December 22, 2016

Ms. Susan M. Cosper
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities (File Reference Number 2016-310)

Dear Ms. Cosper:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, Targeted Improvements to Accounting for Hedging Activities (the Proposed ASU). Bank of America Corporation (BAC) provides a diverse range of banking and non-banking financial services and products domestically and internationally. As one of the world’s largest financial institutions, we hold approximately $2.2 trillion of consolidated assets on the balance sheet and routinely enter into derivatives for risk management purposes.

We support the Board’s efforts to simplify the accounting for hedging activities and address weaknesses in the current model. We are supportive of the Proposed ASU as we believe it will improve the alignment of hedge accounting and risk management activities by removing various obstacles that currently occur when trying to apply hedge accounting.

In particular, we believe the following targeted improvements are significant improvements to financial institutions that utilize derivatives as part of their asset-liability management activities:

- For fair value hedges of interest rate risk, allowing an entity to hedge partial-terms by assuming the hedged item has a term that reflects only the designated cash flows being hedged,
- Permitting an entity the election to measure the change in fair value of a hedged item on the basis of the benchmark rate component of the contractual coupon cash flows determined at hedge inception, rather than on the full contractual coupon cash flows (except in certain circumstances),
- For prepayable financial instruments, permit an entity to consider only how changes in the benchmark interest rate affect a decision to settle a debt instrument before its scheduled maturity in calculating the change in the fair value of the hedged item attributable to interest rate risk.

However, in regards to and considering the spirit of the above improvements, we believe there is an additional simplification the Board could adopt as part of the Proposal that would apply primarily to prepayable assets, such as mortgage-backed securities (MBS), or portfolios of prepayable financial assets, such as fixed rate mortgage loans.
Under current hedge accounting requirements, the ability to apply hedge accounting to a portfolio of prepayable assets is difficult due to the volatile effects that changes in interest rates can have on the number of prepayments that occur within a portfolio. This difficulty would also exist in a hedge of a mortgage-backed security (MBS). An important consideration is that while the number of prepayments that occur will be volatile, a portion of the portfolio will remain outstanding for a longer period of time. The current hedge accounting guidance restricts entities ability to hedge this portion of the portfolio as it does not allow entities to identify a subset of the portfolio as the portion that is not prepaid at the end of a hedge period, (as described in DIG Issue F9, which was not ratified but continues to be included on FASB website).

The conclusion applicable to DIG Issue F9 is inconsistent with how entities manage duration for these types of (or portfolio of) instruments in their risk management activities. For example, the portion of the portfolio that is expected to have a longer duration will be managed to the risks specific to that portion versus the management of the risks related to the other portion of the portfolio which is expected to have a shorter duration. The current hedge accounting guidance does not allow entities to consider the risks in this manner. Instead, the risk of prepayments to a portfolio must be considered to exist for every portion of a portfolio that is designated in a hedge relationship. We believe there is an opportunity to remove this barrier and better align hedge accounting with risk management activities.

Consistent with the simplification for partial term hedging, the Proposal could be updated so that when a specific portion of an asset or liability (or a portfolio of similar assets or a portfolio of similar liabilities) is the designated hedged item in a fair value hedge, an entity would be allowed to assume that if prepayments occur, the undesignated portion of an asset or liability (or a portfolio of similar assets or a portfolio of similar liabilities) of a hedged item is prepaid prior to the designated portion of the hedged item. For example, in a portfolio of fixed rate mortgages or MBS, an entity could designate a specific amount of a portfolio of fixed rate mortgages or MBS for changes in fair value (attributable to interest rate risk or all contractual cash flows). Because it is likely that prepayments will occur to a portion of the portfolio, the entity would assume the prepayments apply first to the portion of portfolio of fixed rate loans that was not designated in the hedge. Important to the above hedge accounting application is that the portfolio of assets, which would include both the designated and undesignated portion of the portfolio, would be identified at inception of the hedge and tracked through the duration of the hedge period. The identification of which loans are prepaid is irrelevant to the risk being hedged as long as the identified amount of the hedged item exists within the portfolio. This would allow entities to align the accounting with the prepayment risk applicable to the stratified portion of the portfolio. We believe this would be more consistent with actual risk management activities versus how prepayment risk is accounted for and required to be considered under the current hedge accounting requirements.

To affect this change, ASC 815-20-25-12(b)(2)(i) could be amended as follows (in underline):

If the hedged item is a specific portion of an asset or liability (or of a portfolio of similar assets or a portfolio of similar liabilities), the hedged item may be expressed as a percentage or amount of the entire asset or liability (or of the entire portfolio). If an amount is expressed, an entity may assume that if prepayments occur, they are first applicable to the portion of the asset or liability (or of a portfolio of similar assets or a portfolio of similar liabilities) that is not part of the designated amount of the asset or liability (or of a portfolio of similar assets or a portfolio of similar liabilities).
An entity shall not express the hedged item as multiple percentages or amounts of a recognized asset or liability and then retroactively determine the hedged item based on an independent matrix of those multiple percentages or amounts and the actual scenario that occurred during the period for which hedge effectiveness is being assessed.

In a portfolio hedge, an entity would still be required to meet the ASC 815-20-25-12(b)(1) similar assets or similar liabilities test that requires the individual assets or individual liabilities to share the designated risk exposure as the aggregated and hedged portfolio for the designated portion of the hedged item. However, when combined with the improvements in the Proposal related to hedging a partial-term and benchmark rate component of the contractual coupon cash flows, an entity’s ability to group assets or liabilities in accordance with ASC 815-20-25-12 is improved.

An operational complexity that would exist in the above example would be how the carrying amount of the hedged item(s) would be adjusted for the changes in fair value that occur on the hedged item(s) attributable to the hedged risk. In addition, how that adjustment would be amortized to earnings would require additional complexities.

Importantly, these complexities would not exist if the hedged item is a single asset such as a MBS whereas the basis adjustment would simply adjust the MBS carrying value and the amortization would be applied in accordance with ASC 815-25-35-8 and 35-9. In regards to portfolio hedges, the operational complexity are not insurmountable and we do not believe the guidance in ASC 815 would need to be updated to allow for the above basis adjustment methodologies, noting that ASC 815 is currently silent to the allocation of basis adjustments in a portfolio hedge.

In considering the basis adjustments, they become most important to the individual assets when or if they are sold, if or when the hedging relationship is discontinued, when the hedged item is assessed for impairment and their applicable subsequent accounting. We believe the following methodologies would allow for the basis adjustments to be properly accounted for and result in them being treated in the same manner as other components of the hedged items.

If the hedged item is a portfolio, we believe the basis accounting adjustments could simply be accumulated and treated as a portfolio level adjustment. If an entity has elected to defer amortization until the portfolio ceases to be adjusted for changes in fair value attributable to the risk being hedged, the adjustment would simply be maintained as a portfolio level adjustment until that time. Once the hedge relationship is discontinued, whether through a de-designation, reaching the end of the hedge period or other reasons, the basis adjustment would be allocated to the individual items in the portfolio on a systematic and reasonable basis. Alternatively, if an entity has elected a policy to immediately begin amortizing the basis adjustments, the allocation would definitely be more difficult. However, we believe that an entity could accumulate the basis adjustments and amortize them at a portfolio level based on the weighted average contractual or weighted average expected life of the portfolio, depending on whether they apply the contractual or prepayment method for amortizing premiums and discounts on loans and debt securities, until the hedge relationship is discontinued.

In regards to assessing the hedged items for impairment, these limitations would be overcome by proper grouping of the assets. For example, if the hedged item was a population of fixed rate loans, the loans would need to have similar risk characteristics so that they could be evaluated collectively for impairment under ASC 450 or ASU 2016-13.
Overall, the above recommended addition would provide additional simplification and alternatives to hedge accounting for many entities, especially as it relates to hedging MBS. While there are and could be additional nuances to accounting for the basis adjustments, we believe the complexities can be operationalized and are not significant enough that they should deter the above recommended addition. Most importantly, the above recommended addition would further improve hedge accounting by allowing entities to better align their risk management activities and hedge accounting and still apply the effectiveness criteria pertinent to the principles of being eligible for hedge accounting.

Attached in Appendix A are our responses to the questions presented in the Proposed Update.

* * *

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

Sincerely,

John M. James
Senior Vice President and Corporate Controller

cc: Paul Donofrio, Chief Financial Officer
Rudolf Bless, Chief Accounting Officer
Randall J. Shearer, Accounting Policy Executive
Appendix A - Responses to FASB's Questions for Respondents

Question 1: The Board decided it would allow an entity to designate the hedged risk as the variability in cash flows attributable to changes in a contractually specified component stated in the contract in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset. Do you agree with that decision? Please explain why or why not. If not, what specific alternatives should the Board consider? Please explain why those alternatives would be beneficial.

We agree with the decision to allow an entity to designate the variability in cash flows attributable to changes in a contractually specified component as the hedged risk in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset as it will allow for a better alignment of hedge accounting with an entity's risk management activities. That is, financial institutions often have a large volume of variable rate financial assets that currently are not eligible to be hedged, for interest rate risk, solely because they aren't indexed to a benchmark rate.

Question 2: The Board decided that it would retain the concept of benchmark interest rates for hedges of fixed-rate financial instruments and forecasted issuances or purchases of fixed-rate financial instruments, maintain the existing list of permissible benchmark rates, and add the SIFMA Municipal Swap Rate to the list.

a. Should the Board retain the current concept of benchmark interest rates for fair value hedges of fixed-rate financial instruments and for cash flow hedges of forecasted issuances or purchases of fixed-rate financial instruments? Please explain why or why not.

We believe the Board should consider adopting a more principles-based approach. While maintaining the current list of benchmark interest rates as examples, the adoption of a principles-based approach is important to allow the accounting to better react when/if there is an expansion of widely-known and widely-used interest rate indexes. At a minimum, the Board should consider whether the concept of the risk-free rate (for a benchmark rate) should be explicitly eliminated as that criteria can be very challenging to apply and does not allow for the accounting to adequately respond to changing market conditions.

b. If the Board continues to maintain the current concept of benchmark interest rates, should the Board consider within the concept expectations that a rate will become widely used?

Yes, please see our response to a.

c. If the Board continues to maintain a list of rates, are there any other rates that should be added to the list? Please explain why a particular rate meets the definition of a benchmark rate.

We're not aware of any other rates that should be added to the list at this time.

d. Are there other alternatives to the current concept of benchmark interest rates the Board should consider (for example, a principles-based approach)? Please describe those alternatives.

We believe the Board should adopt a principles-based definition. If there is an ability to substantially converge with IFRS, we believe the Board should consider that option.
Question 3: The Board decided that it would allow an entity to use either the full contractual coupon cash flows or the cash flows associated with the benchmark rate determined at hedge inception in calculating the change in the fair value of the hedged item attributable to interest rate risk, except when the current market yield of the financial instrument is below the benchmark rate at hedge inception. In that instance, the total contractual coupon cash flows would have to be used. Do you agree with this decision? Please explain why or why not.

While we agree with the decision to allow an entity to use either the full contractual coupon cash flows or the cash flows associated with the benchmark rate determined at hedge inception in calculating the change in the fair value of the hedged item attributable to interest rate risk, we do not agree with the limitation that restricts the use of cash flows associated with the benchmark rate when the current market yield of the financial instrument is below the benchmark rate. If the current market yield of the financial instrument is below the benchmark rate and there is a change in the benchmark rate, we do not believe the ability to hedge that interest rate risk should be restricted due to market timing or other reasons that may have caused the market yield to be below the benchmark rate. In other words, by mandating that all contractual coupon cash flows be incorporated into the hedge when the current market yield of the financial instrument is below the benchmark rate, the hedge will need to consider other risks, (i.e., liquidity, credit, etc.), applicable to the instrument despite the ability to isolate the interest rate risk applicable to the instrument. We do not believe this is consistent with the objective of the Proposal.

Question 4: In regard to hedging forecasted transactions, paragraph 815-30-40-5, as amended, states that “a pattern of determining that hedged forecasted transactions are probable of not occurring would call into question both an entity’s ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions.” What is your policy on what constitutes a pattern? Are there certain instances or scenarios in which missed forecasts should not be incorporated into the consideration of this pattern?

Due to the significant consequences that can result from a “pattern of determining that hedged forecasted transactions are probable of not occurring” (i.e., the potential loss of the ability to use hedge accounting in the future for similar forecasted transactions), we ensure that there is a high probability of our forecasted transaction occurring. As a result, we have not developed a governing policy as to what constitutes a “pattern”.

In regards to certain instances or scenarios in which missed forecasts should not be incorporated into the consideration of a pattern, we think that events that are isolated, nonrecurring or could not have been reasonably expected should not be incorporated into what constitutes a pattern.

Question 5: Are there hedging relationships that would be eligible to meet the requirements in the proposed amendments and IFRS 9, but the hedge results would be recognized and presented differently? If so, please describe the transaction and why it would be recognized and presented differently in accordance with IFRS 9.

Of the strategies we currently employ, we are not aware of any hedging relationships that would be eligible to meet the requirements in the proposed amendments and IFRS 9, but the hedge results would be recognized and presented differently.
Question 6: Do you agree with the following Board decisions on presentation? Please explain why or why not. If not, what other alternatives should the Board consider?

a. For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would modify current GAAP by requiring the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is presented.

We do not agree that the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness should be required to be presented in the same income statement line item in which the earnings effect of the hedged item is presented. Additionally, we disagree that amounts excluded from the effectiveness assessments or related to transactions that are no longer probable of occurring should be presented in the same income statement line item as the hedged item. Including these items has the potential to distort key performance metrics, such as net interest income, and could lead to the inclusion of non-GAAP measures. We believe that maintaining the current ASC 815 requirements will allow entities to better select the presentation that their users most desire.

b. For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would retain current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be recorded currently in earnings. For qualifying fair value and cash flow hedges, the proposed amendments would modify current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be presented in the same income statement line in which the earnings effect of the hedged item is (or will be) presented. For qualifying net investment hedges, there will be no prescribed presentation requirements for changes in the fair value of the hedging instrument excluded from the assessment of effectiveness.

Our response to a. would apply similarly here.

c. For cash flow hedges in which the hedged forecasted transaction is probable of not occurring, the proposed amendments would retain current GAAP by requiring amounts recorded in accumulated other comprehensive income to be reclassified to earnings immediately. However, the proposed amendments would require presentation of reclassified amounts in the same income statement line item in which the earnings effect of the hedged item would have been presented had the hedged forecasted transaction occurred.

Our response to a. would apply similarly here.

Question 7: Do you agree with the proposed disclosure amendments in (a), (b), and (c) below? Please explain why or why not.

a. Cumulative basis adjustments related to fair value hedges

b. Quantitative hedge accounting goals, if any, that an entity sets when developing its hedge accounting objectives and strategies and whether it met those goals
c. Revised tabular disclosure for fair value and cash flow hedges that would focus on the effect of hedge accounting on income statement line items.

We have deep concerns with the requirements of b. We believe quantitative hedge accounting goals, if any, that an entity sets when developing its hedge accounting objectives and strategies, and whether an entity met those goals, will be difficult to measure in the way that the proposed standard requires. We employ a number of different strategies across a variety of hedges. Further, our objectives and strategies are dynamic as we respond to changing market conditions. We recommend that if such disclosure is required, it focus on qualitative, rather than quantitative, factors.

**Question 8:** Unless the hedging relationship meets one of the exceptions that assumes perfect offset at hedge inception, an entity would be required to perform an initial quantitative test of hedge effectiveness and would be allowed to perform subsequent hedge effectiveness assessments qualitatively unless facts and circumstances change. Do you agree with this proposed change? Please explain why or why not.

We agree with the proposed change that allows an entity to perform subsequent hedge effectiveness assessments qualitatively unless facts and circumstances change following an initial quantitative test of hedge effectiveness.

**Question 9:** The Board decided that an entity may elect at hedge inception to perform subsequent assessment of effectiveness qualitatively. However, certain changes in the facts and circumstances associated with the hedging relationship in subsequent periods may require a quantitative assessment of effectiveness to be performed. Once an entity determines that a quantitative assessment of effectiveness is required, the entity would be prohibited to return to qualitative testing in periods after this determination is made. Can situations arise in which an entity no longer may assert qualitatively that the hedging relationship continues to be highly effective but when tested quantitatively would be highly effective? If so, please describe those circumstances. Should an entity be allowed to return to qualitative testing after such a significant change in facts and circumstances precluded it in a prior period? If so, please discuss the factors that an entity should consider to justify a reasonable expectation that the hedge will once again be highly effective on a qualitative basis.

We believe that an entity should be allowed to return to qualitative testing after a significant change in facts and circumstances precluded it in a prior period. For example, consider a situation where an entity is hedging a prepayable liability. At the time of hedge initiation, the likelihood of prepayment may be very low, (i.e. the call is way out of the money), due to the interest rate on the liability versus the market interest rates. Therefore, the entity determines that it will perform its subsequent effectiveness tests qualitatively. However, due to a subsequent change in interest rates, an entity now determines it should perform a quantitative assessment of effectiveness. If rates reverted so that the call option was again way out of the money, we believe the entity should be allowed to return to qualitative testing.
Question 10: Do you agree with the proposed amendment that would allow an entity to perform the initial quantitative testing portion of hedge documentation at any time between hedge inception and the quarterly effectiveness testing date using data applicable as of the date of hedge inception? Please explain why or why not.

We agree with the proposed amendment that would allow an entity to perform the initial quantitative testing portion of hedge documentation at any time between hedge inception and the quarterly effectiveness testing date using data applicable as of the date of hedge inception as it relieves the negative consequences of not performing the tests contemporaneously to the hedge initiation date. While allowing entities to have until the end of a quarter to perform the initial quantitative test is a reasonable limit to set, we would generally expect that entities would still need to perform this test near the hedge initiation date as the ramifications of failing could be significant.

Question 11: The proposed amendments related to the timing of the preparation of hedge documentation and subsequent qualitative testing apply to both public entities and private companies. Are there valid reasons why the content of or the timing of the preparation of hedge documentation should be different for public entities and private companies? If so, please describe the specific types of transactions for which different treatment should be considered.

We are not aware of any valid reasons why the content of or the timing of the preparation of hedge documentation should be different for public entities and private companies.

Question 12: Should the effective date be the same for both public business entities and entities other than public business entities?

The effective date should be the same.

Question 13: How much time is needed to implement the proposed amendments? Should entities other than public business entities be provided more time? If so, how much more time?

Due to the complexity and sophistication of today’s hedge accounting, we believe public and private companies should be allowed at least two years to implement the proposed amendments with the ability to early adopt at any time prior to the required effective date.

Question 14: Do you agree with the proposed transition method and disclosures in paragraph 815-20-65-3? Do you agree with the Board’s decision not to allow a retrospective transition approach? Please explain why or why not.

We do not agree that the pending content should be applied on a modified retrospective basis to existing hedging relationships. We believe the requirement that entities determine the cumulative translation adjustment for net investment hedges would be costly. We would instead recommend a prospective application that doesn’t require an adjustment for the cumulative effect of the change. This would eliminate the need for additional disclosures.