

**Testimony of Steven R. Meier
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Financial Crisis Inquiry Commission
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Chairman Angelides, Vice-Chairman Thomas, and Members of the Commission:

Thank you for the opportunity to appear before you today. My name is Steven Meier, and I am the Chief Investment Officer, Global Cash Management, for State Street Global Advisors (“SSGA”), the investment management operation of State Street Corporation (“State Street”). I hope my testimony will assist the Commission with its important work.

The Commission has asked me to address a number of issues, including (1) my responsibilities at SSGA; (2) the primary instruments available in the short-term funding markets that are used by SSGA in its cash mandates; (3) how SSGA as investment adviser to these funds evaluates the risk of those instruments; (4) the extent of SSGA’s funds’ exposure, if any, to failed institutions; (5) any changes in the short-term funding markets during, and as a result of, the financial crisis; and (6) the causes of, and lessons learned from, the crisis.

Before turning to these topics, please allow me one personal indulgence. The events of 2007 and 2008 were unprecedented, and their consequences were devastating: millions of people saw the values of their homes and savings decline, businesses failed, and our economy entered into a recession. State Street is deeply grateful to the American people and our leaders for their resolve and determination throughout the course of this incredibly difficult period in our nation’s history. And although many are still suffering,

the commitment of America's people and institutions has put us back on the path to recovery.

BACKGROUND AND EXPERIENCE

As requested, let me begin with a brief description of my background and experience, as well as a general overview of SSGA's investment management business in the cash asset class. I have more than twenty-six years' experience in financial services, with a focus on traditional money markets, fixed income, global cash, and financing. Prior to joining State Street, I was a senior repurchase agreement, matchbook and financing trading manager at Merrill Lynch Capital Markets from 1987 to 1992. Following that, I spent seven years at Credit Suisse First Boston in a similar capacity with responsibility for equity and whole loan funding businesses, and financing various forms of alternate assets through repurchase agreements. I have been at State Street for eleven years, including seven years with SSGA. I am currently an Executive Vice President, and my primary responsibility as Chief Investment Officer of the cash asset class is to manage global cash activities, including money market funds, and other cash management products. I am a member of SSGA's Executive Management Group, as well as its Senior Management Group and Investment Committee. I am also a participant on the tri-party repurchase agreement reform task force sponsored by the Federal Reserve Bank of New York.

State Street is one of the world's leading providers of financial services to institutional investors, with nearly \$19 trillion in assets under custody and administration and almost \$2 trillion under management. SSGA is the investment management division of State Street. SSGA manages traditional cash, money market funds, and other

investment programs, as well as all of the other cash products for State Street's securities lending program. In October 2009, SSGA was named the "World's Best Bank" in the Asset Management category by *Global Finance Magazine*.

As you know, State Street was among the initial group of banks asked to participate in the Federal Government's Capital Purchase Program, at a relatively modest \$2 billion level. State Street is pleased to have participated in the Capital Purchase Program, which helped stabilize markets. We were also pleased to be one of the first banks to return the investment to the Treasury Department in June of last year at a profit to U.S. taxpayers. State Street was also selected to serve during the financial crisis as the custodian and administrator for the Federal Reserve's Commercial Paper Funding Facility. On behalf of State Street, I would like to express my appreciation for the prompt and decisive actions taken by the federal government to promote stability and liquidity in the midst of a difficult and uncertain market.

SHORT-TERM FUNDING INSTRUMENTS

With this as background, let me describe three short-term lending instruments and activities that I understand the Commission is interested in: repurchase agreements, commercial paper, and securities lending.

Repurchase Agreement Market

First, let me talk about the repurchase agreement market, which has been in existence since the 1920s as a means of collateralized financing. It is difficult to measure the overall size of the U.S. repurchase agreement market, but estimates of \$8 to \$10 trillion at its peak seem reasonable. It is helpful to divide the repurchase agreement market into two categories based on the type of collateral used in the transaction. The

first category is the traditional repurchase agreement market, which is typically collateralized with U.S. Treasury bills, notes and bonds, agency debentures, or agency mortgage-backed securities (“MBS”). The other category, which is often referred to as “non-traditional” or “alternative,” encompasses repurchase agreements involving any other form of collateral, such as money market instruments, investment-grade and high-yield bonds, asset-backed securities (“ABS”), equities, or unsecuritized whole loans. Repurchase transactions provide our clients with a form of secured investment that offers a yield advantage compared to other short-term investments of equivalent credit quality, and alternative collateral normally will provide a yield advantage over traditional collateral.

There are also two principal types of repurchase agreement transactions defined by settlement mechanics: bilateral and tri-party. In a bilateral repurchase agreement, one party obtains short-term funding by selling securities to a second party, with an agreement to repurchase them at a future date. Settlement of this initial purchase occurs in the buyer’s individual clearing account. In a tri-party repurchase agreement transaction, a third-party custodian intermediates between the two counterparties to the transaction. More than 98% of State Street’s U.S. repurchase agreements settle via a tri-party arrangement, and we deal with the Bank of New York and JP Morgan Chase as the tri-party custodian.

