

JPMORGAN CHASE & CO.

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Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1880-100: Proposed Accounting Standards Update, *Clarifications to Accounting for Troubled Debt Restructurings by Creditors*

Dear Financial Accounting Standards Board:

JPMorgan Chase & Co. (“JPMorgan Chase” or “the Firm”) appreciates the opportunity to comment on File Reference No. 1880-100: *Proposed Accounting Standards Update—Clarifications to Accounting for Troubled Debt Restructurings by Creditors* (the “Exposure Draft”) issued by the Financial Accounting Standards Board (“FASB” or the “Board”).

The Firm believes that many types of loan modifications, including the most common residential mortgage loan and credit card modifications, are considered troubled debt restructurings (TDRs) under current accounting guidance and that the impairment methodologies and disclosures applied to those modifications are appropriate. We are not aware of practice issues that exist with respect to these types of loans that would require clarification by the FASB. For other types of loans, the Firm believes that current accounting guidance in Accounting Standards Codification 450-20, *Loss Contingencies* (“ASC 450-20,” formerly FAS 5) already requires the recognition of associated credit losses, reflecting the credit risk and uncertainty inherent in modified loans that are not considered TDRs under current guidance. However, the Exposure Draft could have the unintended consequence of *restricting* management’s ability to maintain an allowance for loan loss for certain unimpaired modified loans because of the requirement to measure impairment on TDRs under accounting guidance that was intended for impaired loans. We also believe that including significant amounts of unimpaired modified loans in disclosures about impaired loans is contrary to financial statement users’ common understanding of TDRs and impaired loans, and would decrease the usefulness of those disclosures.

JPMorgan Chase believes that the best solution would involve separately considering (i) the most appropriate approach for measuring impairment of modified loans and (ii) the most relevant and meaningful disclosures about loan modifications, including TDRs. With respect to impairment measurement, the Firm believes that it is important that the credit risk and estimated losses associated with modified loans be properly recognized in the allowance for loan losses. However, the Firm strongly believes that the application of Accounting Standards Codification 310-10-35, *Receivables – Overall – Subsequent Measurement* (“ASC 310-10-35,” formerly FAS 114) to all TDRs, even if the loans do not otherwise meet the definition of impaired loans, would not achieve that objective and should be reconsidered in the context of the Board’s current discussions on changes to the loan impairment model.

In the event that the Board decides to finalize the Exposure Draft in substantially its current form, the Firm has significant concerns about the operability of retrospectively identifying TDRs. We believe

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that all the revised guidance should be applied prospectively to new modifications subsequent to the issuance of the revised guidance.

The following sections of this letter discuss in greater detail the Firm's concerns with existing accounting guidance related to TDRs, the effect of the Exposure Draft on those concerns, and the Firm's recommended approach for resolving these matters.

Concerns with TDR Accounting and Reporting

Accounting and Reporting Implications of TDRs – Existing Standards

Under existing accounting standards, modifications of loans that are considered to be TDRs result in the following:

- As of the date of the modification, the restructured loan is automatically considered to be an impaired loan.
- As an impaired loan, the TDR must be measured for impairment under ASC 310-10-35 for its remaining life. In many (if not most) cases, impairment measurement would be based on the present value of expected principal and interest cash flows discounted at the pre-modification effective interest rate.
- The TDR must be disclosed as an impaired loan for its remaining life, unless the loan was modified at a market rate of interest. In the event that a TDR was modified at a market rate of interest and it no longer meets the definition of an impaired loan (except for the fact that at one point it was deemed a TDR), the TDR is no longer required to be disclosed as an impaired loan. However, the Firm understands that ASC 310-10-35 requires the TDR to continue to be measured as an impaired loan, even if the loan is no longer disclosed as such.

