Memorandum to the Board of Directors of the FDIC Regarding Bank of America

Mitchell Glassman
Sandra Thompson
Arthur Murton
John Thomas
MEMORANDUM: The Board of Directors

FROM: Mitchell L. Glassman, Director
Division of Resolutions and Receiverships
Sandra L. Thompson, Director
Division of Supervision and Consumer Protection
Arthur J. Murton, Director
Division of Insurance and Research
John V. Thomas, Acting General Counsel

SUBJECT: Bank of America, National Association, Charlotte, North Carolina
Countrywide Bank, FSB, Alexandria, Virginia
FIA Card Services, Wilmington, Delaware
Merrill Lynch Bank USA, Salt Lake City, Utah
Merrill Lynch Bank & Trust Company, FSB, New York, New York
Bank of America Oregon, National Association, Portland, Oregon
Bank of America, Rhode Island, National Association, Providence, Rhode Island
Bank of America California, National Association, San Francisco, California, CA

Bank of America Corporation (Bank Holding Company) Information
(As of September 30, 2008; $ Thousands):
Total Assets: $1,831,177,000
Total Deposits (including Foreign): $874,051,000
Uninsured Deposits: $290,859,000
Foreign Deposits: $95,523,000
Tier 1 Leverage/Total Risk Based (Lead Bank): 6.01/11.60
UFIR Rating (Lead Bank): (2-2-2-2-2-2/2 - 01/01/2007)
Recommendation

Staff recommends that the Board find that significant operational disruptions of Bank of America Corporation (BAC) and its insured affiliate institutions would have serious adverse effects on domestic economic conditions and financial stability. Significant operational impairments to BAC and its insured depository affiliate institutions would seriously affect counterparty relationships in Qualified Financial Contract markets and would significantly disrupt short-term interbank lending and bank senior and subordinated debt markets, as well as related markets in derivative products and other markets, in which BAC is a significant participant. Further, it is highly likely that if any significant legal entity within BAC suffers a loss of market confidence, this would have a serious adverse effect on all BAC legal entities, including the second largest insured depository institution in the United States. While BAC is undergoing significant stress, staff is of the opinion that management is competent and there is no substantive evidence that management has failed to comply with applicable laws, rules, and supervisory directives and orders. In addition, there is no evidence that management has engaged in insider dealing, speculative practices, or other abusive activity. Consequently, it is recommended that the Board make a systemic risk determination and authorize staff to take action required to avoid or mitigate such risk. The basic parameters of the action for which staff seeks authorization are outlined below and appear in the attached [draft] term sheet. Based on preliminary information, the most likely outcome is that provision of the proposed assistance will not result in a loss to the Deposit Insurance Fund.

In order to prevent the foregoing systemic risk, staff recommends that the Board authorize the FDIC to enter into an agreement with BAC, the U.S. Department of the Treasury (Treasury), and the Federal Reserve Board in exchange for consideration. Under the agreement, Treasury will inject
$20 billion in capital from the Troubled Asset Relief Program. In addition, the U.S. Government (USG) would provide for shared loss coverage on specified BAC assets, with the FDIC’s potential loss protected by the issuance of preferred stock by BAC. The FDIC and the Treasury’s Troubled Asset Relief Program (TARP) will provide guarantees on certain residential assets for 10 years and certain other assets for a period of 5 years. BAC will bear the first $10 billion in losses. Additional losses will be shared with the FDIC, Treasury, and the Federal Reserve covering 90 percent of the losses with BAC bearing 10 percent. After the first $10 billion in losses, the FDIC and Treasury will cover losses pro rata in proportions of 25% for the FDIC and 75% for Treasury up to a cap of $2.5 billion for the FDIC and $7.5 billion for the Treasury. Further losses will be covered 90% by the Federal Reserve through nonrecourse lending. The FDIC will receive compensation in the form of what is projected to be $1 billion in preferred stock and warrants with an aggregate exercise value of 10% of the amount of preferred issued.\footnote{Treasury will receive $3 billion in preferred stock for its guarantee.}

The chart below provides detail on estimated losses.

