JPMorganChase

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Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Letter of Comment No: 263
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Re: File Reference No. 1102-001

Dear Ms. Bielstein:

J.P. Morgan Chase & Co. appreciates the opportunity to provide its views on the FASB's Invitation to Comment on Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123 ("FAS 123"), Accounting for Stock-Based Compensation, and Its Related Interpretations, and IASB Proposed IFRS, Share-based Payment ("IFRS").

We support the efforts of the FASB and the IASB in their work towards convergence of accounting standards worldwide and development of principle-based accounting-standards. SFAS 123 and the proposed IFRS offer a challenging opportunity to achieve these objectives. Both documents follow similar conceptual principles, but present significantly divergent guidance in their conclusions and requirements.

We generally do not believe that the proposed IFRS offers an improvement in guidance over SFAS 123. Our comments in response to the FASB's questions are presented in the attached document.

If you have any questions or would like to discuss the attached comments, please do not hesitate to contact me or David M. Morris at (212) 648-0377.

Very truly yours,

PRIMARY SIMILARITIES AND DIFFERENCES FROM INVITATION TO COMMENT

Issue 1: Statement 123 provides a scope exclusion for ESOPs and certain ESPPs, and the Proposed IFRS does not. Which view do you support and why? (Refer to page 19.)

Since accounting guidance should be principle-based, all stock compensation plans should follow the same principles.

Issue 2: In measuring the fair value of stock options granted to employees, both Statement 123 and the Proposed IFRS require use of an option-pricing model that takes into account six specific assumptions. The standards provide supplemental guidance for use in selecting those assumptions. (Refer to page 20.)

Issue 2(a): Do you believe that an accounting standard should mandate the use of an option-pricing model for measurement purposes? If not, what other approaches do you believe would provide more consistent and reliable estimates of the fair value of employee stock options granted and why? (Refer to page 21.)

Yes, the market has demonstrated that option-pricing models are the appropriate tools to price options. Consistent with market practice, the value of employee stock options should be measured using an option-pricing model.

Issue 2(b): If you agree that an accounting standard should mandate the use of an option-pricing model, do you believe that a particular model should be mandated? If so, which model should be required to be used and why? (Refer to page 21.)

No, one particular option-pricing model should not be mandated. Current models were developed to price short-term marketable options and, recently, these models have been used to price longer-dated marketable options. However, the models do not incorporate all the variables needed to produce accurate valuations of employee stock options, because these models exclude such components as forfeiture and nontransferability, among others items. Companies should be encouraged to experiment with modifications to the basic option-pricing model in order to produce more reliable valuations of their employee stock options based on the terms and conditions of the options granted.

Issue 2(c): If you agree that an accounting standard should not mandate the use of a particular option-pricing model, do you believe that additional disclosures should be made to improve the user's ability to compare the reported financial

results of different enterprises? If so, what types of additional information should be required to be disclosed? (Refer to page 21.)

Yes, footnote disclosure should include identification of the option-pricing model used for measuring the value of employee stock options, including the basic assumptions used in the valuation. Additionally, if the general model is modified to value some or all of the features unique to the employee stock options granted by the company, then a description of the modifications should be provided.

Issue 2(d): Statement 123 and the Proposed IFRS require that certain modifications be made to the outcome of an option-pricing model to address certain features of employee stock options. If you believe that other modifications should be made to improve the consistency and reliability of those outcomes, please describe those modifications and why they should be required. (Refer to page 21.)

Modifications should include:

a) Nontransferability – employees are generally restricted in their ability to transfer their options. Market activity has clearly demonstrated that nontransferable instruments (e.g., unregistered shares) trade at a significant discount to the price of readily transferable instruments. This discount should be reflected in the option's value.

b) Forfeiture – employees generally lose the right to receive the options if they terminate employment prior to completion of the required service period. The value of the option on grant date should reflect this time value. The potential for forfeiture is an additional risk component that should be reflected in the option's value.

c) Performance Targets – certain awards may only vest if designated performance targets are achieved. Targets may be simple, such as the common stock price, or objective, such as achieving sales, levels of production, income, or productivity goals. Targets directly affect the probability of vesting and, although difficult if not impossible to value objectively, the impact of such targets should be incorporated into the model.

