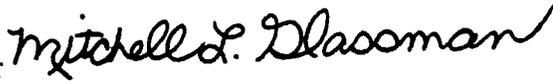
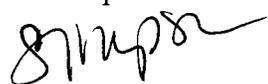


September 29, 2008

MEMORANDUM: The Board of Directors

THROUGH:

Mitchell L. Glassman, Director   
Division of Resolutions and Receiverships

Sandra L. Thompson, Director   
Division of Supervision and Consumer Protection

FROM:

James R. Wigand, Deputy Director   
Franchise and Asset Marketing Branch  
Division of Resolutions and Receiverships

Herbert J. Held, Assistant Director   
Franchise and Asset Marketing Branch  
Division of Resolutions and Receiverships

SUBJECT:

Wachovia Bank, National Association, Charlotte, North Carolina  
Wachovia Mortgage, FSB, North Las Vegas, Nevada  
Wachovia Bank, FSB, Houston, Texas  
Wachovia Bank of Delaware, National Association, Wilmington, DE  
Wachovia Card Services, National Association, Atlanta, Georgia

Wachovia Corporation (Bank Holding Company) Information  
(As of June 30, 2008):

Total Assets: \$781,883,478,000

Total Deposits (including Foreign): \$475,172,374,000

Uninsured Deposits: \$157,100,000,000

Foreign Deposits: \$53,170,000,000

Tier 1 Leverage/Total Risk Based (Lead Bank): 6.27%/11.58%

UFIR Rating (Lead Bank): 3-3-3-4-5-2/3 (9/28/08 Interim Downgrade)

Recommendation

Staff recommends that the Board find that the failure of Wachovia Corporation and its affiliate banks and thrifts would have serious adverse effects on economic conditions and financial stability. Its failure would seriously and negatively affect already disrupted credit markets, including

short-term interbank lending, counterparty relationships in Qualified Financial Contract markets, and bank senior and subordinated debt markets, and would further disrupt the related markets in derivative products and other markets. Staff recommends that the Board accept the bid of Citigroup, Inc., as the least costly available method of dealing with this systemic risk, and that the Board authorize staff to take all steps needed to implement this decision. Based on preliminary information, staff estimates no loss to the Deposit Insurance Fund.

### Executive Summary

Wachovia Bank, NA (Bank) is a nationally chartered bank founded in 1879 that is wholly owned by Wachovia Corporation, a financial holding company regulated by the Federal Reserve. The Bank is the fourth largest bank in the country and the predominant legal entity within Wachovia Corporation, representing 83 percent of consolidated holding company assets. The insured legal entities of Wachovia Corporation consist of three national banks and two Federal savings banks. Other significant holding company subsidiaries include Wachovia Capital Markets, LLC, and Wachovia Securities, LLC. The Bank operates approximately 3,400 banking centers in 21 states, primarily along the eastern and gulf coasts and in California, and engages in foreign activities. The risk profile of the Bank is declining rapidly because of deteriorating liquidity and poor quality assets. Liquidity has reached crisis proportions, such that the Bank is unable to meet its obligations. Most recently, on Friday, September 26, 2008, the Bank was unable to roll \$1.1 billion of its asset backed commercial paper. More short term obligations are due this week that the Bank will likely be unable to pay and there are an estimated \$157.1 billion in uninsured deposits.

The company's rapidly deteriorating financial condition is due largely to its portfolio of pay-option ARM products, commercial real estate portfolio, and weakened liquidity position. On Friday September 26, 2008, market acceptance of Wachovia liabilities ceased as the company's stock plunged, credit default swap spreads widened in excess of 1,400 points (to over 2,000 points), some parties declined to advance the Bank overnight funds, and counterparties advised that they would require greater collateralization on any transactions with the Bank.

Citigroup, Inc., and Wells Fargo performed due diligence in an attempt to acquire the Banks in a private transaction; however, neither were able to reach definitive agreements. The FDIC entered into negotiations with Citigroup and Wells Fargo on September 28, 2008. Both Banks submitted open bank assistance bids to the FDIC on September 28, 2008; however, only the Citigroup proposal resulted in serious negotiations.

Based on the analysis of Citigroup's proposal, staff recommends accepting the Citigroup, Inc. bid to resolve the five insured depository institutions and to resolve the systemic risk posed by a possible failure of Wachovia Corporation and its affiliate banks and thrifts.

