KLA TENCOR CORP
Form 10-K
August 07, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended June 30, 2015

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to

Commission File Number 000-09992
KLA-TENCOR CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	04-2564110
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
One Technology Drive, Milpitas, California	95035
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (408) 875-3000
Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.001 par value per share	The NASDAQ Global Select Market

Securities Registered Pursuant to Section 12(g) of the Act:
None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this

Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant based upon the closing price of the registrant's stock, as of December 31, 2014, was approximately $11.45 billion.

The registrant had 157,530,878 shares of common stock outstanding as of July 17, 2015.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2015 Annual Meeting of Stockholders to be held on November 4, 2015 ("Proxy Statement"), and to be filed pursuant to Regulation 14A within 120 days after the registrant's fiscal year ended June 30, 2015, are incorporated by reference into Part III of this report.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical fact may be forward-looking statements. You can identify these and other forward-looking statements by the use of words such as “may,” “will,” “could,” “would,” “should,” “expects,” “plans,” “anticipates,” “relies,” “believes,” “estimates,” “predict “potential,” “continue,” “thinks,” “seeks,” or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Such forward-looking statements include, among others, forecasts of the future results of our operations, including profitability; orders for our products and capital equipment generally; sales of semiconductors; the investments by our customers in advanced technologies and new materials; the allocation of capital spending by our customers (and, in particular, the percentage of spending that our customers allocate to process control); growth of revenue in the semiconductor industry, the semiconductor capital equipment industry and our business; technological trends in the semiconductor industry; future developments or trends in the global capital and financial markets; our future product offerings and product features; the success and market acceptance of new products; timing of shipment of backlog; our future product shipments and product and service revenues; our future gross margins; our future research and development expenses and selling, general and administrative expenses; our ability to successfully maintain cost discipline; international sales and operations; our ability to maintain or improve our existing competitive position; success of our product offerings; creation and funding of programs for research and development; attraction and retention of employees; results of our investment in leading edge technologies; the effects of hedging transactions; the effect of the sale of trade receivables and promissory notes from customers; our future income tax rate; future payments of dividends to our stockholders; the completion of any acquisitions of third parties, or the technology or assets thereof; benefits received from any acquisitions and development of acquired technologies; sufficiency of our existing cash balance, investments, cash generated from operations and unfunded revolving line of credit under a Credit Agreement (the “Credit Agreement”) to meet our operating and working capital requirements, including debt service and payment thereof; future dividends, and stock repurchases; our compliance with the financial covenants under the Credit Agreement; the expected timing of the completion of our global employee workforce reduction; the additional charges that we may incur in connection with our global employee workforce reduction; the expected cost savings that we expect to recognize as a result of such workforce reduction; the adoption of new accounting pronouncements; and our repayment of our approximately $3.21 billion of outstanding indebtedness.

Our actual results may differ significantly from those projected in the forward-looking statements in this report. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in Item 1A, “Risk Factors” in this Annual Report on Form 10-K, as well as in Item 1, “Business” and Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this report. You should carefully review these risks and also review the risks described in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q that we will file in the fiscal year ending June 30, 2016. You are cautioned not to place undue reliance on these forward-looking statements, and we expressly assume no obligation and do not intend to update the forward-looking statements in this report after the date hereof.

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PART I

ITEM 1. BUSINESS

The Company

KLA-Tencor Corporation ("KLA-Tencor" or the "Company" and also referred to as "we" or "our") is a leading supplier of process control and yield management solutions for the semiconductor and related nanoelectronics industries. Our products are also used in a number of other high technology industries, including the light emitting diode ("LED") and data storage industries, as well as general materials research.

Within our primary area of focus, our comprehensive portfolio of defect inspection and metrology products, and related service, software and other offerings, helps integrated circuit ("IC" or "chip") manufacturers manage yield throughout the entire semiconductor fabrication process—from research and development ("R&D") to final volume production. These products and offerings are designed to provide comprehensive solutions to help our customers to accelerate their development and production ramp cycles, to achieve higher and more stable semiconductor die yields, and to improve their overall profitability.

KLA-Tencor's products and services are used by the vast majority of bare wafer, IC, lithography reticle ("reticle" or "mask") and disk manufacturers around the world. These customers turn to us for inline wafer and IC defect monitoring, review and classification; reticle defect inspection and metrology; packaging and interconnect inspection; critical dimension ("CD") metrology; pattern overlay metrology; film thickness, surface topography and composition measurements; measurement of in-chamber process conditions, wafer shape and stress metrology; computational lithography tools; and overall yield and fab-wide data management and analysis systems. Our advanced products, coupled with our unique yield management services, allow us to deliver the solutions our customers need to accelerate their yield learning rates and significantly reduce their risks and costs.

Certain industry and technical terms used in this section are defined in the subsection entitled "Glossary" found at the end of this Item 1.

KLA-Tencor was formed in April 1997 through the merger of KLA Instruments Corporation and Tencor Instruments, two long-time leaders in the semiconductor equipment industry that originally began operations in 1975 and 1976, respectively.

Additional information about KLA-Tencor is available on our website at www.kla-tencor.com. Our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our website as soon as reasonably practicable after we electronically file them with or furnish them to the Securities and Exchange Commission ("SEC"). Information contained on our website is not part of this Annual Report on Form 10-K or our other filings with the SEC. Additionally, these filings may be obtained through the SEC's website (www.sec.gov), which contains reports, proxy and information statements, and other information regarding issuers that file electronically. Documents that are not available through the SEC's website may also be obtained by mailing a request to the U.S. Securities and Exchange Commission, Office of FOIA/PA Operations, 100 F Street, NE, Washington, DC 20549, by submitting an online request to the SEC at www.sec.gov or by calling the SEC at 1-800-732-0330.

Industry

General Background

KLA-Tencor's core focus is the semiconductor industry. The semiconductor fabrication process begins with a bare silicon wafer—a round disk that is typically 150 millimeters, 200 millimeters or 300 millimeters in diameter, about as thick as a credit card and gray in color. The process of manufacturing wafers is in itself highly sophisticated, involving the creation of large ingots of silicon by pulling them out of a vat of molten silicon. The ingots are then sliced into wafers. Prime silicon wafers are then polished to a mirror finish. Other, more specialized wafers, such as epitaxial silicon ("epi"), silicon-on-insulator ("SOI"), gallium nitride ("GaN") and silicon carbide ("SiC"), are also common in the semiconductor industry.

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The manufacturing cycle of an IC is grouped into three phases: design, fabrication and testing. IC design involves the architectural layout of the circuit, as well as design verification and reticle generation. The fabrication of a chip is accomplished by depositing a series of film layers that act as conductors, semiconductors or insulators on bare wafers. The deposition of these film layers is interspersed with numerous other process steps that create circuit patterns, remove portions of the film layers, and perform other functions such as heat treatment, measurement and inspection. Most advanced chip designs require hundreds of individual steps, many of which are performed multiple times. Most chips consist of two main structures: the lower structure, typically consisting of transistors or capacitors which perform the “smart” functions of the chip; and the upper “interconnect” structure, typically consisting of circuitry which connects the components in the lower structure. When all of the layers on the wafer have been fabricated, each chip on the wafer is tested for functionality. The wafer is then cut into individual chips, and those chips that passed functional testing are packaged. Final testing is performed on all packaged chips.

Current Trends

The growth of consumer demand for mobile devices, including smartphones, tablets and wearable devices, is currently driving growth in the electronics industry and, as a result, growth in the semiconductor industry as well. Contained within each of these latest consumer devices are advanced semiconductors that are helping to enable the features consumers want in device performance, such as smaller product form factors, lower power requirements, bigger and brighter screens and speed, at a lower cost. Alongside this market growth, the industry continues to experience a high rate of change in technology, with the emergence of new techniques and architectures in production today, such as three-dimensional (“3D”) transistors, advanced patterning lithography, advanced wafer-level packaging and semiconductors with critical dimensions at 28 nanometer and below. KLA-Tencor’s inspection and measurement technologies play a key role in enabling our customers’ advanced semiconductor manufacturing processes to support these trends.

Companies that anticipate future market demands by developing and refining new technologies and manufacturing processes are better positioned to lead in the semiconductor market. Accelerating the yield ramp and maximizing production yields of high-performance devices are key goals of modern semiconductor manufacturing. Ramping to high-volume production ahead of competitors can dramatically increase the revenue an IC manufacturer realizes for a given product. During past industry cycles, semiconductor manufacturers generally contended with a few key new technologies or market trends, such as a specific design rule shrink. In today’s market, driven by consumer demand for low-cost electronic goods, the leading semiconductor manufacturers are investing in simultaneous production integration of multiple new process technologies, some requiring new substrate and film materials, new geometries, advanced lithography and advanced packaging techniques.

While many of these technologies have been adopted at the development and pilot production stages of chip manufacturing, significant challenges and risks associated with each technology have affected the adoption of these technologies into full-volume production. For example, as design rules decrease, yields become more sensitive to the size and density of defects and device performance characteristics (namely speed, capacity or power management) become more sensitive to parameters, such as line width and film thickness variation. New process materials, such as high-k dielectrics, SOI wafers and immersion lithography-capable photoresists, require extensive characterization before they can be used in the manufacturing process. Moving several of these advanced technologies into production at once only adds to the risks that chipmakers face.

The continuing evolution of semiconductor devices to smaller geometries and more complex multi-level circuitry has significantly increased the performance and cost requirements of the capital equipment used to manufacture these devices. Construction of an advanced wafer fabrication facility today can cost over $5 billion, substantially more than previous-generation facilities. In addition, chipmakers are demanding increased productivity and higher returns from their manufacturing equipment and are also seeking ways to extend the performance of their existing equipment.

By developing new process control and yield management tools that help chipmakers accelerate the adoption of these new technologies into volume production, we enable our customers to better leverage these increasingly expensive facilities and significantly improve their return on investment (“ROI”). Once customers’ production lines are operating at high volume, our tools help ensure that yields are stable and process excursions are identified for quick resolution. In addition, the move to each new generation’s smaller design rules, coupled with new materials and device innovation, has increased in-process variability, which requires an increase in inspection and metrology sampling.

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KLA-Tencor systems not only analyze defectivity and metrology issues at critical points in the wafer, reticle and IC manufacturing processes, but also provide information to our customers so that they can identify and address the underlying process problems. The ability to locate the source of defects and resolve the underlying process issues enables our customers to improve control over their manufacturing processes. This helps them increase their yield of high-performance parts and deliver their products to market faster—thus maximizing their profits. With our broad portfolio of application-focused technologies and our dedicated yield technology expertise, we are in position to be a key supplier of comprehensive yield management solutions for customers' next-generation products, helping our customers respond to the challenges posed by shrinking device sizes, the transition to new production materials, new device and circuit architecture, more demanding lithography processes, and new back-end packaging techniques.

Products

KLA-Tencor is engaged primarily in the design, manufacture and marketing of process control and yield management solutions for the semiconductor and related nanoelectronics industries and provides a comprehensive portfolio of defect inspection and metrology products, and related service, software and other offerings.

KLA-Tencor's defect inspection and metrology products and related offerings can be broadly categorized into the following groups: Chip Manufacturing, Wafer Manufacturing, Reticle Manufacturing, LED and Compound Semiconductor Manufacturing, Data Storage Media/Head Manufacturing, Microelectromechanical Systems ("MEMS") Manufacturing, and General Purpose/Lab Applications. The more significant of these products are included in the product table at the end of this "Products" section. Every year, we introduce a number of new products; some of the new products we introduced in the fiscal year ended June 30, 2015 are described below. We also provide refurbished KLA-Tencor tools as part of our K-T Certified™ program for customers manufacturing larger design-rule devices, as well as comprehensive service and support for our products.

Chip Manufacturing

KLA-Tencor's comprehensive portfolio of defect inspection and metrology products, and related service, software and other offerings, helps chip manufacturers manage yield throughout the entire semiconductor fabrication process—from research and development to final volume production. These products and offerings are designed to provide comprehensive solutions to help our customers to accelerate their development and production ramp cycles, to achieve higher and more stable semiconductor die yields, and to improve their overall profitability.

Front-End Defect Inspection

KLA-Tencor's front-end defect inspection tools cover a broad range of yield applications within the IC manufacturing environment, including: research and development; incoming wafer qualification; reticle qualification; and tool, process and line monitoring. Patterned and unpatterned wafer inspectors find particles, pattern defects and electrical issues on the front surface, back surface and edge of the wafer, allowing engineers to detect and monitor critical yield excursions. Fabs rely on our high sensitivity reticle inspection systems to identify defects in reticles at an early stage and to prevent reticle defects from printing on production wafers. The defect data generated by our inspectors is compiled and reduced to relevant root-cause and yield-analysis information with our suite of data management tools. By implementing our front-end defect inspection and analysis systems, chipmakers are able to take quick corrective action, resulting in faster yield improvement and better time to market.

In June 2015, we introduced the 8920 system, which provides high productivity inspection for a diverse range of applications, including advanced IC front-end lithography and chemical mechanical planarization ("CMP") processes, automotive device fabrication and advanced legacy fab process control. In July 2014, we launched several front-end defect inspection products that help accelerate yield for next-generation design node devices: 2920 Series, Puma™ 9850 and Surfscan® SP5. The 2920 Series broadband plasma patterned wafer inspection systems are used to discover and monitor defects related to design or process issues, supporting advanced IC development and ramp. The Puma™ 9850 laser scanning patterned wafer inspection system utilizes a range of operating modes to support yield-relevant defect capture for lithography and etch applications and cost-effective excursion monitoring for film and CMP process modules. The Surfscan® SP5 unpatterned wafer inspection system utilizes deep ultra-violet ("DUV") optical technologies and high throughput to assess incoming wafer quality, evaluate and qualify processes during R&D and monitor processes during production.

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The products that we launched during the fiscal year ended June 30, 2015 further strengthened our broad range of offerings that support the front-end defect inspection market. In the field of patterned wafer inspection, we offer our 2920 Series, 2910 Series, 2900 Series, 2830 Series, 2820 Series and 2810 Series systems (for broadband plasma defect inspection); our Puma™ 9850 Series, Puma™ 9650 Series and Puma™ 9500 Series systems (for laser scanning defect inspection); our eS805™ Series and eS800 Series systems (for electron-beam defect inspection); our 8 Series systems (for high productivity defect inspection); and our CIRCL™ cluster tool (for defect inspection, review and metrology of all wafer surfaces - front side, edge and back side). In the field of unpatterned wafer and surface inspection, we offer the Surfscan® SP5 Series and Surfscan® SP3 Series (wafer defect inspection systems for process tool qualification and monitoring using blanket films and bare wafers); and the SURFmonitor™ (integrated on the Surfscan® SP5 and Surfscan® SP3 Series), which enables surface quality measurements and capture of low-contrast defects. For reticle inspection, we offer our X5.2™ and Teron™ SL650 Series products, which are photomask inspection systems that allow IC fabs to qualify incoming reticles and inspect production reticles for contaminants and other process-related changes. In addition, we offer a number of other products for the front-end defect inspection market, as reflected in the product table at the conclusion of this "Products" section.

Defect Review

KLA-Tencor's defect review systems capture high resolution images of the defects detected by inspection tools. These images enable defect classification, helping chipmakers to identify and resolve yield issues. KLA-Tencor's suite of defect inspectors, defect review and classification tools and data management systems form a broad solution for finding, identifying and tracking yield-critical defects and process issues. In July 2014, we introduced the eDR™-7110, an electron-beam wafer defect review and classification system that utilizes improved automatic defect classification capability to quickly identify detected defects and produce an accurate representation of the detected defect population.

Advanced Packaging Process Control

KLA-Tencor offers standalone and cluster inspection and metrology systems for various applications in the field of advanced semiconductor packaging (i.e., at the middle and back-end of the semiconductor manufacturing process). Our CIRCL-AP™ all-surface inspection, metrology and review system supports advanced wafer-level packaging processes, such as 2.5D/3D IC integration using through silicon vias ("TSVs"), wafer-level chip scale packaging ("WLCSP") and fan-out wafer-level packaging ("FOWLP"). Used for packaging applications associated with LEDs, MEMS, image sensors and flip-chip packaging, our WI-22x0 Series products focus on front side wafer inspection and provide feedback on wafer surface quality, quality of the wafer dicing, or quality of wafer bumps, pads and pillars. Our component inspector products inspect various semiconductor components that are handled in a tray, such as microprocessors or memory chips. Component inspection capability includes 3D coplanarity inspection, measurement of the evenness of the contacts, component height and two-dimensional ("2D") surface inspection.

In April 2015, we introduced two systems that support advanced packaging applications: CIRCL-AP™ and the ICOS® T830. The CIRCL-AP™ includes the 8 Series front side defect inspection and metrology module, the CV350i edge inspection and metrology module and the Micro300 2D and 3D metrology module. It provides cost-efficient process control for a range of advanced wafer-level packaging processes. The ICOS® T830 provides automated, optical inspection of IC packages, leveraging high sensitivity and 2D and 3D measurements to determine final package quality for a wide range of package types and sizes.

Metrology

KLA-Tencor's array of metrology solutions addresses IC and substrate manufacturing, as well as scientific research and other applications. Precise metrology and control of pattern dimensions, film thicknesses, layer-to-layer alignment, pattern placement, surface topography and electro-optical properties are important in many industries as critical dimensions narrow, film thicknesses shrink to countable numbers of atomic layers and devices become more complex.

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In August 2014, we introduced our 5D™ patterning control solution which addresses five elements of patterning process control--the three geometrical dimensions of device structures, time-to-results and overall equipment efficiency. Our 5D™ patterning control solution supports advanced patterning technologies through the characterization, optimization and monitoring of fab-wide processes. During the fiscal year ended June 30, 2015, we launched several metrology products that are key components in our 5D™ patterning control solution and help accelerate the ramp of innovative patterning techniques for advanced design node devices:

Overlay Metrology

In February 2015, we introduced the Archer™ 500LCM, a high performance overlay metrology system which provides accurate overlay error data that can be used for scanner corrections or for identification of inline excursions, helping engineers determine when to re-work wafers or adjust processes to meet patterning requirements. Offering both imaging and laser-based scatterometry measurement technologies, the Archer™ 500LCM provides flexible overlay control for all process layers in leading-edge development and high volume production.

Film Thickness and Stress Metrology

In February 2015, we introduced the SpectraFilm™ LD10 system, which utilizes a laser-driven plasma light source to produce reliable, high-precision film measurements for a broad range of film layers, including the thin, multilayer film stacks used in forming complex device structures such as FinFETs. An infrared-based subsystem on the SpectraFilm™ LD10 enables characterization of thick films and film stacks, such as those found in 3D NAND flash devices.

Patterned Wafer Geometry Metrology

In August 2014, we introduced the WaferSight™ PWG system, which measures patterned wafer geometry after a wide range of IC processes, helping identify and monitor variations that can affect patterning. The WaferSight™ PWG enables faster process ramp, overlay control, lithography focus window control and in-line process monitoring for processes such as thin films, etch, CMP and rapid thermal processing (“RTP”).

Reticle Registration Metrology

In August 2014, we introduced the LMS IPRO6 system, which is used by mask shops for comprehensive characterization of reticle pattern placement error, which is a direct contributor to wafer-level pattern overlay error. The LMS IPRO6 utilizes model-based metrology to accurately measure reticle registration for on-device pattern features and standard registration marks, producing higher sampling for better determination of mask quality.

Metrology Data Analysis

In August 2014, we introduced K-T Analyzer® 9.0, which offers advanced, run-time data analysis for a wide range of metrology system types, including overlay, reticle registration, wafer geometry, films, critical dimension and device profile metrology systems.

The products that we launched during the fiscal year ended June 30, 2015 further strengthened our broad range of offerings that support the metrology market. The Archer™ Series of overlay metrology tools enable characterization of overlay error on lithography process layers for advanced patterning technologies. The SpectraShape™ family of optical CD and shape metrology systems fully characterize and monitor the critical dimensions and 3D shapes of geometrically complex features incorporated by some IC manufacturers in their latest generation devices. Finally, the SpectraFilm™ and Aleris™ families of film metrology tools provide reliable and precise measurement of film thickness, refractive index, stress and composition for a broad range of film layers. In addition, we offer a number of other products for the metrology market, as reflected in the product table at the conclusion of this “Products” section.

In-Situ Process Monitoring

KLA-Tencor’s SensArray® SensorWafers are a portfolio of advanced wireless and wired temperature monitoring wafers that capture the effect of the process environment on production wafers. These SensorWafers provide unique insight into thermal uniformity and profile temperature under real production conditions. SensArray products are used in many semiconductor and flat panel display fabrication processes, including lithography, etch and deposition.

