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File References:  
- 1225-001 Exposure Draft, Accounting for Transfers of Financial Assets, an amendment to FASB Statement 140 (Transfers of Financial Assets ED)  
- 1220-001 Exposure Draft, Accounting for Servicing of Financial Assets, an amendment to FASB Statement 140 (Servicing ED)  
- 1210-001 Exposure Draft, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140 (Hybrids ED)  

J.P. Morgan Chase & Co. (JPMC) appreciates the opportunity to comment on the above referenced Exposure Drafts (EDs). JPMC has actively participated in the preparation of the comment letters submitted by the International Swaps and Derivatives Association (ISDA), American Securitization Forum (ASF), Commercial Mortgage Securities Association (CMSA) and the Loans Syndications and Trading Association (LSTA). As such, a number of our concerns are reflected in those comment letters and we urge the FASB to consider the views and adopt the recommendations set forth in those letters. Since we have significant concerns regarding certain provisions of the proposed guidance, we felt the need to provide our overall views separately in this letter.

First we want to express our thanks to the Board and Staff in addressing many of the industry’s comments submitted in response to the June 2003 Exposure Draft on Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (Statement 140), as well as discussions held in the August 2003, May 2004 and June 2004 Public Roundtables. We appreciate the time and effort of the Board and FASB staff in considering such factors in the current Exposure Drafts. Furthermore, we appreciate that the Board expedited the projects on servicing financial assets and the accounting for certain hybrid financial instruments.

While simplification and global convergence of accounting standards has been at the forefront of standard setters’ agendas, we acknowledge that this is not an easy task as it requires a fundamental change in the current behavior of preparers, auditors, regulators and standard setters. However, when possible a concerted effort should be made toward this goal. An

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important step in achieving this goal is the cessation of predominately “rule based” amendments which do not add to the clarity in the underlying principle and only serve to add to the standards’ overall complexity. Another way is to move forward on new accounting standards that are objective-based that limit rules that are inconsistent with the principles outlined in the standard.

We strongly support the timely issuance of the Servicing and Hybrid Exposure Drafts. Through these amendments the FASB Board and Staff has acknowledged constituents’ concerns with the complexities of current accounting standards. By providing a fair value election for the accounting of servicing assets and certain hybrid transactions, the Board is alleviating the need to comply with the onerous rules of hedge accounting for certain servicing assets and the operational burden of bifurcation of hybrid financial instruments as required by Statement of Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities (Statement 133). We have certain comments and suggested revisions to the Servicing and Hybrid EDs that we believe will improve their application in practice. Our suggestions are described in more detail in the Attachments II and III to our letter.

However, we do not support the issuance of the Transfer of Financial Assets ED at this time. We believe that the Transfer of Financial Assets ED is an example of an amendment that will only increase the complexity of an already complicated standard as well as increase the likelihood of inconsistent application and lack of comparability among financial statements. Also, in this ED, the Board introduces detailed form-based rules that seem to conflict with the underlying principles of Statement 140 (e.g., proposed rules on rollovers of beneficial interests are not based on the concept of “control”). Because the FASB has increased the complexity of the standard without any apparent benefit, we believe that there will be a continuing need for interpretive guidance to alleviate tensions between audit firms and preparers of financial statements. There are certain provisions of the Transfer of Financial Assets ED that are useful and should be incorporated in the Hybrids ED. Specifically, the amendments to paragraphs 35c and 40 are useful in clarifying the application of Statement 140 and complement the Hybrids ED.

In summary, we do not support the issuance of the Transfers of Financial Assets amendment and recommend that the Board cease making further amendments to Statement 140 at this time, specifically as it relates to the Transfer of Financial Assets ED, and focus its work with the International Accounting Standards Board (IASB) on a joint, principle-based derecognition standard. Now is the right time for a joint project with the IASB to achieve convergence as derecognition and the use of qualifying special purpose entities (QSPEs) continues to be one of the more significant differences between US GAAP and IFRS\(^2\). We believe that this would require both the FASB and IASB to essentially start with a “clean sheet of paper” to develop a derecognition model for financial assets that is built upon an objective-based standard. Industry participants and users will also need to be an integral part of this process.

