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FDIC Transcript of Board of Directors Meeting Closed Session

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UNITED STATES OF AMERICA

FEDERAL DEPOSIT INSURANCE CORPORATION

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BOARD OF DIRECTORS

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MEETING
CLOSED SESSION

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MONDAY
SEPTEMBER 29, 2008

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The Board convened at 6:00 a.m. in the Federal Deposit Insurance Corporation Board Room at 550 17th Street, N.W., Washington, D.C., Sheila C. Bair, Chairman, presiding.

PRESENT:

SHEILA C. BAIR, Chairman

MARTIN J. GRUENBERG, Vice Chairman

THOMAS J. CURRY, Director

JOHN C. DUGAN, Comptroller of the Currency

JOHN M. REICH, Director, Office of Thrift Supervision

STAFF PRESENT:

Miguel Bran
John H. Corston
Herbert J. Held
Jim Wigand

P R O C E E D I N G S

CHAIRMAN BAIR: Okay. I have no gavel, so we'll just begin this morning the meeting.

(laughter.)

CHAIRMAN BAIR: Okay. I'd like to call the meeting to order. I need a Sunshine motion.

MR. : I move.

CHAIRMAN BAIR: May I have a second? I'll second. All in favor, say aye.

[Chorus of ayes]

CHAIRMAN BAIR: The motion's agreed to. No summary agenda. There's one item on the discussion agenda. It is a memorandum and resolution relating to Wachovia Bank, National Association, Charlotte, North Carolina, and its affiliate insured depository institutions.

Jim Wigand, John Corston, Miguel Bran and Herb Held will present the case.

MR. WIGAND: Good morning, Madam

Chairman, members of the Board. We're here to present a recommendation that the Board find that the respective failure of Wachovia Corporation and its affiliates, 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 and qualified financial contract markets, and bank senior subordinated debt markets and would further disrupt the related markets and derivative products in other markets.

Staff recommends that the Board accept the bid of Citigroup as the least costly available method, mitigating systemic risk, and that the Board authorize staff to take all steps needed to implement this decision.

Based on preliminary information, staff estimates that there will be no expected loss to the Deposit Insurance Fund for this transaction.

MR. CORSTON: Wachovia Bank is a nationally-chartered bank. It's wholly-owned by Wachovia Corporation. The bank is the fourth largest bank in the country and is 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. The bank operates approximately 3400 banking centers in 21 states.

The risk profile of the bank is declining rapidly because of deteriorating liquidity and poor quality assets, and liquidity has reached crisis proportions.

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, market acceptance of Wachovia liability ceased as the company's stock plunged, credit default swap spreads widened, some parties declined to advance the bank overnight funds, and counterparties advised that they would require greater collateralization on any transactions with the bank.

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

Miguel.

MR. BRAN: Thanks, John. Staff recommends the Board find the least-cost resolution of Wachovia and its affiliate banks and thrifts, and they'd have serious adverse effects on economic conditions and financial stability, and would seriously disrupt an already moribund credit market.

The least-costly resolution would likely be a purchase and assumption after the FDIC was appointed receiver. I'd like to first describe some of the economic and financial circumstances we find ourselves in in September 2008.

Short-term funding mechanisms in interbank lending are under considerable strain. This pressure is increasing following the failure of Lehman Brothers, the difficulties of AIG, the closing of WaMu. Libor has jumped a 100 basis points in the last three weeks. Commercial paper rates have risen dramatically. And this has all led to a strained liquidity position for many banks and has resulted in downward pressure on stock prices and upward pressure on credit default swap prices.

All of these effects would likely cause investors to rise sharply their assessments 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.

The potential also exists for the harm to extend to the broader economy. It could undermine business and household confidence and also cause banks to become less willing to lend to businesses and households.

If the systemic risk exception were invoked, staff believes that the transaction described --

[Teleconference is interrupted.]

MR. : [inaudible] is now joining.

CHAIRMAN BAIR: Who joined?

MS. : Hello. This is Julie Williams [ph].

CHAIRMAN BAIR: okay.

MR. BRAN: -- described in this Board case would avoid all or most of the adverse impacts discussed previously. Use of the systemic risk exception may involve cost. The FDIC could suffer some losses from protection of certain asset pools, although the expectation is not. The size of the losses is not known and, as described by Mr. Wigand, is likely to be zero.

In addition, moral hazard will be exacerbated and the potential for market discipline in the future would be reduced for the very largest depository institutions.

In conclusion, staff believes the imposition of a least-cost resolution on Wachovia would almost surely have major systemic effects. Both financial stability and overall economic condition would likely be adversely affected for the reasons already discussed.

Staff believes we have recommended the least-costly alternative, one where equity holders take significant losses, albeit not wiped out. A least-cost resolution that protects most creditors would best ameliorate the adverse effects of a failure on financial markets and the real economy.

