

JPMORGAN CHASE & CO.

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

File Reference: Exposure Draft ED/2010/13 Hedge Accounting

Dear Sir David:

JPMorgan Chase & Co (“JPMorgan Chase” or “the Firm”) appreciates the opportunity to comment on *Exposure Draft ED/2010/13 Hedge Accounting* (the “Exposure Draft”) issued by the International Accounting Standards Board (“IASB” or the “Board”).

We commend the IASB’s efforts to comprehensively reconsider the usefulness and complexity of the current hedge accounting model. We appreciate the Board’s desire to simplify the current model and resolve common practice issues. We believe that certain proposed changes, including the ability to (a) use certain non-derivative financial assets and liabilities as hedging instruments, (b) designate a derivative and another exposure together as the hedged item, and (c) designate certain risk components of nonfinancial assets and liabilities as the hedged risk, collectively represent significant improvements and simplifications to the existing hedge accounting framework.

We believe, however, that the proposed model requires some clarifications and modifications in order to meet the IASB’s goals of reducing complexity. We believe that the proposal to base the hedge effectiveness assessment on the hedge ratio may unintentionally require entities to continue the burdensome process of using statistical assessment methods each period, and may unnecessarily require entities to adjust the hedge ratio each period in order to meet the revised hedge effectiveness requirements. Continuous evaluation of the need to rebalance the hedging relationship would be costly and burdensome for entities and we urge the IASB to address its concerns about the hedge ratio in a way that would not introduce these unintended complexities. We are further concerned that the changes to the requirements regarding dedesignation would increase the documentation and audit burden for common and appropriate changes in risk management and therefore recommend that the IASB continue to allow voluntary dedesignations of hedge relationships.

Our detailed comments on the Exposure Draft are summarized below.

Question 1

Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

We broadly agree that accounting should be aligned with risk management and how financial instruments are used. However, hedge accounting applies to only a subset of activities undertaken for risk management purposes, and therefore, we believe that the ability to reflect the full effect of an entity’s risk management activities through hedge accounting is necessarily limited. We believe that

the IASB's objective could be better described in a way that reflects the narrow scope of hedge accounting by using language similar to that used in BC 197, which states that one function of hedge accounting is to mitigate the recognition and measurement anomalies between the accounting for hedging instruments and the accounting for hedged items.

Question 2

Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?

We agree that non-derivative financial assets and liabilities should be eligible for use as hedging instruments. Allowing the use of non-derivative financial assets and liabilities will increase the amount of hedging instruments available to entities to designate as hedges and may decrease hedging costs by allowing the use for hedge accounting purposes of existing assets/liabilities that offer a natural offset to the risk being hedged.

Question 3

Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?

We support the IASB's proposal that an aggregated exposure of a derivative and another exposure be eligible as a hedged item. As noted in the example in paragraph BC50 of the Exposure Draft an entity may not always desire to hedge multiple risks similarly (i.e. hedging one risk for a different duration than the other). Therefore, we believe this will allow entities to better reflect in the financial statements how they manage the risks of multiple exposures (e.g. foreign exchange and interest rate in the IASB's example) differently.

Question 4

Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (i.e. a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?

We support the IASB's proposal to continue to allow entities to designate risk components of financial assets and liabilities in hedging relationships and we support the IASB's decision to expand the hedging of components to nonfinancial assets and liabilities. The ability to hedge risk components allows entities to transparently reflect in the financial statements the results of their risk management strategies. Nonfinancial assets and liabilities and their risk components expose preparers to similar risks and financial reporting mismatches as financial assets and liabilities. We welcome the consistent treatment for financial and nonfinancial risks.

Question 5

(a) Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item? Why or why not? If not, what changes do you recommend and why?

We support the IASB's proposal to expand the ability to designate as the hedged item a layer of the nominal amount of an existing asset or liability. This ability already exists for forecasted transactions and we believe that the current inconsistent treatment of forecasted and existing transactions is a

weakness of the current model. For example, if an entity designates one portion of a debt issuance liability as a hedged item in contemplation of a potential future extinguishment of another portion of the debt issuance, current accounting standards would not allow the entity to account for the portion of debt that remains outstanding as continuing to be fully hedged. Instead, the entity must consider an equivalent percentage of the extinguished debt and of the remaining debt as each having been designated as the hedged item. We believe that the IASB's proposal to designate a layer of the nominal amount would provide a more meaningful result for such circumstances.

Question 6

Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?