### Supervisory History and Condition

#### *Condition*

Unless the Bank immediately attracts a merger partner, the FDIC and other regulators project that the Bank will likely be unable to pay obligations or meet expected deposit outflows.

The FDIC and the OCC anticipate a number of funding outflows during the week beginning September 29, 2008. Near-term funding outflows include:

- Maturing asset-backed commercial paper, which is not expected to be placed with external parties and, therefore, will need to be funded by the Bank;
- Maturing repurchase agreements, which are not expected to be placed with external parties and, therefore, will need to be funded by the Bank;
- Maturing Variable Rate Demand Notes supported by liquidity facilities/letters of credit issued by the Bank which are not expected to be placed and will be put to the Bank;
- The loss of overnight sweep deposit representing large commercial deposits;
- The loss of a substantial portion of money swept from retail brokerage accounts maintained with affiliated entities; and
- An assumed 1.5 percent daily deposit run-off, which is based on recent experience by other large insured institutions experiencing extreme stress.

<b>Wachovia Bank, N.A. Liquidity Analysis</b>		<b>9/26/08</b>
(\$BN)		
Overnight FFS		8.0
Federal Reserve		2.6
T-Bills & Term CP		10.0
Less: Overnight FFP		-3.5
<b>Cash Equivalents</b>		<b>17.1</b>
Discount Window (Post Haircut)		52.0
Unpledged Securities (Pre-Haircut)		29.0
FHLB		5.0
<b>Available Sources</b>		<b>86.0</b>
<b>Total Cash Equivalents &amp; Sources</b>		<b>103.1</b>

<b>FDIC Stress Scenario (\$BN)</b>		<b>10/7/08</b>
<b>Total Cash Equivalents &amp; Sources</b>		<b>103.1</b>
<b>Less: Actual Maturity &amp; Stress</b>		
1. 1.5% Daily Deposit Outflow		-42.0
2. Corporate Sweeps 100% outflow		-12.0
3. Retail Brokerage Outflow		-30.0
4. VRDN Maturity & Stress		-15.8
5. Maturing Debt		-9.7
6. ABCP (VFCC) Maturity		-3.3
7. Maturing Repo Agreements		-2.7
		<b>-12.4</b>

Potentially available funding sources considered in the above analysis include \$17 billion in liquid assets, \$52 billion of “after-haircut” borrowing capacity based on collateral already posted with the Federal Reserve, \$29 billion in unencumbered securities, and \$5 billion of available funding from the Federal Home Loan Bank. Additional eligible collateral for pledging totals \$117 billion and is comprised of \$97 billion in commercial loans and \$20 billion in consumer loans that are not pay option ARMs.

Uninsured deposits are reported at \$157.1 billion as of June 30, 2008, with \$76 billion comprised of corporate, non-time deposits that are considered highly sensitive. This could result in deposit outflows greater than the 1.5 percent daily withdrawals included in the FDIC stress scenario depicted above.

*Supervisory History*

The insured legal entities of Wachovia Corporation are shown in the table below.

Entities (6/30/08)	Assets	Deposits	CAMELS	Exam Date
Wachovia Bank, N.A.	670,639	450,929	2-3-3-3-2-2/3 <sup>(a)</sup>	6/30/08
Wachovia Mortgage, FSB	76,795	18,009	3-3-2-4-2-1/3	4/30/08 Offsite
Wachovia Bank, FSB	27,992	2,809	3-3-2-4-2-1/3	4/30/08 Offsite
Wachovia Card Services, N.A.	2,224	0	2-2-2-2-2-2/2	6/30/08
Wachovia Bank of Delaware, N.A.	4,814	4,175	2-2-2-2-2-2/2	6/30/08

(a) 9/28/08 - OCC downgraded Capital to a 3, Earnings to a 4, and Liquidity to a 5

**Wachovia Bank, NA**

The Bank is subject to a continuous examination program by the Office of the Comptroller of the Currency (OCC). The June 30, 2008, OCC examination of the Bank resulted in a composite rating downgrade to a “3.” The following table displays the Bank’s historical examination and financial data:

<b>Wachovia Bank, N.A.</b>	<b>6/30/08 OCC</b>	<b>6/30/07 OCC</b>	<b>6/30/06 OCC</b>	<b>6/30/05 OCC</b>
<b>UFIR</b>	2-3-3-3-2-2/3 <sup>(a)</sup>	2-2-2-2-1-2/2	2-2-2-2-1-2/2	2-2-2-2-1-2/2
<b>Classifications/T1+ALLL</b>	33%	9%	10%	13%
<b>Enforcement Action</b>	MOU	None	None	None
<b>Financial Data</b>	<b>6/30/2008</b>	<b>12/31/2007</b>	<b>12/31/2006</b>	<b>12/31/2005</b>
<b>Total Assets</b>	\$670,639,000	\$653,269,000	\$518,123,000	\$472,143,000
<b>Total Loans</b>	\$413,994,000	\$413,349,000	\$302,764,000	\$262,173,000
<b>Total Deposits</b>	\$450,929,000	\$458,186,000	\$353,234,000	\$33,780,000
<b>Tier 1 Leverage Ratio</b>	6.27%	6.71%	6.66%	6.26%
<b>Total Risk Based Capital Ratio</b>	11.58%	11.45%	10.90%	10.70%
<b>Option ARM's/Tier 1+ALLL</b>	138%	146%	0%	0%
<b>Brokered Deposits to Total Deposits</b>	10.98%	8.97%	10.20%	11.48%

(a) 9/28/08 - OCC downgraded Capital to a 3, Earnings to a 4, and Liquidity to a 5

The Bank operates under a Memorandum of Understanding issued in August 2008 that addresses weaknesses cited in the most recent OCC report of examination.

On October 12, 2007, the Bank acquired from Wachovia Mortgage FSB and Wachovia Bank FSB (formerly World Savings Bank FSB and World Savings Bank Texas FSB, respectively) all of those institutions' retail deposits totaling \$76 billion. The Bank also acquired almost \$90 billion dollars in assets, including approximately \$65 billion in pay-option ARM mortgage loans. The pay-option ARM portfolio is concentrated in the California and Florida markets, which represent approximately 60 percent and 10 percent of the total portfolio, respectively. Since the loans were transferred, significant declines in home prices, combined with the effects of previously lax collateral-based underwriting by the World Savings Bank entities, led to serious deterioration in the pay-option ARM portfolio; rising nonperforming loan levels and the need for considerable provisions to the allowance for loan and lease losses resulted in quarterly losses. During the week of September 22, 2008, the Bank increased its cumulative loss estimates for the pay option ARM portfolio from 12 percent to 20 percent. The pay-option portfolio represents approximately 138 percent of capital and reserves.

The Bank's former chief executive officer, Ken Thompson, was removed on June 2, 2008, and Robert Steel was selected as his replacement on July 9, 2008. The Bank's chief financial officer and chief risk officer were also subsequently replaced. These actions to replace senior management failed to dispel market concerns regarding the Bank's condition.

### **Wachovia Mortgage FSB and Wachovia Bank FSB**

The two thrifts retain almost \$70 billion in residential mortgage exposure, which consists almost entirely of pay option ARMs sharing the same risk characteristics as the pay-option ARM portfolio in the Bank. During the first and second quarters of 2008, both thrifts required substantial capital contributions from Wachovia Corporation in order to maintain capital ratios at satisfactory levels.

### **Wachovia Bank of Delaware NA and Wachovia Card Services**

Wachovia Bank of Delaware NA represents a more traditional institution with no pay-option ARM exposure. Likewise, Wachovia Card Services is a recently formed credit card lending operation.

### **Marketing**

An electronic data room was established by the Banks for potential buyers to perform due diligence. No proposals were accepted.

On September 28, 2008, FDIC staff began discussions with Citigroup and Wells Fargo, both of which submitted bids to the FDIC on the same day. Both bids sought open bank assistance from the FDIC. The Wells Fargo bid requires that the FDIC cover potential losses on a pool up to \$127.3 billion in assets (includes \$80.7 billion funded). Wells Fargo assumes the first \$2 billion in losses on the pool of assets, following which the FDIC will share in the losses at the rate of 80 percent. Wells Fargo proposed that total FDIC loss exposure be capped at \$20 billion. Staff estimated this proposal would cost the FDIC between \$5.6 <sup>billion</sup> ~~million~~ to \$7.2 billion. \*

The Citigroup bid requests that the FDIC provide loss sharing on a \$312 billion pool of assets. Losses would be shared as follows: (i) the first \$30.0 billion of losses in the pool, Citigroup assumes 100 percent, and (ii) Citigroup assumes \$4 billion a year of losses for three years. Additionally, FDIC will receive face value of \$12 billion in preferred stock and warrants.

