

Til Schuermann/NY/FRS

09/17/2008 12:20 AM

To

Arthur Angulo/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS

cc

Amy White/NY/FRS@FRS, Kirsten Harlow/NY/FRS@FRS, James P Bergin/NY/FRS@FRS, JohnP McGowan/NY/FRS

bcc

Subject

Re: On-site Primary Dealer Update: September 16th Evening Edition000000000003FFFFF6E6900137CE00000

History:

This message has been replied to.

You know, this is not good. In liq stress scenario C for Morgan (that's their catastrophic scenario), they expect to lose \$21.5bn over the first 2 weeks -- not 2 days -- from PB! Secured funding is holding up -- thanks to facilities presence -- but they are being run. ML's liquidity stress scenario assumes a loss of about \$6-7bn a week from PB -- they have that in the first 2 days -- and they got bought by a bank! At this rate they won't make it past this week.....

GS has already "used up" more than half their MLO allowance for PB drain -- in 2 days!

I think a lot of this is running in the UK, right? Where there isn't the strict lock-up there is in the US B/D....

This is not good..... or am I seeing ghosts?

Til

Til Schuermann
Research, Financial Intermediation
Federal Reserve Bank of New York
(212) 720-5968
<http://nyfedeconomists.org/schuermann/>

Any comments or statements in this message represent the views of the author only and not necessarily those of the Federal Reserve Bank of New York or the Federal Reserve System.

**Amy
White/NY/FRS**

09/16/2008

To

Adam J Weisz/NY/FRS@FRS, Alejandro LaTorre/NY/FRS@FRS, Amy White/NY

10:18 PM

/FRS@FRS, Angela MIKNIUS/NY/FRS@FRS, Anne Golden/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, Brian Begalle/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Chris McCurdy/NY/FRS@FRS, Christopher Calabria/NY/FRS@FRS, Daniel Sullivan/NY/FRS@FRS, Denise Goodstein/NY/FRS@FRS, Dennis Herbst/NY/FRS@FRS, Dianne Dobbeck/NY/FRS@FRS, Elizabeth Tafone/NY/FRS@FRS, Helen Mucciolo/NY/FRS@FRS, Homer Hill/NY/FRS@FRS, James P Bergin/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, Jeffrey Kowalak/NY/FRS@FRS, Jim Mahoney/NY/FRS@FRS, John Leiby/NY/FRS@FRS, JohnP McGowan/NY/FRS@FRS, Jonathan Stewart/NY/FRS@FRS, Kevin Coffey/NY/FRS@FRS, Kevin Messina/NY/FRS@FRS, Kirsten Harlow/NY/FRS@FRS, Lance Auer/NY/FRS@FRS, Lucinda M Brickler/NY/FRS@FRS, Michael Holscher/NY/FRS@FRS, Patricia Mosser/NY/FRS@FRS, Sarah Dahlgren/NY/FRS@FRS, Steven J Manzari/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, Theodore Lubke/NY/FRS@FRS, Thomas Baxter/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, Tim P Clark/BOARD/FRS@BOARD, Timothy Geithner/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS, William Dudley/NY/FRS@FRS, William Rutledge/NY/FRS@FRS, YoonHi Greene/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS

cc

Subject

On-site Primary Dealer Update: September 16th Evening Edition

Amy G. White
Federal Reserve Bank of New York
(212) 720-2448
Amy.White@ny.frb.org

ON-SITE TEAMS REPORT

Morgan Earnings Call: Net Revenues of \$8 billion, Net Income of \$1.4 billion and EPS of \$1.32. Like Goldman, Morgan stated that it does not need to hook up with a bank (which brings its own complications); it's comfortable with diversity and flexibility of IB model. The firm is desperately trying to instill confidence, but expressed extreme frustration with markets. Confident funding costs will normalize, but deferring some key business decisions until that occurs.

Primary Dealer Updates

Merrill:

Merrill's Parent Company Liquidity Pool: Has dropped by roughly \$27 billion in the last three days due to a variety of factors. The pool is currently \$40 billion versus \$83 billion on August 13. We are trying to get in touch with the Treasurer tonight.

Total drain on holding company operating cash is expected to be \$7 to \$8 billion today, primarily as a result of the following funding needs:

- \$3 to \$4 billion to MLI (the UK brokerage firm);
- \$1 billion ML Pro (prime brokerage); and
- \$3.4 billion to fund repo positions.

ML Bank USA is currently providing \$5.3 billion in repo funding (\$4 billion CMOs and \$1.3 billion municipals). Management is considering ways to better utilize ML Bank USA for funding given the 23A relaxation.

P&L: P&L in Counterparty Credit Risk book resulting from **Lehman** bankruptcy and **BoA / Merrill** deal is still being analyzed. Merrill anticipates that this will be a significant loss due to the movement in spreads for Lehman and Merrill.

