From:	Cox, Richard L.
To:	Corston, John H.; Hoyer, Brent D.
Subject:	FW: Funding Vulnerabilities Memo
Date:	Sunday, January 11, 2009 11:49:02 AM
Attachments:	1.11.09 FRB and OCC BAC Funding Vulnerabilities memo.doc

I have not read yet. Printing now to do so.

Rick
704 548-1950, ext. 4217 - Charlotte Field Office
704 819-6266 Cell

From: Jennifer.Burns@rich.frb.org [mailto:Jennifer.Burns@rich.frb.org]
Sent: Sunday, January 11, 2009 11:37 AM
To: Cox, Richard L.; morris.morgan@occ.treas.gov
Cc: Lisa.A.White@rich.frb.org
Subject: Funding Vulnerabilities Memo

Rick,

As promised please see the attached memo on BAC's funding vulernabilities and potential implications for other market participants. Thanks!

Jennifer

Jennifer Joseph Burns
Banking Supervision and Regulation
The Federal Reserve Bank of Richmond, Charlotte Branch
Office 704· 358· 2550 · Cell 704· 287· 2813
jennifer.burns@rich.frb.org
www.richmondfed.org

THE FEDERAL RESERVE BANK OF RICHMOND
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Date: January 10, 2009

To: Rick Cox, FDIC

From: FRB and OCC Staff

Subject: Bank of America Corporation (BAC) Funding Vulnerabilities and Implications for Other Financial Market Participants.

Although the reputation of global banking organizations has been tarnished during the current market crisis, BAC's name is currently held in high esteem among market participants and consumers. BAC's potential fall from grace could shake market and consumer confidence in financial institutions, resulting in spill over effects that could include deposit runs on perceived weaker institutions, dislocation in the slowly improving term markets, a continued frozen unsecured funding market, reluctance to finance all but the most pristine collateral positions, increased margin requirements for secured and derivative counterparties, reactionary draws on unfunded loan commitments, and a disruption in global payment systems.

(in millions)	**Overnight**	**Total**
Deposits		$980,000
Unsecured		
Federal Funds	$68,107	$97,384
Long-term Debt	$4	$362,233
Other	$14,577	$120,891
Secured		
GC Repo	$309,030	$439,724
Non-GC Repo	$74,842	$130,957
FHLB	$500	$92,106
ABCP	$13,870	$59,464

The firm is the largest deposit holder in the United States. As of December 31, 2008, legacy BAC reported $883 billion of deposits, with ML adding an additional $97 billion. Deposits include $193 billion of consumer time deposits, $125 billion of personal checking balances, and $106 billion of personal money market savings. The amount of retail and corporate deposits greater than $250,000 is $93 billion. At recent stressed institutions, deposit run off was particularly seen in commercial MMDAs and sweep deposit accounts. As of year-end, legacy BAC and ML held approximately $48 billion ($32 billion in business MMDAs) and $64 billion, respectively (all sweep). In addition, BAC has identified $4 billion in deposits collateralizing RESI (on-balance sheet synthetic securitizations) transactions that will be withdrawn if their short-term senior unsecured debt rating drops below A1/P1/FI, or their long-term senior unsecured debt rating drops below A/A2/A by S&P, Moody's and Fitch, respectively.

BAC's long tem debt is $453 billion, with 18 percent maturing in 2009 and a further 16 percent maturing before the end of 2010. BAC's largest immediate unsecured funding exposure is overnight Federal Funds and Eurodollars purchased. As of January 8, 2009, BAC had a Federal Funds and Eurodollars purchased position of $68 billion. Recently, the institution has been a large net taker of funds, mostly, to take advantage of the spread between price and interest paid on its Federal Reserve account. Staff thinks the overnight unsecured position is one the most vulnerable funding positions at the company. This is critical because the Federal Funds position effectively funds the institution's cash position of $67 billion. If fund providers back away from BAC, it would significantly reduce the institution's liquid asset buffer and result in early dependence on contingent liquidity sources. Furthermore, it is likely that other financial institutions could experience similar constraints based on the perception of more wide spread industry issues given BAC's strong reputation.

