A Case Study on
Bankers' Trust: How they Lost Trust

Submitted by
Prof Swati Khatkale
ICFAI Business School, Pune
swatidas@ibsindia.org
dei_swatidas@yahoo.co.in
Ph. No. 9921365664
Address: G1, G2 Akshay Nagar I,
Near Vishal Nagar, Aundh Camp,
411027, Pune

Bankers' Trust: How they Lost Trust

Abstract

This case is about a financial advisor, Bankers' Trust on whose advice, many companies lost their money. In the mid-1990s, Bankers Trust was one of the leading financial Institutions in the marketing of innovative financial products like derivatives. Yet Bankers Trust's reputation took a pounding after the bank was sued by several customers alleging various forms of fraud and racketeering with respect to derivatives transactions they had entered into with the bank. Federal Paper Board Company, Gibson Greetings, Air Products and Chemicals, and Procter & Gamble asserted that Bankers Trust had misled them with respect to the risk and value of derivatives that they had purchased from the bank. The first three cases were settled out of court for a total of $93 million. The $195 million Procter & Gamble suit was settled at a net gain to P&G of $78 million. But definitely the major damage was not financial but something else- loss of trust and reputation. This was worsened when several Bankers Trust bankers were caught on tape remarking that their client [Gibson Greetings] would not be able to understand what they were doing. Afterwards badly reputed Bankers' Trust was acquired by Principal Group in Australia and rest by Deutsche Bank in 1998. As the case is about a company which had already been acquired, primary data collection was very difficult. The case is based on secondary data like various articles, newspapers and companies' published balance sheets. The cases of unawareness of the Naïve Risk Averse Investors with the risk associated with financial services can be seen now in the selling of highly risky mutual funds also. Therefore this case deals with the corporate ethics related with marketing of financial services.

"The issue here is Bankers Trust's selling practices. There is a notion that end users of derivatives must be held accountable for what they buy. We agree completely, but only if the terms and risks are fully and accurately disclosed,"[1]

- Edwin L. Artzt, P.& G.'s chairman

When Procter & Gamble and other companies lost their money in derivative transactions, they blamed their advisor Bankers Trust for misleading them. Bankers Trust was a leading financial advisor in Mid Nineties. It established itself as an expert in the niche of risk management and innovative derivatives. But Non disclosure of risk and valuation of the complex derivatives led to legal suits by four of its major clients – Procter & Gamble, Gibson Greetings, Federal Paper Board Company and Air Products & Chemicals. Bankers' Trust had to pay $171 million for out of court settlement of these cases. This comes out as an example of poor customer management. While focusing on increasing profits, Bankers Trust didn't pay adequate attention to make customers feel informed and at ease with their deals. On the other hand, the clients were criticized for not understanding their own derivative transactions and not informing it to share holders.

Background of Bankers Trust

The Bankers Trust, a famous American Financial Institute was originally set up by banks which could not perform trust services. A consortium of banks all invested in a new trust company and thus formed Bankers Trust. The idea was a new trust company would not try and poach their existing customer. Bankers Trust became a big name in the nascent derivatives business in the

early 1990s under leadership of Charlie Sanford. In comparison of JP Morgan's strength of Board room contacts, Bankers' Trust focused on specialization in trading and product innovation.

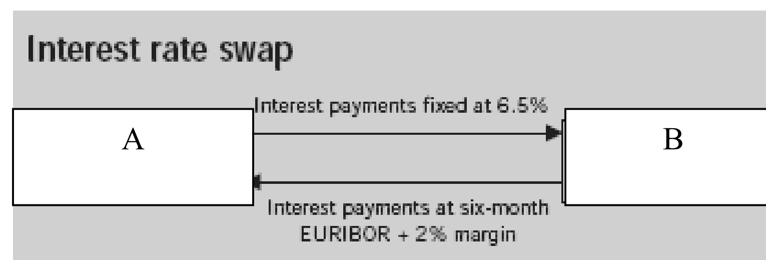
Services of Bankers Trust

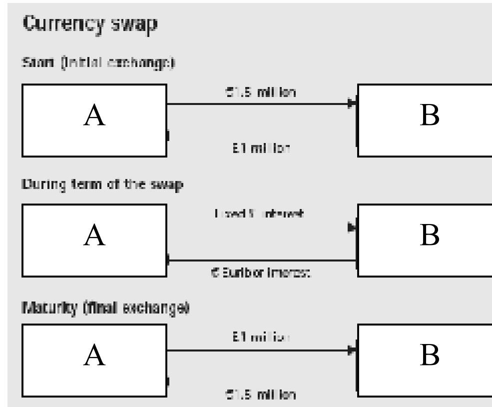
Bankers Trust was specialized in the risk management and derivative business. Derivative is a contract whose value is derived from any other asset like a security, interest rate, currency or commodity etc. Financial derivatives are effective tool of risk management as they transfer risk from naïve party to expert one. For example if an exporter wants to avoid exchange rate fluctuations, he will enter into a contract to fix the price of foreign currency. Thus he will be safe from market fluctuations. This process is called hedging. On the other hand, the counter party thinks that they can make profits out of this transaction, as they will purchase foreign currency at fixed price and sell in the open market at higher prices. Banks and other financial institutions, who can predict various market situations, take its advantage and make money out of it. But they take risk of downward movement of that currency and can suffer loss also. The derivative transactions which take others' risk in anticipation of profits are called speculative derivatives. Derivatives can be classified into two major types- Simple and complex

a) Simple Vanilla Derivatives Simple Vanilla derivatives are single contract of basic type. There are three basic derivatives

