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The Rescue of American International Group – Module B: The Securities Borrowing Facility[1]

Lily S. Engbith,[2] *Alec Buchholtz*,[3] and *Devyn Jeffereis*[4]

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Abstract

In 2008, American International Group (AIG) was among the largest insurance corporations in the world and maintained a profitable securities lending program. However, AIG invested much of the cash collateral received from counterparties in residential mortgage-backed securities, whose value began to collapse rapidly and unexpectedly, creating liquidity strain for AIG when borrowers returned their securities. Because of these strains, credit downgrades, and losses, in September, the company sought assistance from the Federal Reserve which, on October 6, 2008, approved the establishment of the Securities Borrowing Facility by the Federal Reserve Bank of New York (FRBNY). The FRBNY agreed to loan as much as $37.8 billion to AIG to return cash to securities borrowers, accepting as collateral the investment-grade securities that AIG had lent to those securities borrowers. SBF The facility allowed AIG to borrow funds to repay securities borrowers and mitigate liquidity constraints. Its operations were terminated following the creation of the Maiden Lane II facility.

Keywords: AIG, collateral reinvestment, residential mortgage-backed securities, Securities Borrowing Facility (SBF), securities lending

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[1] This case study is one of seven 2021 Yale Program on Financial Stability (YPFS) case studies considering the various elements of the government's rescue of American International Group:

- "The Rescue of American International Group – Module A: The Revolving Credit Facility" Alec Buchholtz and Aidan Lawson.
- "The Rescue of American International Group – Module B: The Securities Borrowing Facility" by Lily S. Engbith, Alec Buchholtz, and Devyn Jeffereis.
- "The Rescue of American International Group – Module C: AIG Investment Program" by Alec Buchholtz, and Aidan Lawson.
- "The Rescue of American International Group – Module D: Maiden Lane II" by Lily S. Engbith and Devyn Jeffereis.
- "The Rescue of American International Group – Module E: Maiden Lane III" by Lily S. Engbith and Devyn Jeffereis.
- "The Rescue of American International Group – Module F: The AIG Credit Facility Trust" by Alec Buchholtz and Aidan Lawson.
- "The Rescue of American International Group– Module Z: Overview" By Rosalind Z. Wiggins, Aidan Lawson, Steven Kelly, Lily S. Engbith, and Andrew Metrick.

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American International Group, Inc.: The Securities Borrowing Facility

At a Glance

Summary of Key Terms	
Purpose: To relieve intense liquidity pressures stemming from increased requests for cash collateral from counterparties that had borrowed securities through AIG's securities lending program.	
Announcement Date	October 6, 2008
Operational Date	October 8, 2008
Termination Date	December 12, 2008
Legal Authority	Section 13(3) of the Federal Reserve Act (12 U.S.C. § 343)
Maximum Loan Extended	$37.8 billion
Peak Utilization	$20.5 billion
Participants	American International Group, Federal Reserve Bank of New York

Beginning in 1997, American International Group (AIG) started an in-house securities lending program whereby high-quality securities were lent out to counterparties in exchange for cash collateral (Peirce 2014, 18). Its insurance subsidiaries would provide high-quality securities to AIG Securities Lending Corp. (formerly AIG Global Securities Lending Corp.), which would lend those securities to counterparties in exchange for cash collateral (Peirce 2014, 18). That cash collateral would then be separately reinvested by the domestic AIG Global Investment Corp. (AIG GIC) to generate income (Peirce 2014, 18). While this practice was seen as a relatively risk-free way to increase returns on corporate bonds and other stable securities, AIG began engaging in more-aggressive investments—in particular, residential mortgage-backed securities (RMBS) and other illiquid assets rather than the usual corporate and sovereign bonds (US COP 2010, 33-34).

On September 15, 2008, three rating agencies downgraded the AIG parent company by two to three levels each (AIG 2009, 4). Despite the creation of an $85 billion federal revolving credit facility the following day, the downgrades triggered a panic among securities borrowers, who demanded repayment of their cash collateral in return for AIG's securities (BdofGov 2008a; US COP 2010, 68). However, AIG found itself unable to meet these demands because it had reinvested the cash in illiquid securities (BdofGov 2008c, 2).

