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Re: File Reference 1082-200
Proposed Interpretation of Consolidation of Certain Special-Purpose Entities, an interpretation of ARB No. 51

Dear Ms. Bielstein:

J.P. Morgan Chase & Co. appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB" or the "Board") June 28, 2002 Exposure Draft of the Proposed Interpretation of ARB No. 51, *Consolidation of Certain Special-Purpose Entities* (the "Exposure Draft", the "ED" or the "Interpretation").

We support FASB's effort to improve comparability of financial statements by clarifying the consolidation rules for Special-Purpose Entities ("SPEs"). However, we have significant concerns with the proposed variable interest model and do not believe the FASB's stated objective of improved comparability between enterprises engaged in similar activities will be met under this proposed model. The proposed model would include assets and liabilities on the balance sheet of an enterprise when that enterprise has neither the opportunity to receive the benefits from the assets nor the obligation to make payments on the liabilities. Additionally, although not specifically addressed in the ED, there is the possibility that an enterprise would record the income statement impact of transactions that would never represent an economic benefit or loss to the enterprise.

We agree with the concept in B19 of the ED, that for risk dispersing SPEs in which no individual party controls the SPE's assets or is responsible for the SPE's liabilities, each party should account for its rights and obligations related to the assets in the SPE , but it would be inappropriate for any party to consolidate the assets and liabilities of the SPE. However, the detailed requirements necessary to qualify as a Financial SPE ("FSPE") are inconsistent with this basic concept and will result in consolidation of many vehicles that effectively disperse risks. In section III, below, we have highlighted certain changes

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that need to be made to the FSPE model to ensure consistency with the Board's conceptual approach to risk dispersing SPEs.

Although we have expressed many of our detailed concerns through the various industry groups in which we participate, we felt it necessary to provide our overall comments separately. If the FASB chooses not to adopt our comments, the ED will create a subjective, complex consolidation model, that not only will be difficult to apply, but more importantly will result in enterprises engaged in similar activities accounting for those interests differently. We believe that this is contrary to the FASB's objective and will actually result in diminished comparability.

Our Key Comments Cover the Following Topics:

I. Definition of an SPE

II. Variable Interest Approach

III. Financial SPE Model

IV. Silo Concept

V. Consolidation Based on Voting Interests

VI. Consolidation Accounting

VII. Disclosures

VIII. Transition

I. Definition of an SPE

The Interpretation is meant to clarify the application of Accounting Research Bulletin No. 51 ("ARB 51") to SPEs. The ED, however, has not clearly defined what vehicles qualify as SPEs. Instead, the ED has defined a Substantive Operating Entity, and states that an enterprise that is a Substantive Operating Entity is not an SPE. While we recognize that it may be difficult to define an SPE, by taking this approach, the ED may scope in various structures unintentionally (e.g., mutual funds). We strongly urge the Board to clearly define the characteristics that are necessary to be deemed an SPE to ensure the consolidation analysis applied to a vehicle is appropriate for the entity.

II. Variable Interest Approach

A. Derivatives as a Variable Interest

Derivative instruments are included in paragraph 18 as a potential variable interest. We do not believe that all derivatives should be included as variable interests, as these instruments generally do not concentrate risks in a fashion that warrants consolidation. In addition, broadly considering all derivatives as variable interests could result in a consolidation/deconsolidation scenario at each reporting date because the derivative could be in-the-money or out-of-the-money in any given period. Further, under Statement 133, derivatives are recorded at fair value on an enterprise's balance sheet, so they are being appropriately accounted for within financial statements.

Because we recognize that there are many forms of derivatives, we propose providing the following indicators for derivative instruments that would be excluded from being considered a variable interest: (1) there are interests in the SPE held by other substantive operating enterprises that are subordinated to the derivative counterparty, (2) the derivatives are marked-to-market by the derivative counterparty, and (3) the derivatives do not concentrate substantially all of the risk and rewards of the SPE's assets with the derivative counterparty (i.e., total return swaps).

B. Market-based fees

We have concerns regarding the guidance for market-based fees. Paragraph 19 indicates that fees from an SPE are presumed to **not** be market based unless they can be demonstrated to be comparable to fees in similar observable arm's length transactions or arrangements. We believe that this presumption is not necessary and should be eliminated. We believe that fees are market based because investors in, and other parties that transact with, an SPE make rational economic decisions.

