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November 16, 2010

Leslie F. Seidman, Acting Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06886-5116

Re: International Accounting Standards Board Staff Draft, *Consolidated Financial Statements*

Dear Ms. Seidman:

JPMorgan Chase & Co. (“JPMorgan Chase” or the “Firm”) appreciates the opportunity to comment on the International Accounting Standards Board’s (“IASB”) Staff Draft, *Consolidated Financial Statements* (the “Staff Draft”). We are providing you our initial observations to the questions included in the roundtable agenda for your consideration. However, due to the relatively short timeframe to review and evaluate the Staff Draft, we may have additional comments once we have the opportunity to more thoroughly consider the implications of the Staff Draft. Also, we strongly encourage the FASB to perform field testing and/or field visits with preparers in order to fully understand the implications of the Staff Draft before proceeding.

We have three major concerns with the Staff Draft:

- 1) The Staff Draft does not include a clear and consistent principle of “control.” We believe that the Staff Draft intends to base the control criteria on the reporting entity’s current power to direct the activities of an entity that most significantly impact its returns. This is evidenced in both paragraphs 10 and B5, which state “An investor has power over an investee when the investor has existing rights that give it the current ability to direct the activities that significantly affect the investee’s returns” [emphasis added]. However, this principle of current control is not consistently applied throughout the Staff Draft, as other sections indicate that the control principle should also consider *expected* or *contingent* control and notions of share control. For example paragraph B20 states “Usually, to be substantive, the rights need to be currently exercisable. However, sometimes the rights are substantive when they give the holder the current ability to direct the relevant activities, even though the rights are not currently exercisable.” The application of this guidance is unclear as we do not understand how the current ability to control can emanate from rights that are currently not exercisable.

In our view the principle of control should be based solely on the party that has current control, considering all current facts and circumstances – including but not limited to current voting rights. We believe this is the most relevant approach to identify control. The proposed guidance should be amended to clearly articulate this principle and to ensure that it is consistently applied throughout.

- 2) The Staff Draft could lead to a party that has control over an entity consolidating that entity if it also has exposure to *any* returns from that entity. In ASC 810-10 (Consolidation of Variable Interest Entities), the significance of the financial interest is an important factor in determining whether the interest held by the reporting entity is a controlling financial interest. It provides that

in addition to having the power to direct the activities that most significantly impact the entity's economic performance, the entity must also have the obligation to absorb losses or have the right to receive benefits from the entity that could potentially be significant. We believe this is an appropriate approach, because we do not believe that an *insignificant* interest in an entity should be considered a controlling financial interest that results in consolidation. Therefore, we believe that consolidation should be required only where a party has (i) current ability to direct the activities that have the most significant impact on the returns of an entity (i.e. current control) and (ii) current access to significant returns from that entity.

- 3) The Staff Draft indicates that kick-out rights held by more than one party are only a consideration in assessing control. We believe substantive kick-out rights are a determinative factor of control, in all cases, regardless of whether the right is held by multiple investors. We agree with the Staff Draft in that the terms of such rights should be reviewed to determine if kick-out rights are substantive.

Our responses to the specific questions set out in the roundtable agenda are as follows:

Question 1

The Staff Draft provides a single concept of control that is used to evaluate control on a consistent basis for all types of entities (both voting interest entities and variable interest entities). Do you agree that a single-model approach to assess control will provide more consistent financial reporting for all types of entities rather than providing separate models for voting interest entities and variable interest entities? If not, why not?

Response to Question 1

We agree with the overall objective of developing a single consolidation model for both voting interest entities and structured entities. Consolidation should be based on the dual principles of having both the current ability to direct the activities that have the most significant impact on the returns of an entity (i.e. current control) and having a significant financial interest in the entity.

However, while the overall principles of the consolidation model should be consistent for all entities, we believe that there will be necessary differences in application to different types of entities (specifically operating entities and limited purpose entities). This is because the attributes that define whether a party has current control over an entity are different depending on the nature, purpose and activities of the entity. Entities that have a limited purpose will need to be evaluated, based on contractual rights and understanding of the limited decisions that may affect the returns of the entity. The evaluation of control over operating entities is more straightforward because there are substantive decisions that must be made, and it is clear that the equity holders and/or board of directors have the decision making authority.

While we support a single definition of control for all entity types, we do not believe that the principle of control is clearly articulated and consistently applied in the Staff Draft and therefore, could lead to inconsistent financial reporting. See our responses to questions 2-8 below.