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Lithography Software

KLA-Tencor's PROLITH™ product line provides researchers at advanced IC manufacturers, lithography hardware suppliers, track companies and material providers with virtual lithography software to explore critical-feature designs, manufacturability and process-limited yield of proposed lithographic technologies without the time and expense of printing hundreds of test wafers using experimental materials and prototype process equipment. Our ProDATA™ process window analysis software tool speeds critical decision making within the IC fab by enabling fast, easy and accurate analysis of experimental data, including CD, roughness, sidewall angle, top loss and pattern collapse.

In January 2015, we introduced PROLITH™ X5.1, which provides simulation capability for anamorphic imaging for high numerical aperture extreme ultraviolet ("EUV") lithography, and supports all lithography technologies, including 193nm immersion lithography, spacer-based Self-Aligned Double Patterning ("SADP") and thick resist lithography for 3D interconnects and MEMS manufacturing. In May 2015, we released the latest version of our process window analysis software tool, ProDATA™ V2.0, which provides engineers with a systematic, robust approach to understanding and optimizing lithography processes across the IC fab.

Wafer Manufacturing

KLA-Tencor's portfolio of products focused on the demands of wafer manufacturers includes inspection, metrology and data management systems. Specialized inspection tools assess surface quality and detect, count and bin defects during the wafer manufacturing process and as a critical part of outgoing inspection. Wafer geometry tools ensure that the wafer is extremely flat and uniform in thickness, with precisely controlled surface topography. Specifications for wafer defectivity, geometry and surface quality are tightening as the dimensions of transistors become so small that the geometry of the substrate can substantially affect transistor performance.

Our wafer inspection portfolio is anchored by the Surfscan® SP3 Series defect inspection systems designed to enable development and production monitoring of polished wafers, epi wafers and engineered substrates. The SURFmonitor™ module characterizes wafer surface quality and captures the low-contrast defects. The WaferSight™ platform offers bare wafer geometry and nanotopography metrology capabilities. Other products that we offer for the wafer manufacturing market are highlighted in the product table at the conclusion of this "Products" section.

Reticle Manufacturing

Error-free reticles, or masks, are necessary to achieving high semiconductor device yields, since reticle defects can be replicated in every die on production wafers. KLA-Tencor offers high sensitivity reticle inspection and metrology systems for mask shops, designed to help them manufacture reticles that are free of pattern defects that could print on the wafers and meet pattern placement and critical dimension uniformity specifications. In August 2014, we introduced the LMS IPRO6 reticle metrology system which enables improved characterization of mask quality through accurate measurement of reticle pattern placement error for on-device pattern features in addition to standard registration marks.

Our reticle inspection portfolio includes the Teron™ 600 Series for development and manufacturing of advanced optical and EUV masks, the TeraScan™ 500XR system for mask shop production of reticles for the 32nm node and above and our X5.2™ and Teron™ SL650 products for reticle quality control capability for IC fabs. These products include the capability for mapping critical dimension uniformity across the reticle. In addition, we offer the LMS IPRO line of reticle metrology systems for measuring pattern placement error. If the pattern on the reticle is displaced from its intended location, overlay error can result on the wafer, which can lead to electrical continuity issues affecting yield, performance or reliability of the IC device.

LED and Compound Semiconductor Manufacturing

LEDs are becoming more commonly used in solid-state lighting, television and notebook backlighting, and automotive applications. As LED device makers target aggressive cost and performance targets, they place significant emphasis on improved process control and yield during the manufacturing process.

KLA-Tencor offers a portfolio of three systems to help LED manufacturers reduce production costs and increase product output: Candela® 8620, Klarity® LED and WI-2280. The Candela 8620 substrate and epi wafer inspection system provides automated inspection and quality control of LED substrates, detecting defects that can impact device performance, yield and field reliability. Klarity LED is an automated defect data management and analysis system for LED yield enhancement. The WI-2280 system is a patterned wafer inspection tool that is designed specifically for defect inspection and 2D metrology for LED applications.

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Our primary products for compound semiconductor manufacturing include Candela CS20 and the P-Series Stylus Profiler, used for the inspection of substrates, epi-layers and process films. In addition, the Candela CS920 is used by power device manufacturers for defect inspection and classification on SiC substrate and epi wafers.

Data Storage Media/Head Manufacturing

Advancements in data storage are being driven by a wave of innovative consumer electronics with small form factors and immense storage capacities, as well as an increasing need for high-volume storage options to back up modern methods of remote computing and networking (such as cloud computing). Our process control and yield management solutions are designed to enable customers to rapidly understand and resolve complex manufacturing problems, which can help improve time to market and product yields. In the front-end and back-end of thin-film head wafer manufacturing, we offer the same process control equipment that we serve to the semiconductor industry. In addition, we offer an extensive range of test equipment and surface profilers with particular strength in photolithography. In substrate and media manufacturing, we offer metrology and defect inspection solutions with KLA-Tencor’s optical surface analyzers.

MEMS Manufacturing

The increasing demand for MEMS technology is coming from diverse industries such as automotive, space and consumer electronics. MEMS have the potential to revolutionize nearly every product category by bringing together silicon-based microelectronics with micromachining technology, making possible the realization of complete systems-on-a-chip. KLA-Tencor offers tools and techniques for this emerging market, such as defect inspection and review, optical inspection and surface profiling, which were first developed for the integrated circuit industry.

General Purpose/Lab Applications

A range of industries, including general scientific and materials research and optoelectronics, require measurements of surface topography to either control their processes or research new material characteristics. Typical measurement parameters that our tools address include flatness, roughness, curvature, peak-to-valley, asperity, waviness, texture, volume, sphericity, slope, density, stress, bearing ratio and distance (mainly in the micron to nanometer range). In September 2014, we introduced the Alpha-Step® D-500 stylus profiler designed for 2D measurements of surface topography and the Alpha-Step D-600 stylus profiler designed for high resolution 2D and 3D surface topography measurements. The two systems support a broad range of R&D and production applications.

K-T Certified

K-T Certified is our refurbished tools program that delivers fully refurbished, tested and certified KLA-Tencor tools to our customers. In addition to high-quality pre-owned 300mm and sub-200mm tools for the integrated circuit, reticle, substrate, MEMS and data storage markets, K-T Certified also offers system software and hardware performance upgrades to extend the capabilities of existing equipment. When a customer needs to move to the next manufacturing node, K-T Certified can help maximize the value of the customer’s existing assets through K-T Certified’s repurchase, trade-in and redeployment services.

K-T Services

Our K-T Services program enables our customers in all business sectors to maintain the high performance and productivity of our products through a flexible portfolio of services. Whether a manufacturing site is producing integrated circuits, wafers or reticles, K-T Services delivers yield management expertise spanning advanced technology nodes, including collaboration with customers to determine the best products and services to meet technology requirements and optimize cost of ownership. Our comprehensive services include service engineers, technical support teams and knowledge management systems; and an extensive parts network to ensure worldwide availability of parts.

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Product Table

The following table presents a representative list of the products that we offered during the course of the fiscal year ended June 30, 2015:

MARKETS	APPLICATIONS	PRODUCTS
Chip Manufacturing		
Front-End Defect Inspection	Patterned Wafer	2920 Series, 2910 Series, 2900 Series, 2830 Series, 2820 Series, 2810 Series
		Puma™ 9850, Puma 9650, Puma 9500 Series
		eS805™ Series, eS800 Series
	High Productivity and All Surface	CIRCL™ with 8 Series, CV350i, BDR300™ and Micro300 modules
		8 Series (8800, 8820, 8900, 8920)
	Unpatterned Wafer/Surface	Surfscan® SP3 and Surfscan SP5 Series
		SURFmonitor™
	Reticle	X5.2™
		Teron™ SL650
	Data Management	Klarity® product family
Advanced Packaging	Wafer-Level Packaging	CIRCL-AP™ with 8 Series, CV350i and Micro300 modules
		WI-22x0 Series
	Component Inspection	ICOS® T640 and ICOS T830
Defect Review	Electron-beam	eDR™-7100 Series, eDR-7000 Series
Metrology	Overlay	Archer™ Series
	Optical CD and Shape	SpectraShape™ product family
	Film Thickness/Index	SpectraFilm™ product family
		Aleris™ product family
	Wafer Geometry and Topography	WaferSight™ Series
		SURFmonitor
	Ion Implant and Anneal	Therma-Probe®
	Surface Metrology	HRP® -350
		P-Series product family
	Resistivity	RS product family
	Data Management	K-T Analyzer®
In-Situ Process Monitoring	Lithography	SensArray® product family
	Plasma Etch	SensArray product family
	Implant and Wet	SensArray PlasmaSuite
Lithography Software	Lithography Simulation	PROLITH™
	Process Window Analysis	ProDATA™

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MARKETS AND APPLICATIONS	PRODUCTS
Wafer Manufacturing	
Surface and Defect Inspection	Surfscan SP3 Series SURFmonitor
Wafer Geometry and Nanotopography Metrology	WaferSight Series SURFmonitor
Data Management	FabVision™
Reticle Manufacturing	
Defect Inspection	TeraScan™XR Teron 600 Series
Pattern Placement Metrology	LMS IPRO Series
LED and Compound Semiconductor Manufacturing	
Patterned Wafer Inspection	WI product family
Defect Inspection (substrates and epi wafers)	Candela® product family
Surface Metrology	P-Series product family MicroXAM Series HRP product family
Data Management	Klarity LED
Data Storage Media/Head Manufacturing	
Thin-Film Head Metrology and Inspection	Aleris product family CIRCL with 8 Series, CV350i, BDR300 and Micro300 modules HRP -250 P-Series product family
Virtual Lithography	PROLITH
In-Situ Process Monitoring	SensArray product family
Transparent and Metal Substrate Inspection	Candela product family
Data Management	Klarity Defect K-T Analyzer
MEMS Manufacturing	
Surface Metrology: Stylus Profiling	P-Series product family HRP product family
Surface Metrology: Optical Profiling	MicroXAM Series
Optical Inspection	8 Series (8800, 8820, 8900, 8920) WI product family
General Purpose/Lab Applications	
Surface Metrology: Stylus Profiling	P-Series product family Alpha-Step® product family HRP product family
Surface Metrology: Optical Profiling	MicroXAM Series
Process Chamber Conditions	SensArray product family

The product information shown in the tables above excludes some products that were solely offered through our K-T Certified refurbished tools program.

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Customers

To support our growing global customer base, we maintain a significant presence throughout Asia, the United States and Europe, staffed with local sales and applications engineers, customer and field service engineers and yield management consultants. We count among our largest customers the leading semiconductor manufacturers in each of these regions.

For the fiscal years ended June 30, 2015, 2014 and 2013, the following customers each accounted for more than 10% of total revenues:

Year ended June 30,		
2015	2014	2013
Intel Corporation	Intel Corporation	Intel Corporation
Samsung Electronics Co., Ltd.	Samsung Electronics Co., Ltd.	Taiwan Semiconductor Manufacturing Company Limited
Taiwan Semiconductor Manufacturing Company Limited	Taiwan Semiconductor Manufacturing Company Limited	

Our business depends upon the capital expenditures of semiconductor manufacturers, which in turn is driven by the current and anticipated market demand for ICs and products utilizing ICs. We do not consider our business to be seasonal in nature, but it is cyclical with respect to the capital equipment procurement practices of semiconductor manufacturers, and it is impacted by the investment patterns of such manufacturers in different global markets. Downturns in the semiconductor industry or slowdowns in the worldwide economy as well as customer consolidation could have a material adverse effect on our future business and financial results.

Sales, Service and Marketing

Our sales, service and marketing efforts are aimed at building long-term relationships with our customers. We focus on providing a single and comprehensive resource for the full breadth of process control and yield management products and services. Our customers benefit from the simplified planning and coordination, as well as the increased equipment compatibility, which are realized as a result of dealing with a single supplier for multiple products and services. Our revenues are derived primarily from product sales, mostly through our direct sales force.

We believe that the size and location of our field sales, service and applications engineering, and marketing organizations represent a competitive advantage in our served markets. We have direct sales forces in Asia, the United States and Europe. We maintain an export compliance program that is designed to meet the requirements of the United States Departments of Commerce and State.

As of June 30, 2015, we employed approximately 2,390 full-time sales and related personnel, service engineers and applications engineers. In addition to sales and service offices in the United States, we conduct sales, marketing and services out of wholly-owned subsidiaries or branches in other countries, including Belgium, China, Germany, Israel, Japan, Singapore, South Korea and Taiwan. International revenues accounted for approximately 71%, 76% and 70% of our total revenues in the fiscal years ended June 30, 2015, 2014 and 2013, respectively. Additional information regarding our revenues from foreign operations for our last three fiscal years can be found in Note 17, "Segment Reporting and Geographic Information" to the Consolidated Financial Statements.

We believe that sales outside the United States will continue to be a significant percentage of our total revenues. Our future performance will depend, in part, on our ability to continue to compete successfully in Asia, one of the largest markets for our equipment. Our ability to compete in this area is dependent upon the continuation of favorable trading relationships between countries in the region and the United States, and our continuing ability to maintain satisfactory relationships with leading semiconductor companies in the region.

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International sales and operations may be adversely affected by the imposition of governmental controls, restrictions on export technology, political instability, trade restrictions, changes in tariffs and the difficulties associated with staffing and managing international operations. In addition, international sales may be adversely affected by the economic conditions in each country and by fluctuations in currency exchange rates, and such fluctuations may negatively impact our ability to compete on price with local providers or the value of revenues we generate from our international business. Although we attempt to manage some of the currency risk inherent in non-U.S. dollar product sales through hedging activities, there can be no assurance that such efforts will be adequate. These factors, as well as any of the other risk factors related to our international business and operations that are described in Item 1A, "Risk Factors," could have a material adverse effect on our future business and financial results.

Backlog

Our shipment backlog for systems and associated warranty totaled $984 million and $977 million as of June 30, 2015 and 2014, respectively, and primarily consists of sales orders where written customer requests have been received and the delivery is anticipated within the next 12 months. Orders for service contracts and unreleased products are excluded from shipment backlog. All orders are subject to cancellation or delay by the customer, often with limited or no penalties. We make adjustments for shipment backlog obtained from acquired companies, sales order cancellations, customer delivery date changes and currency adjustments. Shipment backlog is not subject to normal accounting controls for information that is either reported in or derived from our consolidated financial statements. In addition, the concept of shipment backlog is not defined in the accounting literature, making comparisons between periods and with other companies difficult and potentially misleading.

Our revenue backlog, which includes the gross value of sales orders where physical deliveries have been completed, but for which revenue has not been recognized pursuant to our policy for revenue recognition, totaled $221 million and $269 million as of June 30, 2015 and 2014, respectively. Orders for service contracts are excluded from revenue backlog.

Because customers can potentially change delivery schedules or delay or cancel orders, and because some orders are received and shipped within the same quarter, our shipment backlog at any particular date is not necessarily indicative of business volumes or actual sales for any succeeding periods. The cyclicality of the semiconductor industry combined with the lead times from our suppliers sometimes result in timing disparities between, on the one hand, our ability to manufacture, deliver and install products and, on the other, the requirements of our customers. In our efforts to balance the requirements of our customers with the availability of resources, management of our operating model and other factors, we often must exercise discretion and judgment as to the timing and prioritization of manufacturing, deliveries and installations of products, which may impact the timing of revenue recognition with respect to such products.

Research and Development

The market for yield management and process monitoring systems is characterized by rapid technological development and product innovation. These technical innovations are inherently complex and require long development cycles and appropriate professional staffing. We believe that continued and timely development of new products and enhancements to existing products are necessary to maintain our competitive position. Accordingly, we devote a significant portion of our human and financial resources to research and development programs and seek to maintain close relationships with customers to remain responsive to their needs. In addition, we may enter into certain strategic development and engineering programs whereby certain government agencies or other third parties fund a portion of our research and development costs. As of June 30, 2015, we employed approximately 1,480 full-time research and development personnel.

Our key research and development activities during the fiscal year ended June 30, 2015 involved the development of process control and yield management equipment aimed at addressing the challenges posed by shrinking device sizes, the transition to new production materials, new device and circuit architecture, more demanding lithography processes and new back-end packaging techniques. For information regarding our research and development expenses during the last three fiscal years, including costs offset by our strategic development and engineering programs, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K.

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The strength of our competitive positions in many of our existing markets is largely due to our leading technology, which is the result of our continuing significant investments in product research and development. Even during down cycles in the semiconductor industry, we have remained committed to significant engineering efforts toward both product improvement and new product development in order to enhance our competitive position. New product introductions, however, may contribute to fluctuations in operating results, since customers may defer ordering existing products, and, if new products have reliability or quality problems, those problems may result in reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. There can be no assurance that we will successfully develop and manufacture new products, or that new products introduced by us will be accepted in the marketplace. If we do not successfully introduce new products, our results of operations will be adversely affected.

Manufacturing, Raw Materials and Supplies

We perform system design, assembly and testing in-house and utilize an outsourcing strategy for the manufacture of components and major subassemblies. Our in-house manufacturing activities consist primarily of assembling and testing components and subassemblies that are acquired through third-party vendors and integrating those subassemblies into our finished products. Our principal manufacturing activities take place in the United States (Milpitas, California), Singapore, Israel, Germany and China. As of June 30, 2015, we employed approximately 970 full-time manufacturing personnel.

Some critical parts, components and subassemblies (collectively, “parts”) that we use are designed by us and manufactured by suppliers in accordance with our specifications, while other parts are standard commercial products. We use numerous vendors to supply parts and raw materials for the manufacture and support of our products. Although we make reasonable efforts to ensure that these parts and raw materials are available from multiple suppliers, this is not always possible, and certain parts and raw materials included in our systems may be obtained only from a single supplier or a limited group of suppliers. Through our business interruption planning, we endeavor to minimize the risk of production interruption by, among other things, monitoring the financial condition of suppliers of key parts and raw materials, identifying (but not necessarily qualifying) possible alternative suppliers of such parts and materials, and ensuring adequate inventories of key parts and raw materials are available to maintain manufacturing schedules.

Although we seek to reduce our dependence on sole and limited source suppliers, in some cases the partial or complete loss of certain of these sources, or disruptions within our suppliers’ often-complex supply chains, could disrupt scheduled deliveries to customers, damage customer relationships and have a material adverse effect on our results of operations.

Competition

The worldwide market for process control and yield management systems is highly competitive. In each of our product markets, we face competition from established and potential competitors, such as Applied Materials, Inc., ASML Holding N.V., Hermes Microvision, Inc., Hitachi High-Technologies Corporation and Nanometrics, Inc., some of which may have greater financial, research, engineering, manufacturing and marketing resources than we have. We may also face future competition from new market entrants from other overseas and domestic sources. We expect our competitors to continue to improve the design and performance of their current products and processes and to introduce new products and processes with improved price and performance characteristics. We believe that, to remain competitive, we will require significant financial resources to offer a broad range of products, to maintain customer service and support centers worldwide, and to invest in product and process research and development.

We believe that, while price and delivery are important competitive factors, the customers’ overriding requirement is for systems that easily and effectively incorporate automated and highly accurate inspection and metrology capabilities into their existing manufacturing processes to enhance productivity. Significant competitive factors in the market for process control and yield management systems include system performance, ease of use, reliability, interoperability with the existing installed base and technical service and support, as well as overall cost of ownership. Management believes that we are well positioned in the market with respect to both our products and services. However, any loss of competitive position could negatively impact our prices, customer orders, revenues, gross margins and market share, any of which would negatively impact our operating results and financial condition.

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Acquisitions and Alliances

We continuously evaluate strategic acquisitions and alliances to expand our technologies, product offerings and distribution capabilities. Acquisitions involve numerous risks, including management issues and costs in connection with integration of the operations, technologies and products of the acquired companies, and the potential loss of key employees of the acquired companies. The inability to manage these risks effectively could negatively impact our operating results and financial condition.

Patents and Other Proprietary Rights

We protect our proprietary technology through reliance on a variety of intellectual property laws, including patent, copyright and trade secret. We have filed and obtained a number of patents in the United States and abroad and intend to continue pursuing the legal protection of our technology through intellectual property laws. In addition, from time to time we acquire license rights under United States and foreign patents and other proprietary rights of third parties, and we attempt to protect our trade secrets and other proprietary information through confidentiality and other agreements with our customers, suppliers, employees and consultants and through other security measures.

Although we consider patents and other intellectual property significant to our business, due to the rapid pace of innovation within the process control and yield management systems industry, we believe that our protection through patent and other intellectual property rights is less important than factors such as our technological expertise, continuing development of new systems, market penetration, installed base and the ability to provide comprehensive support and service to customers worldwide.

