

August 19, 2008

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 115

Re: Exposure Draft, *Accounting for Hedging Activities, an amendment of FASB Statement No. 133* (File Reference No. 1590-100)

Dear Mr. Golden:

We appreciate the opportunity to comment on the Exposure Draft, *Accounting for Hedging Activities, an amendment of FASB Statement No. 133* (the Exposure Draft). Bank of America Corporation, the third largest U.S. bank in terms of total assets, provides a diverse range of financial services and products domestically and in selected international markets. We routinely enter into derivative instruments for risk management purposes and on behalf of our customers.

We generally support the Exposure Draft's stated objectives, particularly efforts to simplify hedge accounting, improve usefulness and understandability of disclosure and resolve major practice issues. However, we believe the Exposure Draft fails to meet those objectives. One of the proposed revisions, the elimination of the bifurcation by risk hedge accounting model, significantly revises crucial existing hedge accounting principles with consequences for some of the most basic interest rate risk management strategies. We believe that change alone adds significant complexity to both the assessment of qualification and the measurement of ineffectiveness for hedging strategies. Further, the revisions proposed in the Exposure Draft are inconsistent with the objectives and economics of actual risk management practices, and thus will likely decrease the usefulness and understandability of the resultant financial reporting.

We find it interesting that the Exposure Draft diverges from International Financial Reporting Standards ("IFRS"), particularly as it relates to the principle of bifurcation by risk. IFRS was amended recently to extend bifurcation by risk hedge accounting practices, clarifying the principle and addressing additional discrete risk types such as inflation indices. Conversely, the Exposure Draft would revoke bifurcation by risk hedge accounting except in very limited circumstances. We note that *this divergence occurs at a time when not just convergence with, but conversion to, IFRS is an ever increasing possibility for entities based in the United States.*

Our concerns with the Exposure Draft follow:

1. *The Exposure Draft abandons a long-standing and fundamental hedge accounting principle of bifurcation by risk, thus disconnecting risk management practices and strategies from hedge accounting recognition and measurement.*
2. *The Exposure Draft introduces new rules on dedesignation / redesignation of existing derivatives to require execution of offsetting trades or termination of existing trades. These new rules introduce incremental counterparty credit risk, operational risk and transactional risk.*
3. *As a result of the two fundamental changes noted, the Exposure Draft fails to achieve its stated objective of simplifying hedge accounting. Instead, the Exposure Draft introduces new, more complex hedge accounting measurement requirements for the most basic hedge strategies and programs.*
4. *The Exposure Draft introduces new disclosure requirements focused on the fragmented data resulting from the accounting mechanics rather than addressing the broader risk management practices and results.*

Following are our detailed comments regarding these concerns.

Relationship to International Financial Reporting Standards

As the Board acknowledges, the Exposure Draft is not convergent with International Financial Reporting Standards ("IFRS"). In fact, the Exposure Draft diverges from promulgated IFRS, and, in particular, diverges sharply from modifications to IFRS recently enacted by the International Accounting Standards Board's ("IASB") regarding designated hedged risk (i.e., bifurcation by risk). We do not understand how a proposal that knowingly decreases comparability between generally accepted accounting principles of the United States ("US GAAP") and IFRS can enhance the development of one set of high quality accounting standards or promote consistency in financial reporting during the convergence period.

The Board has long had a stated objective of converging with IFRS. Over the past several months, there has been an increasing level of discussion among key constituencies (including public comments made by Chairman Herz) regarding the movement toward the use of one set of high quality accounting standards globally. Given the apparently increasing likelihood of conversion to IFRS, a proposal that diverges from IFRS creates an unusual burden for both preparers and users of financial statements. Preparers face the prospect of adopting new derivatives and hedging requirements for this Exposure Draft, then converting to IFRS, all within a relatively short time horizon. The Exposure Draft notes that the IASB is working on a project that may revise accounting for derivatives and hedging activities. If that project leads to additional changes to hedge accounting, many entities will experience three major changes to the principles in this complex area of accounting, all within a short time horizon. Similarly, users of financial statements would be required to become familiar with and assess the impacts of multiple revisions to accounting for derivatives and hedging activities. More problematic, given that this Exposure Draft increases the differences to IFRS, assessing the impacts of the changes and comparing the results to global entities will be far more complicated and burdensome during the possible intervening periods.

Considering that derivatives and hedge accounting constitute one of the most complex areas of accounting in terms of technical accounting which in turn places a significant demand on systems, processes and people, the possibility of continuous change is a daunting challenge for both preparers and users of financial statements. On the basis of this concern alone, we believe that the Exposure Draft should be abandoned.