Additionally, the first sentence of paragraph 19, states that "market-based fees are not variable interests unless the holder has an investment at risk or can be required in certain circumstances to transfer assets or issue its own equity or debt instruments to the SPE or a party with an interest in the SPE." We fail to see how an investment at risk should change the characterization of a previously assumed market-based fee to non market-based. We contend that if a fee was deemed to be market-based, then that fee would continue to be deemed market-based irrespective of an enterprise holding other variable interests in the SPE and recommend that the guidance be revised accordingly.

C. Consolidation of the SPE based upon a majority of the Variable Interests

The proposed ED is an interpretation of ARB 51 and although it can be difficult to apply the provisions of ARB 51 to certain SPEs due to the lack of voting interests, the underlying concepts of ARB 51 should be incorporated in the ED. Specifically, consolidation should be based upon holding a **majority** interest, whether that interest is a voting interest or a variable interest. This results in consolidation when the effect is that one party has a majority of the "controlling interest."

Requiring consolidation when one enterprise has a significant variable interest that is significantly more than any other party's variable interest is not workable. This will result in different accounting consequences for transactions in which an enterprise's interest and involvement are exactly the same. For example, assume that an enterprise holds 40% of the variable interest, another party holds 40%

and the remaining 20% is widely dispersed. Presumably, no party would be required to consolidate the SPE. Now assume that the enterprise maintains its 40% variable interest, while the other 40% variable interest holder sells its interest to four different parties who each purchase a 10% interest. The remaining 40% variable interest holder could now be required to consolidate the SPE through no actions of the enterprise. In fact, application of this test may lead to situations where an enterprise consolidates and deconsolidates an SPE at various reporting dates. We fail to see how this will improve financial reporting, and we believe it will lead to less transparency. Additionally, this concept directly contradicts ARB 51, which requires companies to account for their interests based upon their ownership as a percentage of the total ownership, not relative to other parties to a transaction.

We are concerned that the Board has underestimated the operational issues associated with attempting to perform the variable interest test on each reporting date for every SPE in which an enterprise has an interest. The operational burden of requiring parties to obtain current information regarding the holdings of all counterparties to an SPE to determine if their relative variable interest is significant and, we believe, impractical. There is also the question of the legal issues associated with requesting variable interest holders to disclose their interests and details of any transactions they may have entered into to sell (or buy) variable interests. Although the Board acknowledges this impracticality in Footnote 5 indicating that "An entity is not required to conduct an exhaustive search for information about the actions of other unrelated parties that might cause the entity to become the Primary Beneficiary or to cease to be the Primary Beneficiary." This impracticality can be considerably decreased if consolidation is based upon the majority interest holder concept discussed above.

We do believe that, similar to the analysis of entities subject to the voting interest model, the consolidation analysis should take into account all relevant facts and circumstances. It may not be sufficient to rely purely on a quantitative analysis in certain circumstances to determine consolidation. Accordingly, we propose that the presumption that only a majority interest holder would be required to consolidate could be overcome if, (1) an enterprise was a significant non-majority interest holder and (2) the enterprise maintains a controlling interest through other means.

III. Financial SPE Model

A. Risk Dispersing Entities

Throughout the ED, the Board states that this model is intended to require consolidation of SPEs that do not effectively disperse risks and acknowledges that securitizations often do disperse risks. In particular, we note paragraphs B19 and B20 which state:

> "In its deliberations, the Board acknowledged that while many SPEs benefit a primary beneficiary, some SPEs effectively diversify risks and potential benefits related to certain assets or activities. In SPEs that diversify risks, a portfolio of assets is held by an administrator, trustee, or servicer, and the various rights and obligations that arise from those assets and any liabilities incurred to hold those assets are allocated to various parties in accordance with their

tolerance for risk. No individual party controls the SPE's assets or is responsible for the SPE's liabilities. Each party should account for its rights and obligations related to the assets in the SPE, but it is inappropriate for any party to consolidate the assets and liabilities of the SPE.

The Board believes that appropriate application of the provisions of this Interpretation would not result in consolidation of SPEs that effectively disperse risks. However, to simplify implementation and improve consistency, the Board decided to provide additional, more specific guidance on how to analyze one class of risk-dispersing SPEs, which are described in paragraph 22. That class of SPEs hold certain financial assets, have limits on their activities and the interests they can issue, and are legally isolated from the enterprises that hold interests in them."

