



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

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

January 23, 2007

Patrick S. Antrim, Esq.  
Assistant General Counsel  
Bank of America Corporation  
Legal Department  
101 South Tryon Street  
Charlotte, North Carolina 28255

Dear Mr. Antrim:

This is in response to the request by Bank of America Corporation (“BAC”), Charlotte, North Carolina, for an exemption from section 23A of the Federal Reserve Act and the Board’s Regulation W.<sup>1</sup> The exemption would allow BAC’s subsidiary bank, Bank of America, N.A. (“Bank”), Charlotte, North Carolina, to engage in certain covered transactions with its affiliate, Banc of America Securities LLC (“BAS”), New York, New York, in connection with Bank’s proposed securities lending program. BAC also has requested that the Board grant a broader exemption that would apply to securities lending transactions between any subsidiary bank of BAC, on the one hand, and any U.S. broker-dealer affiliate of such bank, on the other hand, on the same terms and conditions as would apply were the transactions between Bank and BAS.

In Bank’s proposed securities lending program, Bank would lend, as principal, to BAS securities that have been pledged to Bank as collateral by unaffiliated customers (“Borrowed Securities”). In addition, Bank, as agent for an unaffiliated trust or custody customer, may lend to BAS securities in the customer’s portfolio and indemnify the customer for any losses incurred as a result of a failure by BAS to return the Borrowed Securities. In both of these types of securities lending transaction, BAS may use the Borrowed Securities for its own purposes but must

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<sup>1</sup> 12 U.S.C. § 371c; 12 CFR part 223.

return the securities on demand by Bank (or Bank's customer in cases where the bank is acting as agent). BAS would provide collateral to Bank, whether acting as principal or as agent for a customer, in the form of cash or U.S. government securities. Bank would ensure that the value of the collateral slightly exceeds the value of the Borrowed Securities on a daily basis throughout the transaction.<sup>2</sup>

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.<sup>3</sup> "Covered transactions" include a purchase of assets by a bank from an affiliate, a loan or extension of credit by a bank to an affiliate, an issuance of a guarantee by a bank on behalf of an affiliate, and certain other transactions.<sup>4</sup> 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.<sup>5</sup> Moreover, section 23A and Regulation W specifically authorize the Board to exempt transactions or relationships from the requirements of the statute and rule if the Board finds such an exemption to be in the public interest and consistent with the purposes of section 23A.<sup>6</sup>

The Board previously has determined that when a bank, acting as agent, lends customer securities to an affiliate and indemnifies the customer for any failure by the affiliate to return the securities, the bank's indemnity is a guarantee by the bank on behalf of that affiliate; therefore, it is a covered transaction subject to section 23A and Regulation W.<sup>7</sup> Although the Board has not previously addressed securities lending as principal under section 23A and Regulation W, the Board

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<sup>2</sup> The amount of collateral that BAS must post is generally 102 percent of the value of the Borrowed Securities.

<sup>3</sup> 12 U.S.C. § 371c(a)(1); 12 CFR 223.11 and 223.12.

<sup>4</sup> 12 U.S.C. § 371c(b)(7); 12 CFR 223.3(h).

<sup>5</sup> 12 U.S.C. § 371c(c); 12 CFR 223.14.

<sup>6</sup> 12 U.S.C. § 371c(f)(2); 12 CFR 223.43.

<sup>7</sup> See Letter dated October 31, 2001, from Jennifer J. Johnson, Secretary of the Board, to Marjorie Gross, J.P. Morgan Chase & Co. ("JPMC Letter").

believes that when a bank, acting as principal, lends securities to an affiliate, the bank is making a “loan or extension of credit” to the affiliate – a covered transaction that is subject to the statute and rule.

This interpretation is consistent with the form of the transaction – a loan by the bank to the affiliate – and is a corollary of Board staff’s long-standing informal position that any transaction in which a bank lends an asset to an affiliate is a “loan or extension of credit” by the bank to the affiliate for purposes of section 23A and Regulation W. Although a securities loan is different from a loan of cash, neither the statute nor the rule limit the scope of this covered transaction type to transactions in which the bank has lent cash to an affiliate. The statute does not define a “loan or extension of credit.” The rule defines an extension of credit broadly as “the making or renewal of a loan, the granting of a line of credit, or the extending of credit in any manner whatsoever.”<sup>8</sup>

Moreover, this interpretation is consistent with the economic substance of the transaction. The transaction imposes risks on the bank that are substantially similar to the risks associated with any collateralized loan of cash by a bank. Throughout the term of the transaction, the bank occupies a position where it stands to lose the difference between the value of the property lent by the bank to the affiliate and the value of the collateral posted by the affiliate in the event the affiliate becomes insolvent or otherwise defaults on its obligation to return the asset lent by the bank. In addition, if the Board were not to view a bank’s loan of a security (or other noncash asset) to an affiliate as an extension of credit by the bank to the affiliate for purposes of section 23A and Regulation W, banks could easily evade the restrictions of the statute and rule.