No assurance can be given that patents will be issued on any of our applications, that license assignments will be made as anticipated, or that our patents, licenses or other proprietary rights will be sufficiently broad to protect our technology. No assurance can be given that any patents issued to or licensed by us will not be challenged, invalidated or circumvented or that the rights granted thereunder will provide us with a competitive advantage. In addition, there can be no assurance that we will be able to protect our technology or that competitors will not be able to independently develop similar or functionally competitive technology.

Environmental Matters

We are subject to a variety of federal, state and local governmental laws and regulations related to the protection of the environment, including without limitation the management of hazardous materials that we use in our business operations. Compliance with these environmental laws and regulations has not had, and is not expected to have, a material effect on our capital expenditures, financial condition, results of operations or competitive position. However, any failure to comply with environmental laws and regulations may subject us to a range of consequences, including fines, suspension of certain of our business activities, limitations on our ability to sell our products, obligations to remediate environmental contamination, and criminal and civil liabilities or other sanctions. In addition, changes in environmental laws and regulations could require us to invest in potentially costly pollution control equipment, alter our manufacturing processes or use substitute materials. Our failure to comply with these laws and regulations could subject us to future liabilities.

Employees

As of June 30, 2015, we employed approximately 5,880 full-time employees. Except for our employees in Belgium (where a trade union delegation has been recognized) and our employees in the German operations of our MIE business unit (who are represented by employee works council), none of our employees are represented by a labor union. We have not experienced work stoppages and believe that our employee relations are good.

Competition is intense in the recruiting of personnel in the semiconductor and semiconductor equipment industry. We believe that our future success will depend, in part, on our continued ability to hire and retain qualified management, marketing and technical employees.

As discussed in our Note 15, “Restructuring Charges,” we announced in April 2015 a plan to reduce our global workforce to streamline our organization and business processes in response to changing customer requirements in our industry. The goals of this reduction are to enable continued innovation, direct our resources toward our best opportunities and lower our ongoing expense run rate. Refer to the above footnote for additional details.

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Glossary

This section provides definitions for certain industry and technical terms commonly used in our business, which are used elsewhere in this Item 1:

back-end	Process steps that make up the second half of the semiconductor manufacturing process, from contact through completion of the wafer prior to electrical test.
broadband	An illumination source with a wide spectral bandwidth.
critical dimension (CD)	The dimension of a specified geometry (such as the width of a patterned line or the distance between two lines) that must be within design tolerances in order to maintain semiconductor device performance consistency.
design rules	Rules that set forth the allowable dimensions of particular features used in the design and layout of integrated circuits.
die	The term for a single semiconductor chip on a wafer.
electron-beam	An illumination source comprised of a stream of electrons emitted by a single source.
epitaxial silicon (epi)	A substrate technology based on growing a crystalline silicon layer on top of a silicon wafer. The added layer, where the structure and orientation are matched to those of the silicon wafer, includes dopants (impurities) to imbue the substrate with special electronic properties.
excursion	For a manufacturing step or process, a deviation from normal operating conditions that can lead to decreased performance or yield of the final product.
fab	The main manufacturing facility for processing semiconductor wafers.
front-end	The processes that make up the first half of the semiconductor manufacturing process, from wafer start through final contact window processing.
in-situ	Refers to processing steps or tests that are done without moving the wafer. Latin for “in original position.”
interconnect	A highly conductive material, usually copper or aluminum, that carries electrical signals to different parts of a die.
lithography	A process in which a masked pattern is projected onto a photosensitive coating that covers a substrate.
mask shop	A manufacturer that produces the reticles used by semiconductor manufacturers.
metrology	The science of measurement to determine dimensions, quantity or capacity. In the semiconductor industry, typical measurements include critical dimension, overlay and film thickness.
microelectromechanical systems (MEMS)	Micron-sized mechanical devices powered by electricity, created using processes similar to those used to manufacture IC devices.

micron	A metric unit of linear measure that equals 1/1,000,000 meter (10^{-6}m), or 10,000 angstroms (the diameter of a human hair is approximately 75 microns).
nanometer (nm)	One billionth (10^{-9}) of a meter.
narrowband	An illumination source with a narrow spectral bandwidth, such as a laser.
patterned	For semiconductor manufacturing and industries using similar processing technologies, refers to substrates that have electronic circuits (transistors, interconnects, etc.) fabricated on the surface.

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photoresist	A radiation-sensitive material that, when properly applied to a variety of substrates and then properly exposed and developed, masks portions of the substrate with a high degree of integrity.
process control	The ability to maintain specifications of products and equipment during manufacturing operations.
reticle	A very flat glass plate that contains the patterns to be reproduced on a wafer.
silicon-on-insulator (SOI)	A substrate technology comprised of a thin top silicon layer separated from the silicon substrate by a thin insulating layer of glass or silicon dioxide, used to improve performance and reduce the power consumption of IC circuits.
substrate	A wafer on which layers of various materials are added during the process of manufacturing semiconductor devices or circuits.
unpatterned	For semiconductor manufacturing and industries using similar processing technologies, refers to substrates that do not have electronic circuits (transistors, interconnects, etc.) fabricated on the surface. These can include bare silicon wafers, other bare substrates or substrates on which blanket films have been deposited.
yield management	The ability of a semiconductor manufacturer to oversee, manage and control its manufacturing processes so as to maximize the percentage of manufactured wafers or die that conform to pre-determined specifications.

The definitions above are from internal sources, as well as the SEMATECH Dictionary of Semiconductor Terms.

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ITEM 1A. RISK FACTORS

A description of factors that could materially affect our business, financial condition or operating results is provided below.

Risks Associated with Our Industry

Ongoing changes in the technology industry, as well as the semiconductor industry in particular, could expose our business to significant risks.

The semiconductor equipment industry and other industries that we serve are constantly developing and changing over time. Many of the risks associated with operating in these industries are comparable to the risks faced by all technology companies, such as the uncertainty of future growth rates in the industries that we serve, pricing trends in the end-markets for consumer electronics and other products (which place a growing emphasis on our customers' cost of ownership), changes in our customers' capital spending patterns and, in general, an environment of constant change and development, including decreasing product and component dimensions; use of new materials; and increasingly complex device structures, applications and process steps. If we fail to appropriately adjust our cost structure and operations to adapt to any of these trends, or, with respect to technological advances, if we do not timely develop new technologies and products that successfully anticipate and address these changes, we could experience a material adverse effect on our business, financial condition and operating results.

In addition, we face a number of risks specific to ongoing changes in the semiconductor industry, as the significant majority of our sales are made to semiconductor manufacturers. Some of the trends that our management monitors in operating our business include the following:

- the increasing cost of building and operating fabrication facilities and the impact of such increases on our customers' investment decisions;
- differing market growth rates and capital requirements for different applications, such as memory, logic and foundry;
- lower level of process control adoption by our memory customers compared to our foundry and logic customers;
- our customers' reuse of existing and installed products, which may decrease their need to purchase new products or solutions at more advanced technology nodes;
- the emergence of disruptive technologies that change the prevailing semiconductor manufacturing processes (or the economics associated with semiconductor manufacturing) and, as a result, also impact the inspection and metrology requirements associated with such processes;
- the higher design costs for the most advanced integrated circuits, which could economically constrain leading-edge manufacturing technology customers to focus their resources on only the large, technologically advanced products and applications;
- the possible introduction of integrated products by our larger competitors that offer inspection and metrology functionality in addition to managing other semiconductor manufacturing processes;
- changes in semiconductor manufacturing processes that are extremely costly for our customers to implement and, accordingly, our customers could reduce their available budgets for process control equipment by reducing inspection and metrology sampling rates for certain technologies;
- the reversal of the historical trend of declining cost per transistor with each new generation of technological advancement within the semiconductor industry, and the adverse impact that such reversal would have upon our business;
- the bifurcation of the semiconductor manufacturing industry into (a) leading edge manufacturers driving continued research and development into next-generation products and technologies and (b) other manufacturers that are content with existing (including previous generation) products and technologies;
- the ever escalating cost of next-generation product development, which may result in joint development programs between us and our customers or government entities to help fund such programs that could restrict our control of, ownership of and profitability from the products and technologies developed through those programs;
- the potential industry transition from 300mm to 450mm wafers; and
- the entry by some semiconductor manufacturers into collaboration or sharing arrangements for capacity, cost or risk with other manufacturers, as well as increased outsourcing of their manufacturing activities, and greater focus only on specific markets or applications, whether in response to adverse market conditions or other market pressures.

Any of the changes described above may negatively affect our customers' rate of investment in the capital equipment that we produce, which could result in downward pressure on our prices, customer orders, revenues and gross margins. If we do not successfully manage the risks resulting from any of these or other potential changes in our industries, our business, financial condition and operating results could be adversely impacted.

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We are exposed to risks associated with a highly concentrated customer base.

Our customer base, particularly in the semiconductor industry, historically has been, and is becoming increasingly, highly concentrated due to corporate consolidation, acquisitions and business closures. In this environment, orders from a relatively limited number of manufacturers have accounted for, and are expected to continue to account for, a substantial portion of our sales. This increasing concentration exposes our business, financial condition and operating results to a number of risks, including the following:

- The mix and type of customers, and sales to any single customer, may vary significantly from quarter to quarter and from year to year, which exposes our business and operating results to increased volatility tied to individual customers.
- New orders from our foundry customers in the past several years have constituted a significant portion of our total orders. This concentration increases the impact that future business or technology changes within the foundry industry may have on our business, financial condition and operating results.
- In a highly concentrated business environment, if a particular customer does not place an order, or if they delay or cancel orders, we may not be able to replace the business. Furthermore, because our products are configured to each customer's specifications, any changes, delays or cancellations of orders may result in significant, non-recoverable costs.
- As a result of this consolidation, the customers that survive the consolidation represent a greater portion of our sales and, consequently, have greater commercial negotiating leverage. Many of our large customers have more aggressive policies regarding engaging alternative, second-source suppliers for the products we offer and, in addition, may seek and, on occasion, receive pricing, payment, intellectual property-related or other commercial terms that may have an adverse impact on our business. Any of these changes could negatively impact our prices, customer orders, revenues and gross margins.
- Certain customers have undergone significant ownership changes, created alliances with other companies, experienced management changes or have outsourced manufacturing activities, any of which may result in additional complexities in managing customer relationships and transactions. Any future change in ownership or management of our existing customers may result in similar challenges, including the possibility of the successor entity or new management deciding to select a competitor's products.
- The highly concentrated business environment also increases our exposure to risks related to the financial condition of each of our customers. For example, as a result of the challenging economic environment during fiscal year 2009, we were (and in some cases continue to be) exposed to additional risks related to the continued financial viability of certain of our customers. To the extent our customers experience liquidity issues in the future, we may be required to incur additional bad debt expense with respect to receivables owed to us by those customers. In addition, customers with liquidity issues may be forced to reduce purchases of our equipment, delay deliveries of our products, discontinue operations or may be acquired by one of our customers, and in either case such event would have the effect of further consolidating our customer base.
- Semiconductor manufacturers generally must commit significant resources to qualify, install and integrate process control and yield management equipment into a semiconductor production line. We believe that once a semiconductor manufacturer selects a particular supplier's process control and yield management equipment, the manufacturer generally relies upon that equipment for that specific production line application for an extended period of time. Accordingly, we expect it to be more difficult to sell our products to a given customer for that specific production line application and other similar production line applications if that customer initially selects a competitor's equipment. Similarly, we expect it to be challenging for a competitor to sell its products to a given customer for a specific production line application if that customer initially selects our equipment.
- Prices differ among the products we offer for different applications due to differences in features offered or manufacturing costs. If there is a shift in demand by our customers from our higher-priced to lower-priced products, our gross margin and revenue would decrease. In addition, when products are initially introduced, they tend to have higher costs because of initial development costs and lower production volumes relative to the previous product generation, which can impact gross margin.

Any of these factors could have a material adverse effect on our business, financial condition and operating results.

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The semiconductor equipment industry is highly cyclical. The purchasing decisions of our customers are highly dependent on the economies of both the local markets in which they are located and the semiconductor industry worldwide. If we fail to respond to industry cycles, our business could be seriously harmed.

The timing, length and severity of the up-and-down cycles in the semiconductor equipment industry are difficult to predict. The cyclical nature of the primary industry in which we operate is largely a function of our customers' capital spending patterns and need for expanded manufacturing capacity, which in turn are affected by factors such as capacity utilization, consumer demand for products, inventory levels and our customers' access to capital. This cyclicality affects our ability to accurately predict future revenue and, in some cases, future expense levels. During down cycles in our industry, the financial results of our customers may be negatively impacted, which could result not only in a decrease in, or cancellation or delay of, orders (which are generally subject to cancellation or delay by the customer with limited or no penalty) but also a weakening of their financial condition that could impair their ability to pay for our products or our ability to recognize revenue from certain customers. Our ability to recognize revenue from a particular customer may also be negatively impacted by the customer's funding status, which could be weakened not only by adverse business conditions or inaccessibility to capital markets for any number of macroeconomic or company-specific reasons, but also by funding limitations imposed by the customer's unique corporate structure. Any of these factors could negatively impact our business, operating results and financial condition.

When cyclical fluctuations result in lower than expected revenue levels, operating results may be adversely affected and cost reduction measures may be necessary in order for us to remain competitive and financially sound. During periods of declining revenues, we must be in a position to adjust our cost and expense structure to prevailing market conditions and to continue to motivate and retain our key employees. If we fail to respond, or if our attempts to respond fail to accomplish our intended results, then our business could be seriously harmed. Furthermore, any workforce reductions and cost reduction actions that we adopt in response to down cycles may result in additional restructuring charges, disruptions in our operations and loss of key personnel. In addition, during periods of rapid growth, we must be able to increase manufacturing capacity and personnel to meet customer demand. We can provide no assurance that these objectives can be met in a timely manner in response to industry cycles. Each of these factors could adversely impact our operating results and financial condition.

In addition, our management typically provides quarterly forecasts for certain financial metrics, which, when made, are based on business and operational forecasts that are believed to be reasonable at the time. However, largely due to the cyclicality of our business and the industries in which we operate, and the fact that business conditions in our industries can change very rapidly as part of these cycles, our actual results may vary (and have varied in the past) from forecasted results. These variations can occur for any number of reasons, including, but not limited to, unexpected changes in the volume or timing of customer orders, product shipments or product acceptances; an inability to adjust our operations rapidly enough to adapt to changing business conditions; or a different than anticipated effective tax rate. The impact on our business of delays or cancellations of customer orders may be exacerbated by the short lead times that our customers expect between order placement and product shipment. This is because order delays and cancellations may lead not only to lower revenues, but also, due to the advance work we must do in anticipation of receiving a product order in order to meet the expected lead times, to significant inventory write-offs and manufacturing inefficiencies that decrease our gross margin. Any of these factors could materially and adversely affect our financial results for a particular quarter and could cause those results to differ materially from financial forecasts we have previously provided. We provide these forecasts with the intent of giving investors and analysts a better understanding of management's expectations for the future, but parties reviewing such forecasts must recognize that such forecasts are comprised of, and are themselves, forward-looking statements subject to the risks and uncertainties described in this Item 1A and elsewhere in this report and in our other public filings and public statements. If our operating or financial results for a particular period differ from our forecasts or the expectations of investment analysts, or if we revise our forecasts, the market price of our common stock could decline.

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Risks Related to Our Business Model and Capital Structure

If we do not develop and introduce new products and technologies in a timely manner in response to changing market conditions or customer requirements, our business could be seriously harmed.

Success in the semiconductor equipment industry depends, in part, on continual improvement of existing technologies and rapid innovation of new solutions. For over 25 years the primary driver of technology advancement in the semiconductor industry has been to shrink the lithography that prints the circuit design on semiconductor chips. That driver appears to be slowing, which may cause semiconductor manufacturers to delay investments in equipment, investigate more complex device architectures, use new materials and develop innovative fabrication processes. These and other evolving customer plans and needs require us to respond with continued development programs and cut back or discontinue older programs, which may no longer have industry-wide support. Technical innovations are inherently complex and require long development cycles and appropriate staffing of highly qualified employees. Our competitive advantage and future business success depend on our ability to accurately predict evolving industry standards, develop and introduce new products and solutions that successfully address changing customer needs, win market acceptance of these new products and solutions, and manufacture these new products in a timely and cost-effective manner. Our failure to accurately predict evolving industry standards and develop as well as offer competitive technology solutions in a timely manner with cost-effective products could result in loss of market share, unanticipated costs, and inventory obsolescence, which would adversely impact our business, operating results and financial condition.

In this environment, we must continue to make significant investments in research and development in order to enhance the performance, features and functionality of our products, to keep pace with competitive products and to satisfy customer demands. Substantial research and development costs typically are incurred before we confirm the technical feasibility and commercial viability of a new product, and not all development activities result in commercially viable products. There can be no assurance that revenues from future products or product enhancements will be sufficient to recover the development costs associated with such products or enhancements. In addition, we cannot be sure that these products or enhancements will receive market acceptance or that we will be able to sell these products at prices that are favorable to us. Our business will be seriously harmed if we are unable to sell our products at favorable prices or if the market in which we operate does not accept our products.

In addition, the complexity of our products exposes us to other risks. We regularly recognize revenue from a sale upon shipment of the applicable product to the customer (even before receiving the customer’s formal acceptance of that product) in certain situations, including sales of products for which installation is considered perfunctory, transactions in which the product is sold to an independent distributor and we have no installation obligations, and sales of products where we have previously delivered the same product to the same customer location and that prior delivery has been accepted. However, our products are very technologically complex and rely on the interconnection of numerous subcomponents (all of which must perform to their respective specifications), so it is conceivable that a product for which we recognize revenue upon shipment may ultimately fail to meet the overall product’s required specifications. In such a situation, the customer may be entitled to certain remedies, which could materially and adversely affect our operating results for various periods and, as a result, our stock price.

We derive a substantial percentage of our revenues from sales of defect inspection products. As a result, any delay or reduction of sales of these products could have a material adverse effect on our business, financial condition and operating results. The continued customer demand for these products and the development, introduction and market acceptance of new products and technologies are critical to our future success.

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Our success is dependent in part on our technology and other proprietary rights. If we are unable to maintain our lead or protect our proprietary technology, we may lose valuable assets.

Our success is dependent in part on our technology and other proprietary rights. We own various United States and international patents and have additional pending patent applications relating to some of our products and technologies. The process of seeking patent protection is lengthy and expensive, and we cannot be certain that pending or future applications will actually result in issued patents or that issued patents will be of sufficient scope or strength to provide meaningful protection or commercial advantage to us. Other companies and individuals, including our larger competitors, may develop technologies and obtain patents relating to our business that are similar or superior to our technology or may design around the patents we own, adversely affecting our business. In addition, we at times engage in collaborative technology development efforts with our customers and suppliers, and these collaborations may constitute a key component of certain of our ongoing technology and product research and development projects. The termination of any such collaboration, or delays caused by disputes or other unanticipated challenges that may arise in connection with any such collaboration, could significantly impair our research and development efforts, which could have a material adverse impact on our business and operations.

We also maintain trademarks on certain of our products and services and claim copyright protection for certain proprietary software and documentation. However, we can give no assurance that our trademarks and copyrights will be upheld or successfully deter infringement by third parties.

While patent, copyright and trademark protection for our intellectual property is important, we believe our future success in highly dynamic markets is most dependent upon the technical competence and creative skills of our personnel. We attempt to protect our trade secrets and other proprietary information through confidentiality and other agreements with our customers, suppliers, employees and consultants and through other security measures. We also maintain exclusive and non-exclusive licenses with third parties for strategic technology used in certain products. However, these employees, consultants and third parties may breach these agreements, and we may not have adequate remedies for wrongdoing. In addition, the laws of certain territories in which we develop, manufacture or sell our products may not protect our intellectual property rights to the same extent as do the laws of the United States. In any event, the extent to which we can protect our trade secrets through the use of confidentiality agreements is limited, and our success will depend to a significant extent on our ability to innovate ahead of our competitors.

Our future performance depends, in part, upon our ability to continue to compete successfully worldwide.