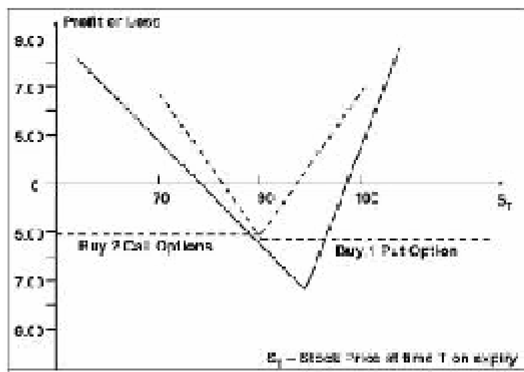
1. **Futures** Future contract means a person is purchasing or selling security, commodity, currency etc in future but its prices are decided in the present. It will not have any affect of future price fluctuation. Long position means the trader has the asset and short means the trader does not have the asset.
2. **Forwards:** Forwards are similar to futures. Futures are exchange controlled derivatives on the other hand forwards are decided by the two parties over the counter.
3. **Options:** Option gives right not the obligation to option holder to buy or sell some security, currency or commodity at a decided price. Option holder gives premium to the other party who is selling option and taking the risk. Right to buy is called call option and right to sell is called put option. If option can be exercised any time during the specified time period then it is called Knock out or American style option. If the option can be exercised only on a certain day after expiry of the period then it is called European style or Knock in option. Knock out options have more premium but they are more risky also.

b) Complex Derivatives The combinations of various simple derivatives lead to complex ones. Swap is one of them, which is a combination of a spot and forward transaction. Swaps are OTC bilateral contracts where the parties agree for a period to exchange cash flows on future dates. There are different types of swaps. Interest rate swaps and currency swaps are the most common, but there are also large markets in other derivatives, such as in credit default swaps.

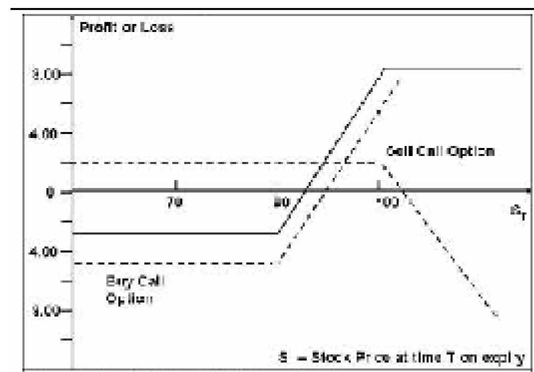




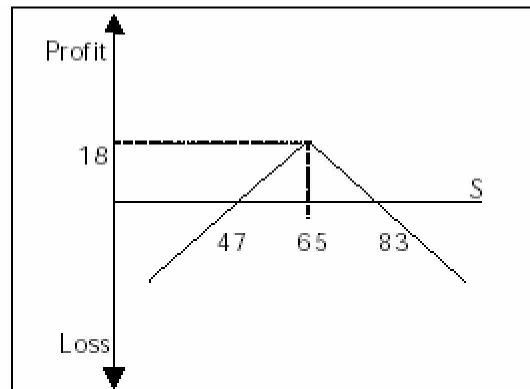
Bankers Trust also advised various other combinations like spread (the price differential between two assets (a difference option) or the same asset at different times or places), Stripe, Butterfly spread, straddle, strap etc. Bankers trust also advised various continuous and linked derivatives like periodic floor in which the strike rate in a given period depends upon the strike set in the previous period. In the case of linked derivatives one derivative executes automatically after another without entering into new contract. In the combination of simple derivatives, Bankers Trust has devised new derivatives like Wedding Ring i.e. the seller will have huge but limited profits (basically premium) if the prices move between certain range and huge unlimited losses if they move beyond the range. It is like combination of selling two options- call & put. BT used to advise Treasury Link swaps, LIBOR Linked Swaps, Interest rate swaps, Knock out call options etc. Most of the derivative transactions were over the counter deals as customization was not possible with exchange traded derivatives. But frauds and operational risk increases as the regulations and controls in over the counter deals are very few.



Long Strap Strategy



Bull Call Spread



Short Straddle or Wedding Ring Strategy

Clients of Bankers' Trust Bankers Trust rendered its services to a number of clients. It usually helped them to predict interest rate movements and on its basis speculate in derivatives in anticipation of high profits. The details about its services to them are the following:

Gibson Greetings
Gibson Greetings was a greeting card and wrapping paper manufacturing company. It was conservative company which was naïve to derivatives. It did not want to incur loss more than $3 million through derivative speculations. Over eight months in derivative contracts with Bankers' Trust it earned $ 260000. This profit made Gibson comfortable about derivatives. After that the company entered into around 29 linked derivatives to earn more profit and paid to Bankers Trust around $13 million. These complex derivatives had fancy names like ratio swap, periodic floor, spread lock 1 and 2, Treasury-linked swap, knockout call option, Libor-linked payout, time swap, and wedding band 3 and 6**.** As many of the contracts contained options, they incorporated leverage (having fixed cost like loan). But after some time Gibson started losing money which was much more than the maximum loss amount specified by Gibson. Its losses increased dramatically in response to small changes in interest rates due to high leverage. When Gibson suffered from $17.5 million loss, Bankers Trust made it enter into another contract that could lead to reduced loss of $3 million or increased loss of $27.5 million. This bet also failed and increased the loss to $20.7 million After Gibson Greetings lost huge amount, it sued Bankers' Trust.

