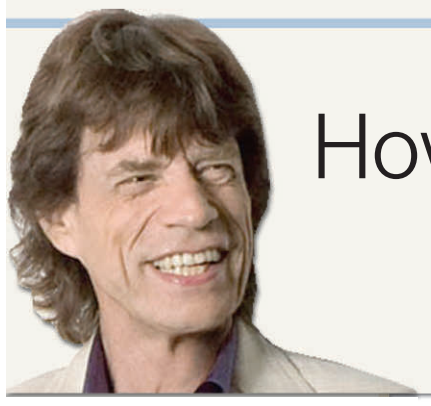
UCLA beats Xavier

SPORTS, 1C



MICK JAGGER

How he still gets what he wants

IN PARADE MAGAZINE

BEST DON'T-MISS GRANDFATHER HIKES

IN TRAVEL, 1I

Charlotte Observer

SUNDAY, MARCH 30, 2008 + www.charlotte.com C D E F • • • Price varies by county | $1.50

SHOT AT FINAL FOUR

Davidson's biggest game ever

By Kevin Cary
kcary@charlotteobserver.com

DETROIT — Davidson basketball player Bryant Barr understands what's at stake today.

"We know the whole Charlotte area will be watching and cheering for us," he said of the Wildcats' 5:05 p.m. Midwest Regional championship game against No. 1 seed Kansas. "It just makes us want it even more."

A victory today at Ford Field would send No. 10 seed Davidson to the Final Four in San Antonio for a shot at its first NCAA Division I title.

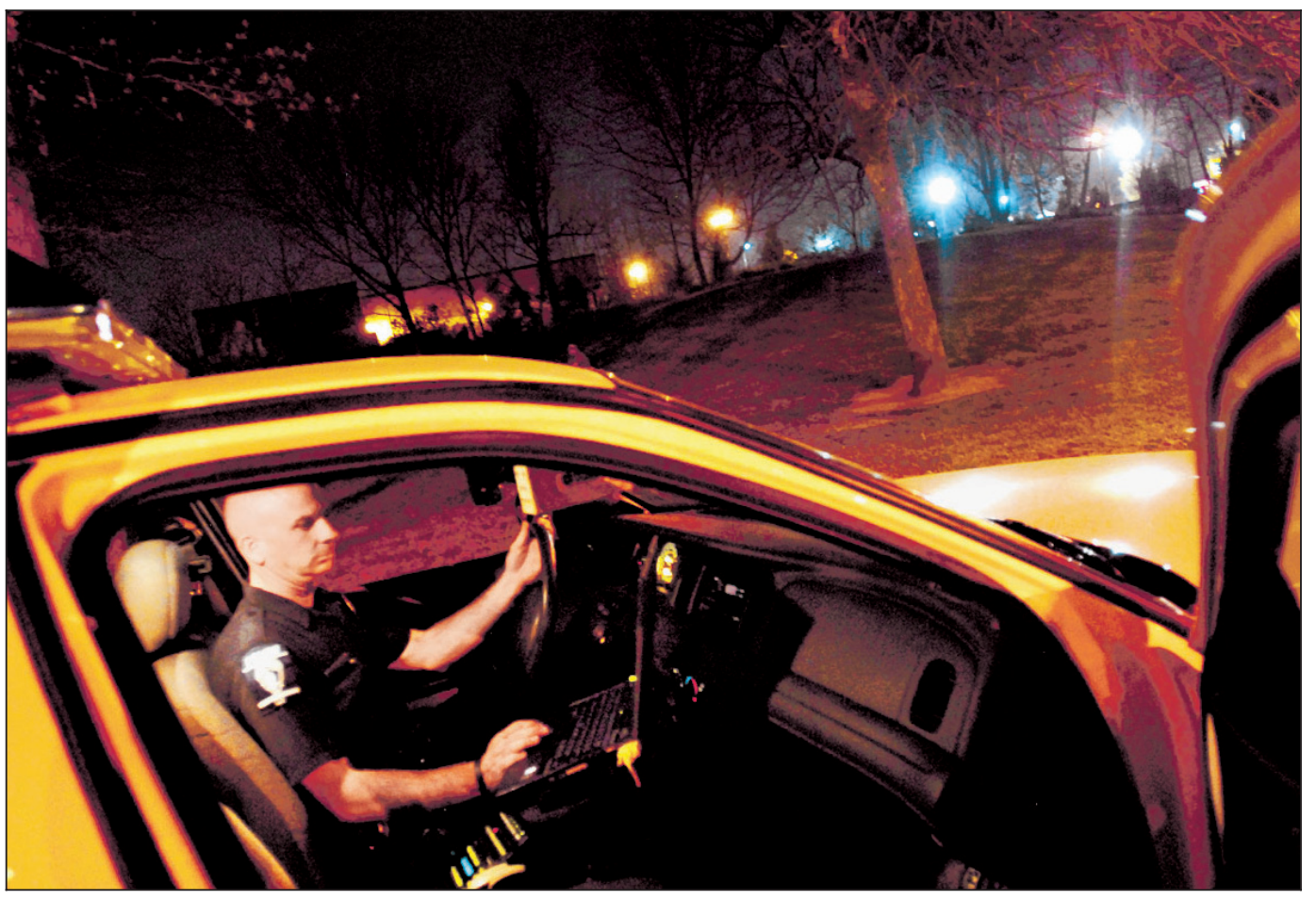
"We might be a little school," said Davidson star guard Stephen Curry. "But we can play with anyone in the country."

More than 550 students – roughly a third of Davidson's 1,700 student population – are expected to see the game in Detroit.

That includes 200 who were expected to board five buses at 3 a.m. today for the 11-hour trip.

POLICE TARGET HOT SPOTS

Crime clusters at apartments, near highways and retail areas



DANA ROMANOFF – dromanoff@charlotteobserver.com

Charlotte-Mecklenburg police Officer R. Sanner patrols the Wood Field apartments near Albemarle Road and Farm Pond Lane. The area is one of the city's hot spots for crime. Some residents say they've noticed a stronger police presence.

By Cleve R. Wootson Jr.
cwootson@charlotteobserver.com

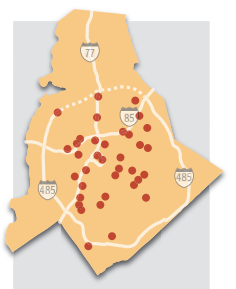
Charlotte-Mecklenburg police have identified 36 "hot spots" where concentrated crime demands their attention – and can make life hard for people who live, work or shop there.

The hot spots contain some of Charlotte's most violent streets but also include upscale retail areas where thefts from cars prompt most calls for police.

The trouble spots are spread across the county, as police have targeted the two or three most consistently challenging areas in each of the 13 patrol divisions. Many hot spots are clustered along highways and in areas packed with aging apartments, though every section of Mecklenburg has a place that keeps police busy.

Charlotte's three major shopping malls and a Ballantyne

SEE TRENDS | 8A



Detailed map inside

See where Mecklenburg County's "hot spots" are for violent and property crime.

Sally Johnson, a resident of a Farm Pond apartment complex in east Charlotte, carries a metal pipe with her when she goes to and from her car in the parking lot.

JEFF SINER – jsiner@charlotteobserver.com

High-crime area has fear as a constant

Staff Reports

The 18-inch metal pipe fits comfortably in Sally Johnson's hand.

She uses it for protection as she makes her way from the parking lot, up a walkway and two flights of stairs, into her east Charlotte apartment. There, her son waits, watching the shadows surrounding his mother.

This has been her nightly routine since Feb. 8, when two men robbed them at gunpoint. Andrew, 15, begged them to leave.

"Just take what you want," he remembers shouting.

The robbers beat her, stole her purse – and her peace of mind.

This is her life in a hot spot, one of 36 areas targeted by Charlotte-Mecklenburg po-

SEE HOT SPOT | 9A

Online Video

A ride-along with a Charlotte-Mecklenburg police officer
WWW.CHARLOTTE.COM/news

AT STATE AGENCIES

Officials told to destroy e-mails

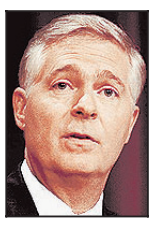
Notes suggest Easley's press office gave order

By Pat Stith
(Raleigh) News & Observer

State government public information officers were instructed by Gov. Mike Easley's press office to delete e-mail to and from the Governor's Office, according to notes the Governor's Office released Saturday.

Andrew Vanore, a lawyer who works for Easley, produced notes made by two public information officers showing that they and others were told at a meeting May 29 to destroy e-mail messages. Vanore said a third public information officer, whom he would not identify, also recalled those instructions.

Vanore said, however, that the notes don't mean what they say. He also said the instructions were not followed.



Easley

The News & Observer had requested the notes of the periodic meetings of the public information officers.

Julia Jarema, public information officer at the Department of Crime Control and Public Safety, recorded this note for the meeting in question: "Public records request – increasing – careful of email – delete emails to/from gov. office every day".

Diana Kees, public information officer at the Department of Environment and Natural Resources, recorded this note: "emails — more & more public records requests (blogs?) be careful w/emails; delete emails to and from gov office every day".

Questions about the way the Easley administration handles e-mail arose after an N&O series, "Mental Disorder: The Failure of Reform," which ended March 2. The series reported on an ill-con-

SEE EASLEY | 12A

Online Extras

Fired public information officer for N.C. Department of Health and Human Services says e-mails were deleted.
WWW.CHARLOTTE.COM/news

Obama

Clinton

Politics | 4A

Will tough fight leave party beaten?

