Bank of America

January 23, 2007

John C. Dugan
Comptroller of the Currency
Docket No. 06-10
250 E Street, SW
Washington, DC 20219

Ms. Jennifer J. Johnson
Docket No. R-1265
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Robert E. Feldman
RIN 3064-AD10
Attention: Comments
Executive Secretary, Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

John M. Reich
Docket 2006-34
Director, Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Re: Risk-Based Capital Standards: Market Risk

Dear Ladies and Gentlemen:

Bank of America Corporation (Bank of America) appreciates the opportunity to comment on the Joint Notice of Proposed Rulemaking entitled "Risk-Based Capital Standards: Market Risk" (the NPR). Bank of America, with $1,460 billion in total assets, is the sole shareholder of Bank of America, N.A., with full-service consumer and commercial operations in 30 states and the District of Columbia. Bank of America provides banking, investing, corporate and investment banking services and financial products to individuals and businesses across the United States of America and around the world.

Since the Market Risk Amendment (MRA) to the 1988 Capital Accord was implemented 10 years ago, capital markets transactions have become increasingly complex, more credit sensitive and, in some cases, illiquid Over the same period, the ability to transfer and mitigate various types of risk has greatly expanded. This is especially evident in the space of credit products, where both the liquidity and effectiveness of instruments for transferring credit risk are much greater than they were a decade ago. The Agencies have issued the NPR in order that the risk-based capital standards would better reflect these developments.

Bank of America broadly supports such efforts by the Agencies to align the regulatory capital framework with the realities of the market. We particularly support the proposal to institute a measure of incremental default risk (IDR) that would better capture the illiquidity of certain credit exposures. If properly designed and calibrated, such a measure could be an important step toward bridging capital calculations for credit exposures between the trading and banking books. We do, however, have significant concerns about a number of proposals in the NPR, as well as some aspects of its general direction:

- The NPR represents a major step away from a principles-based approach and toward a rules-based approach.

- It proposes bifurcating the trading book into positions that will be covered by market risk vs. banking book rules. The additional requirements for documentation and disclosure supporting the bifurcation will impose a major operational burden without commensurate improvement in either risk control or information value to investors.

- The NPR proposes that all these changes be implemented by January 1, 2008, i.e., two years earlier than the implementation requirements for Basel II, and only a short time after these rules will be finalized.

Bank of America is a member of the International Swaps and Derivatives Association (ISDA) and the Institute of International Finance (IIF), and has participated in the preparation of their joint comment letter. With some minor differences, we endorse the ISDA/IIF comment letter. Therefore, we have limited the repetition of many of the more technical comments common to Bank of America, ISDA and the IIF. In this letter, we highlight those aspects of the NPR which are of particular concern to Bank of America. In the attached Appendix, we provide comments on the specific questions raised by the Agencies throughout the text of the NPR.

Principle Versus Rule Based Requirements

The existing regulatory environment under the MRA provides high-level requirements for capturing and measuring market risk, and otherwise gives banks broad latitude to develop the specific approaches that best reflect their business mix and risk management practices. The NPR, by contrast, is much more prescriptive on two dimensions:

- It focuses on the characteristics and categorization of individual trading positions, rather than the principle of measuring the material risks of a trading business.

- To support the bifurcation of covered and non-covered positions, the NPR causes a substantial increase in the amount of documentation required for each trading portfolio.

We understand that the motivation for most of these changes arises from the sharp growth in trading of credit instruments over the past decade. The Agencies are particularly concerned that a bank may try to shift positions from the banking book to the trading book in order to reduce its regulatory capital charge. However, the approach taken in the NPR is an overly blunt, as well as inefficient, instrument for addressing this concern. Moreover, as we will explain further in the next section, we believe that the prescriptive nature of the approach will impose substantially increased operational costs on banks, while providing information to investors that will be, at best, of little value, and at worst, confusing.

The Agencies' concerns could be addressed more effectively within a principles-based approach. Subject to overall capital calibration standards, a bank should be given broad latitude to adopt the methodologies that are most appropriate to its business and risk management approach. We believe that the most effective way to ensure capital adequacy is to focus on capturing the material risks in a bank's trading business, rather than a detailed categorizations of its positions.