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The following summarizes our most significant comments on each of the three Exposure Drafts. Attachments I-III provides more detail of our significant comments and also provides other “drafting” comments for your consideration.

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I. Transfer of Financial Assets ED:
We support the financial components approach for derecognition of financial assets as described in paragraph 5 of Statement 140. Amendments to Statement 140 directly related to the transfer of financial assets should only be in order to clarify this approach. As described above, we do not support the issuance of this ED. However, if the Board decides to proceed with the issuance of the ED we strongly urge the Board and Staff to consider the following comments, which are described in more detail in Attachment I:

- Guidance in paragraph 8A of the ED, in our opinion, is unnecessary and directly conflicts with paragraph 5 of Statement 140, which states that Statement 140 is premised on a financial components approach. We do not believe that the Board has clearly articulated the benefits of paragraph 8A. Rather, we believe the definition of a participating interest will only require further interpretive guidance.

- Guidance in paragraphs 9d, 9e, A9, and A17 of the ED does not clarify the legal isolation requirements. The Board, in its attempt to curtail variations in the application of legal isolation guidance, has further complicated the analysis with no apparent benefit. We are concerned that the FASB's attempt to address issues attorneys face in rendering legal isolation and non-consolidation opinions as noted in paragraph A17, go beyond simple clarifications.

- We interpret the ED to permit derecognition when transferring an entire asset into a non-QSPE, including when a non-prorated interest is held by the transferor, as long as the transfer meets the requirements of paragraph 9 (e.g., transfers to Collateralized Debt Obligations). In other words, the insertion of a QSPE in this example is not required by the ED in order to derecognize the asset. We agree with this interpretation and recommend that the Board clearly articulate this in the Basis of Conclusions.

- We do not support the changes to paragraph 9b, specifically as it relates to requiring that paragraph 9b be met in all transfers in a multi-step transfer and that the transferor has the ability to sell or pledge their beneficial interests. We recommend that the Board delete these new requirements as the Board has not provided a sufficient basis to support these changes. Specifically, the Board should address the application of this provision to two-step transfers.

- We recommend the deletion of paragraph 40 as it is no longer necessary due to the elimination of Derivatives Implementation Group Issue No. D1 “Recognition and Measurement of Derivatives: Application of Statement 133 of Beneficial Interests in Securitized Financial Assets” (“DIG Issue D1”). If the Board does not agree with this recommendation, then we support the proposed deletions in paragraph 35c2 and paragraph 40 and suggest that Board include such changes in the Hybrids ED.

- We are concerned that application of the proposed guidance in paragraph 11b to certain securitization structures provides an opportunity for earnings management in cases in which the transferred assets were not measured by the transferor at fair value with changes recognized in earnings both prior and subsequent to the transfer. Similar to the dissenting board member's view, we believe that any relevance brought about by a momentary fair value measurement should be addressed in a more comprehensive review of subsequent measurement throughout the life of a financial instrument.
II. **Servicing ED:**
We strongly support the proposed accounting for servicing of financial assets. By requiring the initial measurement of servicing assets at fair value, the accounting for loan sales will become simpler. Also, providing entities with the ability to subsequently account for servicing assets at fair value will eliminate the operational burdens of applying hedge accounting to servicing assets under Statement 133.

- We support the proposed disclosures as they will provide the reader of financial statements with useful information as to the nature and results of the business activity related to servicing assets as well as the risk management of those activities. We have certain minor suggestions in Attachment II.

- We encourage the Board to include a transition provision in the amendment to Statement 140 that would permit entities a one-time transfer of securities classified as available-for-sale to a trading classification.

III. **Hybrid ED:**
We strongly support the Board’s efforts in the Hybrid ED to increase similar accounting for similar instruments.

- We agree with the decision to permit fair value remeasurement for hybrid financial instruments that contain an embedded derivative that otherwise would require bifurcation. We believe the fair value election simplifies the application of Statement 133.

