

**From:** Tim P. Clark  
**To:** Rita C. Proctor; Donald L. Kohn; Kevin Warsh; Deborah P. Bailev; Roger Cole; Coryann Stefansson; William Rutledge; Arthur Anzulo; Brian Peters; Jennifer Burns; Mac Alfriend; Randall S. Kroszner; Scott Alvarez  
**Subject:** Update on BAC\_ML  
**Date:** 12/19/2008 02:29 PM

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**The following is a quick update and some preliminary views in advance of the call at 3:30 today.**

We (FRB Richmond, FRB NY and Board staff) are continuing to gather needed info for full assessment of ML through Bank of America (BAC) management, though much of what is needed for a good preliminary assessment on ML is in our possession and being analyzed. We also had a pretty good sense already of conditions at BAC, which have also deteriorated recently as evidenced by their own projection for Q4 having gotten significantly worse in the past week or two, and we are currently working to update are views on BAC as a stand alone entity. As they themselves noted the other night at our meeting, even on a stand alone basis, the firm is very thinly capitalized in terms of tangible common equity (TCE) relative to assets and exposures.

- It is notable that a quick analysis of the TCE/assets ratios of BAC and ML on stand-alone basis and as a combined entity implies that the recent decline in BAC's projected year-end 2008 stand alone number appears to be driving as much of the decline in the combined pro forma ratios as the losses at ML, even as they are portraying the losses at ML as being the key issue here. This is largely the result of declining ratio at BAC stand alone and the fact that most capital in the combined entity will be coming from BAC.

The preliminary assessment on the ML loss numbers is that ML does not appear to be being overly aggressive in some of its larger markdowns -- though we can't yet say that with certainty and for all positions -- so the size of the losses/write downs may not be over-stating the problems at ML to a large extent in an attempt to 'kitchen sink' the losses in advance of the acquisition date. Details on the sources of the 'new' \$4 billion of losses are being sought right now and that will be included in the analysis once we get a bit more clarity.

General consensus forming among many of us working on this is that given market performance over past several months and the clear signs in the data we have that the deterioration at ML has been observably under way over the entire quarter -- albeit picking up significant around mid-November and carrying into December -- Ken Lewis' claim that they were surprised by the rapid growth of the losses seems somewhat suspect. At a minimum it calls into question the adequacy of the due diligence process BAC has been doing in preparation for the takeover. [As an aside, BAC management told us they could not provide electronic versions of ML files, and one wonders how that is possible since they have been doing the due diligence for months and having e-files would have made that much simpler and more effective for them. May have helped limit their current surprise.]

As per our meeting with management the other night, BAC management has identified a \$78 billion portfolio of positions and exposures that are causing the problems at ML. Those are as follows:

**From:** Donald L Kohn  
**To:** Scott Alvarez; Kevin Warsh  
**Cc:** Brian F Madigan; Michelle A Smith  
**Subject:** Re: BofA  
**Date:** 12/30/2008 08:34 PM

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Agree with scott until last sentence. "If trouble occurs" implies we wouldn't work with them to head off trouble. One of the options discussed today was a limited ringence maybe plus capital raise announced on Jan 20. It's tricky because of tarp, but tarp should have some unused, though committed, resources. I think such a plan is risky for BAC because its an admission of weakkness. Very different circumstances from BS-JPM. But if bac and our staff think it's needed we shouldn't rule out. Could be necessary to buy time to the more general tarp capital injection.

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Sent from my BlackBerry Wireless Handheld  
▼ Scott Alvarez

----- Original Message -----

**From:** Scott Alvarez  
**Sent:** 12/30/2008 07:58 PM EST  
**To:** Kevin Warsh  
**Cc:** Brian Madigan; Donald Kohn : Michelle Smith  
**Subject:** Re: BofA

Mr. Chairman,

Ken will want to get you to commit as much as possible on this call. I'd be cautious for two reasons. First, we aren't sure yet what exactly we should do here. There is some disagreement between the OCC and BA, on the one hand, and our collective staff (Board, Richmond and NY), on the other, about what type and how big of a problem exists at BA (as opposed to ML). Any help will depend on getting our arms around that, and then judging the market reaction to our aid. Second, our potential solutions depend significantly on some amount of TARP money being available when it comes time to act and on the FDIC being willing to play a role like it did in Citi. BA won't want a loan, which is all we can do on our own. The availability of TARP money around January 20 will depend on Paulson's ability to convince Congress to give the funds to Tim, on Congress acting without imposing new restrictions on hows the funds are to be used, and on whether a new, unexpected problem arises before January 20 (or whenever the next tranche is granted). So we can't be sure at this point what we can do.

So, I'd stick to the message you suggested before. Consummating the deal is important to BA and ML as well as financial markets. Failure to consummate at this point would send bad signals about BA, not just ML. And we will watch carefully how events develop and work with BA if trouble occurs.