The Federal Reserve Board will, under certain circumstances, provide non recourse financing secured, in part, by assets designated by the USG and BAC.\footnote{The FDIC, Treasury and the Board of Governors of Federal Reserve will be referred to collectively as the USG.} BAC will manage the assets, with instructions provided by the FDIC, TARP and Federal Reserve. The template will include a foreclosure mitigation policy agreeable to the USG. In addition, BAC will be subject to specific limitations on executive compensation and dividends during the loss share period. FDIC staff will work with all parties to ensure that BAC is subject to appropriate periodic reporting.

The Federal Reserve has agreed to work with the FDIC regarding appropriate reporting including monitoring the use of government assistance.
The BAC proposed asset pool (Pool) contains up to $115 billion of financial instruments including cash assets with a current book (i.e., carrying) value of up to $32 billion and a derivatives portfolio with maximum potential future losses of up to $83 billion. An independent analysis of the Pool was conducted by PIMCO that provides an estimated Base and Stress loss forecast of $5.5 billion and $20 billion, respectively. Such estimates are subject to further refinement.

These estimates only represent losses to the current carrying value and do not include gains where PIMCO’s analysis indicates assets have been written down below future expected losses. PIMCO noted data deficiencies associated with the hedged collateralized debt obligations and other referenced assets that limited the ability to generate market-implied losses on a held to maturity basis.
The FDIC, and OCC have determined that the insured entities meet the requirements under Section 13 (c) 8 of the FDI Act for receiving direct financial assistance before the appointment of a receiver. Additionally, assistance will increase existing capital levels and improve liquidity.

Commitments by Bank of America Corporation
In exchange for the guarantees discussed above, BAC has agreed to 1) limit its common stock dividends to $.01 per share per quarter for three years unless consent is given by the USG; 2) develop an executive compensation program that rewards long-term performance and profitability to be approved by the USG; and 3) implement loan modification procedures acceptable to the USG. Additionally the FDIC and TARP will receive preferred stock and related warrants as reasonable compensation for the guarantees provided.

Related Transaction

As part of the same overall transaction, Treasury will make a substantial preferred stock investment. The stock will have an 8% dividend yield. Warrants to purchase common stock will be issued as part of this transaction.

Summary Description

Bank of America, N.A. (BANA) is a nationally chartered bank founded in 1904 that is the lead bank within Bank of America Corporation (BAC), a financial holding company regulated by the Federal Reserve. BANA is the second largest bank in the U.S. with $1.4 trillion of assets and prior to BAC’s acquisition of Merrill Lynch, BANA represents approximately 80 percent of BAC’s consolidated assets. The BANA is also the largest holder of insured deposits in the U.S. with over 10 percent of total domestic deposits. BAC and BANA’s executive management is identical and risk is managed on a line of business rather than a legal entity basis.

BANA’s core business is its domestic retail banking franchise with over 6,100 branches in 33 states. The Bank participates in virtually every financial activity permissible to banks.
Foreign operations are modest relative to the overall size of the bank, with activities focused on serving corporate customers and trading, primarily in Western Europe. In addition to eight insured bank charters, BAC has four significant non-insured affiliates: Banc of America Securities, LLC, a full-service investment bank and brokerage firm; Banc of America Investments (BAI), a retail brokerage business; Banc of America Specialist, a NYSE specialist firm; and Columbia Management, the nation's eighth largest mutual fund company.

BAC’s risk profile has increased over the past year as a result of trading losses, declining asset quality largely in home equity and credit card portfolios, and acquisition of three higher risk institutions since October 2007, including LaSalle, Countrywide, and Merrill Lynch & Co, Inc (ML). ML reported $23.8 billion in net losses prior to the fourth quarter 2008. The merger with ML significantly increases BAC’s exposure in 2009.

