

Testimony of Robert K. Steel
Former CEO of Wachovia Corporation
Financial Crisis Inquiry Commission
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Chairman Angelides, Vice-Chairman Thomas, and Members of the Commission: Thank you for the opportunity to appear here today before the Financial Crisis Inquiry Commission. My name is Robert Steel, and I served as CEO of Wachovia from July 11, 2008 until December 31, 2008.

The Commission has asked me to address a number of issues, including the deterioration of Wachovia's credit portfolio in 2008 and the company's discussions with potential merger partners in late September and early October of 2008.

In 2006, approximately two years prior to my arrival at the bank, and at a time when Wachovia's market capitalization was approximately \$86 billion, Wachovia acquired Golden West Financial Corporation of Oakland, California for approximately \$25.5 billion. Golden West added significant size to Wachovia's then-small California retail banking presence and also added approximately \$120 billion of residential mortgages to Wachovia's balance sheet, which at the time had assets of about \$553 billion. Substantially all of the Golden West mortgage portfolio consisted of a product referred to as "option ARMs," or adjustable rate mortgages with monthly payment options.

As the Commission is aware, the housing market deteriorated throughout 2007 and 2008. In light of the worsening outlook for housing prices, changing borrower behavior and mark-to-market valuation losses on Wachovia's RMBS, CDOs and leveraged lending portfolios, Wachovia reported a loss in the first quarter of 2008 of \$707 million. Second quarter losses, which, like the first quarter 2008 losses, had been calculated prior to my arrival on July 11, amounted to \$9.1 billion, including a \$5.6 billion loan loss provision. These losses reflected worsening housing and economic conditions and, more specifically, anticipated future losses in Wachovia's loan portfolio, primarily the Golden West portfolio.

As we entered the late summer and autumn of 2008, a series of unexpected and unprecedented events occurred in rapid succession in the financial services industry that increased the uncertainty and stress in the financial markets. These events included the conservatorship of Fannie Mae and Freddie Mac on Sunday, September 7, 2008, the bankruptcy of Lehman Brothers Holdings and the acquisition of Merrill Lynch by Bank of America announced on Monday, September 15, 2008, and growing concerns about the viability of American International Group, which later culminated in a transaction in which the Federal Reserve acquired most of AIG's equity. On Thursday, September 25, in an unusual action, the Office of Thrift Supervision announced the seizure of the largest savings bank in the United States, Washington Mutual Bank, FSB, and the subsequent placement of Washington Mutual Bank into FDIC receivership, followed by a sale to JPMorgan Chase for approximately \$1.9 billion. In addition, on September 25, the tentative agreement in the U.S. Congress regarding the Administration's economic stabilization proposal collapsed.

The combination of the events from earlier in September, the seizure of Washington Mutual Bank on Thursday, the 25th and the collapse of Congressional agreement regarding the Administration's economic stabilization proposal precipitated a sharp downward turn in the financial markets. The cost to insure Wachovia debt as evidenced by credit default swap spreads increased substantially from Thursday, September 25 to Friday, September 26. On Friday, September 26, there was significant downward pressure on Wachovia's common stock and deposit base, and as the day progressed, some liquidity pressure intensified as financial institutions began declining to conduct normal financing transactions with Wachovia.

In light of these deteriorating market conditions during the week of September 22, it appeared that Wachovia was no longer in a position to engage in the public offering and private placement transactions necessary to raise capital which, in turn, was considered to be the best method short of selling the company for sustaining Wachovia in this tumultuous environment. Heading into the weekend of September 27-28, management advised the Board of Directors that, in light of the bank's inability to access the capital markets, Wachovia had begun discussions

with both Citigroup and Wells Fargo regarding a possible merger and that management intended to pursue both options during the weekend. The failure of these negotiations could have resulted in Wachovia filing for bankruptcy and the national bank being placed into FDIC receivership. Such a result would have had a major impact on Wachovia's creditors, counterparties, employees and, more broadly, on the U.S. economy.

On September 26, Wachovia entered into a Confidentiality Agreement with both Citigroup and Wells Fargo and initiated intense substantive negotiations with each of these banks toward a possible acquisition of Wachovia.

On Saturday, September 27, and in an early morning meeting on September 28, Richard M. Kovacevich, the Chairman of Wells Fargo, communicated to me that Wells Fargo was considering an offer to purchase all of Wachovia in a stock-for-stock transaction, pending completion of due diligence activities. Mr. Kovacevich commented that Wells Fargo was working on a transaction that would not require government assistance and that he believed Wells Fargo could meet the Monday morning timetable.

Both Wells Fargo and Citigroup conducted extensive due diligence investigations of Wachovia on September 27 and 28. In response to Mr. Kovacevich's request, Wachovia's outside counsel prepared and transmitted a draft Agreement and Plan of Merger to counsel for Wells Fargo. Representatives of Citigroup, on the other hand, indicated to me that their interest was to acquire only Wachovia's banking subsidiaries, with an FDIC guarantee and assistance. As a result, the transaction would have created a residual entity with the nonbank assets and other liabilities.