Happy to talk with you about this.

Scott

**From:** [Arthur Angulo](#)  
**To:** [Lisa A White](#)  
**Cc:** [Brian Peters](#); [Jennifer Burns](#); [Kevin Coffey](#); [Tim P Clark](#)  
**Subject:** Re: BoA/ML FG Information  
**Date:** 01/02/2009 09:23 PM

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I fully agree that BAC should realize that getting us complete info ASAP is in their interest...and that it is inconceivable that the type of info to which Kevin referred is not readily available.

▼ [Lisa A White](#)<sup>address deleted</sup>

**Lisa A White**<sup>address deleted</sup>

01/02/2009 05:53 PM

**To:** [Kevin Coffey](#)<sup>address deleted</sup>  
**cc:** [Arthur Angulo](#)<sup>address deleted</sup>, [Brian Peters](#)<sup>address deleted</sup>, [Jennifer Burns](#)<sup>address deleted</sup>, [Tim P Clark](#)<sup>address deleted</sup>  
**Subject:** Re: BoA/ML FG Information

Kevin--

We were surprised as well. I think we still need to work to our original deadline. If after the initial conversations on Monday, it still seems like it's going to take a longer period of time to get me the information, I'm happy to quickly elevate this up the chain as they are aware of the timelines we're working under and it's in their best interest for us to have as much info as possible as soon as we need it.

Will you please call me asap on Monday if you're not getting what you need on these topics?

Thanks for your help, Kevin.

Lisa<sup>address deleted</sup>  
▼ [Kevin Coffey](#)/!

**Kevin Coffey**<sup>address deleted</sup>/!

01/02/2009 05:45 PM

**To:** [Lisa A White](#)<sup>address deleted</sup>,  
**cc:** [Brian Peters](#)<sup>address deleted</sup>, [Jennifer Burns](#)<sup>address deleted</sup>, [Arthur Angulo](#),  
[Tim P Clark](#),  
**Subject:** BoA/ML FG Information

Lisa, just wanted to follow-up from the phone call with BoA and get your thoughts.

I was a little surprised that the BoA folks thought getting more granular information on the FG deals would take a fair amount of time (ie., try to get things Tuesday

address deleted  
12/22/2008 02:14 PM  
To Scott Alvarez/<sup>address deleted</sup>  
cc Kevin Warsh/  
Kroszner/<sup>address deleted</sup>, Randall S  
Kohn/<sup>address deleted</sup>, Donald L  
Bailey/, Deborah P  
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**

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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 accuracy 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

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

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I agree we and Treasury gave our views on what we thought the likely effects would be of not proceeding, but that's different than ordering Lewis to proceed. We didn't take the decision out of his hands or threaten punitive supervisory action if he didn't proceed. I want to avoid the Fed being the centerpiece of the litigation. Lewis needs to have every incentive to analyze the facts and document and justify his decision. If he thinks he can rely on us, he'll assert there was nothing he could do and he can be reckless--not the right incentive. Moreover, once we're in the litigation, all our documents become subject to discovery and, as you'll remember from Deborah's presentation, some of our analysis suggests that Lewis should have been aware of the problems at ML earlier (perhaps as early as mid-November) and not caught by surprise. That could cause other problems for him around the disclosures BA made for the shareholder vote. In any event, we can always decide at the time of litigation whether to help even if now we hold fast.

Scott

Mac  
Alfriend/ address deleted

12/21/2008 08:17 AM

To Christopher Calabia address deleted  
cc Alexa Philo address deleted, Arthur Angulo address deleted,  
brian.peters@ address deleted, Coryann  
Stefans address deleted, Daniel  
Sullivan address deleted, Deborah P  
Bailey/ address deleted, Dennis  
Herbst/ address deleted, Grace Dailey@ address deleted,  
Jane Majeski/ address deleted, Jeffrey M  
Robles/ address deleted, Lisa A White/  
Morgan Risheri address deleted, Scott D  
Nesson/ address deleted, Stacy L  
Coleman address deleted, Tim P  
Clark

Subject Re: ZFRSSE - MER stand-alone analysis

Good analysis of both companies. Merrill is really scary and ugly..Probably will not be on 9:30 call

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Mac Alfriend  
Senior Vice President, Banking Supervision and Regulation  
The Federal Reserve Bank of Richmond  
Office 804-697-8411 Cell 804-512-4186  
address deleted  
[www.richmondfed.org](http://www.richmondfed.org)



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**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**

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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.