Some Democrats fear that if the close contest between Sens. Hillary Clinton and Barack Obama goes on too long, it will hurt the party in November. And they fear alienating large blocs of voters if superdelegates decide the nomination.

▶ Edwards won't say if he'll make an endorsement. **4A.**

MoneyWise | 1D

How Charlotte's economy is faring

Assessing the state of jobs, retail, housing and growth.

Dreary

Low: 43. High: 45. Chilly with periods of light rain today and tonight. Warmer Monday. **Forecast, 28A.**

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CUSTOMERS, EX-EMPLOYEES QUESTION PICK-A-PAYMENT

Complex Wachovia mortgage program worries some

Staffers had a sample script – and sales goals to meet

By Rick Rothacker
rrothacker@charlotteobserver.com

When she stopped by a Wachovia branch in Charlotte last month, Marilyn O'Connor asked about refinancing her townhome. Instead, she got a pitch for a "Pick-A-Payment" mortgage that offered flexible payment options but a higher interest rate.

O'Connor said she initially agreed to apply for a Pick-A-Payment loan until she learned the interest rate. The full principal and interest payment option had a rate of 6.85 percent, higher than the 6.75 percent rate on her existing mortgage. A regular 30-year fixed rate at the time had a 5.5 percent rate, according to her loan documents.

"I said, 'Are you crazy?' " O'Connor, 66, said. "I'm not going to spend that much on interest. It was very disheartening."

Since buying Pick-A-Payment specialist Golden West Financial in 2006, the Charlotte-based bank has been rolling out these nontraditional loans at branches and mortgage offices around the country. But the push has become a sore spot with some customers and employees. Loan officers say they have faced intense pressure from the company to persuade borrowers to use the loans.

Wachovia has required its loan officers to sell a minimum number of Pick-A-Payment, traditional and other loans or face discipline, including termination, according to interviews and documents. A

SEE WACHOVIA | 6A

MORE INSIDE, 6A

- Selling Pick-A-Payment mortgages: A sample script from Wachovia
- Wachovia No. 2 in option ARMs

Complex mortgage plan worries some

Wachovia *from 1A*

training script obtained by the Observer tells loan officers, known as mortgage consultants, how to sell Pick-A-Payment loans, including empathizing with customers' cash flow problems.

An excerpt: *Do you have any credit card debt? [Wait for acknowledgement.] I know I certainly have my share. And we're paying 13 to 29 percent.*

The bank said it has sales goals like any company. Spokesman Don Vecchiarello declined to provide details on past targets but on Friday said the bank no longer has a "specific Pick-A-Payment goal at this time for employees to sell."

While Wachovia dismisses employees from time to time for underperformance, "we have not terminated anyone for not selling enough Pick-A-Pay loans and will not in the future," Vecchiarello said.

The loans can be more profitable for the bank because they carry a higher interest rate than traditional mortgages and because the bank keeps them in its own portfolio, instead of selling them off to investors. Consumer advocates contend they should be reserved for savvy customers who understand a complex product that can increase a borrower's loan balance instead of decreasing it.

Analysts also are worried because Pick-A-Payment loans are showing higher delinquencies than traditional mortgages amid the U.S. housing crisis, particularly in tough housing markets such as California. The bank's stock is down more than 56 percent since agreeing to buy Golden West, which also gave Wachovia new West Coast branches. The shares closed Friday at $25.99, down $1.08.

The bank, which has burnished a strong customer service reputation in recent years, acknowledges the loans aren't right for all customers but argues they offer flexibility to borrowers who need extra cash for savings or to pay down other debt. The bank says the loans come with numerous protections, including a cap on the amount the loan balance can increase. It also analyzes the borrower's ability to repay based on the full interest rate, not a low introductory rate.

Pick-A-Payment loans are "one of the many products we're able to offer," Vecchiarello said. "We feel like we do it in the right way."

Monthly options

The Pick-A-Payment, or Pick-A-Pay, loan gets its name because it comes with four monthly payment options. Homeowners each month can make one of four payments:

- Full interest and principal payment that pays off the loan in 30 years.
- A higher payment that would pay off the loan in 15 years.
- An interest-only payment.
- A minimum payment that doesn't cover all of the necessary interest, with the unpaid interest added to the loan balance.

The loan comes in adjustable-rate and fixed-rate versions.

Wachovia has expanded into these mortgages at a time when others are pulling back. Charlotte-based Bank of America, for example, stopped making the loans last year.

Since buying Golden West, Wachovia has been promoting Pick-A-Pay loans with a TV commercial, in-branch brochures and information on its Web site. The push comes as Wachovia and other banks are trying to improve profits as they wrestle with bigger loan losses and a slowing economy. Wachovia faces particular scrutiny because it bought Golden West for $24 billion at the peak of the housing boom.

The Observer in January reported that employees receive higher incentive pay for selling Pick-A-Pay and some other loans. The bank says it pays the extra compensation because the loans take longer to explain to customers. Consumer advocates worry that could encourage employees to sell inappropriate loans to customers.

The bank has three main ways to sell mortgages: call centers that handle phone calls and Web site inquiries; loan officers who work in mortgage offices; and loan officers who work in bank branches. The Observer has heard from employees in all three areas who say they have faced mandates to sell more Pick-A-Pay loans.

A former Wachovia mortgage consultant in Texas told the Observer he was supposed to sell two Pick-A-Pay loans per month, a requirement he didn't meet. The consultant, who spoke on condition of anonymity because he didn't want to jeopardize his career, said he felt the loans were proper for only a limited number of customers. In particular, he didn't think they were right for first-time homebuyers who might not understand their loan balance could increase.

"That's all we heard about was Pick-A-Pay," said the consultant, who said he was dismissed for "production reasons." "If you sold a 30-year fixed (rate mortgage), they'd say, 'Why didn't you sell a Pick-A-Pay?' "

Another former loan officer, who also spoke on condition of anonymity to protect her career, told the Observer she left last year because of the pressure. She said she didn't want customers to owe more money on their loan when they went to sell their home. "I want them to have 10 percent down for their next home," she said.

According to an employee document dated last fall, loan officers in branches had a "minimum standard" requiring them to sell one Pick-A-Pay loan, one traditional mortgage and one other type of mortgage per month. A higher "performance goal" called for selling two Pick-A-Pay loans per month, plus six other loans. If standards were not met, "it may lead to further corrective action up to and including termination," the document said.

Vecchiarello, the bank spokesman, said the company's sales goals have been changing in a rapidly shifting mortgage environment. The company, he said, wants its employees to sell a mix of loans, including traditional mortgages that can be sold to investors as well as Pick-A-Pay and other mortgages that it keeps in its portfolio.

Ira Rheingold, executive director of the National Association of Consumer Advocates, said pressure on employees to sell Pick-A-Pay mortgages worries him "enormously" because the loans aren't suitable for most borrowers.

"Employees are caught in the middle trying to hold onto their jobs," he said. "Unless (borrowers) are really sophisticated and understand what they're doing, it's a recipe for disaster."

Additional scrutiny

In the past couple of years, nontraditional mortgages have gained more scrutiny from regulators because of concerns about their complexity and the risk they can present lenders.

In 2006, regulators issued guidance to banks that included a caution against employee incentive plans that could lead to a heavier concentration of these loans in financial institutions' books. "Attention should be paid...to using compensation programs that do not improperly encourage lending personnel to direct consumers to particular products," the guidance, signed off on by five regulatory agencies, said.

The Office of the Comptroller of the Currency and the Office of Thrift Supervision, two regulators that monitor Wachovia, declined to comment on the bank's policies.

Vecchiarello said Wachovia's goal is to listen to customers, assess their needs and provide them with options. "That's the beauty of our model," he said.

In the case of O'Connor, the Charlotte customer, a Wachovia loan officer outlined a sample Pick-A-Pay loan that had four monthly payment options, ranging from $917.18 to $442.63, according to materials she received.

O'Connor, who works part time in home health care, said she didn't want flexibility at the expense of a higher interest rate. "Listen, I pay my mortgage no matter what," she said. "If something comes up, that's why I have savings."

After turning down the Pick-A-Pay loan, she initially chose to refinance her home through Wachovia with a traditional 30-year fixed-rate mortgage at an estimated rate of 5.5 percent. Then she and her husband, Michael, decided to hold off on refinancing all together. She lost a $75 application fee.

Vecchiarello, the bank spokesman, said the bank's loan officer appears to have acted appropriately by giving a customer options. The Pick-A-Pay loan "is a valuable product to offer to customers," he said. "It's not right for everyone."

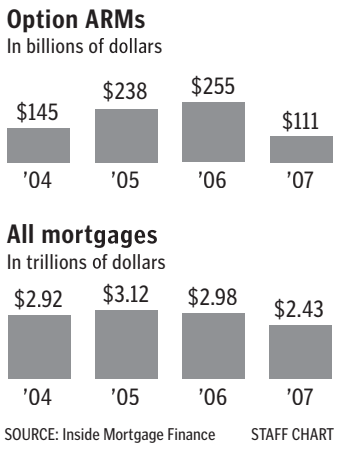
Rick Rothacker: 704-358-5235

DANA ROMANOFF – dromanoff@charlotteobserver.com

Marilyn O'Connor felt that Wachovia did not have her best interests in mind when she tried to refinance her townhome. A loan officer originally suggested Pick-A-Payment for her mortgage, O'Connor says.

