



BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 5, 2009

Gregory A. Baer, Esq.  
Deputy General Counsel  
Regulatory & Public Policy  
Bank of America  
730 15th Street, NW  
Washington, DC 20005

Dear Mr. Baer:

This letter is in response to the requests from Bank of America Corporation (“BAC”), Charlotte, North Carolina, for temporary exemptions from the application of certain aspects of the Board’s market risk rule for bank holding companies (the “Market Risk Rule”) in connection with BAC’s acquisition of Merrill Lynch & Co., Inc. (“Merrill Lynch”), New York, New York.<sup>1</sup>

On November 26, 2008, the Board approved the application by BAC to acquire Merrill Lynch, and the acquisition was consummated on January 1, 2009.<sup>2</sup> To facilitate the orderly transition of Merrill Lynch to the Board’s Market Risk Rule, BAC has requested that, through December 31, 2009, BAC be permitted to use Merrill Lynch’s trading risk models for regulatory capital calculations. This includes (1) certain Value-at-Risk (“VaR”) models approved by the SEC, as supplemented by supervisory add-ons approved by the SEC (together, “SEC-approved models”), that would be used to determine BAC’s capital requirements for specific risk under the Market Risk Rule; and (2) methods approved by the SEC that would be used to determine BAC’s capital requirements under the Market Risk Rule for those trading assets formerly held by Merrill Lynch, including collateralized debt obligations that were subject to jump-to-default capital requirements, that the SEC did not require to be included in the VaR-based models of Merrill Lynch.

Under the Market Risk Rule, an institution with significant exposure to market risk must maintain adequate capital to support that exposure.<sup>3</sup> In addition to the

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<sup>1</sup> 12 CFR part 225, Appendix E.

<sup>2</sup> Bank of America Corporation, November 26, 2008. Before its merger with BAC, Merrill Lynch was subject to the capital requirements established by the U.S. Securities and Exchange Commission (“SEC”). See Appendix E to 17 CFR 240.15c3-1.

<sup>3</sup> 12 CFR parts 208 and 225, Appendix E, § 1(a). Positions covered by the Market Risk Rule (“covered positions”) generally include all assets, liabilities, and off-balance-sheet items in an organization’s trading account, and all foreign exchange and commodity

requirement for an institution subject to the Market Risk Rule to have a VaR model to measure general market risk, the institution also must capture its exposure to idiosyncratic or specific market risk either through a model approved by the Federal Reserve or by applying standard specific risk charges.<sup>4</sup> The Board has authority to provide exemptions from the Market Risk Rule.<sup>5</sup> The Board concludes that the limited and temporary relief described above would permit BAC to complete the transition to the Market Risk Rule in a safe, sound, and orderly manner.

To allow an appropriate amount of time for Federal Reserve staff to conduct in-depth reviews of all relevant market risk models, the Board has decided that BAC may use certain SEC-approved models to calculate its risk-based capital requirements for specific risk under the Market Risk Rule, provided that in no case shall BAC use the SEC-approved models to calculate any capital requirements under the Market Risk Rule after the December 31, 2009, reporting date. Based on the Board's preliminary review, the risk-based capital requirements for specific risk produced by the SEC-approved models appear to be sufficiently conservative for the transition to the Board's Market Risk Rule. During 2009, Federal Reserve staff will, among other things, review the existing specific risk models of BAC on a model-by-model basis. After Federal Reserve staff completes its review of each model, BAC may continue to use that model to calculate the specific risk of covered positions under the Market Risk Rule only if BAC has demonstrated to the Federal Reserve that the model adequately measures the specific risk of covered positions. If BAC has not made such a demonstration, it must begin applying the standard specific risk capital requirements in the Market Risk Rule to all covered positions that are covered by the model immediately after Federal Reserve staff completes its review of the model.<sup>6</sup>

In addition, BAC may continue to use methods approved by the SEC to determine its capital requirements under the Market Risk Rule for those trading assets formerly held by Merrill Lynch, including collateralized debt obligations that were subject to jump-to-default capital requirements, that the SEC did not require to be included in the VaR-based models of Merrill Lynch, until the December 31, 2009, reporting date. After that time, all the requirements in the Market Risk Rule will apply to these assets as follows: they must be included in the general VaR of BAC, and BAC must either have a specific risk model approved by Federal Reserve staff for these investments or apply the standard specific risk capital requirements in the Market Risk Rule to them.

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positions both in and outside the trading account. Most covered positions are excluded from the Board's general risk-based capital rules for bank holding companies ("Credit Risk Capital Rules"). 12 CFR part 225, Appendices A and F.

<sup>4</sup> See 12 CFR part 225, Appendix E, § 5. If an institution has not demonstrated to the Federal Reserve that its model measures the specific risk of covered positions, it must use the standard specific risk capital requirements in the Market Risk Rule.

<sup>5</sup> See 12 CFR part 225, Appendix E, § 1(b)(3).

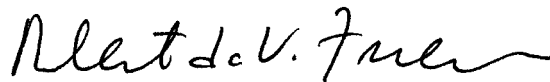
<sup>6</sup> See 12 CFR part 225, Appendix E, § 5.

During and after the transition period to full implementation of the Board's Market Risk Rule, BAC must maintain the accounting controls surrounding its computation of capital requirements for market risk. These controls are a critical element supporting the reliability of reported capital requirements.<sup>7</sup>

These determinations are specifically conditioned on compliance by BAC with all the commitments and representations made to the Board in connection with the requests for exemptions. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the requests and, as such, may be enforced in proceedings under applicable law. These determinations are based on the specific facts and circumstances of BAC. Any material change in those facts or circumstances or any failure by BAC to observe any of its commitments or representations may result in different determinations or in revocation of the exemptions.

Please contact Lisa White of the Federal Reserve Bank of Richmond at (704) 358-2548 if you have any questions.

Sincerely yours,



Robert deV. Frierson  
Deputy Secretary of the Board

cc: Lisa White  
Federal Reserve Bank of Richmond

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<sup>7</sup> In addition, BAC may not use internal models approved by the SEC to calculate its risk-based capital requirements for counterparty credit risk and instead must use the approach in the Credit Risk Capital Rules to calculate its capital requirements arising from counterparty credit risk. See 12 CFR part 225, Appendix A, § III.E. Furthermore, all the qualitative requirements in section 4(b) of the Market Risk Rule will apply immediately to BAC's covered positions with capital requirements that are determined based on VaR models. See 12 CFR part 225, Appendix E, § 4(b).