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February 15, 2012

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

File Reference No. 2011-220 – Proposed Accounting Standards ASU, *Consolidation (Topic 810) – Principal versus Agent Analysis (the “proposed ASU”)*

Dear Ms. Cospers:

JPMorgan Chase & Co (“JPMorgan Chase” or “the Firm”) appreciates the opportunity to comment on the proposed Accounting Standards ASU, *Consolidation (Topic 810) – Principal versus Agent Analysis*, issued by the Financial Accounting Standards Board (“FASB” or the “Board”). JPMorgan Chase supports the Board’s efforts to develop consolidation guidance that is converged with International Financial Reporting Standards (“IFRS”). In particular, the Firm agrees that:

- The evaluation of a decision maker’s capacity should be based on a qualitative assessment and should consider the purpose and design of the entity, the rights held by other parties, the decision maker’s compensation and the decision maker’s other economic interests.
- Kick-out and participating rights should be evaluated consistently for both variable interest entities (“VIE”) and non-VIE limited partnerships and similar entities.
- Interests that expose a decision maker to negative returns (or both negative and positive returns) are fundamentally different than interests that expose the decision maker to only positive returns, and therefore should be evaluated differently in the principal versus agent assessment.

Money Market Funds

We encourage the Board to either provide a scope exception for money market funds or include an example to illustrate how the proposed guidance should be applied to money market funds for which the investment manager provides explicit or implicit support. While we support the principles of the proposed ASU, we are concerned that the proposed framework may be difficult to interpret and apply consistently to money market funds and therefore believe more explicit guidance is necessary. We understand that the FASB does not intend for investment managers to consolidate money market funds (as explicitly stated in question 10 of the proposed ASU and the Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (“SFAS 167”) deferral for certain investment management funds (ASU 2010-10, paragraph BC 16)). We agree with this conclusion given the unique purpose and design of money market funds and the fact that consolidation of these funds would decrease the usefulness of investment managers’ financial statements.

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Money market funds in the United States serve a unique purpose and have narrowly defined design parameters as they are typically regulated by the Securities and Exchange Commission's Investment Company Act of 1940 (the "Act"). The unique purpose and regulatory requirements of these funds result in the following attributes:

- a. There are substantive restrictions on the quality, maturity and diversity of investments held by these funds.
- b. These funds represent a vital component of the short term US capital markets, providing creditworthy borrowers access to competitively priced short-term funding and investors with an attractive yielding and more diversified alternative to bank deposits.

We believe that the consolidation of managed funds, and money market funds particularly, would not provide useful information for financial statement users given the fee based nature of the asset management business. Financial statement users, including analysts and rating agencies, have indicated that consolidated managed funds would need to be omitted from asset managers' financial statements and asset management fees separately presented (not eliminated) to appropriately assess asset managers' results and financial position. For example, in its December 2009 publication, "New Accounting Rules Will Alter the Financial Statements of Certain US Asset Managers," Standard & Poor's ("S&P") indicated that, regardless of changes to accounting guidance, the rating agency would continue to ask companies to provide financial statements and related information on a deconsolidated basis so that they could analyze asset managers' operating performance and financial profiles separately from those of the funds they manage and companies in which they invest. As a result, consolidation of managed money market funds will almost certainly lead to a significant increase in the use of non-GAAP measures to accurately describe the underlying results and operations, liquidity and financial position of consolidating investment managers.

While we agree that in most circumstances, the ownership of a significant subordinated interest is an important factor in assessing whether a decision maker is acting in a principal capacity, we believe that implicit or explicit support agreements provided to money market funds have a unique purpose and design and should not result in a conclusion that the investment manager of a money market fund is acting in a principal capacity. We are concerned that the emphasis on subordinated interests in the proposed guidance may make it difficult to appropriately interpret and apply to money market funds, and therefore encourage the FASB to provide an explicit scope exception for money market funds and other funds that are required to comply with or operate in accordance with requirements that are similar to those included in the Act. An explicit scope exception could acknowledge the unique nature of these funds and alleviate concerns that inappropriate analogies are made to other variable interest entities or structures. Alternatively, a money market fund example that includes an implicit or explicit support agreement could also be effective to reaffirm the Board's intent that money market funds should not be consolidated under the proposed ASU.

