

JPMORGAN CHASE & CO.

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Managing Director & Corporate Controller

September 1, 2010

Mr. Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference no. 1810-100: Proposed Accounting Standards Update—Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear Mr. Golden,

JPMorgan Chase & Co (“JPMorgan Chase” or “the Firm”) appreciates the opportunity to comment on File Reference no. 1810-100: *Proposed Accounting Standards Update—Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the “Exposure Draft”) issued by the Financial Accounting Standards Board (“FASB” or the “Board”). The Firm not only prepares its own financial statements, but is also a significant user of other entities’ financial statements – through our lending and trading relationships with thousands of corporate clients, and investment and asset management activities. Our comments reflect our views from both perspectives.

We do not support the majority of the proposals in the Exposure Draft, based on their incompatibility with how we manage our business and analyze our performance. We acknowledge that various users of financial statements – analysts, investors, and regulators, to name just a few – often have varied interests and we believe that income statements and balance sheets must be supplemented with appropriate footnote disclosures to meet the variety of objectives that exist. We believe that the most important tools for communication with our investors – the income statement and balance sheet – are most relevant, reliable, and useful if they convey information in a manner consistent with how we manage our business and analyze our own performance. To help you understand our perspective, we have summarized some fundamentals about the banking business and financial risk management. In addition, we present below the effect of the Exposure Draft on our risk management and operations, and on the users of our financial statements who seek to understand our business results.

Trading, Lending, and Investing

At its core, a large diversified bank includes three distinct ways of deploying capital and realizing profits or losses for the firm. Trading activities involve assets and liabilities that are purchased, sold and risk-managed on a fair value basis, and may result in the realization of gains or losses in a very short period of time. Lending activities involve assets held for a longer period

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of time to collect contractual cash flows and earn a yield over time. Investing activities involve assets that are generally held for longer periods of time, but that may need to be sold prior to maturity (thus realizing economic gains or losses) to support the firm's risk management and investment objectives.

A thorough understanding of the nature and risk management of these activities is critical to determining how such activities should be reflected in financial statements.

The Trading Portfolio

The purpose of our sales and trading business is to support our clients who wish to buy or sell securities or other financial instruments, and in so doing, to earn a profit margin on the price at which we buy and sell the positions. In our trading business, we provide research expertise, advice and execution capabilities to over 16,000 clients who range from state and municipal pension plans to corporations and governments. Experienced specialists are prepared to buy or sell large amounts of stocks and bonds, foreign currencies or commodities for clients and to give them immediate cash or liquidity when they need it. We execute approximately 2 million trades and buy and sell close to \$2.5 trillion of cash and securities each day. On an average day, we own, for our account, approximately \$440 billion in securities – we view this portfolio of securities to be akin to the inventory of a retailer. We hold the securities so that we can quickly meet the demands of clients who wish to purchase them. Our derivatives portfolios are similarly positioned in order to be able to meet client demand for financial instruments that will help them manage and hedge their financial risks.

Although we run our sales and trading business to support clients, it is a risky business. Due to the volumes of client transactions and inventories discussed above, and due to market movements, the financial risks in our trading portfolio can change quickly. Therefore, securities and derivatives are bought and sold both in response to client demand, and also in order to keep risks levels within acceptable ranges. Because trading positions are often sold or economically offset in the short-term, the price at which they can be sold or hedged in current markets is an important factor in the profitability and risk of the trading portfolios. As a result, our traders and risk managers focus on the fair value of the portfolio as a key measure of risk and as the key measure of business performance. The results of a trading portfolio are also presented on a fair value basis in the internal financial statements and other reports presented to senior management.

The Lending Portfolio

The purpose of our lending activity is to provide competitive sources of funding to meet the financing needs of our customers, and in so doing, to earn a profit on the fees and rates charged to those customers, net of any credit losses and funding costs. Our primary loan portfolios are not held as inventory to be sold to satisfy client demand as in our trading books, but instead are held to earn a return on the initial outlay of cash through the return of principal plus interest over the life of the loan. As of June 30, 2010, we had over \$700 billion in loans outstanding to consumers, corporations, small businesses, municipalities, and not-for-profit organizations. Our lending decisions are based on our assessment of the ability of the corporate or individual borrower (including collateral) to generate sufficient future cash flows to meet their loan payment obligations over time.

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Because the vast majority of the loans in our primary lending portfolios will be held for collection rather than sold, their current fair values are not the primary measures used for risk management or business performance measurement purposes. This is not the result of an incomplete or flawed risk management framework. Rather, it is a reflection of the fact that, given strong funding and liquidity risk management (discussed further below), a buy and hold strategy will avoid the realization of short-term price risks. Lending assets are managed for the long-term and for the collection of cash flows, and therefore the metrics that we and our investors use to understand risk and business performance reflect that intent. Credit exposure levels, obligor risk ratings and credit scores, net interest margin, nonperforming loan statistics, loan delinquency levels, and net charge-offs are the primary measures used to understand risk and business performance for lending activities. These measures are all based on amortized cost, and would not be easily translated to, or understood if based on, fair value.

The Investment Portfolio

The primary purposes of the investment portfolio are to protect the Firm's net interest margin throughout economic cycles by centrally managing the structural interest rate risk of the Firm (which manifests as changes in net interest margin in future time periods), and to invest excess capital. Structural interest rate risk is created by the assets and liabilities generated by various banking and funding instruments, such as loans, credit card receivables, deposits, and long-term debt. These instruments collectively generate changes in net spreads over time, and therefore net interest margin is a key metric by which performance is evaluated. These assets and liabilities have different maturities, interest rates, prepayment characteristics and other provisions that give rise to certain interest rate risks in each time period over the course of their terms. These net sensitivities to changes in interest rates at each point on the interest rate curve are managed by entering into interest rate sensitive instruments whose interest rate risks are in the opposite direction of the exposures being managed.

As in many banks, our central Treasury function is responsible for managing these aggregate interest rate positions. Unlike credit risk, which generally has fewer natural offsets from other business activities, the interest rate risk of loans, investment securities, demand deposits and long-term debt significantly offset each other, offering considerable risk management and cost-saving advantages to banks with centralized risk management. For the centralized risk management of structural interest rate risk, we purchase highly liquid, high credit-quality interest rate sensitive securities in order to reduce or manage the exposures in each time period along the yield curve. These securities include U.S. Treasury securities, U.S. government agency mortgage-backed securities, other highly rated government-issued and government-guaranteed obligations, and certain other high credit-quality securities. Since the securities manage the net loan, deposit and long-term debt exposures that are held or issued to their maturities in most cases, the securities used for structural interest rate risk management are held for a much longer period of time than in a trading book. However, due to their high liquidity and high credit quality, the securities are able to be quickly sold in response to changes in the structural interest rate risk profile.

A bank's structural interest rate risk profile is not static. Market movements change the interest rate risk of a firm's assets and liabilities in its lending and funding activities, and of the investment securities used to manage the interest rate risk, resulting in changes in the net residual

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structural interest rate risk along the yield curve and thus changes in net interest margin. The net interest rate risks also change in response to business changes, such as significant changes in client demand for our lending products, or changes in customer deposit balances. These changes in the interest rate risk profile, if large enough, could give rise to a need to rebalance the interest rate risk exposure to ensure the exposure is properly managed.

Rebalancing the portfolio to manage these changes in interest rate risk requires the Firm to sell or purchase interest rate sensitive assets. Because the lending and funding activities are managed as long-term assets and liabilities, these rebalancing actions necessarily take place in the investment portfolio – by purchasing or selling interest rate sensitive securities with various coupon rates and maturities. In very stable interest rate and economic environments, such rebalancing may occur infrequently. In other times, very rapid changes in market conditions may necessitate more frequent or more significant rebalancing.

So while the investment portfolio is not managed explicitly to generate profits from the sale of securities, the need to rebalance the portfolio may sometimes result in the realization of gains or losses based on market prices. Since net interest margin, and not realized gains and losses, is the primary measure of performance of the investment portfolio, the impact of securities sales are highlighted in the financial results separately from margin. Analysts can and do ascribe a different multiple to those earnings than to net interest margin or other core earnings.

Risk Management

In credit sensitive financial instruments, such as loans, certain securities and derivatives, there are three components of the financial instrument's fair value: credit risk, interest rate risk, and liquidity risk. Liquidity risk may be used to refer to a variety of risks, but in this context we use the term to refer to the risk of a lack of demand (and a correspondingly lower market price) for a financial instrument we hold, often due to a market-wide need to raise cash.

In the trading portfolio of a typical financial services firm, all three of these risks are managed, since the significant turnover (buying and selling) of many of the portfolio positions makes all three of the risks relevant to the profitability of the portfolio. Credit risk and interest rate risk in trading portfolios are managed together, generally by calculating statistical measures of the potential losses from various market movements, and limiting position sizes to limit those potential losses. Credit risk is further discretely managed by entering into collateral agreements, limiting exposures to any one obligor, diversifying exposures to obligors that would tend to experience difficulty in similar market environments, and by buying credit protection on obligors to provide an offsetting gain in the event of a loss due to a failure to pay. Interest rate risk is further discretely managed within the trading portfolio by buying or selling interest rate sensitive financial instruments to create an interest rate exposure that offsets the exposure being hedged. Liquidity risk is managed by limiting the size of the net risks of the portfolio, for example by hedging the risks of a client transaction by placing an offsetting transaction with a dealer.

In a typical retained loan portfolio, however, only credit risk is managed within the loan portfolio itself. Credit risk in a lending portfolio is managed by creating a portfolio that is diversified by obligor, industry, and geography, by limiting concentrations of similar risks, and by employing strategies such as loan workouts, restructurings, forbearance and other actions intended to

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minimize loss. To the limited extent possible based on the availability of hedging instruments, credit risk in a lending portfolio is also managed by buying credit protection on obligors to provide an offsetting gain in the event of a loss due to a failure to pay. Unlike in the trading portfolio, interest rate risk is not managed in the lending portfolio itself, but typically is managed centrally in the Treasury function along with interest rate risk resulting from other core banking activities such as issuing deposits and long-term debt. Liquidity risk is not managed in a lending portfolio. Because banks hold loans in order to earn a profit by collecting interest and principal payments over time, selling the loans and experiencing exposure to liquidity risk is not expected unless other sources of funding cannot be accessed (see Funding and Liquidity discussion below).

Because the purpose of the investment security portfolio is to manage the interest rate risk of the Firm, that risk is managed in the portfolio. Credit risk and liquidity risk in the investment portfolio are managed by purchasing only high credit quality and highly liquid securities.

Funding and Liquidity

As liquidity risk and the relevance of fair value data for long-term investments is also related to the ability to hold an instrument for the medium or long-term versus the need to sell it in the short-term, it is useful to discuss how the above mentioned financial assets are funded and how liquidity is managed. In the funding context, liquidity refers to the availability of cash or assets that are easily convertible into cash.

The primary sources of liquidity for JPMorgan Chase include a diversified deposit base and access to the long-term debt and equity capital markets. Other sources of funding include a variety of unsecured short- and long-term instruments including federal funds purchased, certificates of deposit, time deposits, bank notes, and commercial paper, as well as secured financing arrangements (including repurchase and securities lending transactions). Generating funding from a broad range of sources in a variety of geographic locations enhances financial flexibility and limits dependence on any one source. Similar to other firms, proceeds from our deposits and capital markets issuances are distributed to the segments for investment via the central Treasury function. As cash proceeds from the various unsecured funding sources are fungible, the funding instruments and the financial asset investments are not linked in any way.

Our Firm's funding strategy is intended to ensure liquidity and diversity of funding sources to meet actual and contingent liabilities during both normal and stress periods. Said another way, our strategy is intended to ensure that the Firm has sufficient liquidity at all times so that long-term investments can continue to be held according to their economic merits, rather than sold in distressed markets in order to generate liquidity. Consistent with this strategy, JPMorgan Chase maintains large pools of highly liquid unencumbered assets and significant sources of secured funding, and monitors its capacity in the secured and unsecured funding markets across various geographic regions, currencies and in various stress scenarios in which access to certain funding is severely limited or nonexistent. Throughout the recent financial crisis, the Firm successfully raised both secured and unsecured funding, and maintained its strategy to hold long-term investments for collection of principal and interest.

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The Exposure Draft

With an understanding of the above fundamentals, it becomes more apparent as to why the Exposure Draft is not aligned with core banking activities and would not easily facilitate an understanding of the current performance of a bank.