Application of Impairment Guidance to TDRs that are Impaired Loans

The accounting standards described above generally produce a reasonable and appropriate result when a TDR is also an impaired loan. ASC 310-10-35 indicates that a loan is impaired when, "based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement." Based on this definition, certain types of loan modifications will naturally result in impaired loans. For example, if the lender forgives principal or reduces the borrower's contractual interest rate in connection with the restructuring, then the lender has granted a concession and the loan is also impaired since the lender does not expect to collect all amounts due according to the contractual terms of the loan agreement. Additionally, when the lender forgives principal or permanently reduces the borrower's contractual interest rate, the loan also would be impaired for its remaining life because the contractual cash flows under the modified terms would always be less than the original contractual cash flows.

We believe that this application is consistent with the original intent and application of TDR guidance, which supports the notion that TDRs are typically also impaired loans. Specifically, paragraph 35-9 of Accounting Standards Codification 310-40, *Troubled Debt Restructurings by Creditors* ("ASC 310-40,"

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formerly FAS 15) states that:

*Usually, a loan whose terms are modified in a troubled debt restructuring **already will have been identified as impaired** because [it would have been probable that all contractual cash flows would not be collected] **before a formal restructuring** [emphasis added].*

Application of Impairment Guidance to TDRs that are Not Impaired Loans

When the impairment measurement provisions of ASC 310-10-35 are applied to loans that are not otherwise impaired, there is an unintended and inappropriate accounting result. For example, consider a loan that has principal and interest payments based on a 15-year amortization schedule and a balloon payment at the end of a three-year term, which is then modified to extend the maturity date by one year at the existing contractual rate of interest. Assume that the borrower continues to make principal and interest payments as required under the loan agreement based on the 15-year amortization schedule (thereby demonstrating both the willingness ability to repay the loan), the lender believes that the loan is adequately collateralized and there is no current doubt as to the collection of contractual principal and interest. If this modified loan is characterized as a TDR, ASC 310-10-35 would evaluate loan impairment based on the present value of the loan's cash flows discounted at the contractual interest rate, which would be equal to the recorded investment in the loan. Therefore, applying the ASC 310-10-35 impairment measurement methodology to loans that are not impaired would typically suggest that no allowance for loan losses should be recorded (i.e., there is no impairment to recognize).

In the Firm's view, recording no allowance for such modified loans is not appropriate. The Firm believes that, although based on a loan-specific evaluation all principal and interest is expected to be collected, across a portfolio of such modified loans there are likely incurred but unidentified losses that should be recognized in the allowance for loan losses. Unfortunately, paragraph 35-35 of ASC 310-10-35 does not allow impairment measured under ASC 310-10-35 to be supplemented with an allowance measured under 450-20, even if no impairment is measured under ASC 310-10-35.

This issue generally arises for loans evaluated individually under ASC 310-10-35 (generally larger balance loans where there is a specific indicator (delinquency, borrower distress, or other) that all amounts due will not be collected). In contrast, the issue is not particularly problematic for loans that are collectively evaluated for impairment under ASC 310-10-35 (e.g., smaller-balance homogeneous loans such as residential mortgage loans or credit card receivables) because the underlying cash flow estimates are developed at a pool level. Therefore, for these types of loans, it would be appropriate to adjust the cash flow estimates to incorporate pool-level assumptions for variables such as probabilities of default and loss severities.

Expanded scope of TDRs in Exposure Draft

JPMorgan Chase believes that the Exposure Draft may increase the number of situations that result in TDR characterization even when the underlying loan is not impaired. This expansion is primarily the result of two provisions of the Exposure Draft: (i) the requirement to determine whether a restructuring is at a market rate and (ii) the requirement to evaluate short-term and/or temporary modifications as TDRs.

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Specifically:

- Loan modifications that do not result in a reduction in the interest rate, but rather are classified as a TDR because the interest rate is not increased to a market rate of interest (or such market rate of interest is unidentifiable), and
- Loans that are modified for a short period of time based on a defined and temporary borrower circumstance. Consider a situation where a lender grants the borrower a concession (i.e., the lender would agree that the restructuring is a TDR), but the lender has neither reduced the interest rate on the loan nor has it forgiven principal. An example of this would be an amortizing loan where the lender allows the borrower to make interest-only payments for a short period, and then the loan is either re-amortized over its remaining term or the unpaid principal payments are due and payable at the maturity date of the loan. Further assume that, at the time of the restructuring, there was doubt as to the full collection of both interest and principal, so the loan was also considered to be impaired at the date of the restructuring.