Question 2

The Staff Draft does not incorporate the U.S. GAAP concept of a variable interest entity or a structured entity. Rather, the Staff Draft provides that the way in which control is assessed will vary depending on how the activities that significantly affect the entities' returns are directed. For example, how control is assessed will depend on whether the decisions that significantly affect the returns of an entity are made through voting rights. Without an explicit definition of a variable interest entity, do you believe that (ignoring the differences when analyzing decision making relationships and the effect related party

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arrangements have on the analysis) the Staff Draft will produce the same consolidation conclusions as the recently issued U.S. GAAP guidance for consolidating variable interest entities (FASB Accounting Standards Codification™ Subtopic 810-10, Consolidation)? If not, what are the situations that produce a different conclusion and why? Do you think it is sufficiently clear how to assess power and control for all types of entities in the Staff Draft?

Response to Question 2

While we would theoretically prefer a single model, we believe that a consolidation standard would be more practical to apply if it were to define and acknowledge the differences between operating entities and limited-purpose entities. Such a definition would assist in identifying the significant activities of the entity that should be assessed for control. As noted in our response to question one, the inherent differences between operating entities and limited-purpose entities make the practical assessment of control quite different for these types of entities.

The existing guidance in ASC 810-10 has been useful in differentiating the types of entities. ASC 810-10 states that variable interest entities are legal entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the legal entity to finance its activities without additional subordinated financial support. In contrast, for operating entities the usual condition for a controlling financial interest is ownership of a majority voting interest.

We understand that the intent of the Staff Draft was to produce the same consolidation conclusions as the consolidation guidance recently issued for variable interest entities in ASC 810-10. However, based on our initial assessment, we identified some differences between current US GAAP and the Staff Draft. For example:

- The Staff Draft does not include the concept of significance when assessing exposure, or rights, to variable returns from its involvement with the investee.
- Paragraph B52c of the Staff Draft requires the assessment of returns that are not available to other interest holders. We do not believe that ASC 810-10 considers benefits received outside of the assets held by the entity, such as cost savings. We believe that systematic consideration of such benefits would be difficult to apply, because such benefits are often not known or quantifiable by other investors, making it very difficult to assess the reporting entity's returns compared to other parties' returns from the entity.

There may be less obvious differences between the Staff Draft and ASC 810-10 that are identified after a more complete review. These differences may affect the consolidation conclusions reached in fairly common fact patterns, including:

- Servicers of securitizations that have an immaterial interest in the entity (e.g., such as retention requirements mandated by regulatory requirements) (see our response to question 3 below);
- A dominant shareholder that does not have unilateral current control over the entity (see our response to question 4 below);
- Step acquisitions or acquisitions that have not yet been approved by shareholders (see our response to question 6 below);

Question 3

The Staff Draft proposes that in order to control an entity, the reporting entity must have the power to direct the activities of that entity. Power is defined as having existing rights that give the reporting entity the current ability to direct the activities that significantly affect the entity's returns. Do you agree with

the control principle as articulated in the Staff Draft? Do you agree that there are situations when a reporting entity can have control of an entity controlled through voting rights with less than a majority of voting rights? Why or why not?

Response to Question 3

We agree with the principles outlined in B1 and B5 in determining whether an investor controls the investee. However, these principles are not consistently applied throughout the Staff Draft. In particular we do not believe that any form of contingent or future control is relevant when assessing current control, and we fail to see how a minority stake holder could control an entity as discussed in paragraph B39 (see the first application example in this paragraph).

Furthermore, we do not believe that the Staff Draft contains sufficient guidance to make it operational. The high level principles set out in the Staff Draft can be applied and interpreted in many different ways, which would be contrary to the objective of providing consistent application of the guidance. Therefore, we would suggest that the guidance be clarified in the following areas:

- Current control is the most relevant approach to defining control and this principle should be consistently applied throughout the Staff Draft. Assessment of current control considering all relevant facts and circumstances, will likely result in more consistent conclusions than considering less apparent factors such as contingent or future control.
- Paragraphs 6 and 7 refer to exposure or rights to variable returns as a criterion for control. We believe that this guidance should be modified to include a certain level of significance. Exposure to insignificant amounts of variability should not result in consolidation.