Procter & Gamble
Procter & Gamble Co. is a Fortune 500, American global corporation based in Cincinnati, Ohio, that manufactures a wide range of consumer goods. In late 1993, Proctor & Gamble financial managers, well known for actively managing their interest costs, expected interest rates to drop and went to Bankers Trust searching for aggressive interest rate swaps that would allow them to profit on these expectations. P&G told to Bankers Trust about ways of replacing a fixed-to-floating swap that was maturing. P&G's specific objective was to negotiate a new $100 million swap that would (a) again put it in the position of paying floating rates and (b) squeeze these to a minimum. Specifically, the company wanted to pay 40 basis points (0.4 of 1%) less than its standard, upper-crust commercial paper rate (then about 3.25% for six-month paper). Bankers Trust responded with a highly levered, extremely risky, and extremely complex five-year interest-rate swap agreement. In this the P&G had to pay 75 basis points less than rate of Commercial Paper, if the interest rates of 30 years and 5 years treasury bills will remain constant or go down. Five-year Treasury rates rose from 5% in early November 1993 to 6.7% on May 4,

1994. P&G's other benchmark, 30-year Treasury rates, went from about 6% to 7.3%. Because of large duration the effect of rise in interest rate on long term bonds was very high. When interest rates headed up, Proctor & Gamble's treasurer realized the magnitude of the company's potential derivatives losses and decided to get out of the swap. Because of the intricate complexities and linked derivatives of the agreement, however, P&G lost $157 million to lock-in interest rates (which were 1,412 basis points (14.12%) above the commercial paper rate) in only six months of a five year contract. When interest rates headed up, Bankers' trust entered into another contract with P& G- a wedding band. When this strategy also failed, it led P& G to pay even higher rate of interest from 14.12% above Commercial Paper (CP) to 16.40% above CP. CEO Edwin Artzt, called the swaps ***"a violation of the company's policy against speculative financial transactions"***[2] and banned all leveraged swaps. As the Bankers Trust had suggested the contracts, P& G blamed them for the losses.

Air Product & Chemical It also entered into interest rate swap, a derivative in which the value of the transaction fluctuated with changes in interest rates. As interest rates rose sharply in 1994, the value of the contracts dissolved, and the losses mounted. Air Products and Chemicals contended that the contract violated its corporate policy against risky investments. It lost $107 million. Bankers Trust had to pay $67 million to the company in Out of Court settlement deals
Similarly Federal Paper Board Company also entered into derivative contracts to speculate on the interest rates and lost $12 million
A director of another company who also faced the same problem remarked about it as**, *"it's a lot like gambling. You get in deep. And you think, 'I'll get out of it with this one last trade"*[2]** In the midst of this trouble, one of Bankers' competitors, Citicorp, ran an ad containing a definite dig: ***"You expect derivatives to solve problems, not create them."***[2]

Unawareness of Clients' Management & Disclosure of Tapes

Most of the clients of Bankers' Trust were unaware about the risk associated with the derivative contracts. Their business was totally different from financial derivatives and they were not experts of derivatives, still they took speculative positions to make money. They did not know anything about the valuation models and the details of derivative contracts they entered into and were totally dependent on the advice of Bankers Trust. The major issue in this case was bankers trust did not inform the risk related to the derivative products to its clients: i. e. What losses they could face if things would go wrong.

At the time of huge losses, Bankers Trust misrepresented the loss to Gibson because it exceeded the limit specified. Bankers Trust made Gibson enter into another contract in anticipation of recovering money and getting more consultancy charges. Their efforts failed and they have to disclose the loss which was much more than specified limit. Things complicated because many tapes were found regarding the deal. Two Bankers Trust people holding an incriminating phone conversation were taped, caught in fact by an internal system that Bankers used to monitor trades. These people were removed from company but the information was leaked to BT's clients which were suffering from huge losses due to the derivative contracts entered through Bankers' Trust. A few excerpts of the tapes are the following: The managing director at the securities affiliate of the bank that was handling Gibson's purchases from the bank told his supervisor when Gibson's contract was made ""***From the very beginning, [Gibson] just, you***

know, really put themselves in our hands like 96%." [Gibson] probably doesn't understand it quite as well as they should. I think that they have a pretty good understanding of it, but not perfect. And that's like perfect for us."[2] The essence of the problem described on the tape was that actual losses of Gibson far exceeded what Gibson had been told. One unidentified manager talked about the "differential" in the case of Gibson "***I think that we should use this [a downward market price movement] as an opportunity. We should just call [the Gibson contact] and maybe chip away at the differential a little more. I mean, we told him $8.1 million when the real number was 14. So now if the real number is 16, we'll tell him that it is 11. You know, just slowly chip away at that differential between what it really is and what we're telling him***."[2] By this way they wanted to bridge the gap of actual loss and loss shown to Gibson in the name of market fluctuation. "***We gotta try and close that gap...If the market hasn't changed at all, or was just kind of dottering around within a couple of ticks, then you know, there's nothing that we can really say...But when there's a big move...and he is down another 1.3, we can tell him he is down another two. And vice versa. If the market really rallies like crazy, and he's made back a couple of million dollars, you can say you have only made back a half a million***."[2] But the day to recover losses did not come and Bankers' Trust had to tell the actual loss figures gradually. The losses mounted from $8.1 million to $13.8 million and then to $17.5million.

The case of P&G was similar but not the same. They had incurred loss of $195 million, which they had not paid to Bankers' Trust. Their financial manager was using interest rate swaps for a long time period, but they were not provided with the information about the valuation of derivative contract. They also revealed around 6500 tapes as well as 300000pages of written material proving that they were misrepresented. They focused on eight Bankers customers besides P&G- Gibson Greetings, Equity Group Holdings, Adimitra Rayapratama, Air Products & Chemicals, Federal Paper Board, Sandoz, Sequa, and Jefferson Smurfit. According to P&G ``***It is now apparent that Defendants' treatment of P&G was not an isolated incident or a `garden-variety fraud,' but rather part of a pattern of mail, wire, and securities fraud spanning a number of years and involving multiple victims.'***[2]' In one tape two employees were discussing the derivative contracts sold to P& G in late 1993 where one asked: ``***Do they [P&G] understand that? What they did?"*** The other replied: ``***No. They understand what they did but they don't understand the leverage, no."*** The first employee then responded***: ``But I mean...how much do you tell them. What is your obligation to* them?"**[2] The second employee answered: **``To tell them if it goes wrong, what does it mean in a payout formula..."** The first employee, referring to the huge profits the bank stood to make on the transaction, replied. ``***They would never know. They would never be able to know how much money was taken out of that,***" "***That's the beauty of Bankers Trust***." P&G also stated ``***P&G was bound by a pricing model which [Bankers] did not disclose"***[2] In its filings, P&G explained three primary schemes Bankers allegedly used to defraud its clients. It said the bank fraudulently induced clients to buy complex derivatives, misrepresented the contracts' value, and then induced clients to buy additional complex derivatives, either for further ``alleged gains" or to stanch losses. It quoted one banker describing a client's portfolio as being in total disarray: ``***If this ever comes out in the press, it is the most insane mess of trading I've ever, ever seen...they just kept trying to trade them out of losses...Everything they put in [the client's account] lost***." The tapes also revealed the wrong culture developed in Bankers' trust. P&G called it ``***culture of greed and duplicity"***. According to P&G: ``***Fraud was so pervasive and institutionalized that Bankers Trust employees used the acronym `ROF'--short for rip-off factor, to describe one method of***

