WELLS FARGO

January 23rd, 2007

Wells Fargo Comments on the Market Risk Amendment

To: Addressees

Office of the Comptroller of the Currency
250 E Street, SW
Public Reference Room, Mail Stop I-5
Washington DC 20219
regs.comments@occ.treas.gov

Regulations Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington DC 20552
Attention: No. 2006-34
regs.comments@ots.treas.gov

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th St. & Constitution Ave., NW
Washington DC 20551
regs.comments@frb.gov

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th St., NW
Washington DC 20429
comments@fdic.gov

Re: **OCC** Docket No. 06-10; **FRB** Docket No. R-1266; **FDIC** (No Docket Number); **OTS** Docket No. 2006-34; Risk Based Capital Standards: Market Risk; Federal Register Vol. 71, No. 185; September 25, 2006

Wells Fargo & Company appreciates the opportunity to participate in the ongoing dialogue on the Market Risk Amendment. We are a diversified financial services company, employing 169,000 people and providing banking, insurance, investments, mortgage and consumer finance to more than 23 million customers from more than 6,000 stores, as well as through the internet and other distribution channels across North America. As such, we have a keen interest in the framing of the Basel Accord and hope that the comments that we offer in this paper will be of assistance in providing solutions to the issues that exist in the current proposal.

Sincerely,

Paul Ackerman
Treasurer and Executive Vice President
343 Sansome Street, 2nd Floor
San Francisco, CA 94104
415-396-5196

Summary of Comments

As a general matter we support revisions to the market risk rules and the Agencies' efforts to better align market risk capital charges to actual risk in a bank's operations. However, we remain concerned about the proposal in two broad areas:

1. The U.S. interpretation of the Market Risk Amendment has become entirely too prescriptive and inflexible in its vision of the risk management processes to which banks must adhere. This is in stark contrast to the original supposition of Basel II – that each bank would be allowed to continue to use its existing risk management practices, so long as they could be shown to have been effective over time. The regulations should only aspire to establish a more risk sensitive framework for constructing minimum bank regulatory capital requirements. It can not, and should not, attempt to dictate how banks actually manage risk. For those institutions, like Wells Fargo, with proven risk management processes in place, it would be imprudent, and perhaps dangerous, for them to make significant changes to their risk management systems in the absence of quantifiable and validated data that clearly demonstrates that an alternate system is more robust and accurate, and could be successfully inculcated into their risk management processes.

2. The disclosure requirements of the Market Risk Amendment remain overly prescriptive, inappropriate and unnecessary. We believe that the disclosure requirements are not appropriate because public disclosure requirements ought to be set solely by those agencies that safeguard the interests of investors (i.e. the SEC, FASB, and the rating agencies), not by banking supervisors who have neither the responsibility, nor the focus, nor the expertise to take on that role. Furthermore, such requirements seem unnecessary to us, because, outside of Basel, the market will dictate those elements of bank risk management disclosure that are most necessary to improve transparency.

Detailed Responses to Specific Questions

Question #2 (pp 55963): 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 agree with the Agencies that not everything classified as trading asset / liability on the Call Report would be covered under VaR but only positions "held by the bank for the purpose of short-term resale or with the intent of benefiting from actual or expected price movements or to lock in arbitrage profits". We are already explicitly splitting FAS 133 hedges and economic hedges as positions not monitored under VaR.

<u>Question #3 (pp 55963)</u>: The agencies request comment on whether there is a better approach that matches more effectively the true economic impact of these transactions.

There is no clear demarcation on the treatment of trading book / banking book transactions with respect to market / credit risk calculations. This is open to interpretation. Specific examples provided by the agencies would greatly help.

Products with the same level of risk should be treated identically (same amount of capital allocated) whether they go by the market risk or the credit risk calculations. Doing otherwise would create arbitrage situations that would undermine the purpose of the regulations.

<u>Question #6 (pp 55964)</u>: 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 agree with the agencies that a trading strategy and a hedging strategy are important and need to be in place. As long as the overall objectives of the bank are met, policies and procedures that enforce how these strategies are implemented are unnecessarily detailed.

<u>Question #7 (pp 55965)</u>: 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.

Currently we capture the prepayment risk by using sophisticated prepayment models that capture the impact of the level of interest rates on prepayments. There is inherent inconsistency in calculating the prepayment risk over a 1-year horizon when VaR is calculated over a 10-day horizon and the turnover of trading portfolios is generally high. Subsequently, this is better handled as per the Asset Liability Management guidelines. Furthermore, different institutions use different prepayment models over a wide spectrum of sophistication – from very simple (Constant CPRs) to extremely elaborate (prepayments by state concentration) – so the vague guidelines could result in drastically different answers for the level of prepayment risk.

The written approval by the Federal Reserve is unnecessary. The Fed and OCC are already auditing the models so comments could be part of the audit recommendation rather than an initial approval. Also, models evolve over time so the proposed change is not clear whether approval would be required for every model enhancement.

<u>Question #8 (pp 55967)</u>: 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 would agree that the exclusion of fees makes the back-testing results more robust and we are already doing this for the majority of our portfolio. However, in some cases, separating those profit components is very difficult and the results would rarely be significantly different. The fees and commissions are part of the overall trading strategy.

The hypothetical backtesting, while theoretically a pure approach, would prove extremely burdensome. The hypothetical backtesting could be recommended as a best practice to be performed once a quarter for selected transactions from portfolios but it would be close to impossible to implement for the overall trading portfolio.

<u>Question #9 (pp 55967)</u>: 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.

A clear definition of what constitutes material risk should be provided and should not be left to interpretation.

Also, not allowing for partial modeling (i.e. capturing only some of the risks through a model) discourages model developments. As a result, there is no incentive for a bank to model its specific risk even partially.

<u>Question #10 (pp 55967)</u>: 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.

Most of the commodity contracts and FX deals are either exchange-traded or the price is directly affected by specific commodity price or exchange rates – risks already captured under the general market risk. Foreign exchange swaps are primarily undertaken to offset debt liabilities and are usually completely funded. We do believe that it is necessary to hold capital on the trading book for these transactions.

<u>Question #14 (pp 55969)</u>: The agencies seek comment on all aspects of the proposed public disclosure requirements.

The proposed detailed disclosure of quantitative and qualitative aspects of a banks' internal modeling is excessively burdensome. Public disclosure requirements ought to be *set solely by those agencies that safeguard the interests of investors (i.e., the SEC, the FASB, and the rating agencies).*

Disclosure should be inline with the risk management principles of a firm and should give insights into the calculations. The attribution of the risk to specific factors could prove difficult especially if the model is built around the historical VaR analysis where all the factors are changing simultaneously. It would be onerous and unnecessary to split interest rate risk from credit spread risk and FX risk from interest rate risk.

Certification by the bank's board of directors and senior management that the institution has made all necessary disclosures and maintains effective internal controls is duplicative to other regulatory guidelines (FDICIA), and accounting requirements under Sarbanes Oxley. Not only would this lead to unnecessary and duplicative certification, but it could possibly be seen as requiring a separate and additional independent auditor attestation, thereby increasing the regulatory and financial burden on banks.