From:	
To:	Deborah P Bailey
Cc:	Donald L Kohn; Kevin Warsh; Michelle A Smith; Randall S Kroszner; Rita C Proctor; Roger Cole; Scott Alvarez
Subject:	Re: status
Date:	12/21/2008 10:03 AM
Encrypted	

Thanks. I think the threat to use the MAC is a bargaining chip,.and we do not see it as a very likely scenario at all. Nevertheless, we need some analysis of that scenario so that we can explain to BAC with some confidence why we think it would be a foolish move and why the regulators will not condone it.

My current thinking is that we should have a regulator call without treasury (including though occ and fdic) to work out our joint position. We then need a second call, perhaps with fewer staff than the first, to discuss the findings and implications with Treasury. That all has to happen today, so anything we can do to move the regulators call up a bit would probably be helpful. Depending on how that goes, it might be principals only calling Lewis tonight or tomorrow morning.

I talked to Lacker yesterday but have not spoken to Lewis since the call on Friday.

12/17/08

Ken Lewis
Joe Price
Moynihan

BA

Ken Lewis - consumer credit deteriorating rapidly
- 5 day delinq + 30 day delinquency in cards
[- 2.5b reserve addition]

- after tax loss abt [$1.4b] 4Q
w/ [2b] added preffered

[4.4b] profit for year

[9.20] Tier 2
[2.60] Tangible common to total (outlier, not lowest)

- ML : orig forecast breakeven 4Q
↳ in last month losses grown
↳ 3.5b to 5b → 12.5b]
[pretax, abt 18b losses

↳ abt 50% tangible equity

[- Tier 1 8.6 > proforma
Tang/total 2.2]

BA believes destroyed some ability to earn
+ material adverse change

KL: inclination to call MAC clause
↳ big litigation

(2)

JPrice - source of deterioration at ML

Predecessor
- core items incurred abt 3.5 b loss
↳ proprietary trading losses
↳ some subordinated tranches
↳ core rates/currency business
not enough positive offset

- asset management bus down

- private equity writedown abt $2 b

- correlation books

↳ unusual losses based on mkt movements
make up most of losses

↳ standalone loss abt $12.5 b loss after-tax

- aggressive marks at yearend
& as part of deal?
↳ don't believe so

- have discussed #s w/ Thane

- most jumps late Friday & BA
analyzed over weekend

BB - isn't it bigger risk to trigger MAE clause
than to acquire co?
KL - tough call, big risk
worried abt cap ratio & stk price

(3)

HP: at start of deal, BA concerned
that ML would try to
wiggle out of deal
↳ HP assured wld not
↳ extraordinary now BA trying
to get out.

KL: started w/ expectation of flat 4Q,
now slid to expectation of
$12.5b ~~pt~~ after tax loss for 4Q

↳ plan to talk to bd of dir
then Thane by end of week

BB: - expose system to risk 2 ways
- ML
- BA

- TARP pretty fully committed

- best thing from system point
of view to go forward

+ then can address next year
if needed b/c no $ available

KL: "Citi" guarantee
↳ cap losses

total $60
at current
marks

mondine CDS	50b
investment port	13b
correlation book	18b
principal investmt	11b
asset type lending	

Leveraged finance bus	3b
comm'l RE	5b
CDO	16
RM (non Ldo)	3.5

(4)

BA book
leveraged loans
CMB
correlation book
CDOs

KL
- not asking for any help at BA

BB: downside of the $50 b doesn't sound
big for BA

HP: key to Citi was tail risk
beyond expected risk
w/ preferred stk as payment

KL: problem is lack of common at ML
given losses

HP: how'd this happen?
- ML CFO seemed to have
good handle on risk

BB: need to consider effect on BA
+ see effect on jt co + visibility

- big problem for mkts +
both co of not doing deal

KL: excited abt strategic potential
over time

5

HP: pause while analyze

KL: agree to wait

could move closing date
but bad effects

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
(DRAFT)

Date: January 10, 2009

To:

From:

Subject: Considerations regarding invoking the systemic risk exception for Bank of America Corporation