Slower mortgage lending

Option adjustable-rate mortgages, which Wachovia calls Pick-A-Payment loans, have declined faster than traditional mortgage originations overall.



SOURCE: Inside Mortgage Finance STAFF CHART

Selling Pick-A-Payment mortgages

A training script obtained by the Observer gives Wachovia loan officers a sample pitch for selling Pick-A-Payment loans, which offer customers flexible payment options but can increase a borrower's loan balance.

In the 14-page document, the first two pages emphasize the variety of products the bank offers but the rest is mostly about Pick-A-Pay loans and how "savvy homeowners can turn their mortgages into smart financial planning tools" in today's economy.

From the presentation:

If you're like us, there's more coming out than coming in some months, and we start putting more and more charges on our credit card. ...What can we do? Uncle Sam isn't going to take less. Or the car company. Or the credit card company. The children need to be cared for. You can't get along without insurance. Plus, you need to eat, and keep the lights on. That leaves your mortgage payment. ...What if you could pay a lot less on your mortgage some months when you need flexibility?

The script instructs loan officers to tell customers that choosing the minimum payment option adds to the customer's loan balance. But the focus is on the extra "cashflow" customers can get by paying less per month.

Wachovia has training programs for everything the bank does as it tries to help its salespeople be the "best they can be," bank spokesman Don Vecchiarello said. "The most important thing," he said, "is listening to the customer."

Wachovia No. 2 in option ARMs

According to Inside Mortgage Finance, Wachovia in 2007 was the second biggest provider of option adjustable rate mortgages, or option ARMs – the category that includes Pick-A-Payment loans.

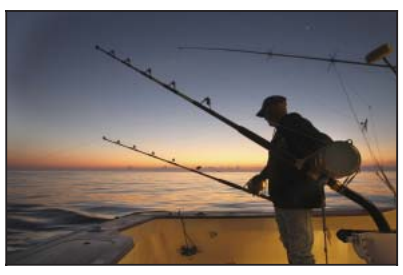
Seattle-based Washington Mutual was No. 1 with $23.67 billion in loans, ahead of Wachovia's $22.81 billion. About one-fourth of Wachovia's $97 billion in mortgage volume last year was in option ARMs.

Over the last six months, about 11 percent of loans made in the Carolinas were Pick-A-Pay loans, the bank said.

One of the key features of an option ARM is that borrowers can make a minimum payment that doesn't cover all of the interest. When this occurs, the total loan balance grows, instead of shrinks.

Wachovia calls the amount added to the loan balance "deferred interest."

At the end of December, Wachovia borrowers had accumulated $3.1 billion in deferred interest, nearly double the balance at the end of 2006. The amount, though, was a small part of the bank's $227 billion consumer real estate portfolio, which includes mortgages and home-equity loans.



6 EASY PLACES STAY CHEAP ON THE N.C. COAST. TRAVEL

The Charlotte Observer

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Clinton ends bid with call to elect Obama

After a heated campaign, she praises him and talks about her milestone run.

By Adam Nagourney and Mark Leibovich
New York Times

WASHINGTON — Sen. Hillary Clinton ended her campaign for president Saturday with a rousing farewell to thousands of supporters and an emotional and unequivocal call for them to get behind Sen. Barack Obama, who defeated her for the Democratic nomination.

For 28 minutes, standing on a stage in the National Building Museum, Clinton spoke not only about the importance of electing Obama, but also the extent to which her campaign was a milestone for women seeking to become president.

She urged women who had followed her campaign not to take the wrong lesson from her loss.

"You can be so proud that, from now on, it will be unremarkable for

SEE **CLINTON,** 7A

SEE VIDEO OF CLINTON'S SPEECH
www.charlotte.com/politics

RON EDMONDS – ASSOCIATED PRESS PHOTO

Sen. Hillary Clinton, D-N.Y., speaks in Washington on Saturday. "I ask all of you to join me in working as hard for Barack Obama as you have for me," Clinton said.

Funding of pet projects thriving

Anger over earmark abuse hasn't stopped lawmakers from adding billions in spending to legislation.

By Andrew Taylor and Jim Kuhnhenn
Associated Press

WASHINGTON — So much for trimming the pork.

The practice of decorating legislation with billions of dollars in pet projects and federal contracts is thriving on Capitol Hill – despite public outrage that helped flip control of Congress two years ago.

More than 11,000 of those "earmarks," worth nearly $15 billion, were slipped last year into legislation telling the government where to spend taxpayers' money this year, keeping them at the center of Washington's culture of money, influence and politics.

It's a pay-to-play sandbox where, critics say, waste and abuse often obscure the good that earmarks can do.

An examination of many of those earmarks in a project sponsored by the Associated Press Managing Editors found much greater disclosure since 2006, but it found no end to what has become ingrained behavior in Congress.

Millions of the dollars support lobbying firms that help companies, universities, local governments and others secure what critics such as Republican presidential candidate John McCain call "pork-barrel" spending. The law forbids using federal grants to lobby, but lobbyists do charge their clients fees that often equal 10 percent of the earmark they help win.

Earmark winners and their lobbyists often reward the lawmakers who sponsor their projects with campaign contributions. For many members of Congress – especially those on the appropriations committees, such as Rep. John Murtha, D-Pa. – campaign donations from earmark-seeking lobbyists and corporate executives are the core of their fundraising.

Rep. David Price, the only N.C. lawmaker who's on an appropriations committee, said he didn't keep track of how many of the $90 million in earmarks he sponsored were

SEE **EARMARKS,** 11A

2008 Earmarks

NATIONAL TOTAL
$15 billion

N.C. TOTAL
$234 million

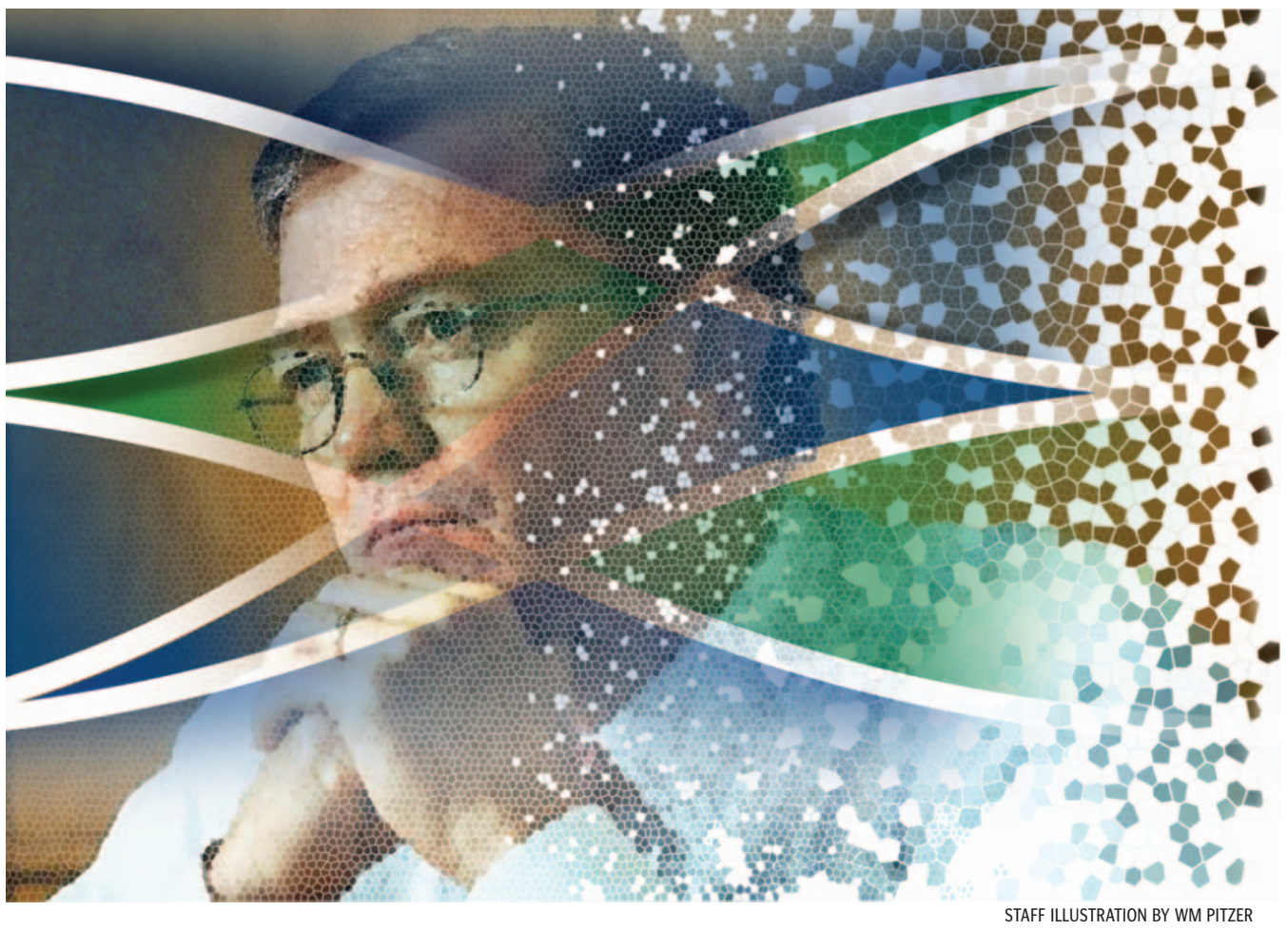
S.C. TOTAL
$151 million

ONLINE DATABASE
State-by-state earmarks
charlotte.com/news

WHAT'S AN EARMARK?