fleecing clients.'*'[2] An internal document about a proposed derivative for Federal Paper Board allegedly told that Bankers would make $1.6 million on the deal, including a ``***7 [basis point] rip-off factor.***'' In another video tape recording by BW one employee was joking with another "***Bankers Trust can do for Sony and IBM is get in the middle and rip them off--take a little money***." The employee then added: ``Let me take that back. I just realized that I'm being filmed.***'' In another conversation it was found one employee remark over P&G's deals as ``***This could be a massive huge future gravy train.***'' Even the tape showed that a few employees were having fear about the destiny of BT ``***fears of SEC probes***." ``***This wave was always...made up of polluted water,***" one said. The other replied ``***as soon as we quit selling dynamite, maybe we'll have a good business.'***'[3]
Bankers Trust remarked about these allegations that ``***What P&G has done is to use material we provided to manufacture a distorted view of transactions, markets, individuals, and the corporation in a manner designed to serve its own objectives and to obscure P&G's own accountability***''[3] for not paying its required due amount. Bankers described P&G as ``***sophisticated, experienced, and knowledgeable about the use of interest-rate derivative contracts and the risks presented by those contracts.***'' The bank added ``***Although P&G would like this court to believe that it is a naive and unsophisticated user of derivatives transactions, the fact is that as part of its regular course of business and with authorization from top management...P&G's Treasury Department managed a large and sophisticated portfolio of derivative transactions***."[2] They also stated ``***Rather than putting its own house in order, and accepting its losses, P&G chose instead to bring this lawsuit.***''[3]

For all of these deeds, the Commodity Futures and trading Commission and the Securities and Exchange Commission jointly fined Bankers Trust $10 million. In addition to it the SEC posed a ban on ex BT marketer Gary Missner to do anything related to financial services for 5 years and pay fine of $1 million. 5 other people were removed from Bankers' Trust regarding the tapes.

But Colleen P. Mahoney, deputy director of enforcement for the commission made the clients like Gibson and P&G Managers also culprit. According to them it is the duty of the manager to understand the contract, which it is entering into. He remarked "***The fact that Bankers Trust committed fraud in selling derivatives does not absolve Gibson from making sure they have the internal controls necessary to control the risks of these transactions and to account for them accurately on their financial statements.***"[4] Even P&G had acknowledged that its internal procedures were not followed when it agreed to this derivative.

Unawareness of Shareholders

Due to mistakes of Bankers Trust and management of client companies, shareholders of these companies lost money. In 1989, 1990, and 1991 Gibson earned over $2.50 a share, averaging more than eight percent on sales but in 1994 after losses in derivative transactions, Gibson's stock dropped $15, well below its $19-a-share book value. This happened because it overstated assets of $8.8million and lost $20.5 million due to derivative contracts. In a February 11, 1995 article in The Cincinnati Enquirer, Jeff Stein, an analyst with McDonald & Co., asserted that the plummeting of Gibson's stock price "***could be the final catalyst that may be needed to put the 'For Sale' sign up on this company. They've done nothing but disappoint the Street.... The financial health of the company appears very uncertain.***"[5] Though one year ago a November Forbes article, one Harris portfolio regarded the same company as "***probably a reasonable***

assumption*" that "*earnings of this financially solid company have nowhere to go but up.*[5]"** The reasons of financial distress was not something operational but financial. Hans Stoll, a finance professor and derivatives expert at Vanderbilt University, remarked after that the swaps are simply ***"not something that a corporation that manufactures things should be involved in."[2]
SEC also took serious action against Gibson as Gibson was speculating on interest rates with derivatives, but was using accounting rules meant for hedging that allowed the gains or losses from the transactions to be postponed until they matured. (Please see the balance sheet of Gibson Greeting where it has only mentioned profits/ losses due to derivative transactions and nothing else). The commission also criticized Gibson for not disclosing the nature of the risks of its derivative position in the management discussion and analysis section of its quarterly financial reports. Separately, it found that by not maintaining adequate internal controls to keep tabs on the risk of its derivatives positions, Gibson violated securities laws that require companies to maintain accurate books and records. According to it ***"The fact that Bankers Trust committed fraud in selling derivatives does not absolve Gibson from making sure they have the internal controls necessary to control the risks of these transactions and to account for them accurately on their financial statements."***[4]

Out of Court Settlements and acquisition by Deutsche Bank

Bankers Trust was sued by its 4 clients. As the both Bankers' Trust and the clients' management were criticized by Security Exchange Commission, they settled them out of court. The $195 million Procter & Gamble suit was settled at a net gain to P&G of $78 million. The other three cases were settled out of court for a total of $93 million including $14 million to Gibson Greetings. Apart from it they had to pay huge amount to Securities Exchange Commission. New CEO Frank Newman was not able to save the company by the resulting reputation damage & lack of a natural client base. In 1997 to strengthen the business and to grow in investment banking business, Bankers Trust acquired Alex Brown & Sons. Alex Brown & sons was founded in 1800 and was a public corporation since 1986. The bank suffered major losses in the summer of 1998 when Russia defaulted. Many insiders believed that aggressive strategies of Frank Newman and high lending of the bank were the main reasons of those losses. In November 1998, Deutsche Bank acquired Bankers Trust for $9.8 billion. The CEO received $110 as compensation for severance. In Australia, Bankers Trust was acquired by Principal Group from Deutsche Bank and three years later it was sold to Westpac. This organization is running in the name of BT Financial Group. Even the Trust and Custody business that Deutsche Bank acquired from Bankers Trust was sold to State Street two years later.