Our industry includes large manufacturers with substantial resources to support customers worldwide. Some of our competitors are diversified companies with greater financial resources and more extensive research, engineering, manufacturing, marketing, and customer service and support capabilities than we possess. We face competition from companies whose strategy is to provide a broad array of products and services, some of which compete with the products and services that we offer. These competitors may bundle their products in a manner that may discourage customers from purchasing our products, including pricing such competitive tools significantly below our product offerings. In addition, we face competition from smaller emerging semiconductor equipment companies whose strategy is to provide a portion of the products and services that we offer, using innovative technology to sell products into specialized markets. The strength of our competitive positions in many of our existing markets is largely due to our leading technology, which is the result of continuing significant investments in product research and development. However, we may enter new markets, whether through acquisitions or new internal product development, in which competition is based primarily on product pricing, not technological superiority. Further, some new growth markets that emerge may not require leading technologies. Loss of competitive position in any of the markets we serve, or an inability to sell our products on favorable commercial terms in new markets we may enter, could negatively affect our prices, customer orders, revenues, gross margins and market share, any of which would negatively affect our operating results and financial condition.

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Our business would be harmed if we do not receive parts sufficient in number and performance to meet our production requirements and product specifications in a timely and cost-effective manner.

We use a wide range of materials in the production of our products, including custom electronic and mechanical components, and we use numerous suppliers to supply these materials. We generally do not have guaranteed supply arrangements with our suppliers. Because of the variability and uniqueness of customers' orders, we do not maintain an extensive inventory of materials for manufacturing. Through our business interruption planning, we seek to minimize the risk of production and service interruptions and/or shortages of key parts by, among other things, monitoring the financial stability of key suppliers, identifying (but not necessarily qualifying) possible alternative suppliers and maintaining appropriate inventories of key parts. Although we make reasonable efforts to ensure that parts are available from multiple suppliers, key parts may be available only from a single supplier or a limited group of suppliers. Also, key parts we obtain from some of our suppliers incorporate the suppliers' proprietary intellectual property; in those cases we are increasingly reliant on third parties for high-performance, high-technology components, which reduces the amount of control we have over the availability and protection of the technology and intellectual property that is used in our products. In addition, if certain of our key suppliers experience liquidity issues and are forced to discontinue operations, which is a heightened risk during economic downturns, it could affect their ability to deliver parts and could result in delays for our products. Similarly, especially with respect to suppliers of high-technology components, our suppliers themselves have increasingly complex supply chains, and delays or disruptions at any stage of their supply chains may prevent us from obtaining parts in a timely manner and result in delays for our products. Our operating results and business may be adversely impacted if we are unable to obtain parts to meet our production requirements and product specifications, or if we are only able to do so on unfavorable terms.

Furthermore, a supplier may discontinue production of a particular part for any number of reasons, including the supplier's financial condition or business operational decisions, which would require us to purchase, in a single transaction, a large number of such discontinued parts in order to ensure that a continuous supply of such parts remains available to our customers. Such "end-of-life" parts purchases could result in significant expenditures by us in a particular period, and ultimately any unused parts may result in a significant inventory write-off, either of which could have a material and adverse impact on our financial condition and results of operations for the applicable periods.

If we fail to operate our business in accordance with our business plan, our operating results, business and stock price may be significantly and adversely impacted.

We attempt to operate our business in accordance with a business plan that is established annually, revised frequently (generally quarterly), and reviewed by management even more frequently (at least monthly). Our business plan is developed based on a number of factors, many of which require estimates and assumptions, such as our expectations of the economic environment, future business levels, our customers' willingness and ability to place orders, lead-times, and future revenue and cash flow. Our budgeted operating expenses, for example, are based in part on our future revenue expectations. However, our ability to achieve our anticipated revenue levels is a function of numerous factors, including the volatile and cyclical nature of our primary industry, customer order cancellations, macroeconomic changes, operational matters regarding particular agreements, our ability to manage customer deliveries, the availability of resources for the installation of our products, delays or accelerations by customers in taking deliveries and the acceptance of our products (for products where customer acceptance is required before we can recognize revenue from such sales), our ability to operate our business and sales processes effectively, and a number of the other risk factors set forth in this Item 1A.

Because our expenses are in most cases relatively fixed in the short term, any revenue shortfall below expectations could have an immediate and significant adverse effect on our operating results. Similarly, if we fail to manage our expenses effectively or otherwise fail to maintain rigorous cost controls, we could experience greater than anticipated expenses during an operating period, which would also negatively affect our results of operations. If we fail to operate our business consistent with our business plan, our operating results in any period may be significantly and adversely impacted. Such an outcome could cause customers, suppliers or investors to view us as less stable, or could cause us to fail to meet financial analysts' revenue or earnings estimates, any of which could have a material adverse impact on our business, financial condition or stock price.

In addition, our management is constantly striving to balance the requirements and demands of our customers with the availability of resources, the need to manage our operating model and other factors. In furtherance of those efforts, we often must exercise discretion and judgment as to the timing and prioritization of manufacturing, deliveries, installations and payment scheduling. Any such decisions may impact our ability to recognize revenue, including the fiscal period during which such revenue may be recognized, with respect to such products, which could have a material adverse effect on our business, financial condition or stock price.

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Our outstanding indebtedness was substantially increased in the second quarter of our fiscal year ended June 30, 2015 and, as a result, our capital structure is more highly leveraged.

As of June 30, 2015, we had approximately $3.21 billion aggregate principal amount of outstanding indebtedness, consisting of $2.50 billion aggregate principal amount of senior, unsecured long-term notes and approximately $711.3 million of term loans under a Credit Agreement (the "Credit Agreement"). Additionally, we have commitments for an unfunded revolving credit facility of $500.0 million under the Credit Agreement. We may incur additional indebtedness in the future by accessing the unfunded revolving credit facility under the Credit Agreement and/or entering into new financing arrangements. Our ability to pay interest and repay the principal of our current indebtedness is dependent upon our ability to manage our business operations, our credit rating, the ongoing interest rate environment and the other risk factors discussed in this section. There can be no assurance that we will be able to manage any of these risks successfully.

In addition, the interest rates of the senior, unsecured long-term notes may be subject to adjustments from time to time if Moody's Investors Service, Inc. ("Moody's"), Standard & Poor's Ratings Services ("S&P") or, under certain circumstances, a substitute rating agency selected by us as a replacement for Moody's or S&P, as the case may be (a "Substitute Rating Agency"), downgrades (or subsequently upgrades) its rating assigned to the respective series of notes such that the adjusted rating is below investment grade. Accordingly, changes by Moody's, S&P, or a Substitute Rating Agency to the rating of any series of notes, our outlook or credit rating could require us to pay additional interest, which may negatively affect the value and liquidity of our debt and the market price of our common stock could decline. Factors that can affect our credit rating include changes in our operating performance, the economic environment, conditions in the semiconductor and semiconductor equipment industries, our financial position, including the incurrence of additional indebtedness, and our business strategy.

In certain circumstances involving a change of control followed by a downgrade of the rating of a series of notes by at least two of Moody's, S&P and Fitch Inc., unless we have exercised its right to redeem the notes of such series, we will be required to make an offer to repurchase all or, at the holder's option, any part, of each holder's notes of that series pursuant to the offer described below (the "Change of Control Offer"). In the Change of Control Offer, we will be required to offer payment in cash equal to 101% of the aggregate principal amount of notes repurchased plus accrued and unpaid interest, if any, on the notes repurchased, up to, but not including, the date of repurchase. We cannot make any assurance that we will have sufficient financial resources at such time or will be able to arrange financing to pay the repurchase price of that series of notes. Our ability to repurchase that series of notes in such event may be limited by law, by the indenture associated with that series of notes, or by the terms of other agreements to which we may be party at such time. If we fail to repurchase that series of notes as required by the terms of such notes, it would constitute an event of default under the indenture governing that series of notes which, in turn, may also constitute an event of default under other of our obligations.

The term loans under the Credit Agreement bear interest at a floating rate, which is based on the London Interbank Offered Rate plus a fixed spread, and, therefore, any increase in interest rates would require us to pay additional interest, which may have an adverse effect on the value and liquidity of our debt and the market price of our common stock could decline. The interest rate under the Credit Facility is also subject to an adjustment in conjunction with our credit rating downgrades or upgrades. Additionally, under the Credit Agreement, we are required to comply with affirmative and negative covenants, which include the maintenance of certain financial ratios, the details of which can be found in Note 7, "Debt." If we fail to comply with these covenants, we will be in default and our borrowings will become immediately due and payable. There can be no assurance that we will have sufficient financial resources or we will be able to arrange financing to repay our borrowings at such time. In addition, certain of our domestic subsidiaries under the Credit Agreement are required to guarantee our borrowings under the Credit Agreement. In the event that we default on our borrowings, these domestic subsidiaries shall be liable for our borrowings, which could disrupt our operations and result in a material adverse impact on our business, financial condition or stock price.

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Our leveraged capital structure may adversely affect our financial condition, results of operations and earnings per share.

We completed our leveraged recapitalization transaction during the fiscal quarter ended December 31, 2014, which included raising approximately $3.25 billion in new borrowings, consisting of $2.50 billion aggregate principal amount of senior, unsecured long-term notes and approximately $750.0 million of term loans under the Credit Agreement, payment of a special cash dividend of approximately $2.76 billion and prepayment of our $750 million of existing senior notes due in 2018. Our issuance and maintenance of higher levels of indebtedness could have adverse consequences including, but not limited to:

- a negative impact on our ability to satisfy our future obligations;
- an increase in the portion of our cash flows that may have to be dedicated to increased interest and principal payments that may not be available for operations, working capital, capital expenditures, acquisitions, investments, dividends, stock repurchases, general corporate or other purposes;
- an impairment of our ability to obtain additional financing in the future; and
- obligations to comply with restrictive and financial covenants as noted in the above risk factor and Note 7, “Debt.”

Our ability to satisfy our future expenses as well as our new debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors. Furthermore, our future operations may not generate sufficient cash flows to enable us to meet our future expenses and service our new debt obligations, which may impact our ability to manage our capital structure to preserve and maintain our investment grade rating. If our future operations do not generate sufficient cash flows, we may need to access the unfunded revolving credit facility of $500 million under the Credit Agreement or enter into new financing arrangements to obtain necessary funds. If we determine it is necessary to seek additional funding for any reason, we may not be able to obtain such funding or, if funding is available, we may not be able to obtain it on acceptable terms. Any additional borrowing under the Credit Agreement will place further pressure on us to comply with the financial covenants. If we fail to make a payment associated with our new debt obligations, we could be in default on such debt, and such a default could cause us to be in default on our other outstanding indebtedness.

There can be no assurance that we will continue to declare cash dividends at all or in any particular amounts.

Our Board of Directors first instituted a quarterly dividend during the fiscal year ended June 30, 2005. Since that time, we have announced a number of increases in the amount of our quarterly dividend level as well as payment of a special cash dividend that was declared and substantially paid in the second quarter of our fiscal year ended June 30, 2015. We intend to continue to pay quarterly dividends subject to capital availability and periodic determinations by our Board of Directors that cash dividends are in the best interest of our stockholders and are in compliance with all laws and agreements applicable to the declaration and payment of cash dividends by us. Future dividends may be affected by, among other factors: our views on potential future capital requirements for investments in acquisitions and the funding of our research and development; legal risks; stock repurchase programs; changes in federal and state income tax laws or corporate laws; changes to our business model; and our increased interest and principal payments required by our approximately $3.21 billion aggregate principal amount of outstanding indebtedness and any additional indebtedness that we may incur in the future. Our dividend payments may change from time to time, and we cannot provide assurance that we will continue to declare dividends at all or in any particular amounts. A reduction in our dividend payments could have a negative effect on our stock price.

We are exposed to risks related to our commercial terms and conditions, including our indemnification of third parties, as well as the performance of our products.

Although our standard commercial documentation sets forth the terms and conditions that we intend to apply to commercial transactions with our business partners, counterparties to such transactions may not explicitly agree to our terms and conditions. In situations where we engage in business with a third party without an explicit master agreement regarding the applicable terms and conditions, or where the commercial documentation applicable to the transaction is subject to varying interpretations, we may have disputes with those third parties regarding the applicable terms and conditions of our business relationship with them. Such disputes could lead to a deterioration of our commercial relationship with those parties, costly and time-consuming litigation, or additional concessions or obligations being offered by us to resolve such disputes, or could impact our revenue or cost recognition. Any of these outcomes could materially and adversely affect our business, financial condition and results of operations.

In addition, in our commercial agreements, from time to time in the normal course of business we indemnify third parties with whom we enter into contractual relationships, including customers, suppliers and lessors, with respect to certain matters. We have agreed, under certain conditions, to hold these third parties harmless against specified losses, such as those arising from a breach of representations or covenants, other third party claims that our products when used for their intended purposes infringe the intellectual property rights of such other third parties, or other claims made against certain parties. We may be compelled to enter into or accrue for probable settlements of alleged indemnification obligations, or we may be subject to potential liability arising from our customers' involvements in legal disputes. In addition, notwithstanding the provisions related to limitations on our liability that we seek to include in our business agreements, the counterparties to such agreements may dispute our interpretation or application of such provisions, and a court of law may not interpret or apply such provisions in our favor, any of which could result in an obligation for us to pay material damages to third parties and engage in costly legal proceedings. It is difficult to determine the maximum potential amount of liability under any indemnification obligations, whether or not asserted, due to our limited history of prior indemnification claims and the unique facts and circumstances that are likely to be involved in any particular claim. Our business, financial condition and results of operations in a reported fiscal period could be materially and adversely affected if we expend significant amounts in defending or settling any purported claims, regardless of their merit or outcomes.

We are also exposed to potential costs associated with unexpected product performance issues. Our products and production processes are extremely complex and thus could contain unexpected product defects, especially when products are first introduced. Unexpected product performance issues could result in significant costs being incurred by us, including increased service or warranty costs, providing product replacements for (or modifications to) defective products, litigation related to defective products, reimbursement for damages caused by our products, product recalls, or product write-offs or disposal costs. These costs could be substantial and could have an adverse impact upon our business, financial condition and operating results. In addition, our reputation with our customers could be damaged as a result of such product defects, which could reduce demand for our products and negatively impact our business.

Furthermore, we occasionally enter into volume purchase agreements with our larger customers, and these agreements may provide for certain volume purchase incentives, such as credits toward future purchases. We believe that these arrangements are beneficial to our long-term business, as they are designed to encourage our customers to purchase higher volumes of our products. However, these arrangements could require us to recognize a reduced level of revenue for the products that are initially purchased, to account for the potential future credits or other volume purchase incentives. As a result, these volume purchase arrangements, while expected to be beneficial to our business over time, could materially and adversely affect our results of operations in near-term periods, including the revenue we can recognize on product sales and therefore our gross margins.

In addition, we may, in limited circumstances, enter into agreements that contain customer-specific commitments on pricing, tool reliability, spare parts stocking levels, response time and other commitments. Furthermore, we may give these customers limited audit or inspection rights to enable them to confirm that we are complying with these commitments. If a customer elects to exercise its audit or inspection rights, we may be required to expend significant resources to support the audit or inspection, as well as to defend or settle any dispute with a customer that could potentially arise out of such audit or inspection. To date, we have made no significant accruals in our consolidated financial statements for this contingency. While we have not in the past incurred significant expenses for resolving disputes regarding these types of commitments, we cannot make any assurance that we will not incur any such liabilities in the future. Our business, financial condition and results of operations in a reported fiscal period could be materially and adversely affected if we expend significant amounts in supporting an audit or inspection, or defending or settling any purported claims, regardless of their merit or outcomes.

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There are risks associated with our receipt of government funding for research and development.
We are exposed to additional risks related to our receipt of external funding for certain strategic development programs from various governments and government agencies, both domestically and internationally. Governments and government agencies typically have the right to terminate funding programs at any time in their sole discretion, or a project may be terminated by mutual agreement if the parties determine that the project's goals or milestones are not being achieved, so there is no assurance that these sources of external funding will continue to be available to us in the future. In addition, under the terms of these government grants, the applicable granting agency typically has the right to audit the costs that we incur, directly and indirectly, in connection with such programs. Any such audit could result in modifications to, or even termination of, the applicable government funding program. For example, if an audit were to identify any costs as being improperly allocated to the applicable program, those costs would not be reimbursed, and any such costs that had already been reimbursed would have to be refunded. We do not know the outcome of any future audits. Any adverse finding resulting from any such audit could lead to penalties (financial or otherwise), termination of funding programs, suspension of payments, fines and suspension or prohibition from receiving future government funding from the applicable government or government agency, any of which could adversely impact our operating results, financial condition and ability to operate our business.
We have recorded significant restructuring, inventory write-off and asset impairment charges in the past and may do so again in the future, which could have a material negative impact on our business.
Historically, we recorded material restructuring charges related to our prior global workforce reduction, large excess inventory write-offs, and material impairment charges related to our goodwill and purchased intangible assets. During the fiscal year ended June 30, 2015, we recorded net restructuring charges of $31.6 million of which $22.4 million was recorded in the fourth quarter of fiscal year ended June 30, 2015, primarily related to our plan to reduce our global employee workforce in order to streamline our organization and business processes in response to changing customer requirements in our industry. Such workforce changes can also temporarily reduce workforce productivity, which could be disruptive to our business and adversely affect our results of operations. In addition, we may not achieve or sustain the expected cost savings or other benefits of our restructuring plans, or do so within the expected time frame. If we again restructure our organization and business processes, implement additional cost reduction actions or discontinue certain business operations, we may take additional, potentially material, restructuring charges related to, among other things, employee terminations or exit costs. We may also be required to write-off additional inventory if our product build plans or usage of service inventory decline. Also, as our lead times from suppliers increase (due to the increasing complexity of the parts and components they provide) and the lead times demanded by our customers decrease (due to the time pressures they face when introducing new products or technology or bringing new facilities into production), we may be compelled to increase our commitments, and therefore our risk exposure, to inventory purchases to meet our customers' demands in a timely manner, and that inventory may need to be written-off if demand for the underlying product declines for any reason. Such additional write-offs could constitute material charges.
As noted above, in the past, we recorded a material charge related to the impairment of our goodwill and purchased intangible assets. Goodwill represents the excess of costs over the net fair value of net assets acquired in a business combination. Goodwill is not amortized, but is instead tested for impairment at least annually in accordance with authoritative guidance for goodwill. Purchased intangible assets with estimable useful lives are amortized over their respective estimated useful lives using the straight-line method, and are reviewed for impairment in accordance with authoritative guidance for long-lived assets. The valuation of goodwill and intangible assets requires assumptions and estimates of many critical factors, including revenue and market growth, operating cash flows, market multiples, and discount rates. A substantial decline in our stock price, or any other adverse change in market conditions, particularly if such change has the effect of changing one of the critical assumptions or estimates we previously used to calculate the value of our goodwill or intangible assets (and, as applicable, the amount of any previous impairment charge), could result in a change to the estimation of fair value that could result in an additional impairment charge.
Any such additional material charges, whether related to restructuring or goodwill or purchased intangible asset impairment, may have a material negative impact on our operating results and related financial statements.

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We are exposed to risks related to our financial arrangements with respect to receivables factoring and banking arrangements.

We enter into factoring arrangements with financial institutions to sell certain of our trade receivables and promissory notes from customers without recourse. In addition, we maintain bank accounts with several domestic and foreign financial institutions, any of which may prove not to be financially viable. If we were to stop entering into these factoring arrangements, our operating results, financial condition and cash flows could be adversely impacted by delays or failures in collecting trade receivables. However, by entering into these arrangements, and by engaging these financial institutions for banking services, we are exposed to additional risks. If any of these financial institutions experiences financial difficulties or is otherwise unable to honor the terms of our factoring or deposit arrangements, we may experience material financial losses due to the failure of such arrangements or a lack of access to our funds, any of which could have an adverse impact upon our operating results, financial condition and cash flows.

We are subject to the risks of additional government actions in the event we were to breach the terms of any settlement arrangement into which we have entered.

In connection with the settlement of certain government actions and other legal proceedings related to our historical stock option practices, we have explicitly agreed as a condition to such settlements that we will comply with certain laws, such as the books and records provisions of the federal securities laws. If we were to violate any such law, we might not only be subject to the significant penalties applicable to such violation, but our past settlements may also be impacted by such violation, which could give rise to additional government actions or other legal proceedings. Any such additional actions or proceedings may require us to expend significant management time and incur significant accounting, legal and other expenses, and may divert attention and resources from the operation of our business. These expenditures and diversions, as well as an adverse resolution of any such action or proceeding, could have a material adverse effect on our business, financial condition and results of operations.

General Commercial, Operational, Financial and Regulatory Risks

We are exposed to risks associated with a weakening in the condition of the financial markets and the global economy.

