

JPMORGAN CHASE & CO.

Shannon S. Warren
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LETTER OF COMMENT NO. 41

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File References:

- 1610-100 Exposure Draft, *Accounting for Transfers of Financial Assets, an amendment to FASB Statement No. 140* (the "SFAS 140 Exposure Draft")
- 1620-100 Exposure Draft, *Amendments to FASB Interpretation No. 46(R)* (the "FIN 46(R) Exposure Draft")

Dear Mr. Golden:

JPMorgan Chase & Co. ("JPMorgan Chase" or the "Firm") appreciates the opportunity to comment on the above referenced Exposure Drafts. We support the Financial Accounting Standards Board's (the "FASB" or the "Board") objectives to improve the accounting standards and financial reporting for transfers of financial assets and variable interest entities (VIEs). Overall, we agree with the FASB's decision to eliminate the concept of qualifying special purpose entities ("QSPEs") from US GAAP and to modify the consolidation framework for VIEs from the current quantitative risks and rewards model to a more qualitative approach based on control. We believe these changes, in principle, will result in greater transparency and are necessary to align US GAAP with current International Financial Reporting Standards ("IFRS").

While we are supportive of the FASB's efforts, we are concerned that the FASB and the International Accounting Standards Board ("IASB") are currently working on separate projects that will amend the accounting standards for both derecognition of financial assets and consolidation. We are aware that the FASB and IASB are coordinating their efforts with respect to developing these standards. However, in our view there are currently a number of inconsistencies between the FASB's and IASB's proposals and should the two Boards continue to pursue their projects separately, then it seems likely that the final standards will ultimately differ. This could result in US companies having to implement two sets of significant changes in consolidation and derecognition accounting standards in quick succession, based on the expected SEC proposed Roadmap on US convergence with IFRS. This will not increase transparency for the accounting of such activities, could confuse users of financial statements and will be costly for preparers.

As convergence is a high priority on the agendas of both the FASB and the IASB, JPMorgan Chase strongly urges the FASB to work with the IASB to develop in the short term a converged standard on consolidation and derecognition for financial assets under US GAAP and IFRS, and not to issue separate standards. Both the FASB and IASB have spent a significant amount of time in the past year on their individual consolidation projects, thus we believe it is practical for the Boards to develop and issue in 2009 a final, converged standard for consolidation of variable interest entities that would include elimination of the QSPE exception and modify paragraph 9b of SFAS 140. We expect that the wider

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consolidation project for non-variable interest entities and derecognition of financial assets will require additional time to complete; however, we believe that the additional time is warranted for the sake of convergence, as well as to ensure that the standards are fully vetted with both users and preparers.

We also urge both Boards to fully consider in the short-term the ability to use linked presentation on the face of the balance sheet for certain consolidated entities. The elimination of QSPEs coupled with the proposed changes in the FIN 46(R) Exposure Draft will result in more transactions being consolidated, under US GAAP. In certain structures we believe that this additional consolidation could be misleading for users as “over consolidation” can result in a lack of transparency and misinformation to the same extent as “under consolidation”. Therefore, we believe that a linked presentation model would be appropriate for certain consolidated vehicles. In determining whether linked presentation is appropriate, the Board should consider whether:

- the reporting entity has the ability to control the assets within the vehicle for its own benefit;
- the reporting entity has the right or obligation to regain control of the assets within the vehicle;
- the assets are isolated for the benefit of the third party beneficial interest holders; and whether
- the reporting entity has any obligation to repay the beneficial interest holders in the event that the specific assets provide insufficient funds to repay financing provided by beneficial interest holders.

For certain consolidated VIEs, it is our view that linked presentation on the face of the balance sheet, coupled with enhanced disclosure, will properly reflect the reporting entity’s risk to the consolidated entity and give users the information they need in their own assessment of the reporting entity’s risk and financial performance. We recognize that there are significant challenges in developing a linked presentation model, but believe that the improvement to financial reporting would justify the effort.

