

JPMORGAN CHASE & CO.

Louis Rauchenberger
Managing Director & Corporate Controller

April 1, 2011

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Supplementary Document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Impairment*

Dear Sir David and Ms. Cospers,

JPMorgan Chase & Co (“JPMorgan Chase” or “the Firm”) appreciates the opportunity to comment on *Supplement to ED/2009/12*, and File Reference No. 2011-150, Supplementary Document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Impairment* (the “Supplementary Document”) issued by the International Accounting Standards Board (“IASB”) and the Financial Accounting Standards Board (“FASB”) (collectively, the “Boards”).

As noted by the Financial Stability Board and others, the most recent credit crisis highlighted shortcomings in the existing accounting standards for loan impairment, and we support the Boards’ efforts to address these concerns with a high quality and converged standard that meets the needs of financial statement users – including creditors, investors, and regulators. In particular, we support the removal of the requirement for financial assets that a loss be deemed “probable” before it can be recognized in the financial statements – a change that by itself would represent the single most important improvement to address criticism that certain credit losses were not recognized early enough in the credit cycle.

We believe that the revised impairment standard should be based on two basic principles:

- A robust loss estimate is critical, and management’s view of losses inherent in the portfolio must not be narrowly confined. The loss estimation process should begin with internal and external loss data and other available information regarding the credit quality of the loan portfolio. The estimate must also consider other factors that help inform the level of credit losses inherent in the portfolio but that may not yet be evident in credit risk metrics, including factors such as changes in underwriting standards, loan covenant terms and other loan characteristics, recent or expected deterioration or improvement in economic conditions, changes in loss emergence patterns over a credit cycle, and the level of estimate imprecision and uncertainty in loss estimates. Incorporation of these

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factors would align the accounting for loan losses with how we consider loss estimates for credit risk management purposes and would result in appropriate recognition of losses inherent in the portfolio – even during the benign economic and credit conditions that often precede downturns in the credit cycle. It would also address the concerns of many financial statement users through the recent credit crisis by facilitating timely recognition of credit losses in the periods in which they are inherent (yet not readily observable through common credit risk metrics) rather than concentrating credit loss recognition into the later stages of a credit cycle.

- The allowance for loan loss must be adequate to cover inherent losses in the loan portfolio at each balance sheet date. We support the concept of accruing for credit losses that can be reasonably estimated within the foreseeable future. This concept is simple and facilitates transparent communication with financial statement users regarding loss expectations and the credit quality of the loan portfolio. We believe this simplicity and transparency are particularly important to the users of financial statements, who often wish to overlay their own judgments regarding expected credit losses to the estimate provided by management.

We believe these principles are aligned with the objectives of investors, regulators and other financial statement users who have been critical of existing accounting standards during the recent credit crisis and should serve as the foundation of a single global loan impairment standard. Such a standard would promote consistency in credit loss reserves among global financial institutions – a goal of increasing significance due to the current emphasis on global regulatory capital rules and the global nature of the financial services industry. However, the two principles above are paramount because they are fundamental to confidence in financial reporting and the banking sector. Therefore, we would give those principles priority over a converged accounting standard that fails to meet those objectives.

Our comments below respond to the Supplementary Document in three sections:

- First, we summarize our approach to credit risk management and credit loss estimation. We believe that the loan loss accounting framework should be aligned with how management monitors, manages, and measures the credit risk in its portfolio, and therefore it is important to begin with this basic understanding.
- Second, we provide observations on the time proportional approach and the foreseeable future floor components of the Boards' proposal. We based these observations on analysis we performed to apply the Boards' proposal to our own portfolio and credit loss experience to understand how the loan loss reserves would be estimated through a credit cycle under the Boards' proposal.
- Finally, we provide our more detailed views on the Boards' proposal and our suggested next steps.

Credit Risk Management and Credit Loss Estimation

Credit Risk Management

Wholesale loans

The Firm's risk-rating methodology is the foundation for the Firm's credit risk management process for wholesale loans. Each credit extension to a wholesale customer is assigned a risk-rating based on the borrower's financial strength and the nature and characteristics of any

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collateral or other structural support. Upon origination or purchase, most credit facilities bear a risk-rating that reflects management's expectation that the loan will perform according to its contractual terms, although such risk ratings acknowledge that there is a risk of default even for currently performing loans. On a portfolio basis, we know that certain of these loans will result in losses; however, we are unable to identify specifically which loans within the portfolio will eventually suffer loss. Primary responsibility for wholesale loans that are performing consistent with original expectations is held by credit executives who maintain a direct relationship with the borrower. These credit executives, supported by independent reviews, actively monitor and re-assess the risk-ratings assigned to each credit extension in order to properly identify borrowers who may be at increasing risk of default.

