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November 12, 2009

Via email

Russell G. Golden, Technical Director File Reference No. 1740-100 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

Re: File Reference: No. 1740-100 Derivatives and Hedging (Topic 815) –

Scope Exception Related to Embedded Credit Derivatives

Dear Mr. Golden:

Wells Fargo & Company (Wells Fargo) is a \$1.2 trillion diversified financial services company providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, brokerage and consumer finance. We appreciate the opportunity to comment on the Exposure Draft of proposed Accounting Standards Update to Topic 815, *Scope Exception Related to Embedded Credit Derivatives* (proposed Exposure Draft).

The amendment to paragraphs 815-15-15-8 and 815-15-15-9 would redefine when an entity must evaluate embedded credit derivatives for bifurcation. Specifically, this amendment indicates that only the concentration of credit risk in the form of subordination would be exempted from potential bifurcation and separate accounting under paragraphs 815-10-15-11 and Section 815-15-25.

General Comments

We do not support the guidance set forth in the proposed Exposure Draft and we continue to support the model that exists today¹ for evaluating embedded credit derivatives in securitized financial assets. We believe that the existing model is well understood, is consistently applied in practice and provides clear and understandable principles for evaluating embedded credit derivatives. Specifically, existing guidance states changes in creditworthiness of a securitized financial interest is not an embedded credit derivative, provided such change results from assets and liabilities (regardless of form – cash or derivatives) held by the issuing entity. The proposed Exposure Draft represents a fundamental change from this model and we question whether such a change is warranted given that many of these hybrid securities are currently reported at fair value; generally as available for sale securities. In such cases, changes in fair value are recorded to other comprehensive income, except for changes in fair value related to credit impairment,

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¹ Paragraphs 815-15-25-11 through 815-15-25-13 and paragraphs 815-15-15-8 and 815-15-15-9, when taken together, provide the existing guidance for evaluating whether a beneficial interest in a securitized financial asset contains an embedded credit derivative that requires bifurcation. These paragraphs originated from SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*, issued in 2006.

which are recorded in earnings. We fail to understand how bifurcation of the embedded credit derivative, which requires all changes in fair value for the bifurcated instruments to be recorded to net income, is an improvement to the options provided in existing guidance. We acknowledge the Board's concerns that investors and other users of financial statements desire relevant information about embedded credit derivatives in certain hybrid financial instruments because bifurcation is not currently required. However, if users want additional information about such instruments, we believe that providing that information is best accomplished through meaningful disclosure rather than the proposed changes to the accounting model.

We would also encourage the Board to consider the impact that the proposed changes would have on liquidity in the credit derivatives market. Many companies may have invested in the hybrid instruments impacted by the proposed Exposure Draft as longer-term investments on the presumption that they would be accounted for on a contractual yield basis, rather than a mark-to-market basis. The presence of such investors enhanced the liquidity of the credit derivatives market by providing additional outlets for the risk transference process. The disabling of this investment channel would both diminish the liquidity in the CDS market and potentially add to its volatility, as there may be a rush to unwind these trades in light of the proposed Exposure Draft (this latter concern could be mitigated by including a grandfathering provision to any proposed changes, as we elaborate on below).

Further, the proposed Exposure Draft is not aligned with the current IASB standard, and therefore, the proposed changes should be tabled and the issue addressed in the joint IASB/FASB Accounting for Financial Instruments Project. On December 15, 2008, the FASB announced the addition of another FASB agenda project, *The Accounting for Financial Instruments*. This project has as its objective the improvement of the decision usefulness of financial instrument reporting for users of financial statements. The project will replace the FASB's and the IASB's respective financial instruments standards with a common standard. One of the stated goals of this project is to improve the accounting and disclosures associated with derivatives and other financial instruments. We recommend that the FASB postpone the proposed Exposure Draft effective date until it can be analyzed during the deliberations of the *Accounting for Financial Instruments* project. Because the proposed change does not achieve alignment between the FASB and IASB, and both Boards are in the process of drafting proposed standards to account for financial instruments including derivatives, we do not feel is appropriate for the FASB to issue new guidance that does not achieve alignment and is subject to change in the project for which the FASB intends to release an Exposure Draft in the coming months.

For these reasons, we strongly urge the Board to retain the existing accounting model for evaluating embedded credit derivatives in securitized financial assets.

If the Board decides to proceed with the proposed changes for evaluating embedded credit derivatives, we offer the following primary comments:

- 1. The proposed change lacks clarity We do not believe the proposed Exposure Draft, provides the clarity the Board was seeking to provide. The Board's stated intention in issuing this standard is to clarify the scope exception for embedded credit derivative features related to the transfer of credit risk in the form of subordination of one financial instrument to another; however, the proposed guidance creates further ambiguity in the application of the scope exception to embedded credit derivatives.
- 2. <u>Grandfather existing hybrid instruments</u> We believe that should the FASB proceed with this proposed Exposure Draft, the scope of the standard should only apply to transactions

entered into after the effective date and therefore allow "grandfathering" of existing hybrid instruments held by Companies as of the effective date from the proposed Exposure Draft.

3. The timing just does not work -The proposed timing of the effective date of the proposed Exposure Draft seriously overestimates existing systems capabilities and underestimates the project management time needed to create data collection, aggregation and reporting processes in a well controlled Sarbanes-Oxley compliant environment.