OTC Market Activity

Rates and Muni Derivatives: Some Customers are wary of trading with Merrill.

Credit Derivatives: Assignments / Terminations are higher than normal volume. Same situation as yesterday whereby we are seeing increased volume from firms looking to put trades on with / assign trades to Merrill that are currently on with **AIG, Morgan, Goldman.**

Goldman

Goldman's Free Credit Withdrawals: Goldman itself does not express significant concern and we don't see anything in funding that is of significant concern at this point. Goldman realized \$10 billion in free credit withdrawals, which is moderately concerning to them. Rating agencies are expected to announce rating decision Wednesday and Thursday.

Tokyo: Another counterpart indicated it is ceasing unsecured bond borrows pending a review of Goldman's earnings and its credit exposure to US broker-dealers.

Morgan

Morgan's Stanley's Parent Company Liquidity Pool and its Prime Brokerage Business: Free credit withdrawals of \$20 billion over the last two days, contributing to a \$23 billion decline in the parent company liquidity pool to \$106 billion. Rating agencies are expected to announce rating decision Wednesday or Thursday.

Counterparties issues that have been escalated to senior management:

BNP Paribas - As of 9/15 LC pricing increases, globally, from 40bps to 75bps. Morgan's lines will be frozen at current usage.

Commerzbank - suspended intra-day clearing limits and asked Morgan to pre-fund all outgoing payments.

Danske - asked for the uncommitted, unsecured LC facility to be collateralized.

JP Morgan Chase - wants Custody/Security Agreement negotiations in Europe to be expanded

RBC - implemented new exposure limit of \$1.6 billion - previously an excession was approved.

Sumitomo Mitsubishi - turning down all IRS with Morgan - firm is trading with **Goldman**, but not **Merrill** or **Morgan**.

Comments Submitted by CPC Teams

UBS

UBS's "Financial Institutions "watchlist" includes **Merrill**, **AIG**, **WaMu**, **Wachovia**, **Nat'l City** and, more recent addition, **Morgan**.

Some hedge funds are moving Prime Brokerage (mostly securities financing) away from broker-dealers or requiring separate custodian accounts. UBS noted this had been occurring recently for **Merrill**, **Lehman** and, to a lesser extent, **Goldman**.

Citi:

NY Equity picked up \$200 million: Citi noted good flows and communication from PB clients as they are nervous and diversifying away from **Goldman** and **Merrill**.

Lehman Notes

Citi will clear in CLS for Lehman Brothers Inc. as long as there is sufficient cash on hand intra-day.

Citi does NOT act in any clearing, settlement, or paying agent capacity with any of the Lehman legal vehicles that have filed for bankruptcy; but, will resolve any trades that Citi committed to on a T+3 basis prior to the filing.

Citi is **not** the settlement bank for Lehman GSD.

Credit Suisse:

In addition to **AIG**, CS is closely monitoring **Merrill**, **Morgan**, **Citi**, **UBS**, and **WaMu**.

Novation activity has increased markedly. CS CRM noted an increase in novation requests from counterparties looking to novate away from **Goldman and Morgan**. These novation requests are concentrated in the credit driven products (CDS, ABX, CMBX).

CS CRM reported concern regarding a failed FX trade with **LBI (broker/dealer)**. CS expected the trade to settle on Monday. As CS did not receive the payment, it held payment. CS then agreed to net payment over to 2 days. This trade failed again today. This was not a trade clearing through CLS. At this point, CS is looking to issue a Failure to Pay notice, which will then give LB a cure period.

The firm is requiring a credit authorization for all **Lehman** non trade related payments.

SSC

SSC is holding 84 payments valued at \$1.4 billion in CMAC queue. Of those, 41 payments valued at \$230 million are for **Lehman** and **Neuberger**.

Update: SSC did get paid on the collateral that was due to them from **Lehman** on Friday's value date and paid on all other trades that were settled today. Most Lehman settle within CLS, but where they are not they are handled DVP.

JPMC

Fidelity will no longer extend term repo loans to **Lehman**.

Merrill borrowed \$2.4 billion in a bilateral overnight repo from JPMC; this was partly due to changing collateral requirements and partly due to a mistake).

Funding: JPMC is seeing significant inflows from all of the prime brokers – **Morgan, Goldman, Merrill, and Lehman**. Probably received \$2-3 billion from this today. But management views this as flight-to-quality, and temporary.

BNPP: Counterparty Risk: BNPP continues to be cautious on **Merrill** exposure as it looks for more clarity surrounding BoA assuring the debt of Merrill.

SocGen: Newedge is seeing large inflows of high quality Hedge Funds futures clients from **Lehman** in the US and **Lehman International** as well. Clients from other firms such as **Merrill** and MF Global are contributing to the increase.