich, R-Ohio, told the four analysts.

Committee Chairman Joseph Lieberman, D-Conn., said 10 of 15 analysts covering Enron still rated it a "buy" or "strong buy" as late as Nov. 8. That was the day Enron restated earnings for losses going back to 1997 and two weeks after the Securities and Exchange Commission announced it had opened an inquiry into Enron's accounting.

The analysts defended themselves, saying that Enron's core business activity seemed healthy, but that the company had kept important information hidden. Had the analysts known the truth behind Enron's financial position, they said, they would not have been so bullish on the stock.

"Each day there are new allegations in the media concerning Enron about which I previously was unaware," testified Curt Launer, managing director of equity research at Credit Suisse First Boston.

Launer downgraded Enron on Nov. 28 from "strong buy" to "hold." On Dec. 2, Enron made a Chapter 11 bankruptcy filing that was the biggest ever in the USA.

A key concern for the senators was whether the analysts' views had been compromised by the fact that their employers earned large sums of money from Enron by underwriting securities, providing loans and, in some cases, investing in the company's controversial limited partnerships. All of the analysts denied that their firms' investment banking activities influenced their judgment when rating Enron's stock.

"I have complete freedom with respect to the recommendations that I make concerning any (stock), and my compensation is not tied to the recommendations that I make," testified Anatol Feygin, a senior analyst at J.P. Morgan Securities. "I have never received any compensation in any form from any company that I analyze, including Enron."

Money extra

Document usat000020020228dy2s0000o

COVER STORY
NEWS
Special Report: Activists challenge corporations that they say are tied to slavery ; Team of legal and academic stars pushes for apologies and reparations

James Cox
3,164 words
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They owned, rented or insured slaves. Loaned money to plantation owners. Helped hunt down the runaways.

Some of America's most respected companies have slavery in their pasts. Now, 137 years after the final shots of the Civil War, will there be a reckoning? A powerhouse team of African-American legal and academic stars is getting ready to sue companies it says profited from slavery before 1865. Initially, the group's aim is to use lawsuits and the threat of litigation to squeeze apologies and financial settlements from dozens of corporations. Ultimately, it hopes to gain momentum for a national apology and a massive reparations payout by Congress to African-Americans.

Neither goal will be easily achieved.

There is considerable evidence that proud names in finance, banking, insurance, transportation, manufacturing, publishing and other industries are linked to slavery. Many of those same companies are today among the most aggressive at hiring and promoting African- Americans, marketing to black consumers and giving to black causes.

So far, the reparations legal team has publicly identified five companies it says have slave ties: insurers Aetna, New York Life and AIG and financial giants J.P. Morgan Chase Manhattan Bank and FleetBoston Financial Group.

Independently, USA TODAY has found documentation tying several others to slavery:

* Investment banks Brown Bros. Harriman and Lehman Bros.

* Railroads Norfolk Southern, CSX, Union Pacific and Canadian National.

* Textile maker WestPoint Stevens.

* Newspaper publishers Knight Ridder, Tribune, Media General, Advance Publications, E.W. Scripps and Gannett, parent and publisher of USA TODAY.

Successive generations of African-Americans, starting with slaves freed in 1865, have failed to persuade Congress to apologize and make restitution for slavery. Attempts by descendants of slaves to sue the federal government for damages have been dismissed.

By targeting corporations, the activists are opening a new chapter in black America's quest to be compensated for 2 1/2 centuries of bondage. The activists contend that major corporations today possess wealth that was created by slaves or at the expense of slaves -- and that it's time for African-Americans to reclaim that wealth.

Evidence against corporations sits in university libraries, historical collections and corporate archives. Slaves haunt the pages of old letters, newspapers, receipts, payroll sheets, account books, annual reports and court records.

Ads seeking 'my Negro boy'

There are insurance policies naming their masters as beneficiaries; railroad rule books prescribing 39 lashes of the whip for recalcitrant slaves; newspapers publishing ads offering rewards for the return of "my Negro boy."

The list of corporations tied to slavery is likely to grow. Eventually, it could include energy companies that once used slaves to lay oil lines beneath Southern cities, mining companies whose slaves dug for coal and salt, tobacco marketers that relied on slaves to cultivate and cure tobacco.

Slavery's long shadow also could fall over some of Europe's oldest financial houses, which were leading financiers of the antebellum cotton trade.

