



Richard D. Levy
Executive Vice President & Controller

MAC A0163-039
343 Sansome Street, 3rd Floor
San Francisco, CA 94104
415 222-3119
415 975-6871 Fax
richard.d.levy@wellsfargo.com

April 25, 2011

Via email

Ms. Leslie Seidman, Chairman
File Reference No. 2011-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Sir David Tweedie, Chairman
ED/2011/1
International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
United Kingdom

File Reference: No. 2011-100, Proposed ASU, Balance Sheet (Topic 210), Offsetting

Dear Ms. Seidman and Sir David Tweedie:

Wells Fargo & Company (“Wells Fargo”) is a \$1.3 trillion diversified financial services company providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, brokerage and consumer finance services. We appreciate the opportunity to comment on the Proposed Accounting Standards Update, Balance Sheet (Topic 2010), *Offsetting* (the “Proposed ASU”).

Executive Summary

Wells Fargo objects to the proposed elimination of the existing FASB guidance for offsetting which is based upon a framework in the United States that is technically sound, meaningful, well understood and operationally functional. We believe the legal basis underpinning existing U.S. GAAP has been well documented and has been proven to be very effective. We see no reason to deviate from the existing U.S. offsetting framework as it is a better reflection of risk management activities, consistent with how users evaluate significant business risks and already provides sufficient information about gross amounts through supplemental disclosure. The proposed gross presentation will provide users with less relevant information because it will distort the actual exposure to credit, liquidity and market risks of an entity. Accordingly, we reject the conclusion of the Boards that “offsetting on the basis of a conditional right of set-off would not result in financial statements that are representationally faithful”.

To achieve net presentation, the Boards seem to give overriding precedence to management intent and whether rights of set-off are conditional. However, set-off rights serve the substantive purpose of risk mitigation in the event of counterparty default. In the absence of these events, transactions may be settled

on a gross basis as a means to achieve operational efficiency. Accordingly, the Boards should not focus on management's intent and whether such rights are conditional, but rather on the enforceability of such rights. The U.S. offsetting framework is based on long-standing and well-grounded principles that have endured legal scrutiny, even during the most recent financial crisis. The Boards should acknowledge the differences in bankruptcy and other laws among global jurisdictions rather than create an artificial level playing field that precludes the set-off of financial instruments subject to legally enforceable netting arrangements. Accordingly, a high quality and converged standard for offsetting should establish principles that are consistent with the risk management objective and whether the underlying jurisdictional legal framework supports that objective.

The perceived benefits of the proposed guidance will not outweigh its initial and on-going implementation costs. Considerable effort will be required to evaluate cash settlement processes, financial reporting system capabilities, counterparty arrangements and understanding the settlement mechanics of positions cleared through clearinghouses, traded through exchanges and over the counter positions. We are also concerned that economically similar instruments will be accounted for differently as a result of the proposed guidance.

For these reasons, we do not support the proposed guidance. Given the relative unimportance of this project compared to other major on-going MOU projects under consideration by the Boards, we encourage the Board to maintain the existing U.S. offsetting framework and defer deliberations on this project indefinitely. However, if the Boards decide to proceed with this project, we urge the Boards to permit a linked presentation within the statement of financial position. We believe a linked presentation will provide similar information to users while maintaining the integrity of the statement of financial position and present a more accurate reflection of the financial risk exposure.

Conceptual Concerns with the Proposed ASU

The existing U.S. offsetting framework is far superior to the framework in the Proposed ASU and we strongly oppose the overarching presumption that gross presentation is a more appropriate presentation of the financial risk exposures of an entity. We concur with the alternative view expressed in the Proposed ASU¹ that gross presentation will not provide better information about the timing and uncertainty of cash flows and will significantly separate the true risk exposure and potential economics of associated instruments and collateral arrangements. For the following reasons, we believe net presentation based on the U.S. offsetting framework more appropriately aligns the economics, business practices and risks associated with the various positions of an organization with the information presented in the financial statements.