Bifurcation by Risk

We strongly disagree with the Exposure Draft's elimination of the bifurcation by risk hedge accounting model. Bifurcation by risk is one of the original and most fundamental principles of the hedge accounting model. Ironically, the principle was developed for the very reason this Board is discarding the approach: the hedge and the hedged item have different recognition and measurement attributes.¹ The principal argument from 1997 still rings true today: recognizing changes in fair value for unhedged risks presents misleading results regarding an entity's hedging activities. As the Board observed in 1998, "the principal purpose of providing special accounting for hedging activities is to mitigate the effects on earnings of different recognition and measurement attributes."² We note that those different measurement attributes continue to exist today and resolution of those issues cannot be solved comprehensively in this Exposure Draft.

Given that the Exposure Draft's proposal was considered and rejected in the development of the current hedge accounting model, and that the rationale for that rejection still exists today, we do not understand why this Board believes that such a significant modification is warranted given that the bifurcation of risk approach has been widely accepted in practice and effective in capturing the underlying economics of the risk management strategy employed through the use of hedging with derivatives.

In our view, the bifurcation by risk principle is preferable as it most closely resembles the economic result of risk management practices and strategies. Risk management practices, tools and strategies focus on bifurcation by risk that is, mitigating or balancing discrete risk types. Similarly, by definition, derivative instruments are designed to protect against changes or variability in those discrete risks, such as the interest rate risks common to financial institutions. We believe applying the same principle to hedge accounting is the most representationally faithful to the business practices and related economic outcomes and provides the best information to the user of the financial statements.

We believe abandoning this principle will impair the usefulness of financial statements. While some financial statement users may view information about the unhedged risks of an entity useful, we do not believe this Exposure Draft accomplishes that goal for the following reasons.

- Hedge accounting is an elective model. Entities consider many factors when assessing whether hedge accounting will be applied, including elements such as costs to build and maintain the infrastructure, adaptability of the infrastructure to the natural evolution of the risk management strategies, and operational and compliance risks. Typically one of the most important criteria is whether the financial reporting represents the economics, both the success and failure, of management's hedge strategies. With the changes proposed, we believe the faithful representation of those economics will decline substantially. Thus, while entities may or may not continue to utilize derivatives in their risk management practices, we believe fewer entities will elect to apply hedge accounting.
- For those entities that continue to apply hedge accounting under the new guidance in the Exposure Draft, changes in fair value attributable to the unhedged risks will be recognized *only* for that subset of exposures which are designated as being hedged. By definition, the subset is not indicative of the risks of the entity as a whole. Thus, we do not understand how recognizing changes in fair value for unhedged risks for this narrow subset can be meaningful to an investor.

¹ Original FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, issued June 1998, paragraph 366 and retained to the date of this letter.

² Original FASB Statement No. 133, paragraph 366 and retained to the date of this letter

We believe the impact of this change as provided for in the Exposure Draft is so pervasive as to significantly impact whether entities can achieve hedge accounting for basic risk management strategies, such as converting floating rate assets or liabilities to a fixed rate. In our view, these changes will likely discourage many entities from attempting to utilize hedge accounting. As a result, we believe financial statement disclosures and presentation of risk management practices will be *less* comparable across entities with similar practices. For example, some entities may continue to follow hedge accounting and to explain the impacts of unhedged risks. Other entities may choose to economically hedge without applying hedge accounting and explain the impacts of their hedging instruments, but not the hedged exposure or net hedged position. Still other entities may choose to discontinue hedging. Should entities abandon hedge accounting, we believe that the impacts of that decision will likely be less understandable and less transparent to users of the financial statements.

Dedesignation / Redesignation

The Exposure Draft places significant restrictions on an entity's ability to dedesignate / redesignate derivatives in hedging relationships. This is inconsistent with current risk management practices and will increase the costs of risk management activities. We disagree with this element of the Exposure Draft.

Risk management practices typically utilize an enterprise wide risk management approach that considers naturally offsetting positions and risks in assessing where more costly discrete tools such as derivative instruments may and should be utilized. Accordingly, risk management techniques are not intended to hedge the discrete risk of a unique position for its life, but rather to mitigate the overall risk type for the entity for a period of time. Risk positions change frequently, even daily, depending on the entity's activities, views on acceptable levels of risk as well as other economic impacts such as market movements.

Dedesignation / redesignation of derivatives permits risk managers to adapt to these changes and manage their exposures optimally. In some circumstances, hedging instruments are generic (e.g., a basic interest rate swap) and while the instrument may no longer be useful in one portfolio, it is useful in balancing risk in another portfolio with the same basic underlying risk. In other circumstances, the hedging instrument may no longer be useful and may be terminated. The applicable accounting principles and practice for each of these activities is clear in the existing literature.

To dedesignate a derivative, the Exposure Draft would require an entity to cash settle the original derivative instrument or enter into an exact offsetting position to effectively cancel the position. If an entity chose to hedge a new or modified risk, a new derivative would need to be entered into instead of being able to redesignate an existing derivative that may be economically effective in hedging the new exposure. In situations where cash settlement was not elected, this will result in *increasing* the number of transactions outstanding, thus increasing real risks to the entity including liquidity risk (derivatives are a source or use of funds), operational risk (increased transactions), and credit risk (increased counterparty exposures). In addition, the proposed rule increases the costs to the entity, both in terms of transactional costs and operational costs. Conversely, following the risk management practice of simply dedesignating the derivative from the original relationship and designating a new avoids increasing risk to the entity as well as avoids the incremental costs to the entity.