Negative market perception of BAC has been building recently. Over the past year, the holding company’s stock price declined approximately 70 percent on concerns associated with several factors, including the cost of the Merrill Lynch merger, and general uncertainty regarding further deterioration in credit quality and capital markets. BAC will announce fourth quarter results that are significantly lower than market expectations for both legacy BAC and legacy ML on January 20, 2009. Resulting post-merger tangible common equity capital levels will also be reported well below expectations. Market reaction to these announcements could significantly impair BAC’s access to required funding sources and its ability to meet obligations going forward.
Supervisory History and Condition

Condition

BAC is the largest deposit holder in the U.S, with over 10 percent of insured domestic deposits. Despite this fact, the company must maintain access to the wholesale funding markets to ensure sufficient liquidity for daily operations. Market reaction to BAC’s fourth quarter 2008 results may disrupt available funding sources to the point that BAC is unable to meet its ongoing obligations. To date, BAC has been able to maintain sufficient access to unsecured funding markets and has selectively used the FDIC guarantee program to issue unsecured debt. However, staff anticipates that negative market reaction, as outlined above, could result in critical disruption of overnight unsecured funding and reluctance from counterparties to finance non-government collateral positions. This would result in heightened vulnerability to deposit runs, larger repo haircuts, increased margin requests, and reactionary draws on unfunded loan commitments.

Within BAC, ML’s reliance on secured funding markets is of particular concern, as it finances $144 billion in positions overnight of which approximately 50 percent is firm inventory. The following table identifies the current position of funding sources subject to market stress, potential funding requirements, and potential funding sources under various government programs. FDIC staff estimates that in the event of severe negative market reaction, BANA may, at a minimum, require heavy utilization of various government funding programs.
BAC’s capital position has also become strained with recent acquisitions and losses, particularly in terms of tangible common equity (TCE). While BAC’s regulatory capital ratios are considered adequate, tangible equity capital is low and presents market perception issues, as equity analysts, rating agencies, and counterparties have increased their focus on common tangible capital. Fourth quarter 2008 losses in conjunction with 2009 forecasted net operating losses of $3 billion will further strain the capital position and impair the ability to raise common equity. As indicated in the table below, tangible common equity will fall below 2 percent under all scenarios, except management’s forecast which is considered optimistic.

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3 BAC calculates the TCE ratio as Tangible Common Equity (without deducting MSR’s)/Total Tangible Assets.
The above regulatory base forecast utilizes BAC’s global recession scenario, which is considered realistic based on economic indicators. The regulatory base forecast provides for a net operating loss of $3 billion in 2009, with a $17.9 billion reserve build, and an $8.7 billion reduction in trading revenue that is consistent with 2008.

The 2009 earnings outlook for the BAC is not favorable. BAC management projects net income for the company on a combined basis of approximately $14.8 billion ($13.4 billion for legacy BAC and $1.4B for legacy ML). Given the current environment, FDIC and OCC supervisory staff believe management’s projection is very optimistic. Staff has developed an adjusted forecast showing a loss of $3.0 billion, based on higher loan losses and larger provisions to reflect continued deterioration in the credit portfolios, the lack of securitizations in 2009; and decreased trading results associated with continued market disruptions.

**Supervisory History**

The insured legal entities of BAC are shown in the table below, and the larger entities are discussed below.

<table>
<thead>
<tr>
<th>Insured Entities (9/30/2008)</th>
<th>Assets</th>
<th>Deposits</th>
<th>CAMELS</th>
<th>Exam Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of America, N.A.</td>
<td>1,359,071</td>
<td>846,231</td>
<td>222222/2</td>
<td>1/1/2007</td>
</tr>
<tr>
<td>FIA Card Services, N.A.</td>
<td>160,210</td>
<td>13,380</td>
<td>222222/2</td>
<td>1/1/2007</td>
</tr>
<tr>
<td>Countrywide Bank, FSB</td>
<td>112,947</td>
<td>55,370</td>
<td>343432/3</td>
<td>4/2/2007*</td>
</tr>
<tr>
<td>Merrill Lynch Bank USA</td>
<td>61,643</td>
<td>50,943</td>
<td>122211/2</td>
<td>3/19/07</td>
</tr>
<tr>
<td>Merrill Lynch Bank &amp; Trust Co.</td>
<td>35,846</td>
<td>22,703</td>
<td>223411/3</td>
<td>8/6/07</td>
</tr>
<tr>
<td>Bank of America, RI, N.A.</td>
<td>36,154</td>
<td>0</td>
<td>222222/2</td>
<td>1/1/2007</td>
</tr>
<tr>
<td>Bank of America California, N.A.</td>
<td>22,003</td>
<td>0</td>
<td>222222/2</td>
<td>1/1/2007</td>
</tr>
</tbody>
</table>
Bank of America, N.A. (BANA)

The OCC downgraded the Liquidity CAMELS component from "1" to "2" at year-end 2007 primarily due to challenging market conditions and the parent's payment of $21 billion in cash for LaSalle in the fourth quarter of 2007.  

