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August 19, 2010

Via email

Russell G. Golden, Technical Director
File Reference No. 1810-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference: No. 1810-100, *Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815) – Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*

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 Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the “Proposed ASU”).

Executive Summary

Wells Fargo supports the FASB’s efforts to develop a comprehensive framework which addresses the accounting for financial instruments. We are supportive of an impairment model that allows for earlier recognition of expected credit losses and a simplified approach to accounting for derivatives and hedging. However, we strongly oppose the expansion of fair value as the primary balance sheet measurement attribute for virtually all financial instruments. Furthermore, based upon the overwhelming feedback we have received, we do not believe the use of fair value for loans which management intends to holds for investment is supported by a majority of investors or analysts. We also disagree with the proposal to measure credit impairment based on static economic assumptions, the proposed treatment of a company’s own credit, and the measurement approach for core deposits.

Our conceptual and operational concerns with the Proposed ASU are expressed below. In addition, we have provided comments related to specific areas of the Proposed ASU in the attached Appendix.

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Classification and Measurement

We are strongly opposed to the expansion of fair value as the primary measurement attribute for financial instruments for many reasons, including:

- **The majority of financial statement users do not support fair value as the primary measurement attribute for financial instruments:** The feedback we have received from analysts and investors that follow Wells Fargo is consistent with the independent surveys performed by PricewaterhouseCoopers¹ and Barclays², which indicate that the majority of investment professionals do not support fair value as the default model. In fact, users prefer the existing fair value disclosures and are more concerned with and give precedence to traditional performance measures, including credit performance, net interest margin, capital strength, and asset-liability management. We believe fair value information for financial instruments not traditionally accounted for at fair value can be useful, but it would be more relevant to continue to provide this information to users through footnote disclosures.

We acknowledge the existence of certain user groups who robustly and forcefully support fair value as the primary measurement attribute for use in financial statements. We do not believe these user groups are representative of the majority of bank investors or analysts as we have observed a broad and pervasive range of users that do not favor this approach. We believe many proponents of the expanded use of fair value stand to benefit economically from the increased market volatility that would result from adopting this proposal. The FASB should not disregard the views of the industry, its regulators and the professional analysts who actually cover the industry, all of whom oppose this aspect of the proposed guidance.

- **The business strategy of an enterprise should not be dictated by the accounting model:** The FASB proposal to recognize and measure virtually all financial instruments at fair value will create significant volatility in recorded balances. Investors will place greater emphasis on short term fluctuations in the value of long duration financial assets, to the detriment of their ability to discern the long-term earnings power of their investment. This means banks will be less able to secure long-term capital precisely when they will need it most. As a consequence, companies may be forced to alter their business strategies and investment decisions to compensate for the volatility created by the proposed accounting. In doing so, companies will either avoid offering certain products, stop engaging in business activities with accounting volatility that is more magnified than the actual economic volatility, bear the full impact of this volatility, or incur the incremental cost of hedging such accounting risks in order to avoid fluctuations in market values. The role of an accounting model should be to provide a framework to recognize actual results and explain the impacts of decisions made by management. An accounting model should never become the primary driver of management behavior. The requirement to use fair value as the primary measurement attribute for nearly all financial instruments will disconnect the existing model's emphasis on management's intended business strategy (i.e., hold for investment vs. intent to trade). Furthermore, it will only serve to cement a short term focus on fair value measures, which for thinly traded or illiquid "Level 3" instruments is considered by many to be one of the major problems during the recent economic crisis.

¹ PricewaterhouseCoopers Survey: What Investment Professionals Say About Financial Instrument Reporting, June 2010

² Barclays Capital Survey: Bank Brief Newsletter Survey, June 2010

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- A mixed attribute model provides accounting and economic symmetry: Wells Fargo supports the current mixed-attribute model which provides for measurement of financial instruments at either amortized cost or fair value. Such a model is well understood and widely accepted by both management and users because it is conducive to providing metrics that are commonly used by investors. In addition, the current mixed attribute model ensures both accounting and economic symmetry between financial assets and liabilities as it inherently reflects an enterprises' business strategy, which promotes effective asset-liability management. For these reasons, amortized cost remains the most relevant measure for financial assets held for investment or capital appreciation, and financial liabilities, such as deposits and most forms of debt, which are used to fund these assets.

The IASB proposal recognizes that an enterprise's business model is integral to the classification and measurement of financial instruments. In contrast, the fair value model proposed by the FASB disregards this relationship because it inherently and wrongly presumes that liquidation values are the most relevant measurement for the balance sheet and that an enterprise needs to measure its financial instruments assuming that it intends to trade or engage in short term monetization strategies. We disagree with this approach and believe that the FASB should seek convergence of its proposed guidance towards the model put forth by the IASB.

- Requiring fair value for financial instruments will diminish reliability: Reliable financial information is paramount to effective financial reporting. Many of the financial instruments, such as loans, and non-marketable equity investments, which would be measured at fair value under the proposed guidance, have no readily discernable market in which to determine fair value. Accordingly, the determination of fair value for these instruments would be based on "Level 3" valuation techniques. These highly subjective valuations will compromise the integrity and comparability of reported results, reduce investor confidence and encourage speculation. Ultimately, we believe the required use of pervasive "Level 3" estimates in financial statements will lead to an increase in the cost of capital for financial institutions.

The FASB implicitly acknowledged these concerns when it issued FSP FAS 157-4³ (the "FSP") in April 2009. The FSP was issued to address the difficulties related to the determination of fair value in inactive markets, which at that time, related primarily to debt securities that normally traded in very active markets. There is visible evidence that the implementation of the FSP coincided with the beginning of the recovery of the debt securities markets from the recent credit market disruption, due to the dampening effect that it had on implied market liquidity premiums. Given these concerns about reliability, the practical difficulties associated with determining fair value for "Level 3" financial instruments, as well as the likely adverse impacts to financial institutions, we fail to understand how the proposed fair value guidance improves financial reporting.

- Securities sales facilitate effective asset-liability management: The Board believes that a company's asset-liability management approach is core to the analysis of the business strategy of an enterprise and that earnings should be reflective of an entity's business strategy. As such, it should not be necessary to consider the holding period or frequency of sales for individual securities when assessing whether the business strategy for financial instruments is to hold for the collection of contractual cash flows. Rather, such analysis should be performed at the enterprise or portfolio level instead of the instrument level with emphasis and primacy placed on how securities are used in connection with an enterprise's

³ FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*

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overall asset-liability management strategy. Moreover, this assessment should focus on the nature of the security sales rather than how often and if such sales are made.

Banks commonly use portfolios of debt securities as part of their overall asset-liability management strategy for managing net interest margin and core profitability. Effective asset-liability management involves the maximization of net interest margin while preserving liquidity through mitigating exposures to liquidity risk, interest rate risk, and mismatches in duration. Purchases and sales of securities are a fundamental component of this strategy and it is often necessary to dynamically manage funding needs, as well as interest rate and liquidity risk on a macro basis in response to changing market conditions or core business activities. The Board's proposal is fatally flawed because the frequency and level of re-balancing the securities portfolio is often difficult to predict as it is dependent upon the confluence of factors such as loan growth, current and expected deposit levels, and duration and mix of funding sources, all of which are affected by future events and conditions.

The proposed rules will adversely impact the ability of an enterprise to implement effective asset-liability management due to the likely accounting measurement mismatch between the portfolios of debt securities and other components of the banking book, such as loans and deposits. In response to this, companies may seek to significantly reduce their securities portfolio, which in turn, effectively eliminates a tool commonly used to manage enterprise-level interest rate and liquidity risks. We strongly urge the FASB to amend the proposed guidance in accordance with our recommendations above.

- Transparency can be better provided through an enhanced credit impairment model: The recent credit market disruption highlighted the need for more transparency related to the risks associated with financial instruments. In the basis for conclusions, the Board states that, the use of fair value accounting imposes market discipline because it forces an entity to cope with current market conditions, especially in times of market turmoil, when fair value measurement of all financial instruments would serve as an "early warning system". However, this logic is fundamentally flawed. The credit market disruption highlighted the exaggerated and often false warnings emitted by illiquid markets, where liquidity, not default risk, became the dominant factor in perceived market valuations. To the extent that reduced liquidity is caused by the inability of the marginal investor to fund itself, it creates a feedback mechanism where the weakest hand drives down the market price for securities whose fundamentals may not have changed at all. Overreliance on fair value will cause financial statement users to draw incorrect conclusions about the strength of an otherwise healthy enterprise. Furthermore, the requirement to measure all financial instruments at fair value underemphasizes and obscures the most significant risk to financial instruments that are not held for trading purposes, credit risk. A comprehensive credit impairment model that allows for earlier recognition of expected losses will better satisfy user concerns about exposure to financial instruments. Concerns about the drivers of other market-related changes in the fair value of financial instruments which management intends to hold for long term cash flows can be provided to users through disclosure. Accordingly, it is not necessary to require the measurement of financial instruments held for other than trading or market making purposes at fair value.
- The default measurement for non-derivative financial liabilities should be the settlement amount: Earnings impacts related to changes in a financial institution's own credit risk produce counterintuitive results that often confuse investors and other users of financial statements. Because these changes present quality of earnings issues, analysts and investors often disregard these changes when they analyze reported and future performance results. In addition, the requirement to separate changes in the price of credit from an entity's own credit standing is conceptually flawed. Changes in credit

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grades, as well as the price of credit, are components of overall credit risk. In fact, changes in a financial institution's credit rating do not reduce the legal amount owed. Unless an entity is no longer a going concern, the legal debt outstanding will be paid off at the contractual balance due, not the contrived balance required under the proposed accounting. This represents another area where the FASB's proposed guidance diverges significantly from the IASB's proposed guidance.

Credit Impairment

We are generally supportive of an impairment model that allows for earlier recognition of expected credit losses. However, there are significant operational and conceptual weaknesses in the proposed credit impairment model. The most significant concerns we have regarding the proposal include the following:

- **Future conditions or events must be considered in the determination of expected credit losses:** Wells Fargo is a proponent of a credit impairment model with a longer emergence period that allows for earlier recognition of expected credit losses. However, we do not agree with the Board's decision to diverge from the proposed IASB model by only allowing the consideration of past events and existing conditions when determining the amount of expected credit losses. Typically, future expectations are based on historical and current economic trends, published statistical data, borrower specific data, and reasonable forward looking expectations, all of which are fundamental to our current quarterly processes for determining our financial condition. Precluding the consideration of this information from the determination of expected credit losses is not consistent with sound credit management or a market participant's view of credit risk inherent in fair value. Accordingly, credit loss reserves will lag changes in the market's credit assumptions, resulting in reported results that will be misleading to investors.

The credit market disruption highlighted the need for more transparency related to an enterprise's exposure to credit risk. The notion of expected credit losses, whether based on expected cash flows, statistical data or implicit in a quoted price, inherently considers how expectations of future economic conditions affect current and historical conditions. The determination and disclosure of credit losses based on a static or historical view of credit exposure will not be reflective of actual credit losses inherent in financial assets, but rather a "rules driven" determination of exposure to credit risk, which in turn, may mislead financial statement users. In addition, this proposal will be operationally burdensome because it will require preparers to maintain multiple sets of books and records to monitor cash flows based on a static view (impairment), a market participant view (fair value), and the reporting entity's view (internal risk management).

- **The determination of expected credit losses can be simplified:** Depending on the nature of the financial asset, the credit impairment model requires the use of historical loss rates or expected cash flows to determine expected credit impairment. For many asset classes, expected credit losses are and can be determined using statistical and historical data, combined with reasonable expectations about future economic conditions, rather than complex expected cash flow estimates. We recommend the FASB allow companies to utilize this data in lieu of mandating the use of expected cash flow estimates to determine credit impairment. Such an approach will significantly simplify the determination of credit impairment, provide substantially similar results, and remain faithful to the principles in the Proposed ASU.
- **A single impairment model should be utilized for both originated and purchased financial assets:** Although based on expected cash flows, the proposed model requires a separate reserve methodology for purchased financial assets. In a credit impairment framework based on expected cash flows, the

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FASB recognized that it is no longer necessary to separately distinguish purchased credit impaired financial assets. Accordingly, we do not believe there is a conceptual basis to differentiate between originated and purchased financial assets. Furthermore, this will simplify the credit impairment framework.

- The Board should consider the models proposed by the IASB's Expert Advisory Panel (the "EAP") to enhance the effectiveness and operationally of its proposal: We are currently evaluating various alternative credit impairment models. While our analyses are still in process, Wells Fargo does support certain aspects of the alternative credit impairment models under consideration by the EAP. Aspects of these models that will improve the proposed credit impairment model include the flexibility to use alternative calculations of expected credit losses, consideration of future events or conditions, a differentiated approach between financial assets with indications of impairment ("bad" book) and those that do not ("good" book), no "day one" loss recognition for "good" loans, use of incurred losses as a built-in floor the "good" book, and the segregation of interest income from credit costs.

In addition to the above, the model should include a provision for accelerated recognition of changes in expected credit losses for the "good" book to further enhance the FASB proposal. For example, such acceleration may be based on performance trends or reasonable forward-looking expectations about the credit cycle. We encourage the Board's efforts to consider these, as well as explore other alternative credit impairment models given the operational and conceptual weaknesses in the FASB's proposed mode. In addition, adoption of a model similar to the EAP model will avoid the counter-intuitive result of recognizing a "day one" credit loss for newly originated loans, as currently required under the FASB's proposal.

- Accounting for subsequent changes in expected credit losses must be symmetrical: In anticipation of changes to the credit impairment framework as a result of the comment letter process and consistent with the IASB proposal, we urge the FASB to ensure the symmetrical accounting for subsequent changes in expected credit losses for all assets subject to the assessment of credit impairment. We do not support a model where adverse changes in expected losses are recognized immediately in earnings and positive changes in expected losses are accounted for prospectively over time. Treating changes in expected credit losses symmetrically will ensure companies are not unduly penalized when expected credit losses deteriorate.

Derivative and Hedge Accounting

We are supportive of a simplified approach to accounting for derivatives and hedging. We strongly support the reasonably effective threshold for hedge accounting, the relaxed requirements for the assessment of hedge effectiveness, as well as the continuation of the bifurcation-by-risk approach to hedging. The FASB should retain the preceding proposals in the final guidance regardless of any changes that may be made to the classification and measurement section of the Proposed ASU as a result of the comment letter process. Notwithstanding our support of the Board's simplification efforts, we have identified significant conceptual weaknesses in the proposed guidance which are described below.

- De-designation strategies are an integral component of prudent and cost-effective risk management: Wells Fargo strongly disagrees with the proposed prohibition on voluntarily de-designation of hedge accounting relationships. Hedging the risks embodied in large portfolios of financial assets or liabilities is inherently dynamic. As economic conditions change, the risk profile of the hedged exposure may be impacted, making it necessary to enter new hedging relationships and exit, or de-designate, existing hedge relationships to properly manage exposures to the hedged risk. For example,

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a default or prepayment may have a corresponding impact on the interest rate risk of the hedged item due to a change in the notional amount. As such, the proposal to terminate or offset hedging relationships in lieu of utilizing de-designation strategies would result in the incurrence of significant incremental costs without any measureable economic benefit.

The objective of dynamic hedging strategies is to promote effective risk management by ensuring the hedging relationship contemplates the changing economic conditions of the hedged item. De-designation strategies are consistent with the principle that qualifying hedge accounting strategies must be effective. Without the ability to utilize dynamic hedging strategies, an enterprise will not be able to align their most current risk management analyses with their hedging relationships. The FASB's concern that these valid risk management strategies may be used to manage earnings is misguided and unwarranted. The impact of de-designating a hedging relationship will only be recognized prospectively because de-designations and re-designations must be documented contemporaneously and therefore in advance of any anticipated market movements. Providing enhanced disclosure requirements about why and how companies use de-designation strategies would better address the Board's and user concerns rather than mandating a prohibition on hedge accounting for these strategies.

- **Bifurcation of embedded derivatives facilitates effective economic hedging strategies:** We disagree with the FASB's proposal to initially and subsequently measure all hybrid financial assets and liabilities at fair value if they contain embedded derivatives that would otherwise require bifurcation under current guidance. Such a requirement is not consistent with the risk management strategies employed for these instruments and accordingly, will exacerbate accounting measurement mismatches. For example, companies may use free-standing derivatives to economically hedge bifurcated derivatives, which are typically the primary source of a hybrid instrument's variability. If the entire hybrid instrument is subsequently measured at fair value, the free-standing derivative will not be effective at offsetting the risks of the embedded derivative.

The Board's proposed guidance for hybrid instruments does not represent an improvement in financial reporting. Rather, we believe it would be more appropriate to account for the host contract in accordance with the business strategy for the entire hybrid instrument rather than defaulting to fair value through earnings. Such a model would promote consistency with other non-hybrid instruments with similar business strategies. Accordingly, the proposed guidance for hybrid instruments should be modified to provide preparers an option either to bifurcate embedded derivatives or measure hybrid instruments at fair value with changes in earnings.

Other Conceptual and Operational Weaknesses of the Proposed ASU

We have the following additional concerns with the Proposed ASU:

- **The implementation costs and control risks do not justify the benefits:** Existing accounting systems cannot accommodate the proposed fair value and credit impairment guidance. For example, loan accounting systems cannot track fair value separately from amortized cost, calculate and store expected cash flow information or handle the proposed changes to interest income recognition. Other systems that would be impacted include credit, deposit, security and risk management systems. Accordingly, the proposed guidance will require companies to significantly enhance or in certain cases, replace entire financial reporting systems. Given the operational complexities associated with the proposed guidance and our experience with the accounting for purchased credit impaired loans (SOP 03-3⁴), it

⁴Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*

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will be necessary to address the proposed accounting and reporting deficiencies with manually-intensive processes, utilizing simple databases or spreadsheet tools, to augment the existing IT infrastructure.

Accounting for large components of a financial institution's balance sheet in this manner will severely stress the control environment, making it difficult to meet Sarbanes-Oxley requirements and cause financial institutions to be more susceptible to financial statement errors. Given these and the other operational and conceptual weaknesses that we have identified throughout this letter, we do not believe any measurable benefits will be derived to justify an undertaking of this scale and cost.

- Effective field testing must be performed to indentify any unintended consequences: We urge the FASB to conduct proper field testing with financial institutions to identify and understand the consequences of the proposed guidance. Unintended consequences may adversely impact an enterprises' access to credit or equity markets, cost of capital, availability of consumer and commercial credit, and certain business and risk management strategies employed by management.

As part of its field testing, the FASB should also consider the IASB proposed guidance for classification and measurement, credit impairment and the upcoming proposed guidance on hedging. The FASB should also conduct field testing with banking and other financial regulators to determine whether the proposed guidance adversely affects systemic risk for the entire banking industry. Understanding the systematic and systemic consequences of the proposed guidance is paramount to effective standard setting and high quality financial reporting.

Finally, the proposal should be subject to a robust and transparent cost / benefit analysis to determine if the benefits of the proposal would exceed the overall cost (measured in terms of the estimated financial cost to comply with the proposal and the anticipated increase in financial statement and systemic risk). Given the potential widespread implications of the Proposed ASU, we strongly encourage the FASB to publish the results of this cost study in connection with its re-exposure of Proposed ASU for additional comment prior to final issuance.

- Successful convergence is imperative prior to the final issuance of the Proposed ASU: Wells Fargo supports the convergence efforts of the FASB and IASB. Accounting for financial instruments is a critical issue for financial institutions and it is imperative that the regulatory and accounting framework provide a level playing field for all market participants. However, to date, the FASB and the IASB have been unable to converge their respective proposals on classification and measurement and credit impairment. Given the magnitude of the Proposed ASU, its significance relative to the joint project initiative under the FASB's and IASB's Memorandum of Understanding (the "MoU"), and the aggressive pace and extent of change associated with the remaining MoU projects, we do not understand the Board's decision to issue the Proposed ASU prior to the completion of its convergence efforts.

The Board cannot reasonably expect preparers to evaluate multiple proposals by the two Boards or require a multi-step implementation of the same standard as a bridge to ultimate convergence. The process to generate high quality financial reporting standards must afford sufficient time to preparers to evaluate the nature and extent of the proposed changes, as well as the knowledge that such standards will not be subject to unreasonable change in the foreseeable future.

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Conclusion

We are strongly opposed to many of the provisions included in the Proposed ASU, including the pervasive expansion of the use of fair value, the required use of static data in the determination of expected credit losses, and the overall lack of consistency between the proposal and a financial institution's business strategy. In addition, the Proposed ASU will reduce the reliability of financial reporting due to the pervasive use of "Level 3" information and introduce significant operational complexities. Given these concerns and our belief that the fair value guidance has overwhelmingly been rejected by bank analysts and investors, we strongly encourage the FASB to revise the Proposed ASU to address the identified shortcomings and to work with the IASB to develop a single converged financial reporting model for financial instruments.

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
International Accounting Standards Board Members
Jim Kroeker – Securities and Exchange Commission
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

APPENDIX

Classification and Measurement

Wells Fargo does not support the proposed guidance for the classification and measurement of financial instruments. In addition to the comments provided in the preceding cover letter, we have the following additional comments:

Level 3 Disclosures

- Given the significant increase in “Level 3” valuations for financial instruments as a result of the proposed guidance, we are concerned with the relevance and operability of the measurement uncertainty disclosures proposed in the recently issued exposure draft on fair value measurements⁵. We encourage the Board to consider whether concerns regarding transparency of “Level 3” valuations can be better addressed through meaningful qualitative disclosure of valuation inputs, valuation methodologies, valuation practices and validation procedures.

Loan commitments and letters of credit

We do not support the proposed guidance for loan commitments and letters of credit. Our specific concerns are as follows:

- A general principle of the proposed guidance is the earnings of an enterprise should be reflective of its business strategy. Due to the likely significant difference between the transaction price and fair value of these arrangements, which is more fully described below, a substantial portion of the initial measurement will be recorded in earnings. Wells Fargo does not support fair value as the primary measurement attribute for loans held for investment and related loan commitments and letters of credit. We also question the cost and benefit of tracking and estimating fair value when financial statements users would be better served with improved disclosure regarding the nature and extent of these arrangements.
- In FAS 149⁶ the FASB provided a scope exception for all loan commitments other than commitments related to mortgage loans held for sale due to concerns about the assessment of the net settlement criteria for qualification as a derivative. We are not aware of any changes in the nature of these arrangements that would assuage these concerns and thus justify the proposed guidance for loan commitments.
- If the Board decides to retain fair value accounting for loans held for investment and related commitments and letters of credit, the scope exception related to revolving credit card arrangements should be extended to other revolving lines of credit. The Board granted the scope exception for revolving credit card arrangements because it was concerned the requirement was not practical as these arrangements typically have small balances, high volumes and are revolving in nature. The complexity involved in the valuation of revolving arrangements was also acknowledged in SOP 03-3, which provided a scope exception for revolving instruments for similar reasons. These concerns remain valid and we encourage the FASB to extend the scope exception to cover home equity lines of credit, and similar consumer and commercial revolving credit arrangements. Although they typically carry higher

⁵ Proposed Accounting Standards Update, *Amendments for Common Fair Value measurement and Disclosure Requirements in US GAAP and IRFS*

⁶ Statement of Financial Accounting Standards No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*

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balances, commercial revolving arrangements share similar characteristics. However, as consumer assets are typically accounted for in large homogenous pools, this fact is mitigated and thus, less of a differentiating factor.

- It is not clear how the proposed definition of a loan commitment applies to a lending arrangement that has been conditionally approved, subject to additional requirements, such as appraisals, clear title, and environmental assessments. Are these conditions considered ‘pre-specified terms and conditions’? Typically, these commitments would not be legally binding until the borrowers fulfill the conditional requirements. From a timing standpoint, the commitment would be very close to funding at this stage which further makes the cost/benefit of the proposed accounting treatment questionable.

Core deposits

As previously discussed, we support the amortized cost classification for loans held for investment and likewise support amortized cost classification for deposits. However, if the Board chooses to retain the proposal to account for core deposits at remeasurement value, we have the following comments:

- The FASB should not change the existing definition of core deposits. The term ‘core deposit’ is used throughout the financial services industry to describe a low-cost source of stable funding. Currently, core deposits of financial institutions include most demand deposits and certain time deposits. A codified accounting definition of the term that differs from the current industry definition will create inconsistent disclosures and unnecessary confusion for investors, regulators and other financial statement users. If the Board chooses to retain the proposal to account for core deposits at remeasurement value, such value should be calculated based on deposits without contractual maturities.
- The requirement to separately present surge balances, temporary accounts and transient accounts on the balance sheets is unnecessary. To comply with this proposed requirement, it would be necessary to separately monitor individual customer accounts in order to track and separately record seasonal fluctuations in deposit balances. This would create significant operational complexity that would not provide any additional value to users. As the face amount of these deposits would approximate their re-measurement value, these balances should be included in the overall re-measurement value of core deposits.
- The proposed definition of alternative funds rate is fatally flawed. An alternative source of funds that is both cost effective and sufficient in volume and duration does not exist. We have over \$600 billion of deposits that would be subject to the remeasurement valuation requirements. According to IFR Markets⁷, annual domestic investment grade corporate debt issuance volumes from 2005 through 2009 averaged \$617 billion, with a highest single year issuance of \$726 billion. Accordingly, to determine the proposed alternative funds rate, it would be necessary to assume an issuance of replacement debt that is comparable to the size of the average annual issuance for the entire market. We recommend that the Board redefine the alternative funds rate based on a rate representative of a marginal cost to issue term debt of similar duration and remove the sufficient in volume requirement.
- The proposed remeasurement value calculation is mathematically flawed. The exposure draft requires discounting the period average deposit balance based on the difference between the alternative cost of funds rate and the all-in-cost-to-service rate over the weighted-average life of the deposits. An appropriate present value technique would calculate the remeasurement value based on the present value of expected future cash flows discounted at the alternative funds rate. Expected future cash flows

⁷ Thompson Reuters’ ifrmarkets.com: US CREDIT CLOSE: First Half 2010 Stats Edition, July 1, 2010

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should reflect the all-in-costs to service the deposits over the implied maturity. Discounting the deposits at a spread over their weighted average life will not produce the same result as discounting expected cash flows at the alternative cost of funds. The result of the proposed calculation is a valuation that is not meaningful as it is inconsistent with an approach a market participant would use to value deposits.

- The proposed remeasurement value includes a significant portion of the core deposit fair value, which is primarily attributable to an entity's long-term relationship with depositors. Accordingly, clarification is needed to understand how the proposed remeasurement value approach affects the valuation and subsequent measurement of core deposit intangible assets associated with deposits acquired in a business combination or similar transaction.

Transaction price

We do not support the proposed guidance that requires earnings recognition for significant differences between the transaction price and fair value of financial instruments measured with changes in other comprehensive income. This guidance will result in an accounting model that is not reflective of an entity's business model. Our specific concerns are as follows:

- We do not agree that significant differences between the transaction price and fair value of transactions arising in the course of customary lending activities of financial institutions should be recognized in net income. Financial institutions may originate held for investment loans at below-market interest rates to build or improve customer relationships, generate goodwill in their communities or to comply with the Community Reinvestment Act. The proposed guidance will result in the recognition of "day one" losses due to normal and customary lending activities that will likely be offset by other benefits in future period earnings.
- Under existing guidance, servicing is a component of the fair value of certain commitments to originate loans for sale. However, the transaction price typically does not include the servicing value. The proposed guidance would require "day one" gains for virtually all loan commitments because the transaction price and fair value would be significantly different. We do not believe such differences should be reflected in earnings if the commitment does not relate to a loan originated for sale.
- Determining whether there is a significant difference between the transaction price and fair value is not operational. For example, prevailing interest rates offered on customer products typically vary among institutions. It is not possible to gain transparency into business objectives or motivations and pricing strategies of other financial institutions. Additionally, there is not a secondary market for the vast majority of loans and related commitments. Accordingly, it is not possible to obtain reliable evidence to substantiate the difference between fair value and transaction price. We also encourage the FASB to provide further guidance on how to assess whether such differences are significant.

Equity method and cost method of accounting

We do not agree with the proposal to limit the criteria for the use of the equity method of accounting to investments that are "related" to the entity's consolidated business. We also do not agree with the elimination of the cost method of accounting for non-marketable investments. Our specific concerns are as follows:

- We do not agree with the proposed change to the criteria for equity method accounting. We believe that the proposed language will add significantly to the complexity of accounting for equity method investments and reduce the relevance and reliability of accounting for these investments. For strategic

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investments, periodic re-measurement of an investment's fair value with changes recorded in earnings is not relevant to investors because strategic investments are made for the purpose of enhancing the investor's core businesses and long-term operating cash flows, not for short-term investment. Financial institutions make strategic investments with companies engaged in many diversified businesses to gain access to new markets and technologies or to create or strengthen business relationships. We believe the equity method continues to be appropriate where significant influence is present.

- Fair value will not be a reliable measurement for many cost or equity method investments. Companies must gather inputs at each measurement date by looking to comparable public entities, recent transactions, and/or cash flow analyses, any or all of which may be difficult to perform or costly to obtain and are necessarily highly subjective. In particular, obtaining market comparables or looking to transactions of similar organizations poses unique challenges in the private equity market since many transactions involving these entities do not involve fair value exchanges in liquid markets. We would only support fair value for equity method investments that are both non-strategic and where the fair value is readily determinable and therefore reliable. We would also like to note that current accounting guidance for equity method investments specifically allows for a one-quarter lag for financial information used to account for these investments. Issues of obtaining timely financial information for both equity and cost method investments will persist and may be exacerbated if they are accounted for at fair value. Should the Board ultimately determine that a broader application of fair value to these investments is appropriate, we recommend that any final guidance include an explicit provision allowing for this lag in financial information for use in determining fair value for these investments.
- The expansion of fair value to equity method investments will generate significant interpretive issues that likely will create diversity in practice, resulting in different accounting models for similar (strategic, long-term oriented) equity method investments. This will reduce comparability, create additional burden on preparers and auditors, and result in less meaningful information for users of the financial statements.
- Requiring equity method accounting only for entities with similar business operations is inconsistent with the Board's consolidation rules. Consolidation of all entities where control is present is required regardless of differences between the parent and subsidiary's business operations. Since equity method accounting is "one-line consolidation", equity method accounting should be required where significant influence is present, regardless of differences in business operations.
- Accounting for equity method investments at fair value is inconsistent with the proposals of the IASB accounting model and therefore creates an additional and unnecessary difference that will potentially need to be converged in the future.

Credit Impairment

In addition to the conceptual and operational comments provided in the preceding cover letter, we have the following additional comments:

- The Proposed ASU does not permit the use of forward curves for expected changes in variable rates of interest when estimating future expected cash flows for variable rate instruments. Financial institutions are adept at evaluating expectations of future interest rates, which is integral to effective overall asset-liability management. Forward interest rate curves represent market observable data that are routinely used to value financial instruments. Accordingly, the use of only static interest rates for these instruments would be inconsistent with how market participants and sophisticated financial statement

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users would evaluate our exposure to interest rate and credit risk. Consistent with our comment in the preceding letter related to the consideration of future conditions or events, the FASB should amend the proposed guidance to permit the use of forward interest rate curves.

- With certain exceptions, the proposed guidance requires the consideration of both the timing and amount of cash flows when measuring the amount credit impairment. However, the FASB should further clarify whether the evaluation of the existence of credit impairment is based on gross cash flows, regardless of timing, or net cash flows.
- Operationally, the interest income and allowance methods prescribed for pooled assets are fatally flawed because they would effectively require the allowance for credit losses be allocated and maintained at the individual asset level, or at best, require the use of static pools with common risk characteristics. Credit risks are not managed at the loan level or on a static basis, but rather pools of financial assets that exhibit similar credit behavior are analyzed together, regardless of origination date. The cost associated with the implementation and on-going administration of this information will be significant. Accordingly, it will not be operational to alter proven risk management strategies to systematically track credit loss expectations either individually, or by date of origination or acquisition.
- Further implementation guidance is necessary for the determination of credit impairment based on the application of an historical loss rate, including how the time value of money should be considered.
- The FASB recently issued guidance⁸ that establishes individual pools of PCI loans as the unit of account. As such, modified PCI loans accounted for in homogenous pools remain in the pool after modification, regardless of whether a modification is considered a TDR. However, the Proposed ASU supersedes this recently issued guidance by requiring the removal of modified loans from the pool. We support the existing and recently issued guidance and ask the Board to retain this guidance in the Proposed ASU.
- The Board should not require a collective determination of impairment with similar financial assets when there is no indication of impairment at the individual asset level. In many cases, individual assessments of impairment may be more precise than collective assessments due to the often unique cash flow characteristics for individually assessed instruments, such as securities or large commercial loans. When credit impairment is not necessary based on a more precise individual assessment, an impairment based on a collective assessment should not override such an assessment as it would produce a result that is not meaningful and will mislead financial statement users.

Interest Income Recognition

Wells Fargo does not support the proposed methodology for the calculation of interest income which commingles credit losses and interest income due to the inclusion of the allowance for credit losses. In addition, we do not support the proposed guidance for the suspension of interest accrual. Our additional concerns regarding the proposed guidance are as follows:

- We share the concerns of the Board described in the Alternative Views section of the Basis of Conclusions as the proposed guidance will produce counterintuitive results and confuse financial statement users. For example, the proposed methodology will understate interest income and overstate

⁸ ASU 2010-18, *Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset—a consensus of the FASB Emerging Issues Task Force*

recoveries for performing assets because cash interest will almost always exceed the calculated interest income as well as credit allowance requirements. Accordingly, the excess allowance created by this approach will need to be reversed through the provision for credit losses.

- The co-mingling of credit losses and interest income will obscure important performance metrics commonly used by both financial statements users and management, who evaluate net interest margin and credit risk separately.
- We do not support the proposed suspension of interest accrual when the expected yield on a financial asset is negative. The calculation of interest income should be based on the premise that accrual is appropriate to the extent cash flows are expected to be collected. This proposed guidance is inconsistent with existing, more conservative, regulatory guidance for the determination and reporting of non-accrual loans, which is primarily delinquency based. Discussions with our regulators do not indicate support for the FASB's proposal. Accordingly, the proposed model would result in inconsistent disclosures that will only serve to confuse financial statement users. We strongly urge the FASB to work with the regulators to create a uniform definition for non-accrual assets.

Derivatives and Hedging

We have the following additional concerns related to the proposed guidance for derivatives and hedging:

- The shortcut and critical terms match methods should be retained as an acceptable method of assessing whether hedging relationships are reasonably effective. We believe this will simplify the assessment of many "plain-vanilla" hedging relationships.
- We encourage the FASB to provide additional implementation guidance, including a list of factors to consider in the assessment of a hedging relationship. Such guidance should include examples of the most common hedging strategies, including the strategies that would likely qualify or not qualify as reasonably effective. This guidance would be extremely helpful to both preparers and auditors by providing them with a useful guide to assessing the effectiveness of the most common hedging strategies. We are concerned that, absent more specific guidance from the FASB, auditors and regulators may develop their own interpretations regarding the assessment of hedge effectiveness. Without enhanced implementation guidance, there may be implicit requirements for preparers to perform quantitative assessments to avoid "second guess" risk, increased diversity in practice and complexity in applying the new guidance.
- For plain-vanilla hedge relationships, such as hedging fixed-rate debt with a pay floating-rate swap, the long haul method can result in a significant amount of ineffectiveness due to the impact of credit spreads. Conceptually, the measurement of effectiveness of a hedging strategy designed to hedge the designated benchmark interest rate should not contemplate the impact of credit spreads. The method permitted under the IASB model does not consider credit spreads. Rather, it only considers the designated interest rate components in the hedging strategy. This approach has been a longstanding component of the IASB hedge accounting model and has proven to be a useful and operational method for preparers. We encourage the FASB to incorporate this concept into the proposed hedge accounting guidance.
- We believe the FASB should expand the definition of a benchmark interest rate to include other common and liquid interest rate indices such as the fed funds, prime or BMA index. Existing guidance allows only the designation of LIBOR or U.S. Treasury rates as the benchmark in an interest rate risk

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hedge. Market participants manage interest rate exposures based upon the benchmark interest rate that give rise to that exposure, which is not limited to LIBOR or U.S. Treasury rates. For strategies designed to hedge other common interest rate indices, companies either do not qualify for hedge accounting or are forced to recognize ineffectiveness in earnings that is not consistent with the economics or risk management objective. In most instruments, the contractual interest rate can be transparently decoupled into an underlying benchmark rate and a credit spread component, which allows the hedged interest rate risk to be identifiable and measurable. With this change, the hedge accounting model will better reflect the economics of these hedging strategies and achieve a greater degree of convergence with the IFRS model.

- If the FASB does not accept our recommendations on hedge accounting, we recommend that the transition guidance provide for prospective application of the proposed guidance for hedge accounting. We are concerned that the proposed transition guidance will require companies to assess and measure hedge effectiveness for historical periods for which information may be difficult or impractical to obtain.