An earmark is a specific project not requested by the president but inserted into spending bills. Critics call it "pork barrel" intended to benefit a politician's constituents in return contributions or votes. Advocates say earmarks ensure community projects are funded.

THE SWIFT FALL OF KEN THOMPSON



STAFF ILLUSTRATION BY WM PITZER

1976
Joins First Union out of Wake Forest's business school.

2000
Succeeds Ed Crutchfield as CEO and leads a massive restructuring.

2001
Merges First Union with Wachovia, fending off rival bid by SunTrust.

2002
First receives recognition for top customer satisfaction in banking.

2006
Seals $24 billion purchase of Golden West Financial to expand into California and mortgages.

JUNE 1
Retires at board request.

He was respected for cautiously building Wachovia into a banking pillar, but some missteps and a tumbling economy brought an end to his tenure

By Rick Rothacker
rrothacker@charlotteobserver.com

At a party before last month's Wachovia Championship, bank clients and VIPs were preparing for a sun-splashed week at Quail Hollow Club watching the world's best golfers.

The Charlotte bank had suffered a tumultuous spring. But chief executive Ken Thompson's mood was good.

"Why wouldn't it be?" says Charlotte businessman Cameron Harris, who saw his friend at the event. "He didn't know his board would turn on him."

A month later, Thompson, 57, would be out of a job, forced to retire by the board after eight years at the helm and 32 years at the company.

People who know Thompson say he was surprised by the timing and disappointed. He had been determined to turn the bank around.

Just two years ago, Thompson's ouster would have been unthinkable. Wachovia's stock had appreciated significantly under his tenure, he'd revitalized customer service and his acquisitions had cemented the bank as a long-term player in the industry.

The former Rocky Mount high school sports star had become a respected figure on the Charlotte civic scene and in the banking world. Earlier this year, he rose to chairman of a prestigious industry trade group.

His decision, however, to buy mortgage specialist Golden West Financial in May 2006 at the peak of the housing boom would prove a

Smith

pivotal blunder. The deal flayed his reputation as a cautious buyer and later unleashed burgeoning loan losses.

Against this backdrop, a rash of missteps in April and May that raised questions about management's grip on the company's business practices ultimately would cost Thompson his job. The bank's board, led by influential chairman Lanty Smith, decided that cumulative "disappointments and setbacks" required a new leader.

Smith, a director for 21 years, had backed Thompson's deals over the years and voiced support for him just weeks earlier. In an inter-

SEE **THOMPSON,** 4A

TODAY'S MUST-READ

Seniors you should know: Christina Nixon conquers high school while battling a rare disease that brings uncertainty each day. **1B**

98° 72°

Blistering: Partly cloudy but hot

Vol. 139, No. 160

ASSOCIATED PRESS PHOTO

ANCHOR GUIDED VIEWERS THROUGH OLYMPIC MASSACRE

Jim McKay, the ABC sports broadcaster who covered 10 Olympic Games and anchored "Wide World of Sports" for 25 years, died Saturday. In 1972, he guided viewers through the sporting world's most horrific moment, the 1972 Israeli massacre at the Munich Olympics. **2C**

Big Brown loses
No Triple Crown winner this year. **1C**

Run for judge rich in drama

Bill Belk opposes the man whose ruling cost him big in a divorce. He wants to "reform the system."

By Jim Morrill
jmorrill@charlotteobserver.com

Bill Belk hasn't had much luck with judges.

In a marathon divorce case, one denied him custody of his children. Another awarded his ex-wife a majority of their $5 million joint estate. And in February, a third found him in contempt and threatened to slap him in jail.

On the day Belk got the contempt order – for failing to give his ex-wife tickets to a North Carolina football game – he went to Raleigh and filed to run for judge. His fall opponent: Ben Thalheimer, the Mecklenburg County judge who presided over the long and costly property phase of his divorce.

District Court seems an unlikely career move for a scion of Charlotte's most prominent retail family, a millionaire socialite who lives in a gated community and enjoys foreign travel and fine wine. The workload is heavy and complex, even tedious. The starting pay is $106,445.

"I'm not running just for District Court," Belk says. "I'm running to reform the system."

Critics call it sour grapes. Some warn his bid could have a chilling effect on judges who rule in cases involving rich litigants who could threaten their careers.

It's one of more than a dozen contested court races facing Mecklenburg voters. All are nonpartisan and relatively obscure, certain to be eclipsed by higher-profile campaigns and more likely to be decided by name recognition than issues.

"There are no safe District Court seats anymore," says retired Judge Chase Saunders. "All one can hope for is an informed

SEE **RUN,** 6A

Bill Belk

Judge Ben Thalheimer

The swift fall of Wachovia's Ken Thompson

THOMPSON

■ from 1A

view, he said the decision was difficult because Thompson was a friend, but board members had a "higher obligation to the company, its shareholders and its employees."

In March, as Thompson's troubles were building, state Rep. Ruth Samuelson, R-Mecklenburg, ran into him at the Foundation for the Carolinas annual meeting at the Charlotte Convention Center. Thompson, who declined to comment on his departure, was set to become the philanthropy's chairman.

Samuelson

Samuelson, who valued his counsel over the years, gave him a hug and told him she was praying for him. "It must not be working," he joked, Samuelson recalls. He added: "This is the hardest thing I've ever had to go through."

N.C. Gov. Mike Easley, a boyhood friend from Rocky Mount who regularly seeks his economic advice, talked to Thompson about a week ago, when his departure was already underway. Thompson was handling it well and praised the company and its employees, Easley said.

Easley

In high school, Thompson would chew out teammates who didn't give their full effort on the football field. Easley knew Thompson had driven himself just as hard over his three-decade career. "I told him, 'You need to take a break,' " Easley said.

First Union-Wachovia merger

Thompson had long been a rising star when he took over in 2000 as CEO of First Union, which would later become Wachovia. An internal survey of First Union's top 30 leaders showed he ranked No. 1 in three categories: integrity, leadership and teamwork.

Known as an approachable hard worker, his first task was to revive a company suffering indigestion from rapid-fire acquisitions under predecessor Ed Crutchfield. In a massive restructuring, he closed poor-performing units, slashed jobs and sold off businesses.

Crutchfield

His next stroke was a surprising in-state merger in 2001 with Winston-Salem-based Wachovia, which allowed the company to cut costs and chase more customers in wealthy markets. The deal carried a relatively low price tag, and First Union took Wachovia's more respected name. The combined company soon unveiled a new marketing tagline: "Uncommon Wisdom."

Thompson frequently labeled Wachovia a survivor in a consolidating industry and forged deals to absorb Prudential Securities in 2003 and to buy SouthTrust bank in 2004. But he passed on riskier purchases of FleetBoston Financial and credit card issuer MBNA. Both companies ended up in the hands of Charlotte rival Bank of America.

"I don't think Ken ever regretted missing on those deals," said a source familiar with the situation. "He wasn't a deal junkie."

Instead, he started a credit card operation from scratch, built branches in California and hired mortgage loan officers. But these moves were slow and expensive. At times, he expressed frustration that his stock price appeared to suffer because of Wall Street's nervousness about another big deal.

In the spring of 2006, Golden West approached Wachovia about a sale. The Oakland, Calif.-based savings and loan would give Wachovia an immediate beachhead in California, plus a mortgage business that historically had fared well in tough economic times.

Wachovia mortgage executives were surprised because the bank had stayed away from the kind of risky loans that Golden West offered. The deal, approved by the board, came together in 11 days and immediately faced investor backlash because the housing market was showing signs of slowing.

OBSERVER FILE PHOTO

Then-CEO of Wachovia Bud Baker (left) jokes with First Union CEO Ken Thompson as they leave the Wachovia shareholders meeting in Winston-Salem in 2001 after their proposed merger won wide approval.

Later, analysts would question whether Wachovia did a thorough enough examination of Golden West's portfolio. But the source familiar with the situation said the bank's biggest mistake was not predicting such a precipitous decline in the housing market.

As the deal was coming together that summer, Thompson remained optimistic. "We think we got the right mortgage company," he said in an interview.

Mortgages go downhill

While many financial institutions were blindsided by the depths of the housing collapse, Wachovia faced particular pitfalls.

Golden West's so-called Pick-A-Payment mortgages would end up souring faster than traditional mortgages. These loans allowed customers to pay less than the necessary interest, inflating borrowers' balances. They also were concentrated in hard-hit California markets.

Next, in the second half of 2007, a credit crunch whacked investment banking operations at Wachovia and peers. The bank took billions of dollars in writedowns because the value of mortgage-related securities had plunged. Profits sank 19 percent to $6.3 billion in 2007, the first down year since 2000.

Some analysts also were worrying about another recent Wachovia deal: last year's $6.8 billion buyout of brokerage A.G. Edwards. They wondered if the bank could retain top brokers and clients.

A vocal opponent was Ben Edwards III, the retired A.G. Edwards CEO, whose successor forged the deal. In an interview, he said he's heard a lot of dissent within both companies. "I think it was an ill-advised thing from the get-go," said Edwards.

Wachovia's board expressed its displeasure by eliminating bonuses for Thompson and his lieutenants. In January, Smith said management and the board shared blame for the Golden West deal but told the Observer that he had confidence in Thompson and his team.