- We do not believe that the proposed Statement should be delayed in order to include implementation guidance on how to evaluate whether an instrument contains an embedded derivative that would require bifurcation or on how to evaluate and account for interests issued by QSPEs. We believe that our recommendations discussed in Attachment III regarding paragraph 16 of Statement 133 and in Attachment I regarding the elimination of paragraph 40 of Statement 140 address these issues.

- We believe that the proposed effective date does provide sufficient time for implementation by calendar year reporting enterprises. However, we believe that certain aspects of the Statement should also be applicable to certain instruments obtained before the effective date, as discussed in Attachment III.
In conclusion, JPMC supports the timely issuance of the Hybrid and Servicing EDs as these projects advance the goal of simplification of accounting standards. In contrast, we do not support the issuance of the Transfer of Financial Assets ED as we believe that the majority of the proposed modifications made in the ED will only serve to increase the complexity of Statement 140 with little apparent benefit. In lieu of the issuance of the Transfer of Financial Assets ED, we support a joint initiative by the FASB and the IASB to develop a new framework with respect to derecognition of financial assets.

In the event that the Board pursues the issuance of the Transfer of Financial Assets ED, we would request the Board to consider our comments detailed in Attachment I of our letter, and in the ISDA, ASF, CMSA, and LSTA letters. Also, given the substantive nature of these comments, the Board and Staff should adjust their timeframe for this project in order to allow enough time to review these comments and study the issues we raised before issuing the guidance as final.

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 212-270-7559 or Shannon Warren at 212-648-0906.

Very truly yours,

Joseph L. Sclafani
Transfers of Financial Assets Exposure Draft

If the Board decides to move forward with the issuance of the Exposure Draft, then there are several areas that we recommend redrafting in order for the standard to provide a consistent, conceptual framework that can be practically implemented by preparers of financial statements.

The following topics are discussed below:

1. Participating Interests
2. Legal Isolation/Opinions
3. Modifications to Paragraph 9b
4. Initial Measurement at Fair Value
5. Derivatives in QSPEs
6. Rollover of Beneficial Interests

1. Participating Interests

We agree with the dissenting Board member’s viewpoints described in paragraphs A50-A52 that the principle of the financial-components approach reaffirmed in Statement 140 was designed to address all transfers of financial assets with continuing involvement, including transfers of portions of financial assets. We agree that it is inappropriate to amend Statement 140 to impose the requirement to use a QSPE to achieve sale accounting for transfers of portions of financial assets that do not involve a pro rata division of cash flows when legal counsel has concluded that this additional step is unnecessary to achieve legal isolation. We are also concerned that the proposed language in paragraph 8A will create uncertainty in the identification of transactions that are impacted by the new guidance. For these reasons, we strongly urge the Board to delete this requirement in the final amendment. If the Board does not agree, then we request the Board to consider the following clarification points:

Paragraph 8Ac states, “participating interest holders have no recourse to the transferor (or its consolidating affiliates or agents) or to each other....”

By not limiting the recourse limitation to the transferor only, the guidance could be read to exclude interests in financial assets with recourse to other interest holders (i.e. transferor’s recourse to participating interest holders with respect to funding commitments or a participating interest holder with respect to another participating interest holder under a setoff sharing provision.)

Further, given the definition of recourse provided in Statement 140, the proposed language appears to disqualify interest holders with recourse to the transferor pertaining to contractual breaches for non-performance by the transferor. Such breaches could include misrepresentations or non-performance of a servicing obligation which are necessary in many sale transactions. We do not believe that restricting this level of recourse was the FASB’s intention when drafting the amendment.

Also, we do not understand why only servicing fees representing adequate compensation can be excluded from determining the proportionality of cash flow. This provision implies that servicing fees representing more than adequate compensation (i.e., creation of a servicing asset) must be divided among the participating interests in proportion to their share of ownership. In other words the creation of a servicing asset would disqualify the transferred interests from meeting the definition of a participating interest. We suggest the Board delete the phrase “representing adequate compensation” or clarify that profit margins
can be generated by the servicer. Furthermore, we suggest deleting the last sentence in paragraph 8Ab, which states that the ownership shares must remain constant over the life of the original financial asset. We are concerned that sales treatment would be disallowed if a transferor subsequently participates or assigns the unparticipated portion of its interest in the original financial asset, or if a participant subsequently converts its participation into an assignment.