BAC's largest secured funding source is repo and securities lending. BAC is also the largest user of tri-party repo funding through BONY that could result in significant systemic risk. The potential exists for the tri-party repo market to become frozen due to reluctance of counterparties to finance positions. Repo and securities lending totaled $571 billion, with $384 billion or 67 percent rolled overnight. The quality of the repo and securities lending collateral is generally good with $440 billion consisting of Treasury and agency collateral. This collateral class is less vulnerable to counterparties pulling away, but could result in additional haircuts which currently are 0-2 percent for

Treasuries and 3-5 percent for agency pass-through securities. The remaining repo and securities lending collateral is more vulnerable to investors pulling away or requiring higher haircuts and consist of $83 billion in investment grade bonds, $22 billion of liquid equities, and $26 billion of other collateral. Management reported illiquid repo collateral totaling $50 billion, which is most vulnerable to funding difficulties. The company's current unencumbered investment collateral totaled $85 billion, which consist mostly of agency MBS.

The banking organizations representing the largest fund providers to BAC are shown in Table 1 on page 9.

The company also utilizes FHLB funding to finance longer-term assets. At year-end, the company's FHLB funding totaled $92 billion. Generally, the majority of this funding is relatively short with $11 billion maturing within 1-month and $41 billion maturing within 1-year. This funding source is less vulnerable, and the company reports $77 billion of available loan collateral that could be pledged to the FHLBs for funding.

Legacy BAC has been a substantial user of government related liquidity programs. Utilizing three depository subsidiaries, legacy BAC has accessed the TAF in varying amount since September 2008. The current outstanding balance is $55 billion, with $30 billion maturing in January, and $25 billion maturing in March. In addition, the institution will be bidding for $20 billion in the 28-day auction on January 12th. The discount window capacity is $106 billion. While Banc of America Securities LLC has reduced its usage of the PDCF and TSLF to zero, ML entities still use these programs for a combined amount of $21 billion. In terms of unsecured funding, legacy BAC has issued $15 billion to the CPFF which matures in January. More recently, the institution has issued $20 billion in 2- to 3½-year medium term notes guaranteed under the TLGP, with 108 billion of additional capacity.

BAC has a variety of contingent liquidity exposures that could be a drain on the liquidity position. Adverse market perception could result in draws on commitments and investors pulling out of ABCP programs. BAC has $1.3 trillion in unfunded loan commitments, of which $827 billion are credit card commitments for which normal funding through the securitization market is no longer available. BAC has $338 billion is unfunded commercial loan commitments which includes $1 billion in unfunded leverage loans that are expected to fund in January. BAC has ABCP with a committed balance of $89 billion and a current outstanding balance of $54 billion, of which at least $5 billion is currently not eligible for the CPFF, and the remaining amount would also become ineligible for the CPFF if the company is downgraded below A-1/P-1.

BAC is a major player in a wide range of derivative markets, both as a counterparty to OTC trades and as a broker. Adverse market perception could result in several actions that could impact BAC's market-making ability. Specifically, BAC may have difficulty entering into uncollateralized trading positions, thereby losing access to the dealer market. In addition, similar to the reaction legacy BAC had to other troubled firms, dealers may only want to enter into trades with BAC that reduce the dealer's counterparty exposure to these entities. These actions could make it difficult for BAC to enter into transactions to meet client needs and hedge the company's own risk exposures. In addition, the combination of legacy BAC and ML has effectively resulted in reducing the number of market-makers. Therefore, if BAC's market-making abilities are impaired this could result in a broader systemic risk to the market-place.