For wholesale loans that have a higher risk of credit loss, prompt identification and active management are critical to preserving the Firm's capital and maintaining the borrower's solvency. As such, the Firm has a dedicated workout group within the credit risk management function that acts as an advisor to the credit executives that have the direct relationship with the borrower to develop a strategy to maintain the relationship with the borrower and facilitate continued collection of principal and interest, while more closely monitoring the borrower's financial condition.

As the credit risk increases and/or performance on an individual loan declines such that the Firm believes that all contractual principal and interest will not be received according to contractual terms or the underlying problems require special workout expertise, the workout group assumes direct responsibility for the loan. The primary objective of the workout group is to develop a strategy to maximize the recovery of the loan and to prevent dissolution of the borrower, if possible. These strategies include restructuring the loan terms to avoid default or bankruptcy, restructuring the loan terms within the context of a bankruptcy proceeding, working with the Firm's loan origination team to raise additional capital or provide/syndicate post-bankruptcy debtor-in-possession financing, and - if all other reasonable collection and workout efforts are unsuccessful - foreclosing on or liquidating the borrower's assets.

Consumer loans

Similar to wholesale loans, consumer loans are originated or purchased with a certain loss expectation based on the characteristics of the borrower and the loan. These expectations are formed based on factors such as loan-to-value ratios, borrower's credit risk scores, the term of the loan, lien position, level and quality of documentation obtained and the source of the loan. Although loans are underwritten individually with the expectation that the borrower will perform according to the terms of the loan, we know on a portfolio basis that certain of these loans will result in losses; however, we are unable to identify specifically which loans within the portfolio will eventually suffer loss.

Unlike wholesale loans, our borrower relationships and the size of typical consumer loans do not facilitate an ongoing risk-rating based review of consumer borrowers. Therefore, we rely on other processes to monitor and manage the credit quality of our consumer loans. A significant element of this ongoing credit risk management process is initiated based upon borrowers that have become delinquent. The main objective is to assist borrowers in the resolution of delinquent loans, thus minimizing loss and sustaining long-term borrower relationships. In carrying out this objective, the Firm's consumer collections groups initiate contact with borrowers to determine the reason for the delinquency, negotiate payment plans, obtain payment commitments and follow up on agreed-upon future payments.

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If the Firm's collection efforts are not successful, then the collections groups transfer the accounts to a designated loss mitigation unit. For home lending in particular, loss mitigation groups provide counseling and workout options for borrowers who are experiencing difficulty in making their monthly mortgage payments. Such workout options include various forms of loan modification, short sale and deed in lieu of foreclosure. After exhausting all other reasonable collection and workout efforts, the Firm may need to foreclose on specified collateral underlying the loan in order to recover its investment.

In addition to this delinquency-based process (and more significantly during the most recent financial crisis), the Firm may identify loans that warrant enhanced credit risk management for a reason other than delinquency, including loans to borrowers determined to be at risk of imminent default (e.g., due to an expected payment reset on a variable rate loan), loans with high loan-to-value ratios, certain discontinued products, etc. The actions that the Firm may take to manage the credit risk associated with these loans vary based on the underlying facts and circumstances. For example, if a borrower is determined to be at risk of imminent default, then the Firm may offer a loan modification to the borrower even though the loan is current. In other cases, the Firm may simply continue to monitor the loan and, at the same time, consider the elevated level of credit risk in its credit loss estimation process.

Credit Loss Estimation

The Firm's loss estimation process varies by the type of loan and the information available to the Firm. Wholesale loans tend to have shorter contractual tenors and the Firm has internal and external sources of loss history data by borrower, industry or credit rating view that can be applied in the risk assessment on a loan by loan basis. Consumer loans generally have longer tenors (excluding certain types of loans such as credit card and auto loans, which have shorter expected lives) and consumer loan relationships generally offer fewer opportunities to collect updated customer credit risk information, other than credit score information. Although these credit scores are used in monitoring and managing consumer credit risk, consumer loan portfolios tend to comprise large number of homogeneous loans with smaller balances, which can be segmented into portfolios with relevant common risk characteristics other than credit scores. Consumer credit losses are therefore estimated at the portfolio/segment level, generally based on borrower payment behavior (e.g., delinquencies) and collateral information.

