7-1-2008

Federal Reserve Bank Email from Joseph Sommer to Jamie McAndrews Meg McConnell and Lucinda M Brickler Re another triparty option

Joseph Sommer

James McAndrews

Margaret McConnell

Lucinda Brickler

From:	Joseph Sommer
To:	Jamie McAndrews; Meg McConnell; Lucinda M Brickler
Cc:	Antoine Martin; Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jan Voigts; Lawrence Sweet; Michael Schussler; Morten Bech; Patrick M Parkinson; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William BRODOWS; William Dudley
Subject:	Re: another option we should present re triparty?
Date:	07/13/2008 08:50 AM

I agree with your analysis, but I don't endorse the word "permanent.". The question is whether the government wishes to get into the private equity business--not whether the government wishes to get into the investment banking business.

Your mileage may vary, but the question is one of PE.

Sent from my BlackBerry Handheld.

▼ Jamie McAndrews

----- Original Message -----
From: Jamie McAndrews
Sent: 07/12/2008 09:46 PM EDT
To: Meg McConnell; Lucinda Brickler
Cc: Antoine Martin; Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jan Voigts; Joseph Sommer; Lawrence Sweet; Michael Schussler; Morten Bech; Patrick Parkinson; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William BRODOWS; William Dudley
Subject: Re: another option we should present re triparty?

Woops;

Antoine makes the following point:

"The question we should ask is: In hindsight, is there anything we would do differently in the case of BS?
If we think we would do something fundamentally differently, then we should tell Tim what and why.

My impression is that we would do essentially the same thing, so there is not much to talk about for the very short-term. Of course, there is lots to do in the medium and long term."

The thing we would have to decide is whether the distressed firm was likely to be sold. If we think that the run had progressed too far and that it wouldn't be sold, then any lending we did to it would be a permanent addition to the government's balance sheet--like Northern Rock, again.

That is the crucial question at the time a decision must be made. If we think it can be sold, then proceed as in BS. If not, discuss with the Treasury its appetite for a permanent addition to the government's balance sheet by lending to the distressed firm; if there is little appetite for that, then lend to the distressed firmks creditors, and work to contain the spread of the problem with communication policy.

The difficulty of making the determination of whether we think the firm can be sold is high, especially given that the refusal of the clearing bank to unwind the repos means that a run on the firm is fait accompli.

Jamie

Sent from my BlackBerry Wireless Handheld (www.BlackBerry.net)

▼ Meg McConnell

----- Original Message -----
From: Meg McConnell
Sent: 07/12/2008 09:07 PM EDT
To: Lucinda Brickler
Cc: Antoine Martin; Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jamie McAndrews; Jan Voigts; Joseph Sommer; Lawrence Sweet; Michael Schussler; Morten Bech; Patrick Parkinson; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William BRODOWS; William Dudley
Subject: Re: another option we should present re triparty?

I guess I'm not sure about the analogy to the BSC situation. In that case we were lending to JPMC on a nonrecourse basis, but we weren't doing so because they were BSC's clearing bank, but rather because they intended to purchase BSC, and thus ultimately stand behind all of BSC's obligations--tri-party or otherwise. And as Michael pointed out, the "beauty" (in the legal sense of the word) of the LLC was that we could lend to the LLC and the LLC could buy from BSC the assets that JPMC would not. I'm wondering whether without a buyer for LEH in the picture, what the end game is for the scenario you describe below (i.e., what is this a bridge to, given that there is no one in the wings waiting to buy LEH's assets and stand behind the remainder of their liabilities?). Do you see what I mean or am I missing something?

▼ Lucinda M Brickler/NY/FRS

Lucinda M Brickler/NY/FRS

07/12/2008 06:22 PM

To	Chris.McCurdy@ny.frb.org, Patrick M Parkinson/BOARD/FRS@BOARD, Sandy.Krieger@ny.frb.org, Lawrence.Sweet@ny.frb.org, Arthur Angulo/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS, Jamie McAndrews/NY/FRS@FRS, Morten Bech/NY/FRS@FRS, Antoine Martin/NY/FRS@FRS, Michael Schussler/NY/FRS@FRS, Joseph Sommer/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS, HaeRan Kim/NY/FRS@FRS, Catherine Kung/NY/FRS@FRS, Brian Begalle/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, William Dudley/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, Thomas Baxter/NY/FRS@FRS
cc	
Subject	another option we should present re triparty?

Perhaps another option we could offer Tim on triparty...

If JPMC refuses to unwind LB's triparty one morning out of fear of being caught with the entirety of this exposure when the music stops, by that evening they (and we) will likely have a much bigger problem to deal with as scores of investors pull away from triparty repo.

Instead of merely offering to take all of the risk to LB on our shoulders by stepping in as the intraday creditor (as the current proposal suggests), perhaps we just need to offer JPMC an outcome that is slightly more palatable.

We could encourage them to unwind and tell them that if LB fails on their watch, we will facilitate off balance liquidation support for some or all of the assets (a la Bear). (The mechanics of this are hazy, but one way would be to enter into the dreaded non-recourse loan with JPMC against the assets in question. They can pay back the loan by handing us the collateral. The legal community doesn't like this because it smells not so much like a loan, but an outright purchase of assets I'm not sure what authority we used to purchase the Bear assets.)

We would apply our conservative margins on the assets--to reduce the likelihood that FRBNY will experience a loss, but capping the clearing bank's losses at a level that is more palatable outcome than if they use their nuclear option. (As Jamie McAndrews and his team have pointed out, there must be some value that this business brings that them would make some level of losses to preserve it tenable.)

Could we offset the sting of margins that would protect us from loss with giving them notes in the liquidation vehicle that would entitle them to any profits made on the sale of the assets allowing them the possibility of recovering some of their losses (a la Checki-LEC?)

This has the advantage of containing the problem without taking on the whole potential for losses. Allows the clearing bank to see light at the end of a tunnel of the default of a $236 billion exposure.

This is an idea Chris hatched back in May. Our writeup from that time is attached. Let me know your thoughts...

Lucinda
[attachment "FRBNY Liquidation Facility 5-23.doc" deleted by Meg McConnell/NY/FRS]]

Lucinda Brickler
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