

Eat the Rich: Investment Banks Can't Afford to Bail Out Wealthy Clients

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Wall Street, it is no surprise, loves the wealthy. But could tensions arise in that relationship as the credit crunch hits both banks and wealthy individuals and makes both very protective of their pocketbooks?

There are already signs. Goldman Sachs Group and others, including Merrill Lynch, held out for months on [buying back auction-rate securities from their wealthy clients](#) before agreeing Thursday to do so. Now banks' rich clients may be nearing another problem: capital calls from private-equity firms.

When private-equity firms make investments, they issue "capital calls," or requests that investors pony up with the money they have pledged. In flush times, of course, capital calls aren't a problem. When times get tough, rich individuals—and some companies—try to hold on to their cash and can become delinquent on their capital calls. Typically, investment banks cover for their clients by advancing the bank's own money to the private-equity firm until the client can pay it back.

The problem? Investment banks now are so capital-constrained that they likely won't be able to intervene as much. At the same time, the deepening fear that the economy is nearing a recession means corporations and rich individuals may try to hoard their money and avoid capital calls.

Laurence Allen, the managing member of NYPPEX, an exchange that also advises banks and investors on the sales of their holdings in private-equity funds, says the stage is set for a replay of the period from 2000 to 2002, when a number of Wall Street's private clients became delinquent on their capital calls. He noted that one investment bank made advances of \$1.5 billion for such capital calls through its funds-of-funds programs in that time. The total extent of capital-call delinquencies was around \$7 billion to \$10 billion, Allen estimated.

That said, it hasn't been a problem yet, if only because private-equity firms aren't making enough investments—buyout activity is down roughly 80% from last year—to require many capital calls.

"Right now we're in the first inning," Allen said.