

## State Of Nevada Securities Lending

- NOTE: Securities lending is the temporary loan of a security from an institutional investor's portfolio to a broker/dealer or dealer bank to support that firm's trading activities.
- State Treasurer's Office has been involved with securities lending since 1996. Since that time, the state has earned approximately \$12 million in additional revenue based on securities lending.
- Wachovia Global Securities Lending (Wachovia), formerly Metropolitan West, is currently the state's securities lending agent for the General Portfolio.
- In March 2007, as is standard practice, Wachovia acting in its role as the state's securities lending agent loaned approximately \$50 million in U.S. government securities to approved counter parties.
- In turn, Wachovia took the cash collateral and invested that money in Lehman Brothers Holdings, Inc., a company that met the statutory obligation of being rated at "A" or better. The loaned securities were, per standard practice, collateralized at 102%.
- At the time of the purchase of the note, the rating for Lehman Brothers Holdings, Inc. was A+/A1, and the note was scheduled to mature (pay out) on March 23, 2009.
- In 2007, when market volatility continued to be an issue, Treasurer Marshall consulted with Wachovia before making the proactive decision in December 2007 to discontinue the practice of loaning securities, long before the current financial crisis our nation is facing.
- Throughout this period, Wachovia was consistently advising the state not to sell based on their opinion that the investment would be made good, whereas selling those securities would result in a financial loss to the state.
- Acting in its role as our securities lending agent, Wachovia (formerly Met West) has received an average payment of \$385,000 per year (approximately \$2.7 million since 2002) as its earning percentage share from the investment portfolio. The prudent decision was to rely upon their advice as the experts in this field.
- On September 15, 2008, Lehman Brothers Holdings, Inc. filed for bankruptcy.  
NOTE: The day before the bankruptcy filing, the corporate note had a rating of A/A2.
- Following the announcement of the bankruptcy of Lehman Brothers Holding, Inc., Treasurer Marshall reviewed the state's 2002 Forward Delivery Agreement with Lehman Brothers Commercial Bank, a subsidiary of the parent corporation. As a result of the review, Treasurer Marshall recommended to the State Board of Finance at its October 24, 2008, meeting that the state terminate its agreement with Lehman Brothers Commercial Bank.
- The recommendation was based on Section 7.6 of the agreement, which states that if Lehman Brothers Commercial Bank's unsecured debt is suspended or withdrawn by Moody's or Standard and Poor's, or if their rating is downgraded below "Baa3" by Moody's or "BBB-" by S&P, they must assign the agreement to another qualified provider acceptable to the state within 30 days of

the assignment and inform the state of that downgrade. Lehman did neither, thus defaulting on the contract.

- On September 15, 2008, S&P downgraded Lehman Brothers Commercial Bank to "BB-" (below BBB-) and on September 25, 2008, S&P discontinued rating Lehman Brothers Commercial Bank.
- As of the required contractual notification date of October 15, 2008, Lehman Brothers Commercial Bank had not advised the state of these rating changes. Further, Lehman did not offer to transfer the contract to a qualified party.
- With this in mind, by unanimous vote, the Board of Finance advised the State Attorney General's Office of its intent to terminate the agreement and instructed the Attorney General's Office to file a Complaint for Declaratory Relief, which was accomplished on October 27, 2008.
- As a result of these actions, US Bank will continue to serve as the paying agent for the state's debt, while the State Treasurer's Office will now retain the interest earnings formerly accruing to Lehman Brothers Commercial Bank.
- We estimate that in Fiscal Year 2009, the state will collect approximately \$600,000 in additional investment earnings; in FY 2010, \$700,000; and in FY 2011, we estimate additional interest earnings of close to \$950,000.
- Over the would-be remaining life of the terminated contract—which was scheduled to conclude in 2028—we believe the state will net somewhere between \$23-30 million in additional interest for the Bond Interest Redemption Fund.
- **NOTE:** All of this is pending court affirmation of the state's actions.
- Treasurer Marshall's decisive action in December 2007 placed Nevada far ahead of many states, many of whom have suffered more significant losses as a result of Lehman Brothers' bankruptcy.
- Also, the fact that Nevada's agreement with Lehman Brothers Commercial Bank was a secured investment (as opposed to unsecured) provides the state with an enhanced ability to recover lost funds based on the hierarchy established by bankruptcy courts.
- These actions by Treasurer Marshall helped mitigate Nevada's losses as a result of the financial collapse of the many investment and banking giants.
- As for the initial \$50 million loan, it has yet to be determined if the state will incur any losses as a result of the bankruptcy.

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