Adverse perception in the market-place could lead to counterparties wanting to renegotiate credit support agreements on derivative transactions in order to increase collateral margin requirements. On January 9, 2009, BAC had approximately $121 billion in collateral posted with $154 billion received related to derivatives trading. A 1-notch downgrade in rating would result in a contractual increase in collateral posting by $10 billion, with an additional $3 billion for a 2-notch downgrade. However, as previously mentioned adverse market perception could result in renegotiations that would increase collateral requirements.

Legacy BAC is a significant participant in U.S. payment and securities settlement systems as well as in several foreign payment systems. For example, legacy BAC settles significant values over both CHIPS and Fedwire.[1] It is a direct participant and settles foreign exchange transactions through CLS. Legacy BAC is also a direct participant in the Depository Trust Company (DTC), the Fixed Income Clearing Corporation (FICC), and the National Securities Clearing Corporation (NSCC) and participates in derivatives clearing activity.

Under the *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System*, legacy BAC is a significant market participant in three of the five critical financial markets (wholesale payments, foreign exchange, and U.S. government and agency securities), and ML is a significant market participant in a fourth market (corporate and municipal securities).[2] An inability of these organizations to fulfill their obligations in these markets and the related systems would lead to widespread disruptions in payment and settlement systems in the U.S. as well as abroad.

Significant in Critical Financial Market					
FIRM	**WHOLESALE PAYMENTS[3]**	**FOREIGN EXCHANGE**	**COMMERCIAL PAPER**	**CORPORATE SECURITIES**	**U.S. GOV'T & AGENCY SECURITIES[4]**
Bank of America	✓	✓			✓
Merrill Lynch				✓	

[1] In 2005, legacy BAC was among the top five participants in both CHIPS and Fedwire, as measured by the dollar value of transfers.
[2] The last update to the market-share data used to determine which firms are "significant" was in 2005.
[3] Federal funds activity and other overnight funding transactions depend on wholesale payment systems for settlement. As such, disruptions in wholesale payment systems can have significant implications for the supply of and demand for overnight funds. Because of this dependency and the fact that reliable information on the Fed Funds market is limited, the agencies do not identify key Fed Funds participants separately from key wholesale payments participants. The agencies view firms with at least five percent of the combined total dollar value of transfers over the Fedwire funds service and CHIPS as significant in wholesale payments.
[4] The U.S. government and agency securities market includes U.S. government bills, notes, bonds, and agency securities, including mortgage-backed securities issued by government-sponsored enterprises, as well as repurchase and reverse repurchase agreements and tri-party repurchase agreements involving U.S. government and agency securities.

Legacy BAC is a significant automated clearing house (ACH) participant within the debit and credit retail payments channel. According to the most recent data, legacy BAC's more than 2.8 trillion ACH items processed placed them second in transaction volume among all U.S. banks.[5]

[5] 2007 NACHA, Electronic Payment Associate Facts and Statistics

Table 1

Banking Organizations Providing Funding/Exposures to Bank of America

Banking Organizations	Funding/Exposures Provided In Billions
Bank of New York	$46.1
State Street	$45.3
JPM Chase	$41.6
Fidelity Investments	$27.8
Citibank	$24.5
Northern Trust Corp	$24.3
Blackrock	$20.9
JP Morgan Asset Mgmt	$18.0
Goldman Sachs Asset Management	$18.0
PIMCO	$16.4
Barclays Global Investors	$14.6
Wells Capital Management	$13.3
Deutsche/BT	$12.8
Bank of New York Mellon Asset Mgmt	$11.6
HSBC	$11.4
BNP Paribas	$11.2
Goldman Sachs Capital Markets	$10.8
Charles Schwab Corporation	$10.4
Bank of International Settlements	$9.1
Mellon Financial Corporation	$8.4
Dresdner Bank AG	$8.4
Federated	$7.8
Mizuho Corporate Bank LTD	$6.6
Goldman Sachs International	$5.8
Barclays Bank PLC	$5.6
Total Consolidated Top 25	**$430.7 ***

* Total difference from BAC source is caused by rounding. BAC also provides funding/exposures to the above counterparties totaling $67.6B.