It soon became clear that this repayment model was unsustainable, and AIG would need additional federal assistance to return cash collateral to securities borrowers (US COP 2010, 68). On October 6, 2008, the Federal Reserve approved the establishment of the Securities Borrowing Facility (SBF) by the Federal Reserve Bank of New York (FRBNY) in order to relieve liquidity strains stemming from the requests by counterparties to withdraw from securities lending agreements and get their cash collateral back (BdofGov 2008c, 2). With the SBF, the FRBNY made as much as $37.8 billion in cash available to AIG, enough to unwind all of AIG's outstanding securities lending transactions (BdofGov 2008c, 1, 3). Counterparties

received their cash collateral back and returned the securities AIG had lent them (US COP 2010, 68). AIG then posted those securities to the Fed as collateral for SBF loans (US COP 2010, 68).

Summary Evaluation

The creation and implementation of the Securities Borrowing Facility was seen as a successful intervention that allowed AIG to repay its counterparties' cash collateral and terminate its troublesome securities lending agreements (US COP 2010, 69). The SBF did not address the mark-to-market losses on the illiquid RMBS in which AIG had reinvested cash collateral (Peirce 2014, 42). Maiden Lane II, a separate special-purpose vehicle established during the November 10 restructuring of federal support for AIG, would be responsible for moving these assets off the company's books (US COP 2010, 71).

American International Group: United States Context	
GDP (SAAR, Nominal GDP in LCU converted to USD)	$14,681.5 billion in 2007 $14,559.5 billion in 2008
GDP per capita (SAAR, Nominal GDP in LCU converted to USD)	$47,976 in 2007 $48,383 in 2008
Sovereign credit rating (five-year senior debt)	As of Q4, 2007: Fitch: AAA Moody's: Aaa S&P: AAA As of Q4, 2008: Fitch: AAA Moody's: Aaa S&P: AAA
Size of banking system	$9,231.7 billion in total assets in 2007 $9,938.3 billion in total assets in 2008
Size of banking system as a percentage of GDP	62.9% in 2007 68.3% in 2008
Size of banking system as a percentage of financial system	Banking system assets equal to 29.0% of financial system in 2007 Banking system assets equal to 30.5% of financial system in 2008
Five-bank concentration of banking system	43.9% of total banking assets in 2007 44.9% of total banking assets in 2008
Foreign involvement in banking system	22% of total banking assets in 2007 18% of total banking assets in 2008
Government ownership of banking system	0% of banks owned by the state in 2008
Existence of deposit insurance	100% insurance on deposits up to $100,000 for 2007 100% insurance on deposits up to $250,000 for 2008
Sources: Bloomberg, World Bank Global Financial Development Database, World Bank, Bank Regulation and Supervision Survey, Federal Deposit Insurance Corporation	

I. Overview

Background

Beginning in 1997, AIG Securities Lending Corp. operated a securities lending program whereby high-quality securities were pooled from state-regulated insurance subsidiaries and lent out to counterparties in exchange for cash collateral, which was typically 102% of the value of the securities (Peirce 2014, 18, 21). To generate income, the cash collateral would then be reinvested by another AIG subsidiary, AIG Global Investment Corp. (AIG GIC), which shared the program's proceeds 50-50 with AIG insurance subsidiaries (Hutchings 2010). In the unexpected event that AIG GIC could not return the cash collateral in a timely manner, cash from the holding company and the assets of the insurance subsidiaries would be available (AIG 2008a, 108; Peirce 2014, 19).

Traditionally, AIG would invest the cash collateral from securities lending conservatively in corporate and sovereign bonds, producing modest returns of only a few basis points (US COP 2010, 33-34). However, in the years before the financial crisis, GIC employees began to invest in other long-term investments as a means of increasing their return on cash collateral reinvestment (US COP 2010, 33-34). AIG GIC therefore began reinvesting primarily in residential mortgage-backed securities (RMBS) and other asset-backed securities (McDonald and Paulson 2015 , 85). By the end of 2007, 65% of AIG's securities lending cash collateral had been reinvested in these types of assets (AIG 2008a , 108).[5]

Under pressure from state insurance regulators, the company began to unwind part of its securities lending program in 2007 (Moriarty 2010, 2); the size of the program fell from $76 billion at the end of 2007 to $58 billion on September 12, 2008 (AIG 2008a, 108; Dinallo 2010, 16).