Issue 2(e): Do you believe that additional guidance for selecting the factors used in option-pricing models is necessary to provide added consistency and comparability of reported results? If so, what types of guidance should be provided and in which areas? (Refer to page 21.)

Yes, additional guidance should be provided to the extent that such guidance establishes a base that can be built on as option-pricing models evolve to address the difficulties in valuing employee stock options. Existing option-pricing models, such as the Black Scholes and Binomial models, are widely used and provide a relatively simple and consistent valuation. Designating these models as a base standard will not produce accurate valuations, but will provide a level of consistency and comparability in the results reported. Further, this approach would provide companies with a foundation to develop enhanced option-pricing models that would produce more reliable valuations.

Issue 3: Do you believe that employee and nonemployee transactions are distinct and, therefore, warrant different measurement dates for determining the fair value of equity instruments granted? If so, why? If not, why not? (Refer to page 24.)

No, whether the grantee is an employee or nonemployee, the underlying premise of the transaction is the same--the company is willing to exchange value (i.e., stock options) for value received (i.e., goods or services). Therefore, at the date that the critical terms of the transaction are known, the transaction should be valued.

Issue 4: Do you believe that the fair value of equity awards granted to nonemployees that include performance conditions can be measured with sufficient reliability to justify a grant-date measurement method? If so, why? If not, why not? (Refer to page 24.)

Grant-date measurement of fair value of nonemployee performance awards would be as reliable as grant-date measurement of fair value of employee performance awards. Measurement of performance conditions encompasses a wide range of possibilities, both financial and nonfinancial. If the performance condition is one that can be objectively quantified and incorporated in the valuation model, then the fair value of the award might be reliably measured. However, as stated above in our response to Issue 2(d), assigning value to a performance condition is very subjective and, thus, may not produce a reliable measurement.

Issue 5: Do you believe the notion of issuance is conceptually of importance in the design of a standard on stock-based compensation? If so, why? If not, why not? (Refer to page 25.)

Issuance is a very important concept. A transaction is not complete until there is an exchange of value between the company and the grantee. Issuance is consummation of the transaction, i.e., the unconditional issuance of stock or options by the company in exchange for specified services or performance received from the grantee.

Issue 6: Do you believe an equity instrument subject to vesting or other performance conditions is issued, as defined by Statement 123, at the grant date? If so, why? If not, why not? (Refer to page 25.)

We agree with the Statement 123 definition that an equity instrument is not issued until consideration is received and the instrument is transferred without further obligation. As stated above, a transaction is not complete until there is an exchange of value. Grant date may be viewed as the date a company awards an employee a "subscription" that sets the price of the stock or options transaction. Upon satisfaction of the required service or performance conditions for the award, the employee's subscription obligation is "paid in full." It is at that time, the vesting date, that the stock or options are actually issued.

Issue 7: Do you believe that the effect of forfeiture should be incorporated into the estimate of fair value per equity instrument (IASB approach)? If so, why? If not, why not? (Refer to page 28.)

The risk of forfeiture should be incorporated into the estimate of fair value. The fact that the award can be lost if the grantee does not fulfill the service or performance requirements is a restrictive feature embedded in the terms of the award and, therefore, a component of its value. However, incorporation of forfeiture risk in the option's value does not mean that accrued compensation expense related to forfeited awards should not be reversed. The total compensation expense to be recognized over time should equal the fair value of the option at grant date times the actual number of options issued at vesting date.

Issue 8: Should failure of an award holder to satisfy the conditions that entitle the holder to retain or receive the promised benefits affect the amount of compensation expense that should be recognized related to that award? If so, why? If not, why not? (Refer to page 28.)

Yes. A simple way of viewing a forfeiture event is to compare it to a cash transaction. Assume a company offers a cash award to an employee if he or she remains with the company for a three-year period. If the employee stays for the three-year period, then he or she will receive the cash bonus payment. The company will record the expense over the three-year "vesting" period. If an employee leaves after two years, then he or she does not receive the cash payment and the company would adjust the expense accrual, accordingly, for the lower cash amount to be paid (i.e., reversal of the expense accrual at date of forfeiture). The accounting for the compensation expense that is related to a stock award should be the same as for a cash award. There is no basis for compensation expense to be recognized differently depending on the form of the compensation payment.