The Firm applies a rigorous estimation and review process to arrive at its best estimate of credit losses. Wholesale credit losses are estimated based upon the Firm's risk rating system. These risk ratings correspond to estimated loss factors (probability of default and loss given default) based on independent verifiable data and the Firm's own loss experience in its loan portfolio. Consumer credit losses are estimated by applying loss rates and other risk indicators to pools of loans with common characteristics. Loss rates are derived from various sources that include delinquency roll rate models, loss severity models and risk migration models. For all loans, these initial loss estimates are reviewed and adjusted to consider factors not directly observable in current credit data, such as current macroeconomic conditions, changes in underwriting standards, collateral value trends, and borrower behavior trends, each of which affect credit losses but are not yet reflected in the factors used to derive the initial estimates.

The Firm continuously evaluates the performance of its loss estimation process and regularly enhances the process and inputs to ensure high quality loss estimates. For both wholesale and consumer loans, the Firm's loss estimates are single best estimates - not probability weighted expected outcomes. Although the Firm considers various sets of assumptions in estimating credit

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losses, specific probabilities to assign to the various alternatives - including possible future credit market environments - do not exist.

Observations on the Boards' proposal

To understand how the Boards' proposal could be applied to loan portfolios in practice, we used our own major loan portfolios and associated credit loss estimates (developed as discussed above) to estimate loan loss reserves and credit costs through a credit cycle. We evaluated periods between 12 and 36 months as the "foreseeable future" period referred to in the proposal. Based on our analysis, we developed several observations on the results and the process.

The allowance determined using the time proportional approach is difficult to explain because it is not anchored in common credit risk management processes or information. Stating the formula is the only way to explain it.

While the mechanics of the time proportional calculation are understandable for those who know the formula, the reason for reserving for a *portfolio age-based portion* of *expected future* losses is difficult to understand. We found the time proportional approach difficult to explain conceptually to internal users of our modeling results. While the IASB's original proposal had conceptual merit (recognizing the *full-life* expected credit losses proportionately over the loan's life), the Supplementary Document addresses the practical concerns with that approach by instead focusing on *remaining life* credit losses multiplied by the age based-ratio. BC 71 suggests that the time proportional approach is intended to provide "an approximation of the outcomes in the IASB's original exposure draft", however we did not find that to be true. We found under the time proportional calculation, the portion of lifetime credit losses recognized in earnings exceeded a pure time-proportional amount because the recognized credit losses equal realized credit losses plus a portion of remaining expected credit losses.

In addition, we found some changes in the reserve from period to period difficult to understand intuitively. For example, we found that in some periods where remaining life losses had declined, the loan loss reserve actually increased because the age-based ratio was increasing (thus reserving for a greater portion of the remaining life losses). We found such changes to be not intuitive and required explanation via the calculation. Based upon our discussions with users of bank financial statements, we believe that they would prefer that changes in the allowance be driven solely by changes in loss estimates rather than changes in both loss estimates and portfolio characteristics such as weighted average age and expected life. The value of trend information over time is reduced if those trends are masked by the influence of multiple variables.

The definition of the bad book is an important driver of the overall allowance amount under the time proportional approach and the twelve month minimum, but has a lesser effect if a longer foreseeable future period is used.

The Boards' proposal requires that loan portfolios be divided into a "good book" (subject to a reserve equal to the greater of (a) time proportional expected credit losses and (b) credit losses expected to occur in the foreseeable future) and a "bad book" (subject to a reserve covering remaining life expected credit losses). The proposal requires that the bad book includes loans for which the collectability has become so uncertain that the entity's credit risk management objective changes from collection of principal and interest to recovery. Such a definition is necessarily judgmental, as there often is not a clear and distinct point at which management's objective changes.

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We found that this judgment was less important to the overall allowance amount if a longer foreseeable future period were used in the good book reserve estimate, because there was less difference between losses expected to occur in the foreseeable future and remaining life expected credit losses for the population of troubled loans. We believe this is because loans that can be identified for the “bad book” on a loan-specific basis will generally realize credit losses in relatively short order.

