BOARD OF GOVERNORS
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June 12, 2007

Courtney D. Allison, Esq.
Senior Vice President and
Assistant General Counsel
Wachovia Corporation
Legal Division
NC0630
301 South College Street
Charlotte, North Carolina 28288

Dear Ms. Allison:

This is in response to the request by Wachovia Corporation ("Wachovia"), Charlotte, North Carolina, for an exemption from section 23A of the Federal Reserve Act and the Board's Regulation W for transactions in which Wachovia Bank, National Association ("Bank") borrows securities from U.S. broker-dealer subsidiaries of Wachovia ("Affiliated Broker-Dealers").[1]

Background

Bank engages in a wide variety of transactions that result in Bank's having a synthetic long position in one or more underlying securities. In some cases, Bank's hedging methodology requires it to enter into short sales in the underlying securities. Bank typically establishes these short sales by borrowing the securities it sells short (the "Borrowed Securities").

Bank has proposed to enter into these securities-borrowing transactions with Affiliated Broker-Dealers. Bank has indicated that it has chosen to borrow securities from Affiliated Broker-Dealers (rather than from an unaffiliated securities lender) to help maintain the confidential and proprietary

[1] 12 U.S.C. § 371c; 12 CFR part 223. Wachovia has also requested that the Board grant a broader exemption for securities-borrowing transactions between any subsidiary bank of Wachovia and an Affiliated Broker-Dealer.

nature of Bank's hedging activities and to enable Bank to use the operational and systems capabilities of Affiliated Broker-Dealers (instead of maintaining its own securities-borrowing infrastructure).

Bank would borrow securities from Affiliated Broker-Dealers under a written securities-borrowing agreement, which would require Bank to post collateral to an Affiliated Broker-Dealer -- usually in the form of cash but sometimes in the form of other securities or letters of credit -- to secure its obligation to return the Borrowed Securities. The value of the collateral posted by Bank would have to equal a certain minimum percentage (the "margin percentage") of the value of the Borrowed Securities. The margin percentage would range from 100 to 105 percent, depending on the nature of the collateral and the Borrowed Securities. In the vast majority of cases, including the typical case in which Bank borrows a U.S. equity security secured by U.S. dollars or U.S. Treasury securities, the margin percentage would be 102 percent. Bank has represented that both the form and amount of collateral posted by Bank would be customary for securities-borrowing transactions between unaffiliated counterparties.

The cash collateral typically provided by Bank in a securities-borrowing transaction would not be held by the Affiliated Broker-Dealer in a segregated account during the term of the transaction. Instead, the Affiliated Broker-Dealer would re-pledge the cash collateral to secure a contemporaneous and parallel borrowing of the Borrowed Securities from a nonaffiliate.

During the term of the securities-borrowing transaction, Bank would mark to market on a daily basis the Borrowed Securities and any collateral and would call on a daily basis for the return of collateral to the extent that the value of the collateral exceeds the agreed margin percentage of the value of the Borrowed Securities.[2] Bank would be able to terminate a securities-borrowing transaction on any business day by returning the Borrowed Securities to the Affiliated Broker-Dealer, and the Affiliated Broker-Dealer would be able to terminate a transaction by giving Bank three business days' prior notice.

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[2] Bank also would have an obligation, upon request by an Affiliated Broker-Dealer, to post additional collateral to the extent that the value of the collateral drops below the margin percentage of the value of the Borrowed Securities.

Legal Analysis

Section 23A and Regulation W limit the aggregate amount of "covered transactions" between a bank and any single affiliate to 10 percent of the bank's capital stock and surplus, and limit the aggregate amount of covered transactions between a bank and all its affiliates to 20 percent of the bank's capital stock and surplus.[3] "Covered transactions" include the purchase of assets by a bank from an affiliate, the extension of credit by a bank to an affiliate, the issuance of a guarantee by a bank on behalf of an affiliate, and certain other transactions.[4] In addition, the statute and rule require a bank to secure its extensions of credit to, and guarantees on behalf of, affiliates with prescribed amounts of collateral.[5] Section 23A and Regulation W also authorize the Board to exempt, at its discretion, transactions or relationships from the requirements of the statute and rule if the Board finds such exemptions to be in the public interest and consistent with the purposes of section 23A.[6]

The Board has previously determined that a bank's collateralized borrowing of securities from an affiliate is an extension of credit by the bank to the affiliate for purposes of section 23A and Regulation W.[7]

The Exemption

In light of the facts and circumstances of this proposal, the Board believes that granting an exemption would be appropriate and consistent with precedent, as long as Bank complies with the following conditions.[8]

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[3] 12 U.S.C. § 371c(a)(1) and 12 CFR 223.11 and 223.12.

[4] 12 U.S.C. § 371c(b)(7) and 12 CFR 223.3(h).

[5] 12 U.S.C. § 371c(c) and 12 CFR 223.14.

[6] 12 U.S.C. § 371c(f)(2) and 12 CFR 223.43.

[7] See Board Letter dated June 7, 2005, to John H. Huffstutler, Esq. (Bank of America Corporation).