2. Legal Isolation/Legal Opinions

We are concerned that the clarifications to the legal isolation criteria in paragraphs 9d, 9e, A9 and A17 do not add clarity for legal counsel in rendering legal isolation opinions. In fact, we discussed these changes with several prominent law firms and received mixed views of what type of interpretations will be necessary in order to meet the proposed requirements in the amended Statement 140. As such, we do not believe this additional guidance will reduce inconsistencies and improve comparability as the Board intended.

Also, the clarification in paragraph 27 intended to relieve the operational burden of requiring a legal opinion if a transferor has a reasonable basis to conclude that the appropriate legal opinion or opinions would be given if requested, will not mitigate the need to obtain opinions to satisfy auditors. It would be helpful to clarify that only consolidated affiliates directly related to the transfer should be considered in the legal opinion. It would likely be an expensive endeavor to evaluate all consolidated affiliates involvement and obtain opinions sufficient to comply with Sarbanes-Oxley requirements when clearly there is no risk of substantive consolidation in bankruptcy.

We do not object to the principle of applying the isolation requirement of paragraph 9(a) of Statement 140 to the transferor and its consolidated affiliates. However, the FASB should clarify the wording in paragraph A9 of the ED that the transferred assets must be isolated from all entities, which are consolidated into the transferor, but not from all sister entities located above the transferor in the consolidation chain. Paragraph A9, as proposed, is inconsistent with the wording of paragraph 3.b. and paragraph 9a of the Exposure Draft since paragraph 3.b. applies the isolation criteria to the transferor and its consolidated affiliates, but paragraph A9 applies the isolation requirement to the consolidated group that includes the transferor. A consolidated group includes affiliates under the ultimate parent that are not consolidated with the transferor (e.g., sister companies). The isolation requirement applied to the consolidated group that includes the transferor would make it impossible for transfers of financial assets to sister companies to meet the sales criteria in the transferor’s separate stand-alone financial statements since both parties are in the same consolidated group. We believe that derecognition should be permitted for purposes of the transferor’s separate stand-alone financial statements even though the transaction would be eliminated in consolidation in the ultimate parent’s consolidated financial statements. This clarification is needed as it may result in negative regulatory and tax consequences.

Concerns on Paragraph 9d and 9e

Paragraph 55 clearly states that, “a change in law, status of the transferee as a qualifying SPE, or other circumstance may result in the transferor’s regaining control of assets previously accounted for appropriately as having been sold...” Guidelines in this paragraph along with paragraph 9 provide a sound, workable framework for assessing legal isolation. There is no need for the additional clarification provided in paragraphs 9d and 9e. As drafted paragraphs 9d and 9e go well beyond simple clarifications of paragraph 55 and existing industry views.
Specifically, we are concerned that the guidance in paragraph 9d would require an on-going review of subsequent transactions that were unrelated to the original transfer. We expect to have significant operational difficulties monitoring and refreshing legal isolation opinions for activities unrelated to the initial transfer. Paragraph 9d appears to require that any activity done in connection with the transfer should be considered in the legal isolation analysis. "In connection" is not clear and implies that activity done with beneficial interest holders, even activity not contemplated at inception would require a reassessment under paragraph 9.

A second hurdle is the requirement to obtain hypothetical legal opinions upon transfer of a financial asset. Paragraph 9e requires legal opinions to consider all activities with beneficial interest holders as if they had been done directly with the QSPE. This paragraph is simply not necessary and we have received varying views from law firms on their ability to write such an opinion. Also, we do not believe 9e is necessary as attorneys in giving legal opinions take into account material involvement of affiliates.

**Legal opinions outside of US jurisdiction**
The deliberations, basis of conclusion, and requirements in the amendment appear to be focused on U.S. bankruptcy law.

The proposed amendments to paragraphs 9 and 27 introduce a specific requirement that the isolation test in paragraph 9(a) can only be satisfied if the transfer is legally a sale under the laws of the applicable jurisdiction. This adds to the separate requirement for an analysis that, in the event of the transferor's bankruptcy, receivership or other insolvency, the transferred asset would not be deemed to be part of the estate of the transferor.