Lloyd's of London, the giant insurance marketplace, could become a target because member brokerages are believed to have insured ships that brought slaves from Africa to the USA and cotton from the South to mills in New England and Britain.

The original benefactors of many of the country's top universities -- Harvard, Yale, Brown, Princeton and the University of Virginia, among them -- were wealthy slave owners. Lawyers on the reparations team say universities also will be sued.

Ties can be tenuous

The connection between modern-day corporations and slavery can be tenuous. Records seldom show the extent to which a given company depended on slave labor or profited from sales to slave owners. Many of the companies that are potential targets for reparations lawsuits didn't exist until after emancipation, some not until the 20th century. Instead, they bought the slave histories of other companies in corporate acquisitions over the years.

Last August, insurance giant AIG, founded 54 years after the Civil War, bought another insurer, American General. With the purchase came U.S. Life Insurance, which American General had acquired in 1997. In going through U.S. Life's archives last fall, AIG discovered that the unit had insured slaves in its early years.

Aetna first confronted allegations it had insured slaves two years ago. Since then, it has struggled to put the matter to rest, apologizing and pointing out that it funds college scholarships for African-Americans, pays for studies on racial disparities in health care and sponsors a national forum on race.

Antebellum-era slave polices "don't reflect what our company is today at all," says Aetna spokesman Fred Laberge. "We have a strong record of diversity and supporting causes and hiring."

USA TODAY contacted all the companies named in this article. Some acknowledged the evidence, others disputed it. Many declined comment. Of those that did comment, virtually all said the current company isn't liable for what happened before the Civil War.

Behind the new legal thrust is the Reparations Coordinating Committee, headed by Harvard law professor Charles Ogletree and author-activist Randall Robinson. The team includes heavyweight trial lawyers Johnnie Cochran and Dennis Sweet, and scholars such as Harvard's Cornel West, Georgetown's Richard America and Columbia's Manning Marable.

"Once the record is fleshed out and made fully available to the American people, I think companies will feel some obligation" to settle, Robinson says. "Regret's not good enough. Aetna made money, derivatively at least, from the business of slavery. . . . Aetna has to answer for that."

The legal obstacles are daunting. Slaves and their masters are dead. Company records, though sometimes damning, are seldom complete. Damages may be impossible to calculate. Most important, no company accused of profiting from slavery was breaking U.S. law at the time: Slavery was not a crime.

"We've never seen a case where someone who died hundreds of years ago can have a simple, common-law tort revived. The law wasn't designed for this," says Anthony Sebok, a tort expert at Brooklyn Law School.

Statutes of limitations on torts, or injury claims, typically last no longer than two or three years and have been extended in rare exceptions to only 30 years. Before broadening a tort case to a class- action lawsuit, reparations advocates must find the descendant of a slave damaged by one of the defendants. Then they must decide who qualifies as a slave descendant and who, in essence, is black.

The reparations team could choose instead to sue for restitution, arguing that companies were "unjustly enriched" from their use of uncompensated labor. Those cases often hinge on whether plaintiffs can give a clear, precise accounting of what was wrongfully taken from them and what they produced. That's easy when someone wants restitution for a lost object, such as a building. But how do you separate the output of slaves from that of other workers on, for example, a railroad?

Earlier reparations cases -- targeting the government -- have been dead ends. The group wants to avoid a repeat of Cato v. United States, a $100 million reparations case brought against the federal government in 1995. A sympathetic U.S. Appeals Court in San Francisco dismissed the case after saying it could not find a legal basis for it. The panel said descendants of slaves must go to Congress, not the courts, to get redress for crimes against their ancestors.

That's not to say there is no precedent for reparations. Since 1995, the state of Florida has paid about $2 million in reparations to the victims of a 1923 race riot in the black settlement of Rosewood.

Ultimately, the court of public opinion could be the one that matters most. That much was clear to the German, Austrian, Swiss and French companies sued by Holocaust survivors and other Europeans victimized by the Nazis.

The Holocaust cases, filed by the dozens between 1996 and 2000, were weak on the law and almost certain to be dismissed by U.S. courts. But they were corrosive to the reputations of defendant companies as long as they could linger on court dockets. The companies have settled for more than $8 billion, at the urging of the U.S. government, which mediated.

