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MEMORANDUM FOR THE RECORD

Event: Teleconference with State Street (SS) about Repo and Commercial Paper (with SS outside counsel present)

Type of Event: Conference Call

Date of Event: March 15, 2010

Participants - Non-Commission:

State Street:
Steve Meier – Executive Vice President & Global Cash CIO, State Street Global Advisors;
David Phelan – Attorney

Wilmer, Cutler, Pickering, Hale and Dorr, LLP (WilmerHale):
Mike Sharp – Attorney; Reg Brown – Attorney

Participants - Commission:

Tom Krebs, Mina Simhai, Troy Burrus, Jay Lerner, Ron Borzekowski, Greg Feldberg, Landon Stroebel and Desi Duncker

MFR Prepared by: Desi Duncker

Date of MFR: March 15, 2010

Summary of the Interview or Submission:

This is not a transcript of the meeting and should not be quoted as such

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On Monday, March 15, 2010 Tom Krebs, Mina Simhai, Troy Burrus, Jay Lerner, Ron Borzekowski, Greg Feldberg, Landon Stroebel, and I had a conference call with Steve Meier and David Phelan of State Street and Mike Sharp and Reg Brown of WilmerHale. *Note that the following is merely a synopsis of the comments of the State Street team and is not necessarily a statement of fact or of the opinions of the FCIC team.*

Mr. Meier's Background

Mr. Meier stated that he is responsible for $560 billion in assets under management (AUM), down from $700 billion at its peak. He works on the short-end of the curve, and has been employed at State Street for 11 years. He is the CIO for all cash, and is primarily responsible for managing cash collateral. He is also a member of the task force for tri-party reform. Mr. Meier has also worked in securities lending.

Repurchase Agreement (Repo) Market

The repo market is large and has been around since the 1920s. It started to get attention in the early 1980s, around which time there was structured reform. Repo is the key source of financing for banks, broker-dealers, and bank holding companies. Traditional repo is collateralized with Treasuries and agencies. Non-traditional repo is collateralized with money markets, municipal bonds, equities and asset-backed securities.

Dealers engage in matchbook trading. A reasonable estimate of the size of the market at its peak is $8 – 10 trillion (which Mr. Meier said he read in an article). A good source of the size of this market is JP Morgan and Bank of NY Mellon, given their tri-party status. Bilateral repo is for dealers to gain access to certain securities—the settlement mechanism is delivery, versus custodian for tri-party repo. In tri-party, they don't have the ability to rehypothecate until default. The repo and securities lending markets are similar, except that in repo they're putting up more liquid assets, and securities lending uses a reverse margin, typically cash. (The terms haircut and margin are similar—haircut is just a mechanism to calculate margin.)

Bear Stearns

Bear Stearns (BSC) was a client of State Street in many different businesses. In the early part, there were between $3 – 5 billion of transactions with traditional collateral, and SS kept them short-term. State Street did not have a strategic relationship with BSC.

Mr. Meier became concerned with Bear Stearns as a counterparty, as they were relying too much on short-term financing—$71 billion in financing was turning over daily. BSC wasn't raising capital, and there were concerns about their liquidity. When BSC went down, State Street had no exposure.

State Street Global Advisors, the Investment Management Division of State Street, was acting as agent for disclosed third parties. State Street was limiting their exposure. The problem was that so was everyone else.

Mr. Meier stated that he sees a trend against short-term funding, especially as regulators lean on these companies. In early 2007, State Street had the same concern with Countrywide (which was the other counterparty SS had this concern about, aside from Bear Stearns). SS stopped doing business with them on July 2, 2007, as they weren't comfortable with the risk heading into the holiday weekend, given the situation with subprime mortgages. They took reasonable forms of collateral, but were concerned about the headline risk. The transactions were all short-term.

Repo transactions roll overnight, and this happens every day. The Repurchase Agreement is negotiated, and 98% of transactions settle on a tri-party basis. The question is the suitability of the counterparty.

We don't really share information with other traders. We act based on our own interests.

For derivatives, the bank or broker-dealer puts their creditworthiness on the line.

Lehman Brothers ("Lehman" or LEH)

To put LEH in context, Mr. Meier stated that Countrywide and Bear Stearns were not strategic partners, as they didn't have a lot of confidence in them. For BSC, they only covered them with a middle-market sales force, not an institutional sales team. Lehman was more strategic, as there was activity as a borrower of securities. State Street felt that Lehman would be around for a while. They had $22 billion in outstanding repo, $18 billion in the U.S. Post-Bear Stearns, State Street continued to feel comfortable, especially given the PDCF. The BSC takeover was carefully orchestrated by the Fed, so they thought this would happen again.

In June '08, SS extended to Lehman a $500 million whole loan repo with unsecuritized raw receivables—initially set up as a residential mortgage facility. State Street was taking mortgage collateral. But they did extensive diligence. They went and visited their service center. The securities were held at BNYM. They were comfortable with their pricing practices. They were given assurances by Ernst & Young. A third-party was involved—Tri-Mark, based in Atlanta, GA.
Then State Street started shoring up the facility, limiting funding to 30 days and requiring higher levels of collateralization.

As for the market as a whole, Mr. Meier said he was not sure about other firms, but that the pipelines were still out there, and the assets still needed to be financed. He noted that when Lehman defaulted, State Street still had $13.3 billion extended to them (albeit down from the aforementioned $22 billion).

Rehypothecation

For bilateral trades, it's delivery versus payment, and collateral can be rehypothecated. There's general or special issue collateral. They take in cash collateral, with a rebate rate (*i.e.*, Fed funds less 10 basis points). It gets down to the motivation of the counterparty.

Securities are borrowed to pledge as collateral.

Commercial Paper (CP)

Traditional CP has a maturity of less than 9 months. ABCP features a series of SPVs that own the securities.

State Street typically buys both—traditional CP, as well as ABCP conduits for which they get CUSIP-level details. They look at the liquidity support provider, if SS is comfortable with them, then they're fine. The SIV is a subset of ABCP, structured more aggressively, usually with only a 10 – 20% liquidity backstop.

State Street buys GE paper. They typically buy unsecured CP from GE, which is rated A1+/P1, and is a big issuers on the short end. SS does not buy Tier 2, by choice. Also, they do not invest in a broker-dealer on an unsecured basis.

The CP market got turned on its side in August '07, when investors worried that ABCP conduits had subprime.

In Response to Various FCIC Questions

- Most assets that State Street manages are not 2a-7. SS does more separate accounts, or co-mingled accounts.
- In September '08, there were market issues, given Fannie/Freddie, and then Lehman.
- CP markets are unsecured, and were out to prime funds and the government.
- State Street manages assets on behalf of clients for liquidity. After Lehman, the market became very stressed, and there was no secondary market liquidity. SS didn't have redemption requests, but clients shifted to safer funds, *i.e.*, gov't securities.
- Pre 2007, the Tier II spread over Tier I was generally 2 – 10 bps, although this is an educated guess since SS doesn't purchase Tier II.
- Other than BSC and Countrywide, State Street also reduced its exposure to Wachovia.
- Mr. Meier said that the tri-party mechanism works well, and that he wouldn't do anything to change it.

- Mr. Meier said he believed that the crisis was caused by a confluence of factors. Too much liquidity, leverage that was too high, and not enough oversight (*i.e.*, audit firms).
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