The requirement under paragraphs 9 and 27 of Statement 140 for a true sale opinion will disadvantage institutions that issue US GAAP financial statements (or consolidated subsidiaries thereof) to take part in the loan trading market where different legal considerations apply. For example, it is possible for transferred assets to be isolated under English law from a transferor's estate in its insolvency - without a "legal sale". We strongly urge the Board to reconsider the imposition of the requirement for a true sale opinion where legal isolation is possible without a "legal sale".

If the requirement for a true sale opinion is imposed as contemplated by paragraphs 27A and 27B of the ED, institutions who sell loans in the London market through English incorporated consolidated subsidiaries will not be able to derecognize the loans under US GAAP despite technically meeting the isolation requirement.

3. **Modifications to Paragraph 9b**
   It appears that the Board has limited the definition of a beneficial interest to those interests issued by a QSPE. The ED also eliminates the term retained interest. By limiting the term beneficial interest to those interests issued by a QSPE and eliminating retained interest, we are unsure what terminology the accounting guidance uses to describe an interest issued by a non-QSPE (e.g., CDO). We suggest that the Board clarify that the term beneficial interest is not limited solely to interests issued by a QSPE. This definition also causes issues relating to the Hybrids ED. See comments in Attachment III.

We note two other significant changes made by the Board in paragraph 9b. First, the proposed amendment extends the free transferability requirements in paragraph 9b to transferor beneficial interests. This is a new requirement as the original 9b in Statement
only required that the transferee have the right to pledge or exchange its beneficial interests. We understand in that certain structures, transferors that retain a beneficial interest are restricted from selling that interest, for example due to tax regulations or by the rating agencies. Since Statement 140 is a control based model, it is not necessary that the transferor have the right to freely pledge or exchange its beneficial interests in order to achieve derecognition, as long as the transferee can exchange or sell their interest.

We also note that paragraph 9b has been modified to require satisfaction at every step of a multi-step transaction. We do not believe this requirement is necessary, particularly for a two-step transaction as outlined in paragraph 83. Two-step transactions are structured in order to isolate transferred financial assets beyond the reach of the transferor and its creditors, even in bankruptcy. In a two-step, it is in the first step that legal isolation is achieved. In many cases a true sale at law could not be achieved in the second step; however since legal isolation was achieved in the first step, the Board agrees that the requirements of 9a have been met. Thus, it is the fact that the two-step transaction as a whole meets the requirements of paragraph 9a. We believe that the same logic should apply for achieving the requirements of 9b in a multi-step transaction. In other words as long as the ultimate transferee in a multi-step transaction is permitted to sell or pledge the assets or its beneficial interests, it would be inconsistent to require in this case for the first step to meet the provisions of paragraph 9b. We also note that the Board did not add an additional requirement for meeting the requirements of paragraph 9c in multi-step transactions.

Based on the above, we strongly recommend that the Board not proceed with the proposed modifications to paragraph 9b.

4. Initial Measurement of Fair Value
We understand the concept in paragraph 11 that upon completion of a transfer of financial assets the transferor’s beneficial interest obtained as part of the transfer is effectively a new asset. Therefore, the recognition of a gain on the transfer would be appropriate and this concept is in line with the FASB’s fair value initiative.

However, we are troubled by this when applied to certain securitization structures as it creates the opportunity for earnings management, especially for non-mark-to-market businesses. For example, in credit card securitizations, under the proposed rules a gain would be recognized when the transferor adds credit card receivables to the credit card securitization trust even though the transferor did not sell any additional beneficial interests to third parties. In this situation, the seller’s interest is increased without any third party involvement, yet a gain would be recognized when there is no culmination of an earnings process.