- **The existing U.S. offsetting framework is consistent with risk management practices.** Many organizations manage various risks such as credit risk, market risk, and liquidity risk on a portfolio basis, rather than an instrument-by-instrument basis. Netting arrangements allow organizations to benefit from net settlement features and limit performance risk in the event of a counterparty default or bankruptcy. The current offsetting framework is a product of the manner in which organizations manage risk, which is consistent with the objective of the Boards to more closely align financial reporting with risk management activities. This objective is widely supported by market participants, as evidenced through the comments received by the Boards on the classification and measurement of financial instruments, IASB hedge accounting proposal and joint credit impairment proposal.

¹ Paragraphs BC 81-83

- **Legally enforceable master netting agreements facilitate risk reduction.** Master netting agreements provide for net settlement with counterparties in the normal course of business or in the event of default. Many financial instruments are subject to master netting arrangements because such agreements are effective at managing counterparty credit risk and provide an efficient means to settle open positions. Because individual counterparties often have multiple open positions and thus engage in a high volume of transaction activity, master netting agreements are often modified to incorporate new positions or remove exited positions. Accordingly, individual counterparty relationships may be in either a net asset or net liability position that could be net settled with the counterparty in the normal course or upon a default event. This significantly reduces the exposure to credit risk of an entity as the economic exposure to one particular instrument would be offset with other instruments. Gross presentation will not capture this risk reduction concept embedded within legally enforceable master netting arrangements.
- **We are not aware of successful challenges to the legal enforceability of U.S. master netting arrangements.** Legally enforceable master netting agreements effectively combine a pool of individual positions with a single counterparty into a single net position from a legal and credit risk standpoint. Market participants have upheld the legal construct underlying master netting agreements, which have become a market mechanism to formally settle claims between counterparties in the normal course of business and in the event of default. The economic crisis experienced within recent years has proven the merits of this legal framework. According to the International Swaps and Derivatives Association, Inc.'s (ISDA) memo provided to the Boards on November 15, 2010², there have not been instances in which close-out netting provisions within ISDA master netting agreements were found to be unenforceable in jurisdictions where ISDA has published an opinion confirming such enforceability. Given the current legal framework surrounding master netting agreements, the legal enforceability and market recognition of such agreements, we believe the Proposed ASU should recognize the benefits of such arrangements and permit net presentation where they are applicable, as in the current US netting framework.
- **Exposure to credit risk is often mitigated by collateral arrangements.** Collateral and similar arrangements are often required by counterparties, clearing houses, and exchanges to facilitate the reduction of risk due to payment or other default. The amount, nature and frequency of collateral provided consider both counterparty creditworthiness and the nature of the underlying positions. Often the amount of collateral required is adjusted based on changes in the fair value of underlying positions (typically determined on a daily basis). Accordingly, in the event that a position declines in value, additional collateral is required. This serves to protect the reporting entity, clearing house or exchange, as applicable, from counterparty default. Gross presentation of these collateral arrangements will fail to give recognition to this reduction in risk and provide misleading information to users.
- **Credit and liquidity risk typically converge upon a default event.** In the event a default were to occur on positions within a master netting arrangement, the credit and liquidity risks converge and are mitigated through the legal right of set-off. As positions are netted with one another and settled on a net basis, the remaining credit and liquidity risks are only applicable to the open net position, if any. These risks associated with net open positions are further mitigated by the presence of daily postings of high-quality/liquid collateral that are adjusted based upon the daily fair value of the net position. Therefore, the gross presentation of such amounts seems to ignore the substance of such arrangements (rather is purely form-driven) and would be inconsistent with the true risk exposure and actual settlement mechanics.