As part of a multinational insurance group and financial institution, AIG insurance subsidiaries were subject to supervision by many state insurance regulators and other regulators across the world (US COP 2010, 16-17). The Office of Thrift Supervision (OTS) supervised the holding company on a consolidated basis because AIG owned a small thrift (Peirce 2014, 8). However, AIG was not subject to regulation by the Federal Reserve (GAO-2011, 143). The Fed had been monitoring the company's exposures and potential losses in subprime mortgage-linked securities since late 2007, but it was unaware of the company's liquidity issues stemming from cash collateral reinvestment in RMBS (GAO 2009, 17; GAO 2011, 18).

The heavy focus on long-term investments in RMBS and other illiquid securities forced AIG to realize losses and proved to be a strain on AIG's liquidity when those markets began to collapse in late 2007 (Peirce 2014, 26-28). AIG recorded net realized losses of $6.7 billion on

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[5] These investments included corporate debt, mortgage-backed, asset-backed, and collateralized securities, and cash/short-term investments (AIG 2008a, 108). The buildup of RMBS was gradual, as the limits on reinvestment in ABS holdings was increased from 50% in 1999 to 66% in 2003, and then to 75% in December 2005 (Peirce 2014, 23).

the cash collateral reinvestment portfolio in the first half of 2008, and the portfolio also suffered rating downgrades—the proportion of securities in the portfolio rated below single-A was less than half a percent at the end of 2007 but had grown to 4.8% by June 30, 2008 (AIG 2008a, 108; AIG 2008b, 111-112). At the end of June 2008, AIG's total liability for the return of collateral equaled $75.1 billion, while the market value of its investments in RMBS and other securities totaled only $59.5 billion (AIG 2008b, 111). Thus, even if AIG had been able to sell its entire securities lending portfolio, the proceeds at market prices would not have been sufficient to pay off securities borrowers.[6]

As AIG sought to reduce its total securities lending portfolio in 2008, it had to raise cash by entering new securities borrowing contracts on worse terms (Peirce 2014, 27-28). Traditionally, it had been able to demand 102% of the value of its securities (AIG 2009, 3). But in 2008, the company was forced to offer a haircut on the value of its securities in order to get cash from securities borrowers (AIG 2009, 3). Securities borrowers began to demand these haircuts so that, in case AIG could not repay cash collateral upon termination of their securities lending contracts, proceeds from the sale of securities would make the borrowers whole (Peirce 2014, 28). At some points, AIG accepted collateralization levels as low as 80% (from Credit Suisse) and 73% (from Barclays)[7] (Hutchings 2010). Still, AIG would mark their securities to market daily and provide cash from the holding company to ensure that the overall book reflected 102% collateralization based on current market values, as required by state insurance regulators (Hutchings 2010; Peirce 2014, 27; AIG 2008b, 111).

As markets roiled throughout the summer of 2008, AIG's liquidity problems became increasingly clear to securities borrowers (GAO 2011, 19). In July 2008, AIG's CEO asked the FRBNY to allow the company to access the discount window (GAO 2011, 19). The FRBNY refused, saying that doing so would worsen investors' concerns about the company's liquidity (GAO 2011, 20). Three rating agencies downgraded AIG's credit rating by two to three notches on September 15, 2008, resulting in an additional $20 billion in collateral demands and transaction termination payments (AIG 2009, 4). To improve their own liquidity and reduce exposure to AIG's credit risk, securities borrowers stepped up their cash demands (McDonald and Paulson 2015, 86-87). On September 15 alone, AIG made payments of $5.2 billion to securities borrowers (AIG 2009, 4). AIG's lead life insurance regulator testified that securities borrowers demanded a return of about $24 billion between September 12 and 30 (Dinallo 2010, 17).

On the morning of September 15, AIG also met with representatives from Goldman Sachs, JP Morgan, and the FRBNY to discuss a syndicated secured lending facility in the form of a $75 billion bridge loan sponsored by large financial institutions (AIG 2009, 4). These efforts would aim to provide AIG with liquidity relief until it sold sufficient assets to meet its

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[6] At the insistence of local regulators, the AIG holding company provided a guarantee to the life insurance subsidiaries to compensate for the shortfall. Initially the company guaranteed $500 million; however, this guarantee grew to $1 billion and finally $5 billion (Dinallo 2010, 16).

[7] For instance, if AIG were to loan $100 million worth of securities through its lending program, it would typically expect $102 million in cash collateral. However, AIG's distressed position would have compelled its collateral reinvestment arm to accept as little as $80 million from Credit Suisse or $73 million from Barclays in exchange for the same amount of securities.

liquidity needs and stabilize (AIG 2009, 4). By the morning of September 16, it became clear that the proposed private-sector solution would not come to fruition (AIG 2009, 4).