We do not consider a transfer of receivables into a securitization trust in exchange for additional seller’s interest a new financial asset in a QSPE. The seller’s interest still has many characteristics of the underlying receivables. For example, the seller’s interest in many securitization structures are not in certificated or in registered form, are not marketable, and do not have readily determinable fair values. In addition, the seller’s interest is sold in conjunction with either a credit card portfolio or credit card business sale transaction and not sold like a typical asset-backed security. As such, we consider the seller’s interest to be akin to a retained participating interest in a pool of assets and should be recorded as such.
To this end, we echo the concerns raised in paragraph A54, “…this change introduces discretionary timing of gains and losses on entire assets for non-substantive economic changes (such as the use of a qualifying SPE to sell a small disproportionate interest in the cash flows of an asset, would trigger recognition of the gain or loss on the whole asset, even though the transferor retains control over most of the cash flows of the asset).” Since we are concerned with potential abuses in this area as well, we agree with the dissenter that any added relevance brought about by a momentary fair value measurement should be addressed in a more comprehensive review of subsequent measurement throughout the life of a financial instrument.

5. Derivatives in QSPEs

We support the deletions in paragraphs 35c and 40, which eliminate certain requirements restricting passive derivatives that can be held by the QSPE pertaining to a transferor’s retained interest. We recommend that these changes to paragraphs 35c and 40 be included as part of the Hybrids ED since it directly correlates with that amendment. However, we strongly recommend that paragraph 40 in its entirety be eliminated as the rules in Statement 140 are not consistent with a control based model and it is no longer clear what purpose these rules serve.

The financial asset derecognition rules in Statement 140 are built upon a control-based model. We do not believe that the rules in paragraph 40 are consistent with a control model; instead they were incorporated as part of Statement 140 to ensure a transferor could not use a QSPE to avoid the accounting for derivatives at fair value. The rescission of DIG Issue D1 and the requirement to measure embedded derivatives requiring bifurcation at fair value have eliminated the need for the paragraph 40 restrictions.

Further, it is not clear whether or how to apply paragraphs 35 and 40 to derivatives newly bifurcated from beneficial interests as a result of the Hybrids ED. At a minimum, we do not believe that bifurcated derivatives should cause a QSPE to lose its qualifying status, as long as they are passive, and urge the Board to include guidance that beneficial interests that include embedded derivatives or are derivatives in their entirety need not be evaluated under the provisions of paragraphs 35 and 40. We strongly recommend the elimination of paragraph 40 as the most effective way to address this issue, and note that this recommendation will also eliminate some of the complexity of Statement 140.

If the Board does not agree with the suggestion of eliminating paragraph 40 in its entirety we believe the proposed changes to paragraphs 35 and 40 would be strengthened with the addition of certain provisions in paragraph 9 of the recently issued proposed FASB Staff Position (FSP) 140-c, Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140, specifically relating to the guidance on prepayments.

6. Rollover of Beneficial Interests

The requirements added to paragraphs 35 and 45A pertaining to the rollover of beneficial interest are complex, difficult to understand and will lead to differing interpretations on what constitutes more than a trivial incremental benefit. We understand the intent of this paragraph is to prevent transferors from effectively retaining control over assets by having the ability to disproportionately benefit from the reissuance of liabilities of a QSPE. However, we do not believe that the Board’s proposed guidance will achieve this result.

The FASB’s definition of “involvement with the entity” includes a wide array of activities that would be assessed as part of this analysis such as many arm’s length service
arrangements (e.g., calculation agent, trustee, collateral manager etc). Many believe that these roles even though negotiated on an arm’s length basis provide incremental benefit purely because of continuity in revenue streams from these services. These views vary widely in practice. Also, that quantification of incremental benefit is not an exact science and requires market based assumptions that will vary depending on the economies of scale and the breadth of offerings of the service provider.

Also, the definition of “rollovers of beneficial interests” should be limited to rollovers of beneficial interests at maturity. Investors, other than the transferor, typically have the ability to change legal documents with a majority or super majority vote possibly initiating a change in funding or collateral requirements. These changes are out of the transferor’s control and therefore should not be considered in the definition of rollovers.