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Other comments

We encourage the Board to consider additional ways to strengthen the principles in the proposed ASU and to make it simpler to apply and interpret in practice:

1. *Substantive Kick-out rights should be considered determinative*

Substantive kick-out or removal rights should be determinative that a decision maker is acting in an agent capacity, even if the rights are held by more than one unrelated party or by an independent board of directors. The evaluation of whether removal rights are substantive should consider all facts and circumstances, including (a) the number and dispersion of the parties that need to collectively exercise the removal rights and (b) whether the decision maker's other interests could create a barrier or significant disincentive to exercise removal rights (consistent with paragraphs 810-10-25-40A and 810-10-25-97c). For example, the guidance provided in the penultimate sentence in Case D would be simpler if the subordinated nature of the asset manager's equity interest were included in the initial assessment of whether the board of director's removal rights are substantive, rather than first concluding the rights are substantive, then ignoring them based upon an evaluation of the asset manager's other interests.

In addition, we disagree with the view expressed in paragraph BC 18 that "... kick-out rights and participating rights should affect only the consolidation analysis *when there is a realistic possibility that the other interest holders may exercise those rights.*" [Emphasis added] In this statement, the Board implies that the possibility of whether a kick-out right will be exercised is relevant in determining whether a kick-out right is substantive. We disagree with this view because there are many rights that are not commonly exercised in practice simply because no need arises in the course of business to do so, and not because the right itself lacks substance. We believe that it is more important to determine whether the kick-out right can be exercised, regardless of the probability that the holders would choose to exercise those rights. In this regard, we agree with the Board's view on participating rights (paragraph 810-10-25-41D): "the likelihood that the participating rights will be exercised by the interest holder shall not be considered when assessing whether a participating right is substantive." Participating rights and kick-out or removal rights should be evaluated similarly by focusing on whether they can be exercised if necessary, rather than whether there is a business need to exercise such rights is probable or likely.

2. *A holder of a required retained interest may be an agent*

Evolving regulatory rules will likely require risk retention by sponsors/originators in certain cases. We understand that such risk retention requirements are intended to align the sponsor/originator's interests with those of the 3rd party investors and to ensure that initial and ongoing decisions are made in the best interests of the 3rd party investors. We do not believe that the Board intends for all such risk retention to cause a decision maker to conclude that it is acting in a principal capacity, and encourage the Board to expand its guidance in this area to include an assessment of how and why the entity is holding the interest(s). These required risk retention positions should be indicators used in the principal versus agent analysis and we recommend that the Board clarify that if the decision maker's only economic interest in the entity is held solely to meet a regulatory requirement, then it should be considered a strong indicator that the decision maker is an agent.

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3. Provide guidance on VIEs that have no on-going decision-making ability

The proposed ASU should provide guidance for assessing VIEs that have no on-going decision-making ability (e.g., pass-thru entities such as agency re-securitizations). Currently there is an inconsistency in practice between US GAAP and IFRS constituents in the application of consolidation guidance related to pass-through entities. SFAS 167 requires a primary beneficiary analysis in all cases and reporting entities need to identify the entity (if any) with decision-making power based on the decisions made up-front in designing the VIE. In contrast, based on interpretative guidance developed by the IASB staff, IFRS constituents may conclude that for VIEs that have no ongoing decision-making ability after initial entity setup, no consolidation is required. We recommend that the FASB incorporate the concepts of the interpretive guidance that was developed by the IASB staff in order to simplify the consolidation analysis of pass-through entities without ongoing decision-making ability and to promote consistency in application.

4. Eliminate guidance on whether a decision maker fee is a variable interest

The guidance in paragraph 810-10-55-37 should be eliminated. We believe that a decision maker with the power to control an entity should need to evaluate only whether it is using its power in a principal or agent capacity. Whether a decision maker's fees are variable interests seems irrelevant and adds unnecessary complexity to the analysis.

The guidance in paragraph 810-10-55-37, sections (a), (d), (e) and (f) requires an analysis of the fees themselves and section (c) requires consideration of other interests held by the decision maker. While some of these criteria require an assessment that is similar to the proposed guidance for assessing whether the decision maker is acting as a principal or an agent, there are some significant differences. Specifically, the guidance in sections (e) and (f) requires an assessment of the size of the fee in relation to both the anticipated economic performance of the entity and the variability the fee absorbs in the entity. These types of assessments can be difficult to apply in practice because of the interpretive decisions required, such as how and when to measure anticipated economic performance. More importantly, the tests in sections (e) and (f) are, appropriately, not part of or relevant to the principal versus agent analysis, and therefore, they should not be required in determining whether a fee is a variable interest.