Concurrent to the private-sector syndicated loan efforts by Goldman Sachs and JP Morgan, the governor of New York announced a plan created by the New York state insurance regulator to provide AIG with additional liquidity on September 15 (Dinallo 2010, 19). This proposal would allow AIG to access $20 billion of assets from its insurance subsidiaries (Dinallo 2010, 19). For example, AIG's property insurance subsidiaries had liquid assets above the legal requirement to protect policyholders; regulators would permit the AIG parent company to borrow these liquid assets in exchange for its less-liquid assets (Dinallo 2010, 19). However, this plan was based on the false belief that AIG was experiencing a brief cash flow problem (Dinallo 2010, 19). Once it became clear that this response would be insufficient to resolve AIG's liquidity issues, the proposal was dropped (Dinallo 2010, 19). On September 16, New York state regulators informed AIG that it would no longer have access to these assets and would be required to repay all loans made under the facility (AIG 2009, 4). The arrangement was formally terminated on September 22 (AIG 2009, 5).

As a consequence of these failed rescue attempts, on September 16, 2008, the Federal Reserve approved an $85 billion emergency Revolving Credit Facility (RCF) for AIG (AIG 2008a; AIG 2009, 5, 201).

Program Description

By October 1, 2008, AIG had drawn down approximately $62 billion from the RCF (BdofGov 2008c, 2). Approximately $11.5 billion of these funds were used to settle transactions involving the return of securities by counterparties (AIG 2009, 166). However, the situation called for more than a stop-gap solution to stem AIG's liquidity pressures (BdofGov 2008c, 2). In response, on October 6, 2008, the Fed approved an additional lending facility through which the FRBNY could engage in securities borrowing transactions with AIG (BdofGov 2008c, 1).

The purpose of the new Securities Borrowing Facility (SBF)—sometimes referred to as the Securities Lending Facility—was to provide AIG with cash to pay back securities borrowers that wanted to terminate their securities lending agreements with AIG (BdofGov 2008c, 2; US COP 2010, 137). The SBF would also alleviate the pressure AIG faced to liquidate RMBS that AIG GIC had purchased with securities borrowers' cash collateral (BdofGov 2008c, 2).

The FRBNY accomplished these goals by effectively taking over the positions of securities borrowers who were returning AIG's securities (BdofGov 2008c, 3). The FRBNY agreed to make as much as $37.8 billion available to AIG to return cash to securities borrowers (BdofGov 2008c, 1). As collateral, the FRBNY accepted the securities that AIG had lent to those securities borrowers (BdofGov 2008c, 3).

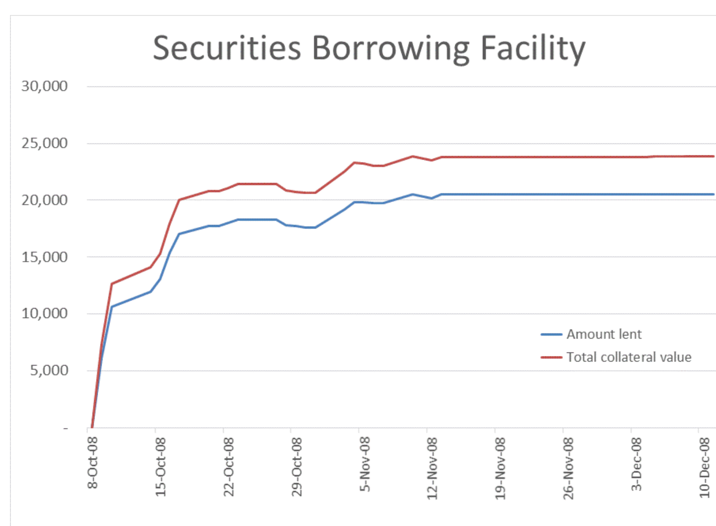
According to the initial conditions of the SBF, transactions would have a term of one day but could be rolled over repeatedly (BdofGov 2008c, 3). The interest rate equaled 100 basis points above the average overnight repo rate offered on the relevant collateral type (BdofGov 2008c, 3). The FRBNY loan was to have a maximum duration of two years (BdofGov

2008c, 3). By the close of business on October 10, 2008, the amount outstanding under the SBF totaled $10.3 billion (BdofGov 2008c, 3).