² <http://www.isda.org/speeches/pdf/Netting-Letter.pdf>

- **The current offsetting framework is widely accepted by market participants and has been explicitly endorsed by the FASB.** The current offsetting framework, which is an integral component of the U.S. financial services industry, was included in U.S. GAAP based on well-grounded legal principles and industry risk management practices. Moreover, the FASB implicitly validated the existing U.S. offsetting framework with the issuance of FSP FIN 39-1³ in April 2007 to specifically permit cash collateral netting for certain derivative contracts. This better reflects how organizations mitigate risk through collateral arrangements, even if the right to set-off is conditional upon a default event. As a result, users of the financial statements are better able to understand the true risk exposure of an organization in the event adverse events were to occur. The net presentation of collateral arrangements and the corresponding positions have been relied upon by users of the financial statements for many years with sufficient incremental disclosure of gross amounts in the notes to the financial statements. Based on the outreach activities of the Boards, financial statement users have not expressed a preference for gross presentation. Accordingly, we do not understand how the decision to discard the current U.S. netting framework results in an improvement in financial reporting.
- **Gross presentation may result in different accounting for economically equivalent instruments.** The substance rather than the form of financial instrument risk exposures with a counterparty should drive the financial statement presentation of such exposures. We believe that the basis for presentation should be consistent with the economics of the counterparty relationship and legal substance of the master netting agreement. Otherwise, economically equivalent contracts may be accounted for differently based on the proposed guidance. For example, an organization may enter into a cross-currency interest rate swap or separately enter into a currency swap and an interest rate swap. Although the economics and financial risks of these scenarios are identical, the proposed guidance may require gross presentation of the interest rate swap and currency swap which is not consistent with the actual risk exposure.
- **Gross presentation will distort an entity's financial position and key metrics.** We acknowledge that users find both gross and net information useful. With this in mind, the current offsetting framework already provides significant disclosure of gross and net positions throughout the footnotes of the financial statements. Gross presentation within the statement of financial position will distort key financial metrics, such as the leverage ratio, return on assets and regulatory capital ratios. Gross presentation of derivative assets subject to master netting arrangements will obscure an entity's true asset position as it will inaccurately present such assets as available to pay claims to general creditors⁴ and equity holders. Such a presentation also distorts true risk exposures by giving disproportionate prominence on the statement of financial position to assets whose risks are significantly mitigated by master netting agreements (and related collateral requirements) relative to other asset classes such as loans, securities and other assets that are not subject to similar arrangements.

These reasons may be why banking and broker/dealer regulators view such risks on a net basis. For example, banking regulators consider the relevant measure of credit exposure for an organization relative to derivatives and repurchase agreements subject to master netting arrangements to be based on a net basis when determining capital adequacy metrics. Additionally, the Proposed ASU requires extensive and complex disclosure of net exposures in the footnotes along with gross presentation in the statement of financial position. This implies net amounts are required by users of the financial

³ ASC 210-20-45

⁴ Other than the counterparty to the derivative contracts subject to such master netting arrangements

statements to fully understand the actual risk exposure of an organization and inherently suggests the Proposed ASU may be flawed in concept by requiring gross presentation within the statement of position.

Operational Concerns with the Proposed ASU

Our operational concerns with the proposed guidance are as follows:

- **The simultaneous settlement criterion needs further clarification.** The Boards defined simultaneous settlement as a settlement that occurs at the same moment such that there is equivalently exposure to one net instrument. It is not clear if the Boards intended “at the same moment” to be interpreted literally or whether settlement on the same day will suffice. As many financial instruments, such as repurchase agreements and most centrally cleared derivatives, are settled in a batch process performed on a daily basis (but not necessarily “at the same moment” within the day), we are concerned financial instruments settled through clearinghouses may not meet the simultaneous settlement requirement and must be presented in the financial statements on a gross basis. If the Boards decide to proceed with the proposed guidance, we strongly urge the Boards to incorporate daily settlement practices in the definition of simultaneous settlement. This would ensure that industry standard settlement practices are appropriately considered.
- **Industry practice for broker/dealer receivables and payables for unsettled regular-way trades should be maintained.** Broker/dealers present unsettled regular-way trades on a net basis in the statement of financial position. Broker/dealers frequently trade a high volume of positions, the majority of which are settled within three business days with little or no risk exposure other than the risk of counterparty default. When there is a counterparty performance failure, the broker/dealer properly reflects the transaction on a gross basis within the statement of financial position and manages the settlement risk accordingly. We fail to understand why presenting these amounts on a gross basis represents an improvement in financial reporting. Current systems and processes are not designed to capture the necessary information for gross presentation. Accordingly, the Proposed ASU will represent a significant change to long-standing industry practices that will cause operational burden in terms of system costs and process changes for broker/dealers. We do not believe the perceived benefits justify these costs.
- **The proposed disclosure requirements are extensive and redundant.** Existing U.S. GAAP already requires disclosure of gross positions and collateral amounts related to derivative instruments⁵ and collateral pledged or received in transfers of financial assets accounted for as secured borrowings⁶. Further, the existing derivative disclosures are relatively new requirements with most companies adopting SFAS 161⁷ in 2009. Much of the proposed disclosures, which require presentation in a single footnote, overlaps existing U.S. GAAP disclosures and does not appear to appropriately incorporate and recognize that such disclosures already exist. We therefore question the necessity of the proposed disclosure requirements and believe attention should be given to appropriately assimilating the proposed disclosures with existing (and relatively recently deliberated) disclosure requirements.