Wachovia Corporation submitted an open bank assistance proposal. Approximately \$200 billion of the Bank's loans would receive FDIC credit protection, of which the Bank would provide \$25 billion of first loss protection. In return, Wachovia would issue to FDIC, \$10 billion of preferred stock and warrants on common shares.

Considering current market conditions, staff estimates the Citigroup transaction could result in aggregate losses ranging from approximately \$35 to \$52 billion. However, based upon the terms of the Citigroup proposal, these losses would be absorbed by Citigroup and result in no loss to the Deposit Insurance Fund.

All proposals submitted required some form of regulatory capital relief from their primary federal regulators.

### Systemic Risk

Given the forecasted size of the losses at Wachovia Bank NA, it appears likely that any transaction effected by the FDIC under a least-cost framework would require the FDIC to impose significant losses on the Bank's subordinated debt-holders and, possibly, senior note holders. In addition, absent invocation of the systemic risk exception available under the FDI Act, the FDIC is prohibited from using deposit insurance funds to benefit senior or secured debt-holders of a company.

However, staff believes that a least-cost resolution of Wachovia Bank NA would have significant adverse effects on economic conditions and the financial markets. Term funding markets have been under considerable stress for more than a year, and these pressures have increased greatly following the failure of Lehman Brothers, the difficulties at AIG, and the closing of Washington Mutual. LIBOR rates have increased more than 100 basis points since early September; commercial paper rates have also risen dramatically, and the volume of financial paper outstanding has declined sharply. In both of these markets, the maturity of new issues has shortened a great deal as investors have become much less willing to lend beyond overnight. Concerns about actual and potential losses on financial institutions' obligations have caused outflows from prime money market mutual funds totaling nearly \$400 billion over the past two weeks. Since these funds are normally substantial purchasers of commercial paper and short-term bank obligations, these outflows have added to the pressures in those markets. More

generally, investors appear to have become more concerned about the outlook of a number of U.S. banking organizations, putting downward pressure on their stock prices and upward pressure on their collateralized debt security spreads.

In this environment, a least-cost resolution of Wachovia Bank NA with no assistance to creditors and the potential for meaningful losses imposed on the Bank's debt would be expected to have significant systemic consequences. A default by Wachovia Corporation and a partial payout to debtors of Wachovia Bank NA would intensify liquidity pressures on other U.S. banks, which are extremely vulnerable to a loss of confidence by wholesale suppliers of funds. Investors would likely be concerned about direct exposures of other financial firms to Wachovia Corporation or Wachovia Bank NA. Furthermore, the failure of Wachovia Corporation would lead investors to doubt the financial strength of other institutions that might be seen as similarly situated. Wachovia's sudden failure could also lead investors to reassess the risk in U.S. commercial banks more broadly, particularly given the current fragility of financial markets generally and the term funding markets for financial institutions.

In addition, if a least-cost resolution did not support foreign depositors (who are considered non-deposit, general creditors under the FDI Act); the resolution could imperil this significant source of funding for other U.S. financial institutions. More generally, given Wachovia's international presence, global liquidity pressures could increase and confidence in the dollar could decline. Further, losses on Wachovia Corporation and Wachovia Bank NA paper could lead more money market mutual funds to "break the buck," accelerating runs on those and other money funds. The resulting liquidations of fund assets, along with the further

loss of confidence in financial institutions, might well lead short-term funding markets to virtually cease. Moreover, the individuals and businesses whose deposits have been swept into non-deposit investments or foreign deposits (e.g., at a Cayman branch) would find all or part of their funds unavailable and likely face losses. In the current environment, such an event could shake the public's confidence in bank deposits. All of these effects would likely cause investors to sharply raise their assessment of the risks of investing in similar (albeit smaller) regional banks, making it much less likely that those institutions would be able to raise capital and other funding.