In contrast, we observed that the definition of the bad book became more important if the “good book” allowance were determined using the time proportional approach or credit losses expected within twelve months. This is because the amount of the allowance under the “bad book” methodology could significantly exceed the amount of the allowance determined for those same loans using the time proportional calculation or using the twelve month minimum of expected credit losses.

The time proportional calculation would rarely, if ever, exceed a 24 month floor and a 12 month floor generally does not exceed the time proportional calculation.

The dominance of a 24 month floor over the time proportional approach amount (and of that approach over a 12 month floor) remained constant for each major loan type over time. We found this relationship to be true even at different points in the recent credit crisis.

The allowance under the time proportional approach is affected by several factors other than expected credit losses.

Although the time proportional approach generally seeks to recognize changes in expected credit losses over the remaining expected life of the loans through the age-based ratio, that age-based ratio changes over time due to several complex factors. Therefore, we found it difficult to generalize about the earnings effect of changes in expected losses.

For example, in periods of economic stress, loan originations tend to decrease, and accordingly, the numerator of the age-based ratio, the weighted average age, tends to increase. In addition, the expected life of the loans changes over time because it is directly affected by changes in the amount and timing of expected credit losses, among other factors. Therefore, in periods of economic stress, increases in estimated credit losses that are expected to be realized in the near term will decrease the denominator of the age-based ratio, the weighted average expected life. The combination of the changes in the numerator and the denominator tends to amplify the effect of an increase in expected credit losses. In contrast, if such losses are expected to be realized in the longer term, there may be less of effect on the expected life, and therefore a smaller portion of those increased losses would be recognized immediately under the time proportional approach. This effect highlights that in order to perform the time proportionate approach correctly, it is necessary to estimate the timing of future expected losses (not just the amount of losses) in order to assess the effect of those losses on the expected life of the portfolio.

Whether the time proportional approach and the foreseeable future floor accelerate the recognition of credit losses is largely dependent on the estimate of “probable incurred losses” under current practice.

We were unable to draw any broad conclusions regarding whether the Boards’ proposal would accelerate the recognition of (a) credit losses originally expected at loan origination or (b) subsequent increases in expected credit losses compared to current practice.

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In some circumstances the time proportional approach or foreseeable future floor component (if viewed to be a short period such as 12 months) could result in recognition of amounts less than the current estimate of “probable incurred losses.” This is because for many types of loans, incurred losses are estimated by considering forecasts of realized credit losses over a defined “loss emergence period.” Consider a loan portfolio for which management currently estimates a loss emergence period longer than twelve months. For such loans, a foreseeable future period equal to twelve months of expected losses would result in an allowance for loan losses that is lower than the current estimate of incurred losses. Such situations may be partially mitigated by the bad book concept in the Supplementary Document, but circumstances will likely remain where certain loans remain in the “good book” even with fairly high loss estimates, if the specific loans expected to suffer loss cannot yet be identified.

In other circumstances, if the foreseeable future period is longer than the current loss emergence period, then credit losses (both originally estimated and subsequent increases in expected losses) would be recognized earlier than in current practice.

Loss estimation at a pool level would not translate well to securities portfolios.

While some portfolios of similar plain vanilla debt securities may be easily evaluated on a pool basis, we agree with the views of those Board members that believe that debt securities will often have unique risk characteristics that would result in an individual evaluation of impairment. Most of our securities are currently evaluated on an individual basis, and in order to arrive at a portfolio loss estimate, we believe that we would have to continue to build a portfolio estimate from the sum of the individually calculated estimates.

JPMorgan Chase Views

We believe that the revised impairment model should result in an allowance for loan loss that is sufficient to cover credit losses expected within the foreseeable future (but limited to the remaining expected life of the loans) and should incorporate loss estimates that reflect management’s best estimate of credit losses inherent in the loan portfolio. We also believe that the impairment model should be anchored in actual credit risk management processes and result in an allowance that can be simply and clearly communicated to users of financial statements.

Loss Estimates

One of the primary criticisms of the existing accounting standards is that the recognition of credit losses (through large reserve builds) tended to occur near the peak of the credit crisis, rather than in prior periods. We believe that this is in part due to narrow interpretations of the existing incurred loss model that were too dependent on currently observable credit quality information and too focused on abbreviated loss emergence periods.