Issue 9: Do you agree that the result of the IASB's approach to calculate the fair value of equity instruments of nonpublic entities would be closer to fair value than minimum value? If so, why? If not, why not? (Refer to page 29.)

No, there is no assurance that the factors considered by the IASB's approach will correlate with the fair value of a nonpublic company's option. Two seemingly similar companies can have stock values that are widely different. If an option-pricing model is intended to measure value of a company's stock, then the key measure to validate that value is the company's stock price. Because a nonpublic company does not have this metric, the option value cannot be objectively validated.

Issue 10: Which of the two attribution methods described by the standards do you believe is more representationally faithful of the economics of stock-based compensation arrangements and why? (Refer to page 35.)

Each method offers a reasonable approach for the timing of expense recognition - straight-line or units of service - as both are estimates and no different than alternative methods used for recognizing depreciation. The straight-line method is simpler and results in expense recognition equally over the term, but, other than that, there is no difference to indicate that one is better than the other. Whichever method is used, it only provides a formula for timing the expense estimate, which should be trued up at maturity to reflect the cost of the options that actually vest.

Issue 11: Statement 123 does not ascribe value to services received in exchange for equity instruments that are later forfeited (that is, recognized compensation expense is reversed upon forfeiture), whereas the Proposed IFRS ascribes value to such services through its units-of-service attribution method (that is, recognized compensation expense is not reversed upon forfeiture). If you support the Proposed IFRS's view, do you believe the units-of-service method ascribes an appropriate value to services received prior to forfeiture? If so, why? If not, why not? (Refer to page 35.)

No, as stated in our response to the previous issue, expense should be trued up to reflect the cost of only those options that actually vest.

Issue 12: Do you believe that the actual outcome of performance awards should affect the total compensation expense incurred by an enterprise? If so, why? If not, why not? (Refer to page 38.)

Yes, compensation expense should reflect the value of the awards earned under the performance criteria. As discussed in Issue 8, compensation cost to be recognized as expense should represent the value given up by the company. Therefore, compensation expense should be recognized only if the performance goals are achieved and the award is issued.

Issue 13: Do you believe that this issue is important in considering an attribution model's validity? If so, why? If not, why not? (Refer to page 40.)

No, the attribution period should not extend past the vesting date. Once the option vests, the company has transferred ownership of the option to the grantee. Payment has been rendered (i.e., the required terms and conditions have been met) and the transaction is complete.

Issue 14: Do you believe that the measurement-date criteria in Issue 96-18 accurately reflect the economics of transactions with nonemployees? If not, why not? (Refer to page 43.)

No, the accounting for transactions with nonemployees should follow the accounting for similar transactions with employees. This would be consistent with a principle-based accounting model.

Issue 15: Do you believe that all of the tax benefits derived from stock-based compensation arrangements should be recognized in the income statement? If so, why? If not, why not? (Refer to page 46.)

No, the initial tax benefit recorded is based on the compensation expense recognized in the period. Incremental tax benefits arise based on actions by third parties (i.e., the employees) at future dates, based on market values. As such, they result from equity related transactions unrelated to the operating activities of the company and, consequently, should be accounted for as equity transactions.

Issue 16: As discussed in paragraph 83 of this Invitation to Comment, the Proposed IFRS expands on the disclosure requirements in Statement 123. Do you believe that those expanded disclosures would be more informative to users of financial statements? If so, why? If not, why not? (Which of the disclosure requirements should be eliminated or modified in that case?) (Refer to pages 47 and 48.)

The IFRS disclosures shown in paragraph 83 should not be required. The information to be disclosed is support for the assumptions used in the valuation process. Other assets and liabilities recorded on the balance sheet are carried at fair value, but disclosure of the underlying bases for their valuation assumptions is not required.

Issue 17: Please describe any additional disclosures that you believe should be required in order to inform a user of financial statements about the economics of stock-based compensation arrangements. (Refer to page 48.)

As stated in our response to Issue 2(c), disclosure should be provided to describe the method used to produce the valuation. Additionally, if the option-pricing model used is modified to incorporate other variables into the valuation, then information should be provided to describe the nature and effect of the modifications.