We believe that paragraphs 22 and 23 have failed to achieve the Board's objective of not requiring consolidation of risk-dispersing entities that hold financial assets. The Board has utilized the Statement 140 ("SFAS 140") Qualifying SPE ("QSPE") criteria as the foundation for determining whether an SPE meets the FSPE definition. Utilizing the SFAS 140 QSPE criteria as the foundation in defining an FSPE is too narrow and will not allow many risk dispersing entities to be considered FSPEs.

The most significant limitations in utilizing the SFAS 140 QSPE criteria are the restrictions on the use of derivatives. We fail to see why derivatives that prevent a vehicle from being considered a QSPE should impact the risk dispersing qualities of an SPE. If this limitation is not lifted, SPEs that hold, or have the ability to acquire "synthetic assets", such as synthetic Collateralized Debt Obligations ("CDOs"), would be excluded from the FSPE model, while SPEs with economically similar characteristics, such as funded CDOs, may be included in the FSPE model. Also, there may be further potential impact on the FSPE model depending on the outcome of the impending Statement 133 "D-2" guidance. We propose to eliminate most limitations on derivatives in the FSPE model and recommend that the only necessary limitations are that the derivative does not have either of the following characteristics: (1) it provides the derivative holder with the ability to control the vehicle, or (2) it concentrates substantially all of the risk and rewards of the SPE's assets with the derivative counterparty.

We do not believe that FSPEs should be restricted from holding equity securities. Holding equity securities does not diminish an SPE's risk dispersing attributes. We recommend that these restrictions be removed to allow SPE's that effectively disperse risk to qualify as FSPEs. We also recommend that, to ensure clarity, the ED include the relevant sections of SFAS 140, appropriately modified, as opposed to incorporating them by reference.

B. Paragraph 23

We agree that additional consolidation guidance should be provided for FSPEs. However, the guidance included in paragraph 23 does not include any thresholds regarding the size of a variable interest and therefore may result in consolidation more frequently than would be required under the variable interest model. We do not believe that this was the FASB's intent. For this reason, we believe that prior to reviewing the three tests in paragraph 23, an enterprise must first hold a majority of the variable interests.

Additionally, we believe that the test in Paragraph 23.b. may result in the consolidation of certain FSPEs in circumstances where the risks are not sufficiently concentrated to justify consolidation. Therefore, paragraph 23.b. should be revised as follows to clarify the level of support that meets this condition. An enterprise should only meet this condition if (a) it holds a subordinated interest and (b) it is reasonably possible that losses on that subordinated position are expected to be significant. In applying part (b) of this test, we believe that expected losses would only be expected to be significant if (i) other subordinated interests in the SPE are not expected to cover expected future losses of the SPE and (ii) the level of expected losses not covered by more subordinated interests (and thus exposing the subject interest to expected losses) is significant. This revision would provide evidence that there is the type of risk exposure on a subordinated interest that is potentially consistent with a controlling financial interest.

IV. Silo Concept

We believe the Silo Concept has conceptual merit and would support the application of this model to Master Trusts in addition to multi-seller vehicles ("MSV"). Although separate series of securities in a Master Trust share a single pool of assets, a Master Trust generally functions like separate SPEs with respect to their allocable shares of the assets. Therefore, a Silo analysis for this type of vehicle is appropriate.

We believe that the initial step in analyzing an SPE is to first determine if the SPE has Silos. Each individual Silo should then be reviewed to determine if it will be evaluated for consolidation under the FSPE model or the variable interest model. We propose all parties to the transaction, including the transferors, administrators, and liquidity and credit enhancement providers, perform their consolidation analyses based on individual Silos. This would provide for a consistent application of the consolidation model from enterprise to enterprise and avoid the possibility that the same Silo would be consolidated by more than one enterprise.

V. Consolidation Based on Voting Interests

Paragraph 9b requires that when an SPE is evaluated under the voting interests model, one should determine whether the "equity investment is sufficient to allow the SPE to finance its activities without relying on financial support from variable interest holders." It is further required that the equity investment should be greater than or equal to the expected future losses of the SPE. We agree with the concept of utilizing expected future losses to determine if there is sufficient equity for an SPE, however, the concept is only applied in the ED if the equity is greater than 10% of the SPE's total assets. If the equity is less than 10%, not only is there the presumption that this equity amount is not sufficient, but further, an enterprise is then required to determine if there are comparable businesses that are not SPEs with the same level of equity. We believe that the expected loss concept should be applied consistently to determine the sufficiency of a vehicle's equity and do not support the establishment of arbitrary bright lines without conceptual basis.

