JPMorganChase

Joseph L. Sclafani
Executive Vice President and Controller

Letter of Comment No: 2
File Reference: FSPFAS140C
Date Received:

Director, TA&I--FSP
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Comments on Proposed FSP 140-c
Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140

Dear Director, TA&I--FSP:

J.P. Morgan Chase & Co. is grateful for the opportunity to comment on the Financial Accounting Standards Board's ("FASB" or the "Board") FSP 140-c, *Clarification of the Application of Paragraphs 40(b) and 40(c) of the FASB Statement No. 140* (the "proposed FSP").

We appreciate the FASB's efforts to clarify paragraph 40 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140) as a result of issues raised by constituents, including representatives from our firm at the April 26, 2005 meeting with the FASB staff. We agree with the Board's decision in paragraph 9 of the proposed FSP that the requirements of paragraphs 40(b) and 40(c) of SFAS 140 must be met when the beneficial interests are issued by the qualifying special purpose entity (QSPE) or when a passive derivative needs to be replaced upon the occurrence of a specified event outside the control of the transferor. However, we have significant concerns that paragraph 10 of the proposed FSP redefines the intent of paragraph 40 of SFAS 140 as it pertains to secondary market making activities. Since this issue is appropriately remedied in the recently issued SFAS 140 Exposure Draft which will supersede this FSP shortly as discussed further below, we respectfully request that the Board not issue this FSP at this time. The remainder of this letter summarizes our concerns with the proposed FSP.

Paragraph 10 of the proposed FSP requires a preparer to measure anticipated market making activity at inception when determining if a derivative instrument pertains to third party beneficial interests; this requires a comprehensive analysis of whether, at the time the beneficial interests of the QSPE are issued, the notional amount of the derivative is expected to exceed the amount of beneficial interests outside the control of the transferor. We interpret this to mean that paragraph 10 of the proposed FSP requires the notional of the derivative(s) to be less than the amount of beneficial interests issued to third parties by an

J.P. Morgan Chase & Co. • 270 Park Avenue, Floor 28, New York, NY 10017-2070

Telephone: 212 270 7559 • Facsimile: 212 270 9589 joseph.sclafani@chase.com

amount equivalent to the estimated balance of beneficial interests that could be held at any point in time as part of secondary market making activities. We have the following concerns with this paragraph:

Firstly, we do not believe that secondary market making should impair the qualified status of a QSPE. As specified in paragraphs 187 and 188 of SFAS 140 and again in paragraph 4 of the proposed FSP, the Board limited the notional amount of the derivatives in a QSPE to the amount of beneficial interests held by parties other than the transferor, its affiliates, or its agents to prevent transferors from using QSPEs to avoid derivative accounting under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). The purpose of the transferor/underwriter acting in the capacity of secondary market maker is not to circumvent the requirements of SFAS 133, but to accommodate investors by providing liquidity to the market. Investors look to originators/underwriters of securities to create liquid and stable markets for asset-backed securities. A market maker holds beneficial interests purchased in the market in a trading portfolio (which is marked to market through earnings) with the intent of selling them to third party investors within a short period. The market maker is not avoiding SFAS 133 accounting as both the derivative and the beneficial interest are accounted for on a mark-to-market basis through earnings. Since both the beneficial interests and derivatives would be marked to market through earnings, it is reasonable to interpret that paragraphs 40(b) and 40(c) of SFAS 140 did not intend to include secondary market marking activity.

Second, in most securitization structures, independent rating agencies provide credit ratings for the senior beneficial interests. In order to obtain the desired rating for senior beneficial interests, rating agencies generally require that the derivative in a QSPE offsets the risk being hedged in its entirety. The proposed FSP would require that the notional amount of derivative be reduced to reflect the amount of anticipated secondary market making activity. Such a reduction would result in additional exposure for third party beneficial interest holders and complicate rating of these tranches by rating agencies. Thus, reducing the notional amount of the derivative held by a QSPE to less than the notional amount of beneficial interests held by third parties is inefficient. Furthermore, establishing a practice whereby an originator/underwriter does not make a market in their securitization transactions is not commercially feasible.

Finally, as noted above, the recently issued Exposure Draft (ED) amending SFAS 140 is expected to replace the incremental guidance in the proposed FSP. Paragraphs 40a and 40b of the SFAS 140 ED permit a QSPE to hold a derivative with a notional balance that is equal to the total amount of beneficial interests issued by the QSPE. If the proposed FSP is released in its current form, then reporting entities would be required to implement the guidance in the proposed FSP for new and existing QSPEs, knowing that guidance will change again at the implementation date of the SFAS 140 amendment. It should also be noted that QSPEs that apply the FSP will not be permitted to apply the provisions of the SFAS 140 amendment, since the amendment can only be applied to new or modified QSPEs. Thus, firms would be subject to two sets of accounting rules for the same type of transactions. We see no financial reporting benefit from this.

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In summary, we recommend that the Board not issue a final FSP on this topic and remove the project from the FASB's agenda. We believe the proposed FSP, as currently written, does not provide a short-term, workable solution for secondary market making activity as it provides short-lived interpretation of paragraph 40 of SFAS 140 that will add additional complexity in rating and selling beneficial interests.

This issue will be better resolved through the amendment to SFAS 140 as currently proposed by the Board.

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