



Book raises questions about WestLB deal

By Clay Harris in London

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Even before WestLB's principal finance unit run by Robin Saunders came under scrutiny by the German financial regulator BaFin, a former senior executive in the bank's London office had raised questions about its Formula One motor racing funding deal in a book* to be published later this summer.

Janet Tavakoli was head of financial engineering in WestLB's global financial markets division until July 2002. An expert in credit risk management, she is now president of her own consulting firm, Tavakoli Structured Finance in Chicago.

Ms Tavakoli said this week that the section about WestLB and Formula One, which are not named but are clearly identifiable, had been completed months before the probe began.

In the book, Ms Tavakoli said a senior German officer of WestLB had asked her opinion of its \$800m exposure to a securitised transaction arranged by its principal finance group.

She noted Morgan Stanley, which co-led the deal, had "discounted the bonds slightly, and thus earned lower net fees, in order to sell the bonds to its customers. [WestLB] couldn't distribute the bonds at full price through its sales force". According to Ms Tavakoli's book, WestLB's "next most preferred choice would have been to sell the bonds to the conduit previously set up by the finance group for the purpose of buying their products. That wasn't possible, however, because the bonds did not have a high enough rating. The bank decided to buy the bonds and put them on the bank's balance sheet.

"I pointed out that even if one loved the exposure, it was not prudent to have a high concentration of this risk. The bank wouldn't have considered taking down an enormous position in those bonds if they hadn't arranged the deal. If the bank saw the bonds in the general market place, the bonds wouldn't have the same halo effect. At a minimum, the senior officer might want to do some 'what if' scenarios: competitive threats, serious injuries to the key crowd draws, the public losing enthusiasm for the sport, or mismanagement (or fraud) in the franchise. What were the threats to the revenue stream backing the bonds?

"The senior officer looked as if he had an orange stuck in his throat and protested that he liked the risk. There is a difference between having an open mind and believing something because you want it to be true.

"The chairman of the board had signed off on the deal and had signed off on the bank taking the position on balance sheet. This was a marquee deal. The bank got a lot of publicity and earned fee income. It was a watershed. The bank finally had a foothold in the principal finance business.

"The senior officer did the politically correct thing in defending the decision. [He] suspected he had a problem, but he had to paddle up denial with everyone else.

"Shaken confidence triggers a craving for new converts. At this rate the bank was in danger of doing another deal like this just to prove they were right the first time. The bank manager had reason to worry. Market conditions had changed, and the bonds were looking even less liquid than when the bank brought the deal. Viewership was way down, and new competition threatened to produce competing televised sporting events, making the rights to televise potentially less attractive. One of the holders of a right to televise became embroiled in its owner's bankruptcy proceedings.

"Potential investors weren't keen to add this bond to their portfolios. The bank wouldn't be able to sell a major chunk of their position at the price it owned the bonds.

"Meanwhile, the principal finance group reported the net revenues after funding costs as accruing profit and held no reserves against the position.

"I like the idea of reserves. Even with the best of intentions, even with the best bright shining deal, things can go sideways."

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