Outcomes

The Federal Reserve intended the Securities Borrowing Facility to provide temporary stabilization to AIG's tight liquidity situation (BdofGov 2009, 17). The facility enabled the repayment of cash collateral to securities borrowers and relieved pressure on AIG to liquidate its RMBS holdings in a rapid and disorderly fire sale (BdofGov 2008c, 2). Additionally, the FRBNY stood in a position to replace all AIG counterparties, as it was "prepared to borrow securities to extend AIG's currently outstanding lending obligations where those obligations are not rolled over or replaced by transactions with other private market participants" (AIG 2008c). Peak government exposure totaled $20.5 billion in November 2008 before the SBF was terminated with the establishment of Maiden Lane II as part of the November restructuring of federal assistance (Bdof Gov 2010). See Figure 1.

Figure 1: SBF Borrowing Over Time



Source: BdofGov 2010..

Following the launch of the SBF, securities it funded continued to lose market value, stressing AIG's balance sheet and posing the risk of further downgrades (Peirce 2014, 42; US COP 2010, 68-70). In response, the Fed and Treasury authorized the creation of Maiden Lane II on November 10, 2008 (FRBNY 2008). This new special-purpose vehicle, which was to be funded by a senior loan from the FRBNY and a cash contribution from AIG, was designed to purchase the AIG GIC portfolio of RMBS (FRBNY 2008; US COP 2010, 86-87). With the proceeds received from the establishment of Maiden Lane II, AIG terminated the SBF and repaid all outstanding collateral obligations to the FRBNY as counterparty to the SBF (FRBNY 2008). The FRBNY then returned to AIG the obligations that it had been holding as collateral against the SBF loan (FRBNY 2008; Board of Governors of the Federal Reserve System 2010).

Finally, AIG's entire domestic securities lending program was terminated with the repayment of all debts to the FRBNY (FRBNY 2008).

II. Key Design Decisions

1. The Securities Borrowing Facility was part of a multifaceted rescue package for AIG.

On September 16, 2008, the Board of Governors authorized the FRBNY to enter into the $85 billion RCF with AIG. By October 1, AIG had drawn down approximately $62 billion from the RCF, part of which was used to repay counterparties that settled rather than rolled over securities borrowing agreements. In light of this usage and evidence that "AIG was likely to face additional, significant liquidity pressures due to the expected decision by other securities borrowing counterparties to not renew their securities borrowing positions with AIG," the Board approved a recommendation from the FRBNY to establish the Securities Borrowing Facility (BdofGov 2009, 17). (The facility was then still referred to as a securities lending facility.) The SBF was created as a temporary measure to "reduce the pressure on AIG to liquidate" the RMBS portfolio related to its securities lending program and maintain the value of AIG's subsidiaries during the portfolio wind down (US COP 2010, 71; BdofGov 2008c, 2-3). The RCF and the Securities Borrowing Facility were part of a large package of assistance established by the government to address AIG's severe liquidity and capital issues (Massad 2012). In all, AIG-targeted government interventions totaling $182.3 billion would be funded by the FRBNY and Treasury, including loans, asset purchases, and capital investments (Massad 2012).

2. The Securities Borrowing Facility was authorized by the Board of Governors of the Federal Reserve under Section 13(3) of the Federal Reserve Act (12 U.S.C. § 343).

The Federal Reserve Board authorized the FRBNY to enter into the Securities Borrowing Facility pursuant to Section 13(3) of the Federal Reserve Act, the board's emergency lending authority. Section 13(3) had three basic requirements: (1) the Board must determine that "unusual and exigent" circumstances exist, by the affirmative vote of at least five members, or if fewer than five members of the Board are available, then by the unanimous vote of such fewer number, (2) the loans must be secured to the satisfaction of the lending Reserve bank, and (3) the lending Reserve bank "must have obtained evidence that adequate credit was not available from other banking institutions" (Title 12 U.S.C. 343, 112). In determining that exigent and unusual circumstances existed, the Board considered that "as of October 1, AIG had drawn down approximately $62 billion of the RCF," some of which had been used to repay counterparties returning securities that they had borrowed from AIG (BdofGov 2008c, 2). In addition, the Board noted "the expectation that additional securities borrowing counterparties would decide to not renew their securities borrowing positions with AIG, and the continuing fragile position of the financial markets"[8] (BdofGov 2008c, 2). This formed