VI. Consolidation Accounting

Guidance for consolidation accounting needs to be incorporated into the final Interpretation. While we acknowledge that guidance regarding the accounting for and presentation of consolidated subsidiaries exists, there are unique accounting and presentation issues that arise when an entity with no recourse to its parent is consolidated, particularly when the subsidiary is bankruptcy-remote. For example, it does not seem reasonable that an enterprise incur a write down for impairment of a consolidated asset when the parent will never suffer a loss because the liabilities are only repaid based on the assets held by the SPE. Financial statement presentation and accounting become distorted when the parent company does not have the rights and obligations to the assets and liabilities it consolidates. The Board needs to address the accounting results upon consolidation because there is the potential to produce results that do not accurately reflect the performance of the consolidated entity. Further, we believe that the proposed model is incomplete unless the resultant consolidation accounting has been fully addressed.

The Board should consider utilizing a "Matched Presentation" approach for assets and liabilities of SPEs required to be consolidated, provided the assets of the SPE have been legally isolated and the SPE has issued debt that is non-recourse to the consolidating entity. Under this approach, the SPE's gross assets would be shown on a separate line, immediately followed by a deduction for the non-recourse debt and third party equity interests issued by the SPE, arriving at a net interest in the SPE. Similarly, a separate section of the income statement would display the net interest and other expenses and third party equity interests in the income of the SPE. In our view, a "Matched Presentation" is one way to make clear the exposure of the consolidating entity.

VII. Disclosures

Paragraph 25 of the ED provides disclosure requirements for SPEs in which an enterprise provides significant administrative services and is not the Primary Beneficiary. We do not believe there is a benefit to broadly requiring disclosure of the assets and liabilities of the SPE that an enterprise services. In fact, we are concerned that this disclosure could lead to further confusion as this may imply that the administrator has rights and obligations to the assets and liabilities of the SPE. Additionally, administrators may not have complete access to the information required for this disclosure. For these reasons, we believe that the paragraph should be significantly narrowed to only include administrators of MSVs. Further, we suggest that an enterprise that is an administrator of a MSV be required to include the following footnote disclosures in its financial statements, in the aggregate, for all MSVs administered:

1. The purpose of the SPE and the nature of the reporting enterprise's contractual arrangements with the SPE.
2. The amount and types of ABCP and other securities issued by the SPE outstanding as of the latest balance sheet date and the associated credit ratings.
3. The amount of liquidity commitments provided by the reporting enterprise to the SPE.

4. The amount of any second loss or program-wide credit enhancement provided by the reporting enterprise in the form of subordinated debt, letters of credit or other guarantees and their maturity.

5. Whether and under what circumstances the reporting enterprise could be required to issue its own equity to support the SPE's transactions.

6. Whether an employee of the reporting enterprise has invested in the SPE.

7. Whether the reporting enterprise has sold any of its own assets to the SPE.

VIII. Transition

The Board has proposed that the provisions of the new guidance be applied to all new SPEs created after the final Interpretation is issued. Due to the anticipated implementation issues with this highly subjective model, we propose an effective date for new transactions that begins two months after the final Interpretation is released. This would allow time for consistent methodologies to be developed by different enterprises, which would lead to further comparability in application of the Interpretation.

We also understand the Board's goal to have conformity between new transactions and previously executed transactions as soon as possible. However, the final guidance is not expected until December 2002 and time is required to analyze existing structures, each with its own set of facts and circumstances, to determine the appropriate accounting. We strongly urge an effective date for previously executed transactions, for periods beginning after September 15, 2003. This is an extremely short implementation timeframe given the number of transactions subject to this proposed guidance. We believe that our proposal is a reasonable compromise between the Board's goal of achieving comparability and the significant effort it will require enterprises to assess consolidation for all SPEs with which enterprises transact.

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In conclusion, we believe the Exposure Draft, as currently written, will create a subjective, complex consolidation model, that will be difficult to apply, and will result in enterprises engaged in similar activities accounting for those interests differently. For these reasons, we strongly urge the Board to consider the comments in this letter. Additionally, we urge the Board to consider this guidance along with the proposed Amendment of Statement 133 and the Statement 140 Q&As. All of these proposed standards are significantly interconnected and should not be concluded upon in isolation.

We appreciate the opportunity to submit our views and would be pleased to discuss our comments with you at your convenience. If you have any questions, please contact me at 212-270-7559.

Very truly yours,