In his letter to shareholders in February, Thompson said the bank's deals were on track, but he acknowledged the bad timing of the Golden West purchase. He reiterated a previous statement that the bank's dividend was safe.

Then came April's stunning announcement. The bank disclosed a first-quarter loss of $393 million, cut its dividend by 41 percent and announced a costly cash infusion. Thompson said the move had become necessary because new data showed an acceleration of loan losses.

His credibility was gone with investors.

Some 'self-inflicted' wounds

At the bank's annual meeting April 22, shareholders crowded an uptown hotel ballroom to call for Thompson's resignation. He responded that he was the right person to lead a recovery. Smith again expressed confidence in Thompson.

But a steady drip, drip, drip of miscues followed.

In a 12-day period, the bank agreed to a $144 million settlement over its ties to telemarketers, faced a report that it was under investigation for alleged money-laundering violations, disclosed an expected $1 billion charge over controversial leasing transactions and revealed an insurance loss that nearly doubled its first-quarter red ink.

On May 8, the week after the Wachovia Championship, the board voted to hand Thompson's chairman title to Smith, who was then lead independent director. Thompson said the move let him focus on running the company; analysts said it could mean he was on a short leash.

Four days later, Thompson spoke at an investor conference in New York. Normally, these sessions feature relaxed presentations by CEOs highlighting their successes. Thompson took a serious tone. He admitted Wachovia had some "self-inflicted" wounds and said the bank would hire a third-party group to analyze its risk-management practices.

JEFF SINER – jsiner@charlotteobserver.com

Ken Thompson signals that his drive is going to the left from the 13th tee box during the Wachovia Championship pro-am in April at Quail Hollow Club in Charlotte.

"My job is to address the problem head-on, and that's absolutely what I intend to do with 100 percent commitment," he said.

For months, Thompson had been working long hours and eschewing vacations, Harris said. Meanwhile, chairman Smith was seeking counsel.

About a month ago, Smith called former Wachovia chairman Bud Baker to get his thoughts on the company. Baker, who retired in 2003, said he didn't ask if the board was considering a CEO change, but he told Smith it was "a decision they would have to make," adding: "At the end of the day, the board works for the shareholders and not management."

Smith wouldn't disclose details on the board's decision-making, but said there comes an "inflection" point in an organization when new leadership can be an energizing force. Those who know Smith said he is a strategic thinker who doesn't make snap judgments.

Baker, who engineered the First Union-Wachovia merger with Thompson, said he had no knowledge of the board's workings but wasn't surprised by the move. Baker has sold some of his Wachovia shares over time and plans to give more away to charity, but he noted his family's holdings have lost half their value with the stock's plunge in the past two years.

Thompson was "in a situation where he made some moves that didn't work out," Baker said. "Sometimes in life that happens. We all make decisions that don't work out."

To assist with his retirement agreement, Thompson enlisted the same lawyer who counseled Merrill Lynch CEO Stan O'Neal on his exit. Thompson entered the agreement June 1, the same day Wachovia's board met in New York to install new leadership.

Search begins for new CEO

Early on Monday, Wachovia announced the startling news: Smith would become interim CEO, while vice chairman Ben Jenkins would serve as interim chief operating officer. The bank would launch a search for a new CEO, considering internal and external candidates. Such a hunt could take three to four months, a knowledgeable recruiter said.

Jenkins

The move saddened employees who had known Thompson for years and raised questions about the bank's future, including the possibility of a takeover. Smith said Wachovia planned to remain independent and still had strong businesses.

Some analysts questioned whether Smith was the right person to take charge, citing the board's approval of the Golden West acquisition. Wachovia's shares fell more than 15 percent last week to $20.13, a level last seen in late 1994.

Thompson's plans are unclear. He's required to step down as chairman of the Financial Services Forum because he isn't a sitting CEO. Other companies and charitable causes, including the Foundation for the Carolinas, expect him to stay on their boards. Easley said Thompson will have an array of options. He'd like to tap him for a state board.

Thompson received $1.45 million in severance. He also left with about $28 million in pension benefits, deferred compensation and stock holdings that have since shed some of their value. His stock options are currently worthless.

McColl

Hugh McColl Jr., the former Bank of America CEO and a friend, said he doesn't know what Thompson will do next but expects he will fare "quite well."

"I think he'll still be involved in our city," he said. "He's a very important leader." — STAFF WRITER CHRISTINA REXRODE CONTRIBUTED.

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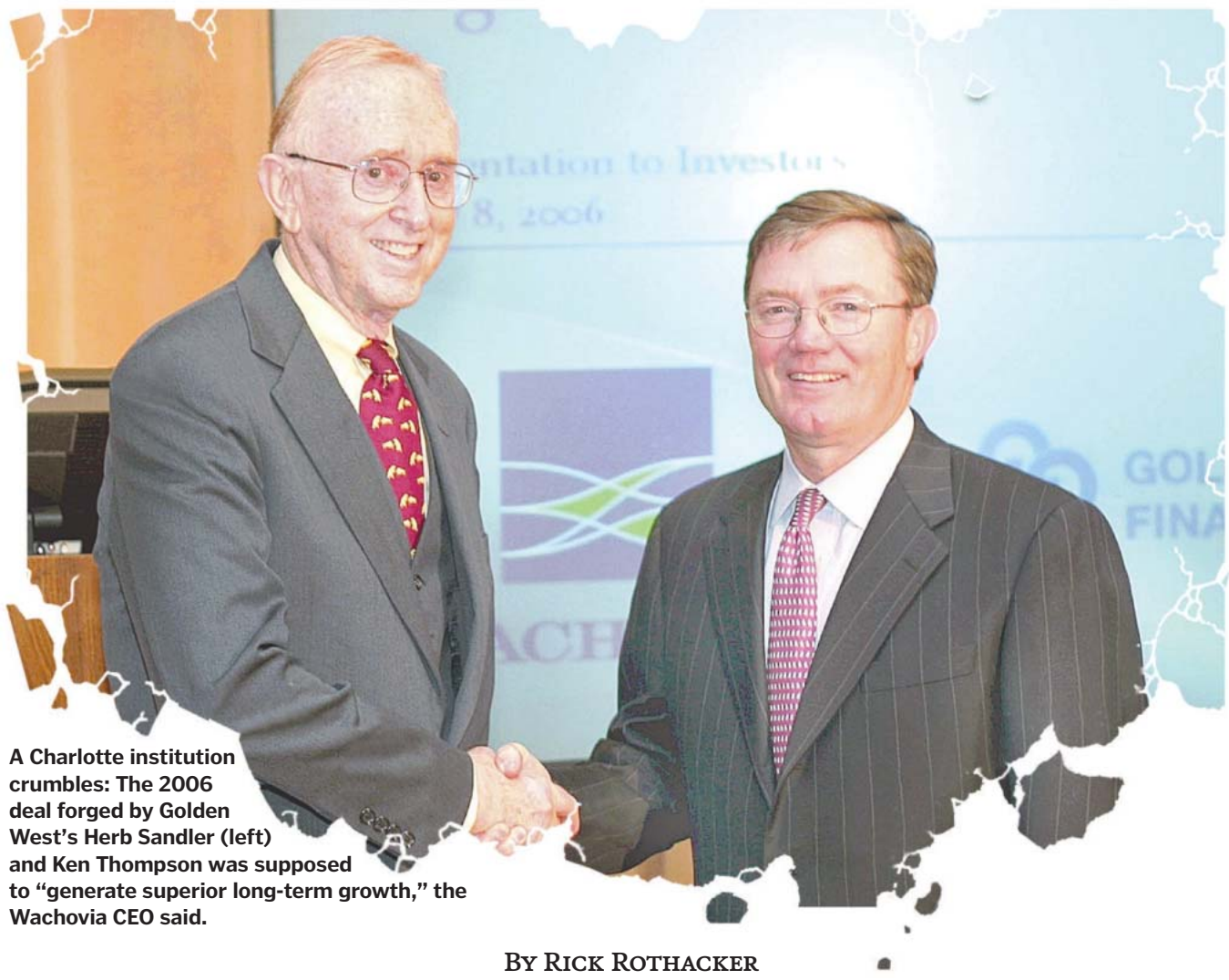
THE GOOD DEAL THAT WASN'T

Wachovia saw strength in its Golden West purchase, but the California loans undermined the Charlotte bank as the financial crisis erupted.



A Charlotte institution crumbles: The 2006 deal forged by Golden West's Herb Sandler (left) and Ken Thompson was supposed to "generate superior long-term growth," the Wachovia CEO said.

By Rick Rothacker
rrothacker@charlotteobserver.com

In front of a ballroom full of N.C. bankers in January 2006, Wachovia chief executive Ken Thompson warned of the dangers of "toxic" home loans.

A problem with so-called option adjustable-rate mortgages, he told the group, was that homeowners can end up owing more at the end of the month than the beginning, which can be a "tough situation" for customers and lenders.

"I have literally been amazed at the terms offered by some mortgage lenders, thankfully not at Wachovia and thankfully not so much in North Carolina," he said.

Four months later in May 2006, Thompson took a $24 billion plunge into the mortgage business by buying Oakland, Calif.-based Golden West Financial. Its specialty? The same loans he had cautioned against: option ARMs.