Further, the FASB states that “no party” can have the ability to obtain more than a trivial benefit by holding multiple forms of involvement. This proposed restriction may result in the transferor consolidating entities that lose their QSPE status based upon the inconsequential actions of third parties. For example, it may be interpreted that an unrelated third-party that provides a form of liquidity commitment may be in a position to disqualify the securitization trust from its qualifying status if it purchases a subordinated interest in that securitization trust, resulting in the consolidation of that securitization trust into the transferor’s consolidated financial statements. It is our understanding that this was not the intention of the FASB staff to have a standard that determines what is consolidated on the balance sheet or remains off-balance sheet that is based on the actions of third parties since the principle is based on the transferor’s ability to control, not other, unrelated parties. At a minimum, this paragraph should be clarified to reflect that this test only pertains to the transferor and its affiliates.
Attachment II

**Servicing Assets Exposure Draft**

JPMC strongly supports the proposed accounting for servicing of financial assets - specifically requiring the initial measurement of servicing assets at fair value and then permitting entities to subsequently account for servicing assets under either a fair value or a lower-of-cost-or-market approach. Requiring the initial measurement of servicing assets at fair value simplifies accounting for loan sales. Also, providing entities with the ability to subsequently account for servicing assets at fair value eliminates the operational burdens of hedging servicing assets under Statement 133.

JPMC is generally in agreement with the proposed disclosures as these disclosures will provide the reader of financial statements with useful information as to the nature and results of the business activity related to servicing assets (as well as the risk management of those activities).

However, we do recommend the following minor modifications for clarity:

- Paragraph 17.e. (3) e “The amount of contractual servicing fees...” should become Paragraph 17.e. (4). The current presentation of these paragraphs implies that the amount of contractually specified servicing fees should be included in the servicing asset balance activity “roll-forward” that occurred during the period. The amount of contractually specified servicing fees earned should be disclosed outside the balance activity “roll-forward”.
- Paragraphs 17.e. (4) and Paragraphs 17.e. (5) should be renumbered accordingly.
- Similar formatting adjustments should also be made to the disclosure requirements for servicing assets accounted for under a lower of cost or market approach (i.e., Paragraph 17.f.(3)f should become Paragraph 17.f.(4)).

We also encourage the Board to include a transition provision in the amendment to Statement 140 that would permit entities to transfer securities previously classified as available-for-sale to a trading classification without calling into question the accounting treatment for those securities under FASB Statement No. 115, “Accounting for Certain Investments in Debt and Equity Securities.” Historically, JPMC has maintained a portfolio of available-for-sale securities specifically identified as instruments used to economically hedge MSRs. JPMC can easily identify the specific securities used for this economic hedge (for which the transitional provision would apply) and therefore would not call into question the accounting for all other available-for-sale securities held by the Firm for other business reasons. We believe that other companies using available-for-sale securities as economic hedges of MSRs isolate their specific securities in a similar manner.
Hybrids Exposure Draft

We support the Board’s efforts to simplify and increase the consistent application in the accounting for hybrid financial instruments. Therefore, we support the timely issuance of the Hybrids ED in its final form, and also strongly encourage a timely issuance of the Fair Value Option.

Information Used to Determine the Existence of a Freestanding or Embedded Derivative

Paragraph 3(b) of the Hybrid ED requires an evaluation of the “contractual terms of the beneficial interest” and an evaluation of “sufficient information about the payoff structure and the payment priority of the instrument” in order to determine the existence of a freestanding or embedded derivative. Under paragraph A16, the Board explained that an understanding of “the payoff structure and the subordination status of the instrument will require an understanding of the nature and amount of assets and the nature and amount of liabilities and other beneficial interests comprising a transaction.”

It is not always clear when analyzing a structure for an embedded derivative how these provisions should be applied. For example, assume an entity is formed and acquires fixed rate Japanese government bonds (“JGBs”) from the market and issues $100 of fixed-rate US dollar denominated debt to fund the asset purchase. In addition, the entity enters into a foreign currency swap under which it makes fixed Japanese yen payments and receives fixed US dollar payments. Based solely on the contractual terms of the debt it would appear that the interest issued by the entity is fixed-rate US dollar denominated debt without an embedded derivative. However, if the holder were to analyze the underlying assets or liabilities of the entity, the interest could be interpreted to be a Japanese Yen denominated host contract with an embedded currency swap.