In order to address these issues, we believe it is important for the revised impairment model to incorporate robust loss estimates that fully capture management’s view of losses inherent in the portfolio. Loss estimates must begin with considerations of the current credit quality of the loan portfolio, including current credit metrics such as borrower behavior and collateral values, historical loss rates and other internal and external loss data and information. The loss estimates must also incorporate management judgment to consider other factors such as:

- changes in underwriting standards, loan covenant terms and other loan characteristics,
- recent or expected deterioration or improvement in economic conditions,
- changes in loss emergence patterns over a credit cycle, and

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- the level of estimate imprecision and uncertainty in loss estimates.

Consideration of these factors is necessary to ensure timely recognition of credit losses when they are inherent in the portfolio, rather than when the credit losses are manifested through more clearly observable credit quality indicators such as delinquency or default. The economic and credit conditions, underwriting practices and borrower behavior that lead to downturns in the credit cycle build over time, and we believe the final standard should be explicit that these macro factors that affect the risk profile of the loan book should be appropriately considered when estimating credit losses inherent in the portfolio.

Loss Horizon

We support a model that recognizes expected losses that can be reasonably estimated in the foreseeable future, but no longer than the average remaining expected life of the loan portfolio. We believe that this model results in an allowance for credit losses that is sufficient at each balance sheet date to cover credit losses expected within the foreseeable future and facilitates clear and transparent communication with financial statement users regarding loss expectations and the quality of the loan portfolio.

We believe that the foreseeable future should be no longer than the average remaining expected life of the portfolio. This is particularly relevant for loans, such as credit card loans, that have a short expected life, which may be substantially less than the time period over which management can estimate losses for the related business. The foreseeable future must be considered no longer than the average remaining expected life of the portfolio because credit losses that are expected to be realized after the average remaining expected life of the portfolio pertain to future originations, not current loans, and therefore are not appropriate to be accrued at the balance sheet date.

Time proportional approach

We do not support a model based on a time proportional approach because such an approach, by itself, would result in delayed recognition of certain losses in comparison to the current incurred loss model. Under the time proportional approach, an increase in expected credit losses would not be fully recognized immediately, but would be spread over time based on the defined time proportional ratio unless the increased expected losses significantly shortened the expected life of the portfolio. This spreading could occur even if those losses were considered probable, and would have been recognized immediately under the current incurred loss model. The result of this delayed recognition is that the allowance for loan loss could fail to cover some portion of credit losses that management reasonably expects to occur. We believe that sufficiency of the allowance for loan loss reserve at the balance sheet date is a key focus for financial statement users.

We believe that the existence of the bad book only partially mitigates this concern, because there are losses that are considered probable but cannot be identified to an individual loan. In these circumstances, the loans would necessarily remain in the good book, where the use of the defined ratio would limit the recognition of rising expected losses. While we appreciate the objective to recognize credit losses more smoothly over time to more closely align with interest income recognition, we are concerned that the time proportional approach, by itself, achieves that objective by *delayed* recognition of certain credit losses compared to a “foreseeable future” model. We do not believe this is an appropriate or desirable result.

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Foreseeable future floor

In our view, a floor limited to a 12 month foreseeable future period would be insufficient for some loan portfolios. We expect that a 12 month floor would be less than the time proportional approach calculation for most loan portfolios and may therefore be ineffective at addressing the concerns regarding the time proportional approach for most loan portfolios. Based on our experience in the credit crisis, we believe that investors would expect the allowance for loan losses to cover more than twelve months of losses for most loan portfolios other than for short-term receivables such as credit card loans. We believe that the inability to provide for losses that management expects to emerge in the future would be perceived negatively by financial statement users, and cast an erroneous impression of a firm's ability to anticipate near term expected economic conditions and their impact on loan portfolios.

Bad book identification

If the final impairment model is based on the best estimate of losses expected to occur within the foreseeable future period for which the amount of credit losses can be reasonably estimated, we believe that a bad book is unnecessary. The vast majority of remaining lifetime expected losses on impaired loans would be expected to occur within the foreseeable future, and thus be recognized immediately without the need for a bad book. We believe that by eliminating the need for a bad book, an allowance based on losses expected in the foreseeable future would greatly simplify the application and transparency of the final impairment model.