Wachovia, a brand known for conservative lending, had changed course and forged its biggest deal ever. Two and a half years later, the purchase has played a central role in the Charlotte bank's near collapse and its planned sale to San Francisco-based Wells Fargo. Shareholders vote Tuesday on the takeover.

In buying Golden West, Thompson and his board exposed the bank to a nontraditional lender with 60 percent of its mortgages in California even as experts warned of a housing bubble and the perils of option ARMs. The purchase left the bank especially vulnerable in the global financial crisis that ensued. Now the acquisition is a key chapter in a tragic tale that has cost investors billions and threatened thousands of jobs.

So why did Thompson do it? The purchase fit his goals of establishing a major presence in California and building his mortgage business. His competitors were reaping profits from the housing frenzy. And he became comfortable with Golden West's lending tactics and sterling track record.

But the deal seemed out of character. It came together in a matter of days. Some

SEE **WACHOVIA**, 10A

PHOTO ILLUSTRATION BY DAVID PUCKETT – dpuckett@charlotteobserver.com

Arts groups cut costs to survive economic storm

While there have been a few bright spots, year-end donations will be critical to the future.

By Steven Brown
sbrown@charlotteobserver.com

At 6 a.m. every weekday, the radio beside Debbie Hains' bed lets fly with classical music from WDAV-FM. When she heads off to work, she listens to WDAV in the car, too.

So when a friend urged her to make a donation, Hains did – for her first time.

"Since I'm getting some benefit from them, I should support them," said Hains of Huntersville. "I thought it was an important thing to do."

Despite the nation's economic woes, WDAV's fall campaign attracted 360 new donors, out of 1,400 donors. That may be the one good-news story to come from an autumn that has been as scary for Charlotte arts groups as it has been for anyone who sees jobs vanish.

Just as groups were launching their seasons came the day one arts leader calls "the cliff": Sept. 29, when Wachovia announced it would be bought by a healthier bank, and the day box-office phones across Charlotte stopped ringing. Even though ticket buyers have roused somewhat in the meantime, donors are the next big unknown. So arts groups are laboring to avoid the precipice.

"It's like somebody has pulled a trap door," says James Meena, general director of Opera Carolina.

WDAV is the fortunate one: Its autumn drive raised $190,000 – a little short of its $200,000 goal, but not bad in mid-recession.

"I'm grateful and a little relieved," general manager Benjamin Roe said.

There's no telling when Roe's colleagues at other groups will be able to share his sense of relief.

With the president-elect and others predicting the national economy will get worse, Mint Museums executive director

SEE **FUNDRAISING**, 6A

Obama's word man has the world waiting

From a laptop in a coffee shop, a 27-year-old crafts the next president's inauguration speech.

By Eli Saslow
Washington Post

WASHINGTON — The job requires him to work unnoticed, even in plain view, so Jon Favreau settles into a wooden chair at a busy Starbucks just blocks from the White House. Deadline looms, and he needs to write at least half a page by the end of the day. As the espresso machines whir, Favreau opens his laptop, calls up a document titled "rough draft of inaugural" and goes to work on the most anticipated speech of Barack Obama's life.

Favreau

During the campaign, the 27-year-old helped write and edit some of the most memorable speeches of any recent presidential candidate. When Obama moves to the White House next month, Favreau will join his staff as one of the youngest chief speechwriters. He helps shape almost every word Obama says, yet the two men have formed a concert so harmonized that Favreau's own voice disappears.

SEE **SPEECHWRITER**, 4A

INAUGURATION 2009 GUIDE
Details on the ceremony.
charlotteobserver.com/inauguration

HOLIDAY CARD WINNER

We received more than 900 entries from children in the Observer's seventh annual Holiday Card Contest. Each day through Christmas, we will publish one card on the front page. There were so many great cards that we'll also publish more in Thursday's Observer.

Taylor Rose Moen, 6

Taylor is the daughter of Tom and Barrie Moen of Cornelius and is in first grade at J.V. Washam Elementary School. She used markers to make her card. Taylor wants to be an artist and author when she grows up.

SEE MORE CARDS
Go to www.charlotteobserver.com/holiday

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Check out highlights of our staff photographers' best work in The Big Picture, and see all 100 at www.charlotteobserver.com/galleries. **17A**

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Vol. 139, No. 356

THE GIFT OF GIVING
STORIES OF HOPE & NEED
Find out how to give, 2A

4-year-old Blake has no parents, but he has Jenn

Boy's plight brought a Charlotte woman to tears – and compelled her to help in a big way.

By Fred Clasen-Kelly
frkelly@charlotteobserver.com

DAVIE HINSHAW – STAFF PHOTO

Jenn Snyder holds a photo of herself and Blake's grandmother Patty Davis, taken after Davis learned the family was being given a house.

Over the past 18 months, Jenn Snyder has established a college fund, collected furniture – and even helped get a home – for the family of 4-year-old Blake Davis.

Snyder didn't even know Blake until she saw him on television in June 2007.

The Ohio boy's missing mother had just been found dead. The prime suspect was his father.

"I was sobbing watching the press conference," said Snyder, 36, of Charlotte. "I thought, 'This little boy has no mom or dad.' "

She decided to help.

Snyder has spent more than a year collecting money and donations to help Blake and his family in Akron, Ohio.

A trust fund she established – Blake's Bright Tomorrow – raises money for the boy's college education. She is also trying to find someone willing to give the family a vehicle to replace their car, which she said often breaks down.

Her effort has already persuaded a mortgage company to donate a foreclosed house to the family. Businesses

SEE **BLAKE**, 2A

The good deal that wasn't: Tracing Wachovia's demise

WACHOVIA

■ *from 1A*

key executives weren't consulted. The two cultures collided at a bank known for smooth mergers. And perhaps most remarkably, Wachovia kept pushing Golden West's option ARMs, even as other lenders backed away.

Had Wachovia executives passed on the deal, the company might still have a future on its own. But once they placed the bet on Golden West, it's debatable whether they could have escaped the financial meltdown that would follow. "If you look back on it, who could have predicted that?" asks former Wachovia director Robert Brown, who voted to approve the deal.

In the aftermath, federal officials are investigating the sale, and shareholders have filed lawsuits against Wachovia and company officials.

Thompson, 58, declined to comment for this story. He was dismissed in June. In a statement, Wachovia said the deal was an attractive fit when it was announced and "can only be evaluated fairly based on circumstances existing at that time."

Thompson a selective deal maker

Thompson took over then-First Union in 2000 with the bank suffering from fast-paced deals and plunging profits.

Well-liked throughout the ranks, the company veteran from Rocky Mount launched a massive restructuring, presided over a smooth merger with Winston-Salem's Wachovia in 2001 and preached a devotion to customer service.

He also became known as a selective deal maker. In 2003, he passed on FleetBoston Financial. Two years later, he turned down credit card giant MBNA. In both cases, he didn't budge on price and resisted taking on too much risk for a bank of Wachovia's size. Its bigger crosstown rival, Bank of America, later swooped in to score both $35 billion-plus deals.

Thompson, however, had declared his desire to expand his retail banking presence into California. Flush with deposits, he also wanted to make more loans to consumers.

In 2005, banks were making big profits in a roaring housing market. Average U.S. home prices increased nearly 13 percent, climbing at a near-record pace. In California, home prices were up more than 117 percent over five years.

But late in the year, loan delinquencies and foreclosures edged up. Economists warned of the possible risks of a slowing housing boom. Regulators also began increasing scrutiny of nontraditional loans.

In September 2005, Thompson showed a tolerance for more risk in buying two small California lenders that made some subprime loans to borrowers with weaker credit. At that time, Wachovia was largely building its traditional mortgage business by hiring loan officers and investing in technology. A big acquisition would be a faster way to grow.

In late April 2006, Thompson learned Golden West might be for sale. The tip came from a chance encounter between an investment banker working for Golden West and an attorney who advised Wachovia. A few days later, Thompson and his chief financial officer, Tom Wurtz, were on a plane for California.

Acquisition takes shape

In more than four decades at the helm of Golden West, husband-and-wife co-CEOs Herb and Marion Sandler had turned a savings and loan with a few locations into a top 20 mortgage lender with 285 branches.

Along the way, the company was heralded for posting double-digit profit growth year after year. But with an aging leadership team and a dependency on just one type of mortgage, Golden West began to explore its alternatives, Herb Sandler said in an interview.

On Tuesday May 2, 2006, Thompson and Wurtz met with the Sandlers and other top Golden West executives at a downtown San Francisco hotel. Herb Sandler, then in his mid-70s, says he and his team had investigated Wachovia and heard good things about Thompson and how he handled mergers.

Thompson and Wurtz seemed to know a lot about the company's business already, Sandler said. It may have helped that Wurtz, with the N.C. bank since the mid-1990s, previously worked for the Office of Thrift Supervision, which regulated Golden West. At the agency, the lender was seen as a model outfit.

Thompson grew comfortable with the lender's nontraditional loans, later praising its "conservative" approach.

Its option ARMs, known as Pick-A-Payment loans, gave customers monthly payment options, including a minimum payment that didn't cover all of the interest owed. Choosing that option caused the loan balance to grow, instead of shrink, a worry for regulators and consumer advocates.

The lender had pioneered its option ARM in the 1980s, but faced increasing competition from the likes of Countrywide Financial and Washington Mutual. Golden West boasted numerous safeguards, including a cap on how much the minimum payment could increase each month. Unlike most rivals, it held onto its loans, a major incentive to make good mortgages.