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Jeffrey Lacker, address deleted



Jeffrey Lacker, address deleted

12/20/2008 11:12 AM

To "Mac Alfriend" address deleted, "Sally Green"  
address deleted, "Jennifer Burns"  
"James McAfee"  
, Trish

Nunley, address deleted

cc

Subject The ChairMan

Just had a long talk with Ben. Says they think the MAC threat is irrelevant because its not credible. Also intends to make it even more clear that if they play that card and then need assistance, management is gone. (Forgot to tell him KL is near retirement.) Hopes a Citi-like deal can be done w/o us taking 3rd loss, but if we got away w/ the gov just backstopping \$74 that would be cheap given the size of the companies. He'd be surprised if that's all it takes though.



Preliminary, confidential views from scott and me (see note below plus attachment) without benefit of sup and reg staff input

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--Sent from my BlackBerry Wireless Handheld

**From:** Kevin Warsh  
**Sent:** 12/21/2008 12:42 PM EST  
**To:** Kevin Warsh, Chairman's email address redacted.

Attached please find some discussion points that Scott and I iterated overnight. Obviously, the actual talkers will depend significantly on what we hear from our Staff this afternoon.

Great work on de-escalating BA, the more time we have the better.

It is key that we understand how December is faring for BA's comparable banks. It is also critical to understand BA's view on disclosure requirements (e.g., 8-K), particularly whether they would need to discuss pro forma financials if and when transaction is consummated in first week of January. If their first disclosure is at time of Jan 19 earnings announcement, then we can better evaluate the prospects for a private capital raise by the company in the new year.

Thanks

Kevin

December 21, 2008

**Talking points for BankAmerica Discussion**

**[Bracketed language below is for further internal discussion purposes and subject to revision based upon briefing by Staff this afternoon]**

1. Abandonment of the transaction on the eve of consummation, especially after the extensive preparations that BA has already taken, would surprise the market and have serious adverse effects not only for ML, but also for BA. Of course, it would have negative implications for the System.

\* The market would doubt the judgment of BA's management and its ability to perform adequate due diligence and manage risks. It would call into question the risks inherent BA's existing footprint, including Countrywide.

\* Abandoning the transaction would expose the weaknesses in BA's capital and asset quality, as analysts attempt to determine why BA did not believe it had the resources to acquire ML.

\* The market would conclude that BA was too weak to address the problems at ML, particularly because ML brings with it \$10 billion in Government TARP capital in addition to its own capital.

2. BA's assertion that it would successfully exercise the material adverse effects clause is not credible, according to Fed and other key US Government (USG) attorneys.

\*The public assertion of the claim, however, would likely cause the demise of ML in much the same fashion as the collapse of Lehman.

\*This would cause significant reputational consequences for BA, in the markets, with the public and with the regulators.

3. If USG were to provide aid to BA in connection with the acquisition of ML, BA would look very weak in the eyes of the market (e.g., look more like Citi and less like JPM)

\* Except for the CPP (which has already provided BA with \$15 billion and promised BA another \$10 billion upon completion of the ML transaction), the Fed and Treasury have established a policy on assisting only troubled companies in time-constrained, emergency situations.

\* The ML deal has taken place in full view of the market over an extended period of time and without any indication of extraordinary weakness. Markets will be focused on the 2009 pro forma financials, not the 4Q ML write-downs.

\*Were the US Government to provide aid at this point, it would appear that BA was itself too weak to acquire ML and had poor leadership and inadequate risk-management systems in place across its entire footprint.

4. In spite of all of this, if BA believes that aid from USG is essential, and the USG chooses to provide aid to BA, it will come at a price – both economically and reputationally. Assistance, generally, has taken any/all of three forms – regulatory, capital, or with respect to distressed assets. [We may need to revise this judgment later today]

\*Regulatory: Relief takes various forms [but we must be alert here that extraordinary relief might smack of forbearance and markets and ratings agencies may not be as tolerant as regulators]

\*Capital: [The central problem here is likely to be insufficient capital in a fast deteriorating economic environment. The solution, thus, may well be a new capital raise, which could include a mix of private and public capital as USG could provide backstop in various forms].

\*Distressed Assets: [The pool of “distressed assets” at ML have already undergone massive write-downs, so tail-risk looks smaller than in other situations. Also, the size of the distressed pool looks relatively small compared to size of pro forma BA balance sheet]

5. If, however, BA maintains that the distressed assets are the central cause of the expected pro forma weakness, and USG more clearly understands BA's rationale, then BA should be expected to be required to —

- \* take all the expected losses from any designated portfolio plus provide an additional cushion for extraordinary losses;
- \* pay rates for any aid it receives significantly in excess of the CPP ; and
- \* provide some measure of upside compensation to the US Government.

Moreover, BA will be subject to restrictions on its business activities that, at a minimum, will include—

- \* a ban on dividends without US Government approval,
- \* more severe executive compensation limitations than those from the CPP,
- \* limitations on various types of corporate expenses,
- \* a government foreclosure prevention policy,
- \* restrictions on further acquisitions/transactions,
- \* requirements to raise additional capital in agreed time-frame, and
- \* more intrusive review and involvement by the US Government in the selection of management of BA, including the board of directors.