We believe that evaluation of the assets and liabilities of the vehicle should be required only if the contractual terms of the interests are inconsistent with the economic risks of the interests. In the above example, the interest issued by the entity would not be considered to include an embedded currency swap. We believe that these results are consistent with the Board’s intent with respect to embedded derivative identification and current application of Statement 133, and note that the same issues are present for interest rate as well as foreign exchange risk. We recommend that the Exposure Draft specify that the investigation of the assets and liabilities of an entity is required when the existence or lack of an embedded derivative cannot be determined by evaluating the contractual terms in conjunction with the economic risks of the interests.

Amendment to Statement 133, paragraph 16

We recommend that the Board reinstate the phrase “If an entity cannot reliably identify and measure the embedded derivative instrument that paragraph 12 requires to be separated from the host contract, the entire contract shall be measured at fair value with gain or loss recognized in earnings, but it may not be designated as a hedging instrument pursuant to this Statement” found in paragraph 16 of Statement 133. We appreciate that the Board removed the phrase with the understanding that the provision was not currently being utilized and with the belief that the fair value election for hybrid financial instruments made the phrase unnecessary. However, we believe that the importance of this provision will be heightened due to the repeal of DIG Issue No. D1, and the Exposure Draft’s “look through” requirements addressed above. While measurement will be simplified through the new fair value election, the identification of derivatives requiring bifurcation will be much more complex. We are especially concerned about the analysis of whether a residual interest contains a derivative requiring bifurcation. Maintaining the phrase from paragraph 16 allows entities to qualitatively assess instruments for embedded
derivatives, and upon identification of an embedded derivative for which identification and measurement may be unreliable, measure the entire instrument at fair value.

**Effective Date and Transition**
We support the Board’s decision not to require preparers to perform a bifurcation evaluation of interests that previously had not been subject to Statement 133 because of the DIG Issue D1 exemption. We also recommend that the Board allow an entity to elect fair value accounting for all hybrid instruments previously bifurcated that are not being used as hedging instruments under Statement 133 at transition date as a cumulative effect adjustment. We believe that the recommendation addresses the Board’s concerns about the complexities associated with the recognition of gains and losses on host contracts. We believe the financial reporting and operational benefits of consistent accounting for the types of instruments (e.g., structured notes) that were bifurcated under current Statement 133 and will likely be measured at fair value under the proposed amendment outweigh the perceived costs or issues noted in paragraph A30. Thereafter, the election would be made on an instrument-by-instrument basis consistent with paragraph 5.

In addition, we are unclear as to how to apply the transition provisions of the amendment to Master Trust, Multi-issuance and other vehicles that issue new beneficial instruments. If the Board does not agree with our recommendation to eliminate paragraph 40 of Statement 140, we question whether bifurcable derivatives contained in beneficial interests issued by a qualifying special purpose entity ("QSPE") after the transition date could potentially taint the qualifying status of an entire Master Trust or Multi-issuance vehicle. The impact on existing vehicles and transition provisions need to be fully considered. We believe that the provisions of this proposed amendment should not disqualify QSPE status for entities that are deemed to be QSPEs under existing guidance.

**Use of the Term “Beneficial Interest”**
The Transfer of Financial Assets ED defines a beneficial interest as:

“A right to receive all or portions of specified cash inflows to a qualifying SPE, including senior and subordinated shares of interest, principal, or other cash inflows to be “passed-through,” premiums due to guarantors, commercial paper obligations, and residual interests, whether in the form of debt or equity.”

This definition specifies that only QSPEs can issue beneficial interests.

The use of the term “beneficial interest” in the Hybrid ED implies that the amendments specified in paragraphs 3b and A18 are applicable only to those vehicles that are QSPEs. However, we believe that the Board intended that these provisions apply to interests issued by special purpose entities (SPEs), qualifying or not, and variable interest entities. As noted in Attachment I, we recommend that the Board clarify that the term beneficial interest is not limited solely to interests issued by a QSPE. If the Board does not agree, then we recommend that the Board clarify that the provisions of the Hybrids ED are applicable to all interests issued by an SPE qualifying or not and variable interest entities.