Adam M. Gilbert
Managing Director

To avoid excessive repetition of comments previously made, we request the agencies incorporate by way of reference our March 26, 2007 letter in response to the Basel II NPR. Also in the Appendix to this letter, we indicate which portions of the Guidance refer to major issues previously addressed in our Basel II NPR response and include related excerpts from our NPR comments. We generally have not remarked on differences between the current and prior versions of the Guidance since earlier versions predate the NPR and are of limited relevance.

Our comment letter is structured as follows:

I. Major Issues Addressed in Our NPR Response
II. Summary of Additional Key Issues
Appendix A: Detailed Comments on Specific Standards
Appendix B: Excerpts from Our NPR Response

Our comments are formatted with reference to the draft standards including, where appropriate, the relevant explanatory text in italics. We have no comment on standards that are not referenced in this letter. Except for inclusion of prior Basel II NPR comments on counterparty credit risk, retail seasoning, and major issues identified in Section I, our comments are largely incremental to those made in the NPR response.

I. Major Issues Addressed in our NPR Response

JPMorgan Chase & Co. has fully and consistently supported the goals of Basel II capital adequacy reform: to create a more risk-sensitive capital framework and provide incentives for banking organizations to improve their risk management and measurement practices. We have a substantial investment program in place to implement the most advanced approaches to Basel II.

In our response[6] to the Basel II Notice of Proposed Rulemaking (NPR)[7] we noted with concern several specific requirements in the NPR that depart significantly from the international Basel II Accord. These departures imposed constraints and calculations that reduced the risk sensitivity of capital calculations, ran counter to the objective of improved risk management, unnecessarily added to costs and placed firms subject to this NPR at a competitive disadvantage. Several of the proposed supervisory standards further amplify and reinforce some of these key NPR proposals and heighten our concerns.

The specific supervisory standards of concern in this regard are as follows:

---

[6] Our comment letter is available on the http://www.fdic.gov/ and other agency websites.
[7] *Federal Register*, Vol. 71, No. 185, September 25, 2006: p. 55830.

JPMorgan Chase & Co. • 270 Park Avenue, New York, NY 10017-2014
Telephone: 212 270 8928 • Facsimile: 646 534 2055
gilbert_adam@jpmorgan.com

Adam M. Gilbert
Managing Director

- Wholesale Definition of Default The proposed standards require use of the NPR definition of default for wholesale exposures, which is inconsistent with the definition in the Accord. In our NPR response, we opposed this change to the definition of default under which all obligations to a wholesale borrower must be considered in default if the sale or transfer of any exposure to the borrower resulted in a credit-related loss of 5% or more of initial carrying value. We requested that the agencies return to the language of the Accord, which requires recognition of default in the event of a material credit-related loss based on a bank's own judgment. We noted that imposition of a fixed percentage to determine materiality will create a greater risk of misclassification, substitute for a more fully fact-based determination of the obligor's likelihood to pay and impose additional regulatory burdens on those international firms operating in multiple jurisdictions because they will be required to maintain two definitions and two sets of capital calculations.

- Downturn Loss Given Default (LGD) The standards require the imposition of the supervisory mapping function for downturn LGD using the specific formula defined in the NPR. We opposed the application of this supervisory mapping function because it will systemically overestimate the impact of economic downturns on exposures with low to moderate LGDs. To the extent that banks can demonstrate sufficient conservatism in their estimation processes such that their estimate incorporates downturn conditions, the need to apply a markup via a supervisory formula to obtain a downturn LGD is obviated. The standards (consistent with the NPR) also impose supervisory LGDs in place of internal estimates for an entire exposure category where a bank can produce credible and reliable internal estimates for most but not all of the exposures[8], which we also opposed in our NPR response. We previously noted that maintaining multiple LGDs (expected, downturn and supervisory) is further problematic because this creates a gap to internal practice. The final rule can reflect the objective that LGD estimates are reasonable and appropriately conservative for a range of economic conditions without these additional requirements or standards.

- Hedge Fund Treatment The supervisory standards for securitization exposures make it clear that any exposure that can be considered to be "tranched" must be treated under securitization rules. While the treatment of hedge fund investments and investment funds with material liabilities is not clearly specified in either the NPR or the Guidance, there is a strong implication that hedge funds would be considered first loss tranches and be deducted from capital. We oppose this interpretation, which in our view creates an overly broad definition that could be similarly extended to other exposure categories. We

[8] The NPR defines five broad credit exposure subcategories: residential mortgage, retail revolving, other retail, high volatility commercial real estate (HVCRE) and wholesale ex HVCRE.

JPMorgan Chase & Co. • 270 Park Avenue, New York, NY 10017-2014

Telephone: 212 270 8928 • Facsimile: 646 534 2055
gilbert_adam@jpmorgan.com