In the future, the borrower's financial condition may improve and, because the lender neither reduced the interest rate on the loan nor forgave principal, the loan may once again reach a point where there is no current doubt as to full collection of original contractual principal and interest. However, because the loan was considered a TDR on the date of the restructuring, the entity would be required to measure the loan as an impaired loan based on the present value of discounted cash flows for the remainder of its life, which could be many years. Again, in this scenario, it is likely that the allowance determined under the ASC 310-10-35 impairment measurement methodology would be lower than that which would result from measuring this loan for impairment using a formula-based approach that considers pool-level probabilities of default and historical loss rates (i.e., ASC 450-20).

Each of these general situations is discussed in more detail below.

Demonstrating a Market Rate

Under the Exposure Draft, any extension, renewal, or refinancing of a loan to a commercial borrower who may be experiencing financial difficulty is potentially a TDR unless the lender can demonstrate that the restructured interest rate is also a market interest rate. In many cases, but particularly in the weaker points of the business cycle, market rates may not be observable due to illiquidity, market disruption, or simply the nature of the loan. Lenders do not always know, except perhaps anecdotally, the extent to which other lenders are willing to lend to a particular borrower and at what rate.

Particularly for commercial loans, the lender may believe that it is extending, renewing or refinancing the loan at a fair interest rate considering a number of factors, such as: (i) the loan's pricing relative to the lender's overall pricing strategy, considering any information that is available to the lender about relevant market pricing; and/or (ii) enhancements obtained such as additional collateral or guarantees, excess cash sweep provisions, additional covenants that benefit the lender in some manner, and/or principal paydowns. If such loans were characterized as TDRs, the existence of a potential "concession" would be evaluated based on whether the loan's interest rate is at market, but impairment measurement is based on whether the lender expects a shortfall (or a very substantial delay) in contractual cash flows, which often would not be the case. JPMorgan Chase believes that this represents a fundamental and problematic

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disconnect between the conceptual basis for identifying TDRs and the corresponding impairment measurement requirement as discussed above.

In addition, the Firm believes that paragraph 310-40-15-8A will result in diversity or confusion in practice because it does not clearly state how this market rate guidance should be applied. This paragraph states:

If a debtor does not otherwise have access to funds at a market rate for debt with similar risk characteristics as the restructured debt, the restructuring would be considered to be at below a market rate and therefore should be considered a troubled debt restructuring.

One issue with this paragraph is that it appears to create a different standard than the two-step process historically used to identify TDRs. That is, if a borrower cannot obtain funds from an outside source at a market rate, it appears that the restructuring would be a TDR regardless of whether the borrower is experiencing financial difficulty. JPMorgan Chase believes that the borrower's financial condition is still an appropriate factor to consider and that, while an inability to obtain funds at a market rate may be a consideration in the assessment of financial difficulty, it should not, in itself, determine whether a restructuring is a TDR. As previously noted, a borrower's access to alternative sources of funding at market rates can be significantly impacted by other factors, such as market conditions.

Finally, paragraph 310-40-15-8A does not link the market rate to the rate being offered in the restructuring. As such, it is confusing whether the restructured rate must be equal to the market rate or if the borrower must simply have access to funds at a market rate.

Short-Term or Temporary Modifications

Another area that potentially presents impairment measurement issues is the characterization of short-term or temporary modifications as TDRs for the life of the loan, again, regardless of whether the loan meets the definition of an impaired loan. In a number of cases, loans that are deemed to be TDRs as a result of short-term or temporary modifications may not meet the definition of an impaired loan even at the date of the "restructuring." For example, if a lender grants a short-term extension of a loan at its contractual rate to conduct due diligence (e.g., gathers financial statements and tax returns) before taking further action, this would appear to result in a TDR under the Exposure Draft. However, it is not necessarily the case that this same loan would also be impaired. In many cases under similar circumstances, the lender would fully expect to collect all contractual principal and interest on loans such as these.