The markets for semiconductors, and therefore our business, are ultimately driven by the global demand for electronic devices by consumers and businesses. Economic uncertainty frequently leads to reduced consumer and business spending, which caused our customers to decrease, cancel or delay their equipment and service orders from us in the economic slowdown during fiscal year 2009. In addition, the tightening of credit markets and concerns regarding the availability of credit that accompanied that slowdown made it more difficult for our customers to raise capital, whether debt or equity, to finance their purchases of capital equipment, including the products we sell. Reduced demand, combined with delays in our customers’ ability to obtain financing (or the unavailability of such financing), has at times in the past adversely affected our product and service sales and revenues and therefore has harmed our business and operating results, and our operating results and financial condition may again be adversely impacted if economic conditions decline from their current levels.

In addition, a decline in the condition of the global financial markets could adversely impact the market values or liquidity of our investments. Our investment portfolio includes corporate and government securities, money market funds and other types of debt and equity investments. Although we believe our portfolio continues to be comprised of sound investments due to the quality and (where applicable) credit ratings, a decline in the capital and financial markets would adversely impact the market value of our investments and their liquidity. If the market value of such investments were to decline, or if we were to have to sell some of our investments under illiquid market conditions, we may be required to recognize an impairment charge on such investments or a loss on such sales, either of which could have an adverse effect on our financial condition and operating results.

If we are unable to timely and appropriately adapt to changes resulting from difficult macroeconomic conditions, our business, financial condition or results of operations may be materially and adversely affected.

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A majority of our annual revenues are derived from outside the United States, and we maintain significant operations outside the United States. We are exposed to numerous risks as a result of the international nature of our business and operations.

A majority of our annual revenues are derived from outside the United States, and we maintain significant operations outside the United States. We expect that these conditions will continue in the foreseeable future. Managing global operations and sites located throughout the world presents a number of challenges, including but not limited to:

- managing cultural diversity and organizational alignment;
- exposure to the unique characteristics of each region in the global semiconductor market, which can cause capital equipment investment patterns to vary significantly from period to period;
- periodic local or international economic downturns;
- potential adverse tax consequences, including withholding tax rules that may limit the repatriation of our earnings, and higher effective income tax rates in foreign countries where we do business;
- government controls, either by the United States or other countries, that restrict our business overseas or the import or export of semiconductor products or increase the cost of our operations;
- compliance with customs regulations in the countries in which we do business;
- tariffs or other trade barriers (including those applied to our products or to parts and supplies that we purchase);
- political instability, natural disasters, legal or regulatory changes, acts of war or terrorism in regions where we have operations or where we do business;
- fluctuations in interest and currency exchange rates. Fluctuations in currency exchange rates may adversely impact our ability to compete on price with local providers or the value of revenues we generate from our international business. Although we attempt to manage some of our near-term currency risks through the use of hedging instruments, there can be no assurance that such efforts will be adequate;
- longer payment cycles and difficulties in collecting accounts receivable outside of the United States;
- difficulties in managing foreign distributors (including monitoring and ensuring our distributors' compliance with all applicable United States and local laws); and
- inadequate protection or enforcement of our intellectual property and other legal rights in foreign jurisdictions.

Any of the factors above could have a significant negative impact on our business and results of operations.

We might be involved in claims or disputes related to intellectual property or other confidential information that may be costly to resolve, prevent us from selling or using the challenged technology and seriously harm our operating results and financial condition.

As is typical in the semiconductor equipment industry, from time to time we have received communications from other parties asserting the existence of patent rights, copyrights, trademark rights or other intellectual property rights which they believe cover certain of our products, processes, technologies or information. In addition, we occasionally receive notification from customers who believe that we owe them indemnification or other obligations related to intellectual property claims made against such customers by third parties. With respect to intellectual property infringement disputes, our customary practice is to evaluate such infringement assertions and to consider whether to seek licenses where appropriate. However, we cannot ensure that licenses can be obtained or, if obtained, will be on acceptable terms or that costly litigation or other administrative proceedings will not occur. The inability to obtain necessary licenses or other rights on reasonable terms could seriously harm our results of operations and financial condition. Furthermore, we may potentially be subject to claims by customers, suppliers or other business partners, or by governmental law enforcement agencies, related to our receipt, distribution and/or use of third-party intellectual property or confidential information. Legal proceedings and claims, regardless of their merit, and associated internal investigations with respect to intellectual property or confidential information disputes are often expensive to prosecute, defend or conduct; may divert management's attention and other company resources; and/or may result in restrictions on our ability to sell our products, settlements on significantly adverse terms or adverse judgments for damages, injunctive relief, penalties and fines, any of which could have a significant negative effect on our business, results of operations and financial condition. There can be no assurance regarding the outcome of future legal proceedings, claims or investigations. The instigation of legal proceedings or claims, our inability to favorably resolve or settle such proceedings or claims, or the determination of any adverse findings against us or any of our employees in connection with such proceedings or claims could materially and adversely affect our business, financial condition and results of operations, as well as our business reputation.

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We are exposed to various risks related to the legal (including environmental), regulatory and tax environments in which we perform our operations and conduct our business.

We are subject to various risks related to compliance with new, existing, different, inconsistent or even conflicting laws, rules and regulations enacted by legislative bodies and/or regulatory agencies in the countries in which we operate and with which we must comply, including environmental, safety, antitrust, anti-corruption/anti-bribery, unclaimed property and export control regulations. Our failure or inability to comply with existing or future laws, rules or regulations, or changes to existing laws, rules or regulations (including changes that result in inconsistent or conflicting laws, rules or regulations), in the countries in which we operate could result in violations of contractual or regulatory obligations that may adversely affect our operating results, financial condition and ability to conduct our business. From time to time, we may receive inquiries or audit notices from governmental or regulatory bodies, or we may participate in voluntary disclosure programs, related to legal, regulatory or tax compliance matters, and these inquiries, notices or programs may result in significant financial cost (including investigation expenses, defense costs, assessments and penalties), reputational harm and other consequences that could materially and adversely affect our operating results and financial condition.

Our properties and many aspects of our business operations are subject to various domestic and international environmental laws and regulations, including those that control and restrict the use, transportation, emission, discharge, storage and disposal of certain chemicals, gases and other substances. Any failure to comply with applicable environmental laws, regulations or requirements may subject us to a range of consequences, including fines, suspension of certain of our business activities, limitations on our ability to sell our products, obligations to remediate environmental contamination, and criminal and civil liabilities or other sanctions. In addition, changes in environmental regulations (including regulations relating to climate change and greenhouse gas emissions) could require us to invest in potentially costly pollution control equipment, alter our manufacturing processes or use substitute (potentially more expensive and/or rarer) materials. Further, we use hazardous and other regulated materials that subject us to risks of strict liability for damages caused by any release, regardless of fault. We also face increasing complexity in our manufacturing, product design and procurement operations as we adjust to new and prospective requirements relating to the materials composition of our products, including restrictions on lead and other substances and requirements to track the sources of certain metals and other materials. The cost of complying, or of failing to comply, with these and other regulatory restrictions or contractual obligations could adversely affect our operating results, financial condition and ability to conduct our business.

In addition, we may from time to time be involved in legal proceedings or claims regarding employment, immigration, contracts, product performance, product liability, antitrust, environmental regulations, securities, unfair competition and other matters (in addition to proceedings and claims related to intellectual property matters, which are separately discussed elsewhere in this Item 1A). These legal proceedings and claims, regardless of their merit, may be time-consuming and expensive to prosecute or defend, divert management's attention and resources, and/or inhibit our ability to sell our products. There can be no assurance regarding the outcome of current or future legal proceedings or claims, which could adversely affect our operating results, financial condition and ability to operate our business.

Recent regulations related to "conflict minerals" may force us to incur additional expenses, may result in damage to our business reputation and may adversely impact our ability to conduct our business.

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the SEC adopted requirements for companies that use certain minerals and derivative metals (referred to as "conflict minerals," regardless of their actual country of origin) in their products. Some of these metals are commonly used in electronic equipment and devices, including our products. These requirements require companies to annually investigate, disclose and report whether or not such metals originated from the Democratic Republic of Congo or adjoining countries. We have an extremely complex supply chain, with numerous suppliers (many of whom are not obligated to investigate their own supply chains) for the components and parts used in each of our products. As a result, we may incur significant costs to comply with the diligence and disclosure requirements, including costs related to determining the source of any of the relevant metals used in our products. In addition, because our supply chain is so complex, we may not be able to sufficiently verify the origin of all the relevant metals used in our products through the due diligence procedures that we implement, which may harm our business reputation. Though we do not anticipate that our customers will need to know our conflict mineral status to satisfy their own SEC reporting obligations (if any), we may also face difficulties in satisfying customers if they nonetheless require that we prove or certify that our products are “conflict free.” Key components and parts that can be shown to be “conflict free” may not be available to us in sufficient quantity, or at all, or may only be available at significantly higher cost to us. If we are not able to meet customer requirements, customers may choose to disqualify us as a supplier. Any of these outcomes could adversely impact our business, financial condition or operating results.

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We depend on key personnel to manage our business effectively, and if we are unable to attract, retain and motivate our key employees, our sales and product development could be harmed.

Our employees are vital to our success, and our key management, engineering and other employees are difficult to replace. We generally do not have employment contracts with our key employees. Further, we do not maintain key person life insurance on any of our employees. The expansion of high technology companies worldwide has increased demand and competition for qualified personnel. If we are unable to retain key personnel, or if we are not able to attract, assimilate and retain additional highly qualified employees to meet our needs in the future, our business and operations could be harmed.

We outsource a number of services to third-party service providers, which decreases our control over the performance of these functions. Disruptions or delays at our third-party service providers could adversely impact our operations.

We outsource a number of services, including our transportation, information systems management and logistics management of spare parts and certain accounting and procurement functions, to domestic and overseas third-party service providers. While outsourcing arrangements may lower our cost of operations, they also reduce our direct control over the services rendered. It is uncertain what effect such diminished control will have on the quality or quantity of products delivered or services rendered, on our ability to quickly respond to changing market conditions, or on our ability to ensure compliance with all applicable domestic and foreign laws and regulations. In addition, many of these outsourced service providers, including certain hosted software applications that we use for confidential data storage, employ “cloud computing” technology for such storage (which refers to an information technology hosting and delivery system in which data is not stored within the user’s physical infrastructure but instead is delivered to and consumed by the user as an Internet-based service). These providers’ cloud computing systems may be susceptible to “cyber incidents,” such as intentional cyber attacks aimed at theft of sensitive data or inadvertent cyber-security compromises, that are outside of our control. If we do not effectively develop and manage our outsourcing strategies, if required export and other governmental approvals are not timely obtained, if our third-party service providers do not perform as anticipated or do not adequately protect our data from cyber-related security breaches, or if there are delays or difficulties in enhancing business processes, we may experience operational difficulties (such as limitations on our ability to ship products), increased costs, manufacturing or service interruptions or delays, loss of intellectual property rights or other sensitive data, quality and compliance issues, and challenges in managing our product inventory or recording and reporting financial and management information, any of which could materially and adversely affect our business, financial condition and results of operations.

We are exposed to risks related to cybersecurity threats and cyber incidents.

In the conduct of our business, we collect, use, transmit and store data on information systems. This data includes confidential information and intellectual property belonging to us, our customers and our business partners, as well as personally-identifiable information of individuals. We allocate significant resources to network security, data encryption and other measures to protect our information systems and data from unauthorized access or misuse. Despite our ongoing efforts to enhance our network security measures, our information systems are susceptible to computer viruses, cyber-related security breaches and similar disruptions from unauthorized intrusions, tampering or misuse, and subject to the inherent vulnerabilities of network security measures. Any of these occurrences could result in disruptions to our operations; misappropriation, corruption or theft of confidential information, including intellectual property and other critical data, of KLA-Tencor, our customers and other business partners; reduced value of our investments in research, development and engineering; litigation with, or payment of damages to, third parties; reputational damage; costs to comply with regulatory inquiries or actions; data privacy issues; costs to rebuild our internal information systems; and increased cybersecurity protection and remediation costs.

We rely upon certain critical information systems for our daily business operations. Our inability to use or access our information systems at critical points in time could unfavorably impact our business operations.

Our global operations are dependent upon certain information systems, including telecommunications, the internet, our corporate intranet, network communications, email and various computer hardware and software applications. System failures or malfunctioning, such as difficulties with our customer relationship management (“CRM”) system, could disrupt our operations and our ability to timely and accurately process and report key components of our financial results. Our enterprise resource planning (“ERP”) system is integral to our ability to accurately and efficiently maintain our books and records, record transactions, provide critical information to our management, and prepare our financial statements. Any disruptions or difficulties that may occur in connection with our ERP system or other systems (whether in connection with the regular operation, periodic enhancements, modifications or upgrades of such systems or the integration of our acquired businesses into such systems) could adversely affect our ability to complete important business processes, such as the evaluation of our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002. Any of these events could have an adverse effect on our business, operating results and financial condition.

Acquisitions are an important element of our strategy but, because of the uncertainties involved, we may not find suitable acquisition candidates and we may not be able to successfully integrate and manage acquired businesses. We are also exposed to risks in connection with strategic alliances into which we may enter.

In addition to our efforts to develop new technologies from internal sources, part of our growth strategy is to pursue acquisitions and acquire new technologies from external sources. As part of this effort, we may make acquisitions of, or significant investments in, businesses with complementary products, services and/or technologies. There can be no assurance that we will find suitable acquisition candidates or that acquisitions we complete will be successful. In addition, we may use equity to finance future acquisitions, which would increase our number of shares outstanding and be dilutive to current stockholders.

If we are unable to successfully integrate and manage acquired businesses or if acquired businesses perform poorly, then our business and financial results may suffer. It is possible that the businesses we have acquired, as well as businesses that we may acquire in the future, may perform worse than expected or prove to be more difficult to integrate and manage than anticipated. In addition, we may lose key employees of the acquired companies. As a result, risks associated with acquisition transactions may give rise to a material adverse effect on our business and financial results for a number of reasons, including:

- we may have to devote unanticipated financial and management resources to acquired businesses;
- the combination of businesses may cause the loss of key personnel or an interruption of, or loss of momentum in, the activities of our company and/or the acquired business;
- we may not be able to realize expected operating efficiencies or product integration benefits from our acquisitions;
- we may experience challenges in entering into new market segments for which we have not previously manufactured and sold products;
- we may face difficulties in coordinating geographically separated organizations, systems and facilities;
- the customers, distributors, suppliers, employees and others with whom the companies we acquire have business dealings may have a potentially adverse reaction to the acquisition;
- we may have to write-off goodwill or other intangible assets; and
- we may incur unforeseen obligations or liabilities in connection with acquisitions.

At times, we may also enter into strategic alliances with customers, suppliers or other business partners with respect to development of technology and intellectual property. These alliances typically require significant investments of capital and exchange of proprietary, highly sensitive information. The success of these alliances depends on various factors over which we may have limited or no control and requires ongoing and effective cooperation with our strategic partners. Mergers and acquisitions and strategic alliances are inherently subject to significant risks, and the inability to effectively manage these risks could materially and adversely affect our business, financial condition and operating results.

Disruption of our manufacturing facilities or other operations, or in the operations of our customers, due to earthquake, flood, other natural catastrophic events, health epidemics or terrorism could result in cancellation of orders, delays in deliveries or other business activities, or loss of customers and could seriously harm our business.

We have significant manufacturing operations in the United States, Singapore, Israel, Germany and China. In addition, our business is international in nature, with our sales, service and administrative personnel and our customers located in numerous countries throughout the world. Operations at our manufacturing facilities and our assembly subcontractors, as well as our other operations and those of our customers, are subject to disruption for a variety of reasons, including work stoppages, acts of war, terrorism, health epidemics, fire, earthquake, volcanic eruptions, energy shortages, flooding or other natural disasters. Such disruption could cause delays in, among other things, shipments of products to our customers, our ability to perform services requested by our customers, or the installation and acceptance of our products at customer sites. We cannot ensure that alternate means of conducting our operations (whether through alternate production capacity or service providers or otherwise) would be available if a major disruption were to occur or that, if such alternate means were available, they could be obtained on favorable terms.

In addition, as part of our cost-cutting actions, we have consolidated several operating facilities. Our California operations are now primarily centralized in our Milpitas facility. The consolidation of our California operations into a single campus could further concentrate the risks related to any of the disruptive events described above, such as acts of war or terrorism, earthquakes, fires or other natural disasters, if any such event were to impact our Milpitas facility.

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We are predominantly uninsured for losses and interruptions caused by terrorist acts and acts of war. If international political instability continues or increases, our business and results of operations could be harmed.

The threat of terrorism targeted at, or acts of war in, the regions of the world in which we do business increases the uncertainty in our markets. Any act of terrorism or war that affects the economy or the semiconductor industry could adversely affect our business. Increased international political instability in various parts of the world, disruption in air transportation and further enhanced security measures as a result of terrorist attacks may hinder our ability to do business and may increase our costs of operations. We maintain significant manufacturing and research and development operations in Israel, an area that has historically experienced a high degree of political instability, and we are therefore exposed to risks associated with future instability in that region. Such instability could directly impact our ability to operate our business (or our customers' ability to operate their businesses) in the affected region, cause us to incur increased costs in transportation, make such transportation unreliable, increase our insurance costs, and cause international currency markets to fluctuate. Such instability could also have the same effects on our suppliers and their ability to timely deliver their products. If international political instability continues or increases in any region in which we do business, our business and results of operations could be harmed. We are predominantly uninsured for losses and interruptions caused by terrorist acts and acts of war.

We self-insure certain risks including earthquake risk. If one or more of the uninsured events occurs, we could suffer major financial loss.

We purchase insurance to help mitigate the economic impact of certain insurable risks; however, certain risks are uninsurable, are insurable only at significant cost or cannot be mitigated with insurance. Accordingly, we may experience a loss that is not covered by insurance, either because we do not carry applicable insurance or because the loss exceeds the applicable policy amount or is less than the deductible amount of the applicable policy. For example, we do not currently hold earthquake insurance. An earthquake could significantly disrupt our manufacturing operations, a significant portion of which are conducted in California, an area highly susceptible to earthquakes. It could also significantly delay our research and engineering efforts on new products, much of which is also conducted in California. We take steps to minimize the damage that would be caused by an earthquake, but there is no certainty that our efforts will prove successful in the event of an earthquake. We self-insure earthquake risks because we believe this is a prudent financial decision based on our large cash reserves and the high cost and limited coverage available in the earthquake insurance market. Certain other risks are also self-insured either based on a similar cost-benefit analysis, or based on the unavailability of insurance. If one or more of the uninsured events occurs, we could suffer major financial loss.

We are exposed to foreign currency exchange rate fluctuations. Although we hedge certain currency risks, we may still be adversely affected by changes in foreign currency exchange rates or declining economic conditions in these countries.

We have some exposure to fluctuations in foreign currency exchange rates, primarily the euro and the Japanese Yen. We have international subsidiaries that operate and sell our products globally. In addition, an increasing proportion of our manufacturing activities are conducted outside of the United States, and many of the costs associated with such activities are denominated in foreign currencies. We routinely hedge our exposures to certain foreign currencies with certain financial institutions in an effort to minimize the impact of certain currency exchange rate fluctuations, but these hedges may be inadequate to protect us from currency exchange rate fluctuations. To the extent that these hedges are inadequate or if there are significant currency exchange rate fluctuations in currencies for which we do not have hedges in place, our reported financial results or the way we conduct our business could be adversely affected. Furthermore, if a financial counterparty to our hedges experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency hedge, we may experience material financial losses.

We are exposed to fluctuations in interest rates and the market values of our portfolio investments; impairment of our investments could harm our earnings. In addition, we and our stockholders are exposed to risks related to the volatility of the market for our common stock.

Our investment portfolio primarily consists of both corporate and government debt securities that are susceptible to changes in market interest rates and bond yields. As market interest rates and bond yields increase, those securities with a lower yield-at-cost show a mark-to-market unrealized loss. We believe we have the ability to realize the full value of all these investments upon maturity. However, an impairment of the fair market value of our investments, even if unrealized, must be reflected in our financial statements for the applicable period and may therefore have a material adverse effect on our results of operations for that period.

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In addition, the market price for our common stock is volatile and has fluctuated significantly during recent years. The trading price of our common stock could continue to be highly volatile and fluctuate widely in response to various factors, including without limitation conditions in the semiconductor industry and other industries in which we operate, fluctuations in the global economy or capital markets, our operating results or other performance metrics, or adverse consequences experienced by us as a result of any of the risks described elsewhere in this Item 1A. Volatility in the market price of our common stock could cause an investor in our common stock to experience a loss on the value of their investment in us and could also adversely impact our ability to raise capital through the sale of our common stock or to use our common stock as consideration to acquire other companies.

We are exposed to risks in connection with tax and regulatory compliance audits in various jurisdictions.