And Golden West had a record of virtually no loan losses – even in downturns.

The meeting, which included no-frills sandwiches for lunch, concluded with a deal well under way. Both sides moved into investigating each other's operations, a process known as due diligence.

Thompson was back in Charlotte the next day to play golf with tour star Vijay Singh in the Wachovia Championship pro-am event. In the coming days, Thompson juggled his tournament hosting duties with high-stakes deal making.

'It was very different'

During the rest of the week, a Wachovia team including chief risk officer Don Truslow and Ben Jenkins, head of the general banking operations, visited Golden West sites in California and Texas.

Top Wachovia mortgage executives were notified the purchase was in the works but they weren't drawn deeply into the due diligence. That contrasted with earlier deals investigated by the bank. Only a few months earlier, for example, mortgage executives helped vet a possible investment in mortgage and auto lender GMAC and recommended against the move. Thompson didn't do the deal.

Some technology executives who had helped check out past acquisitions weren't clued in. "From everything I saw it was very different," one former executive said of Golden West. "It was a done deal. Make it work."

Wachovia reviewed Golden West's loan portfolio, but to what level of detail is unclear. Dozens were involved in the entire due diligence process.

Wachovia executives were impressed with Golden West's low loan losses during a major California downturn in the early 1990s, when housing prices fell 20 percent and unemployment hit 10 percent.

Thompson and other executives also took comfort in the relatively small size of Golden West's loans – less than $250,000 on average. That stemmed from a strategy to avoid the potentially more volatile high-end of the housing market. In more expensive California, the lender's average loan size was about $338,000.

The focus on smaller size loans "gives you incredible confidence" partly because these mortgages would get hit less than larger ones "in a difficult environment," Thompson would say days later.

During his tenure as CEO, Thompson was known for a consensus-style approach to management. In an August 2006 interview, he said he was hands-on when needed but also gave his executives room to lead. Asked if he had any weaknesses, he said he needed a "really good CFO, and I've got one, because I'm not a numbers guy."

Three of the top executives involved in the deal – Wurtz, Truslow and Jenkins – declined to comment for this story.

Bank analyst Gary Townsend, now with Maryland-based Hill-Townsend Capital, said he met with Wurtz in August 2006 and the CFO indicated that he had overcome initial reservations about the Golden West deal after meeting with the Sandlers.

As chief risk officer, Truslow's role was to help evaluate the loan portfolio. Seen as a quiet leader, he joined the bank in 2001 with the Wachovia merger. General banking chief Jenkins, who had come up through the ranks with Thompson, was already leading an effort to build new branches in California.

A voice absent from Thompson's executive suite was longtime CFO Bob Kelly, who had departed about three months before the deal to become CEO of what is now Bank of New York Mellon. Kelly was known for speaking his mind and for sometimes offering contrarian opinions, several current and former executives said. In hindsight, they wonder whether he would have questioned the deal.

"He'd say, 'Let's step back and look at this a different way,' " says a former executive. Kelly declined to comment.

Wall Street reacts

The time it takes to pull together a big bank deal can vary widely. Thompson spent months weighing the 2001 First Union-Wachovia merger. Bank of America looked over MBNA in a little more than a week in 2005. In the current financial crisis, companies are being cobbled together in weekends.

The Golden West deal, from first contact to announcement, took 11 days, with the formal due diligence covering no more than six days.

With speed comes more risk, said Townsend, the analyst, who emerged as a critic of the deal. "I think Ken Thompson wanted to buy Golden West," he said. "Why they pulled the trigger so quickly, I don't know. I don't think there was another bidder."

It's been reported that Citigroup and HSBC passed on Golden West before its talks with Wachovia. But no other bidder ever publicly stepped forward.

On the morning of Sunday, May 7, 2006, Thompson and his team made a final presentation to the Wachovia board, including an assessment of credit quality and risk management.

The directors, who met at least three times during the due diligence period, had an extensive discussion, says Brown, the retired director. "The fact of the matter," the High Point public relations specialist says, "is that when the discussion took place – go back and check the fact book – Golden West had one of the lowest loan default rates in the country."

He also notes that a "major consideration for us was that they had a lot of branches in California and the West."

The directors unanimously approved the acquisition. The next morning at an investor presentation in New York, Thompson told analysts he was "thrilled" with the deal. Sandler called it "a perfect cultural fit."

Asked about the timing, Sandler dismissed TV pundits he'd heard that morning criticizing the option ARM and the possibility of a real estate crisis. "That is a bunch of garbage," he said.

Investors balked. In the first day of trading, Wachovia's stock price dropped nearly 7 percent. As the bank's shares slipped further that week, Wurtz held an unusual follow-up conference call with analysts.

One asked about Golden West's average loan size, wondering whether this implied its customers were less creditworthy. Wurtz said that wasn't necessarily true. He pointed to the smaller loans as a sign of Golden West's lending discipline.

Another question was whether the Sandlers sold at the top of the market. "They have said very specifically that that is not the motivation for their sale," Wurtz said, " ... and I believe them."

Culture clashes emerge

Shortly after the acquisition's announcement, more than two dozen executives from both sides gathered at Wachovia's uptown headquarters complex. It was a get-to-know-you session.

Sitting in on the meeting was Jim Judd, a top Golden West executive who had long piloted the lender's mortgage machine with a no-nonsense, even combative management style. Now, in his late 60s, he would soon be charged with leading the combined mortgage unit – even though his company was the one being bought.

As a Wachovia mortgage executive explained the bank's customer

SEE **WACHOVIA**, 11A

OBSERVER FILE PHOTO

In May 2006, Herb Sandler, co-CEO of Golden West, shares a light moment at a meeting two days after Wachovia announced its purchase of the California thrift. From right: his wife, co-CEO Marion Sandler, and Wachovia executives Ben Jenkins and Bob McGee.

How we did this story

The Observer interviewed more than two dozen current and former Wachovia and Golden West executives, employees and others to produce this account. The paper also reviewed securities filings and court documents and conference call transcripts. Most of the people interviewed would speak only on the condition that their names not be used, often citing the need to protect their jobs or benefits after departing the company. The paper made repeated efforts to talk with top executives, who declined to comment individually or through the company.

To contact reporter Rick Rothacker, e-mail rrothacker@charlotteobserver.com or call (704) 358-5235.

CHUCK BURTON – ASSOCIATED PRESS PHOTO

Wachovia CEO Ken Thompson (right) returned to Charlotte one day after meeting with Golden West officials, to play with Vijay Singh during the Wachovia Championship's pro-am in 2006.

WACHOVIA

■ from 10A

satisfaction surveys, Judd questioned how the data was used. The Wachovia executive said the surveys helped gauge employee performance and calculate incentive pay.

Judd dismissed the effort as stupid, recall sources at the meeting.

Wachovia executives were shocked by the remark, which seemed to disparage Wachovia's ingrained focus on customer service. The summit, in which Thompson made an appearance, would be the beginning of a culture clash that would embroil the combined mortgage unit. Judd could not be reached for this story.

The companies were different in many ways. Wachovia's mortgage unit, part of a giant financial services company, pitched a variety of traditional mortgage products mostly to its banking customers. Golden West largely offered its signature product, option ARMs.

Wachovia mortgage executives didn't see Golden West counterparts as true mortgage bankers, skilled in making a variety of loans and packaging them into securities for investors. Instead, they saw them as slick salesmen who used less than sophisticated tactics. They were aghast at proposals to pitch loans at flea markets and shopping malls.

Golden West executives were frustrated by Wachovia's polite, deliberative culture. At Golden West, they prided themselves on walking out of boring meetings and grilling each other before making decisions. They were bewildered by Wachovia's complex management structure. They bemoaned mind-numbing conference calls in which scores of people dialed in and no decisions were made.

At Golden West's headquarters in Oakland during a regular visit, Sandler met with Thompson and outlined some of his concerns, ranging from management structure to employee incentive pay.

Thompson was a "consummate gentleman," but Sandler says he thinks the Wachovia CEO was a little angry. "Like, 'Who am I to be talking to him like that?' " Sandler says. "My obligation was to make Wachovia a better company."

A source familiar with the situation said Thompson listened to Sandler's concerns over time and acted on some.

After the purchase closed in October 2006, Sandler, a major Golden West shareholder, said he was disappointed that Wachovia rarely asked for help.

Meanwhile, more than a half dozen of Wachovia's top mortgage executives soon left the company, either uneasy with the unit's direction or squeezed out.

Pick-A-Payment loans continue

In summer 2007, Wachovia named one of its own to run the mortgage unit in anticipation of Judd's retirement at the end of that year.

David Pope was a well-respected executive with a diplomat's touch. He had overseen some mortgage functions in the past but was known more for his experience in retail and business banking.

While he might be able to ease tensions between the warring factions, some questioned whether Pope was the right person to navigate what had become one of the worst housing market collapses in history. "Do you want a nice guy or do you want someone who knows the industry and can get you through this environment?" one former Wachovia executive says.

The change in leadership didn't halt Wachovia's sale of Pick-A-Payment loans. Two of Pope's top deputies were from Golden West and backed the product.

By early 2008, the subprime mortgage business had collapsed, and now investors were losing their appetite for other nontraditional loans. Rivals such as Bank of America and Washington Mutual were abandoning option ARMs or tightening standards. Wachovia was diving in deeper.