If the Boards proceed with a two-group impairment model, we support the Boards' efforts to differentiate the two groups based on an entity's internal risk management. As discussed earlier, our credit risk management process does distinguish certain loans for risk mitigation efforts and aligning the split used for accounting and credit risk management practices reduces complexity and eases our ability to transparently describe the results of our credit risk management process to users of our financial statements.

Because credit risk management processes and loan portfolios differ somewhat across entities, we do not believe that the guidance provided as to which loans should be allocated to either book can be prescriptive. However, providing general guidelines based on the SFAS 114 (ASC 310-10-35) definition of an impaired loan (where a creditor believes it will be unable to collect all amounts due according to the contractual terms) would be useful. We believe that this concept of an impaired loan can be applied broadly to all loans (including consumer loans), although it may be implemented differently by loan type. For example, wholesale loans may be evaluated individually, whereas consumer loans may be evaluated based on delinquency or other characteristics.

Discounting

We believe that loss estimates should focus on the principal losses on an undiscounted basis. We believe this sufficiently approximates a discounted cash flow calculation (incorporating interest and principal cash flows) flows at a much more reasonable operational cost. While we understand that a discounted cash flow methodology has some conceptual appeal, it is based on the concept that all loans – even impaired loans – should contribute earnings. (In the discounted cash flow methodology this is achieved by recognizing a higher credit loss in the initial impairment calculation, a portion of which is subsequently accrued to earnings – either as interest income or as a reduction of future credit costs over time). Such a concept is not necessarily intuitive, and it is reasonable to expect that certain loans should be considered non-earning assets.

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Implementation of a principal loss approach would require the Boards to establish guidance that defines when interest income should no longer be accrued on a loan, and to address certain loan modifications that essentially forego interest cash flows to preserve principal cash flows. (See Appendix A for our recommended approaches for these issues.) With a principal loss-based impairment model, rigorous non-accrual guidance, and targeted guidance to address certain loan modifications, we believe that all contractual cash flows would be accounted for. In our view, such an approach would represent a significant simplification compared to a more complex discounted cash flow methodology.

Transparency and communication to financial statement users

An important objective of the impairment model should be to transparently communicate loss estimates to financial statement users. Based on our discussion with analysts, they are most interested in information regarding expected credit losses so that they may evaluate those estimates and overlay their own judgments and views as necessary. To do so, they need information to understand the magnitude of the expected credit losses and the various factors and judgments considered in those estimates. They also need to understand how expected credit losses, and changes in expected credit losses, affect reported earnings and the allowance for credit losses.

The time proportional approach would not satisfy those objectives without significant supplemental disclosures. Because expected credit losses are one of several inputs to the time proportional calculation, they are not directly observable from the allowance for loan loss itself. In addition, changes in these expected losses are not transparently communicated by the time proportional approach because of the calculation required and the significant effects that changes in the age-based ratio may have on the resulting allowance. To compensate for this, we believe many analysts would request disclosure of the discrete inputs, including the lifetime credit loss estimate, and then adjust that credit loss estimate to reflect losses that are expected to be realized in a shorter timeframe, a timeframe closer to the foreseeable future concept. Rather than add complexity to financial statement disclosures and communication with investors, we think it is preferable to present expected loss information more simply and directly as we have proposed.

Comparability and convergence

Due to the global nature of the financial services industry and current emphasis on global regulatory capital rules, we believe that beginning with a single global concept for the allowance for loan loss is of increasing importance. We understand that in implementing any revised impairment standard, there will inevitably be differences in judgments across entities – but such potential for different judgments does not eliminate the benefits of at least starting with a single global concept. For example, the length of the foreseeable future (the future time period over which losses can be reasonably estimated) is a key element of our recommended approach (as well as the Boards' proposal). Although peer banks engaging in business activities of a similar scope will generally have similar forecasting capabilities and similar access to data, we understand that the length of the foreseeable future is ultimately an estimate by management and may vary to some degree. Like other judgments made in estimating the allowance for loan losses, we do not believe that management's judgment regarding the length of the foreseeable future should be confined by a bright line rule, but rather should be determined and supported by management and then adequately disclosed to financial statement users. Allowance coverage ratios and other credit disclosures will provide sufficient supplemental information for users to make their own judgments regarding the adequacy of allowance amounts across peers.

