MAKING MOVES

by Steve Brown

In an unexpected move this morning, Wells Fargo stole Wachovia from Citigroup, saying it would buy the entire company for $15.4B, or about 7x the value offered by Citigroup (which was also leaving AG Edwards and Evergreen behind). Because of this sharp difference in price and structure, no counter offer from Citigroup is expected.

In short, Wells Fargo will assume the risk in Wachovia (albeit after first taking a $32B writedown on Wachovia's toxic mortgage portfolio and a 26% reduction to the CRE portfolio), but get the return of a significant nationwide franchise. In addition, Wells did not ask for any FDIC support, so it is good for taxpayers and the industry. Wells Fargo said it will issue $20B in new common stock as part of the transaction to ensure capital levels remain strong.

As for community banks, the combination of Wells and Wachovia creates a powerhouse of a competitor. The company will have combined assets of $1.4T; $787B in deposits; 48mm customers; 10,761 branches; 12,227 ATMs and more than 280k employees. It will do business in 39 states, as well as D.C. and will have the #1 deposit market share in 17 of those states. This competitor combines a strong customer service culture in Wachovia with a strong sales/cross-selling culture in Wells.

Community bankers should also be aware that a significant branch reduction is likely to come into play (given overlap in certain markets), so if you are lucky enough to be in those areas, opportunities abound to pick up new locations and deposits.

CONGRESSIONAL VOTE

The roller coaster ride continues as the House votes today on the modified economic Rescue Plan. It is expected to pass this time around. Tweaked by the Senate and containing multiple additional add-ons to swing the House vote, the Plan will give the Treasury plenty of room to get going and a $700B war chest to do so. If the Plan passes as presented, the Treasury will be able to buy mortgages, credit card debt, auto loans and other depressed securities. They will also be allowed to provide credit guarantees on whole loans. This part is still a bit murky, but it appears as though it would allow the Treasury to support loans that banks have modified with additional guarantees. In so doing, if these modified loans eventually went bad, the Treasury would at that time pay on the guarantee. This move saves the Treasury from having to pay now and keeps the modification process in the hands of banks. We got lots of calls from community bankers yesterday asking about the insurance coverage. Know that the bill would increase deposit insurance coverage to $250k per depositor per institution, would take effect immediately and would expire on December 31, 2009, unless renewed by Congress. That means a married couple could each put up to $250k in an individual account and $500k in a joint account and be insured for a total of $1mm. Other items in the bill that of interest includes executive pay restrictions (larger participants in the program would lose tax deductions for executive salaries in excess of $500k and "golden parachutes" would be subject to a 20% tax); equity loss tax treatment (community banks could write off FN/FH stock losses as "ordinary" for tax purposes) and funding ($250B is authorized immediately, with an additional $100B after the White House makes a report to Congress). Finally, we expect the Federal Reserve will cut rates by 50bp and for other central banks around the world to follow suit with rate cuts of their own (especially if it fails). As an aside, in case you haven't noticed, the FRB has effectively already done this. They have dumped so much excess liquidity on the market, that yesterday's Fed Funds effective rate was a mere 0.67%. In addition, the Fed funds rate has averaged only 0.91% so far in October and was 1.23% for all of last week. As the Plan moves toward a vote, many questions remain even if it passes as-is, so we will definitively be covering this as events continue to unfold. In the meantime, our advice to bankers is to keep your arms and legs inside and wait for the ride to come to a complete stop before trying to exit.

BANK NEWS

Discount Window

Commercial banks borrowed $49.5B this past week, more than the prior record following 9/11. Total loans from the Fed this week reached $410B.

US Debt

The national debt is now approaching 70% of GDP, a level not seen since the 1950's. For comparison, this surpasses the UK (43%), France, Canada and Germany (all around 65%). Japan, however, remains the highest of any G7 country at almost 195%.