The Exposure Draft is unduly biased toward fair value

As described above, similar assets (and indeed sometimes the exact same assets) are used in completely different ways, resulting in very different business performance profiles for different banking activities. In our view, fair value is the appropriate primary measure for financial instruments that are held for sale in the short-term or otherwise managed on a fair value basis, such as securities and derivatives in the trading portfolio and securities in the investment portfolio that the Firm has the current intent to sell. In the extreme, if a business enterprise were intended to be liquidated entirely, then valuing the entire balance sheet to arrive at a liquidation value would be appropriate – those values would reflect the gains or losses that are subject to being realized by the business and its investors. But for a going concern, our view is that accounting should reflect how the assets and liabilities will be used to generate cash flows for the business and its investors. We do not understand why the Exposure Draft’s default is for financial instruments to be measured at fair value, and for changes in those fair values to impact earnings or capital immediately, regardless of whether changes in fair value will affect the amount of cash flows ultimately realized, particularly given the lack of user consensus preferring such measurement. We believe that using fair value as the primary measure for loans, deposits and long-term debt will cause our financial statements to cease to provide the same level of insight regarding our business performance and how well we are doing at managing the risk of our activities. In a project intended to simplify the communication between preparers and users of their financial statements, we do not believe that the end result should be further complication of the information used to measure business performance.

There are several reasons why we do not think fair value should be given such prominence in the core financial statements. First, fair value incorporates information – such as the opportunity cost of not issuing the loan at today’s interest rates, the liquidity of the overall market, and the different hurdle rates of return demanded by various parties (banks, hedge funds, etc.) —that is not directly relevant to managing the lending portfolio or to understanding its performance. Lenders, as well as financial statement users, focus on analyzing future cash flows as the foundation for credit analysis used to manage and monitor the lending portfolio. While fair value estimates may be useful as an additional data point, such fair value estimates are rarely used in fundamental risk analysis of lending activities. Instead, credit statistics – determined on an amortized cost basis - are the most useful indicators of business performance in the loan portfolio.

Second, expanding the use of fair value does not just affect financial reporting, it could impact risk and capital management. While the Exposure Draft does not seem to define a principle or characteristics for items qualifying for inclusion in the Accumulated Other Comprehensive Income (“AOCI”), preparers vigilantly monitor their capital, and therefore have to be concerned with what finds its way into AOCI. For example, we note that under the proposed Basel III framework, unrealized gains and losses in AOCI are included in Tier 1 Capital. While the

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current economic analysis by banks for entering into long-term lending arrangements is based on the borrower's ability to pay, the amount of unrealized losses in AOCI between the time of funding and ultimate repayment may begin to be a consideration for some banks in deciding whether to remain active in certain products or markets if the Exposure Draft is issued as final. While we understand that that regulators can compel preparers to provide reporting on the regulator's own basis and for their own purposes, we do not believe that the public policy and risk management impacts of accounting changes should be overlooked.

Third, most loans are not actively sold and there are relatively few public transactions that offer management or investors the opportunity to observe current market prices. While we have heard some assert that fair value accounting would provide comparable and consistent information across financial institutions, we respectfully disagree. Estimating the fair value of the loan portfolio is one of the most subjective assessments business managers are required to make. Due to the lack of active secondary markets from which to derive current values, the fair values of loans are typically estimated using a discounted cash flow model that incorporates inputs that rely significantly on internally generated estimates and assumptions. For example, even for the large corporate loan portfolio, only a small portion of the funded loans can be benchmarked (with meaningful adjustments) to either market prices or credit default swap spreads. For other loan portfolios including loans to middle market companies, small businesses, and consumers (other than conforming prime mortgages), and for unfunded commercial loan commitments there is no active secondary market. We do not believe that the core financial statements should incorporate such judgmental assessments when those estimates of fair value will not be the basis upon which cash flows are ultimately realized.

Finally, while the Exposure Draft assumes that the risks of financial instruments (credit, interest rate, and liquidity) are best communicated through a single fair value measure, we believe that informative disclosures are a more transparent and efficient way to communicate those risks. For example, we believe that the credit risks inherent in our lending portfolio are best understood through disclosures about the types of loans we have made, the types of borrowers to whom we have extended loans, how those borrowers are performing, and our expectations about losses. For interest rate and liquidity risk of assets and liabilities intended to be held to maturity, a fair value measurement at a point in time provides little meaningful information. Instead, footnote disclosures and management's discussion and analysis should communicate clearly how a firm measures, manages, and monitors such exposures.

The Exposure Draft impairment model ignores the inherent cyclical nature of credit markets

In extending a loan, we are well aware of the cyclical nature of economic activity and credit risk, and their impacts on the assessment of the borrower's ability to pay. Credit losses follow an observable pattern – low levels of credit losses at the peak of economic activity and credit availability, and high levels of credit losses in recessions.

A particular credit cycle may be deeper or shallower, shorter or longer, but the credit cycle within the broader economy has followed the same general pattern for generations. The peaks and troughs, and the loss rate patterns through the cycle are well documented for previous cycles. Depending on where we are in the cycle, the current rate of asset depreciation/appreciation and the level of loan losses and delinquencies, near term loss rates can be estimated by leveraging

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historical loss experience at different points in the credit cycle, analyzing the impact of current characteristics of the pool, and by forecasting certain core economic indicators such as unemployment, GDP or home price appreciation, as applicable. We incorporate these factors, among others, in the normal credit risk management process, in the pricing of new loan originations, and in loan portfolio purchases. In this way, we seek to avoid overpayment or undercompetitive bidding. Because credit cycles are just that, cyclical, it does not make sense that the Exposure Draft seems to require us to assume that the economic conditions existing today will remain unchanged for the remaining lives of the loans. At the extreme, that would mean that we should assume that the good times will last forever when we are at the peak, and that the bad times will last forever when we are at the trough. We would not make these assumptions in originating new loans nor do we believe such assumptions should be included in calculations of loan impairment.

The Exposure Draft makes it harder to understand and compare credit risk

Under current accounting, analysts can easily find our estimates of credit risk. They are in one line on the balance sheet (the allowance for credit losses) and in one line on the income statement (the provision for credit losses). The Exposure Draft splits credit into multiple line items: into the allowance for credit losses, into other fair value adjustments (representing the difference between the allowance and the portion of the fair value related to credit loss) and into the yield, as well as the provision for credit losses. Analysts and other users will not be able to easily put the pieces of these multiple financial statement line items into one credit risk number in order to compare credit risks among peer firms, and therefore will require supplemental disclosure in order to conduct the same analyses currently performed. If supplementary analysis would be required to make the Exposure Draft's proposals useful, we do not understand the purpose of the changes.

The Exposure Draft is not any simpler than today's model – the complexities are just different

As much as the Exposure Draft requires wholesale changes to the accounting model, it retains much of the current complexity, or adds new and different complexities. It appears to retain three different loan impairment models (for pools, individual loans and purchased loans). The proposal adds an arbitrary bright line to allow amortized cost treatment for certain issuers' own debt liabilities. It adds a new calculation for core deposits that is neither a contractual amount nor a fair value. The Exposure Draft broadly requires fair value for financial assets, but does not allow the forecasts used in a fair value calculation to be used in the calculation of credit impairment. We do not believe that the net result produces a decrease in complexity that would warrant the high cost of implementation.

The Exposure Draft creates significant operational issues

The accounting systems currently used by most companies do not support the frequency of fair value measurements that would be required as a result of the Exposure Draft. While public companies currently provide fair value information for all financial instruments on a quarterly basis, if fair value were to become the primary measure for financial instruments, system enhancements naturally would be required to provide such information on a more frequent basis for capital management and planning purposes. In addition, the proposal to link interest income recognition directly to measures of credit impairment would require significant changes to loan accounting and credit systems. The significance of the transformations of existing accounting

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and credit risk management systems that would be required to implement the Exposure Draft should not be underestimated.

The Exposure Draft does not move us closer to one international accounting framework

The differences between this proposal and IASB's model are significant. We urge the FASB and IASB to issue a truly joint standard that would eliminate duplicative costs for subsidiary financial statements prepared under different GAAP regimes, reduce implementation costs, and produce consistent financial reporting information for users in the short-term.

A true cost benefit analysis has not been performed

Both change and complexity are expensive to implement. Neither change nor complexity is any easier for big companies to implement than for small companies. While we agree with the Board's assertion that any cost benefit analysis is unavoidably more qualitative than quantitative, that does not mean that some reasonable efforts to quantify the costs should not be made. In our view, such costs will be significant and must be weighed against the usefulness of the proposed changes to investors. We do not believe that there is clear and consistent support from users of financial statements for the type and magnitude of changes proposed in the Exposure Draft.

The Purpose of the Balance Sheet

While we do not support the Exposure Draft as written, we do support the FASB's efforts to simplify the accounting model, and believe that such simplification can occur in the short-term. However, in our view, the development of any accounting overhaul for financial instruments must be made in the context of a common understanding of the purpose of the balance sheet. For example, is the purpose of the balance sheet to represent a liquidation value or franchise value, or is it intended to represent the best estimate of ongoing cash flows to be collected as a going concern? Without addressing this conceptual question, we do not believe that such an overhaul attempt will be successful.

We believe that the balance sheet should represent the best estimate of ongoing cash flows to be collected as a going concern, and believe that the Exposure Draft does a much poorer job of that representation than does current US GAAP with an enhanced impairment model. If the FASB's purpose for the balance sheet is to represent a liquidation value, such a purpose would require the fair valuation of the entire balance sheet, including the fixed assets, and premises and equipment for which we have no less intention of holding for the long-term than we have for our loan portfolio. From the mix of cost, fair value, and new remeasurement calculations, and from the arbitrary thresholds for what can be recognized in OCI or carried at amortized cost, we cannot discern the FASB's intended purpose for the balance sheet from the Exposure Draft.

Further, we also cannot discern the FASB's purpose for AOCI within the balance sheet. Is AOCI supposed to be the temporary holding place for items that are never expected to be realized, such as cash flow underhedge income and changes in fair value of held-for-investment loans unrelated to credit impairment, or is there a different purpose for this portion of the balance sheet? In our view, the purpose for the balance sheet generally and for AOCI specifically must be first clarified and then consistently applied in any new model.

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For those who believe fair value information is broadly useful, the current SFAS 107 disclosures provide a framework upon which to build disclosure enhancements. Enhancing disclosure is a much simpler way of meeting the preferences of certain users than by upending the balance sheet. We are supportive of full and comprehensive disclosures that are developed holistically and not on a piecemeal basis to meet the needs of bank analysts, regulators, investors and our other primary stakeholders. We are puzzled by the view that a valid solution to the perceived need to speed up the availability of disclosures is to put them all on the face of the balance sheet. Instead, we believe that issues regarding the timing of disclosures of financial information should be addressed directly and separately from decisions regarding what information most clearly communicates the best estimate of ongoing cash flows to be collected.

User Views

We express these views not only as a preparer, but also as a user of financial statements. We hold approximately \$200 billion of wholesale loans as long-term investments in our lending businesses, and we supervise \$1.7 trillion of assets in our asset management business. As part of extending credit to our wholesale customers and advising clients on investment strategies, we evaluate the financial statements of other companies in the same way that our investors analyze ours. The effective communication of financial information through the core financial statements and footnote disclosures is critical to the process of making effective lending and investing decisions. As a preparer and a user, the feedback we hear from those who cover us and from our internal analysts who cover banking and non-banking clients differs dramatically from the user feedback upon which the Exposure Draft is based.

Based on the feedback we have received, much of the dissatisfaction with current accounting standards relates to dissatisfaction with the impairment models and not with amortized cost itself. Such criticism focuses on: (1) narrow interpretations of existing guidance may result in expected losses not being reported in earnings until too late in the life of the loan, and (2) the perception that the model for purchased credit impaired loans is too confusing. In addition, some of the focus on fair value seems to arise from a dissatisfaction with the transparency and granularity of certain risk disclosures rather than the amortized cost measurement model itself. If the limitations of the current impairment model were addressed to consistently allow the reflection of expected credit losses earlier in the credit cycle, and if best-in-class disclosures providing granular risk transparency were more broadly available across all preparers, we believe that some of the focus on fair value would dissipate.

A Truly Simplified Accounting Model

We believe that the complexities and shortcomings of the current accounting model for financial instruments can be addressed through a few modest, but important, changes to the current accounting model. These changes include: a) a simplified classification model of only three categories of financial instruments, determined by the primary business activity employing the asset or liability; b) a single impairment model for all originated and purchased loans and securities that considers losses expected to be realized within a reliable forecasting period; c) a robust disclosure framework regarding the credit, interest rate and liquidity risks associated with

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financial instruments; and d) a simplified hedge accounting framework aligned with common risk management practices.