Owen Pell, a lawyer at White & Case who represented Chase Manhattan against accusations it illegally blocked accounts held by Jews in wartime France, says dozens of U.S. companies have quietly begun searching their archives in anticipation that they could be named in slavery lawsuits.

Public relations damage

The reparations movement can't win in court, Pell insists. "But companies have learned you don't judge a lawsuit by its merits. You judge it by the potential public relations damage. Corporate America is following this issue. They understand how nasty it could get if someone comes in and says you have blood on your hands."

It shouldn't come to that, says Willie Gary, a reparations team member. He says companies tied to slavery should step forward and make amends by putting money into African-American scholarships and education. "Based on what America stands for and has stood for, it's the right thing to do. There's an opportunity to make a wrong right," he says. "This should be a negotiated matter. We shouldn't be in litigation for 20 years."

Black and white Americans are sharply divided on the issue, a USA TODAY/CNN/Gallup poll shows. Big majorities of African-Americans believe companies that profited from slavery should apologize, make cash payments to descendants of slaves and set up scholarship funds for blacks. About a third of whites believe apologies and scholarships are a good idea; only 11% of whites favor cash payments to slaves' descendants.

Either way, reparations activists are preparing for a fight. Many of them battled to isolate apartheid-era South Africa and make pariahs of U.S. companies operating there in the 1980s. Expect the same bruising tactics -- and some new ones -- this time:

* Pressuring shareholders. That means demanding that pension funds and other big institutional investors dump shares of companies linked to slavery. Activists also may try forcing them to formally debate the issue at annual meetings.

* Swaying consumers. They will try to persuade African-Americans to pull money from accused banks and switch policies from tainted insurers.

* Blocking mergers. Already, they have tried to get government regulators to kill corporate deals by AIG and J.P. Morgan Chase Manhattan on the grounds the companies haven't told shareholders of potential legal liabilities stemming from any past involvement in slavery. The deals went through anyway.

* Enlisting African-American job recruits. The reparations group has close ties to black fraternities and sororities at the nation's colleges. It could urge graduates to shun companies accused of slave profiteering and harass corporate recruiters sent to campuses by accused companies.

The reparations team has been extraordinarily secretive. Members won't reveal the timing, corporate defendants, damages and precise legal argument of any planned lawsuits. That's partly a strategic determination to keep the opposition in the dark. Partly, it reflects unresolved disagreements among the lawyers and scholars putting the case together.

May be the last shot

With each passing day, slavery slips further into time. Gary and other trial lawyers on the team are mindful that this effort may be the last shot at addressing a historical wrong. They say their work is likely to be done pro bono. By not charging, they hope to guard against accusations they're looking to get rich by conducting corporate shakedowns.

One certainty is that new corporate cases are merely the undercard for the main event: The Holy Grail for the reparations movement is a national apology from Congress and a massive federal payout that could take the form of direct payments to African-Americans or trillions in new spending on education and social programs aimed at them.

Central to any national reparations campaign is a belief that present-day gaps between whites and blacks are rooted in the past. Reparations backers argue that disparities in income, education, health, housing, divorce rates and crime grew out of the trauma of 246 years of slavery and more than a century of continuing oppression: Jim Crow laws, lynchings, job discrimination, segregation, mortgage covenants, redlining, racial profiling and other abuses.

Congress has effectively turned a deaf ear to that argument. It has stifled reparations legislation sponsored each year since 1989 by Rep. John Conyers Jr., D-Mich. But by identifying companies that made money off slavery, reparations backers believe they can turn corporations and their CEOs into lobbyists for national restitution.

A few companies may open their checkbooks, Pell says.

"What proponents of reparations are really trying to do is use the lawsuits as a tool," he says. "It's a hammer against businesses to create a call for a federal government solution."

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Contributing: Lauren Ashburn

TEXT OF INFO BOXES BEGINS HERE

Who's involved

On the team of lawyers, scholars and activists who are part of the loosely organized Reparations Coordinating Committee:

Charles Ogletree, RCC co-chairman: Professor of law, Harvard University.

Randall Robinson, RCC co-chairman: Founder of TransAfrica Forum, a think tank and advocacy group devoted to issues related to Africa and the Caribbean. Author of The Debt: What America Owes to Blacks, a book calling for reparations.