The only reason this guidance appears to remain in the proposed ASU is to determine whether a decision maker is in the scope of the disclosures required for VIEs when it has a significant variable interest as stated in paragraph 810-10-50-4. This disclosure does not justify the added operational complexity of this analysis. Alternatively, the Board could create a disclosure requirement that would specifically address decision makers acting in an agent capacity.

5. Codification needs significant clarification

While we understand that the order of the proposed guidance follows Codification numbering, the flow and context of the proposed guidance is confusing and disjointed. Additionally, where consistent guidance is provided across various sections of the codification it is difficult for a reader to comprehend the overarching concepts with all of the repetition in the text, particularly because a reader is forced to evaluate whether differences exist, and if so, whether they are meaningful or unintended. For example:

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- The “LIFO liquidation” guidance in paragraphs 810-10-55-2 through 3 appears to be a mere reordering of paragraphs within the section, but its placement between guidance on “assessing participating rights” and “assessing a decision maker’s capacity” is not a logical flow; and
- Paragraphs 810-10-25-40A and paragraph 810-10-25-97 each provide guidance on evaluating whether kick-out/removal rights include barriers to exercise; the former references “the parties holding the kick-out rights” while the latter references “the limited partners holding the kick-out rights.”

We encourage the Board to find alternative presentation solutions before issuing this proposed ASU as final, as well as for future exposure drafts. Perhaps exposing new guidance as a broad, cohesive principle first (similar to the Revenue Recognition (Topic 605) Proposed Accounting Standards ASU (Revised) issued on November 14, 2011) then providing a cross reference to the individual codification sections and paragraphs would increase the readability and understandability of this proposed ASU and future exposure drafts.

6. Effective Date and Transition

While we do not expect the proposed amendments to significantly affect the consolidation conclusions for securitization entities, asset-backed financing entities, and entities formerly classified as qualifying special-purpose entities, the proposed ASU represents fundamental revisions to the accounting literature and a careful evaluation of various entities under the revised guidance and documentation of conclusions will require significant effort. Therefore, we ask the Board to provide an effective date with no less than a one year implementation period from the date of final ASU issuance to provide adequate time for preparers to appropriately evaluate and operationalize the changes proposed. The Board should also permit early adoption to encourage convergence with the IFRS principal versus agent guidance and to allow a reporting entity to follow the improved consolidation model as quickly as feasible. The benefits of permitting early adoption would outweigh the potential concerns over the temporary lack of comparability between financial statement preparers and those concerns could be addressed through appropriate disclosures.

In addition to the comments above, please see Attachment I for technical clarifications and recommendations.

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

Sincerely yours,



Bret Dooley

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Attachment I

Technical clarifications and recommendations

The following are the Firm's technical clarifications and recommendations:

- The proposed ASU removes the guidance that a decision maker's interests should exclude interests held by employees or employee benefit plans when evaluating whether the decision maker's fee is a variable interest. We are unclear why the change is necessary. While an employee or employee benefit plan is considered a related party for disclosure purposes, we do not believe that they should be included in the analysis for determining whether a decision maker is acting as a principal or agent. The investment objectives and decisions made by an employee (financed or not) or on behalf of an employee benefit plan will often differ from decisions made by the decision maker of an entity with regard to its own interests and those of its affiliates. We do not believe that the Board intended for a decision maker (i.e., an asset manager) to be considered as a principal due to other investments held by an employee or employee benefit plan for their own benefit. Therefore, we recommend that the final ASU reinstate the language in paragraph 810-10-55-37A.
- A decision maker that receives market-based compensation commensurate with the services provided and has no other economic interest in the entity should be considered an agent. We encourage the Board to reaffirm this view in the guidance within paragraph 810-10-25-39J. The guidance in this paragraph could be strengthened by enhancing the guidance in a. and b. as follows: "If both of those conditions are present, and a decision maker has no other economic interest in the entity, the decision maker is an agent. If those conditions are not present, this would be an indicator that the decision maker is a principal...."
- We believe that the requirement for reassessing whether a decision maker is a principal or an agent should be the same as reassessing if the entity is the primary beneficiary. As the principal versus agent determination is a component of the primary beneficiary analysis, we recommend that the Board require an ongoing assessment of both so that consistent application can be achieved.
- Section 810-10-25-39L item "b" provides an example of evaluating a decision maker's exposure to variable returns from other interests in the entity. This example suggests that holding a subordinated interest may be an indicator that the decision maker's exposure to variability of returns is more than that of the others investors, and notes that a 5 percent pro rata interest in an entity would be less indicative of a principal relationship than a 5 percent subordinated interest. While we understand the concept that the Board is trying to provide, we are concerned that this type of example might be drawing a bright line with regard to a significance threshold for investments. Additionally, we believe that this example places too much reliance on subordination by itself as an indicator (e.g., no consideration given regarding why the decision maker is holding the interest). We believe that there are other factors to consider with regard to subordination before one could make the assessment that subordination is an indicator that an entity is acting in the capacity of a principal. We recommend that this example either be deleted or be amended to ensure it is not interpreted that the Board is suggesting a 5% bright-line test to indicate a principal relationship.

