

Jeffrey J. Brown
Senior Vice President
Corporate Treasurer

October 24, 2008

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Consultative Documents: Market Risk

Dear Ladies and Gentlemen:

Bank of America Corporation (Bank of America) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's Consultative Documents entitled "Proposed revisions to the Basel II market risk framework" and "Guidelines for Computing Capital for Incremental Risk in the Trading Book" (both issued for comment by 15 October 2008). Bank of America, with \$1,831 billion in total assets, is the sole shareholder of Bank of America, N.A., with full-service consumer and commercial operations in 32 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.

Bank of America broadly supports such efforts to strengthen the market risk regulatory capital framework by ensuring that capital reflects the broad range of potential risks, and that capital is sufficient to withstand large systemic shocks. We have accordingly supported the Basel Committee's proposal to institute an incremental default risk (IDR) measure that would better capture the illiquidity of certain credit exposures. However, we have significant concerns about the Committee's current proposal to institute a broader Incremental Risk Charge (IRC).

Bank of America is a member of the International Swaps and Derivatives Association (ISDA), the Institute of International Finance (IIF), and the London Investment Banking Association (LIBA), and has participated in the preparation of their joint comment letter. We endorse the ISDA/IIF/LIBA comment letter, but would like to take this opportunity to further emphasize some points of particular importance to us.

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- **Implementation Date.** The proposal would require firms to have in place a model that will capture credit default and migration risks by 1 January 2010, and will capture all other credit and equity risks by 1 January 2011. Even if the requirements were finalized within the next three months, this would only allow one year to develop, test, and implement the default and migration model, and two years to do the same for the other credit and equity risks. We support the proposal in the industry letter that the timeframe be extended by a minimum of one additional year.
- **Double Counting.** The proposal acknowledges that the same risks may be included in both the standard VAR-based charge and the IRC. The IRC is itself calibrated to the same 99.9% confidence level over a 1 year horizon as are banking book exposures under the Basel II IRB charge. If this IRC is then added to a VAR-based charge that covers the same risks, this raises the possibility that a liquid position in the trading book may be allocated more capital than a similar but illiquid position in the banking book. The proposed IRC must therefore include an adjustment to offset or reduce the impact of double-counted risk.
- **Constant Level of Risk.** The fixed 1-year capital horizon, together with the constant level of risk assumption, is likely to produce minimal differences in capital allocation between liquid and illiquid positions. The capital allocation would therefore fail to recognize risk mitigation measures that are available for liquid positions.
- **Treatment of Structured Credit Products.** It is not immediately clear how structured credit products, especially those whose underlying assets are consumer loans, could be modeled in a default and migration framework. The requirements must be sufficiently flexible to enable banks to model these products in a manner that most effectively captures their risks.
- **Validation.** It is not clear how an IRC model would be effectively validated. A model based on a 99.9% confidence level over a 1 year horizon cannot be directly validated at those levels through backtesting. While it is still premature to define the validation requirements, they will eventually have to address the practical limitations and consider alternative validation frameworks, such as those used to validate IRB calculations in the banking book: review of conceptual soundness and other developmental evidence; backtesting over shorter horizons and at lower confidence levels; and comparison with alternative benchmarks.
- **Valuation.** The proposed rules require banks to adjust valuations to reflect the lack of liquidity of certain positions. This is inconsistent with the financial accounting standards produced by the International Accounting Standards Board, which do not permit such adjustments. We do not believe it will be beneficial, particularly in regard to reporting transparency, to have different valuations for accounting and regulatory purposes.
- **Computational Issues.** Calculation of exposure at a 99.9% confidence level over a 1 year horizon, or even over a liquidity horizon as short as 3 months, poses special challenges for complex derivatives:

1. The size of potential market moves may be too large to approximate adequately via delta/gamma sensitivities, so full revaluation may be necessary. However, it can be difficult to properly calibrate input parameters for such large moves. For example, if the inputs are modeled simply by adding historical 3-month changes to current prices, we could inadvertently produce negative forward interest rates or volatilities or other uneconomic characteristics in the input curves. However, the large number of simulations required to adequately estimate exposure at a 99.9% confidence level would make manual inspection and adjustment of the input curves infeasible.
2. The assumption that option positions are maintained fixed with no rehedging over 3 months (or even 1 month) may produce exposures that are excessively large to the point of implausibility. Some type of rehedging assumptions must be incorporated in the model for all but the most illiquid risk factors.

We accordingly support the proposal in the joint comment letter that the industry should be offered an alternative fallback approach, such as a scaled up version of the existing VaR calculation. Such an approach would go a long way toward addressing most of the concerns that have been raised.

Summary

Bank of America continues to support the objective of updating the market risk capital standards to better reflect the evolution of the markets, particularly in light of events during the past year. It is important, however, to ensure that any proposal takes full account of practical considerations related to model development effort, computational limitations, and validation requirements; and that the capital requirements do not impose distortions between the trading and banking books.

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 Market Risk Analytics, at (646) 855-2704 or John S. Walter, our Senior Vice President for Risk & Capital Analysis, at (415) 913-2706.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Jeffrey J. Brown', with a stylized flourish at the end.

Jeffrey J. Brown
Treasurer