The Lost trust of Bankers' Trust: the court Cases

October 1994: Procter and Gamble Co. sued Bankers Trust for $195 million (the company recorded a $102 million charge against fiscal 1994 earnings to cover losses from derivatives transactions), alleging that BT misled it with regard to the value and risks of its derivatives positions.
December 1994: BT signed consent decrees with federal securities regulators and agrees to pay a $10 million fine over allegations that it willfully gave Gibson Greetings inaccurate values for its derivatives portfolio, causing Gibson to violate SEC laws. BT neither admits nor denies guilt.
October 1995: U.S. District Judge John Feikens allowed P&G to add civil racketeering charges to its suit, which allowed the company to seek treble damages.

January 1996: Bankers Trust settled with Air Products and Chemicals, Inc. for $67 million, 63% of the $107 in losses in fiscal 1994 that Air Products wrote off in connection with interest-rate swaps the company entered into with Bankers Trust.
May 1996: Bankers Trust and Procter & Gamble reached an out-of-court settlement in which P&G agreed to pay $35 million of the $195 million it owed BT and had forgon between $5 and $14 million in gains on a separate contract. P&G reported a net gain of $78 million with respect to the issue in its quarterly reports.

Source: http://www.erisk.com/Learning/CaseStudies/BankersTrust.asp

This case raises a number of issues and questions related to financial advisors. The lesson to be learned is what should be the duty of financial advisor to inform its clients? According to Bankers' Trust official "***The loss of even one client is a stinging lesson***."[2] It was ironic that BT, a company that was considered by many to be a leader in risk management and in innovative derivative products, lost so much of its reputation as a result of operational risk. An enterprise risk management program must balance the "hard side" of risk management (including policies, limits and systems) and the "soft side" (including people, culture and incentives). Apart from it, the organization should never give a chance to outsiders to point out on the moral values of organization. Sales practices, incentives and other things should be aligned to maintain the reputation. Customers are the king, so companies should focus to delight customers in a long run by strong customer relationship management. Otherwise one unsatisfied customer can hamper growth of the company.

Another question is what is the duty of the management at the time of entering into derivative contract? According to Douglas Harris, a lawyer in the derivatives operation of dealer J.P. Morgan said that if you are entering into such market, you should understand it first and keep updating about it, ***"From the day I got here, I felt I was falling behind what was going on in the market. That doesn't mean we can't supervise. It just means we're always running to keep up."***[2] Problem lies more into over the counter, bank created derivatives, whose valuation depends upon person to person and accountant also approve it. Therefore mark to market should be followed. Given the range of complications that derivatives present, outside directors cannot possibly achieve close communion with the contracts their companies hold. According to Coopers & Lybrand's Klotz, this case came with an unmistakable message to end-users: "***Buyer beware***." Warren E. Buffet, chairman of Berkshire Hathaway, proposed a solution and said he'd deal with derivatives by requiring every CEO to affirm in his annual report that he understands each derivatives contract his company has entered into. Buffet told "***Put that in, and I suspect you'll fix up just about every problem that exists.***"[2] Moreover shareholders should be informed in the annual report and quarterly results about the amount invested in derivatives and what is their Value at Risk.

Some people blamed derivatives for the losses instead of Bankers Trust or its clients. Due to speculations in derivatives many companies like Baring Bank, LTCM, Orange County, Daiwa Bank etc. lost huge amounts. The Baltimore *Sun* quoted Michael Greenberger, the Commodity Futures Trading Commission, "***Derivatives, when used speculatively, amount to nothing more than gambling***[2]". According to Carol J. Loomis reporter of fortune magazine***"Untangling the derivatives mess they didn't melt down the financial system. But these red-hot instruments proved too tempting for both buyers and sellers. This is the story of how lies, leverage, ignorance-- and lots of arrogance--burned some big players"***[2]. Warren Buffet described them

*"**Weapons of Mass Destruction**[2]"* The Washington Post described derivatives after this case as ***"Derivatives are complex, risky and largely unregulated financial contracts.**[2]"* Therefore Corporate Governance, disclosure practices and government regulations are the checks, which can reduce such cases. RBI has not opened the full derivative market and slowly moving towards over the counter deals. Derivatives are still used all over the world, even in greater volume but with a word of caution, transparency, corporate governance and proper laws. Even P&G boss Artzt still stated ***"Straightforward derivatives--or, as the financial community calls them, plain vanillas--are a very effective way of managing interest rates and foreign exposures. So we plan to continue using them**."* [2]

Sources of Various quotes

1.http://query.nytimes.com/gst/fullpage.html?res=9A00EFDA133FF93BA15753C1A962958260
2.http://money.cnn.com/magazines/fortune/fortune_archive/1995/03/20/201945/index.htm
3. http://www.businessweek.com/1995/42/b34461.htm
4.http://query.nytimes.com/gst/fullpage.html?res=940DE2D91339F931A25753C1A963958260
5. http://www.fundinguniverse.com/company-histories/Gibson-Greetings-Inc-Company-History.html

Exhibit 1: BANKERS TRUST NEW YORK CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
($ in millions, except par value)
(unaudited)

