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FCIC memo of staff interview with Fidelity Investments

Scott Goebel

Norman Lind

Kevin Gaffney

Kevin Mahar

Tom Krebs

See next page for additional authors

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MEMORANDUM FOR THE RECORD

Event: Interview with Fidelity Investments

Type of Event: Telephone Interview

Date of Event: February 23, 2010; 2:05 p.m.

Participants - Non-Commission:

- Scott Gobel
- Norm Lind
- Kevin Gaffney
- Kevin Mahar

Participants - Commission:

- Tom Krebs,
- Mina Simhai
- Troy Burrus

MFR Prepared by: Troy Burrus

Date of MFR: February 23, 2010

Summary of the Interview or Submission:

This is not a transcript of the meeting and should not be quoted as such

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1. On Tuesday, 23 February 2010 Tom Krebs, Mina Simhai and I spoke to Scott, Norm and Kevin of Fidelity Investments regarding repurchase agreements (repos). We identified ourselves to them as agents working on behalf of the Financial Crisis Inquiry Commission (FCIC). We asked them if they would be willing to speak with us regarding repos relating to Fidelity Investments. They agreed and provided the following information:

2. Fidelity has approximately $500 billion in money market assets. They look for short-term investments with liquidity and minimal risk. Repo agreements are good vehicles to meet these requirements. They look for parties to transact with who are of high quality and easy to do business with. They look at transactions and pick the attractive ones

(term, rate of return and the parties involved), usually with entities like JP Morgan. The collateral backing up the deal is not important to them. They are counting on the partner to give them their money back at the end of the period.

3. The typical collateral is US Government treasuries and Government agency bonds and debt. They review the collateral and the parties involved. If problems begin to surface, they stop doing business with that party. They currently have seventy-five to eighty percent of their repos with US Government treasuries, bonds and debt has collateral. The remaining is in non-traditional types (Asset Backed Securities (ABS), non-agency investment grade credit, mortgage backed securities (MBS)). They do a credit analysis on their counterparties. If concern rises, they pull the funds, or they reduce terms and dollar limits with those parties. They make their credit determination prior to trading with them.

4. They only use tri-party repos. They have internal contracts with JP Morgan and Bank of New York. They have a master repurchase agreement which they produced. It is a complex contract with language describing the terms and conditions. Fidelity money market funds have lots of liquidity, so they look for other investment vehicles that also have liquidity. Repos have that liquidity they are seeking. In 2008, the repo market was a $4.5 trillion market according to their internal numbers. This is information they obtained from the Federal Reserve website, which posts a weekly repo amount outstanding every Wednesday. It gives the total amount broken down by repos and reverse repos. As of 23 February 2010 the total is $2.4 trillion with $2 trillion being tri-party and the other being bilateral repos.

5. They do most of their repos with primary dealers (ninety to ninety-five percent). The remainder is done with foreign dealers who are not considered primary dealers. They currently have about $150 billion invested in repos. Ten years ago they had eighty percent of their repos using tri-party arrangements. Two years ago they switched to ninety-five percent tri-party and now they are one hundred percent tri-party. Tri-party is much more efficient than bilateral. Using tri-party you are not moving pieces of collateral and dollars around since all is centralized by tri-party bank. Bilateral is usually done by small volume repo participants.

6. They saw no significant increase in haircuts during the crisis. Haircuts are standardized based on the collateral, with US treasuries typically getting a one to two percent haircut. The New York Federal Reserve is working on standardizing haircuts for the repo market. A task force is looking into the matter and Fidelity has a representative on that task force

(Lucinda Brickler). The task force is looking at the entire market including haircuts, liquidity, and actions taken by lenders and borrowers. Fidelity just dropped their activity with other parties due to risk factors. Other firms in the repo market might do it differently than they do. Fidelity is a much more conservative company. Money market funds make up twenty-five to thirty percent of the repo market according to their research.

7. Collateral for repos is priced on a daily basis. There is a potential for the collateral to decrease in value due to market factors. Every morning all overnight transactions are undone. The tri-party bank could be exposed during the day if there is a decrease in the value of the collateral.

8. During the crisis Fidelity did experience some withdrawals from their institutional investors from their money market accounts. There was also an increase in US Treasuries since firms were seeking safe investments. They were able to meet all the redemptions they received. About one-third of the assets in their institutional investors' accounts were withdrawn. Most of the withdrawals were to meet payroll and other operating costs at their companies.

9. Fidelity had the resources to weather the storm of redemptions. They believe it was a crisis of confidence in short-term markets. People were afraid of not getting their money back from these short-term investments. People were hoarding cash due to the volatility of the markets, which froze up the commercial paper market for several days. The Federal Reserve and the US Treasury restored confidence through their actions. There was a large amount of leverage in many companies trading in the short-term repo market. This added to the crisis when collateral values dropped. The repo market itself was not the cause of the crisis. It was the leverage issue with long-term investments (mostly collateralized debt obligations) of sub-prime value. They lost value which created holes in the balance sheets of several companies who were highly leveraged. Rule 2a7 has been modified by the SEC to change items to correct problems from 2008. There are new liquidity percentages in place which should help.

10. We thanked everyone for the information they had provided and the interview terminated at that point.