At approximately 6:00pm on Sunday, September 28, Mr. Kovacevich reversed course and informed me that Wells Fargo was not prepared on such a compressed timetable to offer to acquire Wachovia without substantial government assistance. Although I did not know it at the time, later that evening, representatives of Wells Fargo proposed to, and discussed with, representatives of the FDIC and other federal banking regulators a possible transaction between

Wells Fargo and Wachovia that included a loss-sharing agreement with the FDIC whereby Wells Fargo's exposure to losses would be limited with respect to specified Wachovia assets that it did not have an opportunity to review in depth during its due diligence.

Shortly after I spoke to Mr. Kovacevich, Sheila Bair, Chairman of the FDIC, contacted me by telephone. She advised me that the FDIC believed that no transaction with Citigroup or Wells Fargo could be effected without government assistance. Chairman Bair confirmed that in the FDIC's view Wachovia's situation posed a systemic risk to the banking system, and that the FDIC was prepared to exercise its powers under Chapter 13 of the Federal Deposit Insurance Act to effect an open bank assisted transaction. Subsequently, Chairman Bair directed Wachovia to commence negotiations with Citigroup.

On behalf of Wachovia, Jane Sherburne, Wachovia's General Counsel, proceeded to sign an Agreement-in-Principle with Citigroup. Under the proposed terms in the Agreement-in-Principle, which was not binding on the parties unless and until the parties entered into definitive agreements that provided for all necessary terms and conditions, Citigroup would acquire Wachovia's banking subsidiaries but not Wachovia Securities, Evergreen Investments, certain insurance-related businesses, other businesses and liabilities or Wachovia itself. Under the terms of the Agreement-in-Principle, Citigroup's offer was contingent upon the FDIC guaranteeing \$312 billion of Wachovia's assets, after Citigroup absorbed the first \$42 billion in losses. Ms. Sherburne also signed an Exclusivity Agreement between Citigroup and Wachovia dated September 29, 2008.

After the signing of the Agreement-in-Principle and Exclusivity Agreement, I participated on behalf of Wachovia in the negotiations with Citigroup toward reaching definitive agreements that would be presented to Wachovia's board and shareholders for approval. These negotiations began immediately and were conducted earnestly and in good faith by a team of Wachovia employees and outside advisors. These negotiations, however, proved extremely complicated and difficult.

Wachovia was under significant pressure from Citigroup and the regulators to conclude a transaction with Citigroup with definitive agreements by the following Monday, October 6, 2008. On multiple occasions I and our advisors attempted to persuade Citigroup to structure a whole company transaction because of its substantially reduced completion risk, but Citigroup refused.

On October 2, 2008, at approximately 7:15pm, I received an unexpected call from Chairman Bair. She initially asked if I had heard from Mr. Kovacevich. I explained that, other than a brief congratulatory call after the announcement of Wachovia's transaction with Citigroup on the previous Monday, I had not spoken to Mr. Kovacevich since the commencement of our negotiations with Citigroup. She advised me that it was her understanding that he would be calling me shortly to propose a merger transaction that would result in Wachovia's shareholders receiving \$7.00 per share of Wells Fargo common stock. As I was on an airplane about to take off, I asked Chairman Bair to coordinate logistics with Ms. Sherburne, our General Counsel. At my request, Chairman Bair shortly thereafter called Ms. Sherburne, and provided details on the proposed transaction, including that it would not require any government assistance, and indicating that it appeared that the Wells Fargo transaction was superior to the Citigroup transaction from the perspectives of both Wachovia and the government. Ms. Sherburne advised Ms. Bair that unless Wachovia had a signed and Board-approved merger agreement from Wells Fargo, it could not consider this proposal. Ms. Bair said that she would so inform Mr. Kovacevich.

When I landed in North Carolina later that evening, I returned Chairman Bair's call to further understand Mr. Kovacevich's proposal. Consistent with what she told Ms. Sherburne, Chairman Bair described Wells Fargo's proposal to me as requiring no government support with no risk to the FDIC fund. At approximately 9:00pm, I received a call from Mr. Kovacevich telling me that momentarily he would be sending me a signed, Board-approved, merger agreement for the acquisition of all of Wachovia. He told me that Wells Fargo had taken a renewed look at Wachovia's assets over the past few days and had decided that it could

consummate a transaction without government support. He did not then or later tell me what led to this decision.

Wachovia's Board of Directors approved the transaction later that evening subject to the receipt of fairness opinions from our financial advisors. After receiving favorable fairness opinions early the next day, Friday, October 3, 2008, Wachovia and Wells Fargo announced the merger agreement to the public.

I would be pleased to answer the Commission's questions. Thank you.