1. LACK OF CLARITY

The proposed changes to paragraph 815-15-15-9, and its related examples, imply a requirement to evaluate whether the assets within the entity are clearly and closely related to each other, rather than to evaluate the contractual terms of the issued liability; and to understand how the assets of the entity may impact the cash flows received pursuant to the contractual terms. This change represents more than a clarification of the existing clearly and closely related model for securitized instruments. We believe that, in order for the Board to achieve its objective to improve clarity and to ensure consistency in practice, it would be appropriate to perform additional due diligence surrounding the application of the new model before making such a significant change. The illustrative examples in paragraph 815-15-55-226 of the proposed Exposure Draft only address scenarios with a single type of cash instrument. However, the proposed Exposure Draft does not address scenarios with multiple types of cash instruments with different credit risks. Therefore it is unclear whether bifurcation is required merely due to the presence of derivatives in the entity or whether an evaluation comparing the credit risk of the derivatives to the cash instruments is required. This lack of clarity creates confusion and interpretive risk for securitized assets that do not involve derivatives, such as U.S. government agency mortgage backed securities. As a result, we are unclear how the new model should be applied to certain common structures with multiple different credit risks associated with the host contracts. In addition, for certain actively managed securitizations, such as CDOs, the composition of cash and derivative instruments may change over time. Accordingly, the nature of the host contract and embedded derivatives may also change, including the determination of whether any embedded derivatives require bifurcation.

2. GRANDFATHERING CLAUSE

Should the FASB elect to proceed with the proposed Exposure Draft, we recommend hybrid instruments with embedded credit derivatives requiring bifurcation under the proposed Exposure Draft that are outstanding at the effective date be excluded from the scope of the proposed Exposure Draft. Companies may have invested in the hybrid instruments impacted by the proposed Exposure Draft as longer-term investments, providing an enhanced interest yield. In such cases, the investments would typically be managed on a contractual yield basis, rather than a mark-to-market basis. For example, companies may have invested in CDOs, which are recorded as available-for-sale securities, and are strategically longer term investments held for purposes other than trading. The change in accounting treatment for these instruments could not have been contemplated when companies entered into the transactions, and in fact, if fair value accounting through earnings was required, companies may not have invested in such securities. Due to the change in accounting, companies in financial services and other industries who manage such assets as long-term investments may elect to sell these instruments due to the exposure to income statement volatility introduced by the change in accounting treatment. This situation would assuredly create unnecessary volatility in the credit derivatives market, as there would be a "domino effect" caused by the unwinding of a trail of risk positions from one market counterparty to the next. For

these reasons, we believe it would be appropriate for the Board to provide a grandfathering clause for instruments recorded on the balance sheet as of the effective date of the proposed Exposure Draft.

3. TIMING OF ADOPTION

November 12, 2009 is the end of the comment period for the proposed Exposure Draft. In order for the Board and the Staff to adequately review and consider the comments received, we would not anticipate that a final standard would be issued before mid-December 2009. The effective date for the provisions of the Exposure Draft are for periods beginning after December 15, 2009, which would be January 1, 2010 for calendar year-end companies. As currently drafted, we do not believe the proposed Exposure Draft is operational within the time frame established by the proposed effective date, given the lack of understandability of the new clearly and closely related model and the potentially significant new population of instruments subject to existing credit derivative disclosure requirements.

As a reminder, the resources of financial institutions are preoccupied with the implementation of new accounting standards that are effective in the first quarter of 2010, including FAS 166, Accounting for Transfers of Financial Assets, FAS 167, Amendments to FASB Interpretation No. 46R, and the Exposure Draft of proposed Accounting Standards Update to Topic 820, Improving Disclosures about Fair Value Measurements, and the additional guidance which may be issued during the fourth quarter which would be effective for December 31, 2009, such as the proposed Statement of Financial Accounting Standards Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. Resources at large financial institutions are also focused on the development of entirely new processes and systems for their compliance with Basel II Reporting System guidelines and from SOP 03-3 loan portfolios that resulted from recent significant acquisitions. An effective date prior to June 30, 2010 is not realistic.

Based on the above, we believe that it would take a minimum of six months to comply with the FASB's new clearly and closely related criteria and disclosures from the December 2009 issuance date. Therefore, we recommend an effective date that is no earlier than for periods beginning after June 15, 2010.

Conclusion

We strongly recommend that the FASB reconsider whether changes proposed provide: 1) the intended level of clarity, 2) are aligned with other FASB projects, 3) should be applied to existing instruments, and 4) allow for adequate time for preparers to adopt considering the proposed effective date. Finally, because of the difficulties in making the proposed guidance operational, we strongly urge the effective date of the standard be delayed by six months to permit the application of the appropriate level of management resources.

We appreciate the opportunity to comment on the issues contained in the FASB's invitation. If you have any questions, please contact me at (415) 222-3119.

Sincerely,

/s/ Richard D. Levy

Richard D. Levy Executive Vice President & Controller

cc: Financial Accounting Standards Board Members
Kathy Murphy – Office of the Comptroller of the Currency
Art Lindo – Federal Reserve Board
Robert Storch – Federal Deposit Insurance Corporation
Donna Fisher – American Bankers Association
Gail Haas – New York Clearing House Association