Mr. Lawrence W. Smith
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5166

Letter of Comment No: 70
File Reference: 1250-001
4-17-06

Re: Exposure Draft, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115* (File Reference No. 1250-001)

Dear Mr. Smith:

We appreciate the opportunity to comment on the Exposure Draft, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115* (the "Exposure Draft"). Bank of America Corporation provides a diverse range of financial services and products throughout the United States and in selected international markets, and is the second largest U.S. bank in terms of total assets.

We do not support the mandatory adoption of fair value accounting for all financial instruments, as we believe it does not represent the best or most meaningful measurement attribute for all financial institutions, particularly those that manage their portfolios on a long term basis. However, institutions that use derivatives and other financial instruments to manage economic risk must often choose between volatility in earnings due to asymmetrical accounting models and the constraints and burdens inherent in the successful application of hedge accounting criteria. The fair value option will give these institutions the flexibility to adopt the accounting model that best reflects the way they manage their portfolios. We therefore support issuance of the Exposure Draft as a final Standard without delay.

We also have comments on the following provisions of the Exposure Draft:

- In order to reduce the accounting asymmetry between written loan commitments that are not accounted for as derivatives and derivative products used to mitigate credit risk associated with such commitments, we believe that written loan commitments should be included in the scope of the Exposure Draft.

- In recognition of the fact that an institution may currently designate a portion of an asset, liability or firm commitment as the hedged item in a fair value hedge relationship, we believe that the fair value option should be available for a pro rata portion of a financial asset or liability.

Our detailed comments are set forth below.

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Include Unfunded Loan Commitments in the Scope

Credit risk is perhaps the greatest single risk undertaken by commercial banks today. It is inherent not only in funded loans but also in the unfunded portion of a loan commitment. Consider, for example, revolving loan facilities in which a borrower may draw a portion of the available funds, make a full or partial repayment, and draw additional amounts as needed. Such unfunded commitments may comprise more than half of a commercial bank's large corporate loan exposure. When determining the amount of credit exposure to a particular obligor, an institution combines the outstanding funded balance with the loan equivalent amount (LEQ) of any unfunded commitments. The LEQ, which is based on average portfolio historical experience, represents the portion of an unfunded commitment that is likely to fund in the event of an obligor default. When determining the appropriate risk management action to initiate, most institutions consider the total amount of credit exposure to the obligor which includes the LEQ of any unfunded commitments.

Credit default swaps (CDS) have emerged as a critical tool in the management of credit risk. Yet, despite their effectiveness at economically hedging credit risk, CDS typically are not accounted for as hedges under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133), for two primary reasons. First, a fair value hedge relationship for loan facilities can be established only for funded amounts; it is not available for unfunded commitments, which do not meet the definition of a "firm commitment" in FAS 133. Second, the change in fair value of a credit default swap may not be "highly effective" in offsetting the change in fair value of a loan based on the empirical tests that are required by FAS 133. Nevertheless, credit risk managers consider the performance of credit default swaps, at the point of default, to be highly effective in mitigating credit risk of their large corporate exposures, as demonstrated by the performance of these derivatives in default events since 2001.

As a result, the use of credit default swaps creates accounting volatility due to the mismatch in accounting attributes, with commercial loans being accounted for at historical cost, the unfunded commercial loan commitments receiving no on-balance sheet accounting treatment, and the CDS accounted for at fair value, with changes in fair value reported in earnings. This resulting volatility, which is not representative of the underlying economics, may undermine and inhibit prudent risk management behavior. Due to the magnitude of unfunded lending commitments issued by most financial services companies, we believe that both funded loans and unfunded lending commitments should be included in the scope of the Exposure Draft in order to achieve accounting symmetry.

As stated in paragraph A6(d), written loan commitments that are not derivatives are excluded from the scope of the Exposure Draft because "nonfinancial components affect the determination of the fair value of those written loan commitments." We understand that this statement is intended to refer to the value of servicing rights, which currently are not recognized until the servicing asset has been contractually separated from the underlying loan by sale or securitization of the loan with servicing retained. This is a broad issue that applies to all loan commitments, including those that are accounted for as derivatives. Therefore, we see no conceptual basis for excluding written loan commitments that do not meet the definition of a derivative from the scope of the Exposure Draft. Accordingly, we believe that all written loan commitments should be included in the scope of the Exposure Draft.

Allow the Fair Value Option for a Pro Rata Portion of a Contract

As proposed, the election to adopt fair value accounting would be applied to an entire contract and could not be applied to a portion of a contract. As noted in paragraph 8 of the Exposure Draft, "an entity may not separate the cash flows under an individual contract and elect the fair value option for some cash flows but account for other cash flows under a different subsequent measurement attribute." We understand this requirement to mean that an entity cannot account for different types of cash flows under the same contract using different measurement attributes, and we concur with this provision. However, we recommend that an institution be permitted to elect the fair value option for a pro rata portion of a financial instrument.

We believe that there is precedent for this approach in existing accounting standards. Specifically, FAS 133 permits a pro rata portion of a hedged item to be designated in a fair value hedging relationship. As noted in paragraph 21(a) of FAS 133, "The hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment." An entity that elects to hedge a portion of an instrument will therefore carry the designated portion of the hedged item at fair value while the remainder is carried at historical cost.

One of the stated objectives of the ED is to permit an entity to mitigate the volatility inherent in the mixed-attribute accounting model without having to apply complex hedge accounting provisions. An entity that currently uses hedge accounting for a portion of a recognized financial asset or liability or of an unrecognized firm commitment will not benefit from the fair value option if it is available only on an all-or-nothing basis. Accordingly, we recommend that the Board permit adoption of the fair value option for a pro rata portion of a contract.

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We appreciate the opportunity to express our views in this letter. Should you have questions, please feel free to contact Randy Shearer at 704-388-8433 or me at 704-387-4997.

Sincerely,

John M. James
Senior Vice President
Corporate Controller

cc: Neil A. Cotty, Chief Accounting Officer
Randall J. Shearer, Accounting Policy Executive