The simplified accounting model we support includes only three categories – consistently applied – for all financial instruments. The primary business activity employing the asset or liability would be the primary determinant of the accounting treatment, with secondary consideration given to the characteristics of certain instruments, specifically whether those instruments (e.g. derivatives) exhibit such cash flow variability that they should be reported at fair value, regardless of the entity’s business model. Under our proposal:

- Financial instruments (i) whose cash flows are primarily realized through the sale of the instruments or (ii) managed on a fair value basis, should be accounted for at fair value through income. Therefore, trading portfolios would be carried at fair value.
- Financial instruments (i) whose cash flows are primarily realized through the collection or payment of interest and principal and (ii) not managed on a fair value basis, should be accounted for at amortized cost (and subject to a robust impairment model). As a result of this model, traditional loans and long-term debt would be held at amortized cost.
- Financial instruments (i) whose cash flows are primarily realized through the collection of interest and principal but (ii) for which some level of sales are anticipated in response to major changes in market or business risks, would be classified as “available for sale” under the current available for sale framework, including the robust impairment and disclosure improvements put in place as a result of the credit crisis.
- All instruments that meet the existing definition of a derivative would be carried at fair value through income, unless they are designated as part of a qualifying hedge accounting relationship. (To the extent that a financial instrument includes a feature that meets the existing definition of an embedded derivative, that feature would be bifurcated unless the fair value option is elected for the instrument in its entirety.)
- Hedge accounting would be simplified and aligned with actual risk management practices, allowing qualification for reasonably effective hedges, dedesignation, and calculation of changes in the hedged item solely for the risk being hedged.
- If the fair value option is elected, robust disclosure of the elections made, the rationale for those elections and their effect on earnings would be required. Such disclosures would provide transparency to users of financial statements regarding the use of the fair value option and eliminate the need to develop additional “rules” as to when fair value elections may be made.
- With the business model as a primary determinant for the accounting for financial instruments, reclassification to a different accounting category would be required if the business model changes. We believe that the linkage to business model rather than management intent with respect to a specific financial instrument would result in such

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reclassifications occurring rarely in practice. Transparent disclosure of changes in the business model and the effect of reclassification would enable users to understand the business strategy and better predict future cash flows.

- For all assets classified as amortized cost or available for sale, a single impairment model would apply. We believe that the characteristics of the impairment model are perhaps the most important improvements that the Board can make in this project, and may obviate the perceived desire for other changes to the measurement of financial instruments. We agree with the FASB that the losses that are expected to occur should not face a high hurdle for recognition in the financial results. We also agree that losses expected to be realized in time periods beyond the immediate future should be recognized to the extent that the data supporting the measurement of those losses is reliable. We believe that these two changes will provide the greatest increase in investor confidence in the reported results of financial services activities. The remainder of our impairment model enhancements are designed to simplify the accounting and reporting and improve the understanding of financial asset impairment. Under our proposed impairment model:
 - The amount of expected losses would be recognized as an allowance for credit loss on the balance sheet and as a provision for credit loss on the income statement.
 - Losses need not be probable to be recognized, just expected.
 - Losses would be calculated directly, not as a derivative of the change in expected future cash flows.
 - Losses would be estimated over a reasonable future period determined considering the availability and reliability of data to support credit loss estimates. The time periods used for major asset classes would be disclosed.
 - Loss estimates would consider future changes in macroeconomic conditions, including, first and foremost, the estimated point in time position in the credit cycle.
 - Changes in the estimates of expected losses would result in further provisions or recoveries. Under a single impairment model, AFS securities as well as loans could have recoveries.
 - Estimates of credit loss for performing loans would be calculated and disclosed separately from credit loss estimates for nonperforming or impaired loans. The loss estimates for performing loans would consider principal losses, as the lender remains focused on earning a return and interest income is recognized separately. The loss estimates for nonperforming loans would consider all contractual cash flows, as the lender is generally focused on recovering the remaining investment through the receipt of any available cash flow.
 - Estimates of credit loss would generally remain separate from the calculation and recognition of interest income and be reported separately from the components of net interest margin.

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- Impairment for a financial instrument asset that management intends to sell would be based on fair value, reflecting the cash flows that are expected to be collected upon the sale of the financial instrument asset.
- Financial instruments purchased at a discount related to credit quality would be initially measured on the balance sheet at the face amount less an allowance for credit losses, along with any remaining purchase price discount or premium, and subsequently should be subject to the single impairment model described above. The accounting for purchased and originated financial instruments would be the same, allowing for the easier understanding and aggregation of credit statistics across portfolios.
- Interest accruals would continue to be based on the effective interest rate applied to the amortized cost without consideration of the allowance. If interest payments are not expected to be received, interest income should cease to be accrued.
- The critical risks in financial instruments – credit risk, interest rate risk, and liquidity risk – would be subject to robust disclosures developed in a comprehensive disclosure framework project. Such disclosures would consider information that is important to a financial statement user’s understanding of the risks and uncertainties inherent in the portfolio and how those risks are managed. The Board and securities regulators would coordinate the disclosure framework to ensure a consistent and complete set of disclosures.

Our approach recognizes that there is much about the current accounting framework that works, that users rely upon, and that is worth keeping. The above approach keeps the benefits of the current model in place while significantly simplifying the number of classification, measurement and impairment models, and thereby simplifying the core financial statements and the accompanying disclosures.

We appreciate the opportunity to submit our views and would be pleased to discuss our comments, including further details of our proposed model, with you at your convenience. We have provided more detailed comments on the Exposure Draft in Appendix A. If you have any questions, please contact me at 212.270.3632, Shannon Warren at 212.270.1530, or Bret Dooley at 212.648.0404.

Sincerely yours,



Louis Rauchenberger

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The below comments provide further detailed comments on the Exposure Draft. The comments follow the order of the Exposure Draft to facilitate your review.

It should be noted that it will only be possible to assess the effect of some of the proposed changes in the Exposure Draft after a thorough review of the related amendments to the Accounting Standards Codification, which have yet to be released by the FASB. Therefore it has not been possible to perform that critical review. As the requirements of the Exposure Draft may vary according to the precise wording of those related amendments this may render some of our comments more or less relevant, and we may seek to provide additional comments after we have completed our review.

Scope

- Paragraph 4k: We agree that commitments related to a revolving line of credit issued under a credit card agreement should not be measured at fair value as these commitments are not legally binding and do not meet the definition of a loan commitment as proposed in paragraph 8 of the ED. Because these commitments do not meet the definition of a loan commitment, we don't believe a scope exception is necessary. However, if the Board retains the scope exception, it should include all other agreements that are similarly not legally binding in that exception.

Glossary

- Paragraph 8: We believe that loan origination costs should be limited to third party direct expenses and should not include indirect internal expenses that are not directly linked to the origination of a particular loan. In our view, the definition of direct loan origination costs should be modified and made simpler to converge with current IAS 39 guidance, which states "*Transaction costs* are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument." AG 13 of IAS 39 also states, "Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs." We believe that the IASB definition simplifies the accounting, and encourage the FASB to converge to the IAS 39 guidance.
- Paragraph 8 changes the definition of a "collateral-dependent financial asset" from that for which repayment is expected "solely" from operation or sale of the collateral to one in which repayment is expected "primarily or substantially" through such operation or sale. We believe this change adds complexity through new concepts that will require interpretation (for example, to situations in which the borrower is still expected to pay for some period of time, although eventual default is considered likely). Therefore, we recommend that the definition of "collateral-dependent financial asset" be changed to "a financial asset for which the borrower is expected to default in the short-term, and therefore, repayment is expected to be provided principally through the operation or sale of the collateral."

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Initial Measurement

While we appreciate the ED's acknowledgment of the frequent lack of observable or reliable information regarding market prices, and the existence of multiple markets in which transactions could occur, we believe that the initial measurement provisions and analysis introduced in paragraphs 12b, 16 and 17 overcomplicate matters that raise no significant issues in current practice. We support the conclusions reached in Examples 1 - 3 addressed in paragraphs IG 13-19, but we believe such conclusions are more clearly addressed in current accounting standards, including ASC 835-30-25 and ASC 605-25. In circumstances that do not represent multiple element arrangements, we believe that a financial instrument should be initially measured at the transaction price, consistent with current practice.

If the Board does include paragraphs 14-17, we believe the Board should consider the following:

- Paragraph 12b simply states that a financial instrument should be recorded at transaction price. The reference in paragraph 12b to paragraphs 14-17 does not indicate that an initial measurement at a price other than transaction price is possible. We believe the caveats described in paragraph 14 should be added to paragraph 12b to clarify when a financial instrument should be recorded at transaction price versus fair value.
- The initial sentence in paragraph 17 is confusing, as it does not reference the two requirements in paragraph 14 needed to record a financial instrument at a price other than transaction price. The Board should clarify that the guidance in paragraph 17 applies only when both: (1) reliable evidence exists that the transaction price differs significant from fair value and (2) the difference is due to the existence of other elements in the transaction.
- Paragraph 17 states "If the difference between the transaction price and fair value is not attributable to either of the factors in the preceding paragraph, and an entity cannot identify another element in the transaction or cannot determine the value of the other elements or elements in the transaction, the entire difference between the transaction price of the financial instrument and the fair value shall be recognized in net income in the period of acquisition or incurrence." If another element in the transaction cannot be identified, we do not believe the circumstance would meet the requirement in paragraph 14 (that the difference between transaction price and fair value is due to another element in the transaction) and therefore the transaction price should be used. Further, if another element is identified, but its value cannot be determined, then we do not understand how it can be asserted that there was reliable evidence that a difference between fair value and the transaction price exists, or the amount of that difference. We recommend that paragraph 17 simply state that in cases in which there is no reliable evidence of a difference between the transaction price and the fair value or no other element in the transaction, that the financial instrument is recorded at the transaction price.

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Initial Measurement - Accounting for Fees & Costs

- BC 52: We agree with the Board in its statement “...that the fees and costs relating to a loan origination are integral to the lending transaction and, therefore, should be recognized over the life of a loan...The Board believes that deferring these fees and costs and recognizing them in this manner would preserve net interest margin for those financial instruments in a manner that is consistent with existing accounting standards.” We agree that net interest margin under current US GAAP should be preserved, as it is a key metric that users of our financial statements consider in evaluating our performance. However, because the proposed changes to the interest income recognition model commingle the recognition of credit impairment and interest income, net interest margin under the proposed model is so fundamentally altered (regardless of the treatment of loan fees and costs) that its usefulness is diminished significantly. We are not suggesting that the Board should change the existing guidance as currently proposed in paragraph 13. Instead, we are pointing out the inconsistency in supporting the usefulness of net interest margin as a concept, and also drastically changing its composition. We recommend that loans held for investment continue to be recognized on an amortized cost basis with the goal of preserving net interest margin as an evaluation metric that is important to financial statement users.
- Currently under the guidance in Topic 946, an investment company is permitted to record its investment at the transaction price. The ED changes current practice and will require investments to be recorded at fair value. This proposal affects the accounting for costs incurred to acquire the investments; specifically, it will change the income statement classification of costs incurred. Instead of reflecting incurred costs as part of the basis of the cost of the investment as required by Section 946-320-40, they will be recognized as a direct expense. Most investment funds have expense ratio requirements that will need to be changed if this proposed guidance is finalized. We recommend the Board consider this significant impact and the time required to change the fund documents in order not to disrupt the ability of these funds to raise capital and make future investments.

Subsequent Measurement Principle

As discussed in the main body of our response, we believe that a measurement model whose default is fair value to be flawed. In our view, fair value is the appropriate primary measure for financial instruments that are held for sale in the short-term, such as securities in the investment portfolio that the Firm has the current intent to sell, or otherwise managed on a fair value basis, such as securities and derivatives in the trading portfolio. In the extreme, if a business enterprise were intended to be liquidated entirely, then valuing the entire balance sheet to arrive at a liquidation value would also be appropriate; those values would reflect the gains or losses that are subject to being realized by the business and its investors. But for a going concern, our view is that the accounting should reflect how the assets and liabilities will be used to generate cash flows for the business and its investors. Since the Exposure Draft’s default is for financial instruments to be measured at fair value, and for changes in those fair values to

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impact earnings or capital immediately, regardless of whether changes in fair value will affect the amount of the cash flows when they will ultimately be realized, our core financial statements will no longer provide the same level of insight regarding our business performance and how well we are doing at managing the risk of our activities.

Recognizing a Change in Fair Value in Other Comprehensive Income

The business strategy criteria for Fair Value in Other Comprehensive Income (“FV OCI”) measurement do not fully contemplate the realities of corporate risk management. Standard risk management activities may require intermittent sales of investment securities in response to market events that occur within the context of a long-term investment strategy. Although the guidance does permit “occasional sale or settlement” in describing what might be an acceptable level of sales or settlements, as well as “a large number of sales or settlements” in describing what might not be acceptable for FV OCI classification, we believe the focus on the level of sales or settlements (“portfolio turnover”) to be a fundamental flaw of the model. In practice, a business strategy refers to a long-term plan of action designed to achieve a particular set of goals or objectives. The level of portfolio turnover is not the goal or objective; it is the byproduct of the objective to manage a specified risk, such as a bank’s structural interest rate risk of loans, deposits, long-term debt and other long-duration financial instruments. The byproduct of the business strategy (i.e. portfolio turnover) should not define the business strategy for accounting purposes.

