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8-31-2008

Email from Aaron Katzel Regarding Revised Project Green Talking Points

Aaron Katzel

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From: Katzel, Aaron
Sent: Sunday, August 31, 2008 11:49 AM
To: Pryor, Alan; Habayeb, Elias; Swiatek, Jeff; Berding, Jens; Kelly, Anastasia; Skigen, Patricia; cohenhr@sullcrom.com; Wiseman, Michael; Risoleo, Robert S.; Sanoke Viswanathan (sanoke_viswanathan@mckinsey.com); Anthony_Santomero@mckinsey.com; Liou_Cao@mckinsey.com
Subject: Revised Project Green talking points
Attachments: 20080829 Primary dealer - talking points.ppt

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For your review, attached are revised talking points for Bob Willumstad's proposed meeting next week with Tim Geithner on the primary dealer initiative.

These incorporate comments received from the working group so far, and reflect Rodge's suggestions with respect to the liquidity benefits.

Please send me any questions or comments you have at your earliest convenience so we can finalize these in advance of Tuesday morning's 11:30 meeting.

Rodge and Tony - please let us know your thoughts on whether, in addressing the liquidity benefits, it would be better to (a) speak generally or (b) also provide detail on the amount of available Fed eligible collateral from our analysis.

Thanks very much,

Aaron

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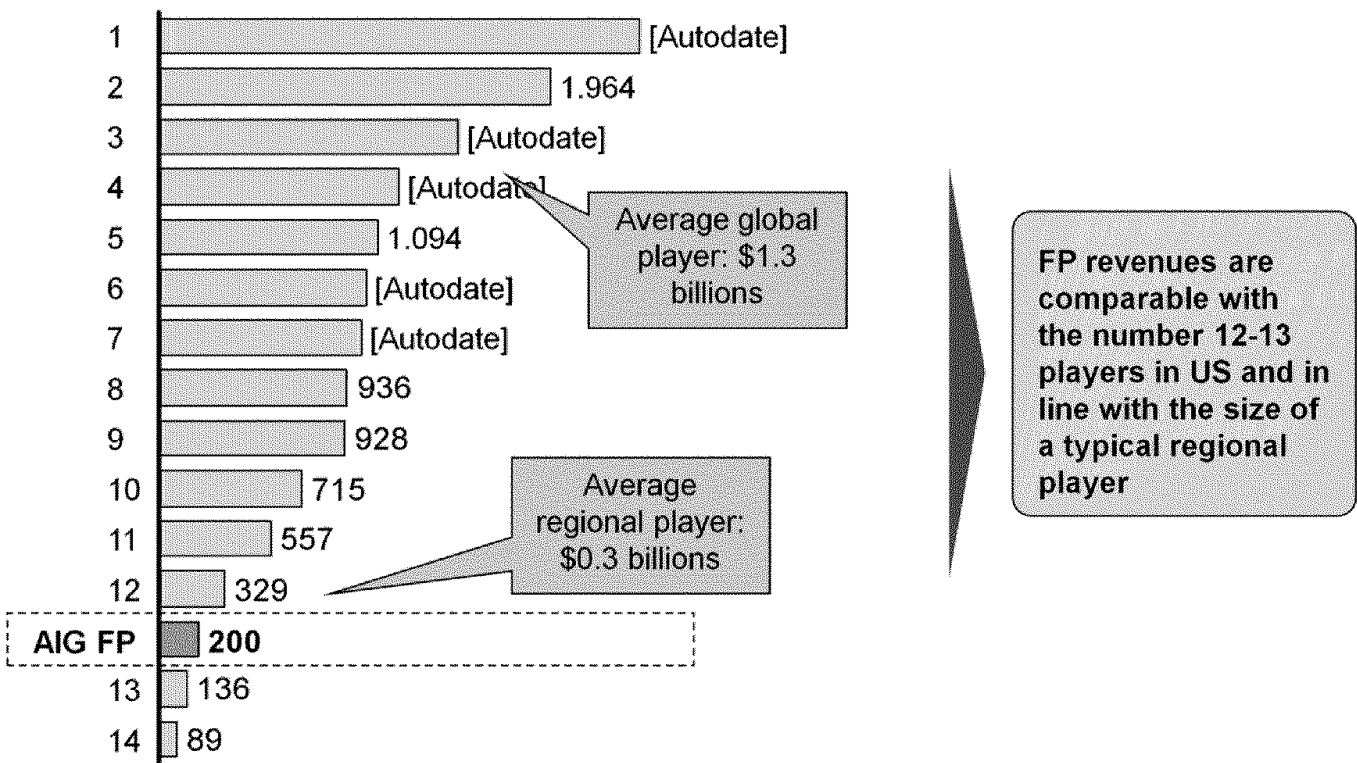
Fed talking points - continued

