Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Authorization to Provide Residual Financing to Bank of America Corporation Relating to a Designated Asset Pool

Overview

On January 15, 2009, the Board of Governors of the Federal Reserve System (Board), based on the unanimous vote of its five members, authorized the Federal Reserve Bank of Richmond (Reserve Bank) under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343) to provide Bank of America Corporation (Bank of America), if necessary, residual financing relating to a designated pool of financial instruments in connection with certain loss sharing arrangements among Bank of America, the Department of the Treasury (Treasury) and the Federal Deposit Insurance Corporation (FDIC). As discussed further below, the Board provided this authorization as part of a package of coordinated actions by Treasury, FDIC, and the Federal Reserve to provide financial support to Bank of America and promote financial stability.

Background

Bank of America consummated its acquisition of Merrill Lynch & Co., Inc. (Merrill Lynch) on January 1, 2009. Based on data for the individual firms as of September 30, 2008, the combined Bank of America organization is the largest banking organization in the United States, with total consolidated assets of approximately $2.7 trillion. As of the same date, Bank of America's lead subsidiary bank, Bank of America, N.A., had total consolidated assets of approximately $1.4 trillion, making the bank the largest U.S. insured depository institution in terms of assets. Merrill Lynch's subsidiary insured depository institutions had an additional $97 billion in assets as of the same date.

Bank of America is a major supplier of credit in the United States, with more than $940 billion in loans and leases outstanding at the end of the third quarter of 2008. As of the same date, Bank of America held more than $776 billion in domestic deposits and more than $98 billion in foreign deposits, making the organization the largest deposit holder in the United States and one of the largest holders of foreign deposits among U.S. banking organizations. Following the combination with Merrill Lynch, Bank of America also is the largest securities broker in the world and provides a broad range of investment banking, capital markets, asset management, and retail brokerage services – both domestically and overseas through its subsidiaries. The combined organization has substantial amounts of commercial paper and long-term senior and subordinated debt outstanding; is a major participant in numerous domestic and international payment, clearing, and central counterparty arrangements; and is a significant counterparty to many major national and international financial institutions.

Financial markets in the United States have been experiencing significant stress for more than a year. During this period, investor confidence in U.S. financial institutions has been shaken by, among other things, sharp and broad-based declines in both equity and home prices; continuing increases in mortgage delinquencies and defaults; resulting substantial drops in the values of mortgages and mortgage-backed securities; dislocations in some term funding markets; losses caused by the failure of several significant domestic financial institutions; and large losses at financial institutions in other parts of the world. The strains in financial markets and pressures on financial firms have contributed to a severe deterioration in the economic outlook for both the United States and many other countries.

These conditions negatively affected Bank of America, Merrill Lynch and their subsidiary insured depository institutions in the first three quarters of 2008. In the first three quarters of 2008, Merrill Lynch posted net losses of $11.8 billion due, in part, to losses on mortgage-related securities and exposures. Bank of America reported net income of $5.8 billion during the same period, a significant reduction from the $14.7 billion in net income reported by the company for the comparable period in 2007. To help strengthen the companies and promote confidence in the financial system, on October 28, 2008, Treasury acquired $15 billion of preferred stock of Bank of America and related warrants as part of the Capital Purchase Program (CPP) established under the Troubled Assets Relief Program (TARP). On the same date, Treasury committed to purchase $10 billion of preferred stock of Merrill Lynch and related warrants under the CPP, with the settlement deferred pending completion of the firm's acquisition by Bank of America.

The ongoing strains in financial markets and weakening of economic conditions, however, placed additional stress on Merrill Lynch and Bank of America during the fourth quarter of 2008. On January 16, 2009, Bank of America reported net losses of $1.8 billion for the fourth quarter of 2008, and Merrill Lynch reported net losses of $15.3 billion for the period. These losses had the potential to weaken materially investor and counterparty confidence in the combined organization and to hamper the ability of the organization and its insured depository institutions to continue to obtain funding in the currently fragile credit markets. Given current market conditions, such adverse developments at the organization, if left unaddressed, could have resulted in other financial institutions experiencing similar funding problems, posed risks to financial stability, and increased downside risks to economic growth.

Overview of the Board's Authorization and Related Programs

In light of these and other factors, Treasury, FDIC and the Federal Reserve agreed on January 15, 2009, to provide Bank of America with a package of programs and facilities to help restore confidence in Bank of America and promote financial stability, which is a prerequisite to restoring vigorous economic growth. Collectively these new measures will augment the capital of Bank of America; protect the company from credit losses on a substantial pool of financial instruments; and better enable the company, its subsidiary depository institutions and the financial system to weather the current difficulties and provide credit and other financial services to consumers and businesses.