In addition to our comments on convergence and linked presentation, the following summarizes our other specific comments on both the SFAS 140 and FIN 46R Exposure Drafts for your consideration¹.

SFAS 140 Exposure Draft

- The definition of a participating interest is too narrow. As currently proposed, certain standard, non-servicing loan fees collected by the transferor and common protection provisions may preclude an interest from meeting the definition of a participating interest. In addition, we do not understand the principle for prohibiting a transferor from assigning a loan to another party, if the transferor has received the consent of the participating interest holder. We recommend that the Board revisit the definition of a participating interest to address these issues that we believe would be problematic for standard loan participations
- We agree that certain conditions that constrain a transferee should preclude sales treatment; however, we do not agree with the requirement that the constraint must *primarily* provide the transferee with a benefit as we are concerned that interpretations of this provision may require some form of measurement of benefit. We recommend removing the word “primarily” from the guidance as it creates a higher standard of benefit than the existing guidance; instead, we recommend that the constraint must provide the transferee or its beneficial interest holders with a significant benefit
- In addition to our comment letter on the Proposed FSP 140-e and FIN 46(R)-e dated October 15, 2008, we have included additional comments on the proposed disclosures for your consideration in Attachment I

¹ Attachment I and Attachment II provide more details of our comments on the SFAS 140 Exposure Draft and the FIN 46(R) Exposure Draft, respectively.

FIN 46(R) Exposure Draft

- We support the principles based approach that the Board has included in the Exposure Draft, specifically modifying the consolidation framework for VIEs from the current quantitative risks and rewards model to a more qualitative approach
- We recommend that the Board reconsider the guidance in 14A (a) and 14 A (b) because the characteristics of control in these paragraphs are stated too broadly and do not clearly articulate the principle indicators of control. Specifically, we are concerned that it is not clear how the indicators of control should be applied to a servicer who is acting solely on the behalf of beneficial interest holders of the VIE and has no other continuing involvement with the VIE. We expect additional implementation issues will arise due to this lack of a clarity
- We recommend that the Board eliminate the quantitative analysis in Step 2 of paragraph 14C. Since it is the Board's belief that a quantitative analysis will not be needed in most cases, leaving this test in the guidance creates the impression that reporting entities will have to continue to perform this test in order to support their conclusion
- We are concerned with the requirement to continuously reconsider whether an entity is a VIE or the reporting entity is the primary beneficiary of a VIE. We agree in concept that a change in control would require a reassessment of consolidation of a VIE. However, we are concerned with the practicality and operational burden of performing and documenting such reassessments for all VIEs on a continuous basis. We believe that the determination of whether there has been a change in control can be captured for the most part by the current criteria in paragraph 7 and 15 of FIN 46R
- The transition guidance provided for in the original implementation of FIN 46 that required the consolidating entity to initially measure the assets, liabilities, and noncontrolling interests of the VIE at their carrying amount is preferable to the fair value proposal included in the Exposure Draft. An entity may choose the fair value option election at initial implementation, where fair value is considered the most relevant ongoing measurement attribute

* * *

We acknowledge the difficulty the Board faces in developing the accounting framework as it relates to both the transfer of financial assets and the consolidation of variable interest entities. In fact, with any new consolidation guidance, there may be situations for where the consolidation results may not be as expected or necessarily improve financial reporting. In order to minimize this, we strongly encourage both the FASB and the IASB to field test their proposed guidance to determine whether it meets their objectives and to obtain a better sense of how the guidance will be implemented in practice. This will help to identify unintended consequences and also will be a good opportunity to determine the benefits of a linked presentation model.

If you have any questions or would like to discuss our comments further, please do not hesitate to contact me at 212-648-0906 or Giovanna Acquilano at 212-648-0908.