We welcome the IASB reconsidering the usefulness, transparency and simplicity of the current hedge accounting framework. While we appreciate the Board's desire to reduce complexity by removing the existing requirement that hedging relationships be "highly effective," we are concerned that the Board's proposed solution would unintentionally cause a similar burden to preparers. Some may interpret the Exposure Draft to require a preparer to regularly perform a quantitative analysis, such as regression, rather than a qualitative test in order to determine that a hedge relationship produces an unbiased result that minimizes expected hedge ineffectiveness. We believe that a simplified hedge accounting model should limit quantitative testing in favor of qualitative review wherever reasonably possible, and we believe that the hedge effectiveness requirements should support such an outcome.

Furthermore, we are concerned that the Board's requirement that a hedge relationship produce an "unbiased" result may inadvertently result in a more onerous quantitative testing in some circumstances than currently required for IFRS or U.S. GAAP. The requirement that a hedge relationship have no deliberate offset may require the hedge relationship to be rebalanced every period in order to achieve the optimal hedge ratio. Constant changing of the hedging ratio will increase the administrative burden of performing hedge accounting and it may also require the entity to incur unnecessary additional costs by entering into new derivative contracts or terminating existing contracts upon rebalancing. We believe that if a hedge relationship is designed, at inception, to be unbiased then rebalancing should not be required, unless deemed necessary for risk management purposes. Subsequent testing should be limited to a qualitative review of whether bias has been introduced since inception. We would also support the FASB's recently proposed guidance that requires hedging relationships to be "reasonably effective" in achieving offsetting changes and believe that threshold would introduce fewer unintended consequences than introducing a hedge effectiveness requirement based on the hedge ratio.

Question 7

(a) Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?

We do not agree with the IASB's proposals relating to rebalancing the hedging relationship because of the reasons stated in our response to Question 6. We believe that if a hedge relationship is unbiased at inception and subsequently based upon a qualitative review then rebalancing should not be required, unless deemed necessary by the entity for risk management purposes.

(b) *Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?*

We do not agree with the IASB's proposals relating to rebalancing the hedging relationship because of the reasons stated in our response to Question 6. We do believe that it is important for an entity to have the *ability* to adjust the hedge relationship as necessary for risk management. However, we do not believe that the accounting should *dictate* transactions to be executed, nor should accounting limit the circumstances that may give rise to risk management transactions.

Question 8

(a) *Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?*

(b) *Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?*

We do not agree with the IASB's proposal that hedge accounting should be discontinued only when the hedging relationship ceases to meet the qualifying criteria. While changes in the risk management objective for an individual instrument are the main cause of dedesignations, we question the benefits of additional documentation and auditing those changes. The Board acknowledged in BC 213-214 that entities commonly manage a net position of derivatives, physical positions and other contracts in a dynamic way and designate a hedged position on a net basis. Given the pace at which markets and net risk positions change (leading to changes in risk management objectives), we believe that dedesignation of a hedging relationship should remain voluntary and that additional documentation detailing the nature of the change in risk management intent should not be required.

Consider the example provided in paragraph BC234, in which a volatile longer-term credit exposure deteriorated and was then protected by credit default derivatives, then significantly improved so that the credit derivatives were sold, but then again deteriorated and was protected again, presumably by purchasing another credit derivative. This example highlights the changing nature of risk management objectives, but excludes consideration of the fact that in a large financial institution, derivative instruments no longer used for hedge accounting purposes may be redirected for other uses (including use in a market making portfolio), thus avoiding the transaction costs associated with selling or terminating the derivative when not needed and purchasing it again when the hedged risk re-emerges. We believe that voluntary dedesignation (without derivative termination or extra documentation of risk management intent) is appropriate.

In addition, there are other circumstances in current practice that result in dedesignations and redesignations of hedge relationships (such as amendments to hedge effectiveness assessment methods or to a derivative's critical terms) that do not appear to be included in the types of rebalancing that would be reflected as a continuation of the hedge relationship in the Exposure Draft. The ability to optimize hedge effectiveness results by making changes to the hedge relationship, derivative terms or hedge accounting methods should be retained by permitting voluntary dedesignations.

Additionally, we urge the IASB to consider hedge accounting on a holistic basis by considering both open and closed portfolios in conjunction with each other and making decisions regarding hedge accounting considering both types of portfolios together. Given that many hedges of net risks similar to those contemplated in BC 213-214 in open portfolios fail to qualify for macro hedging, or would be too complex to apply under that model, we encourage the IASB to continue to allow net risks to be hedged as simply as possible under the closed portfolio model by continuing to allow voluntary dedesignations.

Question 9

(a) Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognized in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?

We do not believe that separate presentation of fair value hedge gains and losses in the statement of other comprehensive income represents an improvement in financial reporting because it will add more complexity to that statement. We believe that presentation of the fair value hedge gain or loss on the hedging instrument and hedged item in footnote disclosures provides users with the information they need in one location. Additionally, the proposed presentation change would result in increased systems cost for preparers to have hedging instruments and hedged items currently being mapped to current period income to be reported in OCI, costs which we believe are unjustified.