	June 30, **1994**	December 31, **1993**
ASSETS		
Cash and due from banks	$ 2,662	$ 1,750
Interest-bearing deposits with banks	1,579	1,638
Federal funds sold	1,574	361
Securities purchased under resale agreements	12,257	9,567
Securities borrowed	5,396	2,937
Trading assets	54,669	48,276
Securities available for sale	6,961	7,073
Loans	13,223	15,200
Allowance for credit losses	(1,340)	(1,324)
Premises and equipment, net	763	719
Due from customers on acceptances	401	455
Accounts receivable and accrued interest	2,367	2,561
Other assets	3,127	2,869
Total	$103,639	$92,082
LIABILITIES		
Deposits		
Noninterest-bearing		
In domestic offices	$ 3,080	$ 3,185
In foreign offices	612	707
Interest-bearing		
In domestic offices	5,671	7,120
In foreign offices	11,099	11,764
Total deposits	20,462	22,776
Trading liabilities	25,151	9,349
Securities sold under repurchase agreements	21,509	23,834
Other short-term borrowings	19,188	18,992
Acceptances outstanding	402	455
Accounts payable and accrued expenses	3,656	3,771
Other liabilities	2,646	2,524
Long-term debt	5,582	5,597
Total liabilities	98,596	87,298
PREFERRED STOCK OF SUBSIDIARY	250	250
STOCKHOLDERS' EQUITY		
Preferred stock	450	250
Common stock,	84	84
Capital surplus	1,319	1,321
Retained earnings	3,404	3,226
Common stock in treasury, at cost:	(358)	(233)
Other	(106)	(114)
Total stockholders' equity	4,793	4,534
Total	$103,639	$92,082

Source: http://sec.edgar-online.com/1994/08/12/00/0000009749-94-000081/Section9.asp

Exihibit2: GIBSON GREETINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands except per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	1994	*1993*
REVENUES	**$ 93,429**	**$ 84,907**
COSTS AND EXPENSES:		
Operating expenses:		
Cost of products sold	36,028	30,996
Selling, distribution and administrative expenses	57,852	49,661
Total operating expenses	93,880	80,657
Operating income (loss) before financing and derivative transaction expenses	(451)	4,250
Financing and derivative transaction expenses:		
Interest expense, net of capitalized interest	1,974	1,656
Interest income	(321)	(429)
Loss on derivative transactions	19,700	-
Total financing and derivative transaction expenses, net	21,353	1,227
Income (loss) before income taxes	(21,804)	3,023
Income taxes	(235)	1,221
Net income (loss)	$ (21,569)	$ 1,802
Net income (loss) per share	$ (1.33)	$ .11
Dividends per share	$ .10	$ .10

Source: http://www.secinfo.com/dwtZa.bz.htm

Exhibit 3; GIBSON GREETINGS, INC. -
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands except per share amounts) (Unaudited)

	September 30, 1995	December 31, 1994	Restated September 30, 1994
ASSETS			
Current assets:			
Cash and equivalents	$ 1,100	$ 2,000	$ 899
Trade receivables, net	96,402	197,799	126,285
Inventories	184,490	127,460	197,742
Prepaid expenses	5,946	5,719	5,580
Prepaid income taxes	24,678	-	7,422
Deferred income taxes	45,239	48,775	37,582
Total current assets	**357,855**	**381,753**	**375,510**
Plant and equipment, net	112,916	119,491	124,083
Deferred income taxes	8,942	8,080	629
Other assets, net	96,457	102,871	116,583
	$ 576,170	**$ 612,195**	**$ 616,805**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Debt due within one year	$ 79,253	$ 117,114	$ 96,608
Accounts payable	22,619	21,779	34,085
Income taxes payable	-	4,742	-
Accrued loss on sale of Cleo, Inc.	82,758	-	-
Other current liabilities	75,489	86,990	101,080
Total current liabilities	**260,119**	**230,625**	**231,773**
Long-term debt	52,093	63,233	63,315
Sales agreement payments due after one year	19,912	21,107	21,707
Other liabilities	21,328	19,730	18,471
Total liabilities	**353,452**	**334,695**	**335,266**
Stockholders' Equity:			
Common stock, par value $.01; and September 30, 1994	166	166	166
Paid-in capital	46,050	45,992	46,057
Retained earnings	183,986	238,282	241,078
Foreign currency adjustment	(1,538)	(1,000)	178
	228,664	283,440	287,479
Less treasury stock,	5,946	5,940	5,940
Total stockholders' equity	222,718	277,500	281,539
	$ 576,170	$ 612,195	$ 616,805

Source : http://sec.edgar-online.com/1995/05/15/00/0000717829-95-000007/Section3.asp

Exhibit: 4
THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS

Millions of Dollars Except Per Share Amounts

	Three Months Ended March 31		*Nine Months Ended March 31*	
	1994	*1993*	*1994*	*1993*
NET SALES	$7,441	$7,350	$22,793	$23,068
Cost of products sold	4,208	4,348	12,830	13,263
Marketing, administrative, and other operating expenses	2,310	2,235	6,932	7,101
Provision for restructuring	--	--	--	303
OPERATING INCOME	923	767	3,031	2,401
Interest expense	119	130	367	402
Other income/(expense), net	(78)*	110	121*	287
EBIT	726	747	2,785	2,286
Income taxes	244	245	980	798
NET EARNINGS BEFORE PRIOR YEARS' EFFECT OF ACCOUNTING CHANGES	482	502	1,805	1,488
Prior years' effect of accounting changes, net of tax	--	--	--	(925)
NET EARNINGS	$ 482	$ 502	$ 1,805	$ 563
PER COMMON SHARE:				
Net earnings before prior years' effect of accounting changes	$ .66	$ .70	$ 2.53	$ 2.08
Prior years' effect of accounting changes, net of tax	--	--	--	(1.36)
Net earnings	$ .66	$ .70	$ 2.53	$ .72
Net earnings assuming full dilution	$ .64	$ .66	$ 2.38	$ .71
Dividends per Common Share	$ .31	$ .275	$ .93	$ .825
AVERAGE COMMON SHARES OUTSTANDING (in millions)		682.7	680.0	

<FN>
* Includes $157 million ($102 million after-tax) charge for the close-out of two interest rate swaps.