Sincerely yours,



Shannon S. Warren

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Detailed Comments on the Exposure Draft, *Accounting for Transfers of Financial Assets, an amendment to FASB Statement No. 140* (“SFAS 140 Exposure Draft”)

The following are the Firm’s specific comments on the SFAS 140 Exposure Draft:

1. *Derecognition of financial assets with continuing involvement*

JPMorgan Chase agrees with the Board’s decision to permit derecognition of financial assets with continuing involvement as long as the sales accounting conditions are met. We believe that the financial-components approach, which requires that each party to the transfer recognize the assets and liabilities that it controls after the transfer and no longer recognize the assets and liabilities that were surrendered or extinguished through the transfer, best achieves the consistent accounting for transfers of financial assets in the marketplace. We agree with the Board’s conclusion in paragraph A28 that a no-continuing-involvement model would not properly reflect the economics of many transfers.

We disagree with the Board’s conclusions that prohibit the accounting for a transfer of a group of financial assets partially as a sale and partially as a secured borrowing. Consistent with the financial component approach and as paragraph 5 (as proposed) states, “the accounting objective for transfers of financial assets is for each entity that is a party to the transaction to recognize only assets it controls and liabilities it has incurred, to derecognize assets only when control has been surrendered, and to derecognize liabilities only when they have been extinguished. Sales and other transfers may result in a disaggregation of financial assets and liabilities into components, which become separate assets and liabilities.” We believe that when a transferor transfers a group of financial assets in their entirety and retains a beneficial interest that has an embedded right to call the remaining assets back when a pool amortizes down to a specified percentage (for example, 1% for a typical commercial mortgage securitization) and such call option is determined not a clean-up call, the transferor’s “control” is limited to the percentage of the portfolio which is subject to the call option (i.e., 1% of the transferred portfolio). The transferor has no effective control over the remaining portfolio that will be collected before the threshold has been met. As such, the transferor should report the portion of the portfolio that it does not have effective control over as a sale and the portion of the portfolio it has control over as a secured borrowing. We believe it would be misleading to report 100% of the transferred financial assets on the balance sheet of the transferor when the transferor only has the ability to “control” a percentage of the portfolio.

2. *Specific criteria for loan participations to be accounted for as sales*

Paragraph 8B.b

Certain non-servicing loan fees collected by the transferor that are generally not divided among the participating interests may be interpreted as creating a disproportionate share of cash flows compared to the participants’ interests. The types of fees collected by the transferor may include loan origination fees and other fees associated with the syndication of loans. While most loan origination and syndication fees are paid up-front at loan closing, some fees may be paid over the term of the loan as negotiated by the lender and borrower.

We do not believe it would be appropriate that these fees retained by the transferor for services provided should preclude an interest from meeting the definition of a participating interest. We ask that the FASB treat these fees similar to the fees allocated to the servicer and exclude origination and other fees earned by the transferor in the determination of whether the cash flows of the loan are divided among the participating interests in proportion to the share of ownership, as these fees are compensation for services performed.

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Paragraph 8B.c

We are concerned that this provision could be interpreted to preclude accounting sale treatment for many loan participations because of the existence of common protection provisions such as: 1) recourse to the transferor to provide a “standard of care” in servicing, administering and enforcing the rights of the contracts in addition to other ongoing contractual obligations (e.g., covenants provided in the participation agreements,); 2) recourse to the participating interest holders with respect to funding commitments (relating to revolving participations) and; 3) recourse to the transferor and/or other participating interest holders under set-off sharing provisions. Participation agreements generally contain provisions that require the transferor to maintain a “standard of care” in administering, servicing and enforcing the underlying contract that provide the participating interest holders with recourse against the transferor for gross negligence, willful misconduct or bad faith. In addition, certain covenants and other ongoing contractual arrangements provided by the transferor may, if breached, create recourse by participating interest holders against the transferor. For participations that contain funding commitments, the transferor generally has recourse to each participating interest holder to fund their pro-rata share of the participating commitment. Additionally, under a set-off sharing provision generally included in standard participation agreements, the transferor and participants agree to share pro-rata any benefits obtained from the exercise of set-off. Therefore, the transferor and each participant have recourse to each other for their pro-rata share of any such set-off benefits.