<table>
<thead>
<tr>
<th>Bank of America, N.A.</th>
<th>1/1/07 OCC</th>
<th>1/1/06 OCC</th>
<th>1/1/05 OCC</th>
<th>1/1/04 OCC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UFIR</strong></td>
<td>2-2-2-2-2-2/2</td>
<td>1-2-2-1-1-2/2</td>
<td>1-2-2-1-1-2/2</td>
<td>1-2-2-1-1-2/2</td>
</tr>
<tr>
<td><strong>Classifications/T1+ALLL</strong></td>
<td>17%</td>
<td>8%</td>
<td>5%</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Enforcement Action</strong></td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$1,359,070,851</td>
<td>$1,312,794,218</td>
<td>$1,196,123,794</td>
<td>$1,082,250,290</td>
</tr>
<tr>
<td>Net Loans</td>
<td>$659,625,970</td>
<td>$669,368,439</td>
<td>$634,494,712</td>
<td>$547,121,048</td>
</tr>
<tr>
<td>Total Deposits</td>
<td>$846,230,545</td>
<td>$793,571,969</td>
<td>$759,600,625</td>
<td>$686,648,523</td>
</tr>
<tr>
<td>Tier 1 Leverage Ratio</td>
<td>6.01%</td>
<td>5.91%</td>
<td>6.60%</td>
<td>6.65%</td>
</tr>
<tr>
<td>Total Risk Based Capital Ratio</td>
<td>11.60%</td>
<td>10.94%</td>
<td>11.11%</td>
<td>10.62%</td>
</tr>
<tr>
<td>Brokered Deposits to Total Deposits</td>
<td>0.00%</td>
<td>0.01%</td>
<td>0.12%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

Countrywide Bank, FSB (CWB)

CWB is the largest mortgage lender in the country. It is also the largest mortgage servicer in the country with a $1.5 trillion portfolio. CWB’s parent, Countrywide Financial Corporation (CFC), has a distribution platform including over 1,000 offices (mostly mortgage origination offices operated by its non-bank affiliate Countrywide Home Loans) and over 50,000 employees. BAC acquired CFC and CWB on July 1, 2008. CFC significantly increased BAC’s exposure to poor performing non-traditional mortgages and home equity loans in high risk geographies. It has also increased reputation and litigation risks.

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4 The OCC operates under a continuous examination program at Bank of America. Examination dates reflect the annual examination start date. There have not been any interim ratings downgrades.
FIA Card Services, N.A. (FIA)

FIA is BAC's credit card bank. On-balance sheet loans represent approximately nine percent of BAC assets. FIA activities are mostly domestic, with foreign activities primarily in the United Kingdom and Canada, but also include Ireland and Spain to a lesser extent. Asset quality has deteriorated significantly due to the consumer led recession and the pace of deterioration has accelerated in recent months. Stressed portfolios include U.S. consumer cards (65 percent of the portfolio), unsecured consumer finance and small business cards. These portfolios have high charge-off rates which are expected to remain elevated into 2010. FIA historically relied heavily on the credit card securitization market for funding.

Merrill Lynch Bank, USA (MLBUS)A

MLBUS, an industrial bank chartered by the State of Utah, is a wholly-owned subsidiary of ML Group, Inc., which is wholly owned by the top tier parent, Merrill Lynch & Co., Inc. MLBUS provides a variety of commercial and consumer lending products to new and existing Merrill Lynch clients. Merrill Lynch & Co., Inc., through its subsidiaries and affiliates, provides investment banking and advisory services, wealth management, investment management, insurance, and other services on a global basis to individual and institutional investors.

Merrill Lynch Bank & Trust Company, FSB (MLBT)

MLBT is a wholly-owned subsidiary of ML Group, Inc., which, in turn, is owned by Merrill Lynch & Co., Inc. MLBT has traditionally been a residential mortgage lender and a
provider of trust services, but in 2006 the bank ventured into the subprime mortgage lending business with the purchase of First Franklin Mortgage, which was subsequently sold to a non-bank affiliate in September 2008 as a result of increasing losses.