BAC has requested an exemption from section 23A and Regulation W for these covered transactions to allow Bank to lend securities to BAS on terms and conditions that are standard in the industry and that Bank has represented are the same terms and conditions under which Bank would, in good faith, lend securities to unaffiliated broker-dealers. Granting the requested exemption for the covered transactions generated by the Bank’s proposed securities lending program would be appropriate and consistent with Board precedent.<sup>9</sup>

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<sup>8</sup> 12 CFR 223.3(o).

<sup>9</sup> See JPMC Letter; and Letter dated May 5, 2005, from Robert deV. Frierson, Deputy Secretary of the Board, to Michael Wiseman, Sullivan and Cromwell.

In the proposed principal and agency securities lending transactions with BAS, the risk of loss to Bank does not appear to be substantial due to the daily mark-to-market and remargining procedures to be employed by Bank and the proposed use of cash and U.S. government securities as collateral to mitigate Bank's exposure to BAS. 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 BAS 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 the securities lent to BAS by Bank (whether acting as principal or indemnifying agent) against such collateral does not in the aggregate exceed the lesser of (i) 5 percent of Bank's capital stock and surplus or (ii) 5 percent of the total market value of the securities lent to BAS by Bank (whether acting as principal or indemnifying agent).<sup>10</sup>

Bank would continue to be subject to the market-terms requirement of section 23B and Regulation W in connection with the proposed securities lending program. In particular, section 23B would prevent the bank from lending securities as principal to BAS or agreeing to indemnify a securities lending customer on behalf of BAS unless the bank would agree to enter into the same transaction with or on behalf of a nonaffiliate. Although Bank does not propose to lend securities to unaffiliated companies at this time, securities lending and borrowing transactions are fairly standardized, and it should be relatively easy for examiners to ensure that Bank's securities lending transactions with BAS comply with section 23B by comparing the practices of Bank and BAS with the practices of other banks.

BAC has indicated that granting the exemptions would enable the bank's customers to obtain additional securities lending opportunities (and, consequently, an increased yield on their investment portfolios) and an increased ability to diversify the risks of securities lending, when Bank is acting as agent for its customers. Moreover, BAC has stated that, when Bank lends securities as principal, the supply of

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<sup>10</sup> If the total market value of Borrowed Securities lent to BAS by Bank (as principal or indemnifying agent) against property other than cash or U.S. government securities exceeds this threshold, the marginal amount would be treated as a nonexempt covered transaction under section 23A and Regulation W and, accordingly, would be subject to the requirements of the statute and rule.

available securities for securities borrowers will increase, resulting in greater competition in the marketplace.

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 exemption (subject to the indicated conditions and limits on securities lending transactions collateralized by property other than cash or U.S. government securities).

Consistent with Board precedent, the Board also grants your request for an exemption from the statute and rule for certain short-term, highly collateralized credit extensions by Bank to BAS that are incidental to Bank's proposed securities lending program.<sup>11</sup> In addition, the Board grants your request that any subsidiary bank of BAC, on the one hand, and any U.S. broker-dealer affiliate of such a bank, on the other hand, may rely on these exemptions on the same terms and conditions as would apply were the transactions between Bank and BAS. This broader exemption is subject to the additional condition that the securities lending program of any other subsidiary bank is structured in substantially the same manner as that of Bank (as determined by Federal Reserve staff). The Board reserves the right to rescind any or all of these exemptions if they are used to evade section 23A or Regulation W.

These determinations are specifically conditioned on compliance by BAC 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

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<sup>11</sup> Bank typically has a short-term credit exposure to BAS when Bank credits to its customer's account any dividends, interest payments, or other similar distributions on the Borrowed Securities on the date the distributions are payable by the issuer, regardless of whether BAS, which has an obligation to transmit such distributions promptly, has forwarded the distribution amounts to Bank for the account of the customer. This short-term exposure to BAS would be a covered transaction both when Bank is acting as principal and as agent. In addition, when Bank is acting as agent, rather than as principal, Bank has discretion to advance funds to BAS on behalf of a customer, to pay fees owed by the customer to the borrower or to return excess collateral to the borrower.

securities lending program described in your correspondence and this letter. Any material change in those facts and circumstances or any failure by BAC, 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 view or in a revocation of the exemption.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Jennifer J. Johnson", with a long horizontal flourish extending to the right.

Jennifer J. Johnson  
Secretary of the Board

cc: Federal Reserve Bank of Richmond