Golden West specialized in selling Pick-A-Payment loans mostly through outside brokers, a type of sales force that drew criticism for pumping out mortgages with little regard to their suitability for borrowers. Now, in addition to these brokers, the goal was to sell the loans through Wachovia's more than 3,000 branches coast to coast.

"We thought it was a good product at the time the decision was made to merge with Golden West," Pope said in a February 2008 interview. "We think it's a good product today. We think it will be a good product in the future." He declined to comment for this story.

As the housing crisis worsened early this year, Wachovia loan officers told the Observer their jobs were threatened for not selling enough of the loans, which some felt weren't appropriate for most customers. Executives who came from Golden West called the loan officers whiners who didn't understand the product.

Both sides also sparred over underwriting standards. Wachovia relied heavily on credit scores. Golden West analyzed a borrower's credit history on its own, but didn't always require full documentation of income.

Pope took steps to better merge operations and to craft a long-term mortgage strategy, but the environment inside the unit was worsening, employees said. Initially, Pope's appointment appeared to be a sign Wachovia was reclaiming the unit, a former mortgage employee says, "but there didn't seem to be any action."

California a liability

In late 2007, Wachovia began pointing to "several pockets" in California as the main source of its rising loan delinquencies.

California's Inland Empire and Central Valley regions, where Golden West had about 17 percent of all of its loans, were suffering steep declines in housing prices. These drops would exceed 40 percent in some areas, topping national rankings.

Wachovia would later say Golden West's concentration in these markets was an unintended consequence of its strategy to make loans on moderately priced homes. As home values skyrocketed in California, Golden West was priced out of expensive coastal areas and made more loans in the state's interior.

Now as home prices fell in these once fast-growing areas, foreclosures climbed. Blue-collar workers defaulted as construction-related jobs dried up. Commuters soured on distant neighborhoods as gas prices rose, feeding the downward spiral in home prices. Some borrowers stopped making mortgage payments when the equity in their homes vanished, a new behavior that befuddled bankers.

Once seen as a major attraction, Golden West's presence in California was becoming a liability.

In early 2008, Wachovia executives began acknowledging the bad timing of the deal. But they kept echoing Golden West's faith in the portfolio.

In a January conference call reporting fourth-quarter earnings, Thompson pointed to Golden West's minuscule losses in the 1994 California housing slump. Even if it got worse, he said, "our Pick-a-Pay portfolio will generate very meaningful bottom line profits in 2008 – and I do not believe that investors grasp that fact today."

The picture grew grimmer in February and March as Wachovia's risk managers, led by Truslow, adopted new modeling techniques for predicting defaults. Wachovia now expected cumulative losses of 7.5 percent in the $121 billion portfolio, in contrast to Golden West's history of virtually none. That meant the bank had to start setting aside much more money to cover current and future Pick-A-Payment losses.

That contributed to stunning news April 14. Wachovia revealed a $393 million first-quarter loss, a cut to the lucrative shareholder dividend and plans to raise capital. Thompson was contrite: "I know these actions are not without costs, and I wish they were not necessary, but they are."

Along with the earnings announcement, Wachovia disclosed some potentially troubling statistics about the Pick-A-Payment portfolio. In 2005 and 2006, at the height of the housing boom, Golden West had made more loans to borrowers with lower credit scores than in the past. Also, the amount of deferred interest in the portfolio – the result of borrowers choosing the minimum payment – had climbed to $3.5 billion, or 3 percent of the loan book, up from $449 million, or 0.39 percent, in 2005.

In an interview the day of the earnings report, Thompson said the company was analyzing its mortgage strategy but he expected the bank to offer an array of products, including Pick-A-Payment loans. Around then, Wachovia began tightening Pick-A-Payment lending standards, requiring minimum credit scores and income verification.

Cascade of problems

A week later on April 22 at Wachovia's annual meeting, investors, who had seen their shares fall by about half since the Golden West deal was announced, called for Thompson's job. Soon after, Wachovia disclosed an embarrassing cascade of unrelated problems, including a settlement of up to $144 million over ties to telemarketers who scammed its elderly customers.

Thompson was losing his hold on the company. In May, lead director Lanty Smith, who had backed him at the shareholder meeting, assumed Thompson's chairman title. In an effort to bring in outside help, Thompson contacted former Bank of America CFO Al de Molina about a possible role. Thompson also worked on changes to the bank's finance and risk management structure. He didn't get the chance to test his plans.

On Thursday May 29, Smith called him into his 40th-floor office. Thompson's more than three-decade career at the company was over. He later reviewed the language in the June 2 news release. He wanted it clear that he had been asked to step down, stressing, "I didn't throw in the towel."

Smith, who took over as interim CEO, attributed the move to a series of missteps, not just one incident. He began the search for Thompson's successor immediately, but the vacuum in the corner office rattled investors and earned the board criticism for not having a ready replacement. Smith declined to comment for this story.

In June, Wachovia stopped making Pick-A-Payment loans.

Regulators step in

The following month, Smith tapped a new CEO: Bob Steel, a U.S. Treasury official and friend from the Duke University board of trustees. Steel began crafting a recovery strategy, building on some of the work already underway.

For the mortgage unit – where Wachovia now said Pick-A-Payment losses would reach 12 percent – he announced plans to refinance existing customers into traditional loans and to slash mortgage jobs.

Soon after, CFO Wurtz and risk officer Truslow announced their departures. In a meeting with analysts from research firm CreditSights, they admitted Wachovia was caught off guard by a steep decline in home values. They said the company's policy of making mid-sized loans backfired by leading to the concentration of mortgages in California's Inland Empire and Central Valley regions.

They also acknowledged another weakness in the Pick-A-Payment product:

"It seems that borrowers who choose a mortgage with the option of lower minimum payments may in fact be indicating to the lender that there is more likelihood that they will not have the resources to cover the (full) payment," the analysts wrote.

In addition, they wrote, "Wachovia was frank that it had missed an opportunity" to aggressively "sell down" the portfolio in early 2007 when the loans were still attractive to investors.

By mid-September, Steel's plans became moot. The failure of investment bank Lehman Brothers roared through the credit markets. The Sept. 25 collapse of Washington Mutual, a major option ARM lender, ratcheted up investor anxiety about Wachovia's loans. A federal bailout plan intended to calm roiling markets stalled in Congress.

In a frenzied last weekend of September, federal regulators ordered Wachovia to sell most of its operations to New York-based Citigroup. Days later, Wells Fargo trumped it with a rival offer. In November, Steel said the bank ran out of time to deal with its troubled loans amid historic economic times.

As Sandler sees it, Golden West has been unfairly blamed for Wachovia's myriad problems, and he suspects the bank has overestimated potential losses in the portfolio. He attributes the rising delinquencies to plunging housing prices and Golden West's concentration in California markets – not the nature of its product.

"I plead guilty to being a residential lender," he says. "This has nothing to do with the quality of the lending."

He acknowledges the lender may not have flagged problems in the Inland Empire and Central Valley soon enough. In the past, Golden West had identified overheated markets such as Las Vegas and pulled back.

"Maybe, you could say, 'Gee, we shouldn't have made loans in certain parts of California,' " Sandler says. "We used to pride ourselves in getting out. We probably were not as quick in Inland Empire and Valley areas."

Last month, the U.S. attorney in San Francisco said the Justice Department and the Securities and Exchange Commission were investigating Golden West's lending practices and whether it misrepresented its portfolio to Wachovia during the sale. Wachovia faces lawsuits by shareholders over the deal and from customers who allege improper lending practices.

The Wells deal, pending shareholder approval, is expected to close by year's end.

Wells Fargo has said it plans to phase out the Golden West portfolio. The bank said efforts to work with struggling borrowers show promise, but it's still projecting losses to reach $36 billion – or 29 percent of the portfolio. That's nearly four times Wachovia's initial 7.5 percent estimate in April.

"As we've always said," Wells Fargo CEO John Stumpf told analysts this month, "we do not like the option ARM product."

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Wachovia CEO Ken Thompson leaves the annual shareholders meeting in April in Charlotte. Investors had seen the value of their shares fall by about half since the Golden West deal. "If I had made a mistake like this I'd be out of a job," said investor Tim Vorick, a retired small-business man from Tampa, Fla.

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Wachovia CEO Bob Steel (from left), Wells Fargo CEO John Stumpf and Wachovia general bank head Ben Jenkins met with employees at the bank's uptown headquarters on Oct. 15. Stumpf told workers that his job is "to help all of you stay with the company," but added, "obviously, no commitments, no promises."

After the fall

■ **Ken Thompson:** The former Wachovia CEO, 58, left with severance of $1.45 million and stock awards valued at $7.25 million. The stock has since fallen by more than three-fourths. For 2006 and 2007, Thompson received $7.3 million in salary and bonus.

Wurtz

Truslow

■ **The lieutenants:** Chief financial officer Tom Wurtz, 46, and chief risk officer Don Truslow, 50, have left. General bank head Ben Jenkins, 64, will retire after the Wells Fargo sale is complete. Mortgage head David Pope, 48, will stay with Wells Fargo in an "executive transition role."

■ **Bob Steel:** The current Wachovia CEO, 57, will depart after the Wells Fargo sale.

■ **Herb and Marion Sandler**: The former Golden West co-CEOs run a foundation that benefits asthma research, investigative journalism and other causes. Their stake in Golden West was initially valued at about $2.6 billion under the merger proposal. Herb Sandler said they put $1.3 billion into their foundation, largely in cash. The couple still own Wachovia stock personally. He won't say how much.