In creating the systemic risk exception, the Congress clearly envisioned that circumstances could arise in which the exception should be used. In view of the current intense financial strains which have already seriously impaired the functioning of the financial system and the likely consequences for the financial system and the economy of a least-cost resolution of the fourth largest commercial bank in the United States, staff believes that the circumstances such as Congress envisioned are clearly present and that invocation of the systemic risk exception is justified. Thank you.

Herb.

MR. HELD: An electronic data room was established by the bank in order to allow potential buyers to perform due diligence. However, there were no proposals submitted on an open basis.

On September 28th, the FDIC staff began discussions with Citigroup and Wells Fargo, both of which submitted bids the same day. Both bids sought open bank assistance from the FDIC.

The Wells Fargo bid required the FDIC to cover potential losses on a pool of up to $137.3 billion in assets, of which 80.7 billion has been funded. Wells Fargo would assume the first $2 billion of losses, and thereafter, losses would be shared, 80 percent for FDIC and 20 percent for Wells.

Our analysis of this proposal estimated the cost to be between 5.6 and 7.2 billion dollars. Our exposure in the transaction was capped at $20 billion net.

The Citi bid, Citigroup bid requested that FDIC provide loss-share (audio drops for about a second) on a $312 billion pool. Losses would be shared first. The first $30 billion of losses would be absorbed by Citigroup. Then Citigroup would absorb $4 billion in losses a year for the next three years and after that, FDIC would absorb all the losses. These would be partially offset or, we think, wholly offset by $12 billion of preferred stock transference, which FDIC would receive at the closing of the transaction.

We -- our analysis of the (audio breakup) group portfolio indicates that losses range between 35 and (audio breakup) billion dollars. And even under the most severe scenario, there would be no cost to the DIF fund.

In addition, Wachovia Corporation itself submitted a proposal for open-bank assistance, and it required a pool of $200 billion of loans to have credit protection from the FDIC, and the Wachovia would cover the first $25 billion in losses, and the FDIC would receive $10 billion in preferred stock and warrants.

Based on our analysis, the proposal from Citigroup is no cost, and is clearly the better of these proposals.

MR.   : Now just for a point of clarification, that is making an assumption of the estimated high-end loss of the range of losses. It would appear that the cushion available with the transaction with City would still not result in a loss to the Deposit Insurance Fund, but, you know, once again, you know, we have the range of estimates there, and the point estimate is certainly within the range of the absorption amount (audio breakup) provided by Citi.

CHAIRMAN BAIR: Okay. Thank you.

Vice Chairman Gruenberg.

VICE CHAIRMAN GRUENBERG: Thank you, Madam Chairman. I will say, this is a momentous proposal that's being placed before the Board. It will be the first exercise by the Board of the systemic risk exception that was provided in the Federal Deposit Insurance

Corporation Improvement Act of 1991.

It is a decision, it seems to me, we reach reluctantly, and in some sense, we don't have a desirable option in front of us, but among the options available, this is perhaps the best.

So it's the least bad, perhaps, of a set of undesirable options, and in that regard we're facing extraordinary times, and this is the appropriate action for us to take at this time, and I'm prepared to support this case.

CHAIRMAN BAIR: Thank you.

Director Curry.

DIRECTOR CURRY: I agree with the vice chairman. It's -- sadly, all the elements of the systemic risk has seemed to be amply supported by the case and the circumstances both at Wachovia, and external conditions within the economy at large. So I am also prepared to vote in favor of this.

CHAIRMAN BAIR: Director Dugan.

DIRECTOR DUGAN: Thank you, Madam Chairman. I think these are absolutely extraordinary time. I think it's remarkable that we've come to this situation where an institution like Wachovia, which, in many ways, is a quite viable, attractive franchise, just couldn't withstand the liquidity shock that it was facing because of the extraordinary circumstances in markets. I think that this is a clear example of the need for the systemic risk exception, certainly with the view of the Federal Reserve and Treasury Department, and discussions that we've had over the weekend, I don't think we have any choice. I'd say I want to commend staff. I think they did a very good job of putting this together in a very short period of time, and I think among the competing offers, this was the best option, and one that (audio breakup) no cost to the FDIC fund. It certainly helps them, and I support the resolution.

CHAIRMAN BAIR: Director Reich.

DIRECTOR REICH: Thank you, Madam Chairman. There's a lot that I don't know, unfortunately. I heard staff indicate that equity holders would take significant losses, though not wiped out, and I guess I'd like to know what, what that means. Could somebody --

CHAIRMAN BAIR: Do you want to take that, Jim.

MR. WIGAND: The proposal that Citicorp is tendering, and of course it has to be approved by the shareholders of Wachovia, is for a dollar per share purchase price of the stock.

MR. POLAKOFF: What does the FDI Act require with respect to treatment of equity holders?

MR. : John Thomas is coming to the table.

MR. THOMAS: It requires that (audio breakup) probably not benefit equity holders unless there is a systemic determination. That's why a systemic determination is necessary in this case in order to do this transaction.