SECONDARY SIMILARITIES AND DIFFERENCES FROM APPENDIX A

Issue A1: Statement 123 distinguishes between a principal stockholder and a stockholder for certain transactions, and the Proposed IFRS does not. Which view do you support and why? (Refer to page 52.)

A distinction should not be made as to whether the party is a principal stockholder or a stockholder. Accounting for a transaction should be based on its relevant facts and circumstances.

Issue A2: Do you believe that a probability-weighted average amount of the range should be used when no amount in the range is better than any other? If so, why? If not, what other amount within the range would you propose when no amount in the range is better than any other? Why? (Refer to page 56.)

Yes, because a probability-weighted average amount would be more consistent with the approach taken in Concepts Statement 7 under US GAAP.

Issue A3: Do you agree that option-pricing techniques have sufficiently evolved since Statement 123 was issued to address reload features and, if so, should Statement 123's requirements be changed? If not, why not? (Refer to page 57.)

No, option-pricing techniques have not yet evolved sufficiently enough to reliably value "plain vanilla" employee stock options. Therefore, they are not sufficiently evolved to reliably value more complex instruments. We believe that the approach taken in SFAS 123, valuing each reload event as a new grant provides a workable, interim solution until the time that option-pricing techniques evolve to the point that reliable measurement can be demonstrated.

Issue A4: Do you believe there are circumstances in which an entity may not be able to reasonably estimate the fair value of equity instruments at the grant date? If so, please provide examples of such circumstances and describe how those equity instruments should be accounted for until a reasonable estimate is determinable. (Refer to page 57.)

Yes, as previously stated, performance conditions may require subjective assumptions that prevent reliable measurement at the grant date. For example, performance awards may specify that the number of shares to be awarded on the vesting date is a variable based on the level of future financial or nonfinancial performance attained. In such circumstances, the valuation should be initially based on the assumption that the maximum award will be granted, as it was management's presumption in granting the award that the performance targets were achievable. Periodically, management should reevaluate the probability of achieving the performance targets and, if it is substantiated that the maximum performance target level will not be achieved, then the expense accrual should be adjusted prospectively to reflect the lower level award.

Issue A5: Do you believe there is a single grant date or multiple grant dates for the preceding example? Why? (Refer to page 58.)

There is a single grant date. At the grant date, the parties have a mutual understanding of the critical terms and conditions of the award to be earned over the required service period.

Issue A6: Should SARs be measured at fair value rather than intrinsic value? If so, why? If not, why not? (Refer to page 58.)

Yes, SARs should be accounted for at fair value because they have the same characteristics as options, i.e., value is based on changes in value of the underlying company stock.

Issue A7: In accounting for equity award modifications, should the fair value of the original award be calculated using (a) the shorter of the remaining expected life of the original award or the expected life of the modified award or (b) the remaining expected life of the original award? Why? (Refer to page 61.)

Neither, the underlying premise of SFAS 123 and the proposed IASB standard is that transactions should be accounted for at fair value. Under both documents, when an equity award is modified, expense recognition should be based on the incremental value received as a result of the modification. To use a shorter remaining expected life moves away from a fair value model. Further, if accounting guidance is moving to a principle-based approach, then the rules should reflect principles applied on a consistent basis.

Issue A8: Do you believe that an accounting standard on stock-based compensation should include provisions for distinguishing between repricing and other modification events? Why? (Refer to page 61.)

No, a repricing is a form of modification. Therefore, as stated in the previous issue, the accounting treatment should be consistent with the principle underlying the substance of the transaction.

Issue A9: Which method of accounting for settlements of unvested awards do you believe is more representationally faithful and why? (Refer to page 62.)

The method of accounting for settlements should follow the FASB approach. We agree that settlement is accelerated vesting of the award and it should be treated accordingly. The IASB's proposed units-of-service method is a reasonable alternative that may be used to estimate the timing of expense recognition, but it should not be a limiting methodology that prevents the adjustment of estimated expense to actual expense at maturity.

Issue A10: The Proposed IFRS considers certain factors, including past practice or a stated policy of settling in cash, in evaluating how an entity should account for certain contracts that can be settled in cash or equity, at the entity's option. Do you agree with this view? If so, why? If not, why not? (Refer to page 63.)

Yes, all facts available should be considered in determining the accounting for the award and the awards should be accounted for in a manner consistent with the expected outcome.