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- The Board decision addressed in paragraph BC20 (that liquidation rights should be considered equivalent to kick-out rights) is an important element of the revised model. Therefore, the Board should include reference to “liquidation rights” within the guidance on kick-out rights in paragraphs 810-10-25-40A through C and paragraphs 810-10-25-97 through 99.
- Due to the complex flow of the codification guidance as presented in the proposed ASU, it is important that the accompanying decision tree(s) facilitate a reader’s ability to navigate the guidance provided. The decision trees in the proposed ASU fail to provide an effective overview of the proposed model and should be streamlined to increase their usefulness and understandability. We encourage the Board to replace the decision trees provided in paragraph 810-10-05-6 with the decision tree included in PwC Dataline No. 2011-33, Appendix A. In our opinion, the PwC decision tree improves the overall comprehension of the model and makes navigating the codification more efficient.
- There are several examples included in the proposed guidance that state that the reporting entity has the rights to receive benefits of the VIE because of a fee arrangement (see Case E and F on pages 98 and page 101, respectively). These examples then consider the fees in the primary beneficiary analysis without regard to their significance or insignificance. We do not believe that the Board intends to imply that an insignificant fee is an important consideration in the primary beneficiary analysis. To avoid confusion, the guidance in these examples should be clear that there are other factors that cause the decision maker to be deemed a principal (guarantee in Case E and the residual holding in Case F) and not the fee. Reference to fees in these examples should be removed as the fee is irrelevant to the conclusion that the decision maker is a principal.
- The implementation examples provided for assessing a decision maker’s capacity use the following three quantitative terms: “anticipated economic performance,” “maximum exposure to loss” and “variability of returns.” The difference between “anticipated economic performance” and “variability of returns” is not defined within the guidance, but the application of these two concepts in the proposed ASU seems consistent. We encourage the Board to use one term consistently or clarify the difference. We believe that a decision maker’s compensation and other economic interests could be effectively evaluated through an assessment of the decision maker’s exposure to variability of returns and its maximum exposure to loss.

We also encourage the board to clarify how these concepts should be evaluated. We expect that the assessment of a decision maker’s exposure to variability of returns and its maximum exposure to loss should contemplate a decision maker’s assumptions and expectations over the expected life of the entity, versus being assessed more narrowly over some arbitrary, shorter time horizon (i.e., current year, recent history or performance, etc.). Clarifying this point within the examples would increase consistency in interpretations.

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- We encourage the Board to acknowledge that some partnerships and similar entities have an independent board of directors. For instance, in some partnerships, a group of limited partners form an independent board with oversight and removal rights over the general partner. By changing the references from “the rights held by limited partners” to “the rights held by other parties,” the Board could ensure both that this concept is included in the guidance within paragraphs 810-10-25-96 through 106 and that the analysis of rights held by parties other than the decision maker is complete.
- The examples should be simplified to demonstrate when a principal versus agent analysis is not necessary to determine the primary beneficiary. For example, where there is no clear decision maker (Case H- Joint Venture) or when the decision maker does not earn a specific fee (Case I- Furniture Manufacturer), the concept of principal versus agent does not seem relevant. Thus, such examples should remove the discussion regarding principal versus agent.
- There are duplicative examples provided within the proposed ASU for both the asset-backed collateralized debt obligation (“CDO”) structure and the commercial paper conduit structure. As the principal versus agent analysis (paragraphs 810-10-55-3AN through 3BK) is part of the primary beneficiary analysis (paragraphs 810-10-55-110 through 121 and 134 through 146), the entire analysis can be effectively captured through one example for each structure type.
- The anti-abuse clause included in ASC 810-10-15-14 condition c was important under FIN 46R as there was a difference between the economic risk-based evaluation of VIEs and control-based evaluation of other legal entities. However, because the evaluation of VIEs and non-VIEs are aligned under the proposed ASU, condition c is no longer relevant.