SSGA has a dedicated credit group that evaluates credit for counterparties and issuers for our clients and produces an approved credit list for transactions, including repurchase agreements. In addition, our clients are able to review and set distinct, more restrictive counterparty criteria consistent with their risk tolerance. SSGA’s credit group

takes into consideration a broad range of factors in evaluating potential client counterparties, including financial strength, and sources and uses of funding. We do not rely upon ratings assigned by independent rating agencies. State Street requires that repurchase agreements be properly documented; all transactions are executed under the terms and conditions of a Master Repurchase Agreement, which establishes collateral and pricing requirements. For transactions settling on a tri-party basis, custodial undertakings are executed with the respective custodian bank, counterparty, and SSGA as agent for disclosed clients.

Commercial Paper Market

The commercial paper (“CP”) market is also a type of short-term money market instrument. Like the repurchase agreement market, the CP market can be divided into two categories. Traditional CP is an unsecured obligation issued by bank holding companies, corporations, and non-bank financial institutions. The asset-backed CP (“ABCP”) market consists of conduits or special purpose vehicles that typically have back-up liquidity support provided by a bank or financial institutions. Note that these back-up liquidity lines may also apply to traditional unsecured CP. The conduits and special purpose vehicles typically finance the purchase of a portfolio of intermediate and longer-term assets through the issuance of short-term CP, which is rolled over when due; the liquidity support is basically a source of contingent financing and is used if the CP issuer is unable to finance itself through the CP market due to either market or issuer specific events. At its peak, the ABCP market was around \$1.2 trillion. It has since declined to around \$400 billion.

State Street buys on behalf of our clients both traditional CP and ABCP. Just as in the case with repurchase agreement counterparties, our credit group evaluates CP issuers, establishes an approved list, and sets limits on the maximum tenure and amount of client exposure to individual issuers on the approved list. Our review involves careful vetting of conduits or special purpose vehicles, thorough investigation of the underlying assets and sponsoring entities, and an examination of the institution providing the liquidity support. We do not purchase ABCP on behalf of clients if we are not comfortable with the liquidity provider's reputation and ability to meet its contingent funding obligations.

Securities Lending

The third short-term funding activity I would like to talk about is securities lending. Securities lending is a means by which institutional clients who hold and plan to retain long securities positions can earn incremental income. The asset owner, generally with the assistance of a securities lending agent, lends a security it holds as a long position to a borrower who needs the security to support a short sale or otherwise in connection with the settlement of a securities transaction. The borrower has an obligation to return the borrowed security and provides collateral to secure that obligation, with the market value of the collateral in excess of the market value of the borrowed securities, with 102–105% generally being market convention. This collateral can be either cash, which is most common, or traditional or alternative securities. If the lender receives cash collateral, it reinvests the collateral, pays the broker-dealer a “rebate rate” on the cash pledged to secure the loan, and shares the remaining income with the securities lending

agent. State Street acts as securities lending agent for clients, and SSGA manages the cash collateral on behalf of our clients through an asset-liability construct.

One difference between securities lending and the repurchase agreement market is the ability to rehypothecate the securities on loan. Rehypothecation is implicit in securities lending, where the whole idea is to use the loaned security to make another trade. In the tri-party repurchase agreement context, by contrast, the custodian bank is responsible for the collateral, so the counterparties do not have access to it absent default. Note that bilateral repurchase agreements, with settlement at the borrower's clearing account, can be executed to obtain access to securities for other settlement and trading purposes.

FINANCIAL CRISIS OF 2007 AND 2008

With that overview, let me talk about the events of the past few years and their impact on the short-term funding market in general, and State Street in particular. None of the money market funds advised by SSGA risked breaking the buck, and the other cash products underlying our securities lending program have not experienced material credit losses. The fixed-income and asset-backed markets, however, have experienced extreme illiquidity, and the market prices for those products have not always reflected the quality of the underlying assets. Neither State Street nor our cash funds had material exposure to either Bear Stearns immediately prior to its sale or Washington Mutual immediately prior to its liquidation. While we had expected a managed resolution of Lehman Brothers and consequently our clients had securities lending and repurchase agreement exposure to Lehman and its affiliates, our clients did not incur any losses as a result of such exposure. State Street did incur a loss in conjunction with certain repurchase agreement transactions

between SSGA's clients and Lehman affiliates, where State Street had agreed to indemnify those clients against a borrower default. In that case, the value of the collateral underlying such repurchase agreement transactions proved to have a realizable value substantially less than the value assigned to it by Lehman or an independent pricing service.

Like many others involved in the financial industry—from bankers to investors to analysts to regulators—I have thought long and hard about the lessons to be gleaned from the historic events of the past few years. Our rigorous credit analysis helped protect our investors and allowed SSGA to focus on solid investments during difficult economic conditions. As we have seen, however, credit quality alone may not be sufficient to protect against price degradation when there is limited market liquidity. In addition, the secondary market liquidity mechanism has proven less reliable in a severely distressed market, which has implications for portfolio construction. Lastly, I believe the industry has recognized the need for substantial committed resources and infrastructure to manage money market assets.

I do not believe that blame for the crisis can be pinned on a single event, entity, product, or decision. In my view, the financial crisis flowed from a confluence of factors, many of which this Commission is by now well aware. In particular, I would highlight excessive leverage and inadequate capital requirements, which ultimately contributed to a lack of liquidity and frozen credit markets.

Thank you again for the opportunity to be here today. I would be pleased to answer the Commission's questions.