We are subject to tax and regulatory compliance audits (such as related to customs or product safety requirements) in various jurisdictions, and such jurisdictions may assess additional income or other taxes, penalties, fines or other prohibitions against us. Although we believe our tax estimates are reasonable and that our products and practices comply with applicable regulations, the final determination of any such audit and any related litigation could be materially different from our historical income tax provisions and accruals related to income taxes and other contingencies. The results of an audit or litigation could have a material adverse effect on our operating results or cash flows in the period or periods for which that determination is made.

A change in our effective tax rate can have a significant adverse impact on our business.

We earn profits in, and are therefore potentially subject to taxes in, the U.S. and numerous foreign jurisdictions, including Singapore, Israel and the Cayman Islands, the countries in which we earn the majority of our non-U.S. profits. Due to economic, political or other conditions, tax rates in those jurisdictions may be subject to significant change. A number of factors may adversely impact our future effective tax rates, such as the jurisdictions in which our profits are determined to be earned and taxed; changes in the tax rates imposed by those jurisdictions; the resolution of issues arising from tax audits with various tax authorities; changes in the valuation of our deferred tax assets and liabilities; adjustments to estimated taxes upon finalization of various tax returns; increases in expenses not deductible for tax purposes, including write-offs of acquired in-process research and development and impairment of goodwill in connection with acquisitions; changes in available tax credits; changes in stock-based compensation expense; changes in tax laws or the interpretation of such tax laws (for example, proposals for fundamental United States international tax reform); changes in generally accepted accounting principles; and the repatriation of earnings from outside the United States for which we have not previously provided for United States taxes. A change in our effective tax rate can materially and adversely impact our results from operations.

Compliance with federal securities laws, rules and regulations, as well as NASDAQ requirements, is becoming increasingly complex, and the significant attention and expense we must devote to those areas may have an adverse impact on our business.

Federal securities laws, rules and regulations, as well as NASDAQ rules and regulations, require companies to maintain extensive corporate governance measures, impose comprehensive reporting and disclosure requirements, set strict independence and financial expertise standards for audit and other committee members and impose civil and criminal penalties for companies and their chief executive officers, chief financial officers and directors for securities law violations. These laws, rules and regulations have increased, and in the future are expected to continue to increase, the scope, complexity and cost of our corporate governance, reporting and disclosure practices, which could harm our results of operations and divert management’s attention from business operations.

A change in accounting standards or practices or a change in existing taxation rules or practices (or changes in interpretations of such standards, practices or rules) can have a significant effect on our reported results and may even affect reporting of transactions completed before the change is effective.

New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements and taxation rules have occurred and will continue to occur in the future. Changes to (or revised interpretations or applications of) existing tax or accounting rules or the questioning of current or past practices may adversely affect our reported financial results or the way we conduct our business.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

Information regarding our principal properties as of June 30, 2015 is set forth below:

Location	Type	Principal Use	Square Footage	Ownership
Milpitas, CA	Office, plant and warehouse	Principal Executive Offices, Research, Engineering, Marketing, Manufacturing, Service and Sales Administration	727,302	Owned
Westwood, MA(1)	Office and plant	Engineering, Marketing, Manufacturing and Service	116,908	Leased
Leuven, Belgium(1)	Office, plant and warehouse	Engineering, Marketing and Service and Sales Administration	99,315	Owned
Shenzhen, China	Office and plant	Sales, Service and Manufacturing	47,213	Leased
Shanghai, China	Office	Research, Service and Sales Administration	41,184	Leased
Weilburg, Germany	Office and plant	Engineering, Marketing, Manufacturing, Service and Sales Administration	138,119	Leased
Chennai, India	Office	Engineering	33,366	Owned
Migdal Ha'Emek, Israel	Office and plant	Research, Engineering, Marketing, Manufacturing, Service and Sales Administration	191,982	Owned
Yokohama, Japan	Office and warehouse	Sales and Service	37,418	Leased
Serangoon, Singapore(2)	Office and plant	Sales, Service and Manufacturing	248,155	Owned
Hsinchu, Taiwan	Office	Sales and Service	73,676	Leased

(1) Portions of this property are sublet, are vacant and marketed to sublease, or are leased to third parties.

(2) We own the building at our location in Serangoon, Singapore, but the land on which this building resides is leased.

As of June 30, 2015, we owned or leased a total of approximately 2.1 million square feet of space worldwide, including the locations listed above and office space for smaller sales and service offices in several locations throughout the world. Our operating leases expire at various times through December 31, 2021, subject to renewal, with some of the leases containing renewal option clauses at the fair market value, for additional periods up to five years. Additional information regarding these leases is incorporated herein by reference to Note 13, “Commitments and Contingencies” to the Consolidated Financial Statements. We believe our properties are adequately maintained and suitable for their intended use and that our production facilities have capacity adequate for our current needs.

ITEM 3. LEGAL PROCEEDINGS

The information set forth below under Note 14, “Litigation and Other Legal Matters” to the Consolidated Financial Statements is incorporated herein by reference.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed and traded on the NASDAQ Global Select Market under the symbol "KLAC."

The prices per share reflected in the following table represent the high and low closing prices for our common stock on the NASDAQ Global Select Market for the periods indicated:

	Year ended June 30, 2015				Year ended June 30, 2014		
	High	Low	Cash Dividends Declared per share		High	Low	Cash Dividends Declared per share
First Fiscal Quarter	$80.86	$71.40	$0.50		$62.01	$54.67	$0.45
Second Fiscal Quarter	$84.18	$65.61	$17.00	*	$66.19	$59.46	$0.45
Third Fiscal Quarter	$70.95	$58.29	$0.50		$70.02	$59.73	$0.45
Fourth Fiscal Quarter	$60.30	$55.65	$0.50		$72.64	$62.30	$0.45

* Includes a special cash dividend of $16.50 per share that was declared by our Board of Directors on November 19, 2014 and was paid on December 9, 2014 to the stockholders of record as of the close of business on December 1, 2014 during the second quarter of the fiscal year ended June 30, 2015. Additional information regarding cash dividends can be found in Note 8, "Equity and Long-term Incentive Compensation Plans."

On July 14, 2015, we announced that our Board of Directors had authorized a further increase in the level of the Company's quarterly dividend from $0.50 to $0.52 per share. Additional information regarding the increase in cash dividends after fiscal year-end can be found in Note 19, "Subsequent Events."

As of July 17, 2015, there were 451 holders of record of our common stock.

Equity Repurchase Plans

The following is a summary of stock repurchases for each month during the fourth quarter of the fiscal year ended June 30, 2015[1]:

Period	Total Number of Shares Purchased [2]	Average Price Paid per Share	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs [3]
April 1, 2015 to April 30, 2015	1,350,089	$ 58.93	10,760,336
May 1, 2015 to May 31, 2015	634,622	$ 59.31	10,125,714
June 1, 2015 to June 30, 2015	764,301	$ 57.26	9,361,413
Total	2,749,012	$ 58.55	

(1) Our Board of Directors has authorized a program for us to repurchase shares of our common stock. The total number and dollar amount of shares repurchased for the fiscal years ended June 30, 2015, 2014 and 2013 were 9.3 million shares ($608.9 million), 3.8 million shares ($240.8 million) and 5.4 million shares ($273.3 million), respectively. On July 7, 2014, our Board of Directors authorized KLA-Tencor to repurchase up to 13 million additional shares of our common stock. On October 23, 2014, as part of the leveraged recapitalization transaction, our Board of Directors authorized an increase to the existing stock repurchase program of 3.6 million additional shares of our common stock.

(2) All shares were purchased pursuant to the publicly announced repurchase program described in footnote 1 above. Shares are reported based on the trade date of the applicable repurchase.

(3) The stock repurchase program has no expiration date. Future repurchases of our common stock under our repurchase program may be effected through various different repurchase transaction structures, including isolated

open market transactions or systematic repurchase plans.

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Stock Performance Graph and Cumulative Total Return

The following graph compares the cumulative 5-year total return attained by stockholders on our common stock relative to the cumulative total returns of the S&P 500 Index (as required by SEC regulations) and the Philadelphia Semiconductor Index (PHLX). The graph tracks the performance of a $100 investment in our common stock and in each of the indices (with the reinvestment of all dividends) from June 30, 2010 to June 30, 2015.

	6/10	6/11	6/12	6/13	6/14	6/15
KLA-Tencor Corporation	$100.00	$148.99	$187.01	$218.28	$292.87	$290.54
S&P 500	$100.00	$130.69	$137.81	$166.20	$207.10	$222.47
PHLX Semiconductor	$100.00	$135.83	$139.10	$165.22	$223.35	$233.52

* Assumes $100 invested on June 30, 2010 in stock or index, including reinvestment of dividends.

Our fiscal year ends June 30. The comparisons in the graph above are based upon historical data and are not necessarily indicative of, nor intended to forecast, future stock price performance.

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ITEM 6. SELECTED FINANCIAL DATA

The following tables include selected consolidated summary financial data for each of our last five fiscal years. This data should be read in conjunction with Item 8, "Financial Statements and Supplementary Data," and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K.

	Year ended June 30,				
(In thousands, except per share amounts)	2015	2014	2013	2012	2011
Consolidated Statements of Operations:					
Total revenues	$2,814,049	$2,929,408	$2,842,781	$3,171,944	$3,175,167
Net income[(1)]	$366,158	$582,755	$543,149	$756,015	$794,488
Cash dividends declared per share (including a special cash dividend of $16.50 per share declared during the three months ended December 31, 2014)	$18.50	$1.80	$1.60	$1.40	$1.00
Net income per share:					
Basic	$2.26	$3.51	$3.27	$4.53	$4.75
Diluted	$2.24	$3.47	$3.21	$4.44	$4.66

	As of June 30,				
	2015	2014	2013	2012	2011
Consolidated Balance Sheets:					
Cash, cash equivalents and marketable securities	$2,387,111	$3,152,637	$2,918,881	$2,534,444	$2,038,535
Working capital	$2,902,813	$3,690,484	$3,489,236	$3,300,401	$2,796,414
Total assets[(3)]	$4,826,012	$5,535,846	$5,283,804	$5,096,020	$4,670,498
Long-term debt[(2) (3)]	$3,173,435	$745,101	$743,823	$742,545	$741,267
Total stockholders' equity[(2)]	$421,439	$3,669,346	$3,482,152	$3,315,595	$2,860,893

(1) Our net income decreased to $366.2 million in the fiscal year ended June 30, 2015, primarily as a result of the impact of the pre-tax net loss of $131.7 million for the loss on extinguishment of debt and certain one-time expenses of $2.5 million associated with the leveraged recapitalization that was completed during the three months ended December 31, 2014.

(2) Our long-term debt increased to $3.17 billion at the end of fiscal year ended June 30, 2015, because, as part of the leveraged recapitalization plan, we issued $2.50 billion aggregate principal amount of senior, unsecured long-term notes (collectively referred to as "Senior Notes"), entered into $750 million of five-year senior unsecured prepayable term loans and a $500 million unfunded revolving credit facility and redeemed our $750 million aggregate principal amount of 6.900% Senior Notes due in 2018 (the "2018 Notes"). Refer to Note 7, "Debt" for additional details. Our total stockholders' equity decreased to $421.4 million at the end of fiscal year ended June 30, 2015, because, as part of our leveraged recapitalization plan, we declared a special cash dividend of approximately $2.76 billion. Refer to Note 8, "Equity and Long-term Incentive Compensation Plans" for additional details.

(3) We early adopted the accounting standard update regarding simplification of the presentation of debt issuance costs, which requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Accordingly, we applied the accounting standard update on a retrospective basis by reclassifying the presentation of the debt issuance costs which was originally included in other current and other non-current assets against the long-term debt on the Consolidated Balance Sheets as of June 30, 2014, 2013, 2012 and 2011. The change in the classification of the debt issuance costs reduced total assets and total liabilities by $2.8 million, $3.6 million, $4.3 million and $5.0 million as of June 30, 2014, 2013, 2012 and 2011, respectively. There is no impact to our Consolidated Statements of Operations, Comprehensive Income, Stockholder's Equity and Cash Flows for the fiscal

years ended June 30, 2014, 2013, 2012 and 2011.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements and the related notes included in Item 8, "Financial Statements and Supplementary Data," in this Annual Report on Form 10-K. This discussion contains forward-looking statements, which involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of certain factors, including but not limited to those discussed in Item 1A, "Risk Factors" and elsewhere in this Annual Report on Form 10-K. (See "Special Note Regarding Forward-Looking Statements.")

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions in applying our accounting policies that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base these estimates and assumptions on historical experience, and evaluate them on an on-going basis to ensure that they remain reasonable under current conditions. Actual results could differ from those estimates. We discuss the development and selection of the critical accounting estimates with the Audit Committee of our Board of Directors on a quarterly basis, and the Audit Committee has reviewed our related disclosure in this Annual Report on Form 10-K. The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility is reasonably assured. We derive revenue from three sources—sales of systems, spare parts and services. In general, we recognize revenue for systems when the system has been installed, is operating according to predetermined specifications and is accepted by the customer. When we have demonstrated a history of successful installation and acceptance, we recognize revenue upon delivery and customer acceptance. Under certain circumstances, however, we recognize revenue prior to acceptance from the customer, as follows:

- When the customer fab has previously accepted the same tool, with the same specifications, and when we can objectively demonstrate that the tool meets all of the required acceptance criteria.
- When system sales to independent distributors have no installation requirement, contain no acceptance agreement, and 100% payment is due based upon shipment.
- When the installation of the system is deemed perfunctory.
- When the customer withholds acceptance due to issues unrelated to product performance, in which case revenue is recognized when the system is performing as intended and meets predetermined specifications.

In circumstances in which we recognize revenue prior to installation, the portion of revenue associated with installation is deferred based on estimated fair value, and that revenue is recognized upon completion of the installation.

In many instances, products are sold in stand-alone arrangements. Services are sold separately through renewals of annual maintenance contracts. We have multiple element revenue arrangements in cases where certain elements of a sales arrangement are not delivered and accepted in one reporting period. To determine the relative fair value of each element in a revenue arrangement, we allocate arrangement consideration based on the selling price hierarchy. For substantially all of the arrangements with multiple deliverables pertaining to products and services, we use vendor-specific objective evidence ("VSOE") or third-party evidence ("TPE") to allocate the selling price to each deliverable. We determine TPE based on historical prices charged for products and services when sold on a stand-alone basis. When we are unable to establish relative selling price using VSOE or TPE, we use estimated selling price ("ESP") in our allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. ESP could potentially be used for new or customized products. We regularly review relative selling prices and maintain internal controls over the establishment and updates of these estimates. In a multiple element revenue arrangement, we defer revenue recognition associated with the relative fair value of each undelivered element until that element is delivered to the

customer. To be considered a separate element, the product or service in question must represent a separate unit of accounting, which means that such product or service must fulfill the following criteria: (a) the delivered item(s) has value to the customer on a stand-alone basis; and (b) if the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in our control. If the arrangement does not meet all the above criteria, the entire amount of the sales contract is deferred until all elements are accepted by the customer.
Trade-in rights are occasionally granted to customers to trade in tools in connection with subsequent purchases. We estimate the value of the trade-in right and reduce the revenue recognized on the initial sale. This amount is recognized at the earlier of the exercise of the trade-in right or the expiration of the trade-in right.

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Spare parts revenue is recognized when the product has been shipped, risk of loss has passed to the customer and collection of the resulting receivable is probable.
Service and maintenance contract revenue is recognized ratably over the term of the maintenance contract. Revenue from services performed in the absence of a maintenance contract, including consulting and training revenue, is recognized when the related services are performed and collectibility is reasonably assured.
We sell stand-alone software that is subject to the software revenue recognition guidance. We periodically review selling prices to determine whether VSOE exists, and in situations where we are unable to establish VSOE for undelivered elements, such as post-contract service, revenue is recognized ratably over the term of the service contract.
We also defer the fair value of non-standard warranty bundled with equipment sales as unearned revenue. Non-standard warranty includes services incremental to the standard 40-hour per week coverage for 12 months. Non-standard warranty is recognized ratably as revenue when the applicable warranty term period commences.
The deferred system profit balance equals the amount of deferred system revenue that was invoiced and due on shipment, less applicable product and warranty costs. Deferred system revenue represents the value of products that have been shipped and billed to customers which have not met our revenue recognition criteria. Deferred system profit does not include the profit associated with product shipments to certain customers in Japan, to whom title does not transfer until customer acceptance. Shipments to such customers in Japan are classified as inventory at cost until the time of acceptance.
We enter into sales arrangements that may consist of multiple deliverables of our products and services where certain elements of the sales arrangement are not delivered and accepted in one reporting period. Judgment is required to properly identify the accounting units of the multiple deliverable transactions and to determine the manner in which revenue should be allocated among the accounting units. Additionally, judgment is required to interpret various commercial terms and determine when all criteria of revenue recognition have been met in order for revenue recognition to occur in the appropriate accounting period. While changes in the allocation of the estimated selling price between the accounting units will not affect the amount of total revenue recognized for a particular arrangement, any material changes in these allocations could impact the timing of revenue recognition, which could have a material effect on our financial position and results of operations.
Inventories. Inventories are stated at the lower of cost (on a first-in, first-out basis) or market. Demonstration units are stated at their manufacturing cost and written down to their net realizable value. Our manufacturing overhead standards for product costs are calculated assuming full absorption of forecasted spending over projected volumes, adjusted for excess capacity. Abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and spoilage are recognized as current period charges. We write down product inventory based on forecasted demand and technological obsolescence and service spare parts inventory based on forecasted usage. These factors are impacted by market and economic conditions, technology changes, new product introductions and changes in strategic direction and require estimates that may include uncertain elements. Actual demand may differ from forecasted demand, and such differences may have a material effect on recorded inventory values.
Warranty. We provide standard warranty coverage on our systems for 40 hours per week for 12 months, providing labor and parts necessary to repair the systems during the warranty period. We account for the estimated warranty cost as a charge to costs of revenues when revenue is recognized. The estimated warranty cost is based on historical product performance and field expenses. Utilizing actual service records, we calculate the average service hours and parts expense per system and apply the actual labor and overhead rates to determine the estimated warranty charge. We update these estimated charges on a regular basis. The actual product performance and/or field expense profiles may differ, and in those cases we adjust our warranty accruals accordingly. See Note 13, “Commitments and Contingencies” to the Consolidated Financial Statements for a detailed description.
Allowance for Doubtful Accounts. A majority of our trade receivables are derived from sales to large multinational semiconductor manufacturers throughout the world. In order to monitor potential credit losses, we perform ongoing credit evaluations of our customers’ financial condition. An allowance for doubtful accounts is maintained for probable credit losses based upon our assessment of the expected collectibility of the accounts receivable. The allowance for doubtful accounts is reviewed on a quarterly basis to assess the adequacy of the allowance. We take into consideration

(1) any circumstances of which we are aware of a customer's inability to meet its financial obligations; and (2) our judgments as to prevailing economic conditions in the industry and their impact on our customers. If circumstances change, such that the financial conditions of our customers are adversely affected and they are unable to meet their financial obligations to us, we may need to record additional allowances, which would result in a reduction of our net income.

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Stock-Based Compensation. We account for stock-based awards granted to employees for services based on the fair value of those awards. The fair value of stock-based awards is measured at the grant date and is recognized as expense over the employee's requisite service period. The fair value for restricted stock units granted without "dividend equivalent" rights is determined using the closing price of our common stock on the grant date for restricted stock units, adjusted to exclude the present value of dividends which are not accrued on the restricted stock units. The fair value for restricted stock units granted with "dividend equivalent" rights is determined using the closing price of our common stock on the grant date. The award holder is not entitled to receive payments under dividend equivalent rights unless the associated restricted stock unit award vests (i.e., the award holder is entitled to receive credits, payable in cash or shares of our common stock, equal to the cash dividends that would have been received on the shares of our common stock underlying the restricted stock units had the shares been issued and outstanding on the dividend record date, but such dividend equivalents are only paid subject to the recipient satisfying the vesting requirements of the underlying award). The fair value is determined using a Black-Scholes valuation model for purchase rights under our Employee Stock Purchase Plan. The Black-Scholes option-pricing model requires the input of assumptions, including the option's expected term and the expected price volatility of the underlying stock. The expected stock price volatility assumption is based on the market-based historical implied volatility from traded options of our common stock. We have elected not to include the indirect tax effects of stock-based compensation deductions when calculating the windfall benefits and therefore recognize the full effect of these deductions in the income statement in the period in which the taxable event occurs.