As discussed in the main body of our response, a bank’s structural interest rate risk profile is not static. Market movements and business changes, if large enough, could give rise to a need to rebalance the interest rate risk exposure of the bank to ensure the exposure is properly managed.

Rebalancing the interest rate exposure requires the Firm to sell or purchase interest rate sensitive assets. In very stable interest rate and economic environments, such rebalancing may occur infrequently. In other times, very rapid changes in market conditions may necessitate more frequent or more significant rebalancing. The strict portfolio turnover guidance in the Exposure Draft does not accommodate this risk management reality.

Additionally, the proposed guidance gives equal weight to both the business strategy and the cash flow characteristics of the financial instrument. We believe that the model should instead focus principally on the business strategy, with secondary consideration given to the characteristics of certain instruments, specifically whether those instruments (e.g. derivatives) exhibit such cash flow variability that they should be reported at fair value, notwithstanding the entity’s business model. We note that once a business strategy to collect/pay related contractual cash flows rather than sell the financial asset or settle the financial liability is established, the execution of the strategy can take many forms. Requiring certain characteristics of the debt instrument held is unnecessarily restrictive and may inhibit further the business strategy.

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Subsequent Measurement -Loan Commitments & Standby LOCs

Similar to loans, we do not believe that fair value is the appropriate model for loan commitments that, when drawn, would result in loans that will be held for the collection of principal and interest. We question the usefulness of recording loan commitments on the face of the balance sheet at fair value when experience suggests that only a proportion of the commitments will be drawn.

- Paragraph IG 95: The example implies that the recognition of interest should occur on a cash basis. This example also implies that the interest received is not classified as part of interest income, but is classified in “net income.” We recommend that the example in paragraph IG 95 be modified to demonstrate the accrual of interest, and its classification in interest income for a loan that is measured at fair value through net income (“FV NI”).
- Paragraph IG 104: The example also implies that the recognition of interest should occur on a cash basis. The example should be modified to clarify that interest should be accrued.
- Paragraphs IG 98-101: The example should be clarified as to the manner in which the commitment fee is recognized (i.e. deferred until exercise date or recognized over the life of the commitment).

Subsequent Measurement -Application to Specialized Industries

Paragraph 26b requires investment companies to measure their financial assets and liabilities at fair value and include all changes in their fair value in the net increase (decrease) in net assets for the period. For all financial liabilities of investment companies, neither the option to report changes in FV OCI nor the amortized cost option is available. We believe that the FASB’s proposal results in a reporting entity value that would only be appropriate for investment companies if the entire entity could be sold or merged into another reporting entity. However, investment companies are not generally available for sale or merger into another investment company. Therefore, unless an investment company intends to or is required to settle a liability, we do not believe that fair value of the financial liability is relevant for equity investors. With the exception of derivative and trading liabilities which should continue to be accounted at FV NI consistent with current guidance under Topic 946, we believe that amortized cost is a more relevant measure for financial liabilities of investment companies. Further, the net asset value (“NAV”) of an investment company is currently calculated using amortized cost for financial liabilities. We do not believe that investors would agree to purchase or redeem investment company shares at a value calculated on a different basis, and therefore question why this information would be useful to fund investors or other financial statement users.

The Exposure Draft is also unclear regarding whether Investment Companies as defined in Topic 946 would be required to apply equity method accounting to investments in related investees in which they have a significant influence. The wording of paragraph

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26b relates only to the application of paragraphs 12-17 and 19-25 of the Exposure Draft; there is no similar guidance or "scope out" related to the equity method accounting requirements set out in paragraph 130. In addition, Appendix C notes that Codification Subtopic 946-323 will be amended to reflect the proposed changes to Subtopic 323-10, i.e. to reflect the requirements of paragraph 130 of the ED. From the discussions related to the project "Consolidation: Policy and Procedures—Joint Project of the IASB and FASB (Investment Companies)", we do not believe that it is the Board's intention to require Investment Companies to apply equity method accounting to any of their investments, and so the wording of the related amendments to Subtopic 946-323 should address this issue.

Subsequent Measurement - Qualifying financial liabilities

We do not agree with the creation of new and arbitrary criteria to qualify for the exception to measure a reporting entity's own debt at amortized cost. The selection of a 50% threshold has no reasonable basis, and the threshold itself will cause confusion, as changes in the ratio of fair value and non-fair value assets could change the measurement basis for the new liabilities of certain entities from period to period. In addition, the exception may be available to certain members of an industry group, but not available to others that are considered comparable.

We believe that amortized cost is the most relevant measurement attribute for long-term debt and other liabilities that are not derivatives or otherwise held for trading purposes. It is our experience that users of our financial statements are most interested in the ultimate amount that will be paid to settle the liability, which for almost every non-derivative/non-trading liability, is the principal amount. Fair value measurement of these liabilities represents a purely hypothetical measure, which should not serve as the primary measure, regardless of whether changes in fair value are recognized in OCI or net income. We believe that the amortized cost model has worked well for users, preparers and regulators, and we are not persuaded that a compelling reason to propose a change exists. Further, the model exacerbates the current complexities introduced by including own credit in the fair value of liabilities. Analysts tell us that they remove the own credit adjustment for non-derivative liabilities from our income statement when evaluating our results. We do not believe that changes in fair value due to own credit risk should be included in earnings or capital unless a market participant would factor it in and it is realizable, and do not believe that fair value for liabilities should be expanded without first addressing whether own credit information is a useful or relevant component of the measurement model.

Subsequent Measurement - Demand Deposit LiabilitiesOverview

We generally agree with the ED that the measurement attributes for core banking and funding instruments such as loans, demand deposits and long-term debt cannot be considered individually in isolation and understand why the Board proposed a model for core deposits that is intended to reflect changes in interest rate risk for deposits in a way that would be meaningful (assuming that other instruments including loans would be

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measured at fair value). However, as stated in the main body of our response, we do not support a fair value model for instruments that are held/issued for the collection/payment of interest and principal. Such instruments, including held for investment loans and demand deposits, are managed and reported primarily using a net interest margin measure. Bank analysts and investors find this measure and the others that complement it (which are also based on amortized cost), to be the most useful measures of our performance. Therefore, since we believe that amortized cost is the most relevant measurement attribute for all of those instruments collectively, we do not support any changes to the current amortized cost accounting model for demand deposit liabilities.

In addition, there are several reasons why we do not support the proposal for the new remeasurement calculation for core demand deposits. First, the conceptual basis for the calculation is unclear. While we do not believe that the Board's intent is to reflect an originated intangible on the balance sheet, the similarities in the proposed calculation and the value of a purchased core deposit intangible asset confuse this point, and may result in a double count of a purchased core deposit intangible asset on the balance sheet. The issue of whether a double count exists or does not exist should be addressed, including whether the balance sheet amount is presented net of any purchased intangible, and whether the amount that is posted to OCI is calculated net of any purchased intangible. Second, we believe the calculation reduces transparency and comparability due to the use of entity specific assumptions. Further, since the calculation requires entities to consider a blended alternative cost of funds rate if one source of funding alone is not sufficient in volume, we believe that such a rate is purely hypothetical for an institution like JPMorgan Chase with approximately \$1 trillion in deposits, several hundred billion of which might meet the Board's definition of core. Finally, in consideration of all of the above, we believe that the calculation increases complexity (by introducing a new accounting measurement) in a project that is intended to do just the opposite.

Since remeasurement adjustments for portfolios of both loans and demand deposits could only be effectively realized in a transaction that transfers those portfolios to a third party, such as in a business combination, we do not see the usefulness of basing the remeasurement for either loans or deposits on transactions that are not intended to occur in the normal course of business.

Subsequent Measurement - Short-term receivables and payables

While we appreciate the need for a scope exception for short-term receivables and payables, we cannot resolve the inherent inconsistency of not including all short-term lending arrangements in the scope exception. There are no substantive differences between short-term receivables and short-term lending arrangements, as the intent and result of each is to provide short-term financing. If the intent is to provide an exception based on the low likelihood of a difference between amortized cost and fair value for short-term instruments, and to alleviate the burden to require a fair value measurement for these financial instruments, then the scope exception should be broadened to encompass all short-term financial instruments that are intended to be held for the collection of principal and interest.

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We note that financial institutions do have short-term receivables, representing fee income for advisory and other services we provide. The receivables arise in the normal course of business and are due within short-term periods. We expect that these short-term receivables will be afforded the same scope exception as other short-term receivables.

We also note that paragraph 33 requires that short-term receivables and payables meet the debt instrument criteria in paragraph 21 of the Exposure Draft. However, most short-term receivables and payables resulting from products sold or services rendered do not involve the transfer of any "amount" at inception as required by paragraph 21 (they arise as the result of the product or service provided). This would apparently exclude all such short-term receivables and payables from qualifying for the exception in paragraph 33, which we do not believe that is the Board's intent.

Subsequent Measurement - Investments that can be redeemed for a specified amount

We agree with the proposed guidance in paragraph 34, except that we believe the criteria in 34a - 34d are too limiting and do not capture other instruments that are not held for capital appreciation and are required to be held in order to do business. One example is an investment in an exchange or clearinghouse that is required to be held in order for an institution to execute transactions on such exchange or clearinghouse. Such instruments need not be redeemed only at the amount of the initial investment, but are required to be held in order to conduct the core business activities of a financial institution. We recommend that the guidance be broadened to allow certain instruments to be held at cost when they are required to be held in order to do business.

Credit Impairment of Financial Assets and Interest Income Recognition

Overview

Although there is room for clarification, it appears that the intent of the ED is generally to carry forward and combine: i) the provisions of the former SFAS 5 for loans that have not been individually identified as impaired (including smaller-balance homogeneous loans, other than loans that have been restructured in TDRs); ii) the provisions of the former SFAS 114; and iii) many provisions of the former SOP 03-3, subject to the following fundamental revisions:

1. Eliminate the "probable" threshold for loss recognition;
2. Provide that loss rates applied to financial assets evaluated on a pool basis (e.g., loans for which impairment is currently recognized and measured under the former SFAS 5) must reflect losses expected to emerge over the estimated life of the underlying pool of loans as opposed to the existing incurred loss model;
3. Prescribe which types of forecasted information an entity may or may not use when measuring impairment;
4. Provide new guidance for placing loans on nonaccrual status; and,
5. Require interest income to be measured by applying the effective interest rate to the amortized cost balance net of any allowance for credit losses, rather than to

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simply the amortized cost, which effectively results in a reclassification from interest income to the provision for loan losses.

We support the retention of two separate components of the credit impairment evaluation: one related to loans evaluated on a pool basis, and another related to assets evaluated individually. Assuming that our understanding of the intent of the Board and the provisions of the ED is correct, we also generally support the first two items noted above – the elimination of the “probable” threshold and a lengthening of the loss coverage period (although we do not support a full life of loan loss emergence period for all asset classes because the longer the loss forecasting period, the more uncertainty is introduced to the loss estimation process. Therefore, we support the use of a loss forecasting period that is within a horizon that our loss forecasting process can more accurately predict). We believe that modifying both of these thresholds would reduce the constraints on the ability of entities to recognize expected impairment losses earlier.

Notwithstanding our general support for these two new provisions, we do not support the remaining three proposed changes. We disagree most strongly with the prescriptive guidance on using forecasted information and the new guidance for placing loans on nonaccrual status for different reasons, as discussed below. Regarding the requirement to measure interest income based on the amortized cost balance, net of any allowance for credit losses, we question whether the mechanics of this provision will even operate as the ED suggests. Finally, we suggest that the Board reconsider the benefit of having a distinct accounting model for purchased loans. While the SOP 03-3 model is a theoretically “pure” approach, it has been extremely difficult to operationalize and, based on feedback from the analysts we’ve spoken to regarding SOP 03-03, greatly reduces the understandability of financial statements. The following sections of this Appendix discuss each of these points in more detail.

Prescriptive Guidance on Considering Future Events

Paragraph 42 of the ED addresses whether to consider future events in impairment calculations and states, “In estimating cash flows expected to be collected for its financial assets at each reporting date, an entity shall assume that the economic conditions existing at that point in time would remain unchanged for the remaining life of the financial assets.” We are uncertain about the Board’s intent regarding this guidance, in part because it appears to conflict with other guidance in the ED (for example, the factors listed in paragraph 43 and 44, which in some cases would incorporate fair value and other data that relies on forecasts of future or changing economic conditions). Interpreted literally, we do not believe that the guidance in paragraph 42 is appropriate, nor would it produce an accounting result that makes sense. At the peak of an economic cycle, an entity could be required to assume that the good times would last forever, leading to an inadequate allowance for loan losses. Similarly, near the end of a recession, this same requirement could result in an excessive allowance for loan losses. When originating loans, or when purchasing a portfolio of loans such as in a business combination, lenders do consider the relative severity of the current credit cycle, as well as the point in time within that cycle when determining the initial price willing to be paid to obtain the assets.