Staff believes the consequences of a least-cost resolution could extend to the broader economy. The financial turmoil that could result from a least-cost resolution of Wachovia Bank NA and the likely consequent failure of Wachovia Corporation would further undermine business and household confidence. In addition, with the liquidity of banking organizations further reduced and their funding costs increased, banking organizations would become even less willing to lend to businesses and households. These effects would contribute to weaker economic performance, further damage financial markets, and have other material negative effects.

### *Conclusion*

Staff believes that the imposition of a least-cost resolution on Wachovia would almost surely have major systemic effects. Both financial stability and overall economic conditions would likely be adversely affected for the reasons discussed above. A resolution that protects all

depository institution and holding company creditors would best mitigate the adverse effects of the failure on the financial markets and the broader economy.

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 least-cost resolution of the fourth-largest commercial bank in the United States, staff believes that circumstances such as Congress envisioned are clearly present and that invocation of the systemic risk exception is justified. Staff further believes that the Citigroup proposal represents the least cost alternative available for dealing with this systemic risk.

#### Other Information

If you have any questions concerning this case, please call Herbert Held at extension 8-7329, or Sharon Yore at extension 8-7336.

This recommendation is prepared by:



Sharon Yore  
Franchise and Asset Marketing  
DRR - Washington

This recommendation is supported by:

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George French  
Deputy Director, DSC



Sara A. Kelsey  
General Counsel

## RESOLUTION - Citibank

WHEREAS, staff has advised the Board of Directors (“Board”) of the Federal Deposit Insurance Corporation (“FDIC”) that Wachovia Bank, National Association, Charlotte, North Carolina, Wachovia Mortgage, FSB, North Las Vegas, Nevada, Wachovia Bank of Delaware, National Association, Wilmington, Delaware, Wachovia Bank, FSB, Houston, Texas, and Wachovia Card Services, National Association, Atlanta Georgia (“Banks”), are in danger of default; and

WHEREAS, the Division of Resolutions and Receiverships (“DRR”) has solicited bids from financial institutions for the resolution of the Banks; and

WHEREAS, DRR has received no closed bank proposals for the resolution of the Banks from other financial institutions; and

WHEREAS, a proposal for the resolution of the Banks without the appointment of the FDIC as receiver has been received from Citigroup, Inc., New York, New York (“Citi”), which involves the merger or consolidation of the Banks with another insured depository institution or the sale of any or all of the assets of the Banks or the assumption of any or all of the Banks’ liabilities by another insured depository institution, or the acquisition of the stock of the Banks, any of which would benefit the shareholders of the Banks and except under limited circumstances is precluded by Section 11(a) (4)(C) of the Federal Deposit Insurance Act, as amended (“Act”), 12 U.S.C. 1821(a) (4)(C); and

WHEREAS, the Board has been advised that the Citi bid will be less costly than the other bid received and that it represents the least costly of the available methods of resolving the systemic risks presented by the failure of the Banks; and

WHEREAS, staff has presented to the Board information indicating the liquidation of the Banks under Section 11 of the Act, 12 U.S.C. 1821, would have serious adverse effects on economic conditions or financial stability; and

WHEREAS, staff has advised that assistance to the Banks under Section 13(c) of the Act, 12 USC 1823(c)(1), without the appointment of the FDIC as receiver will avoid or mitigate the serious adverse effects on economic conditions or financial stability; and

WHEREAS, staff has advised 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.

NOW, THEREFORE, BE IT RESOLVED, that by the vote of at least two-thirds of the members of the Board, the Board finds that the liquidation of the Banks, as well as the likely consequent failure of Wachovia Corporation, 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 by the vote of at least two-thirds of the members of the Board, the Board finds that the proposal received from Citi which involves the merger or consolidation of the Banks with another insured depository institution or the sale of any or all of the assets of the Banks or the assumption of any or all of the Banks' liabilities by another insured depository institution, or the acquisition of the stock of the Banks and which requires the provision of assistance under Section 13(c)(2) of the Act, 12 USC 1823(c)(2), in the form of loans to, deposits in, the purchase of assets or securities of, the assumption of liabilities of, guarantees against loss to, or contributions to, the Banks or their acquiror will mitigate the serious adverse effects on economic conditions or financial stability that would be caused by the Banks' failure.

BE IT FURTHER RESOLVED, 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 Corporation, and systemic risks, posed by the Banks, and that the proposal by Citi will do so in the least costly of all available methods..

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 USC 1823(c)(4)(G)(i).

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