6. [BA has made clear previously to the regulators and to the marketplace that it believes this deal is strategically and financially good for BA in the medium-term. BA has said that the franchise value of ML is very strong and its long-term prospects appear good. BA should proceed with the deal and manage the deal as capably as possible, including consideration of announcing a capital raise]

\*[BA should consider the following contingent support of USG. That is, if unforeseen market events threaten the viability of BA, the Federal Reserve and the other Federal Government agencies will consider and use all options available to address the situation at that time.]

**From:** Mac Alfriend  
**Sent:** 12/23/2008 05:44 PM EST  
**To:** Jeffrey Lacker  
**Cc:** Jennifer Burns  
**Subject:** Re: Color from the Chairman

I think he is worried about stockholder lawsuits; knows they did not do a good job of due diligence and the issues facing the company are finally hitting home and he is worried about his own job after cutting loose lots of very good people.

**Mac Alfriend**  
Senior Vice President, Banking Supervision and Regulation  
The Federal Reserve Bank of Richmond  
Office 804-697-8411 · Cell 804-512-4186  
address deleted  
[www.richmondfed.org](http://www.richmondfed.org)



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**From:** Kevin Warsh  
**To:**  
**Cc:** Donald L. Kohn; Michelle A Smith  
**Subject:** BofA  
**Date:** 12/26/2008 11:01 AM

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Don and i did conference calls with Staff from Board, Richmond, NY on situation on Wednesday. Still seems to be consensus that that problems are more significant than ML alone.

We are reconvening with our guys again on Tuesday to discuss in more detail strawman proposals that deal with ML problems predominantly and a more aggressive case that deals with BoA/ML together. Key to our ultimate determination will be market perceptions (that is, will markets see problems beyond ML, particularly given relatively low levels of tangible common equity at parent). To that end, we are working on mix of distressed asset fixes and capital injections that may diverge from Citi model. For example, we are considering a structure where the Government is backstop funder or provides capital match for private capital raise by BoA.

I spoke with Joe Price (CFO of BofA) several times in last couple of days, urging them to think with force and speed during our little window of seeming calm in next week. I asked him and his team to have their own version of strawman proposal for us to consider by next Tuesday as well. They need to take more ownership of situation. Also, spoke with Dugan and McCormick. Dugan's staff will be working with ours to further evaluate pro forma entity and alternatives for consideration on Tuesday. Will continue to keep Treas posted

Separately, Don is continuing to lead discussion about broader uses of TARP and other USG facilities with Tim for Jan 20 and beyond. His group (including NY Fed) is reconvening Monday to discuss.

Thanks

Kevin

address deleted

▼ Kevin Warsh

**Kevin Warsh**/address deleted

To address deleted

cc Donald L Kohn, Michelle A  
Smith/BOARD/EDWARD. Scott  
Alvarez address deleted

12/29/2008 12:58 PM

Subject BofA

Ben:

Spoke with BoA folks this morning, mostly Joe Price (CFO) They seem to have taken on board some of the ideas we discussed with them last week, but did not instill a ton of confidence that they have got a comprehensive handle on the situation. Their views, however, are evolving towards asking for some relief to parent co in addition to ML.

ML: They proposed mix of government capital (common-like, non-voting equity) plus asset wrap (\$140Bn) with "fill the whole" at ML for the "good of the system". Cost of government support here will need to be negotiated here, but they think they are entitled to some favorable terms because they have agreed to go forward to closing. I reminded them that they are the ones who would look equally bad in eyes of market and regulators if they chose to terminate transaction. T

Parent: With respect to BoA, they now propose reducing dividend payout to "nominal" amount.. With respect to capital raise, they want to target all-in-capital raise that takes TCE ration to 3 to 3.5%, which seems like a total capital raise of \$12-15 Bn, with government serving as backstop in event they couldn't raise capital themselves. They'd also like asset wrap of about \$50 Bn for BoA assets "that are comparable to" ML. On BoA pieces, recognize that terms of government support would be more expensive.

They would hope to announce comprehensive package with our support on Jan 20 (happy inauguration day, mr. president).



address deleted

▼ Kevin Warsh

**Kevin Warsh**/address deleted

To address deleted

cc Donald L Kohn, Michelle A  
Smith/BOARD/EDS/BOARD. Scott  
Alvarez address deleted

12/29/2008 12:58 PM

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They would hope to announce comprehensive package with our support on Jan 20 (happy inauguration day, mr. president).

Don and I are talking with Fed staff plus OCC plus Treas tomorrow afternoon, and should have better view of way forward after that. BoA is going to talk with Exec Committee of its Board on Wednesday, and I told Price I'd give him some preliminary guidance by then

Thanks

Kevin