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The reporting entity should not be required to ignore economically relevant factors for accounting purposes.

While we agree that in some cases it would be inappropriate to forecast future events (e.g., when there is no historical precedent or other available data that would support the likelihood of the occurrence of the future event), it is equally inappropriate to completely ignore future events that are deemed likely to occur based upon past events and current conditions (e.g., based upon historical data regarding past credit cycles). To the extent that the past informs the future, all of this would be relevant information that should be considered.

There is a significant conceptual disconnect between requiring entities to measure impairment based on the present value of cash flows expected to be collected (noted in paragraph 39) and, at the same time, placing limits on the entities' use of available information in developing their best estimates of expected cash flows (paragraph 42). If entities are not permitted to use all available information to develop best estimates of future cash flows, we believe the cash flows used in the impairment calculations would likely be significantly different than those that the entity actually expects to collect. We believe that financial statement users will find this model difficult to understand, and that the model would be particularly confusing for users when a significant credit-related adjustment is reported in OCI (based on fair value, which incorporates expectations of future economic conditions) but not recognized as impairment (based on forecasts using current economic conditions), or when the opposite situation occurs and a significant impairment charge is recognized in earnings with an offsetting adjustment reported in OCI.

This accounting model could also produce a counter-intuitive result when applied to purchased loans. These loans would be initially recorded at fair value based upon the present value of cash flows expected to be collected (i.e., the entity's best estimate consistent with market participant assumptions, and including entity-specific data). At the end of the first reporting period after the acquisition date, the entity would be required to remeasure the present value of cash flows expected to be collected based upon an entirely different set of assumptions (i.e., disregarding any forecasted or forward-looking information that was inherent in the present value of the cash flows expected to be collected upon initial recognition). Depending on the timing of these events in relation to the economic cycle, this would likely result in either the recognition of an immediate impairment (even if there has been no change in expected cash flows) or a prospective adjustment of the accretable yield. In the latter case (i.e., a situation where the entity expects further economic deterioration), impairment may not be recognized for an extended period of time. This is because future decreases in expected cash flows would simply be recognized over time as reductions of the accretable yield to the extent of the prior increase.

In summary, we believe that the impairment measurement model should be aligned with management's best and most complete expectations. We strongly urge the Board to

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reconsider its guidance on future events and to allow entities to use all available information, including that which other market participants would consider, in measuring credit impairment.

Interest Income Recognition

We do not believe that the current model of interest income recognition is broken or in need of change. While we agree that the impairment model currently used in US GAAP can be improved with certain amendments, we believe that interest income should continue to remain separate from credit impairment. The ED's proposal seems to be trying to address a perception that interest income recognition is too high in early periods, and that subsequent impairments relate to the high yield reflected in the early periods. We disagree that interest income recognition is the issue however, and believe instead that the issue relates to narrow interpretations regarding when estimated credit impairments may be recognized in income. If impairments are recognized on a timely basis (i.e. when they are first expected to occur), we do not understand how interest income could be perceived to be artificially high, as the amounts relating to credit would be transparently presented, and as the amount of credit loss recognized is not offset by any interest income to be received between the impairment date and the expected loss date.

Our objections to the ED's interest income recognition model generally pertain to three fundamental concerns: 1) we do not generally support an accounting model that commingles the reporting of principal credit losses and forgone interest income for many reasons, including that such presentation decreases transparency for users and is inconsistent with the Firm's risk management practices; 2) decoupling interest income recognition from the underlying contractually required interest payments would introduce significant operational complexity and risk in exchange for a questionable level of improvement in financial reporting; and, 3) the proposed requirements for placing loans on nonaccrual status would produce a significant and unnecessary difference between regulatory and GAAP accounting.

The following paragraphs discuss our most significant specific concerns about the two proposed changes to the interest income recognition model noted at the beginning of this section of the Appendix.

Proposed Guidance on Placing a Loan on Nonaccrual Status

We most strongly object to the provision of the ED that precludes placing a loan on nonaccrual status unless the "entity's expectations about cash flows expected to be collected indicate that the overall yield on the financial asset will be negative" (paragraph 82.) Our first concern with this requirement as proposed is that the ED is unclear whether it contemplates total expected cash flows or remaining expected cash flows. In either case, the proposal is problematic for many reasons. First, the accounting for and reporting of nonaccrual loans, which is largely derived from regulatory reporting standards, has also become broadly and deeply ingrained in firms' GAAP financial statements. Nonperforming loan statistics (of which the nonaccrual loan population is a

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key component) are significant and widely-used credit risk metrics for most banks and users of their financial statements, particularly those that are publicly held. From this perspective alone, we encourage the Board to strongly consider whether it should effectively eliminate such an important and pervasive data element that is widely understood and accepted. In addition, if the practice of placing loans on nonaccrual status were to be generally disallowed under GAAP, this would result in a significant difference between regulatory and GAAP accounting —so significant, in fact, that it would likely require financial institutions to maintain two sets of loan accounting records for the high-risk segments of its loan portfolio.

Operationally, it would be very difficult for banks to comply with the proposed nonaccrual provisions, regardless of how the guidance was intended to be applied (i.e., total versus remaining expected cash flows). One consideration relates to how to apply this guidance to loans that are collectively evaluated for impairment (e.g., smaller-balance homogeneous loans that are currently evaluated under the former SFAS 5). Although those loans are individually considered to be performing, an allowance for loan loss is established for the collective pool, and therefore interest income would also need to be evaluated in the same manner – which would seem to result in the pool becoming the unit of account.

It follows that, similar to the treatment under SOP 03-3, an entire pool would then either be performing or nonperforming because the pool itself is the unit of account. Also, because the pools of loans would be open and highly dynamic for credit risk management purposes, it would be very difficult to continually recalculate life-to-date interest collections on these constantly changing pools. The alternative would be to create closed pools but, on a scale such as this, that would be a practical impossibility. While loans with asset-specific reserves would not be subject to this particular operational challenge, financial institutions would still need to significantly revise existing accounting systems and processes to accommodate these changes.

Another consideration is that the proposed nonaccrual requirement would require entities to estimate all future cash flows for loans (i.e., both principal and interest) when there is otherwise no reason to do so for loans that are collectively evaluated for impairment. This statement is predicated on our assumption that it is not the intent of the ED to change the impairment measurement methodology for loans evaluated for impairment under the former SFAS 5. Paragraph BC 189 of the ED seems to support this assumption and states, “The Board recognizes established practice of using a formula approach for estimating losses related to these types of loans [“small-dollar-value homogeneous loans (such as consumer installment loans, residential mortgages, or credit card loans)”] and the proposed guidance would not change that approach.” The proposed nonaccrual requirement (based upon an assessment of remaining cash flow) would therefore be most problematic for all loans that are collectively evaluated for impairment under the provisions of the ED.

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Paragraph BC 203 implies that it is not practical or possible to develop general nonaccrual guidance that fits all situations. We strongly disagree with this statement; there is extensive regulatory guidance on when to place a loan on nonaccrual status. Risk-rated loans are typically placed on nonaccrual when they are classified as doubtful or worse; scored loans are generally considered to be nonaccrual when they are a specified number of days past due. Very few questions arise, either internally or externally, about the proper application of this guidance.

Unless there is a compelling reason to change the long-standing and well-understood nonaccrual loan accounting model—and we are not convinced that there is broad user support for this approach—we urge the Board to preserve the current accounting model, which appropriately distinguishes principal losses and contractual net interest margin on the income statement. If the Board ultimately decides to retain existing nonaccrual accounting practices (i.e., those that are largely governed by regulatory reporting principles), then it should also eliminate the proposed requirement to recognize income on loans that are individually evaluated for impairment. Under existing regulatory guidance, most loans that are individually evaluated for impairment must be maintained on nonaccrual status (with the exception of performing troubled debt restructurings).

Measuring Interest Income by Applying the Effective Interest Rate to Carrying Amount of Loan

Finally, we do not support the provision of the ED that would require interest income to be measured by applying the effective interest rate to the amortized cost balance, net of the allowance for credit losses because it would result in a commingling of principal credit losses and forgone interest. Regarding net interest margin, paragraph 202 of the ED states, “The Board notes that users of financial statements place significant value on the reported net interest margin. The Board believes that net interest margin should reflect the interest an entity expects to receive on the basis of current assessments of credit impairments. The proposed impairment model would result in the yield (or net interest margin) of a financial instrument changing as a result of changes in the credit impairments.” We agree with the first sentence of this passage and share the Board’s belief in this regard. We also believe, and we think that many users of financial statements agree, that interest margin should reflect the gross interest an entity expects to receive. This appears to be different than the Board’s view, which seems to be that interest margin should reflect the net (credit adjusted) interest an entity expects to receive. This is a very important and fundamental difference, and we believe that it would be worthwhile for the Board to reconfirm its understanding of user preferences across a broad spectrum of users. We believe that gross presentation of interest income and costs of credit is consistent with the gross presentation of other factors that are considered in the pricing of a loan – servicing costs and funding costs. Isolating a single component – the expected cost of credit – to present net against interest income seems somewhat arbitrary when other expected costs, such as servicing costs and funding costs, that are considered in loan pricing, and may fluctuate over time, are not proposed for net presentation. Our view is that the gross interest margin and provision for credit losses

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present useful information separately, and that the current gross presentation allows users to calculate the net amount if so desired.

It appears that this proposed requirement to apply the effective interest rate to the amortized cost balance net of the allowance for loan losses is related, at least in part, to the proposed nonaccrual guidance. Paragraph BC 208 states, “Because interest income would be recognized on amortized cost less any allowance under the proposed guidance, interest would be accrued only on amounts expected to be collected. Therefore, the Board believes that it will generally not be necessary to place financial assets on nonaccrual status.” While this presumption may seem logical on a theoretical basis, we question how it will work in practice.

Under the current accounting model, accrued interest is recorded in a different general ledger account (and a different financial statement line item) than the recorded investment in the loan. When a specific loan is placed on nonaccrual status, future interest accruals cease and accrued but unpaid interest is reversed against interest income. Under this model, the allowance for loan losses relates to the recorded investment in the loan and uncollectible interest will not accumulate on the balance sheet because it is reversed on a loan-by-loan basis as those loans become nonaccrual.

As we understand the proposed accounting model, interest would be accrued on the balance sheet at the effective interest rate but then, instead of being fully recognized into interest income, the portion of interest income attributable to the reserved amount of the loan (or pool of loans) would be added to the allowance for loan losses. However, for loans collectively measured for impairment (i.e., the former SFAS 5 loans), the provision and allowance for loan losses would typically be measured to capture only estimated principal credit losses. Therefore, under this scenario, when an entity remeasures its required allowance, the allowance would in theory appear to be overstated based on the adjustment made to interest income. The entity would then reverse this excess allowance with a credit to the provision. The net result is that the entity would have simply reclassified some amount between interest income and the provision, while the balance of accrued interest would continue to grow on the balance sheet even though some portion of that balance would likely be uncollectible. While some portion of this accrued interest balance should be reserved or reversed since it is not collectible, it is not clear where the offset should go, nor is it clear how to determine the amount of the adjustment. The simplest approach would be to offset it against interest income based on a loan-by-loan assessment of collectability, but that essentially brings the accounting back to the model currently in place.

Based on the above, and at least for loans, we believe that the Board should not revise the existing model for recognizing interest income—either by revising the nonaccrual requirements or by requiring entities to recognizing interest income based on the carrying value of the loans. The current accounting model works well, is relatively easy to control and operationalize, and is well-understood. We believe that the income recognition changes discussed above introduce significant complications with no apparent benefit.

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Accounting for Purchased Loans

As a final point, we do not believe that the Board has achieved the objective set forth in BC 168, which states, “The Board decided that a single, comprehensive impairment model should be developed for all financial assets that meet the criteria for recognizing qualifying changes in fair value in other comprehensive income.” For loans, there appear to be at least three models: a model that is very similar to the former SFAS 5 model (with the exception of the two items noted above), a model that is substantially the same as the previous SFAS 114 model and, for purchased loans, a model that is very similar to the former SOP 03-3 model.

The bank analysts that we have spoken to regarding SOP 03-03 tell us that the SOP 03-3 model is confusing, and that the disclosure information is not nearly as relevant as the information for originated loans. They struggle to interpret the SOP 03-3 information and combine it with originated loan information to get a sense of the overall performance of a lending institution. We ask that the FASB reach out to the leading bank analysts to get their views on what measurement information and presentation is most useful for purchased loans.