Through supervisory review and demonstrated backtesting results, regulators should ensure that a bank's VAR model completely and accurately captures all the material risks within its trading business, and that the bank has accurately reflected illiquid credit risks in its IDR calculation. Within such a framework, we believe that the rules for bifurcating the trading book and for identifying and managing covered positions would be unnecessary.

Bifurcation of the Trading Book

The NPR proposes to bifurcate the trading book into positions which will be covered by market risk rules vs. positions which will be covered by credit risk rules. We believe this proposal is problematic in several respects, and would impose excessive costs on banks without commensurate benefit:

- Ambiguity of rules. The NPR's guidance for determining whether a position should be covered or non-covered is expressed in terms of qualitative characteristics such as trading intent, short-term resale period, and ability to hedge "material" risk elements in a two-way market. All of these elements actually exist in a continuum, and would have to be more precisely specified in order for the bifurcation to become operationally feasible. Thus, either the Agencies would have to develop rules that are even more prescriptive than those in the NPR (which would necessarily contain large elements of arbitrariness), or substantial inconsistency in categorizations across banks would inevitably arise.

Large documentation burden. The NPR would require that a bank develop documented trading and hedging strategies for all its portfolios of positions, and classify all its positions on the basis of liquidity. This is problematic in two respects: First, major banks will typically have hundreds of portfolios comprising hundreds of different instruments. Developing the proposed documentation for all these portfolios and positions would represent a major operational burden and would impose very high costs. Secondly, the NPR proposes several criteria for classifying trading positions and portfolios: designating expected holding periods; designating hedging vs. hedged positions; and designating which positions are held to accommodate customer flow, which are held for proprietary trading, and which are held to make a market. As explained in more detail in the Appendix, these types of classification are not meaningful within the actual practice of a trading business.

- Dual measurement and reporting systems. Banks' internal management and investors are primarily interested in evaluating the potential earnings volatility of all positions within a trading business that are marked to market. Banks would need to continue to measure and report VAR at this level. Therefore, the proposed bifurcation rules would force banks to develop and maintain parallel processes for measuring and reporting VAR, one for internal management and investor reporting, and the other for regulatory reporting.

- Lack of transparency to investors. If a bank reported both sets of VAR calculations to investors, it would be more likely to result in confusion than in added information value. Thus, the proposed rules would do nothing to enhance the objective of improved disclosure under Pillar 3 of the Basel II rules.

We believe that the Agencies' objectives underlying the bifurcation rules would be more efficiently and effectively achieved by mandating a validated VAR model that accurately captures all the material risks in a trading business, supplemented by a robust IDR model that captures the default risk of illiquid credit-sensitive positions.

Implementation Date

The NPR proposed January 1, 2008 as the effective date of the final rule. The only material exceptions would be the extension of the effective dates for implementing an IDR model, and for the VAR model to capture all material aspects of specific risk until January 1, 2010. We believe that the January 1, 2008 date for implementing the remaining revisions is unrealistic:

- Given the additional rounds of discussion that will need to occur, along with necessary refinements and clarifications of the rules, it is unlikely that a final rule will be issued before mid-2007. This would leave limited time for development, testing, and implementation of all required changes.

- If the proposed rules for bifurcation of the trading book are adopted, they will impose major operational burdens in terms of both systems development and documentation. It will be virtually impossible for banks to implement all the changes in such a short time frame.

In addition, this timeframe would impose an inconsistency and/or discontinuity in the capital calculation under the credit risk rules. Under the NPR, the non-covered positions in the trading book would have to come under the Basel I credit risk rules as of January 1, 2008. The capital calculation for these positions would then change again once the Basel II rules become effective, which would be no earlier than 2009.

We believe that sensible operational management, as well as consistency of regulatory treatment, dictate that changes to the market risk rules be aligned with the timeframes targeted in the Basel II process.

Summary

Bank of America supports the Agencies' objective of updating the market risk capital standards to better reflect the evolution of the markets, and particularly those for transferring credit risk, over the past decade. However, the approach proposed in the NPR attempts to do this by imposing arbitrary distinctions among trading positions, in order to subject different categories of trading positions to different sets of capital rules. We believe that this approach is not the most effective way of achieving the Agencies' objectives, and will at the same time impose very substantial operational burdens and costs on banks.