We do not believe it is appropriate that these protective provisions could preclude an interest from meeting the definition of a participating interest and ask the Board to clarify that breaches of on-going obligations would not preclude such interests from meeting the criteria set forth in paragraph 8B.c.

Paragraph 8B.d

The fourth criterion of a participating interest does not permit the transferor or any participating interest holder the right to pledge or exchange the entire financial asset. Under current LSTA master loan participation agreements, the transferor is permitted to assign the underlying loan with the consent of the participants. We believe that as long as the participating interest holders agree to the transfer or assignment of the loan, this should not disqualify a loan participation from being accounted for as a sale. We recommend the Board clarify this criterion.

3. *Constraint to exchange the financial asset that is not designed primarily to provide the transferee with a benefit*

Although we agree that certain conditions that constrain a transferee should preclude sales treatment, we do not agree that the criteria should require that the constraint must *primarily* provide the transferee with a benefit. We believe this modification may be a higher standard than the existing guidance since it shifts the focus from whether a constraint provides the transferor with more than a trivial benefit to a constraint that is designed *primarily* to provide the transferee with a benefit. We are concerned that interpretations of this provision may require some form of measurement of which party benefits more from the constraint. We agree with the guidance provided in paragraph 54D that states “judgment is required to assess whether a particular condition results in a constraint” and it is necessary to consider the overall effect of related rights and obligations in assessing such matters as whether (a) a transferee is constrained, (b) the transferee benefits from such constraint, and (c) the transferor maintains effective control over the transferred financial assets. We therefore request the FASB to delete “primarily” from this criterion and require that the constraint must provide the

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transferee or its beneficial interest holders with a "significant" benefit based on judgment as outlined in paragraph 54D.

4. *Disclosures*

We refer you to our comment letter on the Proposed FSP 140-e and FIN 46(R)-e dated October 15, 2008 regarding disclosures we believe would improve financial reporting.

In addition, we do not agree with the proposed deletion of footnote 10 of paragraph 17.i. (6). JPMorgan Chase does not believe it would be relevant or meaningful to add deals for which we act as servicer but do not have any other continuing involvement to the managed asset disclosures. Our involvement with these deals is recorded as part of mortgage servicing right assets and is therefore subject to the sensitivity analysis or stress test disclosures required under paragraph 17.i.4. Including these deals in the managed asset disclosure would gross up the amounts of total principal outstanding, delinquencies, and credit losses, for no apparent benefit. We urge the FASB to keep footnote 10 in place.

Detailed Comments on the Exposure Draft, *Amendments to FASB Interpretation No. 46(R)* (the “FIN 46(R) Exposure Draft”)

Definition of Control

We agree with the Board’s decision to modify the consolidation framework for VIEs from the current quantitative risks and rewards model to a more qualitative approach based on control. However, based on the proposed guidance in 14A and 14B, we expect practical implementation issues will arise due to the lack of a clear principle in defining control for variable interest entities that for the most part have very limited activities. The following details what we see as the more critical issues with the proposed guidance. We urge the Board not to provide specific rules to resolve these issues, as we believe they would be better addressed through an improvement of the principles, as further discussed below.

Per paragraph 14A (a) of the Exposure Draft, the first characteristic of control is based on “the power to direct matters that most significantly impact the activities of a VIE.” This characteristic is too broad; for example, a servicer that works out a defaulted asset in the VIE on the behalf of beneficial interest holders of the VIE (as described in Example 6) could meet this criterion just as easily as an entity that is actively managing the assets and liabilities of the entity primarily for its own benefit. Furthermore, the proposed amendment requires the identification of the entity that is considered to have the most control over a VIE, regardless of whether the control is current (i.e., they can make decisions currently that affect the profitability of the entity) or contingent on the occurrence of certain future events (i.e., the default of a loan may cause a special servicer to act on behalf of the trust and to sell or to workout a loan).