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4. The very availability of access to additional liquidity as a primary dealer under various Federal Reserve programs is likely to help prevent liquidity pressures from arising
 - [Our internal analysis shows AIG has \$11 - \$21 billion of non-insurance Fed eligible collateral that could be used in connection with the current Fed programs available to primary dealers] [*To be discussed*]
 - Even if the Fed's current programs are revised or terminated next year, we would expect that AIG's status as a primary dealer should help in maintaining market confidence
5. Obviously we do not want to file an application that would not be approved and we would not want to proceed much further with the process if there would not be receptivity at the Fed. Accordingly, we need to ask if in your opinion you believe that we have a reasonable likelihood of success if we submit an application for primary dealer designation?
6. If in the course of conversation the Fed representative indicates that the volume of treasury transactions appears too low for primary dealer designation, AIG should be prepared to respond that they are interested in increasing their volume in treasuries and their presence in treasury auctions
 - Although FP currently does not have a roster of external clients in this area, through its other business lines FP has relationships with select major counterparties (e.g., sovereign wealth funds/non-U.S. financial institutions, major money managers, and leading hedge funds) that could be leveraged for a primary dealership
 - Preliminary analysis indicates that it is feasible to establish a primary dealer operation in a staged manner (e.g., starting with low-risk products such as treasury bills) and ramp up the transaction volume in 12 months to achieve 0.5-1% of the total market share (i.e., ~\$800-1,000 bn daily transaction volume)

AIG's rates revenue is in line with existing regional players *Privileged & Confidential - Not for Distribution*

US rates business revenues*
\$ millions



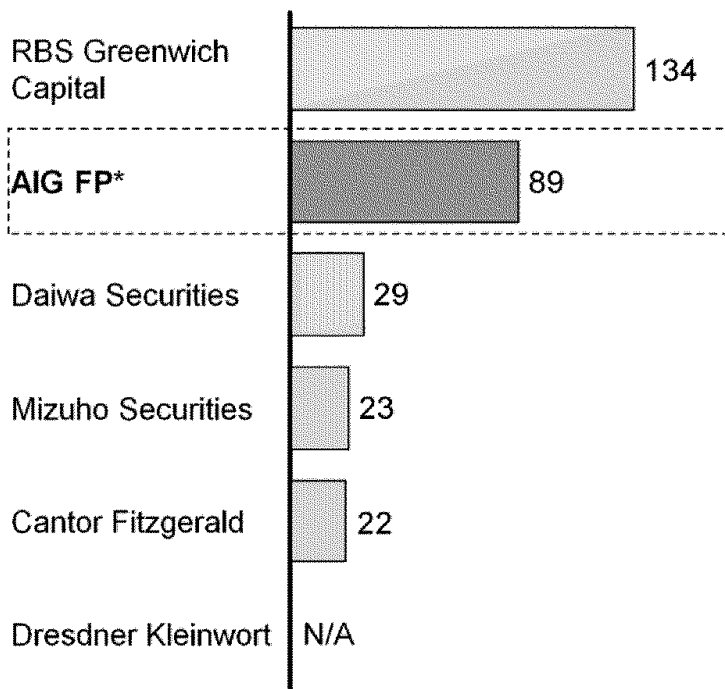
* Sample includes ABN Amro, Barclays Capital, BNP Paribas, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Lehman Brothers, Merrill Lynch, Morgan Stanley, RBS, Société Générale, UBS