We are unclear as to what abuse the proposal is attempting to address or prevent, particularly in light of the increased costs (which are not insignificant) to the entity to comply. We do not understand how increasing both the risks and the costs of the entity in order to apply basic risk management practices can be beneficial to an investor. Accordingly, we do not believe that these provisions in the Exposure Draft should be retained given that the costs of applying them would outweigh any perceived benefit from such application.

Simplification

One of the stated objectives of the Exposure Draft is to simplify hedge accounting. Hedge accounting generally has two critical tasks, both quite complex and typically quantitative in nature:

1. determining if the hedge relationship *qualifies* for special (hedge) accounting, and
2. measuring the hedge *ineffectiveness* to be recognized in the financial statements.

Certain of the Exposure Draft's revisions would, absent other changes, accomplish the Board's stated objective of simplifying hedge accounting. Specifically, the notion of a qualitative assessment of effectiveness, rather than a quantitative assessment, as well as broadening the assessment of effectiveness of the hedge to "reasonably" effective from "highly" effective could have resulted in a simpler hedge accounting model. However, the impact of the two changes discussed above negates these beneficial effects.

We note that elimination of the bifurcation by risk hedging principle for financial instruments would impact nearly every interest rate risk hedge accounting program from the largest public companies down to the smallest of companies who utilize the most basic types of hedging strategies. This change alone would cause many risk management strategies that pass hedge accounting criteria today to fail. As a result, entities would be required to reassess whether hedge accounting could be achieved, assess whether hedging the "unhedged" risks was feasible or cost / benefit justified, determine whether a derivative contract existed that would effectively hedge the risk, and even to determine whether hedging the "unhedged" risks, such as the entity's own credit risk, was appropriate.

If the entity concluded that achieving hedge accounting was possible and preferable, the entity would then have to rebuild its hedge accounting infrastructure. Qualitative assessments are unlikely to be valuable in an interest rate risk scenario, thus assessing whether the hedge qualified for hedge accounting and measuring ineffectiveness would require redesign. New models considering "all-in" risk for hedged exposures would need to be developed, including obtaining new sources of data regarding unhedged risks and assessing the validity / accessibility of the necessary data.

For financial institutions, many hedge accounting programs are built on a notion of pools of exposures as they are typically comprised of numerous similar items sharing the same risk exposure. Entities would be required to assess discrete credit and basis risks in vast pools of assets, liabilities or forecasted cash flows to determine changes in full fair value. Further, this becomes very complicated because many of the assets or liabilities that a financial services company may desire to hedge are not traded in the market and would not have observable credit spreads, thus resulting in the sources of data being extremely limited and thus being heavily modeled.

Entities applying hedge accounting under the current rules already have made significant investments in systems and processes in order to comply with Statement 133. The changes proposed in the Exposure Draft will require additional, likely significant, investments in money and resources to become compliant with the new guidelines. We question whether the incremental benefit expected would justify these costs.

Disclosures

In our view, the Exposure Draft's proposed disclosures would provide significant volumes of data with limited usability and even more limited understandability. For example, the Exposure Draft would require entities to disclose each component of the hedged item: its fair value, its original cost basis, and the source of the adjustments to that original cost basis distinguished between those resulting from the application of hedge accounting and those not. In theory, the amount of any prospective cash flows related to the position would be limited to the fair value of the asset or obligation. Similarly, the adjustments to carrying value have little impact on the timing or uncertainty of those cash flows. Thus, we do not believe the financial statement reader will find these disclosures about the adjustments relevant.

Similarly, the Exposure Draft would require disclosure of the overall weighted-average interest rate both including and excluding the effects of derivatives for hedging relationships employed on an entity's own debt or other borrowings. Considering that risk management practices are focused on enterprise wide risk, we note that the hedge may have mitigated a mismatch in repricing between interest earning assets and interest bearing liabilities. The proposed disclosures are very narrowly focused and are inconsistent with overall risk management practices. We believe that this disclosure will not provide meaningful information to the user of the financial statements.

We believe the disclosures recently promulgated in FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of Statement No. 133*, provide better contextual descriptions and focus on the issues of relevance for risk management programs: the results of the hedging programs (effectiveness / ineffectiveness). We believe a financial statement reader will find these disclosures more useful as the disclosures address the success, or lack thereof, of the entity's risk management programs.

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We note that many of our concerns align with the issues raised in the Alternative Views. We strongly agree with the observations and opinions expressed in the Alternative Views and concur with the identified consequences and operational issues identified therein.

We appreciate the opportunity to express our views in this letter. Should you have questions, please feel free to contact Randall Shearer (980.388.8433) or me (980.387.4997).

Sincerely,

/s/ John M. James

John M. James
Senior Vice President and
Corporate Controller

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