[8] Id. In the absence of an exemption, Bank would be required to count the entire amount of the collateral posted by Bank to an Affiliated Broker-Dealer toward the quantitative limits of section 23A and Regulation W. In addition, Bank would have to obtain Borrowed Securities from the Affiliated Broker-Dealer that had a market value equal to at least 130 percent of the collateral posted by Bank

First, in order to ensure accurate monitoring of Bank's exposure to affiliates and to limit Bank's unsecured exposure to affiliates, Bank must mark to market on a daily basis its securities-borrowing transactions with Affiliated Broker-Dealers, and the securities-borrowing transactions must be subject to daily margin-maintenance requirements. These requirements would ensure that Bank's exposure on a securities-borrowing transaction with an Affiliated Broker-Dealer would be limited to (i) the amount by which the value of the collateral must exceed the value of the Borrowed Securities (usually 2 percent of the value of the Borrowed Securities) plus (ii) the amount by which the value of the collateral might further exceed the value of the Borrowed Securities between the last remargining event and the time when Bank is able to liquidate Borrowed Securities after a default by an Affiliated Broker-Dealer.[9]

Second, in order to enhance Bank's ability to determine the mark-to-market value of the Borrowed Securities and to facilitate efforts by Bank to liquidate the Borrowed Securities if an Affiliated Broker-Dealer defaults, the exemption would be available only for transactions involving Borrowed Securities that have a "ready market," as defined in the net capital rule of the Securities and Exchange Commission ("SEC").[10] Under the SEC's interpretations of the net capital rule, U.S. equity securities have a "ready market" if they are traded on a U.S. securities exchange or are OTC securities quoted by independent market makers in an interdealer network.

In addition, Bank would be required to treat a portion of each securities-borrowing transaction with an affiliate as nonexempt. Specifically, the nonexempt covered transaction amount would be equal to (i) Bank's current

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(assuming the Borrowed Securities were equities) or would otherwise have to obtain additional collateral from an affiliate to comply with the collateral requirements of section 23A and Regulation W.

[9] Bank marks to market its securities-borrowing portfolio on the morning of each business day, based on closing prices for securities from the previous business day, and makes requests for the return of excess collateral on a daily basis. The securities-borrowing agreement between Bank and the Affiliated Broker-Dealers will require the Affiliated Broker-Dealers to return excess collateral on the same business day on which Bank makes the request.

[10] See 17 CFR 240.15c3-1(c)(11)(i).

unsecured exposure to Affiliated Broker-Dealers in securities-borrowing transactions plus (ii) an estimate of Bank's potential future exposure ("PFE") to Affiliated Broker-Dealers in the transactions.[11] Bank's current unsecured exposure to Affiliated Broker-Dealers in securities-borrowing transactions would equal the difference between the cash amount (or current market value of securities) posted as collateral by Bank and the current market value of the Borrowed Securities. Bank's PFE to Affiliated Broker-Dealers in securities-borrowing transactions initially would be fixed at 6 percent of the current market value of the Borrowed Securities,[12] but Bank may ultimately use an internal model to measure PFE or overall exposure for these transactions with the approval of Federal Reserve System and OCC staff.

To address the possibility that this exemption could facilitate Bank's structuring loans to affiliates in the form of securities-borrowing transactions, the exemption would be available only if the Affiliated Broker-Dealer executes a securities-borrowing transaction with an unaffiliated counterparty that is substantially contemporaneous with and on the same basic terms as the Bank's securities-borrowing transaction with the Affiliated Broker-Dealer. The purpose of this requirement is to ensure that exempt securities-borrowing transactions are bank-driven rather than affiliate-driven; that is, that securities-borrowing transactions are not used to finance the securities inventory of an Affiliated Broker-Dealer.

To enhance the ability of Bank to close out securities-borrowing transactions if an Affiliated Broker-Dealer becomes insolvent, Bank must document the transactions as securities contracts for purposes of section 555 of the Bankruptcy Code.[13] This practice should facilitate the ability of Bank to liquidate

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[11] Bank's potential future exposure in a securities-borrowing transaction is the potential additional unsecured exposure Bank may have to the Affiliated Broker-Dealer counterparty if the Borrowed Securities were to fall in value.

[12] This approach resembles the approach taken by the federal banking agencies' risk-based capital guidelines for measuring the credit risk of equity derivative transactions. See, e.g., 12 CFR part 225, Appendix A, § III.E.2.c.

[13] 11 U.S.C. § 555.

these transactions promptly after commencement of an insolvency proceeding with respect to the Affiliated Broker-Dealer.[14]

Bank would continue to be subject to the market-terms requirement of section 23B of the Federal Reserve Act in its securities-borrowing transactions with affiliates. Section 23B requires that these transactions be on terms that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with unaffiliated companies.[15]

Granting the exemption would have public benefits. The exemption would reduce the cost of securities-borrowing transactions for Bank and would, therefore, make Bank more competitive when pricing equity derivative and other transactions for customers.

Conclusion

In light of these considerations and all the facts presented, the request appears to be consistent with safe and sound banking practices and the purposes of section 23A. Accordingly, the Board hereby grants the requested exemption, subject to the conditions and limits discussed above. This exemption also is available to Wachovia's other subsidiary banks, subject to the condition that those transactions are on the same terms as those between Bank and the Affiliated Broker-Dealers, including the terms and conditions outlined in this letter.

This determination is specifically conditioned on compliance by Wachovia and Bank with all the commitments and representations made to the Board in connection with the exemption request. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the request and, as such, may be enforced in proceedings under applicable law. This determination is based on the specific facts and

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[14] If a securities-borrowing transaction between Bank and an Affiliated Broker-Dealer qualifies as a securities contract under the Bankruptcy Code, Bank's ability to liquidate the transaction in the event of the bankruptcy of the Affiliated Broker-Dealer generally cannot be stayed, avoided, or otherwise limited by operation of any provision of the Bankruptcy Code. See, e.g., 11 U.S.C. § 555.

[15] See 12 U.S.C. § 371c-1(a)(1).

circumstances of the securities-borrowing transactions described in your correspondence and in this letter. Any material change in those facts and circumstances or any failure by Wachovia or Bank to observe any of its commitments or representations may result in a different view or in a revocation of the exemption.

Very truly yours,

Robert deV. Frierson

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of Richmond
Office of the Comptroller of the Currency