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Background

Bank of America Corporation[1] ("BAC"), a financial holding company headquartered in Charlotte, NC, is the largest domestic banking institution by asset size, providing commercial and retail banking services and other financial services in the United States and internationally. The company is a dominant provider of deposit and credit products to the U.S. consumer sector, with a particular emphasis on the residential mortgage market. On January 1, 2009, the corporation acquired Merrill Lynch & Co (ML), establishing one of the world's largest wealth management businesses with more than $2 trillion in client assets. Following the combination with Merrill Lynch, Bank of America has become the largest brokerage in the world, with more than 20,000 advisors and $2.5 trillion in client assets and a global leader in wealth management, private banking and retail brokerage with approximately 50 percent ownership in BlackRock, which has $1.4 trillion in assets under management, in addition to the $589 billion in assets under management with Bank of America as of June 30, 2008

At December 31, 2008[2], BAC had assets of $1.82 trillion, including $931 billion in loans and leases. At year end, the tier 1 risk-based capital ratio was 8.97%, and the

[1] Bank of America Corporation or BAC refers to the combined entity resulting from the Bank of America acquisition of Merrill Lynch & CO.
[2] Figures in this paragraph are estimates as the 12/31/08 reporting has not yet been finalized.

tangible common equity ratio[3] was 2.83%. Following the addition of ML, the equivalent proforma capital ratios are 8.52% and 2.55%, respectively.

[3] Calculated as tangible common equity to tangible assets with MSRs included in both the numerator and denominator

Recent difficulties

Beginning in the second half of 2007, BAC and ML started experiencing the challenges of the market turmoil and economic deterioration. ML was particularly impacted by the dislocation in the wholesale funding markets that was considerably acute for standalone broker dealers. The dislocation also had a significant negative impact on both companies' structured credit holdings and securities backed by real estate-related assets. The continued weakening economic conditions have required significant provision builds at BAC to accommodate for deteriorating credit quality. Given the firm's sizeable exposure to the consumer sector, it is likely this trend will continue. While legacy BAC has been marginally profitable throughout this period, ML has reported significant losses. BAC's net income for the first three quarters of 2008 totaled $5.8 billion, while for the same period ML reported losses of $11.8 billion.

ML reported a $5.2 billion net loss for the third quarter of 2008 compared to a net loss of $2.2 billion for the same quarter one year earlier. The third quarter 2008 loss reflects $5.7 billion in net write downs from its sale of U.S. super senior ABS CDOs and the termination and potential settlement of related hedges with monoline guarantors. ML also recorded net write downs of $3.8 billion, reflecting the market dislocations in September and the associated real estate-related write downs and net losses related to GSEs, and U.S. broker dealers. An additional net loss of $2.6 billion resulted from sales of residential and commercial mortgage exposures. The aforementioned write downs were partially offset by a net pre-tax gain of $4.3 billion from the sale of ML's 20% stake in Bloomberg and a $2.8 net gain from the impact of the widening of ML's credit spreads on the carrying value of certain of its long-term debt securities.

The $11.8 billion net loss for the first nine months of 2008 reflects net losses related to U.S. ABS CDOs of $9.8 billion, credit valuation adjustments related to hedges with monoline financial guarantors of $7.2 billion, net losses on residential and commercial mortgage exposures of $5.1 billion, $2.9 billion in net losses on the securities portfolio, $2.1 billion related to major U.S. broker dealers and certain GSEs, and leveraged finance commitments write-downs of $1.8 billion. These losses were partially offset by a net gain of $5.0 billion from the widening of credit spreads on the carrying value of certain of ML's long-term debt liabilities and the aforementioned sale of its 20% stake in Bloomberg.

Earnings for the fourth quarter of 2008 will be considerably disappointing for both firms, especially for ML. Legacy BAC is expected to post a loss of $1.8 billion and ML is expected to post a loss of approximately $15 billion post tax and approximately $21 to $22 billion pre-tax. Reflecting the performance over the past year, BAC's stock price has declined approximately 68 percent closing at $12.99 on January 9, 2009. Both Moody's and Standard and Poors have recently downgraded the company's credit rating and have a negative outlook on the company. Moody's rates BAC's long-term credit rating as Aa3, and Standard and Poors has BAC's long-term credit rating of A+. The current 1-year CDS spread is 112.5, but it is strongly anticipated this spread will widen after the disappointing earnings announcements.

Interdependencies

Despite the sizeable deposit franchise of BAC, the firm must maintain access to the wholesale funding markets to maintain sufficient liquidity. To date, the firm has been able to maintain sufficient access to the unsecured funding markets and has selectively used the FDIC guarantee program to issue unsecured debt. That said, the firm's access to the secured market is equally critical to its survival.