⁵ ASC Topic 815, *Derivatives and Hedging*

⁶ ASC Topic 860, *Transfers and Servicing*

⁷ Statement of Financial Accounting Standards No. 161, *Disclosure about Derivative Instruments and Hedging Activities*

- **The proposed disclosure requirements are not operational without further clarification.** We believe certain aspects of the proposed disclosures are not operational and need to be clarified.
 - **Scope:** We are concerned that the scope of the proposed disclosures could be viewed more broadly than intended. For example, it is unclear if the scope of the disclosures includes traditional loans for which the lender has rights to non-cash collateral in the event of default. We do not believe the scope should include such arrangements as they typically are and will continue to be under presented on a gross basis. Clarification of the scope will help to alleviate unintended consequences.
 - **CVA and DVA:** We do not agree with the proposed requirement to allocate Credit Valuation Adjustments (CVA) and Debt Valuation Adjustments (DVA) to each class of financial instruments. Such adjustments are determined at a counterparty level on a net basis, after consideration of master netting arrangements and related collateral. CVA and DVA are only meaningful at the net exposure level, by counterparty. Accordingly, allocation of such adjustments to each class of financial instruments will not be relevant to financial statement users and thus would not justify the costs that would be incurred to implement a process for disclosure. Accordingly, we recommend removal of this requirement.
- **The perceived benefits of the proposed guidance do not outweigh its costs.** In order for organizations to comply with the guidance within the Proposed ASU, considerable effort will be required. This effort will consist of obtaining a full understanding of all cash settlement processes, which may be unique based on several factors, including type of contract, counterparty preference, clearinghouse practices, collateral maintenance requirements, and margin calculations and application. The guidance will also increase the operational burden for broker/dealers as unsettled regular way trade receivables and payables will no longer receive netting treatment. Moreover, financial reporting systems may not be able to present such information on a gross basis. Accordingly, entities will not only incur significant time and resources to evaluate the implications of the proposed guidance and make necessary systems changes, but will likely need to develop costly and time consuming processes to comply with the requirements of the proposed guidance to achieve net presentation.
- **We encourage the Boards to permit prospective application.** Retrospective application will present a considerable implementation challenge. Considerable effort will be required to re-assess existing netting agreements and identify the population of systems and counterparty arrangements within the context of the Proposed ASU as many arrangements are unique by counterparty and type of asset class. In addition, it will also be necessary to determine whether positions currently presented on a gross basis should be presented on a net basis pursuant to the proposed guidance. The cost of performing these assessments will greatly outweigh the benefits of providing the disclosure on a retrospective basis. If the Boards decide to proceed with the proposed guidance, we encourage the Boards to permit prospective application of the proposed guidance to better enable organizations to work through industry settlement issues and the operational considerations described above.

Ms. Leslie Seidman and Sir David Tweedie
Page 7

Conclusion

We are strongly opposed to the Proposed ASU as the ability of users to accurately interpret the exposure of an entity to significant financial risks will be significantly diminished. Moreover, we do not believe the proposed offsetting framework represents an improvement over the current U.S. offsetting framework. If the Boards decide to proceed with this project, we urge the Boards to permit a linked presentation within the statement of financial position. We believe a linked presentation will provide similar information to users while maintaining the integrity of the statement of financial position and present a more accurate reflection of the financial risk exposure.

* * * * *

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: Kathy Murphy – Office of the Comptroller of the Currency
Stephen Merriett – Federal Reserve Board
Robert Storch – Federal Deposit Insurance Corporation
Donna Fisher – American Bankers Association
Gail Haas – New York Clearing House Association