In our view, the Board should continue to work toward developing a single, comprehensive impairment model for all debt instruments and, in this regard, the Board should reconsider the overall accounting model for purchased loans. BC 197 states that “Using an allowance for credit losses to address the collectability of cash flows the investor does not expect [to] [sic] receive initially (and, therefore, presumably did not pay for) would not faithfully represent the substance of the underlying event.” While we acknowledge that the SOP 03-3 model produces a more theoretically pure accounting result, we believe that the operational complexities and reporting issues associated with having very different bases of accounting applied within an entity’s overall loan portfolio far outweigh any benefit of achieving theoretical purity. We recommend that the Board strongly reconsider the benefits associated with a model that would allow entities to carry forward the allowance for loan losses. We would also support a provision to require the acquirer to recognize any allowance conformity adjustment through its own provision for loan losses. Abandoning the SOP 03-3 accounting model and reinstating a requirement to carry forward the allowance for loan losses would significantly improve financial reporting clarity and transparency. We believe that FASB outreach with the leading bank analysts would confirm that the model we describe above (a pre-141R, pre-SOP 03-3 model) is their preferred model as well.

Consideration of other impairment proposals

In addition to the impairment proposal included in the ED, we considered various other impairment models. In considering these alternatives, we identified several differentiating factors:

- The alignment of the recognition of expected credit losses and the recognition of interest income
- The degree to which all possible future credit losses are incorporated

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- The transparency of the resulting allowance for loan loss and how effectively management's estimate of the losses inherent in the portfolio is communicated to financial statement users
- The operational simplicity of the model, including the sourcing of the necessary data and the reliability of the estimates required

We acknowledge the diversity of views on the topic of impairment and believe that this diversity reflects the relative importance ascribed to each of these factors. For example, certain of the alternative models place heavy emphasis on aligning the timing of recognizing credit losses with the recognition of interest income (which is intended to compensate the lender for credit risk). Thus, these models seem to focus heavily on the income statement effects of the impairment model while placing less emphasis on the operational simplicity of the model and transparency of the expected collectability of assets on the balance sheet.

When we compared various alternative models, we found that the level of and changes in the resulting allowance for credit losses are more dependent on the loss forecasts used in the model used than the actual model applied. Therefore, ensuring a robust loss forecast is the most critical element of any impairment model. Such a forecast should begin with internal and external loss data and other available market information and must incorporate appropriate management judgment in assessing such information to inform a complete view regarding the losses inherent in the portfolio. The remaining objective of the impairment model should be to transparently communicate these loss estimates to financial statement users and to enable financial statement users to overlay their own judgments regarding expected credit losses. We believe that more simple impairment models best facilitate that communication.

The impairment and/or income recognition provisions of certain alternative impairment models are based upon ongoing updates of expected cash flows, with initial estimates of expected cash flows used in the recognition of interest income, and adverse changes in estimates resulting in credit impairment. Given the Firm's recent experience in applying SOP 03-3, and considering the conceptual similarities between SOP 03-3 and these alternative models, the Firm believes that such alternative impairment models are unlikely to be operational for any preparer with a significant loan portfolio absent substantial enhancements to system capabilities, increased data availability, a sizeable ongoing commitment of resources, and fundamental changes to the process by which management assesses and monitors credit risk. This is because in order to reliably estimate the timing and amount of cash flows related to loans, the loans would need to be pooled and segregated at a fairly granular level by common risk characteristics and time period of origination. Given the need to segregate loans in this manner, we believe that the number of pools required for financial institutions would be exceptionally high.

Other alternative impairment models would accommodate "open" portfolios (without tracking specific pools by period of origination) but would still incorporate calculations to spread an expected credit loss amount or rate over an estimated life. Such calculations

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become dependent on separate determinations of expected credit losses for discrete portfolios, and calculations to recognize those amounts over an expected life, subject to a certain “floor” on the amount of the allowance for credit loss based on some forward period of expected loss. While such models offer some improvement in operationality, we remain concerned that the operational complexity is still high without any apparent significant advantage regarding the informational usefulness of the resulting allowance for credit loss.

Credit impairment is a critically important topic that has received a great deal of focus, and we note that several other proposals have been introduced but not yet been fully developed. To obtain further consensus, we encourage the Board to work closely with the IASB and financial institutions to fully evaluate alternative impairment models and explore further whether the operational concerns with alternative impairment models can be addressed, while ensuring that the resulting allowance for credit losses transparently communicates management’s estimates regarding the credit risk in the portfolio. JPMorgan Chase is committed to continue working with industry participants and standard setters to help identify an impairment model that provides the most useful information to users while being operationally practical.

Other points on credit impairment and interest income

- We are concerned with the proposed guidance in paragraph IG 109 that suggests an entity is not permitted to consider separate contracts in the determination of whether a financial asset is impaired. Currently when loans are assessed for impairment, a guarantee or other credit enhancement is considered and may reduce the amount of allowance for loan losses needed, if deemed appropriate; this is consistent with current banking regulatory requirements. We believe that the Board should clarify that the income statement recognition of the impairment and of the guarantee benefit are expected to occur in the same financial reporting period. Furthermore, we recommend the Board allow both the impairment and the benefit of the guarantee be recorded in the same income statement line item (e.g., provision for credit losses). We believe it is appropriate that the above timing and classification reflect the economics of the guarantee and maintain the current representation in credit impairment statistics.
- According to paragraph 62 of the ED, which applies to the financial assets evaluated for credit impairment individually, “If the present value of cash flows expected to be collected is less than the amortized cost of the financial asset, an entity shall recognize a credit impairment in net income and establish an allowance for credit losses.” Based on the proposed definition of amortized cost, this sentence needs to add the term “accrued interest,” for the purposes of evaluating whether an allowance for credit losses is required. We recommend the following change: “If the present value of cash flows expected to be collected is less than the amortized cost plus accrued interest ~~of~~ on the financial asset, an entity shall recognize a credit impairment in net income and establish an allowance for credit losses.”

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- The guidance is not complete as it does not address when a loan modified in a troubled debt restructuring (TDR) should cease to be disclosed as a TDR. Current guidance allows for certain TDRs to no longer be disclosed as a TDR after a year if the loan is performing to its restructured terms and the loan was modified at a market rate at the time of restructuring. We believe that the current guidance is important to retain as it requires disclosures of TDRs only in the periods in which current earnings are affected by the off-market modified interest rates. In contrast, TDRs would cease to be disclosed in periods in which earnings reflect interest rates that were on-market at the time of modification.
- IG 29: It is not clear how the proposed guidance intersects with EITF 96-12 and EITF 99-20, and we believe such intersection should be clarified.
- Example 20 (paragraphs IG 135 – IG 137): The example is too simplistic and conveniently allows for the excess of interest received versus accrued (\$1,800) to be the additional allowance needed for expected credit losses in the subsequent year. In reality, the estimate of impairment would have changed from the prior year, but not to the exact amount of the excess of interest received versus accrued. We would expect that in many cases where loans are evaluated for impairment as a pool, the excess of interest received versus accrued will not be needed in the allowance, and therefore will be reversed as a benefit to the provision for credit losses and not as interest income. The Board acknowledges this point in paragraph BC 206. As discussed above, we strongly recommend that the Board not pursue this proposed guidance as it does not make sense to record cash interest income received as a reversal of a credit impairment. If the Board does choose to proceed, the example should be modified to address more realistic applications of the proposed guidance.
- Additionally, in this example (paragraphs IG 140 and IG 141), it is not clear why at the end of the loan term, a portion of the credit impairment charge would not have been released in accordance with paragraph 81. Specifically, we believe the carrying value should be increased to \$88,400 (the final expected cash flow) resulting in a release of the impairment charge.
- Under existing GAAP, impaired loans and TDRs are subject to an asset-specific measurement of impairment (which may include pooled evaluations for small-dollar value loans), while other originated loans are evaluated using a formula-based approach. Thus, the formula based approach is applied to non-modified, performing loans portfolios, whether they are small-dollar-value homogeneous loans or are non-homogeneous loans. While paragraph BC 189 of the ED clearly indicates that a formula-based approach continues to be appropriate for small-dollar-value homogeneous loans, it does not acknowledge that the formula-based approach could also be applied to other types of loans. The body of the standard itself, however, would not seem to preclude the practice of evaluating performing non-impaired, non-

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homogeneous loans using a formula-based approach. We suggest that the Board clarify paragraph BC 189 to be more consistent with the body of the standard.

Presentation – General

We believe that in order to determine the appropriate presentation (and indeed the appropriate measurement model), the Board needs to first determine its purpose for each of the financial statements. The FASB's presentation requirements for the balance sheets seems to reject the concept that only one primary measurement attribute is relevant for balance sheet presentation in favor of a concept that a number of data points with varying degrees of usefulness and relevance should all be presented on the balance sheet, primarily to solve a perceived disclosure timing issue.

We do not agree that all measures are equally relevant or that all measures meet the threshold for presentation on the balance sheet. Our balance sheet is one of the primary means of communicating our financial health to the users of our financial statements. We believe that secondary information that may be interesting but is not used in the primary business performance analysis does not belong on the financial statements, and would create unnecessary confusion. While we understand some users' desires for certain secondary information earlier in the financial reporting process, we believe that this disclosure issue should be addressed directly by the regulatory community, and not indirectly by complicating the core financial statements.

Presentation - FV NI and FV OCI

Paragraphs 85 and 86 of the Exposure Draft requires an entity to report both the amortized cost and the fair value of financial instruments that are carried at fair value through Net Income or through OCI, as well as a reconciliation between fair value and amortized cost for FV – OCI items. We disagree with this proposed presentation requirement as it gives equal prominence to both measures and over-complicates the face of the balance sheet, making it harder for users to understand and interpret.

In our view an entity should be required to present financial assets and financial liabilities using on the balance sheet using the single most relevant and decision useful measurement model, for example, fair value in the case of trading assets and amortized cost in the case of lending assets. To the extent that other data, including an alternative accounting model, provides useful data to users of the financial statements, it should be presented in the notes to the financial statements. We believe that an amount presented under an historical/amortized cost approach is the most appropriate way to present loans on the face of the balance sheet – as this is the amount that at which the Firm would settle the loans, absent a business combination or other rare transfer.

Presentation - Core Deposits

Similar to our concerns articulated above in relation to financial assets and liabilities that are carried at fair value through OCI, we do not support presenting core deposits using two different measurement models on the face of the balance sheet. Consistent with our comment for loans, we believe that an amount presented under an historical/amortized

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cost approach is the most appropriate way to present Core Deposits on the face of the balance sheet – as this is the amount that at which the Firm would settle the Core Deposit liability, absent a business combination or other rare transfer.

We also note that some constituents have interpreted the current language to suggest that entities should report an average core deposit balance on the period end balance sheet rather than the end of period core deposit balance (as adjusted for the proposed present value adjustment). In other words, if there were no difference between the alternative cost of funds rate and the all-in-cost-to-service rate (i.e., the discount rate would be zero), entities would report the average core deposit balance at period end rather than the end of period core deposit balance. We do not believe that was the Board's intent, but we ask that the language be clarified by the Board if this core deposit present value concept is included in any final standard.

As discussed above, we also ask the Board to clarify whether the core deposit intangibles should be reported net of the core deposit liability balance (or vice versa) due to any double count of the remeasurement amount and the purchased core deposit intangible.

Presentation - Statement of Comprehensive Income (“SOCI”)

As we have set out previously in this letter we have deep reservations as to the merit of the proposal in the Exposure Draft to report financial assets arising from our lending and investing activities at fair value in the balance sheet.

In our view, the development of any accounting overhaul for financial instruments must be made in the context of a common understanding of the purpose for Other Comprehensive Income (“OCI”). Is OCI supposed to capture items that are never expected to be realized and thus are not appropriately reflected in net income, such as cash flow underhedge income and changes in fair value of held-for-investment loans unrelated to credit impairment, or is there a different purpose for this caption? We are not able to discern a purpose for OCI or Accumulated Other Comprehensive Income (“AOCI”) from the Exposure Draft.

Our concerns are exacerbated by the interaction of this project with the proposals in File Reference No. 1790-100: Proposed Accounting Standards Update to Comprehensive Income (Topic 220) (the “Topic 220 Exposure Draft”). The Topic 220 Exposure Draft would require an entity to present net income and other comprehensive income in a single, continuous financial statement. This would give undue prominence to changes in the fair value of financial assets reported in other comprehensive income, only making it harder for users of the financial statements to understand the current performance of a bank. In addition, the presentation of a single statement of comprehensive income would further remove financial reporting from the practical reality of how we manage our business and evaluate our own performance.

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Presentation – SOCI - General - Interest Income and Interest Expense

We agree with the general requirements to report separately interest income and interest expense. However, we cannot discern from the Exposure draft whether interest income and interest expense should be further separated by items held at fair value through net income versus fair value through OCI versus amortized cost versus the core deposit remeasurement amount, etc. We do not believe that such separation by remeasurement attribute is meaningful enough to justify the cost to preparers. We ask the Board to clarify that interest income and interest expense should be presented separately, but in the aggregate.