Systemic Risk

The risk profile of BAC is increasing rapidly due to negative market perception resulting from poor performance, asset quality problems, and high-profile acquisitions. Liquidity pressures may increase to critical levels following the announcement of fourth quarter 2008 operating results that are significantly worse than market expectations.

Market reaction to BAC’s operating results may have systemic consequences given the size of the institution and the volume of counterparty transactions involved. Without a systemic risk determination and implementation of proposed measures outlined above, significant market disruption may ensue as counterparties lose confidence in BAC’s ability to fund ongoing operations. Staff believes the proposed assistance, as outlined above, will serve to mitigate this systemic risk. FDIC staff stress scenario estimates show that funding sources significantly vulnerable to market stress include overnight repos and counterparty collateral posting for trading activity, and that if the feared market reaction materializes, substantial support through government funding programs will be required to meet obligations.

Not providing open bank assistance to BAC would likely have major systemic effects. Both financial stability and overall economic conditions would be adversely affected for the reasons discussed above, and staff believes the consequences could extend to the broader
economy. Disruptions to global money and credit markets have already contributed to sharp
downturns among major coincident indicators of real economic activity. The U.S. economy
entered a recession in December 2007 that is already the longest since the 16-month recession
that ended in 1982. Payroll employment has declined each month in 2008; 2.6 million jobs were
eliminated last year, and over 1.5 million of those were lost in the fourth quarter. The
unemployment rate is now 7.2 percent, up 2.8 percentage points from its cyclical low in March
2007. Retail sales showed sharp declines each month of fourth quarter 2008. In December
2008, retail sales were 2.7 percent lower than in November 2008 and 9.8 percent below
December 2007. The Federal Reserve Board’s index of industrial production in November 2008
was 5.5 percent lower than in November 2007. These developments, among others, point to a
clear relationship between the financial market turmoil of recent months and impaired economic
performance that could be expected to worsen further if BAC and its insured subsidiaries were
allowed to fail. Such an event would significantly undermine business and consumer
confidence.

Conclusion

The FDIC is prohibited from taking action that could expose the deposit insurance fund
in a manner that could benefit debt or equity holders of a company without invocation of the
systemic risk exception available under the FDI Act.

The financial market disruptions of 2007 and 2008 have dramatically reshaped the
financial services sector. Although market spreads indicate that credit terms have moderated
since October 2008, credit markets remain highly stressed, and the improvement we have seen
thus far likely would not have occurred without government intervention. Declining to provide assistance to BAC could further damage financial markets. In creating the systemic risk exception, Congress clearly envisioned that circumstances could arise in which the exception should be used. In view of the current intense financial strains, as well as the likely consequences to the general economy and financial system of a failure to provide open bank assistance to the second-largest commercial bank in the United States, staff believes that circumstances such as Congress envisioned are clearly present. Without implementation of the proposed measures outlined above, significant market disruption may ensue as counterparties lose confidence in BAC’s ability to fund ongoing operations. Further, staff believes that implementation of the proposed measures will mitigate the serious adverse effects on economic conditions or financial stability that are likely to otherwise ensue. Accordingly, staff recommends invocation of the systemic risk exception.
RESOLUTION

WHEREAS, staff has presented information to the Board of Directors ("Board") of the Federal Deposit Insurance Corporation ("FDIC") indicating that the recent unprecedented disruption in credit markets and the resultant effects on the abilities of banks to fund themselves and to intermediate credit place the United States in danger of suffering adverse economic conditions and financial instability; and

WHEREAS, these conditions threaten the stability of a significant number of insured depository institutions, thereby increasing the potential for losses to the insurance fund in the resolutions of such insured depository institutions; and

WHEREAS, staff has advised the FDIC Board that Bank of America, National Association, Charlotte, North Carolina, Countrywide Bank, FSB, Alexandria, Virginia FIA Card Services, Wilmington, Delaware, Merrill Lynch Bank USA, Salt Lake City, Utah, Merrill Lynch Bank & Trust Co., FSB, New York, New York, Bank of America Oregon, National Association, Portland, Oregon Bank of America, Rhode Island, National Association, Providence, Rhode Island, Bank of America California, National Association, San Francisco, California, California ("Banks"). and their affiliates are in seriously weakened condition; and