As with the market rate guidance, the provision of the Exposure Draft that requires entities to assess whether an insignificant delay in cash flows results in a TDR would often result in a disconnect between the identification of TDRs and the measurement of impairment. The Board seems to acknowledge this inconsistency within the Exposure Draft. Specifically, paragraph BC7 states that the "Board further noted that the concept of 'insignificant delay' is to be used in assessing when a receivable is impaired under Section 310-10-35 rather than assessing when a restructuring constitutes a troubled debt restructuring." However, the Firm believes that the TDR identification process cannot be separated from the impaired loan identification process, most fundamentally because as a TDR is required to be measured and disclosed as an impaired loan.

JPMorgan Chase believes that insignificant delays should be explicitly outside the scope of TDR guidance. Excluding insignificant delays is already consistent with current practice and is well defined

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and understood for regulated financial institutions based on current regulatory guidance. Specifically, the OCC's Supervisory Memorandum 2009-7 states, "Any mortgage modifications greater than three months should be accounted for and disclosed as a Troubled Debt Restructure (TDR)."

Rather than effectively rescinding this guidance, JPMorgan Chase believes that it would be preferable to instead codify it within GAAP. The exception greatly simplifies the operational burden of assessing the financial difficulty of borrowers in situations where it is qualitatively clear that little or no impairment would result from the modification. This is especially important for high-volume smaller-balance homogeneous loans, and for customer accommodations made in the normal course of business irrespective of whether a borrower is experiencing financial difficulty (e.g., waiving a late fee for a credit card customer or deferring a missed mortgage payment to the end of the loan term to enable the borrower to catch up); in these cases the operational burden to comply with the Exposure Draft could be significant.

Disclosures of Impaired Loans

In addition to the impairment measurement issues, we believe that a second concern arises regarding the usefulness of disclosing certain TDRs as if they were impaired loans, for two reasons:

- First, a modified loan is generally deemed to be a TDR for its remaining life, regardless of whether the borrower's financial condition improves subsequent to the modification, or whether the modification was only temporary. In contrast, impaired loan disclosures generally provide information regarding the current status of the loan – and loans may be removed from impaired loan disclosures based on improvement in the borrower's financial situation. We believe that the inconsistent treatment between non-modified and modified loans decreases the usefulness of impaired loan disclosures because the cumulative effect of all TDRs in impaired loan disclosures may make it difficult to observe underlying trends in non-modified, nonperforming impaired loan balances.
- Second, TDRs, like other loans, are generally returned to accrual status if the borrower is current in payments and principal and interest payments are expected to be collected as due according to the modified terms (and therefore recovery of the loan's carrying amount is reasonably assured). However, TDRs would remain disclosed as impaired loans even after returning to accrual status, while non-modified loans would be removed from the impaired loan disclosures upon returning to accrual status. We believe that including a large group of assets in the impaired loan disclosures while still accruing interest income will be confusing to financial statement users and will decrease the usefulness of impaired loan disclosures.

The Firm acknowledges that one potential solution would be to simply disaggregate within the impaired loan disclosures loans that were modified in TDRs but that are not currently impaired. However, such a solution merely results in additional disclosures to provide information on impaired loans that is currently provided, and that is most useful to financial statement users. The Firm believes that a preferable solution would be to focus more directly on the disclosures of modified loans that would be most useful to financial statement users.