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We commend the Board's efforts to develop a single global impairment standard in order to provide this consistent starting point. While certain compromises are inevitable to achieve a single global standard, we believe such compromises must remain aligned with two key principles: a) loss estimates must not be narrowly confined and b) the allowance for loan loss must be adequate to cover inherent losses in the loan portfolio at each balance sheet date. In addition, we encourage the Boards to ensure that the final model is as simple as possible while satisfying these objectives.

Exposure of full impairment model

We understand and appreciate the time pressures that the Boards are under to complete this project and other key joint projects, but believe it is imperative that the Board's ultimate conclusions be subject to adequate public comment and field testing to ensure that the results of the final standard are understood and accepted by key constituents, and that unintended consequences are minimized. To understand the results of the Supplementary Document requires extensive modeling and multiple iterations of various assumptions and economic conditions – all of which are time-consuming and the analysis was required to be performed by constituents concurrently with other significant financial reporting priorities. We believe that the Boards would benefit from understanding the scenario analyses performed and ensuring that such quantitative testing was adequate and that the results were consistent with the Boards' expectations.

In addition, several important aspects of the loan impairment model have yet to be exposed, including impairment for securities, purchased loans, troubled debt restructurings as well as non-accrual guidance and these aspects should be subject to the same due process as the elements of the model included in this Supplementary Document. Without the exposure and public debate of critical components of the impairment model that have yet to be developed, unintended consequences are likely to result. Our views on those other critical components are included at Appendix A.

Disclosures

We believe that new disclosure requirements should be aligned with the requirements of ASU No. 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" (the ASU). We believe the ASU achieved its objective of making disclosures regarding credit risk more coordinated, less redundant, and achieved an appropriate balance between relevant quantitative information and qualitative description and context for that information. The ASU requires information at the portfolio level (the level at which the allowance for credit losses is estimated) and at the class level (based on the risk characteristics of the assets and the level at which management assesses and monitors credit risk). We believe this disaggregation at the portfolio and class level to be appropriate and provides for the right balance of credit risk disclosures.

Our primary concern with the proposed disclosures is that certain disclosures are required by class of financial asset, rather than at the portfolio segment level. This disaggregated view is not necessary to provide an understanding of an entity's loan portfolio and allowance for credit losses. We encourage the IASB to review the new credit risk disclosures by US financial institutions in the 2010 Annual Reports, as well as discuss those disclosures with financial statement users prior to recommending additional disclosures.

We are also concerned with the amount of quantitative data required to be disclosed by the IASB proposal, and we have provided several examples of these concerns at Appendix B.

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In summary, we believe that the revised impairment standard should result in an allowance for loan loss that is sufficient to cover credit losses expected within the foreseeable future (but limited to the remaining expected life of the loan portfolio) and should incorporate loss estimates that reflect management's best estimate of credit losses inherent in the loan portfolio. We support efforts to agree on a single global standard, not only because of the general benefits of comparability and consistency in a global market, but also because financial institutions are increasingly operating within a global framework for regulatory capital. However, the principles we have articulated – robust loss estimates and reserve sufficiency -- are paramount and we would give them priority over a converged accounting standard that fails to meet these principles.

It will be possible to assess the effect of some of the proposed changes in the Supplementary Document only after a thorough review of the related amendments to the Accounting Standards Codification. As the requirements of the Supplementary Document 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 when such amendments are available.

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. 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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APPENDIX A

Below are our views on other critical components of the impairment model that we believe must be addressed by the Boards

Non-Accrual loans

The final impairment model should include appropriate non-accrual guidance that would limit the recognition of interest on financial assets on which principal losses are expected. US bank regulatory non-accrual guidance is robust and well understood by preparers, auditors and users of financial statements. We recommend that the Boards consider the incorporation of the existing non-accrual regulatory guidance into the final impairment standard.

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. Abandoning the SOP 03-3 accounting model and instead considering credit losses from purchased loans in the allowance for credit losses would significantly improve financial reporting clarity and transparency. Accordingly, financial instruments purchased at a discount related to credit quality which are to be held for the collection of principal and interest in a lending relationship should be initially measured on the balance sheet at the face amount less an appropriate allowance for credit losses, along with any remaining purchase price discount or premium, and subsequently should be subject to the same impairment model as originated loans. Consistent accounting for these purchased and originated financial instruments would allow for an easier understanding and aggregation of credit statistics across portfolios.

