

April 14, 2010

Honorable Bill Lockyer,
California State Treasurer
915 Capitol Mall, Room 110
Sacramento, CA 95814

Re: March 29, 2010 Letter Regarding Municipal Credit Default Swaps

Dear Treasurer Lockyer:

Bank of America Corporation (“BofA”) and its affiliates (“BAML”) have a long and valued financing relationship with the State of California. We are pleased to assist you in your inquiry about the credit default swaps (“CDS”) market for California debt, as described in your letter dated March 29, 2010 to Brian Moynihan. Thank you for offering us a two day extension, until April 14, 2010, to respond.¹

QUESTION 1

Initially, we note that Bank of America N.A. and its securities affiliates did not engage in municipal CDS trading or publish research on municipal securities prior to BofA’s merger with Merrill Lynch & Co., Inc. (“Merrill Lynch”) on January 1, 2009 (the “Merger”). Most of the trading information given below occurred before January 1, 2009, with either Merrill Lynch International or Merrill Lynch Capital Services, Inc. (together “ML”) as the counterparties.

BAML’s roles in the municipal CDS market include serving as a swaps market maker and dealer, as well as in a custodial role. BAML makes regular two-way markets in municipal CDS, including CDS on California general obligation (“GO”) bonds, acting as a swaps dealer with respect to California GO CDS. In addition, BAML also facilitates California GO CDS trades in a custodial role in connection with its prime brokerage business. As a market maker, we transact California GO CDS trades with a variety of counterparties, including hedge funds, dealers, banks and insurers. From January 1, 2007 through March 31, 2010, BAML executed 125 California GO CDS trades, with only 10 of these trades occurring after the Merger. From January 1, 2007 through March 31, 2010, we executed 22 trades with hedge funds, 93 trades with dealers, 3 trades with banks and 7 trades with insurance companies. There were no trades with monoline insurers during this period. As of March 31, 2010, BAML’s outstanding gross notional amount

¹ While we have diligently tried to collect the information in our organization responsive to your request, because of the short time available we have not been able to ensure that we have located all responsive information.

of California GO CDS was \$1.74 billion, with only \$75 million (or 4%) of this attributable to trades occurring after the Merger. As of March 31, 2010, BAML's outstanding net notional amount of California GO CDS was a net short position of \$39.4 million (that is, ML was a net seller of California GO CDS protection as of that date, and thus net long California GO risk, as it would be if it were a holder of California GO bonds.) These amounts are insignificant when compared to Merrill Lynch, Pierce, Fenner & Smith Incorporated's² trading activity of an estimated \$28.5 billion of California's GO bonds from January 1, 2007 through March 31, 2010 in the primary and secondary markets, both buying and selling the State's securities.

In addition, we have prime brokerage positions which represent our "back-to-back" intermediation of trades between certain hedge fund clients and their counterparties. These transactions are custodial in nature and do not represent risk positions of our firm. The prime brokerage information is as follows: From January 1, 2007 through March 31, 2010 prime brokerage facilitated 23 California GO CDS trades, with none of these trades occurring after the Merger. Of these trades, 10 were with other hedge funds and 13 were with other dealers. As of March 31, 2010, the prime brokerage's outstanding gross notional amount of California GO CDS was \$1.89 billion, with none of this attributable to trades occurring after the Merger. As of March 31, 2010, our prime brokerage clients' outstanding net notional amount of California GO CDS was a net long position of \$209 million (that is, prime brokerage accounts were a net buyer of California GO CDS protection as of that date).

QUESTION 2

Municipal research analysts at BAML and the predecessor Merrill Lynch have periodically published research and made presentations about the municipal market credit outlook during the period of your query. They have typically focused on developments affecting municipal credit on a national basis, and include information about such subjects as state budget deficits, state pension funding levels, state retiree health care and other non-pension benefits funding status, incidence of defaults by municipal sectors, ratings actions, state issuance levels, the extent of issuance of Build America Bonds, and technical market data. With respect specifically to municipal CDS, BAML municipal research analysts have included information in some of their published research describing the structure of municipal CDS, the municipal CDS market and the MCDX index (an aggregated municipal bond CDS index) and commented on pricing in the cash market and the CDS market with respect to California GO bonds, and have also included charts showing historical 5-year and 10-year CDS spreads on State GO bonds for selected states, including California. This CDS-related material is largely descriptive and does not contain any recommendations relating to CDS transactions.

The derivatives desk at BAML has furnished material to certain of its counterparties and potential counterparties describing municipal CDS and their use, the municipal CDS market, and the MCDX index.

² This data does not include information of Banc of America Securities LLC.

In 2007 the Global Markets & Investment Banking Group at Merrill Lynch presented an investor conference focused on municipal CDS, which included description of municipal CDS and their use and the municipal CDS market.

QUESTION 3

BAML has no specific data about how “State of California CDS trading, in recent years, has affected the State, its bond sales and the borrowing costs paid by taxpayers.” Based on our general experience, we believe that the existence of a CDS market with respect to California GO bonds may have encouraged participation in the GO bond market, including participation by entities that might not otherwise participate in municipal GO bond markets by providing such entities a tool to help manage their risk exposure.

QUESTION 4

BAML as a firm does not have a view about either the level of spreads or the extent of trading in the municipal CDS market or the California CDS market over the next two years, and we note that BAML municipal research has not published forecasts with respect to either of these subjects.

We would expect that factors leading to the growth of the municipal bond market, including possible growth of the Build America Bond market and the ability of that market to attract new types of investors to the municipal bond market, would tend to increase the levels of activity and outstanding balances for municipal CDS. Our experience in the corporate CDS market suggests that as the municipal taxable bond market continues to grow, it becomes more likely that activity in the municipal CDS market will increase. Moreover, given the decreased availability of municipal bond insurance, the CDS market provides an alternative means of managing exposure that may be of particular interest to new types of municipal bond investors. Although the municipal CDS market may continue to develop, we would expect that yields of California debt will continue to be primarily driven by the experience and expectations of investors and ratings agencies about such fundamental factors as national and State economic conditions, inflation expectations, State budget actions, levels of debt issuance, and funding levels for State pensions and other post-retirement obligations.

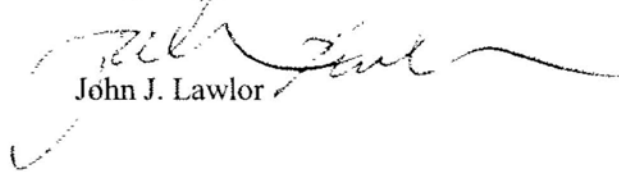
CONCLUSION

We hope this information will be useful to you in your consideration of the municipal CDS market and whether and how it has an effect on financing California’s debt.

This letter is being submitted to you with the request that you keep it confidential and not provide or otherwise disclose it to any party, unless you are required to do so by law. If your office should decide to disclose any of the information to any other government agency or other person, we also ask that you notify us immediately and provide that agency or other person with notice of this request. Furthermore, if any person should request the opportunity to inspect or copy this letter, we ask to be notified immediately and given advance notice of any intended release.

If you have any additional questions, please do not hesitate to contact me.

Very truly yours,

A handwritten signature in black ink, appearing to read "John J. Lawlor", with a long, sweeping horizontal flourish extending to the right.

John J. Lawlor