Question 4

The Staff Draft states that if the activities that significantly affect an entity's returns are directed through voting rights, a reporting entity holding less than a majority of the voting rights (assuming no potential voting rights or other contractual rights exists) has power when it can unilaterally direct the activities of the entity that significantly affect the entity's returns. This assessment requires judgment. The Staff Draft provides application guidance to determine when a reporting entity holding less than a majority of the voting rights in an entity controlled through voting rights has power. Specifically, the Staff Draft provides that, in some cases, a determination can be made about whether a reporting entity has power by just considering the absolute size of the reporting entity's holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders' meetings, and other arrangements. Do you believe that there are circumstances when, considering only these factors, an assessment could be made about whether a reporting entity has power? Why or why not?

Response to Question 4

We believe that it is inconsistent with the principle of control in the Staff Draft to ignore the fact that independent parties (regardless of how many there are) other than the minority shareholder, have the power to outvote that investor, and therefore control an entity. In our view, the current control principle should be based on which entity controls the most significant activities of the company through consideration of both voting rights and other contractual arrangements. Specifically, we do not believe that a minority shareholder controls an entity absent other contractual arrangements that give it control over the most significant activities of the entity.

The factors discussed in paragraphs B38 – B41 (absolute size of the reporting entity’s holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders’ meetings, and other arrangements) are not based on principle of current control. This guidance would lead to the conclusion that a minority shareholder that holds significantly more voting rights than any other investor (i.e., the “dominant shareholder”) controls an entity if the majority of shareholders are widely dispersed. We disagree with the Staff Draft’s conclusions and object to the notion that a dominant shareholder with less than half of the voting rights of an entity is presumed to have the power to direct the activities of an entity if the majority shareholders are “widely dispersed.”

A dominant shareholder with less than a majority voting rights cannot “unilaterally direct the activities of the entity.” The influence of the dominant shareholder is *dependent* upon the actions (or inactions) of others, which may or may not be predictable. In either case, the ability to influence is not akin to the ability to control and, if actions of others are necessary, by definition, cannot be “unilateral.” In our view, the majority shareholders have the current power to control the entity and a dominant shareholder with less than a majority voting rights does not change that fact. The fact that the majority of the shareholders do not disagree with the dominant shareholder does not mean that the majority shareholders do not have control. The decision by the majority shareholders to vote (or not to vote) is itself a form of control.

Furthermore, the concept of a dominant shareholder with less than a majority voting rights has control is inconsistent with paragraph 12 of the Staff Draft, which states “An investor with the current ability to direct relevant activities has power even if its rights to direct have yet to be exercised.” Just because the majority has not yet exercised its rights to out-vote the minority investor does not mean that they will not in the future and, under this guidance, should not be ignored. These factors ignore the shareholders rights and assume that they will not exercise or act on their rights or will act in accordance with the largest minority shareholder. This presumption should not be included in the assessment of power to control.

Question 5

In other circumstances the Staff Draft provides that additional evidence may be needed in order to conclude that a reporting entity holding less than a majority of the voting rights in an entity controlled through voting rights has power. The Staff Draft includes indicators that may provide additional evidence in these circumstances to assist in determining whether the reporting entity has power. Do you believe that these indicators provide sufficient guidance to conclude that a reporting entity has power in situations where it is unclear as to whether a reporting entity has power solely based on the absolute size of the reporting entity’s holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders’ meetings, and other arrangements? If not, what additional indicators should be included or which of these indicators should be removed?

Response to Question 5

Since we believe that current control is the most relevant principle, we do not believe that factors that are not based on current control should be considered.

Question 6

The Staff Draft requires a reporting entity to consider its rights to obtain additional voting rights of another entity, as well as such potential voting rights (options or convertibles, for example) held by other parties, to determine whether the reporting entity has power. Do you believe the guidance in the Staff Draft is appropriate and operational? Specifically, do you believe that the guidance for determining when potential voting rights are considered substantive is operational? If not, what additional guidance would you suggest?

Response to Question 6

The guidance on potential voting rights should be redrafted to make it clear that only currently exercisable voting rights should be considered in determining which party controls the entity. The current proposed guidance is unclear as to whether potential voting rights that are exercisable in the future or are contingent on certain future events constitute current control. Consistent with our comments above and in our response to Question 8 on substantive kick-out rights, the guidance relating to potential voting rights should be clear that only substantive potential voting rights that are currently exercisable should affect the control determination.