Source: 2007 Global Capital Markets Survey; AIG FP financial statements; Federal Reserve Bank of New York; Team analysis

AIG FP has a substantially bigger asset base compared to some primary dealers

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Total company assets
\$ billions



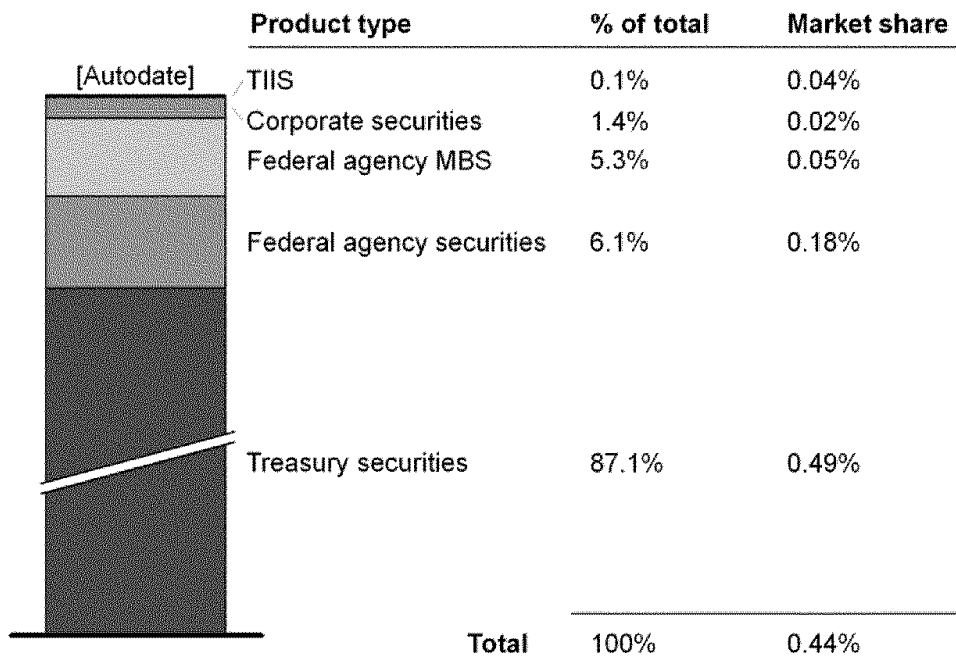
Compared on total assets AIG FP is bigger than most of the primary dealers in the bottom quintile

* As of June 2008

Source: AIG FP financial statements; Company web-sites; Team analysis

Daily transaction volume by product type for a bottom quintile primary dealer

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- Based on Fed information, an existing bottom quintile primary dealer is focused primarily on US treasury securities
- FP's current transaction volume focus is also primarily on government securities
 - 60% U.S. government securities
 - 10% on agency MBS
 - 30% corporate bonds
- To increase transaction volume in the near term, AIG/FP would continue to focus on and expand the volume of Treasury securities in order to achieve a market share of ~0.5%

Source: AIG FP financial statements; Federal Reserve Bank of New York; Team analysis

High-level implementation plan for ramping up transaction volume for AIG's primary dealer