Accounting for Cash-Based Long-Term Incentive Compensation. Cash-based long-term incentive ("Cash LTI") awards issued to employees under our Cash LTI program vest in four equal installments, with 25% of the aggregate amount of the Cash LTI award vesting on each yearly anniversary of the grant date over a four-year period. In order to receive payments under a Cash LTI award, participants must remain employed by us as of the applicable award vesting date. Compensation expense related to the Cash LTI awards is recognized over the vesting term, which is adjusted for the impact of estimated forfeitures.

Contingencies and Litigation. We are subject to the possibility of losses from various contingencies. Considerable judgment is necessary to estimate the probability and amount of any loss from such contingencies. An accrual is made when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We accrue a liability and recognize as expense the estimated costs expected to be incurred over the next twelve months to defend or settle asserted and unasserted claims existing as of the balance sheet date. See Note 13, "Commitments and Contingencies" and Note 14, "Litigation and Other Legal Matters" to the Consolidated Financial Statements for a detailed description.

Goodwill and Intangible Assets. We assess goodwill for impairment annually as well as whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Long-lived intangible assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. See Note 6, "Goodwill and Purchased Intangible Assets" to the Consolidated Financial Statements for a detailed description. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in each business combination. We performed our annual qualitative assessment of the goodwill by reporting unit in our second quarter of fiscal year ended June 30, 2015 and concluded that there was no impairment. There have been no significant events or circumstances affecting the valuation of goodwill subsequent to our annual impairment test. The next annual evaluation of the goodwill by reporting unit will be performed in the second quarter of the fiscal year ending June 30, 2016.

If we were to encounter challenging economic conditions, such as a decline in our operating results, an unfavorable industry or macroeconomic environment, a substantial decline in our stock price, or any other adverse change in market conditions, we may be required to perform the two-step quantitative goodwill impairment analysis. In addition, if such conditions have the effect of changing one of the critical assumptions or estimates we use to calculate the value of our goodwill or intangible assets, we may be required to record goodwill and/or intangible asset impairment charges in future periods. It is not possible at this time to determine if any such future impairment charge would occur or, if it does, whether such charge would be material to our results of operations.

Income Taxes. We account for income taxes in accordance with the authoritative guidance, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. The guidance also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized. We have determined that a valuation allowance is necessary against a portion of the deferred tax assets, but we anticipate that our future taxable income will be sufficient to recover the remainder of our deferred tax assets. However, should there be a change in our ability to recover our deferred tax assets that are not subject to a valuation allowance, we could be required to record an additional valuation allowance against such deferred tax assets. This would result in an increase to our tax provision in the period in which we determine that the recovery is not probable.

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On a quarterly basis, we provide for income taxes based upon an estimated annual effective income tax rate. The effective tax rate is highly dependent upon the geographic composition of worldwide earnings, tax regulations governing each region, availability of tax credits and the effectiveness of our tax planning strategies. We carefully monitor the changes in many factors and adjust our effective income tax rate on a timely basis. If actual results differ from these estimates, this could have a material effect on our financial condition and results of operations.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. In accordance with the authoritative guidance on accounting for uncertainty in income taxes, we recognize liabilities for uncertain tax positions based on the two-step process prescribed within the interpretation. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained in audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit and new audit activity. Any change in these factors could result in the recognition of a tax benefit or an additional charge to the tax provision.

Valuation of Marketable Securities. Our investments in available-for-sale securities are reported at fair value. Unrealized gains related to increases in the fair value of investments and unrealized losses related to decreases in the fair value are included in accumulated other comprehensive income (loss), net of tax, as reported on our Consolidated Statements of Stockholders' Equity. However, changes in the fair value of investments impact our net income only when such investments are sold or an impairment charge is recognized. Realized gains and losses on the sale of securities are determined by specific identification of the security's cost basis. We periodically review our investment portfolio to determine if any investment is other-than-temporarily impaired due to changes in credit risk or other potential valuation concerns, which would require us to record an impairment charge in the period during which any such determination is made. In making this judgment, we evaluate, among other things, the duration of the investment, the extent to which the fair value of an investment is less than its cost, the credit rating and any changes in credit rating for the investment, default and loss rates of the underlying collateral, structure and credit enhancements to determine if a credit loss may exist. Our assessment that an investment is not other-than-temporarily impaired could change in the future due to new developments or changes in our strategies or assumptions related to any particular investment.

Effects of Recent Accounting Pronouncements

Recently Adopted

In July 2013, the Financial Accounting Standards Board ("FASB") issued an accounting standard update that provides guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. Under this accounting standard update, in most circumstances, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in our financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward. This accounting standard update became effective for our interim period ended September 30, 2014, and its adoption did not have a material impact on our consolidated financial statements.

In June 2014, the FASB issued an accounting standard update regarding stock-based compensation that clarifies the accounting treatment when terms of an award provide that a performance target could be achieved after the requisite service period ends. The update requires that a performance target that affects vesting that could be achieved after the requisite service period ends be treated as a performance condition. The update is effective beginning in the first quarter of our fiscal year ending June 30, 2017, with early adoption permitted. We early adopted this accounting standard update in the third quarter of our fiscal year ended June 30, 2015 and the adoption did not have a material impact on our consolidated financial statements.

In April 2015, the FASB issued accounting standards update regarding simplification of the presentation of debt issuance costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The update is effective for us beginning in the first quarter of the fiscal year ending June 30, 2017. Earlier adoption is permitted for financial statements that have not been previously issued and we are required to apply the guidance on a retrospective basis with additional disclosure requirements upon transition. We early adopted this accounting standard update in the fourth quarter of our fiscal year ended June 30, 2015 and the adoption did not have a material impact on our consolidated financial statements.

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Updates Not Yet Effective
In May 2014, the FASB issued an accounting standard update regarding revenue from customer contracts to transfer goods and services or non-financial assets, unless the contracts are covered by other standards (for example, insurance or lease contracts). Under the new guidance, an entity should recognize revenue in connection with the transfer of promised goods or services to customers in an amount that reflects the consideration that the entity expects to be entitled to receive in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The updates are effective for us beginning in the first quarter of our fiscal year ending June 30, 2018. In July 2015, the FASB announced a deferral of the effective date by one year, with early adoption on the original effective date permitted. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. We are currently evaluating the impact of this accounting standard update on our consolidated financial statements.
In April 2015, the FASB issued an accounting standard update for customer's cloud based fees. The guidance changes what a customer must consider in determining whether a cloud computing arrangement contains a software license. If the arrangement contains a software license, the customer would account for the fees related to the software license element in accordance with guidance related to internal use software; if the arrangement does not contain a software license, the customer would account for the arrangement as a service contract. The update is effective for us beginning in the first quarter of our fiscal year ending June 30, 2017, with early adoption permitted. We are currently evaluating the impact of this accounting standard update on our consolidated financial statements.
In July 2015, the FASB issued an accounting standard update for the subsequent measurement of inventory. The amended guidance requires entities to measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The requirement would replace the current lower of cost or market evaluation and the accounting guidance is unchanged for inventory measured using last-in, first-out ("LIFO") or the retail inventory method. The update is effective for us beginning in the first quarter of our fiscal year ending June 30, 2018, with early adoption permitted to be applied prospectively. We are currently evaluating the impact of this accounting standard update on our consolidated financial statements.
EXECUTIVE SUMMARY
KLA-Tencor Corporation is a leading supplier of process control and yield management solutions for the semiconductor and related nanoelectronics industries. Our broad portfolio of defect inspection and metrology products, and related service, software and other offerings primarily supports integrated circuit ("IC" or "chip") manufacturers throughout the entire semiconductor fabrication process, from research and development to final volume production. We provide leading-edge equipment, software and support that enable IC manufacturers to identify, resolve and manage significant advanced technology manufacturing process challenges and obtain higher finished product yields at lower overall cost. In addition to serving the semiconductor industry, we also provide a range of technology solutions to a number of other high technology industries, including the LED and data storage industries, as well as general materials research.
Our products and services are used by the vast majority of bare wafer, IC, lithography reticle ("reticle" or "mask") and disk manufacturers around the world. Our products, services and expertise are used by our customers to measure, detect, analyze and resolve critical product defects that arise in that environment in order to control nanometric level manufacturing processes. Our revenues are driven largely by our customers' spending on capital equipment and related maintenance services necessary to support key transitions in their underlying product technologies, or to increase their production volumes in response to market demand. Our semiconductor customers generally operate in one or more of the three major semiconductor markets - memory, foundry and logic. All three of these markets are characterized by rapid technological changes and sudden shifts in end-user demand, which influence the level and pattern of our customers' spending on our products and services. Although capital spending in all three semiconductor markets has historically been very cyclical, the demand for more advanced and lower cost chips used in a growing number of consumer electronics, communications, data processing, and industrial and automotive products has resulted over the long term in a favorable demand environment for our process control and yield management solutions, particularly in

the foundry and logic markets, which have higher levels of process control adoption than the memory market.

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As we are a supplier to the global semiconductor and semiconductor-related industries, our customer base continues to become more highly concentrated over time, thereby increasing the potential impact of a sudden change in capital spending by a major customer on our revenues and profitability. As our customer base becomes increasingly more concentrated, large orders from a relatively limited number of customers account for a substantial portion of our sales, which potentially exposes us to more volatility for revenues and earnings. We are also subject to the cyclical capital spending that has historically characterized the semiconductor and semiconductor-related industries. The timing, length, intensity and volatility of the capacity-oriented capital spending cycles of our customers are unpredictable. The semiconductor industry has also been characterized by constant technological innovation. The growing use of increasingly sophisticated semiconductor devices in mobile consumer products has caused many of our customers to invest in additional semiconductor manufacturing capabilities and capacity. On the other hand, higher design costs for the most advanced ICs could economically constrain leading-edge manufacturing technology customers to focus their resources on only the large technologically advanced products and applications. We believe that, over the long term, our customers will continue to invest in advanced technologies and new materials to enable smaller design rules and higher density applications that fuel demand for process control equipment, although the growth for such equipment may be adversely impacted by higher design costs for advanced ICs, reuse of installed products, and delays in production ramps by our customers in response to higher costs and technical challenges at more advanced technology nodes.

The demand for our products and our revenue levels are driven by our customers’ needs to solve the process challenges that they face as they adopt new technologies required to fabricate advanced ICs that are incorporated into sophisticated mobile devices. The timing for our customers in ordering and taking delivery of process control and yield management equipment is also determined by our customers’ requirements to meet the next generation production ramp schedules, and the timing for capacity expansion to meet end customer demand. Our earnings will depend not only on our revenue levels, but also on the amount of research and development spending required to meet our customers’ technology roadmaps. We have maintained production volumes and capacity to meet anticipated customer requirements and remain at risk of incurring significant inventory-related and other restructuring charges if business conditions deteriorate. Over the past year, our customers have taken delivery of lower volumes of process control equipment that we had expected. Any delay or push out by our customers in taking delivery of process control and yield management equipment may cause earnings volatility, due to increases in the risk of inventory related charges as well as timing of revenue recognition due to expiration of credits or volume discounts, which, if not used by a stipulated time frame, will expire.

During the most recent quarter, we implemented a plan to reduce our global employee workforce aimed at streamlining our organization and business processes in response to the changing customer requirements in our industry. The goals of this reduction are to enable continued innovation, direct our resources toward our best opportunities and lower our ongoing expense run rate. We expect to substantially complete the global employee workforce reduction by the end of the first quarter of fiscal year 2016, but certain reductions will occur in the second quarter of fiscal year 2016.

The following table sets forth some of our key consolidated financial information for each of our last three fiscal years:

	Year ended June 30,		
(Dollar amounts in thousands)	2015	2014	2013
Total revenues	$2,814,049	$2,929,408	$2,842,781
Costs of revenues	$1,215,229	$1,232,962	$1,237,452
Gross margin percentage	57 %	58 %	56 %
Net income	$366,158	$582,755	$543,149
Diluted income per share	$2.24	$3.47	$3.21

Total revenues during the fiscal year ended June 30, 2015 decreased by 4% compared to the fiscal year ended June 30, 2014. Revenue decreases from sales of both our defect inspection and metrology products for the fiscal year ended June 30, 2015 reflected our customers’ decline in capital spending for process control equipment, due to shifts in the

timing of the new technology ramps and capacity-related expansion plans.
Total revenues during the fiscal year ended June 30, 2014 increased by 3% compared to the fiscal year ended June 30, 2013, as our customers continued to invest in process control and services to improve manufacturing yields as they adopt advanced technologies and new materials to enable smaller design rules required to fabricate advanced ICs.

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Revenues and Gross Margin

(Dollar amounts in thousands)	Year ended June 30, 2015	2014	2013	FY15 vs. FY14		FY14 vs. FY13	
Revenues:							
Product	$2,125,396	$2,286,437	$2,247,147	$(161,041)	(7)%	$39,290	2 %
Service	688,653	642,971	595,634	45,682	7 %	47,337	8 %
Total revenues	$2,814,049	$2,929,408	$2,842,781	$(115,359)	(4)%	$86,627	3 %
Costs of revenues	$1,215,229	$1,232,962	$1,237,452	$(17,733)	(1)%	$(4,490)	— %
Gross margin percentage	57 %	58 %	56 %	(1)%		2 %	

Product revenues

Our business is affected by the concentration of our customer base and our customers' capital equipment procurement schedules as a result of their investment plans. Our product revenues in any particular period are significantly impacted by the amount of new orders that we receive during that period and, depending upon the duration of manufacturing and installation cycles, in the preceding period.

Product revenues decreased by 7% in the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014, primarily as a result of lower revenues from our customers in Taiwan, certain countries in Asia and Europe and Israel, partially offset by higher revenues from our customers in North America, Korea and Japan. The decline in revenues was impacted by the timing of development and new technology ramps of our customers as well as the lower shipments of our products, particularly to our foundry customers in Taiwan, due to timing of capacity-related expansion plans.

Product revenues increased by 2% in the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013, as our customers increased their investments in defect inspection capabilities to address the yield challenges caused by the introduction of new technologies and architectures, and added production capacity to meet the growing needs for advanced ICs demanded in an environment of rising global demand for mobile devices.

Service revenues

Service revenues are generated from maintenance contracts, as well as billable time and material service calls made to our customers after the expiration of the warranty period. The amount of our service revenues is typically a function of the number of post-warranty systems installed at our customers' sites and the utilization of those systems, but it is also impacted by other factors, such as our rate of service contract renewals, the types of systems being serviced and fluctuations in foreign exchange rates. Service revenues increased sequentially over the fiscal years ended June 30, 2013, 2014 and 2015, primarily as a result of an increase over time in the number of post-warranty systems installed at our customers' sites over that time period.

Revenues - Top Customers

The following customers each accounted for more than 10% of our total revenues for the indicated periods:

Year ended June 30, 2015	2014	2013
Intel Corporation	Intel Corporation	Intel Corporation
Samsung Electronics Co., Ltd.	Samsung Electronics Co., Ltd.	Taiwan Semiconductor Manufacturing Company Limited
Taiwan Semiconductor Manufacturing Company Limited	Taiwan Semiconductor Manufacturing Company Limited	

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Revenues by region

Revenues by region for the periods indicated were as follows:

(Dollar amounts in thousands)	Year ended June 30, 2015		2014		2013	
North America	$815,914	29 %	$705,159	24 %	$846,125	30 %
Taiwan	691,482	25 %	741,470	25 %	936,445	33 %
Japan	426,963	15 %	334,653	11 %	310,204	11 %
Europe & Israel	194,670	7 %	306,779	11 %	211,121	7 %
Korea	405,320	14 %	371,139	13 %	292,724	10 %
Rest of Asia	279,700	10 %	470,208	16 %	246,162	9 %
Total	$2,814,049	100 %	$2,929,408	100 %	$2,842,781	100 %

A significant portion of our revenues continues to be generated in Asia, where a substantial portion of the world's semiconductor manufacturing capacity is located, and we expect that trend to continue.

Gross margin

Our gross margin fluctuates with revenue levels and product mix and is affected by variations in costs related to manufacturing and servicing our products, including our ability to scale our operations efficiently and effectively in response to prevailing business conditions.

The following table summarizes the major factors that contributed to the changes in gross margin percentage:

	Gross Margin Percentage
Fiscal year ended June 30, 2013	56.5 %
Revenue volume of products and services	— %
Mix of products and services sold	(0.3)%
Manufacturing labor, overhead and efficiencies	0.2 %
Other service and manufacturing costs	1.5 %
Fiscal year ended June 30, 2014	57.9 %
Revenue volume of products and services	(1.1)%
Mix of products and services sold	0.3 %
Manufacturing labor, overhead and efficiencies	(0.6)%
Other service and manufacturing costs	0.3 %
Fiscal year ended June 30, 2015	56.8 %

Changes in gross margin percentage driven by revenue volume of products and services reflect our ability to leverage existing infrastructure to generate higher revenues. It also includes the effect of fluctuations in foreign exchange rates, average customer pricing and customer revenue deferrals associated with volume purchase agreements. Changes in gross margin percentage from mix of products and services sold reflect the impact of changes in the composition within product and service offerings. Changes in gross margin percentage from manufacturing labor, overhead and efficiencies reflect our ability to manage costs and drive productivity as we scale our manufacturing activity to respond to customer requirements; this includes the impact of capacity utilization, use of overtime and variability of cost structure. Changes in gross margin percentage from other service and manufacturing costs include the impact of customer support costs, including the efficiencies with which we deliver services to our customers, and the effectiveness with which we manage our production plans and inventory risk.

Our gross margin decreased to 56.8% during the fiscal year ended June 30, 2015 from 57.9% during the fiscal year ended June 30, 2014, primarily due to lower volume of products and services, as well as a reduction in manufacturing efficiencies driven by lower manufacturing output and severance-related expenses, a substantial amount of which is related to our global workforce reduction plan that we announced in the fourth quarter of the fiscal year ended June 30, 2015, refer to Note 15, "Restructuring Charges" for additional details. The above decreases were partially offset by a favorable mix of products and services sold and efficiencies derived from other service and manufacturing costs.

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Our gross margin increased to 57.9% during the fiscal year ended June 30, 2014 from 56.5% during the fiscal year ended June 30, 2013, primarily due to lower charges for inventory obsolescence as well as manufacturing and service efficiencies, partially offset by a less favorable mix of products and services sold.

Engineering, Research and Development ("R&D")

	Year ended June 30,				
(Dollar amounts in thousands)	2015	2014	2013	FY15 vs. FY14	FY14 vs. FY13
R&D expenses	$530,616	$539,469	$487,832	$(8,853) (2)%	$51,637 11 %
R&D expenses as a percentage of total revenues	19 %	18 %	17 %	1 %	1 %

R&D expenses may fluctuate with product development phases and project timing as well as our focused R&D efforts that are aligned with our overall business strategy. Historically, our R&D expenses have generally increased over time, primarily due to higher costs associated with advanced product and technology development projects. We incur significant costs associated with these projects, including compensation for engineering talent, engineering material costs, and other expenses, as technological innovation is essential to our success. One of the goals of our plan to reduce our global employee workforce is to streamline our organization and business processes and direct our resources toward our best opportunities.

R&D expenses during the fiscal year ended June 30, 2015 were lower compared to the fiscal year ended June 30, 2014, primarily due to a decrease in engineering materials and consulting costs of $19.8 million associated with the completion of major platform developments, a decrease in depreciation expense of $2.1 million and a decrease in travel expenses of $1.2 million. This was partially offset by an increase in employee-related expenses of $10.6 million mainly as a result of our severance-related expenses, a substantial amount of which is related to our global workforce reduction plan that we announced in the fourth quarter of the fiscal year ended June 30, 2015, refer to Note 15, "Restructuring Charges" for additional details. In addition, the decrease was partially offset by a $6.3 million reduction in external funding used to offset the cost of R&D activities.

R&D expenses during the fiscal year ended June 30, 2014 were higher compared to the fiscal year ended June 30, 2013, primarily due to an increase in employee-related expenses of $41.8 million as a result of hiring additional engineering talent and an increase in travel expenses of $2.6 million, as well as a $4.2 million reduction in external funding used to offset the cost of R&D activities.

R&D expenses include the benefit of $1.9 million, $8.2 million and $12.4 million of external funding received during the fiscal years ended June 30, 2015, 2014 and 2013, respectively, for certain strategic development programs, primarily from government grants.

Our future operating results will depend significantly on our ability to produce products and provide services that have a competitive advantage in our marketplace. To do this, we believe that we must continue to make substantial and focused investments in our research and development. We remain committed to product development in new and emerging technologies as we address the yield challenges our customers face at future technology nodes.