The Staff Draft could be read to require consolidation of an investee where a minority shareholder has potential majority voting rights that are exercisable in five years. Including potential voting rights as a determinative factor in a consolidation analysis without regards to actual current control contradicts the Staff Draft's principle regarding power as stated in paragraphs 10 and B5 that "An investor has power over an investee when the investor has existing rights that give it the *current* ability to direct the activities that significantly affect the investee's returns" [emphasis added].

We do agree that circumstances that appear to provide future control or contingent control should be reviewed carefully to determine whether they actually provide the holder with current control over an entity. We believe that certain potential voting rights (for example, a currently exercisable option to acquire additional shares at a nominal price) may be akin to kick-out rights and should be evaluated in a similar fashion to determine if the potential voting rights are substantive. We do not believe it would be appropriate to consolidate an entity based solely on potential voting rights without determining whether those potential voting rights are substantive and provide the holder with current control. Similarly, we do not believe that it would be appropriate for a reporting entity to deconsolidate an entity when it does have current control but another entity has the *potential* to obtain voting rights, but currently does not have the ability to exercise those voting rights.

Lastly, when determining the proportion to be allocated to a parent and noncontrolling interests in preparing consolidated financial statements (or the proportion allocated to an equity method investor), paragraph B83 of the Staff Draft states that the proportion allocated is determined "taking into account the eventual exercise of potential voting rights and other derivatives that, in substance, give access at present to the economic benefits associated with an ownership interest." The guidance is unclear and raises the following questions:

- Is the Board contemplating situations where the current voting interest percentage held does not equate to the percentage of economic benefits that the holder of the voting interest is entitled to?
- Based on our view that only currently exercisable potential voting rights should be considered in determining which party controls the entity, should the currently exercisable voting rights also be considered in determining the proportion allocated?

Paragraph B83 of the Staff Draft seems to imply that (a) there can never be a difference between voting percentages and how economic risk and rewards are allocated to the shareholders and (b) economic earnings should be allocated in proportion to what voting percentages would be assuming all potential voting rights are exercised. If that was the Staff Draft's intent, we disagree with both items. In practice, shareholders occasionally do agree to share economics using proportions that are different than current and future voting percentages and in those cases, the accounting treatment should align with the economics of the agreement. Further, we do not believe that economic risks and rewards should be allocated based on potential voting rights, as this would result in allocations that are different to what the shareholders are currently contractually entitled to.

Question 7

When determining whether a reporting entity acts as an agent, the reporting entity must consider the overall relationship between it and other parties involved with the entity, considering the following factors:

- a. The scope of its decision-making authority over the entity*
- b. The rights held by other parties*
- c. The remuneration the reporting entity is entitled to in the arrangement*
- d. The reporting entity's exposure to variability in returns as a result of other interests that it holds in the entity.*

Do you believe the guidance related to assessing decision-making arrangements in the Staff Draft is appropriate and operational? Do you believe the Staff Draft would lead to appropriate consolidation conclusions?

Response to Question 7

We agree with the factors that must be considered in determining whether the reporting entity acts as an agent. However, in certain cases it is not clear when certain factors should be given greater weight in the determination of whether the decision-maker is acting as an agent. See our comments below for further information.

We believe that an analysis of “the scope of the decision-making authority” as outlined in paragraphs B58 and B59 should include consideration of whether a decision-maker is acting in a “fiduciary capacity” as dictated by regulation or law. Where a decision-maker’s authority is limited by its obligation to act as a fiduciary on behalf of unrelated investors, we believe that a decision-maker is acting as an agent of the investors. We recommend either eliminating paragraph B59 or replacing it with a requirement to consider the purpose and design of an investee, as that concept is outlined in paragraphs B45 through B49. We agree that a decision-maker’s level of influence in establishing the founding documents or other documents that determine decision-making rights for an investee may be relevant in certain cases (i.e., for certain limited purpose entities where there are no substantive ongoing decisions). However, the fact that an investor was part of the up-front design of an entity and took part in designing the framework for ongoing decision-making should not be heavily weighted without a full understanding of the overall purpose and design of the investee.

We encourage increased focus on an investee’s governance structure when evaluating the “rights held by other parties” as outlined in paragraphs B60 through B62. While the Staff Draft acknowledges the importance of an investee’s governing body or board of directors in paragraph BC 62, this factor should be explicitly included in the application guidance of the standard.