Troubled Debt Restructurings (“TDR”)

We believe the FASB should reconsider the relevance of current TDR accounting and disclosures under US GAAP, and incorporate the results of such reconsideration into the final joint standard on impairment. We believe that there are two separate pieces of information that financial statement users seek to understand regarding loan modifications: (i) the effect the modifications will have on the loan’s yield prospectively and (ii) the amount of credit loss associated with the modified loan. We believe that the yield aspect should be handled through appropriate disclosures in the period of modification. The credit loss aspect should be addressed in the impairment project in a manner consistent with non-modified loans, which should identify and recognize existing principal losses expected in the foreseeable future (or over the loan’s remaining life, if a bad book concept is incorporated and modified loans are deemed to represent bad book loans). This approach would simplify the impaired loan accounting model in general, eliminate classification and measurement inconsistencies that may arise under the current accounting model, and promote the application of an appropriate impairment measurement methodology to all loans.

We understand that in certain modifications, a lender may agree to reduce contractual interest payments in order to improve the recovery of principal amounts. In these circumstances, we understand that a principal-only impairment model may be perceived as insufficient, and that a discounted cash flow approach (considering all contractual cash flows) would be appropriate in such circumstances.

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Securities impairment

While we believe that loss estimation for securities can be similar to that of loans, we do not believe that the impairment evaluation for all securities lends itself to an open pool methodology. For example, securities backed by mortgages are already pooled at the collateral level within a single security. Pools of mortgages underlying a single security can include thousands of loans. To then also require aggregation of multiple mortgage-backed securities for impairment evaluation would in many cases result in groupings that include dissimilar risks due to differences in underlying loan types, issuers, or underwriting standards. In addition, each securitization vehicle distributes cash in a manner or order that is predetermined at the inception of the vehicle. The priority of the allocation of cash flows to each tranche within the securitization and the level of credit enhancement in place to support those cash flows impact the estimation of credit loss for the individual security. We believe that the appropriate aggregation level for loss estimation purposes should be left to the discretion of risk managers, and that unique collateral, credit enhancement, and other features will result in risk managers often determining that loss estimation on a security by security basis is most appropriate.

While we believe that the pooling of loans versus securities will differ, the loss estimation process should be similar. Entities should estimate expected losses using all available and supportable information to estimate cash flows that are expected to be uncollectible at the date of estimation. Losses should be calculated directly, not as a derivative of the change in expected future cash flows. Loss estimates should be recognized when expected, rather than probable. Both increases and decreases in estimated expected losses would result in further provisions or recoveries. Losses should 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 should be disclosed.

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APPENDIX B

Below are our specific examples of our concerns with the level of quantitative data that the IASB proposal would require to be disclosed:

- Z7 – we do not believe that separate reconciliations of changes during a period for the good book and the bad book should be required. A reconciliation for the entire allowance at the portfolio segment level, with the right level of quantitative and qualitative disclosures as required by paragraphs Z10 and Z11, will provide the appropriate level of transparency to the changes in the allowance for credit losses.
- Z7 (b) and Z8- We disagree that alternative allowance calculations should be disclosed because such alternative calculations will add confusion regarding the appropriate allowance determination. We believe that financial statement users would be better served by having a single and consistent definition of the allowance for loan loss.
- Z12- We disagree with the proposed disclosure of the results of back testing prior period allowance for loan losses because users of US GAAP financial statements already have realized loss information through charge-off data. We believe that users who wish to analyze back testing results will prefer to perform their own back testing based on the data provided, rather than interpreting preparer results. We believe this requirement would add unnecessary complexity to disclosures and be less useful than providing the charge-off data directly.
- Z12(b)- The disclosures required in this paragraph are redundant to the proposed disclosures in paragraph Z10
- Z14- We do not understand the value of disclosures of probability of default and loss given default by class of loan. In some cases, these measures are not evaluated and monitored separately, and in other cases, they are assessed on a loan-specific basis (rather than by class of loan). We believe that disclosures, such as the risk ratings and industry and geographic concentrations, at the class level would be more consistent with risk management information and will give financial statement users relevant information to assess the credit quality of the portfolio.