I would add, I think in addition to the dollar a share, there would be some assets left behind in the holding company, but the --

MR. WIGAND: That's correct.

MR. THOMAS: -- bulk of its debt would be assumed. I think Citi's guessing about $2 or 2.60 a share value for stock. That's their guess. It's not ours.

MR. : And what about the debt holders, the subordinated debt, senior debt?

MR. : In all cases the senior subordinated debt holders are being assumed in the transaction.

MR. POLAKOFF: How do we -- what do we think we're doing, or how will litigation risk be affected -- now I'm thinking of WaMu -- equity and debt holders that were wiped out. Are we -- do we run the risk of increased litigation risk for --

MR. : No one has a right, a legal right to a systemic risk determination and being bailed out. I think the answer is this does not change that risk. It may change the risk whether someone sues. It will not change the risk where there's any significant loss, risk of loss in that litigation. Any time somebody sees money, you may get a law suit; but it does not change the legal risk.

MR. : Is there any exposure to the industry for a special assessment?

MR. : If it turns out that the transaction actually does cost more than a simple closing of the institutions here would cost, and right now it looks like a zero cost -- our best estimate, zero cost. If that's true, there'll be no special assessment. If it turns out that there is a cost from doing the systemic finding, and doing the transaction this way, then the industry would be assessed, and they're assessed based on assets minus equity rather than on deposits.

CHAIRMAN BAIR: Treasury's also agreed if there are any losses attendant with this transaction, they will separately fund those, so that our cash balance wouldn't be depleted in any way, and hopefully our reserve balance*.. I guess that's still "up in the air." What do they -- as an accounting matter we could do that.

MR. : Does that -- when you say that they would separately fund the losses, does that mean that the industry would not be assessed, or --

CHAIRMAN BAIR: No. Unfortunately, with our statute, there's a special assessment for any costs associated, or losses associated with a systemic risk exception. But the usual rule for Treasury is that we have to spend down our entire balance before the will allow us to borrow from them. In this case, they've agreed to fund any, any losses that we might suffer in connection with this transaction, so that we would not have to -- it would not deplete our cash balance.

I don't think that's going to happen. I think that the -- at least given --I think staff is right, that it's probably remote that we will suffer any losses under this, given the sizeable first loss position that Citi has taken.

But it was important to me, especially since Treasury are the ones vigorously pushing this, that they agree to separately fund those losses if we do incur them. And we're trying, we're still trying to determine whether they could give us some type of language that would allow us not to have to reserve against those losses if they should occur.

In other words, they would just fund them immediately as they occurred so it wouldn't impact our DIF balance. But we're not talking about that. We haven't worked that out yet.

MR. : Are we anticipating any other possibility of a large failure within the next couple weeks?

CHAIRMAN BAIR: Well, I know John Dugan, he might have some thoughts on that. We're watching that Citi closely. I think we need to have more discussions with OCC. I'm not aware on the staff. John, do you have anything?

DIRECTOR DUGAN: What I would say is if it happens, it will be a liquidity-based issue, not a capital-based issue like this one, and it'll depend on how markets react, and we'll -- institutions have been taking precautions but in the financial storm that we're in, it's difficult to predict what direction it will take for the particular institution which Sheila just mentioned or other institutions, whether supervised by us or others.

CHAIRMAN BAIR: Okay. Any more questions, John?

MR. : I think that's it, Sheila. Thank you.

CHAIRMAN BAIR: Thank you.

Well, i think this is, you know, as Marty said, one option of a lot of not-very-good options. I would note for the record, that both the Treasury and the Federal Reserve Board "weighed in" early on for us to provide a systemic risk exception. In fact, the Federal Reserve Board, several hours ago, voted on a systemic risk exception before we'd even acted. So they clearly, both pressed for this, and I know it was important to the OCC as well.

I have acquiesced in that decision based on the input of my colleagues, and the fact the statute gives multiple decision makers a say in this process.

I'm not completely comfortable with it but we need to move forward with something, clearly, because this institution is in a tenuous situation.

I would like to very much thank and commend the staff for really going above and beyond a very -- you know, usual challenges of the job. We did not really know, until 5:00 o'clock yesterday afternoon, that this was not going to get done on an open bank and assisted basis, and it really put us in a bind. So it is what it is, markets move quickly, and we just take the balls as they come, or pitched at us. But it was a very difficult night and a resolution that is a resolution, and we needed a resolution that, whether it's the best resolution I don't know.

So with that, I will -- may I have a motion with respect to Wachovia Bank.

MR. : I move.

CHAIRMAN BAIR: And may I have a second.

MR. : Second.

CHAIRMAN BAIR: All in favor say aye.

[Chorus of ayes]

CHAIRMAN BAIR: The motion's agreed to. That concludes the discussion agenda. Thank you, gentlemen, for all getting up so early, and John, in your case staying up all night. And if there's no more business, we'll conclude the meeting. Thank you.

(Whereupon, the closed meeting was concluded)