Fund Partners Got Outside Financing

Move to Boost Investments Adds to Financial Woes Of Long-Term Capital

WSJ — A3

9/28/98 By ANITA RAGHAVAN And MICHAEL R. SESIT

Staff Reporters of THE WALL STREET JOURNAL

NEW YORK—The 16 partners of **Long-Term Capital Management** LP obtained outside financing to boost their personal equity investments in the beleaguered hedge fund, compounding their own financial woes when the fund hit the skids this month.

> **Heat on Hedge Funds**
>
> Investors in other hedge funds are sweating about the risk. Meanwhile, banks are expected to pull back on lending for such investing. Article on page C1. In other developments:
>
> ■ Regulators are under pressure to keep a closer eye on hedge funds, A18.
>
> ■ Now, Japan has a chance to wag its finger at the U.S., A23.

The financings came to light late last week when UBS AG, parent of the newly merged Swiss Bank Corp. and the former Union Bank of Switzerland, took a $685.9 million charge to reflect losses on UBS's exposure to the hedge fund. The fund's collapse was staved off only by a $3.5 billion rescue late last week by 14 banks and securities firms.

Bankers now say that two-thirds of the charge that UBS booked was attributable to an equity warrant the bank sold that effectively enabled the partners to turn $250 million of their capital into $750 million of equity. That $750 million represented about half of Long Term Capital's employees' equity in the fund at the start of the year.

Seven-Year Warrant

Under terms of the warrant, Long Term Capital founder John Meriwether and his 15 partners put up $250 million to buy a seven-year warrant from UBS that gave them the $750 million equity investment in the fund. UBS had to write down that warrant last week because it is worth hardly anything at this point. A warrant gives the holder the right to buy securities at a stipulated price, usually within a specified time.

In addition, the partners at Long-Term Capital took out a $100 million working-capital loan from another, unnamed bank, which the partners also used to make an equity investment in the hedge fund. On top of that, some partners took out personal loans totaling between $5 million and $10 million from banks to make their own equity investments in the fund. These partners are now scrambling to renegotiate these loans with these banks in an effort to stave off personal bankruptcy, according to a person familiar with the financial situation of Long-Term Capital and its principals.

When the hedge fund's partners, led by former Salomon Brothers Inc. trader John Meriwether, returned about $2.7 billion of capital to investors late last year, they didn't shrink the fund's portfolio of assets or balance sheet, people familiar with the situation say. "They gave capital back [at the end of last year] because they wanted to jack up the leverage in the fund," said one person close to the fund.

Stake of 30%

In its news release last week, UBS said its Long-Term Capital losses were related to an equity holding in the fund and a structured transaction. Before the writedown, UBS held an equity stake amounting to about $300 million in the fund apart from the warrant, people familiar with the firm say.

The structured transaction with UBS left Mr. Meriwether and his partners ow

Please Turn To Page A18, Column 1

Hedge-Fund Partners Obtained Financing To Boost Investments

WSJ — 9/28/98

Continued From Page A3

ing some 30% of the fund's $4.8 billion in equity, or about $1.4 billion, at the start of the year. Had the fund done well this year, the financing from UBS would have boosted the partners' already-heady gains.

But instead, since the partners had leveraged their personal wealth in the fund, when the fund started hitting the skids—falling 44% in August—it accelerated the losses on the partners' personal investments. To be sure, since the warrant is a seven-year instrument, if the fund recovers and racks up big gains over the next few years, it could be worth more than the $250 million that Mr. Meriwether and his partners paid for it.

The fund borrowed massively against its equity under management to engage in more than $100 billion of risky bond-market trades, which backfired in late summer when prices of risky debt instruments such as European bonds or mortgage-backed securities tumbled after Russia's financial collapse. The result was that by the time the fund was bailed out by Wall Street last week, the $4.8 billion had melted down to only $600 million.

It is unclear which partners will be hardest hit by the fund's troubles and the extent to which they will affect Mr. Meriwether who, unlike some of the other partners, was already quite wealthy by the time he started Long-Term Capital in 1994. Like many hedge-fund managers, though, Mr. Meriwether and his partners tended to reinvest most of their assets in the Greenwich, Conn., fund, analysts said.

A Long-Term Capital spokesman declined to comment as did an official for UBS.

Ironically, Long-Term Capital initially sought to execute the warrant transaction with Swiss Bank Corp. but was turned down by the bank's "credit-risk management people [who] said it was too much of a risk to take because it couldn't be hedged," says someone familiar with the deal.

Instead, Long-Term Capital turned to UBS because it already owned an equity investment in Long-Term Capital, these people say. In the end, Swiss Bank's prescience didn't prevent it from taking a hit on the Long-Term financing. That's because Swiss Bank and UBS have merged since the transaction was executed last year.

Long-Term Capital Case Isn't Federal Bailout, Rubin Says

Dow Jones Newswires

WASHINGTON—U.S. Treasury Secretary Robert Rubin said it would be incorrect to call the rescue of the hedge fund **Long-Term Capital Management** L.P. a government bailout.

"I wouldn't call it a bailout," Mr. Rubin said Friday in remarks to journalists after a speech at Eastern High School in the nation's capital.

He said the decision to provide the hedge fund with additional money was made by its "private-sector counterparts" and said "no public money" was used.

Asked if the near-collapse of Long-Term Capital would mean that new government regulations of hedge funds are needed, Mr. Rubin said he had no position on this.

"There are issues many people have raised" about hedge funds, Mr. Rubin said. He said there are also questions about disclosure of risks taken on b hedge funds, which are usually secretiv about the nature of their investments, and added that there would likely be a debate on the issue.

108