We believe that a better approach would be to apply a uniform and comprehensive risk measurement framework to a bank's entire trading book. This can be accomplished by ensuring that a bank's VAR model completely and accurately captures all the material risks of its trading positions; is comprehensively validated; and is supplemented by an incremental default risk measurement which is properly calibrated and captures the illiquid default risks in the trading book's credit-sensitive positions.

We would be happy to discuss our views in greater detail, or to discuss any new ideas that the Agencies wish to pursue. In that regard, please contact Jeffrey Katz, our Senior Vice President for Risk Architecture, at (212) 847-6704, John S. Walter, our Senior Vice President for Risk & Capital Analysis at (415) 953-0243, or Randy Shearer, our Senior Vice President and Director of Accounting Policy at (980) 388-8433.

Sincerely,

J. Chandler Martin

J. Chandler Martin
Treasurer
Bank of America

Appendix
Specific Responses to NPR Requests for Comment

For all questions, we support the ISDA/IIF comments. For some of the questions, we would like to add further comments as noted below.

1. The agencies seek comment on the thresholds for the application of the market risk capital rule and, if they should be changed, on what appropriate thresholds might be.

- We support the ISDA/IIF comments as stated.

2. The agencies request comment on all aspects of the proposed definition of covered position. The agencies are particularly interested in comment on additional safeguards that the agencies might implement to prevent abuse of the hedge component of the definition of covered position and increase transparency for supervisors.

- We support the ISDA/IIF comments, and we would like to again emphasize our view that the NPR proposal to bifurcate the trading book is overly prescriptive and unnecessary.

- As noted earlier, the fundamental issue is that the NPR focuses inappropriately on the categorical characteristics of positions rather than on the nature of the underlying risks. It is our strong view that all positions that are managed as part of our trading business, and whose material risks can be effectively hedged within trading time frames, should continue to be included under the market risk rules. Note that for this purpose it is irrelevant whether or not such positions are fully hedged in practice by the trading business: A business may discretionarily take a particular risk over an extended period of time, even though they could have fully hedged the risk if they chose to do so. All that matters is that the underlying risks could be materially hedged within a trading time frame.

- The proposed rules would create a breakage between how Bank of America manages and reports its market risk for internal risk management purposes and how it reports its market risk according to regulatory requirements. This would have the effects of:
  - Imposing on Bank of America the cost of building and maintaining dual processes for measuring and reporting market risk.
  - Rendering the regulatory version irrelevant for internal risk management, thereby violating the "use test" criterion that the Agencies would like our risk management systems to meet.

- Investors are primarily concerned with the potential earnings volatility of positions that are marked to market within the trading business. The Agencies' proposed definition of covered positions would represent only a subset of these positions. This would have the effects of:
  - Rendering the regulatory version of VAR of little value for investors.
  - Creating additional confusion for investors if the regulatory version of VAR were to be disclosed in addition to the version used for internal risk management. This would very likely reduce, rather than enhance, the value of our disclosures under Pillar 3 of Basel II.

3. The agencies request comment on whether there is a better approach that matches more effectively the true economic impact of these transactions.

- We support the ISDA/IIF comments. In particular, we support the additional ISDA/IIF proposal that each bank should be given the choice of:
  - o Including in VAR the potential changes in value of both the Credit Valuation Adjustment (CVA) and positions used to hedge the CVA. Under this choice, RWA for counterparty credit risk would only be generated by the bank's exposure to the counterparty credit risk of the seller of the CVA hedges.
  - o Excluding from VAR both the potential change in value of both the CVA and positions used to hedge the CVA. Under this choice, RWA for counterparty credit risk would be generated for the CVA combined with its hedges in accordance with the substitution (or double default) approach.

4. The agencies request comment on the extent and materiality of any distortion of the VaR-based measure due to the inclusion of some, but not all, offsetting transactions, and on any appropriate approaches to address this distortion in the final rule, including, subject to certain restrictions, (1) permitting a bank to include in its VaR-based measure the interest rate risk associated with certain non-covered positions that are hedged by covered positions (while remaining subject to a credit risk capital requirement for the non-covered positions) or (2) permitting a bank to include in its VaR-based measure certain internal interest rate derivatives hedging non-covered positions. The agencies also request comment on any operational considerations such approaches would entail.

- We support the ISDA/IIF comments as stated.

5. The agencies seek comment on the proposed definition of residual securitization position, and on the market maker exception and the conditions to use that exception. With respect to positions that do not qualify for the market maker exception, the agencies request comment on the treatment of those positions under the credit risk capital rules and whether such treatment could give rise to any operational or other issues.