[8] The Board minutes reflect the following detail: "The Board members' discussion of the proposed securities lending facility included consideration of (1) the current state of the financial markets, (2) continuing systemic risk to financial markets and possible risk of loss to the Federal Reserve from the disorderly failure of AIG, (3) the likelihood that no incremental losses would be assumed by the Federal Reserve, thanks to the high-quality

the basis for the Board's determination that exigent and unusual circumstances existed that warranted approval of the Secured Borrowing Facility on the general terms presented before the meeting (BdofGov 2009, 17). It is important to note that state insurance regulators who were responsible for monitoring the insurance subsidiaries involved in the securities lending program also voiced their support (BdofGov 2008c, 2).

Issuance of the loan by the FRBNY also required that the credit could be "secured to the satisfaction" of the lending Reserve Bank (Title 12 U.S.C. 343, 112). The Board minutes observed that: "The advances should be secured by high-quality investment-grade debt obligations that are owned by the insurance subsidiaries of AIG and, thus, were not available as collateral under the current AIG [RCF]" (BdofGov 2009, 17). As added comfort, the Fed did not anticipate any losses from the SBF because "advances made under the Secured Borrowing Facility will be with recourse to AIG and fully secured by investment-grade debt obligations" (BdofGov 2008c, 3).

Section 13(3) also requires that the lending Reserve bank "have obtained evidence that adequate credit was not available from other banking institutions." In authorizing the FRBNY to lend, the FOMC referenced that AIG had thus far borrowed $62 billion under the RCF and had used some of these funds to settle transactions with counterparties returning these third-party securities to AIG under its SecLending Program. (BdofGov 2009, 17) It also considered the current state of the finance markets and conditioned its authority on the FRBNY "obtaining evidence that the borrower is unable to secure adequate credit accommodations from other banking institutions." (BdofGov 2009, 17). Such evidence was apparently obtained by the FRBNY prior to entering into the Securities Borrowing Facility.

3. The maximum size of the loan, funded by the Federal Reserve Bank of New York, would total $37.8 billion.

The size of the loan was determined by the FRBNY to be large enough "to replace all remaining securities borrowing counterparties of AIG," in the event that all counterparties in the securities lending program demanded their cash collateral back (BdofGov 2008c, 3). According to the filing regarding the creation of the SBF, "As of October 6, 2008, approximately $37.2 billion of securities were subject to loans under AIG's securities lending program" (AIG 2008c). Therefore, the available size of the loan was set slightly above the amount of cash collateral owed to securities borrowers at the time the SBF was created (BdofGov 2008c, 3).

collateral taken under the proposed facility and the additional protections provided by the terms of the proposed facility, and (4) the need to coordinate with the relevant state insurance authorities for AIG's insurance subsidiaries" (BdofGov 2009, 17).

4. The FRBNY loan was fully collateralized by investment-grade securities that AIG had previously lent to securities borrowers.

Section 13(3) required that loans be "secured to the satisfaction of the Federal Reserve" (US COP 2010, 56). The securities that AIG had lent to securities borrowers were high-quality fixed-income securities and easily met the Fed's discount window criteria. "These securities that counterparties [were] giving back [were] high-quality corporate bonds—the kind of things we lend against," a Fed official involved in the program told the Financial Crisis Inquiry Commission (FCIC 2011b, 5).

The Congressional Oversight Panel (COP) noted that the quality of the collateral backing the Fed's $85 billion RCF raised "difficult questions," since AIG pledged its stakes in insurance companies that were difficult to value at the time and the private sector consortium had only days earlier concluded that AIG didn't have sufficient assets to back a $75 billion loan (US COP 2010, 227). In contrast, the COP noted that the securities pledged for the SBF were "less risky and more easily valued" than the RCF collateral (US COP 2010, 228). The collateral consisted of high-quality fixed-income securities held by AIG's insurance subsidiaries and included corporate debt obligations, agency pass-through certificates, collateralized mortgage obligations, and obligations of foreign and local governments (BdofGov 2008c, 3).

5. The FRBNY applied the typical haircuts it used for discount window operations.

According to the Fed's Section 129 report on the facility: "All advances made under the new facility will be fully collateralized by investment-grade debt obligations that are subject to an appropriate haircut consistent with the Reserve Bank's usual discount window lending practices" (BdofGov 2008c, 3). Data show the haircut averaged about 14% over the life of the program (BdofGov 2010).