PRELIMINARY

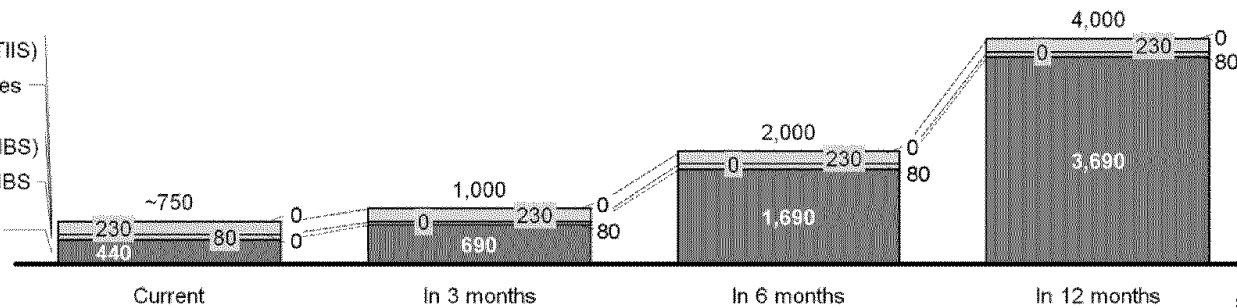
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	Sep '08	Nov '08	Feb '09	Aug '09
Activities to ramp up volume	<ul style="list-style-type: none"> Laid out resources required to increase the flow trade volume by ~8-10 fold Identified 3rd party software packages 	<ul style="list-style-type: none"> Hired or designated 5-10 core people to support basic operations <ul style="list-style-type: none"> Head of Govt. Trading desk Head of compliance Head of financing desk Head of sales Implemented off-the-shelf packages or enhanced existing systems to support trading and reporting Connected to external systems (e.g., Trade web) Implemented additional systems to strengthen risk management 	<ul style="list-style-type: none"> Hired or designated additional 15-20 people to support front and back office (e.g., IT, compliance) Built 5-8 person sales force to start building a client base 	<ul style="list-style-type: none"> Established a 38-60 FTE primary dealer operation Built ~15-20 client relationships Smoothed front-to-back operations for basic treasury flow trades Expanded to support agency debt, MBS, and corporate securities
Capabilities to be added	<ul style="list-style-type: none"> Existing capabilities include secondary market trading, government securities, and derivatives trading 	<ul style="list-style-type: none"> Trading capabilities in the Treasury flow market Daily/weekly reporting Basic risk management capabilities 	<ul style="list-style-type: none"> Capabilities to build primary client relationships Basic market analytics capabilities 	<ul style="list-style-type: none"> Trading capabilities in treasury and agency/MBS flow market Ops./reporting/analytics capabilities to support multiple products

Daily transaction volume in US government and Federal agency securities

\$ millions

Treasury inflation index securities (TIIS)
Corporate securities
Federal agency securities (excl. MBS)
Federal agency MBS
[Autodate]



~\$90-125 million would be required to set up and operate a primary dealer in its first year

PRELIMINARY

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Investments	Category	Description	Size of Primary Dealer		
			Minimal	Small	Med-Large
Upfront	Systems / software	<ul style="list-style-type: none"> • Infrastructure <ul style="list-style-type: none"> – Transaction platforms – Risk management • Connectivity 	\$20mm	\$25mm	\$100mm
	Overhead	<ul style="list-style-type: none"> • Expenses associated with onboarding (setup, training) 			
Ongoing (annual)	People 38-60 FTEs	<ul style="list-style-type: none"> • Front office (14-20 FTEs) <ul style="list-style-type: none"> • 1 Head of Government Trading Desk • 5-7 volume traders to monitor and trade rates by maturity • 3-5 repo traders to manage financing • 5-8 sales and marketing personnel 	\$25mm	\$35mm	\$75mm
		<ul style="list-style-type: none"> • Middle office (9-15 FTEs) <ul style="list-style-type: none"> • 3-5 risk managers to model market and credit risks • 3-5 legal and compliance personnel • 2-3 credit managers to manage counterparty risk • 1-2 market economists 			
		<ul style="list-style-type: none"> • Back office (15-25 FTEs) <ul style="list-style-type: none"> • 8-13 operations FTEs to process transactions, booking and reporting • 7-12 IT support for set-up and ongoing system maintenance 			
	Systems	<ul style="list-style-type: none"> • Maintenance <ul style="list-style-type: none"> • Maintenance of clearing and connectivity functions • Maintenance of risk management / market research systems; ensuring information flow for prop desk 	\$10mm	\$15mm	\$100mm
	Market risk	<ul style="list-style-type: none"> • Bid-ask spread <ul style="list-style-type: none"> • Spread typically fractions of bps on electronic systems (e.g., 0.10 bps for bills, higher for notes / bonds) 	\$35mm	\$50mm	\$300mm
		<ul style="list-style-type: none"> • Funding <ul style="list-style-type: none"> • Repos / warehousing 			
Total			\$90mm	\$125mm	\$575mm

Source: Interviews with industry experts and AIG-FP

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