Alexander Pires:

Washington lawyer who won a $1 billion settlement from U.S. Department of Agriculture for discrimination against black farmers.

Willie Gary: Stuart, Fla., lawyer specializing in personal injury, product liability, wrongful death, medical malpractice and corporate "bad faith" dealings. Firm won $240 million judgment against Walt Disney and $500 million jury verdict against The Loewen Group. Serves as general counsel to Jesse Jackson.

Dennis Sweet: Jackson, Miss., lawyer who won $400 million in Fen- Phen diet pill case against American Home Products. Firm won $144 million judgment against Ford Motor, the largest wrongful death or personal injury verdict in Mississippi history.

J.L. Chestnut: Selma, Ala., civil rights lawyer.

Johnnetta Cole: Professor of anthropology, Emory University.

Adjoa Aiyetoro: Lawyer at the National Coalition of Blacks for Reparations in America (N'COBRA).

Richard America: Lecturer, Georgetown University's McDonough School of Business.

Johnnie Cochran: Trial lawyer who defended O.J. Simpson.

Cornel West: Professor of Afro-American studies and philosophy of religion, Harvard University.

Manning Marable: Director of the Institute for Research in African- American Studies, Columbia University.

James Comer: Psychiatrist and child development expert, professor of psychiatry at Yale University School of Medicine.

Ronald Walters: Professor of government and politics and director of the African American Leadership Institute, University of Maryland.

The costs of the slave trade, then and now

1850

The Richmond, Fredericksburg & Potomac Railroad, part of CSX today, paid slave owners $30 to $150 apiece to rent slaves for a year.

Price in 1850: $150

In today's dollars: $3,379

1856

The Mobile & Girard, now part of Norfolk Southern, offered slaveholders $180 apiece for slaves they would rent to the railroad for one year.

1856: $180

Today: $3,737

1859

The Central of Georgia, a Norfolk Southern line today, valued its slaves at $31,303.

1859: $31,303

Today: $663,033

1865

The Nashville & Chattanooga Railroad, today part of CSX, placed a value of $128,773 on the slaves it lost as a result of emancipation at the conclusion of the Civil War.

1865: $128,773

Today: $1.4 million

1865

The Mobile & Ohio, now part of Canadian National, valued slaves lost to the war and emancipation at $199,691.

1865: $199,691

Today: $2.2 million

Sources: Economic History Services, USA TODAY research

From slavery to reparations

1619: Dutch slave trader arrives at Jamestown, Va., exchanges cargo of Africans for food.

1638: First public auction of 23 slaves held in Jamestown.

1640-1660s: Colonies legalize slavery.

1750: Slaves are 20% of colonies' population and more than 40% of the population of Virginia.

1775: First abolitionist society founded in Pennsylvania. Slaves outnumber colonists 2-to-1 in South Carolina.

1777: Vermont first U.S. territory to abolish slavery.

1780: Pennsylvania first state to abolish slavery.

1780-1810: Arrivals of slaves number as many as in previous 160 years.

1786: George Washington, a slave owner, wishes to abolish slavery "by slow, sure and imperceptible degrees."

1787: Constitutional Convention adopts "three-fifths rule." Slaves are valued at a fraction of a free man for purposes of taxation and representation.

1793: Eli Whitney invents cotton gin, making production easier, increasing the need for slaves.

1808: Importation of slaves outlawed by Congress, but ships continue bringing slaves from Africa.

1859: Last slave ship docks in Mobile, Ala.

1861: Civil War breaks out.

1863: Emancipation Proclamation by President Lincoln frees slaves.

1865: Civil War ends. Gen. William Sherman grants each freed family 40 acres and a mule. President Andrew Johnson later rescinds order. Congress passes 13th Amendment to abolish slavery.

1865-1877: Reconstruction. African-Americans briefly gain voting rights.

1890-1917: National Ex-Slave Mutual Relief, Bounty and Pension Association presses Congress to grant former slaves pensions.

1954-1968: Civil rights era.

1963: Reparations Committee of Descendants of U.S. Slaves is formed by Audley "Queen Mother" Moore. She presents President Kennedy with petition bearing 1 million signatures on the 100th anniversary of the Emancipation Proclamation.

1969: Civil-rights activist James Forman demands that U.S. churches pay African-Americans $500 million in reparations.

