



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 29, 2006

Courtney D. Allison, Esq.
Senior Vice President and
Assistant General Counsel
Wachovia Corporation
Legal Division
NC0630
One Wachovia Center
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.¹ The exemption would allow Wachovia’s subsidiary bank, Wachovia Bank, National Association (“Bank”) to make certain guarantees on behalf of, and extensions of credit to, its affiliated U.S. broker-dealers, including Wachovia Capital Markets, LLC and Wachovia Securities, LLC (together “Wachovia Borrowers”), all also of Charlotte, in connection with Bank’s securities lending program.

In Bank’s securities lending program, Bank, as agent for a customer, lends securities in a customer’s portfolio (“Borrowed Securities”) to another company, typically a securities broker-dealer (“Borrower”). The Borrower may use the Borrowed Securities for its own purposes but generally must return the securities on demand by Bank’s customer. The Borrower provides collateral to Bank, as agent for the customer, in the form of cash or U.S. government securities. The value of the collateral equals or exceeds the value of the Borrowed Securities

¹ 12 U.S.C. § 371c; 12 CFR part 223.

throughout the transaction. Bank actively engages in securities lending transactions with a number of unaffiliated securities broker-dealers.

Section 23A and Regulation W limit the 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 amount of covered transactions between a bank and all its affiliates to 20 percent of the bank’s capital stock and surplus. “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. In addition, the statute and regulation require a bank to secure its extensions of credit to, and guarantees on behalf of, affiliates with prescribed amounts of collateral. The statute and the regulation also have an “attribution rule” that treats as a transaction between a bank and an affiliate any transaction between a bank and a nonaffiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate.

Several aspects of the program, either as currently structured or as it might be structured in the future, expose Bank to credit risk in a manner that raises section 23A and Regulation W issues when the Borrower is an affiliate of the bank. First, in the agreements between Bank and its customers, Bank undertakes to return the Borrowed Securities to the customer whether or not the securities are returned to the bank by the Borrower. This indemnity is limited, however, to the amount by which the value of the Borrowed Securities exceeds the value of the collateral posted by the Borrower. The bank limits its exposure on this indemnity by marking to market daily the Borrowed Securities and any securities collateral and by calling for additional collateral if the value of the collateral posted by the Borrower drops below the value of the Borrowed Securities.

In addition, Wachovia has indicated that during the term of a securities loan, the Borrower has an obligation promptly to transmit to Bank’s customer any dividends, interest payments, or other similar distributions made by issuers on the Borrowed Securities. In the future, the bank may credit the customer’s account with these distributions on the date the distributions are payable by the issuer, regardless of whether the Borrower has forwarded the distribution amounts to the bank for the account of the customer. In such an event, the bank would have a short-term credit exposure to the Borrower in the amount of

any distributions that the bank has credited to a customer's account in advance of having received the distribution from the Borrower.

Finally, Wachovia has stated that during the term of a securities loan, Bank has discretion to advance funds to a Borrower, on behalf of a customer, to pay fees owed by the customer to the Borrower or to return excess collateral to the Borrower.

Bank proposes to engage in securities lending transactions with its U.S. broker-dealer affiliates, including Wachovia Borrowers, on the same terms and conditions, including lending limits, that the bank lends customer securities to unaffiliated broker-dealers. Because these transactions would involve guarantees by the bank on behalf of Wachovia Borrowers, and may in the future involve extensions of credit by the bank to or for the benefit of Wachovia Borrowers, Wachovia Borrowers' participation in the securities lending program would be subject to the quantitative, collateral, and other requirements in section 23A and Regulation W. Wachovia has requested an exemption from the statute and regulation for these covered transactions to allow Bank to conduct its securities lending program with Wachovia Borrowers in the same manner as the bank conducts this program with unaffiliated securities broker-dealers.