Source: http://www.secinfo.com/d2eH7.b3.htm

Exhibit: 5
THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

Millions of Dollars

ASSETS	*September 30* 1994	*June 30* 1994
CURRENT ASSETS		
Cash and cash equivalents	$ 2,429	$ 2,373
Marketable securities	146	283
Accounts receivable, less allowance for doubtful accounts	3,590	3,115
Inventories		
Raw materials and supplies	1,178	1,087
Work in process	198	213
Finished products	1,682	1,577
Deferred income taxes	768	716
Prepaid expenses and other current assets	824	624
	10,815	**9,988**
PROPERTY, PLANT, AND EQUIPMENT	16,408	15,896
LESS ACCUMULATED DEPRECIATION	6,194	5,872
	10,214	10,024
INTANGIBLE ASSETS	4,260	3,754
OTHER ASSETS	1,843	1,769
TOTAL	$27,132	$25,535
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accruals	$ 7,142	$ 6,665
Debt due within one year	1,635	1,375
	8,777	8,040
LONG-TERM DEBT	5,080	4,980
OTHER LIABILITIES	3,351	3,336
DEFERRED INCOME TAXES	459	347
SHAREHOLDERS' EQUITY		
Preferred stock	1,932	1,942
Common stock-	685	684
Additional paid-in capital	590	560
Currency translation adjustments	(2)	(63)
Reserve for ESOP debt retirement	(1,761)	(1,787)
Retained earnings	8,021	7,496
	9,465	8,832
TOTAL	$27,132	$25,535

Source: http://www.secinfo.com/d2eH7.by.htm

Exhibit 6

CONDENSED AVERAGE BALANCE SHEETS OF BANKERS TRUST (in millions)

	3rd Qtr	2nd Qtr	4th Qtr

	1998	1998	1997
ASSETS			
Interest-earning			
Interest-bearing deposits with banks	$ 2,734	$ 4,112	$ 6,211
Federal funds sold	3,883	4,237	4,950
Securities purchased under resale agreements	27,911	26,501	23,074
Securities borrowed	26,582	28,660	16,588
Trading assets	32,570	32,228	30,447
Securities available for sale			
Taxable	10,790	11,778	6,876
Exempt from federal income taxes	1,955	1,739	1,237
Total securities available for sale	12,745	13,517	8,113
Loans			
Domestic offices	12,151	11,474	10,800
Foreign offices	11,021	11,023	9,580
Total loans	23,172	22,497	20,380
Customer receivables	1,712	1,612	1,612
Total interest-earning assets	131,309	133,364	111,375
Noninterest-earning			
Cash and due from banks	2,682	2,475	1,476
Noninterest-earning trading assets	30,669	27,670	25,356
All other assets	11,927	11,373	10,694
Allowance for credit losses	(1,032)	(1,004)	(979)
Total	**$175,555**	**$173,878**	**$147,922**
LIABILITIES			
Interest-bearing			
Interest-bearing deposits			
Domestic offices	$ 21,840	$24,811	$ 21,881
Foreign offices	18,685	20,339	20,966
Total interest-bearing deposits	40,525	45,150	42,847
Trading liabilities	9,660	8,754	5,587
Securities loaned and securities sold under repurchase agreements	34,481	34,834	24,200
Other short-term borrowings	24,230	22,873	20,078
Long-term debt	18,567	16,830	13,050
Trust preferred capital securities	1,463	1,474	1,472
Total interest-bearing liabilities	128,926	129,915	107,234
Noninterest-bearing			
Noninterest-bearing deposits	4,730	4,310	3,366
Noninterest-bearing trading liabilities	25,790	22,753	20,803
All other liabilities	10,652	10,862	10,591
Total liabilities	170,098	167,840	141,994
PREFERRED STOCK OF SUBSIDIARY	304	304	-
STOCKHOLDERS' EQUITY			
Preferred stock	445	593	688
Common stockholders' equity	4,708	5,141	5,240
Total stockholders' equity	5,153	5,734	5,928
Total	**$175,555**	**$173,878**	**$147,922**

Source: http://sec.edgar-online.com/1998/11/17/08/0000009749-98-000107/Section13.asp

REFERENCES

Web links

1. http://en.wikipedia.org/wiki/Bankers_Trust
2. http://en.wikipedia.org/wiki/Procter_%26_Gamble
3. http://findarticles.com/p/articles/mi_qa3682/is_199601/ai_n8740425/pg_2
4. http://home.earthlink.net/~green/whatyour.htm
5. http://money.cnn.com/magazines/fortune/fortune_archive/1995/03/20/201945/index.htm
6. http://query.nytimes.com/gst/fullpage.html?res=940DE2D91339F931A25753C1A963958260
7. http://www.businessweek.com/1995/42/b34461.htm
8. http://www.businessweek.com/1995/42/b34461.htm
9. http://www.derivativesstrategy.com/magazine/archive/1995-1996/0696regw.asp
10. http://www.erisk.com/Learning/CaseStudies/BankersTrust.asp
11. tp://www.equityderivatives.com/services/education/glossary.php?code=S
12. tp://www.equityderivatives.com/services/education/glossary.php?code=SWeblinks

Books:

1. ICFAI's text book of Financial Risk Management
2. ICFAI's text book of Marketing of Financial Services

Article

- Ed Parker of Gide Loyrette Nouel *"**Derivatives uncovered: Swaps, futures and all that jazz",*** ISDA, Legal and Commercial Publishing Limited 2005.

Teaching Notes

Synopsis

This case is about a financial advisor, Bankers' Trust on whose advice on derivatives, many companies lost their money. In the mid-1990s, Bankers Trust was one of the leading financial Institutions in the marketing of innovative financial products like derivatives. Yet Bankers Trust's reputation took a pounding after the bank was sued by several customers alleging various forms of fraud and racketeering with respect to derivatives transactions they had entered into with the bank. Federal Paper Board Company, Gibson Greetings, Air Products and Chemicals, and Procter & Gamble asserted that Bankers Trust had misled them with respect to the risk and value of derivatives that they had purchased from the bank. The first three cases were settled out of court for a total of $93 million. The $195 million Procter & Gamble suit was settled at a net gain to P&G of $78 million. But definitely the major damage was not financial but something else- loss of trust and reputation. This was worsened when several Bankers Trust bankers were caught on tape remarking that their client [Gibson Greetings] would not be able to understand what they were doing. Afterwards badly reputed Bankers' Trust was acquired by Principal Group in Australia and rest by Deutsche Bank in 1998. The cases of unawareness of the Naïve Risk Averse Investors with the risk associated with financial services can be seen now in the selling of highly risky mutual funds also. Therefore this case deals with the corporate ethics related with marketing of financial services.