The earning's guidance provided by the firm to the investor community does not infer that 4Q performance at either organization will be as negative as we have been told. Further, a survey of equity analysts suggests that the investor community have significantly more positive expectations regarding fourth quarter performance. Additionally, these losses will have a considerable impact on the firms collective capital position specifically it tangible capital ratio. Should the earnings report and the deterioration in tangible capital result in a loss of confidence, it is anticipated that the immediate impact would result in the company loosing its ability to fund overnight unsecured and a strong reluctance from counterparties to finance non-GC positions. This occurrence would eliminate immediately at least 50% of BAC's liquid asset buffer, leaving it extremely vulnerable to deposit runs, larger repo haircuts, increased margin requests, and reactionary draws on unfunded loan commitments. Further, given ML's heavy reliance on secured funding markets, where it finances $144 billion in positions overnight (approximately 50% is firm inventory), the impact of a counterparty pull away would have an even more devastating impact.

(in millions as of 1/8/09)	**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

* Note: Deposit data is as of 12/31/08

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. As of year-end, legacy BAC and ML held approximately $48 billion ($32 billion in business MMDAs) and $64 billion, respectively (all sweep) both sources are historically more vulnerable in a counterparty "pull away". 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/F1, 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, where BAC holds a balance of $83 billion. Staff thinks the overnight unsecured position is one the most vulnerable funding positions at the company. This is critical because the Federal Funds purchased position effectively funds the majority of the institution's cash position. 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 widespread 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 BNYM 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 much 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 with $92 billion outstanding. Generally, the majority of FHLB 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 marketplace.

Adverse perception in the marketplace 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.[4] 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). Further, legacy BAC participates in the major derivatives clearing entities, such as the CME Group's range of central counterparties and the Options Clearing Corporation (OCC). Legacy BAC also has numerous bilateral clearing relationships with its counterparties in the over-the-counter markets. ML is a participant in the same broad range of major clearing and settlement organizations in the United States. Legacy BAC and ML combined (and their related entities) participate in numerous exchanges and clearing organizations in a wide range of countries around the world.

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).[5] 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.

Comment [JCM1]: The references to the four "critical markets in the Sound Practices paper may convey the illusion that letting BAC/ML" fail" could be "doable." In light of Lehman, the global impact would be a complete disaster globally. So should we just reference the Sound Practices paper in a footnote? We could use the sentence here on "widespread disruptions... in the US as well as abroad" as the conclusion to the last paragraph?

Significant in Critical Financial Market

FIRM	WHOLESALE PAYMENTS[6]	FOREIGN EXCHANGE	COMMERCIAL PAPER	CORPORATE SECURITIES	U.S. GOV'T & AGENCY SECURITIES[7]
Bank of America	✓	✓			✓
Merrill Lynch				✓	

In the retail payment area, 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.[8] The ACH is the key mechanism for delivering automated payroll payments and automated government transfers such as social security payments, to millions of U.S. households. Legacy BAC is also an important participant in the check clearing system and other key retail payment mechanisms.

[4] In 2005, legacy BAC was among the top five participants in both CHIPS and Fedwire, as measured by the dollar value of transfers.

[5] The last update to the market-share data used to determine which firms are "significant" was in 2005.

[6] 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.

[7] 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.

[8] 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.

address deleted

12/22/2008 02:14 PM

To Scott Alvarez/address deleted

cc Kevin Warsh/ , Randall S Kroszner/address deleted Donald L Kohn/ address deleted , Deborah P Bailey/

Subject BAC

Had a good conversation with Lewis just now. He confirms his willingness to drop the MAC and to work with the government to develop whatever support package might be needed for earnings announcement dates around Jan 20. We discussed his common equity issue. We agreed that having a significant amount of TARP capital in the form of common was not an ideal solution, given the ownership implications. But we agreed both to think about possible solutions (eg, a govt backstop of a capital raise, govt common with limited control rights etc.).

He had a question which I will address to Scott (also to Deborah). He said he now fears lawsuits from shareholders for NOT invoking the MAC, given the deterioration at ML. I don't think that's very likely and said so. However, he still asked whether he could use as a defense that the govt ordered him to proceed for systemic reasons. I said no. It is true, however, that we have done analyses that indicate that not going through with the merger would pose important risks to BAC itself. So here's my question: Can the supervisors formally advise him that a MAC is not in the best interest of his company? If we did, could he cite that in defense if he did get sued for not pursuing a MAC?