Section 23A and Regulation W specifically authorize the Board to exempt, at its discretion, transactions or relationships from the requirements of the statute and regulation if it finds such exemptions to be in the public interest and consistent with the purposes of section 23A.² Granting an exemption from the requirements of section 23A and Regulation W for the covered transactions generated by the inclusion of Wachovia Borrowers as Borrowers in Bank's securities lending program would be appropriate and consistent with Board precedent.³

² 12 U.S.C. § 371c(f)(2); 12 CFR 223.43.

³ See Board letters dated June 7, 2005, to Michael M. Wiseman, Sullivan & Cromwell LLP (The Bank of New York Company); and October 31, 2001, to Marjorie Gross, J.P. Morgan Chase & Co.

Under the indemnity given by Bank to its customers, the risk of loss to the bank does not appear to be substantial due to the daily mark-to-market and remargining procedures employed by the bank and the predominant use of cash and U.S. government securities as collateral to mitigate the bank's exposure to Wachovia Borrowers on the indemnity. In addition, the risk of loss to the bank from any future advances by the bank to customers on behalf of Wachovia Borrowers would be small because, among other things, the advances generally would be repaid on an intraday basis. Moreover, any future advances by the bank to Wachovia Borrowers on behalf of a customer generally would be short-term and secured by all the investment securities in the customer's accounts with the bank.

In light of the higher risks often associated with securities lending transactions collateralized by assets other than cash or U.S. government securities, and consistent with Board precedent, the Board believes that securities lending transactions between Bank and Wachovia Borrowers that are secured by property other than cash or U.S. government securities should be exempt from section 23A and Regulation W only to the extent that the total market value of Borrowed Securities lent to Wachovia Borrowers by Bank's customers against such collateral does not in the aggregate exceed the lesser of (i) 5 percent of the bank's capital stock and surplus or (ii) 5 percent of the total market value of Borrowed Securities lent to Wachovia Borrowers by the bank's customers.⁴

In the case of each of the three types of exposure, as well as other aspects of the transaction that involve payments by Bank to or on behalf of Wachovia Borrowers, the bank would continue to be subject to the market-terms requirement of section 23B and Regulation W. Because numerous unaffiliated Borrowers participate in Bank's securities lending program, examiners would be able to verify on an ongoing basis whether the bank's covered transactions with Wachovia Borrowers in the program are on substantially the same terms as those prevailing with nonaffiliates. Likewise, section 23B prevents the bank from

⁴ If the total market value of Borrowed Securities lent to Wachovia Borrowers by the bank's customers against property other than cash or U.S. government securities exceeds this threshold, the marginal amount would be treated as a nonexempt guarantee by the bank on behalf of an affiliate under section 23A and Regulation W and, accordingly, would be subject to the quantitative limits and collateral and other requirements of the statute and the regulation.

agreeing to indemnify or make an advance to a customer on behalf of Wachovia Borrowers, unless the bank would agree to make the same indemnity or advance on behalf of a nonaffiliate and prevents the bank from making an advance to Wachovia Borrowers on behalf of a customer, unless the bank would make the advance to a nonaffiliate on behalf of the customer.

For the reasons stated above, and in light of all the facts you have presented, the transactions appear to be consistent with safe and sound banking practices and the purposes of section 23A. Accordingly, the Board hereby grants the requested exemptions, subject to the conditions and limits on securities lending transactions collateralized by property other than cash or U.S. government securities discussed above. The Board also reserves the right to rescind this exemption if it is used by Bank to evade section 23A or Regulation W.

These determinations are specifically conditioned on compliance by Wachovia and Bank with all the commitments and representations they 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. These determinations are based on the specific facts and circumstances of the securities lending program described in your correspondence and this letter. Any material change in those facts and circumstances or any failure by Wachovia, Bank, or any other company relying on the exemption granted in this letter to observe any of its commitments or representations may result in a different conclusion or in revocation of the exemption.

Sincerely yours,

/s/ Robert deV. Frierson

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of Richmond
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency