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Via email

Technical Director
Financial Accounting Standards Board
File Reference No. 1590-100
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 83

Re: File Reference No. 1590-100 – Invitation to Comment Proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities - an amendment of FASB Statement No. 133

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$609 billion in assets providing banking, insurance, investments, mortgage and consumer finance services. We appreciate the opportunity to comment on the Board's proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities — an amendment of FASB Statement No. 133.

Wells Fargo supports the Board's efforts to simplify hedge accounting and improve the financial reporting for hedging activities, however, believes the Exposure Draft (ED) does not meet the objectives as described in the proposed standard. Rather, the ED introduces significant new practice issues that will require extensive implementation review and guidance. We agree with the Alternative Views in the ED that the amendments do not significantly simplify the application of Statement 133, produce accounting results that are inconsistent with risk management strategies, and add to the differences between Statement 133 and the international standard on derivatives and hedging (IAS 39, Financial Instruments: Recognition and Measurement) at a time when we should be moving toward convergence.

We believe that the proposed amendments to Statement 133 will change the existing standard significantly and raise significant concerns that need to be addressed before any final guidance is issued. We are particularly concerned that the Board is revising an overly complex and long accounting standard without working more closely with the International Accounting Standards Board (IASB) to ensure that both Boards are working toward a common accounting standard for derivatives. Convergence is a high priority on the agendas of both the U.S. Financial Accounting

Standards Board and the IASB. With the SEC's goal to allow U.S. companies to switch to international accounting standards potentially as early as 2011, we think it is extremely important that any proposed changes completely resolve all differences between U.S. GAAP and international financial reporting standards (IFRS).

We observe that significant differences exist between the current hedge model and IAS 39 (for example, differences in the definition of a derivative, scope exceptions, and when an embedded derivative is required to be bifurcated and subsequent accounting thereof), and rather than attempt to converge the two standards, the proposed amendment creates further divergence. See Exhibit A to this comment letter which describes the significant changes proposed in the ED and how these changes are largely divergent from existing IFRS. If this course of action is continued, it will result in companies being required to interpret and implement the proposed amendment, which is significantly different from current U.S. GAAP, then change to IAS 39 in a few years, then possibly change again in a few years thereafter, depending upon the outcome of the IASB's discussion document on accounting for all financial instruments at fair value. Preparers, auditors, and the Board have incurred substantial time, effort, and costs in the past 10+ years developing and implementing the current hedge model to a point where companies are applying the accounting rules consistently. This onerous and lengthy process will only have to be repeated given the drastic proposed changes by the Board, and likely again once efforts are made to converge with IFRS, leaving hedge accounting rules in an unnecessary state of flux for the foreseeable future. We find this to be, and believe other constituents will agree, an unreasonable outcome. Furthermore, we observe the priorities of the U.S. financial reporting system have changed since the Board added this hedge accounting project to its agenda in May 2007. Accordingly, we do not believe the project to amend Statement 133 should be a high priority for the Board. For these reasons, we believe the Board should drop its project to amend FAS 133 and jointly develop a plan with the IASB to fully converge the accounting, reporting, and disclosure rules for derivative accounting and hedging activities.

In addition to our concerns regarding convergence with IFRS, we have the following specific concerns with the proposed amendment.

#### The proposed amendment does not meet the project's stated objectives

The Board added the hedge model project to its agenda to simplify the accounting and improve the financial reporting for hedging activities, resolve major practice issues, and address differences resulting from recognition and measurement anomalies between the accounting for derivatives and hedged items. While some aspects of the ED are intended to simplify the accounting for hedging activities (e.g., the change from highly effective to reasonably effective and to a qualitative assessment at inception only with quantitative assessments in certain circumstances), the proposed change to no longer allow companies to hedge specific risks overwhelms those aspects. This change profoundly and negatively affects the manner in which companies manage interest rate risks, while at the same time introducing new practice issues which would require extensive implementation guidance. We believe the general requirement to

include risks other than interest rate (e.g., risk attributable to issuer's creditworthiness, risk of default and basis risk based upon the supply and demand in the market for the particular financial instrument) in the hedge accounting results is inconsistent with the Board's objectives of simplification and increased transparency. Hedge accounting for many of the most basic and common hedge relationships is not simplified, but rather becomes significantly more complex. Many companies will likely not be able to apply hedge accounting for certain hedge relationships - even under a "reasonably effective" standard - that otherwise qualify under the current hedge model. For those hedge relationships that will continue to qualify, inclusion of unhedged and unhedgable risks in the hedge accounting may force companies to avoid prudent asset/liability risk management strategies as the asymmetry that exists between the accounting and the risk management would result in financial statement recognition inconsistent with risk management strategies. We believe this leads to financial statement reporting that is less transparent, less representative, and ultimately less useful to the reader.

#### Bifurcation-by-risk should be retained in the hedge model

Derivatives used in practice today for interest rate risk management purposes are generally not designed to hedge risks other than interest rate risk. Companies either choose not to hedge such risks or they are simply unhedgable. Eliminating bifurcation-by-risk will create significant inconsistencies between the accounting results and such risk management strategies. Companies will find the financial statement impact unacceptable due to reflection of unhedged risks in their results. Therefore, to avoid companies being forced to discontinue the use of hedge accounting, resulting in the reduction and/or abandonment of reasonable and expected interest rate risk management strategies, we believe the bifurcation-by-risk model should be retained. Additionally, this leads to more representationally faithful and transparent financial reporting. If the Board believes financial statement users require additional information regarding unhedged risks, we recommend accomplishing that objective by amending existing derivative disclosure requirements.

Through our corporate risk management practice, we globally manage the firm's exposure to interest rate risk. What this means is our balance sheet might be either slightly asset or liability sensitive at any point in time, however the risk profile could shift given our exposure to changes in interest rates, changes in the shape of the yield curve or changes in the mix of the balance sheet triggered by customer behaviors. The most efficient and cost effective way to mitigate a change in our risk profile is typically through the entering into or terminating derivative instruments (primarily interest rate swaps and options – caps / floors) against specific hedged items that result in highly effective hedges. From a risk management standpoint, these strategies are primarily designed to hedge the future cash flows of the hedged item due to interest rate risk, such as converting a hedged item's fixed-rate cash flows to floating or vice versa. Examples of such strategies include using derivatives to a) convert fixed-rate debt issued to floating-rate, b) convert floating-rate debt issued to fixed-rate, c) convert fixed-rate securities to floating-rate and d) convert floating-rate loans to fixed-rate. These are core interest rate risk management strategies for Wells Fargo. We are very concerned the proposed changes would preclude or

significantly limit use of derivatives in this capacity by introducing risks other than interest rate risk (e.g., credit risk) into the hedge relationship. This would significantly increase the risk certain of our existing hedge relationships would not qualify as "reasonable effective" under the proposed amendment. For those that happen to qualify, the reflection of unhedged risks in our financial statement results would be inconsistent with the risk management intent. Therefore, the inability to hedge specific risks could ultimately have the unintended consequence of discouraging or eliminating prudent risk mitigation strategies implemented today. Furthermore, we believe there will be significant complexities to hedging an entity's own debt after it has been issued. We agree with the Board's Alternative Views in the ED stating concern that there are significant issues in hedging one's own credit risk related to self dealing, legal implications, and market perception.

The Board came to the appropriate conclusions in its original deliberations on Statement 133. Paragraphs 336 and 337 of Statement 133 indicate that the board considered a hedging model in which overall changes of the hedged item would be required, but ultimately decided against it for reasons still valid today. The Board acknowledged in paragraphs 351 and 352 that the current hedge model combines elements from each of the approaches considered and it is consistent with all four of its "fundamental decisions."

If the Board's objective in eliminating the bifurcation-by-risk approach is to provide additional information to users about unhedged or unhedgable risks as well as overall risk management perspectives, we believe that users and preparers would be better served by the Board by retaining the bifurcation-by-risk model in Statement 133, yet address the issue by disclosing that information through the existing disclosure framework set forth in Statement 107, Disclosures about Fair Value of Financial Instruments or in Statement 161, Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133. We believe that the Board should first evaluate how users accept the substantive disclosure changes made by Statement 161 and modify these disclosures accordingly prior to overhauling the hedge accounting model.

#### The substantive changes proposed create costs that significantly "outweigh" the benefits

We do not agree with the Board members who indicate that the ongoing financial reporting benefits resulting from proposed changes would exceed the "one-time" costs. The proposed changes will require substantive ongoing costs in addition to initial implementation costs. The proposed model introduces new complexities which will require subsequent ongoing implementation guidance. Preparers have incurred significant costs in order to follow the hedge model in place today, which has been developed over the past 10+ years. These costs have been incurred in order to develop consistency with the approach thoroughly vetted and issued by the Board in issuing a standard that attempted to accomplish user and preparer needs. Although many complex issues have arisen during this time, they have been addressed through the proper channels by preparers, auditors, and the Board. Financial statements under the proposed amendment will not be more representative of the economics of the instruments designated as

accounting hedges and will make it more difficult, if not impossible, to assess the effects of hedging activities. The costs and benefits should also consider how long these changes will be in effect and also consider the cost impacts of other reporting standards being issued at the same time. Additionally, we acknowledge that there will be additional costs incurred as the Board works towards convergence with IFRS as it makes more changes to the accounting models for derivatives and other financial instruments.

# The transition period does not provide enough time for entities to adopt the proposed statement

As indicated previously, we recommend that any hedge model changes coincide with the implementation of comprehensively converging IFRS and U.S. GAAP related to derivative and hedge accounting requirements. If the Board decides to proceed with issuing the ED as drafted, due to the significant increase in complexity introduced in the ED, the proposed effective date does not provide enough time for companies to adopt the proposed statement. The proposed effective date also coincides with the proposed effective date on the proposed Statement 140 and FIN 46R are substantive and will require companies to incur significant costs and resource strain to comply. As such, we believe the transition time and effective date of the proposed amendment to Statement 133 should not coincide with effective date of the amendments being made to Statement 140 and FIN 46R. The Statement 140 and FIN 46R amendments will cause significant complexities in financial statement reporting and transparency for users at a time when the financial markets are already under considerable stress.

While we are concerned about the changes contemplated in the ED, the Company supports the Boards efforts in finding ways to simplify the application of hedge accounting, such as the following:

# Modification of the effectiveness threshold from highly effective to reasonably effective based on qualitative analysis

We support the concept of lowering the threshold for hedge qualification from highly effective to reasonably effective, however, believe that the proposed changes eliminating the bifurcation by risk approach will not allow many relationships to remain qualified under the proposed reasonably effective threshold under either a qualitative or quantitative assessment. We question whether a qualitative analysis will be sufficient in situations which require the entity to consider fair value change variability of all risks, including those risks which are unhedgeable or too costly because of how derivatives are currently structured. Thus, any attempts to simply effectiveness assessments at inception of hedging relationships by reducing the threshold from highly effective to reasonably effective are nullified by the significant changes to the bifurcation by risk approach. If the bifurcation by risk approach is retained, and therefore the change to the effectiveness threshold is meaningful, we believe further guidance is needed to clarify when a qualitative or quantitative assessment is required.

## Ongoing assessments required only when circumstances would suggest that a relationship may no longer be reasonably effective

We support the proposed changes to require an effectiveness assessment subsequent to inception only when circumstances may suggest that the hedging relationship may no longer be reasonably effective. Entities are currently required to assess effectiveness of a hedging relationship at inception based on all terms of the hedging relationship. Entities already evaluate ineffectiveness through their ongoing financial statement reviews to determine whether hedging relationships are working as originally designed and to determine whether hedges are effective from a risk management perspective (which many times is more stringent than "highly effective"). To avoid the potential interpretation that hedge relationships hedging the overall changes in fair value or cash flows inherently require ongoing assessments simply if unhedged or unhedgable risks are present in the hedged item (e.g., credit risk), we suggest the Board further clarify that subsequent assessment is required only when "critical terms" of the original hedge relationship change. We suggest defining critical terms as substantive terms in the hedging instrument and hedged item that significantly impact the change in fair value of or variability in cash flows attributable to the hedged risk.

### Conclusion

While we support the Board's initiatives to simplify the hedge accounting model and related financial reporting, the proposed changes do not meet the Board's objectives. We agree with the Alternative Views presented that the amendments do not simplify hedge accounting, produce accounting results that are inconsistent with risk management strategies, and diverge from IFRS when we should be moving toward convergence.

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We appreciate the opportunity to comment on the issues contained in the Board'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: Ms. Donna Fisher, American Bankers Association
Ms. Gail Haas, New York Clearinghouse Corporation

# Exhibit A Exposure Draft Proposed Changes to Accounting for Hedging Activities Comparisons of Current GAAP, IFRS, and Proposed GAAP

ТОРІС	CURRENT GAAP	IFRS	PROPOSED GAAP	DIVERGENT/ CONVERGENT *
Permitted Hedgeable Risks	Allows hedging of specific risks for both fair value and cash flow qualifying hedge relationships. Hedged risks may be related to overall changes in fair value, benchmark interest rate, foreign currency exchange rate, and credit risk.	Allows hedging of specific risks. The hedged item is adjusted for changes in its fair value related to the risk(s) being hedged. Similarly, for cash flow hedges, the derivative is compared to the change in cash flows of the hedged item due to changes in the hedged risk.	Would amend FAS 133 to only permit companies to hedge changes in overall fair value of the hedged item or, for cash flow hedges, the risk of overall changes in the hedged cash flows – with the following limited exceptions:  • Hedges of interest rate risk, foreign exchange risk or combination thereof allowed for Company's issued debt when hedge is initiated at inception of debt.  • Hedged risk for fair value and cash flow hedges can be foreign exchange risk.	Divergent
Shortcut / Matched Terms	Entity may make an assumption of no ineffectiveness in a hedge relationship qualifying under the shortcut or matched terms methodologies.	Use of the shortcut method is prohibited. An entity must measure ineffectiveness using the "long-haul" method.	Eliminates the ability to use shortcut method or matched terms methodologies and therefore eliminates the ability for entities to make an assumption of no ineffectiveness. "Long-Haul" method utilized to measure ineffectiveness for all hedges.	Convergent
Effectiveness Threshold	The hedging relationship is expected to be "Highly effective" both on a prospective and retrospective basis (80-125% as defined by the SEC).	Hedge relationship is required to be within a range of 80% to 125% both prospectively and retrospectively.	Would amend FAS 133 to require that a hedge be "Reasonably effective" rather than "Highly effective." Reasonably effective has not been defined but is less restrictive than highly effective.	Divergent

<sup>\*</sup> Indicates whether the proposed changes in the Exposure Draft (Proposed GAAP) are convergent with existing IFRS rules, or whether the Proposed GAAP is divergent from existing IFRS rules when convergence already exists.

### Exhibit A (continued)

CURRENT			PROPOSED	DIVERGENT/
TOPIC	GAAP	IFRS	GAAP	CONVERGENT *
Initial Assessment of Hedge Effectiveness (for "Long- Haul" relationships)	The hedging relationship is expected to be highly effective, demonstrated by quantitative effectiveness testing. Highly effective must be calculated to be within a range of 80% to 125%.	The hedging relationship is expected to be highly effective, demonstrated by quantitative effectiveness testing. Highly effective must be calculated to be within a range of 80% to 125%.	Amends FAS 133 to require a qualitative assessment (as opposed to the current quantitative assessment) of hedge effectiveness at inception to assess that:  • An economic relationship exists between the hedging instrument and the hedged item or hedged forecasted transaction.  • Changes in fair value of the hedging instrument would be reasonably effective (reasonably effective is currently undefined) in offsetting changes in the hedged item's fair value or the variability in the hedged cash flows.  In certain situations, a quantitative assessment may be necessary to conclude that a relationship would be reasonably effective.	Divergent
Ongoing Assessment of Hedge Effectiveness (for "Long- Haul" Relationships)	The hedging relationship is expected to be highly effective on an ongoing basis. Prospective and retrospective assessment of effectiveness, accomplished by quantitative effectiveness testing, is required whenever financial statements or earnings are reported, and at least every three months.	The hedging relationship is expected to be highly effective on an ongoing basis. Prospective and retrospective assessment of effectiveness, accomplished by quantitative effectiveness testing, is required whenever financial statements are prepared.	After inception, would require that an entity qualitatively reassess (or quantitatively, if necessary) effectiveness only if circumstances suggest that the hedging relationship may no longer be reasonably effective.	Divergent

### **Exhibit A (continued)**

TOPIC	CURRENT GAAP	IFRS	PROPOSED GAAP	DIVERGENT/ CONVERGENT *
De- designation of Hedging Relationship	Hedging relationship may be voluntarily de-designated at any time without selling or terminating the derivative.	An entity can voluntarily discontinue hedge accounting prospectively if it revokes the designation without settling or terminating the derivative.	Entity can no longer de-designate an otherwise reasonably effective hedge, simply by voluntarily removing the hedge designation. The derivative must be terminated, sold, or mature; or the entity must enter into a perfectly offsetting derivative in order to de-designate a hedging relationship that is reasonably effective and would otherwise still meet the criteria for a qualifying hedge relationship.	Divergent
Ineffectiveness Measurement for Cash Flow Hedges	Ineffectiveness equals the amount by which the cumulative change in fair value of the hedging instrument exceeds the cumulative change in the fair value of the expected future cash flows of the hedged item ("overhedging" recognized as ineffectiveness). However, if the reverse applies ("under-hedging"), ineffectiveness is not recognized.	Ineffectiveness equals the amount by which the cumulative change in fair value of the hedging instrument exceeds the cumulative change in the fair value of the expected future cash flows of the hedged item ("overhedging" recognized as ineffectiveness). However, if the reverse applies ("under-hedging"), ineffectiveness is not recognized.	Ineffectiveness equals the amount by which the cumulative change in fair value of the hedging instrument does not match the cumulative change in the fair value of the expected future cash flows of the hedged item. "Over-hedging" and "under-hedging" are recognized as ineffectiveness.	Divergent

NOTE: In the Exposure Draft on Accounting for Hedging Activities, the FASB states in its introduction and summary, "The accounting for hedging activities in this proposed Statement would diverge from the hedge accounting requirements currently contained in IAS 39, Financial Instruments: Recognition and Measurement. However, in March 2008, the International Accounting Standards Board (IASB) issued a Discussion Paper, Reducing Complexity in Reporting Financial Instruments, that considers two general approaches to changing hedge accounting requirements. The first approach would be to maintain and simplify the existing hedge accounting requirements. The second approach contains many of the concepts that are included in this proposed Statement."