(b) Do you agree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position? Why or why not? If not, what changes do you recommend and why?

We do not object to the IASB's proposal that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position. We understand that some users prefer statement of financial position amounts to be cost or fair value and not subject to hedge accounting adjustments. However, we question how useful the proposed presentation would be to users because we believe that the relative immateriality of most hedging programs to other items on the statement of financial position will result in the line item representing the basis adjustment being presented in "other assets" or "other liabilities" in the statement of financial position, rather than displayed as its own line item. We also believe that presentation as a line item separate from the hedged item increases the control risks associated with subsequent amortization of the basis adjustment, since the hedged item and the basis adjustment are separated. Therefore, we believe disclosure of the basis adjustment for fair value hedges may be more useful for users of financial statements than separate presentation on the face of the statement of financial position.

(c) Do you agree that linked presentation should not be allowed for fair value hedges? Why or why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented?

We agree with the IASB's decision that disclosures about hedging are a superior alternative to linked presentation to provide information that allows users of financial statements to assess the relevance of the information for their own analysis.

Question 11

Do you agree with the criteria for the eligibility of groups of items as a hedged item? Why or why not? If not, what changes do you recommend and why?

We support the IASB's criteria for the eligibility of groups of items as a hedged item and believe that the criteria are a simplification and improvement from the current hedging model and will allow entities more flexibility to hedge groups of items.

Question 12

Do you agree that for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement (e.g. in a net position hedge), any hedging instrument gains or losses recognized in profit or loss should be presented in a separate line from those affected by the hedged items? Why or why not? If not, what changes do you recommend and why?

We agree with the IASB's proposal of presenting in a separate line the income statement impact of the hedging instrument for a group of hedged items that affect different line items. To assign a value from the hedging instrument to each specific position in the group would be difficult if not impracticable for preparers, and therefore we believe the IASB's proposal is a practical alternative.

Question 13

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

We believe the IASB should converge to the similar disclosures that the FASB recently required when it issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities*. The disclosures required by the FASB are similar to the IASB's proposed disclosures in paragraphs 49-52 of the Exposure Draft, and have also been in effect for two annual reporting periods for most entities.

(b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?

We propose that no additional disclosures be added to those in the Exposure Draft and encourage the IASB to converge to the FASB's disclosures related to derivatives and hedging activities.

Question 14

Do you agree that if it is in accordance with the entity's fair value-based risk management strategy derivative accounting would apply to contracts that can be settled net in cash that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements? Why or why not? If not, what changes do you recommend and why?

We agree with the IASB's proposal to amend the language in IAS 32: *Financial Instruments: Presentation* such that commodity and other contracts that are managed on a fair value basis and can be settled net in cash would receive derivative accounting. We believe that derivative accounting would be reflective of how the business intends to manage certain contracts (fair value through profit and loss) and will serve to eliminate an accounting mismatch without the increased operational burden of applying hedge accounting.

Question 15

(a) *Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?*

We agree that any of the three alternatives in the Exposure Draft will add additional complexity to the accounting framework; however we do not believe it would be “unnecessary” because hedging credit risk is a real concern for many institutions, and therefore we encourage the Board to continue to explore these and other alternatives to permit a relevant presentation of credit risk management in the hedge accounting model. We recognize the complexity of this issue, and the need to simplify the current hedge accounting model in the short term, and understand that resolving credit hedging issues may need to be addressed in a separate project.

(b) *If not, which of the three alternatives considered by the Board in paragraphs BC226–BC246 should the Board develop further and what changes to that alternative would you recommend and why?*

We believe the Board should not discard any alternatives at this time. In particular, we believe Alternatives 2 and 3 deserve further exploration and development. While we understand the concern about the ability to elect fair value option subsequent to the initial recognition of an asset or liability, we believe it should be further discussed and explored since it may be the most feasible solution.

Question 16

Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

Presuming that the unintended complexities resulting from the hedge effectiveness assessment and dedesignation requirements can be addressed within that timeframe, we believe that effective date relating to this Exposure Draft should be aligned with the IASB’s other financial instruments projects that will replace IAS 39. Should the IASB not resolve these issues, we have significant concerns about the operationality of the standard for the proposed effective date of January 1, 2013. Additionally, we believe that the effective date and transition for open portfolios should be consistent with the effective date and transition for this Exposure Draft.

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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 212.270.3632, Bret Dooley at 212.648.0404 or Alistair Webster at 44.20.7777.5387.

Sincerely yours,



Louis Rauchenberger