Recommended Approach

JPMorgan Chase understands that the Exposure Draft is intended to achieve two primary objectives: first, to ensure that credit losses associated with loans are accrued on a timely basis, including in circumstances involving loan modifications; and second, to ensure that disclosures transparently convey information regarding modified loans, including situations in which a lender has made interest rate modifications in

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order to mitigate potential principal losses. We believe that these objectives cannot be achieved solely by modifying the definition of a TDR; instead, more fundamental changes should be made to the measurement and disclosures of TDRs. Because these issues are inextricably linked to the Board's deliberations on an appropriate loan impairment model, we believe that the Board should suspend work on the Exposure Draft and instead focus on ensuring that the proposed loan impairment model adequately addresses loan modifications.

However, if the Board decides to proceed with the current project, we recommend that the Board consider certain amendments to the current impairment and disclosure guidance for TDRs. Specifically:

- TDRs should be measured under ASC 310-10-35 and included in the impaired loans disclosures only if they also meet the definition of an impaired loan. If a TDR was an impaired loan at the date of the restructuring but, at a future date, the lender expects to receive all contractual cash flows, the TDR then should be measured for impairment under ASC 450-20 and no longer included in the impaired loans disclosures.

JPMorgan Chase also believes that the Board could achieve a similar outcome by eliminating the guidance in paragraph 35-35 of ASC 310-10-35, which prohibits impairment measurement under ASC 450-20 when a loan is measured for impairment under ASC 310-10-35. This approach appears to be consistent with the Board's views in its recent exposure draft on financial instruments. Paragraph BC192 of that exposure draft states:

The Board believes that an entity should not delay recognition of an impairment loss on a group of financial assets by evaluating them individually when historical experience indicates that a loss is likely to have occurred, but is not yet specifically identified.

- Disclosures should focus on renegotiated loans in which interest rate reductions are offered in order to mitigate principal credit losses. Such modifications have an impact on future interest income recognition, and such effects should be communicated to financial statement users.
- Short-term loan modifications should be excluded from the scope of the TDR guidance, since such modifications typically have an insignificant effect on the amount or timing of cash flows received, and the resulting allowance for loan losses.
- The presumption that a restructuring should be a TDR if the borrower cannot demonstrate access to new independent funding should be eliminated. All facts and circumstances should be considered to determine whether the borrower is experiencing financial difficulty and whether a concession has been granted. Because of the lack of observable market information for borrowing rates even for performing loans, we believe the creation of a presumption will lead to an inappropriate bias in identifying TDRs.

Transition

If the Board proceeds with finalizing the Exposure Draft, JPMorgan Chase questions the practicability of retrospectively identifying TDRs, even if only for disclosure purposes, particularly for commercial loans. Paragraph BC10 explains that the Board is not requiring retrospective measurement of impairment for TDRs because all of the necessary information would be difficult, if not impossible, to obtain. The Firm

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believes that the same issues exist in applying a requirement to retrospectively identify TDRs for disclosure purposes, and that making the assessment using hindsight to recreate assumptions about market rates or other considerations is inappropriate. In many cases, the information needed would not be available as it was not retained in loan accounting systems or otherwise captured in the past because it was not deemed necessary under GAAP guidance at the time. As such, the Firm would suggest that prospective application be allowed.

In addition, if the final standard were to require retrospective identification of TDRs for disclosure purposes, it does not appear that the comparative impaired loans disclosures (i.e., 2010 and 2009) would result in meaningful and consistent information across the periods presented. While the loan balances in those disclosures would be updated based on the expanded definition of a TDR, the related allowance for loan losses would not be updated for periods other than the period of adoption since impairment measurement is applied prospectively. Additionally, the required disclosures regarding the amount of impaired loans with no related allowance and the amount of impaired loans with a related allowance would be confusing because an increase in some of the reported impaired loans could have had a related allowance, but the amount of such allowance would have been determined under ASC 450-20 (because the loan had not been considered impaired at the time), rather than under ASC 310-10-35 as would be required for other TDRs.

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We appreciate the opportunity to share our views and would be pleased to discuss our comments, including further details about our recommended approach, with you at your convenience. If you have any questions, please contact me at 212.270.3632 or Bret Dooley at 212.648.0404.

Sincerely yours,



Louis Rauchenberger