From:
To: Scott Alvarez
Subject: Re: Fw: BAC
Date: 12/23/2008 11:08 AM
Encrypted

Thanks, Scott. Just to be clear, though we did not order Lewis to go forward, we did indicate that we believed that going forward would be detrimental to the health (safety and soundness) of his company. I think this is remote and so this question may be just academic, but anyway: What would be wrong with a letter, not in advance of a litigation but if requested by the defense in the litigation, to the effect that our analysis supported the safety and soundness case for proceeding with the merger and that we communicated that to Lewis?

▼ Scott Alvarez/address deleted

Scott Alvarez/address deleted	To	address deleted
	cc	
12/23/2008 10:18 AM	Subject	Re: Fw: BAC

Mr. chairman,

Shareholder suits against management for decisions like this are more a nuisance than successful. Courts will apply a "business judgment" rule that allows management wide discretion to make reasonable business judgments and seldom holds management liable for decisions that go bad. Witness Bear Stearns. A different question that doesn't seem to be the one Lewis is focused on is related to disclosure. Management may be exposed if it doesn't properly disclose information that is material to investors. There are also Sarbanes-Oxley requirements that the management certify the accuarcy of various financial reports. Lewis should be able to comply with all those reporting and certification requirements while also completing this deal. His potential liability here will be whether he knew (or reasonably should have known) the magnitude of the ML losses when BA made its disclosures to get the shareholder vote on the ML deal in early December. I'm sure his lawyers were much involved in that set of disclosures and Lewis was clear to us that he didn't hear about the increase in losses till recently.

All that said, I don't think it's necessary or appropriate for us to give Lewis a letter along the lines he asked. First, we didn't order him to go forward--we simply explained our views on what the market reaction would be and left the decision to him. Second, making hard decisions is what he gets paid for and only he has the full information needed to make the decision--so we shouldn't take him off the hook by appearing to take the decision out of his hands.

Let me know if you'd like any more info on this.

Scott

address deleted

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

(DRAFT)

Date: January 10, 2009

To:

From:

Subject: Considerations regarding invoking the systemic risk exception for Bank of America Corporation

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Background

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ABCP	$13,870	$59,464

* Note: Deposit data is as of 12/31/08

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. As of year-end, legacy BAC and ML held approximately $48 billion ($32 billion in business MMDAs) and $64 billion, respectively (all sweep) both sources are historically more vulnerable in a counterparty "pull away". 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/F1, 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, where BAC holds a balance of $83 billion. Staff thinks the overnight unsecured position is one the most vulnerable funding positions at the company. This is critical because the Federal Funds purchased position effectively funds the majority of the institution's cash position. 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 widespread 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 BNYM 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 much 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 with $92 billion outstanding. Generally, the majority of FHLB 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 marketplace.

Adverse perception in the marketplace 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.[4] 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). Further, legacy BAC participates in the major derivatives clearing entities, such as the CME Group's range of central counterparties and the Options Clearing Corporation (OCC). Legacy BAC also has numerous bilateral clearing relationships with its counterparties in the over-the-counter markets. ML is a participant in the same broad range of major clearing and settlement organizations in the United States. Legacy BAC and ML combined (and their related entities) participate in numerous exchanges and clearing organizations in a wide range of countries around the world.

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).[5] 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.

Comment [JCM1]: The references to the four "critical markets in the Sound Practices paper may convey the illusion that letting BAC/ML" fail" could be "doable." In light of Lehman, the global impact would be a complete disaster globally. So should we just reference the Sound Practices paper in a footnote? We could use the sentence here on "widespread disruptions... in the US as well as abroad" as the conclusion to the last paragraph?

Significant in Critical Financial Market

FIRM	WHOLESALE PAYMENTS[6]	FOREIGN EXCHANGE	COMMERCIAL PAPER	CORPORATE SECURITIES	U.S. GOV'T & AGENCY SECURITIES[7]
Bank of America	✓	✓			✓
Merrill Lynch				✓	

In the retail payment area, 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.[8] The ACH is the key mechanism for delivering automated payroll payments and automated government transfers such as social security payments, to millions of U.S. households. Legacy BAC is also an important participant in the check clearing system and other key retail payment mechanisms.

[4] In 2005, legacy BAC was among the top five participants in both CHIPS and Fedwire, as measured by the dollar value of transfers.

[5] The last update to the market-share data used to determine which firms are "significant" was in 2005.

[6] 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.

[7] 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.

[8] 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.