1989: Rep. John Conyers, D-Mich., introduces bill calling for study of slavery and federal reparations. It fails. He re-introduces it every year.

1995: Federal appeals court dismisses $100 million reparations case, Cato v. United States, finding no legal basis.

2000: Chicago City Council joins Cleveland, Detroit, Atlanta and Dallas in asking for federal hearings.

Being there: Interactive look at slavery in America, usatoday.com; See also related articles on 8A and 9A.

PHOTO, Color; PHOTO, Color, USA TODAY; GRAPHIC, B/W, Frank Pompa, USA TODAY, Source: USA TODAY research. Margin of error is 4 percentage points for white repsondents, 9 percentage points for black respondents (BAR GRAPH); PHOTO, B/W, Courtesy of New York Historical Society, WGBH/PBS; PHOTO, B/W, Reuters; PHOTO, B/W, GNS; PHOTO, B/W, Annemarie Poyo; PHOTO, B/W, USA TODAY; PHOTO, B/W, Library of Congress;
Caption: Slave ties: 19th-century companies often issued their own currency and bonds. This bill, depicting a slave scene, was issued by the Atlantic and Gulf Railroad, which was built in part by slaves. CSX owns the railroad today and could come under fire for its role in

the events of the past. Farmer- PaellmannHistory: The WGBH/PBS documentary Africans in America: America's Journey Through Slavery showed this image of slaves in Savannah, Ga. Financiers of the antebellum cotton trade could be asked to apologize and make reparations.Auction: A sign offers slaves for sale in Atlanta in 1864.

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MONEY
Lawyers in Enron suits go after companies with cash ; Bankruptcy protection sics plaintiffs on Wall Street

Greg Farrell
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HOUSTON -- Plaintiffs' lawyers in civil suits against Enron are already looking beyond defendant Arthur Andersen to companies with much deeper pockets: Wall Street investment banks.

The goal during the evidence-gathering phase of the Enron civil litigation will be to show that banks that provided funds for Enron were somehow negligent or partially liable for investor losses, say Houston lawyers suing Enron and a senior member of the firm of lead plaintiffs' attorney Bill Lerach.

"Inevitably, they will look at other deep pockets," says Henry Hu, a securities and corporate law expert at University of Texas School of Law in Austin.

Enron is in Chapter 11 bankruptcy protection, so plaintiffs since December have focused on recovering damages from auditing firm Arthur Andersen.

Sources among the plaintiffs' lawyers suing Andersen say the accounting firm floated the figure of $610 million last week as a baseline for settlement talks.

But even the entire sum of Andersen's assets, including the $610 million in insurance from Andersen's and Enron's combined policies, would only be a fraction of the $60 billion in Enron's market capitalization that vaporized over the past year.

Another logical target for plaintiffs' lawyers is Enron's longtime law firm, Vinson & Elkins. In December, a Houston attorney filed an Enron lawsuit naming the law firm as a co-defendant. While V&E succeeded in having itself dropped from that lawsuit, like Andersen, V&E remains an attractive target.

"We're looking at other defendants, including Vinson & Elkins and J.P. Morgan Chase," says Sean Jez of Fleming & Associates, which has also filed a lawsuit against Enron.

It's widely known that Wall Street powerhouses like J.P. Morgan Chase and Citigroup loaned Enron money and participated in some of the firm's controversial limited partnerships. The challenge for plaintiffs' attorneys would be to demonstrate any negligence on the part of investment banks.

"For the vast majority of shareholders, there isn't a clear linkage between their losses and the investment banks that may have known Enron's financial condition," says Jack Coffee, an expert on securities law at Columbia Law School in New York. "The court will be dubious about such claims, because you don't have a theory which can be pled in court."

Still, the lack of precedent won't keep hungry plaintiffs' lawyers from trying to drag Wall Street giants like Morgan, Citigroup and Merrill Lynch onto the docket for damages, says Hu.

"One suspects that regardless of whether or not somebody is truly at fault and technically liable on fiduciary grounds, plaintiffs' lawyers are going to go after them," he says.

Adds Philip Hilder, the Houston attorney who represents Enron employee Sherron Watkins: "You can believe that they will conduct in- depth investigations to determine if there's anything there."

See related stories: 03B

PHOTO, Color, AP;
Caption: Lerach: Lead plaintiffs' attorney.

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