We recommend deleting the last sentence in paragraph B65, which indicates that “remuneration that exposes a decision-maker to returns that vary differently from those of other interest holders may indicate that the decision-maker is not an agent.” Compensation structures for decision-makers often vary for valid business purposes and are agreed upon by all parties. For example, an asset manager may receive performance based compensation computed as a percentage of a fund’s returns that exceed the returns of a specified index. While the total returns of the fund may not vary proportionately to the manager’s compensation, we do not believe such a performance fee should lead to the conclusion that the asset manager is acting as a principal. The considerations in paragraph B63 include ensuring that any remuneration is commensurate with the level of effort and expertise needed to provide the services; includes terms, conditions and amounts that are customarily present in similar arrangements; and exposes the decision-maker to variability of returns and magnitude of compensation that is reasonable to the

investee. We feel that these considerations are adequate in assessing the remuneration allocated to a decision-maker and the method of computation is not relevant for this evaluation.

Finally, in addition to a decision-maker's role as a fiduciary on behalf of investors as highlighted above, consideration should be given to situations where a decision-maker is *required* to hold an investment in an investee. In certain cases investors or industry practice may require a decision-maker to invest in an investee to align the decision-maker's incentives with investor returns. While these interests would increase the variability the decision-maker absorbs from the investee, the fact that other, independent investors are requiring the investment should be considered as further support that the decision-maker is acting as an agent on their behalf. In comparison, where a decision-maker holds a significant proprietary investment in the investee based upon its own desire to increase its exposure to the variability of returns generated by the investee, this fact should be considered as an indicator that the decision-maker is acting in a principal capacity on its own behalf.

Question 8

When evaluating a decision-maker's role, rights held by other parties are considered when determining whether a decision-maker is an agent. Specifically, situations in which a single party holds substantive removal rights and can remove the decision-maker without cause, in isolation, would be sufficient to conclude that the decision-maker is an agent. However, if numerous parties hold such rights, those rights would not, in isolation, be conclusive in determining whether a decision-maker is an agent. In such a situation, those rights would be considered together with the other factors included in question 7 above, to determine whether the decision-maker is an agent. Do you believe that removal rights held by numerous parties should be a factor when evaluating whether a decision-maker is an agent? If so, do you agree that it should be one factor but not in and of itself determinative, when evaluating whether a decision-maker is an agent?

Response to Question 8

Yes, we believe removal rights held by more than one party should be a *determinative* factor when evaluating whether a decision-maker is an agent, but *only* where those removal rights are *substantive*. To be substantive, removal rights should include the following characteristics:

1. The removal rights should not be subject to conditions that make it unlikely they will be exercisable, for example conditions that narrowly limit the timing of exercise;
2. The removal rights should not be subject to financial penalties or operational barriers;
3. There should be adequate compensation available to attract an adequate number of qualified replacement decision-makers;
4. There should be an explicit, reasonable mechanism through which investors can convene to consult each other and make collective decisions; and
5. Investors should have the ability to obtain information necessary to exercise their rights.

Provided that removal rights are substantive, we believe that it is irrelevant how many parties hold those rights, and it should be a determinative factor when concluding that the decision-maker is an agent.

Further, substantive removal rights controlled by investors through an investee's governance structure should also be relevant to determining whether a decision-maker is acting in a principal or agent capacity. As acknowledged in paragraph BC62, the governing body or board of directors will be the body responsible for strategic decision-making for certain investees. Where a governing body or board of directors that are acting on the behalf of investors has substantive removal rights, it is that governing body or board of directors and the investors who gave the governing body such rights that have the power to

control the investee; therefore, power to control is not held by the decision-maker who can be removed without cause.

Question 9

The Staff Draft requires a reporting entity to reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control. Do you believe this principle, and the related guidance in the Staff Draft, is sufficiently clear and operational?

Response to Question 9

We agree with the Staff Draft that requires a reporting entity to reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control.

Other Comments

Paragraph B93 of the Staff Draft states, “If a revaluation surplus previously recognized in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the reporting entity shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.” We are unclear as to what circumstances would result in an adjustment directly from other comprehensive income to retained earnings and request that examples be provided as to when this might occur.

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We appreciate the opportunity to submit our views and would be pleased to discuss our comments with you. If you have any questions, please contact me at 212.270.3632 or Bret Dooley at 212.648.0404.

Sincerely yours,



Louis Rauchenberger