6. The secured borrowing transactions conducted under the facility would have a term of one day but could be rolled over for multiple one-day terms.

The SBF followed the Fed's usual practice in offering credit with a term of one day (BdofGov 2008c, 3). The Fed's discount window loans are typically overnight, although the Fed extended the maturity of discount window loans during the crisis up to 90 days (FCIC 2011a, 252, 363). Prior to the crisis, about 10% of AIG's securities lending transactions with customers had one-day terms; "substantially all" had terms of three months or less (AIG 2008b, 112).

7. The Fed used existing programs as a template in order to get the SBF operational quickly.

Much of the SBF was based on existing programs, such as the discount window and TSLF. For example, the haircuts and one-day term applied to the securities were consistent with conventional discount window calculations (BdofGov 2008c, 3). According to former FRBNY general counsel Thomas Baxter in an interview with YPFS, the FRBNY wanted to utilize some of the features of already standing liquidity programs, in particular the TSLF, and not create new ones from scratch. "At the beginning of October 2008, we had fires burning everywhere

and part of the thinking was that we have to solve this new problem, but let's not try to reinvent the wheel" (Baxter 2018, 14). AIG could not draw on the TSLF because it was not a primary dealer; the Fed did not accept its request to become a primary dealer that came the week preceding its rescue (US COP 2010, 105). Since AIG had problems that were similar to those of primary dealers being addressed by the TSLF, Baxter said, it was natural to create a comparable facility, just one that worked for an insurance company like AIG and focused on RMBS portfolios (Baxter 2018, 14).

8. **The interest rate on the loan equaled 100 basis points above the average overnight repo rate offered on investment-grade debt obligations.**

The FRBNY conducted a daily survey of dealers regarding repo rates on comparable collateral in order to ascertain market rates (BdofGov 2008c, 3). The SBF then charged an interest rate of 100 basis points above the observed repo rates on loans it extended to AIG (BdofGov 2008c, 3).

9. **The FRBNY loan had a maximum duration of two years.**

The Fed stated that it created the SBF with the same maximum duration as the RCF "in order to allow the company to conduct an orderly disposition of certain of its assets" (BdofGov 2008c, 3). While the SBF had a maximum duration of two years, it was wound down just two months later, upon the inception of Maiden Lane II (FRBNY 2008).

10. **The FRBNY announced the SBF on October 8, 2008, through a press release.**

On October 6, 2008, the Federal Reserve Board unanimously approved the creation of the SBF (BdofGov 2008c, 1; BdofGov 2009, 17). Two days later, the facility was established, and the Fed announced its creation through a press release (BdofGov 2008b, US COP 2010, 68). In the release, the Fed acknowledged the use of RCF funds to settle securities lending transactions, explaining that the newly created facility would "allow AIG to replenish liquidity used in settling those transactions, while providing enhanced credit protection to the FRBNY and U.S. taxpayers in the form of a security interest in these securities" (Board authorizes FRBNY to borrow securities from . . . AIG 2008). Because of the short duration of the SBF, a little over two months, there was minimal communication from the FRBNY regarding its management. On November 10, 2008, the FRBNY announced the creation ML II and the subsequent termination of the SBF (AIG RMBS LLC Facility: Terms and Conditions).

III. Evaluation

The SBF achieved its goal of meeting the immediate liquidity demands that AIG faced from securities borrowers (US COP 2010, 137-138). Implementation of the SBF did slow—and ultimately stop—the drain on liquidity associated with AIG's securities lending program (US COP 2010, 137-138). The value of cash collateral that AIG GIC had reinvested in RMBS had fallen substantially in value (Peirce 2014, 26-28). The SBF provided an alternative source of funding for the high-quality assets that had been lent to securities borrowers (BdofGov

2008c, 3). Without SBF funding, AIG would have been forced to sell RMBS at distressed prices or find cash elsewhere within its organization (BdofGov 2008c, 2).

However, the SBF was not designed to address the losses that AIG was experiencing because of the falling values of the RMBS into which AIG GIC had reinvested counterparties' collateral (US COP 2010, 71). Only two months after creating the SBF, the Fed created Maiden Lane II to purchase the RMBS from AIG, thus removing the impact of their devaluation from AIG's balance sheet. The FRBNY was in a position to hold the assets and allow for their orderly liquidation over time (US COP 2010, 71).

IV. References

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