

From: Lowitt, Ian T [ilowitt@lehman.com].

Sent: 5/12/2008 2:10 PM.

To: Pellerani, Carlo [carlo.pellerani@lehman.com]; Azerad, Robert [RAzerad@lehman.com].

Cc: Engel, Steven J [sengel@lehman.com]; Goldband, Craig [cgoldban@lehman.com]; Tonucci, Paolo [paolo.tonucci@lehman.com].

Bcc:

Subject: RE: FT Lex Column: Who is the ECB lending to?.

Need to see if we can get other brokers to price these for us, so we are not only price available. Ian

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>From: Pellerani, Carlo
>Sent: Monday, May 12, 2008 1:57 PM
>To: Azerad, Robert
>Cc: Engel, Steven J; Goldband, Craig; Tonucci, Paolo; Lowitt, Ian T
>Subject: RE: FT Lex Column: Who is the ECB lending to?

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>As you know we have ~EUR 5.3bn with ECB and this will go to ~EUR10bn in next month or so, our self-imposed pit stop after my last chat with ECB a couple of months ago. I have a meeting with head of open market operations (Papadia) later this week to assess if we could go bigger than that, understanding how others have changed and trying to sense how the ECB is feeling. I am also organising Benoit to meet Gonzalez-Paramo (ECB board member and Papadia's boss) plus Dick is meeting Trichet on Wednesday.

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>The biggest worry I have is the comment below on valuation. At the moment we basically put transactions which were created by us, that are not trading, at par and hence are vulnerable to the ECB tightening their criteria. With EUR10bn+ this is not insignificant... We need to come up with bright ways of hedging ourselves from this risk; I feel we need to assume a portion of the ECB financing is unreliable, not because of the counterparty, but because of the asset. Robert, can you think how we would incorporate this into our models? Maybe we slowly move to a place where we cash capitalise our stressed haircuts and in this process assign a portion of this to ECB? Any other bright idea?

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>Thx
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>Carlo

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>From: Azerad, Robert
>Sent: 12 May 2008 16:17
>To: Tonucci, Paolo; Lowitt, Ian T; Pellerani, Carlo
>Cc: Engel, Steven J; Goldband, Craig
>Subject: FT Lex Column: Who is the ECB lending to?

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>FYI
>
>Robert

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>Who is the ECB lending to?
>Published: May 12 2008 09:45 | Last updated: May 12 2008 14:47
>Is the European Central Bank propping up dodgy lenders? Since the credit crunch began, some have argued the ECB's lending policies are too generous and transfer banks' private risks onto the public.
>The numbers suggest worries may have been exaggerated. The ECB had €445bn of loans outstanding to eurozone banks in early April, just €1bn more than in April 2007, and almost a third below January's peak. Research by Fitch Ratings shows this is 1.6 per cent of total eurozone banking system assets.
>True, banks are borrowing for longer. The longer-term refinancing operations (between three to six months) offered by the ECB now represent more than half of total ECB lending, up from a third in March 2007. And structured products such as asset-backed securities (ABS) make up nearly a fifth of the collateral provided by banks to the ECB – versus 4 per cent in 2004. Safe government bonds have fallen from over 30 to 17 per cent.
>Spain and the Netherlands, accused of exploiting the ECB's generosity, are responsible for much of the use of ABS (including mortgages) as collateral. But these countries' share of total ECB lending is fairly small. Spain's banks account for nearly a tenth of eurozone banking assets and 9 per cent of total ECB lending. The Netherlands borrows even less. Germany remains the biggest user of ECB facilities. Its borrowing has been fairly stable over time.
>There are, nevertheless, legitimate concerns. It is unclear how much of eurozone banks' borrowing is actually on

behalf of banks outside the region – UK banks, for instance. And, potentially, banks could be holding on to more liquid assets, while using riskier collateral in ECB transactions. The ECB applies its own valuation models to collateral as well as demanding a haircut. It can also require banks to replace collateral if its quality sharply deteriorates. As yet, there is no evidence it has done so.

>The ECB's decision last autumn to increase its lending and loosen some of the terms of such lending, looked risky. Its gamble, so far, appears to be paying off.

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