- We support the ISDA/IIF comments. Our general view, as stated earlier, is applicable here: If residual securitization positions are managed within a trading business, if the material underlying risks can be hedged effectively, and if the material underlying risks can be measured accurately and included in VAR, then residual securitization positions should be included within the definition of covered positions.

6. The agencies seek comment on these requirements and on whether different or additional policies and procedures would be beneficial for ensuring appropriate identification of positions to which the market risk capital rule should be applied and appropriate risk management of covered positions.

- We support the ISDA/IIF comments. We would particularly like to emphasize our view that several aspects of the NPR proposal in this case are overly prescriptive, unnecessary, and are in fact inconsistent with the way trading businesses are normally managed. While we certainly agree with the view that banks should have clearly defined policies and procedures for measuring and managing the risks in a trading business, we believe that several of the specific proposals are inappropriate and unnecessary:

  - o The detailed requirements for determining which of a bank's trading assets and trading liabilities are trading positions are unnecessary. Covered positions should include all positions in a trading business whose material underlying risks can be hedged within a trading time frame.

- The proposed requirement that a bank must articulate the expected holding period associated with each portfolio of trading positions is unnecessary. The only meaningful time frame is that under which the material risks within a trading book can be hedged. A trading desk may choose to take a discretionary view in a particular risk exposure over an extended period of time, even though that exposure could have been neutralized immediately if the desk chose to do so. For example, a trading desk may have a long-term view that interest rates will decline, and so may hold a long position in U.S. Treasury securities over a period of months. Such positions should nevertheless be included within the covered positions of the trading business.

- The proposed requirement that a bank must articulate which positions are being hedged and which positions serve as hedging instruments is inconsistent with the way trading desks operate in liquid markets. In many (if not most) cases, it is meaningless to designate positions as being hedged vs. hedging. For example, it is common for trading businesses to take a position (either long or short) in U.S. dollar swap spread risk. In such cases, the desk will take a position in one direction in U.S. Treasury securities, and will take the opposite position in U.S. dollar interest rate swaps. Both sets of instruments are part of the same position: It would be completely arbitrary to designate one set of instruments as being hedged and the other set of instruments as a hedging position.

- The proposed requirement that a bank must articulate whether each portfolio of trading positions is to accommodate customer flow, to engage in proprietary trading, or to make a market in positions is inconsistent with the way trading desks operate:

  - In many cases, a single trading desk may have mandates in more than one of these categories. However, for purposes of both efficiency and overall risk transparency, the desk will manage and report all its positions within a consolidated portfolio.

  - Even when a desk's mandate is primarily in one category, for example, market making, the desk will almost always have risk limits in which it may take some discretionary positions. It would be impossible, in general, to distinguish such a desk's positions as being attributable to market making vs. proprietary trading.

- To return to our general view, the policies and procedures for managing the trading business should focus on the management of risks, and should not focus on arbitrary categorization of particular sets of positions.

7. The agencies request comment on all aspects of prepayment risk, including the extent and materiality of prepayment risk, whether material prepayment risk may warrant a further explicit requirement that banks hold capital against prepayment risk over a one-year horizon under both the internal models and standard approaches to specific risk, and the interplay between prepayment risk and default risk for purposes of determining the bank's overall measure for market risk. The agencies also seek comment on how an explicit capital requirement for prepayment risk could be designed.

- We support the ISDA/IIF comments, and would like to emphasize further that it is unnecessary to single out pre-payment risk as an additional risk against which capital should be held. In a properly designed VAR calculation, the volatility of prepayment risk will already be captured through either the volatility of security prices themselves, or through the volatility of parameters which measure prepayment uncertainty, such as option adjusted spread. It is important to note that even though the volatility of these measures may be simulated over a VAR time horizon, these measures themselves impound the impact of uncertainty in prepayment rates over the entire lifetime of the instruments.

- The question of specific risk modeling of prepayment risk is really a question of the adequacy of the granularity of the prices incorporated in the VAR model, which is in turn a general question applicable to all positions. Such a question is best left to the review of a bank's VAR model by its own regulators, who will assess the materiality of the bank's risks in each case, as well as the availability of market information at a particular level of granularity.