Presentation - SOCI - FV NI

We agree that realized and unrealized gains or losses should be presented on a combined basis for financial instruments for which changes in fair value are recognized in net income, and agree that the sum of the realized and unrealized amounts should be presented separately within net income if material to the reporting entity. However, if a financial instrument qualifies for hedge accounting, we believe that consistent with Topic 815, the entity should select the most appropriate income statement classification, which may result in classification of hedging instrument results classified in the line item of the host contract that differs from the classification of financial instruments measured at fair value through net income that are not designated in qualifying hedge relationships.

Presentation - SOCI - FV OCI

In general we are supportive of the proposed presentation requirements set out in paragraph 91 for instruments that are recorded at fair value through OCI, except for the separate presentation of interest income and expense as noted above.

In addition, we believe that foreign exchange gains and losses should be reported in earnings for all monetary financial instruments, including those that are measured at fair value through OCI. Unlike other interim changes in fair value that will not be realized in cash if held to maturity (absent credit impairment), foreign exchange gains and losses will be realized. We believe that our proposal is consistent with the concepts of Topic 830 Foreign Currency Matters, which requires gains and losses on all monetary financial instruments to be recorded in earnings when the relevant foreign exchange rate changes. Not only will this treatment result in timely recognition of cash flow effects that will ultimately take place, it also eliminates the current unnecessary burden of applying hedge accounting for the foreign exchange gains and losses on any financial instruments carried at FV OCI.

Presentation - SOCI - Own Credit

Our view is that the fair value measurement of a non-derivative liability should not include an adjustment to reflect the entity's estimates of obligor non-performance risk ("own credit") unless market participants would include such an amount in measuring the fair value of the instrument and such amount is realizable. Our view acknowledges the reality that the current marketplace does not consistently reflect the creditworthiness of the obligor in the pricing, valuation or settlement for non-derivative liabilities such as

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structured notes and long-term debt. We also believe that such an approach is consistent with the concept that an exit price should reflect the entity's assumptions about the assumptions of another market participant.

Consequently, the Firm believes that that estimates of own credit on all financial liabilities should not be recognized in the balance sheet or in earnings/OCI if market participants would not include such an amount in measuring fair value or such amount is not realizable. The Firm shares the widespread concern of most investors and analysts that the results of own credit adjustments on such liabilities – booking gains when a company's own credit is deteriorating – is not decision useful information and should not be included in earnings or capital. The Exposure Draft attempts to deal with this issue by providing disclosures to allow users to “back out” own credit risk adjustments from the statement of financial position and in earnings/OCI. In our view, a preferable course would be to simply disclose the own credit adjustment for such liabilities in the footnotes to the financial statements instead of recognizing that adjustment on the statement of financial position and earnings/OCI. In addition, we do not believe that users perceive the value of changes in own credit due to idiosyncratic risk to be any more valuable than changes due to systemic risk, and therefore do not believe that the presentation of the idiosyncratic portion to provide benefits that justify the costs of calculating and displaying this information.

Disclosures – General

While the Exposure Draft represents a complete restructuring of the accounting for financial instruments, the disclosures continue the pattern of piecemeal development of information requirements that have collectively resulted in an overwhelming volume of data that obscure rather than inform. The additional disclosures provided in the Exposure Draft, add further confusion by their volume. We believe that, given a blank sheet of paper users would design a disclosure framework with much less data, but much more meaning, than the cumulative requirements in place today.

We believe that if the accounting model for financial instruments is so fundamentally reworked, a correspondingly fundamental overhaul of the disclosures must be concurrently delivered.

Disclosures – Financial Liabilities Measured at fair Value

Given the concerns that we have set out above with respect to only presenting separately the idiosyncratic element of own credit, the Firm does not agree with the need to disclose how this amount is derived. In addition we note that this qualitative disclosure does not address the issue that users will not have sufficient information to allow them to back out all changes in fair value arising due to own credit risk.

Disclosures – Financial Instruments for Which Qualifying Changes in Fair Value Are Recognized in Other Comprehensive Income

We do not agree with the proposed disclosure requirements set out in paragraph 101. We have set out above our concerns with giving fair value and amortized cost equal

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prominence. We are equally concerned with the proposed requirement to separately disclose the amount of purchase discount related to credit and that related to other factors. Such a disclosure would be a significant burden for financial institutions, given the sheer volume of our financial instrument investments. Given the general confusion among investors and analysts about how to consider the SOP 03-3 disclosures, we do not believe that there is consensus among users that purchase discount information is truly useful for making investment decisions. Consequently, we firmly believe that such disclosure requirements would not pass a cost/benefit analysis.

Disclosures - Core Deposits

We do not support the proposed requirements to disclose the key inputs and assumptions used to measure core deposit liabilities (both quantitative and qualitative) as well as disclose a sensitivity analysis of the effects of a 10% increase and 10% decrease in the discount rate (i.e., the difference between the alternative cost of funds rate and the all-in-cost-to service rate). Consistent with our view regarding the lack of usefulness or relevance of the new remeasurement attribute, we do not believe these disclosures would provide useful information.

Disclosures – Financial Liabilities Measured at Amortized Cost

We support providing robust fair value disclosure for financial instruments that are not measured at fair value in the statement of financial position. We believe that the current SFAS 107 disclosures should be the starting point for any disclosure enhancements regarding fair value. As we do not support the requirement that financial liabilities could only be measured at amortized cost if they would create or exacerbate a mismatch if measured at fair value, we do not support the related disclosure requirement.

Disclosures - Level 3

The Exposure Draft makes reference to the project that would require preparers to provide a measurement uncertainty analysis disclosure about fair value measurements that are categorized in level 3 of the fair value hierarchy (Topic 220 Exposure Draft). We believe that the Exposure Draft and the Topic 220 Exposure Draft should be deliberated together, so that the measurement uncertainty disclosures are assessed in context of the ED's disclosure requirements. For example, if the Exposure Draft is issued as written, many financial institutions will have a significant increase in the population of level 3 instruments (for example, as a result of held-for-investment loans). This impact on the costs and operational burdens of the measurement uncertainty disclosures should be considered.

In addition, the following interim requirements are clear in the Exposure Draft, but not clear in the Topic 220 Exposure Draft, and should be made consistent. Paragraph 109 of the Exposure Draft states that for interim periods, if the unobservable inputs used to measure the fair value have changed significantly from the last reporting period, the reporting entity shall provide this disclosure in the current period. If the unobservable inputs used to measure fair value have not changed significantly, the entity shall disclose this fact in the interim period.

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Derivatives and Hedging

Overview

We are supportive of the FASB's efforts to simplify the accounting for derivatives and hedging activities and generally agree with many of the proposed changes to the derivatives and hedge accounting model. However, we strongly disagree with the Board's decision to eliminate a company's ability to dedesignate hedge accounting relationships. Risk management is performed on a dynamic, responsive basis. As changes occur in the risk profile of the hedged risk exposure, it is prudent and appropriate to dedesignate existing hedge relationships and reestablish a new hedge relationship based on the current risk profile. We do not understand how changes in risks can be managed in the hedge accounting framework without the necessary dedesignation provisions.

In addition, while we agree that the embedded derivative bifurcation requirements should be the basis for a classification model if it must be based partially on cash flow criteria, we believe that those criteria should be modified to make the classification and measurement model relevant to standard risk management practices.

We also support the Board's decision to continue to permit designation of certain eligible hedged risks. However, we believe that the FASB should take the opportunity to further converge the hedge accounting model with the IASB's model. Converging to a portions approach for the interest rate risk inherent in fixed rate debt, as well as a reconsideration of eligible hedged risks that are separately identifiable and measurable, would reduce the complexity and operational burden imposed on firms by the elimination of shortcut method for fair value hedges.

Below are more detailed observations relating to derivatives and hedge accounting in the Exposure Draft:

Bifurcation of Embedded Derivative Features

As previously discussed, we agree that the classification and measurement of financial instruments should be driven principally by the business strategy of the entity (or a division of an entity). We also believe that certain instruments, including derivatives, should be measured at fair value notwithstanding the business strategy to which they are subject. If the Board continues to include cash flow criteria in the classification and measurement model, we believe the guidance should be modified such that prior to the classification review of the host contract, a company would have the ability to bifurcate embedded derivative features based on the current bifurcation rules and therefore classify the embedded derivative component at FV-NI. This would then provide for the classification of the host contract consistent on management's business strategy for such instruments within a model similar to that proposed by the Board.

If the Board is unwilling to continue to permit bifurcation of embedded derivatives, then the Board should allow for preparer judgment in determining the potential significance of

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the effect that an embedded derivative feature has on the cash flows of the instrument. Broadly requiring all financial assets and liabilities with embedded derivative features to be carried at FV-NI without regard to the embedded features' potential significance to the overall cash flows of a financial instrument creates complexity in interpreting the application of embedded derivative guidance and will negatively impact the execution of common and prudent risk management strategies, particularly for simple debt instruments with small or de minimis embedded derivative features.

Hedge Effectiveness

We support the Board's modification of the qualifying criteria for when hedge accounting can be applied, with the movement to a 'qualitative' test based on a 'reasonably effective' threshold and noting that judgment is required when making such a hedge effectiveness determination. However, we recommend that the Board address when a qualitative test is sufficient to mitigate the risk of auditors and regulators developing their own quantitative thresholds for what meets their definition of "reasonably effective." Paragraph BC 216 of the Exposure Draft states "this proposed Update would amend the hedge effectiveness guidance...to no longer require... (b) a quantitative assessment...or (c) ongoing effectiveness testing (although in rare circumstances the latter two may still be necessary)." In contrast, paragraph BC 218 states, "the Board believes that the costs of compliance would be reduced because entities would not have to develop sophisticated quantitative statistical models to prove a hedging relationship is effective in situations in *which it is obvious (emphasis added)* that a hedging relationship is effective." We believe that the above language will lead to a lack of consistency for determining when a qualitative or quantitative test is appropriate, and recommend the Board replace this language in the Exposure Draft with the following:

The Board believes that the costs of compliance would be reduced because entities would not have to develop sophisticated quantitative statistical models to prove a hedging relationship is effective in situations in which ~~it is obvious~~ a qualitative assessment would conclude that a hedging relationship is reasonably effective. The Board does not believe that bright lines should determine the circumstances in which a qualitative assessment is sufficient or quantitative test is required. The Board believes that it is necessary to use judgment when determining whether a hedging relationship is reasonably effective.

In addition, paragraph BC220 of the Exposure Draft discusses the Board's reasoning for not defining reasonably effective, stating that "judgment should include a holistic consideration....That would include, for example, consideration of whether the objective of applying hedge accounting was to compensate for accounting anomalies or to achieve a fair value measurement option for items not currently eligible for fair value measurement." However, hedge effectiveness is a quantitative test. We do not believe that it is appropriate or auditable to insert qualitative criteria into a quantitative test. In addition, it is unclear what is meant by "accounting anomalies" and whether ample practical issues have or have not occurred that would support the need to create an anti-abuse provision related to the inappropriate motives for applying hedge accounting.

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Given the broad scope and application of the fair value option, it does not seem probable that a desire to achieve a fair value option is a true motivator for hedges of risks arising from financial instruments. In summary, we do not believe an additional criterion to consider the purpose of a hedge is necessary and are concerned that such a requirement would result in unintended consequences. We therefore recommend removing the final two sentences in paragraph BC220.

Dedesignation of a Hedging Relationship

The basis for the Board's conclusions that prohibits companies from removing the designation of a hedge accounting relationship states:

“Because the economics of the relationship between the hedging instrument and hedged item (or forecasted transaction) have not changed, the Board believes that the accounting should not change. The Board acknowledges that an entity could override the special accounting under fair value and cash flow hedges by terminating the derivative designated as the hedging instrument and entering into a similar new derivative, which action involves actual economic transactions. However, the Board does not believe that arbitrary dedesignation (which does not involve actual economic transactions) should be used as a tool for changing measurement attributes and/or managing the classification of certain items reported in net income.”

As previously noted, we strongly disagree with the Board's changes to the dedesignation requirements. As changes occur in the risk being hedged, companies will commonly add new hedging relationships and remove, or dedesignate, existing hedge relationships. For example, we use daily dedesignations and redesignations for hedges of commodities inventory carried at the lower of cost or market that are hedged with commodity derivatives. Because the amount of the hedged item changes daily due to purchases and sales of the commodities being hedged, we need to dedesignate existing derivatives or redesignate previously designated derivatives in order to adjust the hedging instrument notional to the revised exposure amount. As an even starker example of the need to dedesignate and redesignate, we hedge the foreign currency risk of FX denominated AFS securities. Even if the face amount of the security holdings do not change at all, the FX exposure changes daily because the price (in currency) of the security changes. For example, if the price of a euro denominated security changes from 99 to 98, that one point drop causes a change in the FX exposure subject to SFAS 52 revaluation which would require a partial dedesignation of the derivative notional amount. We also dedesignate and redesignate in order to adjust the hedged amounts in Net Investment hedges in accordance with Derivatives Implementation Group Issue No. H7. Because such risk management strategies are prudent and appropriate, we believe that the current provisions allowing for dedesignations and redesignations are proper and necessary. We are not aware of any practice issues related to dedesignations, and cannot discern how such provisions could be problematic, since designations occur prior to market price changes.