Kick-out rights

Paragraph 14A (a) states that an “enterprise’s determination of whether it has the power to direct matters shall not be affected by the existence of substantive kick-out rights unless a single enterprise has the unilateral ability to exercise such substantive kick-out rights.” This proposed guidance conflicts with both the current guidance in paragraphs B19 (d) and B20 of FIN 46R and the guidance in EITF 04-5, which respects the substance of substantive kick out rights, even if held by a group. Provided there are mechanisms in place to facilitate the exercise of kick out rights (as described in paragraph B20 of FIN 46R), we do not see the meaningful distinction of substantive kick-out rights held by a group of beneficial interest holders of a VIE as compared to a group of limited partners subject to the guidance in EITF 04-5. The Board’s conclusion for ignoring substantive kick-out rights (i.e., because of its concern that companies may have structuring opportunities to achieve a conclusion that no single party consolidates a VIE) is unwarranted because the kick-out rights by definition have to be substantive in order to be considered in determining control. The overriding principle of the proposed standard is that a reporting entity does not control a VIE if it is subject to substantive kick out rights held by third parties. In our view, the additional requirement that a single party must be able to unanimously remove the reporting entity from its position of control is a bright-line rule that contradicts that principle.

Paragraph 14A (b)

In addition to the issues noted above with the proposed guidance in paragraph 14A (a), we are concerned with the second characteristic of a controlling financial interest described in paragraph 14A (b), as “the right to receive benefits from the variable interest entity that could potentially be significant to the variable interest entity or the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity.” This requirement will ultimately result in some sort of quantitative analysis in order to determine whether a variable interest has the potential to receive benefits that are significant to the VIE. For example, a servicing fee paid received may not be significant to the overall cash flows of the VIE at the outset of a transaction; however, depending on the future performance of the assets held within the entity, this fee could become more significant over time (e.g., higher than expected

credit losses reduce the total amount of cash flows available to the beneficial interest of the VIE). Therefore, an assessment of the probability of what may occur will be necessary to determine whether an interest could potentially be significant over the life of the VIE. In our view the principle should be that the primary beneficiary is the entity that controls the VIE and as a result of that control, it currently has access to benefits that are likely to be significant. We believe that a servicer that earns a standard, market based fee should not be considered the primary beneficiary because the actions taken by the servicer do not significantly impact the fee they earn.

Example 6

We are troubled by the conclusion in Example 6 of Appendix A. In Example 6, the transferor is deemed to be the primary beneficiary because they are the transferor, the servicer, and owner of the residual tranche. We agree with the conclusion that the transferor is the primary beneficiary; however, the basis for our conclusion differs from the Board. We believe the transferor is the primary beneficiary because they service the assets and own the residual tranche; the actions they take as servicer impact them as owner of the residual tranche. However, the Board concluded that the transferor is the primary beneficiary through its servicing fee and the obligation to absorb losses through the residual tranche, because either could potentially be significant to the VIE. We are concerned whether the Board would have concluded that the servicer is the primary beneficiary, even without holding the residual tranche. For the reasons noted above, we do not think that a servicer who is acting on behalf of the beneficial interest holders and does not own a significant interest in the VIE, should be the primary beneficiary.

Quantitative Analysis

We support the Board's approach of lessening the role a quantitative analysis in the assessment of whether or not a firm is considered to be the primary beneficiary of a VIE. Paragraph B21 in the Exposure Draft states that "the Board expects it to be uncommon for an enterprise to default to the quantitative model...the proposed Statement, was to provide a more-principles-based approach to determining a primary beneficiary." However, notwithstanding the Board's belief that a quantitative analysis will not be needed in most cases, we are concerned that there will be pressure for reporting entities to perform a quantitative analysis to support their consolidation analyses where different parties reach different conclusions under the qualitative analysis (e.g. a preparer and its auditors). Accordingly, we recommend that the Board eliminate the quantitative analysis in Step 2 in paragraph 14C.