WHEREAS, staff has advised that severe financial conditions exist which threaten the stability of the Banks which are insured depository institutions possessing significant financial resources; and

WHEREAS, a proposal for the stabilization of the Banks and their affiliates without the appointment of the FDIC as receiver has been developed in consultation with the Board of Governors of the Federal Reserve System ("Federal Reserve Board") and the Secretary of the Treasury ("Treasury") (collectively, the "USG"), which involves the USG provision of guarantees against loss on certain residential assets for 10 years and certain other assets for a period of 5 years; and
WHEREAS Bank of America Corporation ("BOA") will take a first loss position equal to $10 billion; and

WHEREAS for losses above $10 billion, there is a loss sharing agreement where losses are shared 10 percent by BOA and 90 percent by the USG with Treasury and the Corporation taking a second loss position up to $10 billion, with the Corporation taking a 25% share of such losses up to a maximum of $2.5 billion, and the Federal Reserve Board having agreed to take the remaining risk through non-recourse lending on the pool of assets ("Proposal"); and

WHEREAS the Corporation is receiving $1 billion in preferred stock as compensation for its taking the 25% participation in the second loss position; and

WHEREAS, the Proposal is subject to prudential regulatory oversight and executive compensation restrictions, with the guarantees having a limited duration, and staff believes that the Proposal will avoid or mitigate the serious adverse effects on economic conditions or financial stability is the most cost effective available method; and

WHEREAS, the Corporation and the Office of the Comptroller of the Currency, have determined that the bank meets the conditions under section 13 (c) 8(A)(i) and (ii) of the Federal Deposit Insurance Act ("FDI Act") for receiving direct financial assistance before the appointment of a receiver; and

WHEREAS, staff has recommended that the FDIC Board make a systemic risk recommendation supporting action or the provision of assistance by the FDIC as necessary to avoid or mitigate such risk; and

WHEREAS the Corporation has been advised that the Federal Reserve Board is expected to make a similar recommendation and that the Treasury, after consultation with the President, is expected to make the systemic risk determination in this situation.

NOW, THEREFORE, BE IT RESOLVED that the Board finds that the instability of the Banks would have serious adverse effects on economic conditions or financial
stability and would create systemic risk to the credit markets.

BE IT FURTHER RESOLVED, that the Board finds that severe financial conditions exist which threaten the stability of a significant number of insured depository institutions or of insured depository institutions possessing significant financial resources and the Banks are insured depository institutions under such threat of instability and that the Board takes this action in order to lessen the risk to the insurance fund posed by the Banks.

BE IT FURTHER RESOLVED that the Board finds that the recommended actions will mitigate the serious adverse effects, and systemic risks, posed by the Banks.

BE IT FURTHER RESOLVED, that the Board finds that the Proposal involves the provision of assistance or other action as authorized under section 13(c)(1) of the FDI Act, 12 U.S.C. § 1823(c)(1), in the form of guarantees against loss to, or contributions to, the Banks, and that the Proposal will mitigate the serious adverse effects on economic conditions or financial instability that would be caused by the Banks' continued seriously weakened condition.

BE IT FURTHER RESOLVED, the Board finds that the conditions for receiving direct financial assistance before the appointment of a receiver under section 13 (c) 8(A)(i) and (ii) of the FDI Act have been satisfied.

BE IT FURTHER RESOLVED, the Board hereby authorizes the Chairman, or her designee, to provide the written recommendation to the Secretary of the Treasury specified under section 13(C)4)(G)(i) of the Act, 12 U.S.C. § 1823(C)(4)(G)(i).

BE IT FURTHER RESOLVED, the Board hereby authorizes the Director, Division of Resolutions and Receiverships, or his designee, and all other FDIC staff to take all appropriate action to implement the provision of assistance or other actions authorized hereunder, including but not limited to: credit support in the form of loan guarantees, and loss sharing; and to take any other action necessary and appropriate in connection with this matter.