Research behind the case

As this is a case about a company which had been acquired by another company, the data sources are mostly secondary like articles, newspapers, books and balance sheets of the companies.

Suggested courses including course level (undergrad/grad) and course type (policy, OT, MIS, etc.);: Financial Risk Management & Derivatives, Marketing of Financial Services, Business Ethics, Corporate Governance & Disclosure practices. Usually these subjects are part of MBA course curriculum elective subjects, they can be discussed there. It can be included into BBA classes also.

Guide questions and Answers:

Q1. How the situation of Procter and Gamble and Gibson Greetings are different? What kind of risk was the most prominent in this case?

Suggested Ans. Gibson greetings was totally naïve to derivatives and specified limit of the loss, still Bankers' trust crossed the limit and told lies about the losses. In the case of Procter & Gamble, they were using interest rate swaps before also, gained from it and considered it to be profit centre. They were aware that losses can occur but got assurance from Bankers' Trust about favorable situations and their help P&G at any bad situation. But situations turned out to be negative. The risk associated with the case is operational risk- risk generated through people, systems, frauds, environment etc. It was informed operational risk with Procter & Gamble and uninformed operational risk with Gibson Greetings.

Q2. Derivatives are time bomb- and they are the main reasons of the losses. Do you agree with the above statement that derivatives, which are risk management tools, can lead to losses? Who is responsible for losses?

Suggested answer: According to famous investor and CEO of Berkshire Warren Buffet derivatives are time bombs. He said so because derivatives can lead to huge losses if used for speculative purposes with high leverage. Using derivatives for speculative purposes is one reason of theses losses. Another reason is misrepresentation of the complex derivative contracts by Bankers Trust to its clients. On the other hand managers of client companies are also responsible for any deal they are signing. The financial manager has the responsibility to utilize the money of shareholders in best possible way.

Q3. What are the issues that have to be kept in mind while marketing of financial products like derivatives?

Suggested Answer: The issues that should be kept in mind are: Considering risk also apart from the returns at the time of allocation of product or service, Disclosure of possible outcomes – risk & returns related with the contract, Defining Value at risk, mark to market approach and following honesty in the operations.

Q4. If you were new CEO of Bankers' Trust instead of Newman, what strategy will you implement to revive the unit?

Suggested answer: The first and foremost thing to do was strengthening moral values of sales force & employees with the help of awards. Training the sales force to assess the risk and return of the customer and disclosing all the material information. These steps should be publicized so that the image as well as the client base of the company will improve. As Bankers trust was following aggressive strategy to gain profits, the strategy should be changed. Instead of speculation- (taking high risk in anticipation of high return), Bankers Trust should give its advice for more traditional services like hedging, financial planning & control. If they would have more conservative path, they would not have been affected by Russia's Default. Russia's default affected companies because companies were taking advantage of interest rate differential

between US and Russian interest rates. When the Russian Government defaulted, their currency depreciated and those who were speculating got huge losses.

Additional Reading

Book references

- K Seethapathi *Financial Derivatives October,* 2002
- K Seethapathi and V Subbulakshmi *Financial Derivatives : Options* June 2003

Articles References

1. Derivatives From Wikipedia,
2. Dong Gang Improving Risk-Adjusted Returns of Fixed-Portfolios with VIX Derivatives The Icfai Journal of Derivatives Markets, Vol. IV, No. 2, 2007
3. Dutta Dibyendu Value at Risk A New Tool of Risk Measurement Treasury Management September 2005
4. Falkenstein Eric Value-at-Risk and Derivatives Risk Derivatives Quarterly Volume 4, Number 1 Fall 1997
5. Jonathan Duchac, E, Wilkerson, Jack E Jr Evaluating and controlling derivatives operational risk Journal of Bank Cost & Management Accounting, The, 1996
6. Joshipura Mayank and Gandhi Ajab Creating Low-risk Trading Strategies Using Derivative Products Treasury Management, September 2007
7. Kumar E Naveen Hedge Funds Meltdowns Icfai Reader January 2007 24
8. Myths behind derivatives Investment World, Sunday, June 11, 2000
9. Paul Yash Pahuja Derivatives: Risks and Best Practices The ICFAI Journal of Financial Risk Management, March 2006
10. Ramon Jose Aragonés, Blanco Carlos, And Dowd Kevin Incorporating Stress Tests into Market Risk Modeling Institutional Institutional Investor, Spring 2001
11. Siems Thomas F. 10 Myths About Financial Derivatives Cato Policy Analysis No. 283 September 11, 1997
12. The Sovereign Society The Derivatives Time Bomb How to Turn the Coming Mega-Catastrophe into Explosive Profits

Cases

- Agarwal Vijaya *Risk Measures at Orange County*- Value At Risk And Applications, The ICFAI University Press.
- Arora Sumit, Gupta Vivek *The Fall of Barings Bank* Case Folio April 2004
- Datta Guru P *Long Term Capital Management Fund* ECCH Case

A suggested teaching plan (issues and time allocation/issue);

1. Company Overview: 10 minutes
2. About the Derivative Contracts what BT sold: 15 minutes
3. The legal suits and analysis of their reasons: 15 minutes
4. The tale of tapes and disclosure & corporate governance requirements: 10 minutes
5. The questions and the suggested course of action for Bankers' Trust : 10 minutes

Total : 60 minutes