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We also find the proposed conditions for a permissible dedesignation to be unnecessarily restrictive. Entering into an offsetting derivative to achieve the same purpose as a dedesignation is costly and unnecessary. Given the Board's proposal to limit a company's ability to dedesignate a hedge accounting relationship, it is unclear what hedging strategies the Board is referring to or contemplating in paragraph BC223 to the Exposure Draft when the paragraph notes "many hedge accounting strategies would not be affected by the proposal... However, it may be necessary to change the way a hedging relationship is designated." Given the significant change resulting from disqualifying hedge dedesignations, the Board should clearly articulate what changes to documentation would be required to achieve the similar result. We also recommend that the Board clarify whether a derivative designated in a hedge relationship that subsequently fails to meet the criteria set forth in paragraph 119 (a) of the Exposure Draft can be redesignated in a new qualifying hedge relationship.

In addition, the language regarding offsetting of derivatives is unclear. Paragraph 120 of the Exposure Draft states an offsetting derivative must be expected to 'fully offset' future changes in the fair value or cash flows of the original derivative instrument. Current practice for effectively terminating a derivative that was part of a designated hedge accounting relationship typically involves entering into a directionally opposite derivative that is at-market (zero fair value) with either the same or a different counterparty that offsets the market risk associated with the original derivative. A literal interpretation of the guidance would appear to require an entity entering into what would likely be an off-market offsetting derivative due to changes in market rates from the original derivatives designation date, and could further be interpreted as requiring the offsetting derivative to be with the same derivative counterparty to ensure fully offsetting credit risk. While we disagree with the Board's dedesignation proposals, at a minimum the criteria for effective terminations should allow for an entity to enter into an at-market (zero fair value) derivative that offsets the market risk associated with the original derivative in order to make execution of a prudent risk management technique more operational and cost effective. The shortcut and matched terms criteria worked well for determining the nature of such at-market derivatives, and we believe the continued use of those criteria would be appropriate.

Moreover, we believe that the provisions that would preclude the original hedging derivative and the new offsetting derivative to be redesignated in a new hedge accounting relationship for their remaining lives will create operational complexities and costs that we do not believe are justified. As companies appropriately risk manage their changing risk exposures, the Exposure Draft would require the execution of additional derivative transactions for an 'effective' dedesignation. Companies with large derivative portfolios would also be required to implement new systems and procedures to identify and track derivatives that are no longer eligible for hedge accounting relationships for a prolonged period of time. We therefore recommend that the Board eliminate the proposed restrictions on the subsequent designation of the original hedging derivative instrument or the offsetting derivative instrument.

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Measuring and Reporting Ineffectiveness in Cash Flow Hedging Relationships

Paragraph 123 of the Exposure Draft provides for the recognition of ineffectiveness in current earnings due to both under-hedging and over-hedging, which is a significant change to current practice. The basis for the Board's decision to require both under-hedging and over-hedging in earnings states that:

"The Board also believes that in those situations there should be no distinction between whether the change in value of the actual derivative is greater than or less than the change in value of a derivative that would mature on the date of the forecasted transaction and provide cash flows that would exactly offset the hedged cash flows....The Board believes it is preferable to treat overhedges and underhedges consistently."

The Board's Basis for conclusions does not address why this fundamental change from ASC Topic 815 is an improvement to financial reporting or results in simplification, and further does not address the change in the conclusion the Board reached when it originally issued ASC Topic 815 (formerly SFAS 133, paragraphs 379 and 380). In those paragraphs, the Board explained its decision to prohibit recognition in other comprehensive income of nonexistent gains or losses relating to the change in present value of the cash flows associated with non-contractual, forecasted transactions. We support the prior Board's rationale for limiting recognition of ineffectiveness in earnings to amounts by which the actual derivative instrument exceeds, on an absolute basis, the projected present value of the hedged cash flows. Nothing has changed since the Board reached that conclusion and we therefore do not agree that such a significant change should be made without further diligence addressing how reporting these nonexistent gains and losses in OCI and earnings provides more transparent financial information.

In our view, the consideration of this change must be made in the context of a common understanding of the purpose of the balance sheet, and for AOCI within the balance sheet. Is AOCI supposed to be the temporary holding place for items that are never expected to be realized, such as cash flow underhedge income, or is there a different purpose for this portion of the balance sheet? In our view, the lack of a conceptual framework for what AOCI represents complicates the consideration of how to treat underhedges. We believe that the purpose for the balance sheet generally and for AOCI specifically must be first clarified and then consistently applied in any new model.

Other Items

Convergence

We urge the FASB to take the opportunity during this comprehensive reconsideration of hedge accounting to consider convergence with the IASB's model in certain areas, which we believe will enhance the current hedge accounting model.

One area relates to the measurement of ineffectiveness, which has been a source of complexity in application of the current FASB model. Since the issuance of IAS 39, *Financial Instruments: Recognition and Measurement*, IFRS preparers have had the

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ability to hedge a portion of a financial instrument's cash flow or fair value. Pursuant to the IASB's tentative conclusions reached as part of its deliberations on its hedge accounting project, a preparer is permitted to define the hedged item as a portion of the cash flow or fair value of a financial asset or financial liability. The calculation of the change in value of the hedged item due to the change in the hedged risk is therefore less complex in the IASB model given the interest rate alignment of the hedging derivative and the measurement of the identified hedged risk, and its consistency with the intended risk management objective. To facilitate the objectives of simplification and convergence, we recommend that the Board modify the Exposure Draft to provide companies the ability to define the hedged item in a fair value or cash flow hedge as all or a separately identifiable and measurable portion of a financial asset or liability's cash flow or fair value, consistent with IFRS.

In addition, to make the current hedge accounting model more relevant and to achieve a greater degree of convergence with IFRS, we recommend that the Board permit other observable and reliably measurable interest rate risks to be eligible hedged risks. The Master Glossary of the ASC defines the benchmark interest rate as "a widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market. It is a rate that is widely used in a given financial market as an underlying basis for determining the interest rates of individual financial instruments and commonly referenced in interest-rate-related transactions." However, ASC Topic 815 provides a narrow interpretation of this definition, limiting the benchmark interest rate to either the rate on U.S. Treasury obligations or the LIBOR swap rate. Companies commonly hedge interest rate risk exposures that, in many cases, do not qualify as a benchmark interest rate as defined in ASC Topic 815 (for example, the Overnight Indexed swap rate, Federal Funds Rate and Prime Rate-based financial instruments), and we therefore believe the Board should revisit this restriction.

We note that the Board's previous rationale for limiting the definition of the benchmark interest rate to LIBOR was a function of financial markets considering LIBOR rates as inherently liquid, stable and a reliable indicator of interest rates, as well as the Board's belief that allowing more than two benchmark rates to define interest rate risk was unnecessary and would make the resulting financial statements more difficult to understand. We believe that given the evolution of the financial markets, as well as the increase in disclosures relating to derivatives and hedging activities, these concerns have been mitigated. Since many of the common interest rate indexes are similarly liquid and stable as LIBOR, expanding the ability to hedge separately identifiable and reliably measurable interest rate risks beyond the benchmark interest rate risks defined in ASC Topic 815 would not undermine the Board's original basis for allowing a hedge of a benchmark interest rate. In addition, with the introduction of the derivative and hedging disclosures in ASC Topic 815-10-50, the identifiable and measurable interest rate risks that a company has designated would be disclosed to investors. We also believe revisiting the narrow definition of the benchmark interest rate would facilitate the statement by the Board in SFAS 138, where "The Board determined that any definition of

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the benchmark should be flexible enough to withstand potential future developments in financial markets.”

Hedged risk

We agree with the Board’s decision to continue to permit bifurcation-by-risk. However, we believe that the basis for bifurcation-by-risk is completely separate from the narrow or broad application of amortized cost in measuring financial instruments. We do not support the expanded use of fair value, but do not believe that the Board’s decision in this area should have any consequence on bifurcation-by-risk.

Even under a mixed-attribution model, the retention of the bifurcation-by-risk approach for financial instruments is necessary and valid for several reasons. Companies select the derivative that best and most simply reflects the risk being hedged economically, and a rescission of the bifurcation-by-risk approach would force companies to replace derivatives based on observable and liquid indices with derivatives that incorporate new (and often unobservable) risks they never intended to hedge (i.e. issuer credit spread or own credit spread). If companies are unable to change their hedging instruments to incorporate all risks inherent in the hedged item, they will have three mutually exclusive choices: (1) hedge the risk, but choose not to apply hedge accounting and increase earnings volatility from the hedged risk, (2) hedge the risk, apply hedge accounting, if possible, but face increased earnings volatility from the unhedged risk, or (3) not hedge and incur no volatility but retain economic risk. In practice, preparers have found the explanation of earnings volatility from items not meeting the current SFAS 133 hedge accounting criteria to be difficult to explain to users. In summary, regardless of the classification and measurement decisions, we fail to understand how the additional burdens of eliminating the bifurcation-by-risk would simplify hedge accounting and improve financial reporting.

Transition

Paragraph 137 of the Exposure Draft requires transition by means of a cumulative effect adjustment to the statement of financial position for the reporting period that immediately precedes the effective date. It is unclear if the Board intends for the cumulative catch-up to require a look-back at historical hedge accounting relationships. We believe that given the uniqueness of hedge accounting, and the significant amount of work required to interpret previous years’ derivative and hedge accounting designations under the proposed rules, the Board should provide for a full prospective transition, grandfather hedge accounting relationships that exist at the transition date, and if applicable, permit derivative instruments that are dedesignated at transition to be newly designated at the transition date.

Equity Method

We do not agree with the proposed requirements set out in the Exposure Draft relating to investments over which the investor has significant influence (“equity method investments”). The accounting for such investments would be determined based on whether the investee’s activities are “related” to those of the investor. In our view, this

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approach is inappropriate because it is inconsistent with the “business strategy” approach that is proposed in the Exposure Draft to determine the correct measurement model for other financial assets and liabilities. In addition, the proposal is not consistent with the way that we manage our business, and is confusing for large diversified corporations for which many different businesses could be deemed to be related in some way.

The requirements of the Exposure Draft seem to be premised on the notion that entities have historically elected the fair value option when the investee’s activities are unrelated to those of the reporting entity as investor. Not only is this a generalization, but it may not be consistent with the way that certain investments are managed. For example, it is possible that a universal bank could make an equity method investment in an investee whose operations are related to those of the bank, with an intention to sell that investment in the short-term for a profit. Under the Exposure Draft such an investment could not be carried at fair value, even though the investment would be managed on fair value basis and there exists an intention to sell in the short-term.

Conversely an entity may make a long-term equity investment in an investee that is operating in an industry into which the investor is looking to expand in the future. Even though the investor is looking to hold the investment for long-term, the proposed model would require the investor to carry it at fair value through earnings. This would result in an accounting model that is not representative of the business strategy of the investor. An entity may also make a long-term equity investment in an investee (for example, certain qualified affordable housing projects) with the primary intention of receiving returns in the form of tax benefits, including both tax deductions from operating losses and tax credits. Because the investee's operations may not be related to the entity, the ED would require the entity's investment to be carried at fair value through earnings. Where the entity's intent is to hold the investment for the longer term to realize cash flows, recognition of these investments at fair value through earnings does not align with the business strategy or investment economics expected to be realized from holding the investment.

The Firm believes that the accounting model for equity method investments should follow the business strategy to which the investment is subject. This could be achieved by leaving the existing guidance in US GAAP, including the availability of the fair value option. An alternative approach would be to require equity method investments to be accounted for using the equity method investment if they are held for long-term investment purposes, with others being carried at fair value through earnings.

Additional Disclosures Related to Equity Method Investments

Given our position on the most appropriate accounting model for equity method investments, we do not agree with the disclosures proposed in paragraph 132.

Effective Dates and Transition

The Exposure Draft represents a wholesale overhaul of the accounting for financial instruments. Accordingly, we believe that the effective date should be determined only

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after extensive field testing that includes collection of data on the cost of implementation of the proposals. Changes of this magnitude cannot be evaluated for benefits relative to cost on an entirely qualitative basis as the Board proposes. Some effort to quantify the costs must be undertaken, and those costs must be discussed publicly, and the uses of the information must be thoroughly examined in the context of such costs. We do not believe that the deliberations to date regarding the costs and benefits of this proposal have been sufficient to provide a basis for the issuance of a final standard.

Other Considerations

While we understand that the Board's mandate does not include explicit consideration of the effects of its accounting standards on risk management practices and public policy considerations, we think these are important concerns with your proposal. We urge the board to understand and consider the effects of the proposal and conduct extensive field testing before proceeding.