On going re-assessments

We believe that the determination of whether there has been a change in control can be captured for the most part by the current criteria in paragraph 15 of FIN 46R. Similarly, we believe the guidance that exists in the current paragraph 7a-7d in 46R would demonstrate when there has been a change in circumstances that requires the determination of whether an entity is a VIE under FIN 46R. Without the guidance currently in paragraph 7 and 15 of FIN 46R, we are concerned with the practicality of performing and documenting such reassessments for all VIEs on a continuous basis.

Transition guidance

We do not agree that the assets, liabilities, and noncontrolling interests of VIEs newly consolidated as a result of this guidance should be at fair value at transition. Instead, we believe the transition guidance included within the original FIN 46, which required the consolidating entity to initially measure the assets, liabilities, and noncontrolling interests of the VIE at their carrying amount, is preferable. We expect that for certain VIEs, the ongoing measurement of the assets and the liabilities in the VIE will not be at fair value. Thus, requiring such assets and liabilities to be recorded at fair value at initial adoption will not improve transparency in financial reporting. While we recognize that the proposed transition guidance is similar to other accounting standards, such as SFAS 141R and SOP 03-03 for purchased

credit impaired loans, we believe that a different measurement basis is warranted for the acquisition of a business or purchases of loans, versus a change in an accounting standard. In cases where the ongoing measurement basis for the assets and liabilities in the VIE will be fair value, then the reporting entity may choose the fair value option election at initial implementation.

Co-ordination with the IASB

In our view there are currently a number of fundamental differences between the consolidation model proposed in the FIN 46(R) Exposure Draft and the current IASB Staff consolidations draft (discussed at the joint FASB IASB Board meeting in October 2008), including:

- The dividing line between a voting interest entity and a variable interest entity (a structured entity) is different between the two proposals. The IASB Staff consolidations draft considers structured entities to be those where the activities are substantially pre-determined while the FIN 46(R) Exposure Draft retains the substantive equity tests in paragraph 5;
- The IASB Staff consolidations draft requires consolidation where a reporting entity controls another entity “for the benefit of the reporting entity”. It goes on to state that the benefits are not limited solely to the cash flows of the assets of an entity and may include tax benefits or enhancing the value of assets outside the entity in question. It does not, however, stipulate how significant the benefits have to be before consolidation is required. In contrast, the FIN 46(R) Exposure Draft is clear that benefits are limited to assets of the respective entity being analyzed in question and that consolidation is required when a reporting entity controls a vehicle and receives benefits that could potentially be significant to the vehicle.
- The FIN 46(R) Exposure Draft provides guidance a reporting entity is not required to consolidate an entity that it currently controls if another entity can unanimously remove that entity from its position of control (i.e. has substantive kick-out rights). The IASB Staff consolidations draft is less clear, addressing the issue of ‘kick out rights’ from the opposite perspective, requiring a reporting entity to consolidate an entity if it has the right to remove another party which currently controls that entity.

In practice such differences (noting that the items described above do not represent an exhaustive list) can lead to different consolidation conclusions for similar structures. Additionally, with the convergence of international accounting standards and US GAAP, it does not seem to be efficient for both standard setters to continue to work on their projects separately. Instead we strongly urge the Boards to combine their projects and work towards a converged standard that is applicable for a wider range of entities.

Other Clarifications

Paragraph 1A

Paragraph 1A states, “The enterprise with a variable interest or interests that provide the enterprise with a controlling financial interest in a variable interest entity...”

We recommend the Board rephrase this sentence to make it clear that an enterprise must have a variable interest in order to have a controlling financial interest in a variable interest entity. We propose the following wording change:

“The enterprise with a variable interest (s) that provide the enterprise with a controlling financial interest in a variable interest entity...”