The following describes the three components of the assistance provided to Bank of America. Additional information concerning these actions is included in the attached term sheet.

1. Additional Equity Investment by Treasury.

Treasury will acquire an additional $20 billion in newly issued senior preferred stock of Bank of America under the Targeted Investment Program established under the TARP. The preferred stock carries an 8 percent dividend payable to Treasury, and includes terms designed to protect the interests of taxpayers. For example, as required by the Emergency Economic Stabilization Act of 2008 (EESA), Treasury will receive warrants to purchase common stock of Bank of America at a strike price of $13.30 per share and with an aggregate value of $2.0 billion. Under the terms of the preferred stock, Bank of America also will be required to abide by enhanced executive compensation and corporate expenditure standards. In addition, Bank of America will be prohibited from paying dividends on common stock in excess of $0.01 per share per quarter for three years without the consent of Treasury.

2. Treasury and FDIC Loss-Sharing Arrangements with Bank of America.

Treasury and FDIC also have agreed to share with Bank of America losses on a designated pool of up to $118 billion of loans, securities backed by residential and commercial real estate loans and corporate debt, derivative transactions that reference such securities, and other financial instruments. The designated pool of financial instruments represents primarily assets of Merrill Lynch that now are held by Bank of America and will remain on Bank of America's consolidated balance sheet. Under the terms of the guarantee arrangement, Bank of America will retain a $10 billion first loss position in the pool of financial instruments. A second loss position in the pool of financial instruments (covering losses after the first $10B of losses in the pool) will be shared among Bank of America, Treasury and FDIC. Bank of America will bear 10 percent of the second loss position; the remaining 90 percent portion of the second loss position would be allocated between Treasury and FDIC on a pari passu basis – 75 percent to Treasury, up to a maximum of $7.5 billion, and 25 percent to FDIC, up to a maximum of $2.5 billion. These loss-sharing arrangements will be in effect for 10 years for residential mortgage-related assets and 5 years for other assets. As compensation for these guarantees, Treasury and FDIC will receive (i) $3 billion and $1 billion, respectively, of preferred stock in Bank of America, which will bear dividends at 8 percent per annum; and (ii) accompanying warrants. The amount of preferred stock received as compensation for the guarantee may be adjusted, as necessary, based on the results of an actuarial analysis of the final composition of the designated pool of financial instruments, as required by section 102(c) of the EESA.

Under the terms of the guarantee arrangement, Bank of America will be required to maintain a foreclosure mitigation policy acceptable to Treasury and to abide by the executive compensation and corporate expenditure requirements attached to the preferred stock for as long as the guarantee arrangement is in place.

3. Residual Federal Reserve Financing.

In connection with these actions, the Board authorized the Reserve Bank, under section 13(3) of the Federal Reserve Act, to provide Bank of America with financing for the pool of financial instruments if and only if Bank of America incurs additional mark-to-market and credit losses in the pool that exceed $18 billion. The financing would be provided to Bank of America on a non-recourse basis, except with respect to interest payments and fees. It is expected that the maximum amount of Federal Reserve financing would be less than $97 billion. The Reserve Bank's credit exposure on the loan would be reduced by the Bank of America first loss position, the shared Treasury/FDIC/Bank of America second loss position, and a continuing 10-percent loss share agreement between the Reserve Bank and Bank of America. The Reserve Bank's credit exposure would be further limited by Bank of America's pledge of U.S. Treasury securities or other assets eligible for Reserve Banks to purchase under section 14(b) of the Federal Reserve Act. Outstanding advances made to Bank of America under the facility would bear interest at a floating rate equal to the 3-month overnight index swap rate plus 300 basis points per annum. The Reserve Bank also will charge Bank of America a fee of 20 basis points per annum on undrawn amounts. Any residual financing provided by the Reserve Bank would complete the unexpired term of the guarantee arrangement by Treasury and FDIC – that is, 10 years for residential mortgage-related assets and 5 years for other assets from the date of inception of the guarantee arrangement.

In light of the substantial decline in the market value of the pool of financial instruments that must occur before the Reserve Bank would be obligated to lend, and the protections against loss provided by Bank of America, Treasury and FDIC that must be exhausted before the Reserve Bank would suffer losses on the facility, the Board does not expect that the Reserve Bank's facility will result in any losses to the Federal Reserve or the taxpayer.

Attachment