8. The agencies request comment on the exclusion of fees, commissions, reserves, and net interest income for the trading profit or loss used for regulatory backtesting, including the appropriateness and feasibility of these exclusions, and whether additional items should also be excluded. The agencies also request comment on the role of hypothetical backtesting-- specifically, whether hypothetical backtesting is feasible as part of model validation; whether other forms of backtesting should also be used; and whether regulatory backtesting should be based on hypothetical backtesting.

- We support the ISDA/IIF comments. We would particularly like to emphasize the following points:

- We are concerned about the proposal to exclude net interest income (NII) from regulatory backtesting. Exclusion of NII could create inconsistencies both in comparing trading profit/loss with VAR, and within the calculation of trading profit/loss itself:

    - If VAR includes the change in portfolio due to the passage of time ("theta"), then the trading profit/loss against which it is compared should also include the impact of the passage of time, which would require the relevant components of NII to also be included

    - Exclusion of NII may create discrepancies in measuring trading profit/loss within portfolios which include instruments in which interest income is paid explicitly (such as bonds) and instruments in which interest payments are impounded within the valuation (such as futures).

  The question of including NII in regulatory backtesting should be determined by individual banks in consultation with their own regulators.

- Regarding hypothetical backtesting, we propose that these rules should not prescribe the particular types of tests that will be needed to validate a particular bank's VAR model. Depending on the positions in a particular portfolio, other tests may be more informative for determining the accuracy of the VAR calculation. Each bank should agree with its own regulators on what types of tests are necessary.

9. The agencies request comment on the proposed timeframe for phasing out partial modeling of specific risk and on whether it would allow banks enough time to implement the proposed changes.

- We support the ISDA/IIF comments as stated

10. The agencies seek comment on the extent and materiality of specific risk for commodities and foreign exchange positions and on whether and how a specific risk capital requirement for those positions could be developed under both the internal models and standard approaches.

- We support the ISDA/IIF comments as stated. We would also reiterate the point that this question seems to suggest some confusion as to what is meant by "specific risk." Specific risk had previously referred to specific issuer risk, and commodities and foreign exchange positions do not have issuer risk in the same sense as credit and equity positions. The focus here would more appropriately be on the question of whether a bank's VAR model for commodities and foreign exchange positions is sufficiently granular; but this is a general question that is appropriately asked of any VAR model for any set of positions. Going forward, we suggest it may be less useful to draw distinctions between "general market risk" and "specific risk" in designing a VAR model. Rather, a VAR model should be designed to capture all material risks, regardless of their sources. The relevant questions would then be whether the VAR model is sufficiently granular to capture material differences between risks, and whether it appropriately reflects correlations (or lack of correlations) between different positions.

11. The agencies request comment on how a bank should adjust the incremental default risk capital requirement to adjust for the impact of liquidity, concentrations, hedging, and optionality.

- We support the ISDA/IIF comments as stated. Any decisions regarding incremental default risk should be deferred pending the outcome of the ISDA/IIF/LIBA Working Group discussions.

12. The agencies request comment on all aspects of the proposal to reflect in the market risk capital requirement a measure of incremental default risk. Specifically, the agencies seek comment on the feasibility of measuring incremental default risk at a one-year, 99.9 percent confidence level and the appropriateness of the assumption of a constant level of risk.

- We support the ISDA/IIF comments as stated. Any decisions regarding incremental default risk should be deferred pending the outcome of the ISDA/IIF/LIBA Working Group discussions.

13. The agencies request comment on the extent to which banks, at present, measure incremental default risk and the prospects for development of methodologies to capture this risk fully in internal models by the proposed January 1, 2010 deadline. The agencies also request comment on the fallback methods proposed for banks unable to develop an internal model to capture incremental default risk by January 1, 2010.

- We support the ISDA/IIF comments as stated.

14. The agencies seek comment on all aspects of the proposed public disclosure requirements.

- We support the ISDA/IIF comments as stated. We would emphasize the need for further clarity on the qualitative disclosure requirements, as the current proposal, as written, could impose a very substantial documentation burden on banks without providing commensurate value to investors.

- The requirement for a standalone Market Risk Disclosure Policy has limited use. It places undue burden on management and the board of directors to draft, complete and approve a standalone policy with such a narrow scope. A complete disclosure policy that encompasses all Basel II disclosure would be more effective and better support implementation and supervision of risk based capital requirements.