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Selling, General and Administrative ("SG&A")

(Dollar amounts in thousands)	Year ended June 30, 2015	2014	2013	FY15 vs. FY14		FY14 vs. FY13	
SG&A expenses	$406,864	$384,907	$387,812	$21,957	6 %	$(2,905)	(1)%
SG&A expenses as a percentage of total revenues	14 %	13 %	14 %	1 %		(1)%	

SG&A expenses during the fiscal year ended June 30, 2015 were higher compared to the fiscal year ended June 30, 2014, primarily due to an increase in employee-related expenses of $8.3 million mainly as a result of severance-related expenses, a substantial amount of which is related to our global workforce reduction plan that we announced in the fourth quarter of the fiscal year ended June 30, 2015 (refer to Note 15, "Restructuring Charges" for additional details), an increase in cost of support for sales evaluation of $6.5 million, an increase in certain expenses of $2.5 million as a result of our one-time leveraged recapitalization expense that was completed in the three months ended December 31, 2014, a payment related to a contractual settlement for $2.0 million, an increase due to the impairment charge recorded for certain long-lived assets of $1.7 million and an increase in legal fees of $1.6 million. In addition, during the three months ended December 31, 2013, SG&A expenses were favorably impacted by our receipt of $1.1 million in proceeds from a class action settlement, as well as our recovery of $1.1 million in receivables that had previously been classified as a bad debt expense during the three months ended December 31, 2013, both of which resulted in a decrease of our SG&A expense for the fiscal year ended June 30, 2014. The increases described above were partially offset by a decrease in travel related expenses of $4.3 million and a decrease in marketing-related expenses of $1.9 million.

SG&A expenses during the fiscal year ended June 30, 2014 were slightly lower compared to the fiscal year ended June 30, 2013, primarily due to lower levels of consulting expenses of $4.5 million and a decrease in amortization of intangible assets of $2.6 million as some intangible assets became fully amortized. This was partially offset by an increase in employee-related expenses of $4.4 million as a result of hiring additional personnel.

Restructuring Charges

In April 2015, we announced a plan to reduce our global employee workforce to streamline our organization and business processes in response to changing customer requirement in our industry. The goals of this reduction are to enable continued innovation, direct our resources toward our best opportunities and lower our ongoing expense run rate. We expect to recognize significant cost savings from a number of activities we have recently undertaken, including estimated annual cost savings of approximately $100 million of employee related costs as a result of our announced global employee workforce reduction. During the fiscal year ended June 30, 2015, we recorded a $31.6 million net restructuring charge, of which $8.0 million was recorded to costs of revenues, $11.1 million to engineering, research and development expense and $12.5 million to selling, general and administrative expense. A net restructuring charge amounting to $22.4 million was recorded during the fourth quarter of fiscal year ended June 30, 2015, a substantial majority of which was related to our global workforce reduction plan. Refer to Note 15, "Restructuring Charges" for additional details.

The following table shows the activity primarily related to accrual for severance and benefits expense for the fiscal year ended June 30, 2015:

(In thousands)	Year ended June 30, 2015
Beginning Balance	$2,329
Restructuring costs	31,569
Adjustments	1,177
Cash payments	(10,188)
Ending Balance	$24,887

The accrual for severance and benefits as of June 30, 2015 is expected to be paid out by the end of our fiscal quarter ending December 31, 2015.

We expect to incur additional charges, including additional severance costs and other related costs, in connection with the completion of our global workforce reduction during the first two quarters of fiscal year 2016.

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Interest Expense and Other Expense (Income), Net

	Year ended June 30,		
(Dollar amounts in thousands)	2015	2014	2013
Interest expense	$106,009	$53,812	$54,176
Other expense (income), net	$(10,469)	$(16,203)	$(15,112)
Interest expense as a percentage of total revenues	4%	2%	2%
Other expense (income), net as a percentage of total revenues	—%	1%	1%

The increase in interest expense during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014 was primarily attributable to the issuance of $2.50 billion aggregate principal amount of senior, unsecured long-term notes and entry into the $750 million unsecured prepayable term loan facility during the three months ended December 31, 2014, as compared to $750 million of 2018 Senior Notes for the fiscal year ended June 30, 2014. The interest expense during the fiscal year ended June 30, 2014 remained relatively unchanged compared to the fiscal year ended June 30, 2013.

Other expense (income), net is comprised primarily of realized gains or losses on sales of marketable securities, gains or losses from revaluations of certain foreign currency denominated assets and liabilities as well as foreign currency contracts, impairments associated with equity investments in privately-held companies, interest related accruals (such as interest and penalty accruals related to our tax obligations) and interest income earned on our investment and cash portfolio. Since June 30, 2014, our investment balance for our marketable securities portfolio declined by $973 million as a result of our strategic decision to liquidate certain marketable securities in our investment portfolio to fund our working capital requirements. With this decision, our interest income earned from our investment portfolio is expected to decline and the realized gains as a result of liquidation of our investment portfolio are not expected to recur.

The decrease in other expense (income), net during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014 was primarily attributable to a net decline of $4.7 million in gains from the sale of equity investments in privately-held companies, a $1.1 million decrease in interest income from our investment portfolio as a result of our decision to liquidate certain marketable securities and a $1.1 million increase in net foreign currency losses resulting from the volatility of the foreign currencies against the U.S. dollar, which was partially offset by a decrease in an impairment charge of $1.0 million related to an equity investment in a privately-held company that was deemed to be other-than-temporary impairment and an increase of $0.9 million of realized gains from the investment portfolio liquidation.

The increase in other expense (income), net during the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013 was primarily attributable to an increase of $3.7 million gain from the sale of an equity investment in a privately-held company, partially offset by an impairment charge of $1.4 million recognized during the three months ended December 31, 2013 related to an equity investment in a privately-held company that was deemed to be other-than-temporary impairment, and a decrease in interest income of $1.3 million driven by lower interest rates.

Loss on extinguishment of debt and other, net

For the fiscal year ended June 30, 2015, loss on extinguishment of debt and other, net, reflected a pre-tax net loss of $131.7 million associated with the redemption of our $750 million of 2018 Senior Notes during the three months ended December 31, 2014. Included in the loss on extinguishment of debt and other, net is the $1.2 million gain on the non-designated forward contract that was entered into by us in anticipation of the redemption of the 2018 Senior Notes, which were redeemed during the three months ended December 31, 2014. Refer to “Note 7, Debt” and “Note 16, Derivative Instruments and Hedging Activities” for further details. We had no loss on extinguishment of debt and other, net, in the fiscal years ended June 30, 2014 and 2013.

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Provision for Income Taxes

The following table provides details of income taxes:

	Year ended June 30,		
(Dollar amounts in thousands)	2015	2014	2013
Income before income taxes	$434,131	$734,461	$690,621
Provision for income taxes	$67,973	$151,706	$147,472
Effective tax rate	15.7 %	20.7 %	21.4 %

The provision for income taxes differs from the statutory U.S. federal rate primarily due to foreign income with lower tax rates, tax credits, and other domestic incentives.

Tax expense as a percentage of income during the fiscal year ended June 30, 2015 was 15.7% compared to 20.7% for the fiscal year ended June 30, 2014. Tax expense as a percentage of income decreased primarily due to an increase in our research and development credits, an increase in the domestic manufacturing deduction as a percentage of income, and a decrease in the percentage of income earned in the U.S. as a result of the loss on extinguishment of debt compared to income earned outside the U.S. in jurisdictions with lower tax rates.

Tax expense as a percentage of income during the fiscal year ended June 30, 2014 was 20.7% compared to 21.4% for the fiscal year ended June 30, 2013. Tax expense decreased primarily due to a decrease in tax reserves and an increase in the percentage of our revenues that were earned outside the U.S. in jurisdictions with lower tax rates, partially offset by a decrease in our research and development credits and an increase in tax expense related to employee stock activity.

Our future effective income tax rate depends on various factors, such as tax legislation, the geographic composition of our pre-tax income, the amount of our pre-tax income as business activities fluctuate, non-deductible expenses incurred in connection with acquisitions, research and development credits as a percentage of aggregate pre-tax income, the domestic manufacturing deduction, non-taxable or non-deductible increases or decreases in the assets held within our Executive Deferred Savings Plan, the tax effects of employee stock activity and the effectiveness of our tax planning strategies.

In the normal course of business, we are subject to tax audits in various jurisdictions, and such jurisdictions may assess additional income or other taxes against us. We are under a United States federal income tax examination for the fiscal year ended June 30, 2013. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material adverse effect on our results of operations or cash flows in the period or periods for which that determination is made.

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Liquidity and Capital Resources

	As of June 30,		
(Dollar amounts in thousands)	2015	2014	2013
Cash and cash equivalents	$838,025	$630,861	$985,390
Marketable securities	1,549,086	2,521,776	1,933,491
Total cash, cash equivalents and marketable securities	$2,387,111	$3,152,637	$2,918,881
Percentage of total assets	49 %	57 %	55 %

	Year ended June 30,		
(In thousands)	2015	2014	2013
Cash flows:			
Net cash provided by operating activities	$605,906	$778,886	$913,188
Net cash provided by (used in) investing activities	918,221	(676,109)	(241,447)
Net cash used in financing activities	(1,302,972)	(458,887)	(428,510)
Effect of exchange rate changes on cash and cash equivalents	(13,991)	1,581	(9,135)
Net increase (decrease) in cash and cash equivalents	$207,164	$(354,529)	$234,096

Cash and Cash Equivalents and Marketable Securities:

As of June 30, 2015, our cash, cash equivalents and marketable securities totaled $2.39 billion, which is a decrease of $766 million from June 30, 2014. The decrease is primarily attributable to payment of a special cash dividend of approximately $2.72 billion, payment of regular quarterly cash dividends of $324.8 million, payment for the redemption of our 2018 Senior Notes of $877.4 million, payment for stock repurchases of $602.9 million, payment of principal amount and prepayment of term loans and interest with respect to Senior Notes, term loans and unfunded revolving credit facility aggregating to $98.3 million, payment of interest up to the redemption date with respect to our 2018 Senior Notes of $32.8 million, partially offset by net proceeds of an aggregate of $3.22 billion from our issuance of Senior Notes, borrowings under our five-year senior unsecured prepayable term loans under our Credit Facility, and net proceeds from cash generated from operating activities. As of June 30, 2015, $1.47 billion of our $2.39 billion of cash, cash equivalents, and marketable securities were held by our foreign subsidiaries and branch offices. We currently intend to permanently reinvest $1.34 billion of the cash held by our foreign subsidiaries and branch offices. If, however, a portion of these funds were to be repatriated to the United States, we would be required to accrue and pay U.S. and foreign taxes of approximately 30%-50% of the funds repatriated. The amount of taxes due will depend on the amount and manner of the repatriation, as well as the location from which the funds are repatriated. We have accrued (but have not paid) U.S. taxes on the remaining cash of $136.3 million of the $1.47 billion held by our foreign subsidiaries and branch offices. As such, these funds can be returned to the U.S. without accruing any additional U.S. tax expense.

Cash Dividends and Special Cash Dividend:

The total amount of regular quarterly cash dividends paid during the fiscal years ended June 30, 2015, 2014 and 2013 was $324.8 million, $298.9 million and $265.9 million, respectively. The increase in the amount of regular quarterly cash dividends paid during the fiscal year ended June 30, 2015 reflected the increase in the level of our regular quarterly cash dividend from $0.45 to $0.50 per share that was instituted during the three months ended September 30, 2014. The amount of accrued dividends payable for regular quarterly cash dividends on unvested restricted stock units with dividend equivalent rights was $0.9 million as of June 30, 2015. We did not have accrued dividends payable in the fiscal years ended June 30, 2014 and 2013. These amounts will be paid upon vesting of the underlying unvested restricted stock units as described in Note 8, “Equity and Long-term Incentive Compensation Plans.” On July 14, 2015, we announced that our Board of Directors had authorized a further increase in the level of our quarterly cash dividend from $0.50 to $0.52 per share. Refer to Note 19, “Subsequent Events” for additional information regarding the quarterly cash dividend increase announced subsequent to June 30, 2015.

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On November 19, 2014, we declared a special cash dividend of $16.50 per share on our outstanding common stock which was paid on December 9, 2014 to our stockholders of record as of the close of business on December 1, 2014. Additionally, in connection with the special cash dividend, our Board of Directors and our Compensation Committee of our Board of Directors approved a proportionate and equitable adjustment to outstanding equity awards (restricted stock units and stock options) under the 2004 Equity Incentive Plan (the "2004 Plan"), as required by the 2004 Plan, subject to the vesting requirements of the underlying awards. As the adjustment was required by the 2004 Plan, the adjustment to the outstanding awards did not result in any incremental compensation expense due to modification of such awards, under the authoritative guidance. The declaration and payment of the special cash dividend was part of our leveraged recapitalization transaction under which the special cash dividend was financed through a combination of existing cash and proceeds from the debt financing disclosed in Note 7, "Debt" that was completed during the three months ended December 31, 2014. The total amount of the special cash dividend accrued by the Company during the three months ended December 31, 2014 was approximately $2.76 billion, substantially all of which was paid out during the three months ended December 31, 2014. As of June 30, 2015, we have $41.1 million accrued dividends payable for the special cash dividend with respect to outstanding unvested restricted stock units, which will be paid when such underlying unvested restricted stock units vest as described in detail in Note 8, "Equity and Long-term Incentive Compensation Plans." We did not declare any special cash dividend in the fiscal years ended June 30, 2014 and 2013. Other than the special cash dividend declared during the three months ended December 31, 2014, we historically have not declared any special cash dividends.

Stock Repurchases:

The shares repurchased under our stock repurchase program have decreased our basic and diluted weighted-average shares outstanding for the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014. The stock repurchase program is intended, in part, to offset shares issued in connection with the purchases under our ESPP program, the vesting of employee restricted stock units and the exercise of employee stock options.

Fiscal Year 2015 Compared to Fiscal Year 2014

Cash Flows from Operating Activities:

We have historically financed our liquidity requirements through cash generated from operations. Net cash provided by operating activities during the fiscal year ended June 30, 2015 decreased compared to the fiscal year ended June 30, 2014, from $779 million to $606 million primarily as a result of the following key factors:

- A decrease of cash collections by approximately $270 million during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014,
- An increase of debt-related interest payments of approximately $40 million during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014,
- An increase in payments of approximately $15 million upon vesting of cash-based long-term incentive ("Cash LTI") awards during the fiscal year ended June 30, 2015 under our Cash LTI employee compensation plan, compared to the fiscal year ended June 30, 2014,
- An increase in payroll payments of approximately $15 million during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014, partially offset by
- A decrease in accounts payable payments of approximately $143 million during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014, and
- A decrease in income tax and other tax payments net of tax refunds of approximately $30 million during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014.

Cash Flows from Investing Activities:

Net cash provided by investing activities during the fiscal year ended June 30, 2015 increased to $918 million compared to the fiscal year ended June 30, 2014 from net cash used in investing activities of $676 million, primarily as a result of an increase in the proceeds from sale of available-for-sale and trading securities, net of sales and maturities, of approximately $964 million during the fiscal year ended June 30, 2015, compared to the purchases of available-for-sale and trading securities, net of sales and maturities, of approximately $593 million during fiscal year ended June 30, 2014. In addition, we acquired a privately-held company for a total purchase consideration of $18 million in cash during the fiscal year ended June 30, 2014.

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Cash Flows from Financing Activities:

Net cash used in financing activities during the fiscal year ended June 30, 2015 increased compared to the fiscal year ended June 30, 2014, from $459 million to $1.30 billion, primarily as a result of the following key factors:

- An increase in dividend payments of $2.74 billion during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014, reflecting the payments for the special cash dividend during the fiscal year ended June 30, 2015 and an increase in our quarterly dividend payout amount from $0.45 to $0.50 per share that was instituted during the three months ended September 30, 2014,
- Payments for redemption of the 2018 Senior Notes and payments for the term loans, including prepayment for the principal amount for the term loans, aggregating to $916 million during the fiscal year ended June 30, 2015, whereas no such payments were made during the fiscal year ended June 20, 2014,
- An increase in common stock repurchases of $362 million during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014 and
- A decrease in proceeds from the exercise of stock options of $65 million during the fiscal year ended June 30, 2015 compared to the fiscal year ended June 30, 2014, partially offset by
- Net proceeds of $3.22 billion from issuance of Senior Notes and the term loans during the fiscal year ended June 30, 2015.

Fiscal Year 2014 Compared to Fiscal Year 2013

Cash Flows from Operating Activities:

Net cash provided by operating activities during the fiscal year ended June 30, 2014 decreased compared to the fiscal year ended June 30, 2013, from $913 million to $779 million primarily as a result of the following key factors:

- An increase in payroll of approximately $44 million during the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013,
- An increase in accounts payable payments of approximately $39 million during the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013,
- An increase in income tax and other tax payments of approximately $19 million during the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013 and
- Payments of approximately $15 million upon vesting of Cash LTI awards during the fiscal year ended June 30, 2014 under our Cash LTI employee compensation plan, whereas no such payments occurred during the fiscal year ended June 30, 2013.

Cash Flows from Investing Activities:

Net cash used in investing activities during the fiscal year ended June 30, 2014 increased compared to the fiscal year ended June 30, 2013 from $241 million to $676 million, primarily as a result of an increase in the use of cash for purchases of available-for-sale and trading securities, net of sales and maturities, of approximately $424 million during the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013. In addition, we acquired a privately-held company for a total purchase consideration of $18 million in cash during the fiscal year ended June 30, 2014.

Cash Flows from Financing Activities:

Net cash used in financing activities during the fiscal year ended June 30, 2014 increased compared to the fiscal year ended June 30, 2013 from $429 million to $459 million, primarily as a result of the following key factors:

- An increase in dividend payments of $33 million during the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013, mainly due to an increase in the quarterly dividend payout amount that we announced in July 2013, and
- A decrease in proceeds from the exercise of stock options of $14 million during the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013, partially offset by
- A decrease in common stock repurchases of $32 million during the fiscal year ended June 30, 2014 compared to the fiscal year ended June 30, 2013.

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Debt Issuance - Senior Notes:

In November 2014, we issued $2.50 billion aggregate principal amount of senior, unsecured long-term notes (collectively referred to as "Senior Notes"). We issued the Senior Notes as part of the leveraged recapitalization plan under which the proceeds from the Senior Notes in conjunction with the proceeds from the term loans (described below) and cash on hand were used (x) to fund a special cash dividend of $16.50 per share, aggregating to approximately $2.76 billion, (y) to redeem $750 million of 2018 Senior Notes, including associated redemption premiums, accrued interest and other fees and expenses and (z) for other general corporate purposes, including repurchases of shares pursuant to our stock repurchase program. The interest rate specified for each series of the Senior Notes will be subject to adjustments from time to time if Moody's Investor Service, Inc. ("Moody's") or Standard & Poor's Ratings Services ("S&P") or, under certain circumstances, a substitute rating agency selected by us as a replacement for Moody's or S&P, as the case may be (a "Substitute Rating Agency"), downgrades (or subsequently upgrades) its rating assigned to the respective series of Senior Notes such that the adjusted rating is below investment grade. If the adjusted rating of any series of Senior Notes from Moody's (or, if applicable, any Substitute Rating Agency) is decreased to Ba1, Ba2, Ba3 or B1 or below, the stated interest rate on such series of Senior Notes as noted above will increase by 25 bps, 50 bps, 75 bps or 100 bps, respectively ("bps" refers to Basis Points and 1% is equal to 100 bps). If the rating of any series of Senior Notes from S&P (or, if applicable, any Substitute Rating Agency) with respect to such series of Senior Notes is decreased to BB+, BB, BB- or B+ or below, the stated interest rate on such series of Senior Notes as noted above will increase by 25 bps, 50 bps, 75 bps or 100 bps, respectively. The interest rates on any series of Senior Notes will permanently cease to be subject to any adjustment (notwithstanding any subsequent decrease in the ratings by any of Moody's, S&P and, if applicable, any Substitute Rating Agency) if such series of Senior Notes becomes rated "Baa1" (or its equivalent) or higher by Moody's (or, if applicable, any Substitute Rating Agency) and "BBB+" (or its equivalent) or higher by S&P (or, if applicable, any Substitute Rating Agency), or one of those ratings if rated by only one of Moody's, S&P and, if applicable, any Substitute Rating Agency, in each case with a stable or positive outlook. In October 2014, we entered into a series of forward contracts to lock the 10-year treasury rate ("benchmark rate") on a portion of the Senior Notes with a notional amount of $1.00 billion in aggregate. For additional details, refer to Note 16, "Derivative Instruments and Hedging Activities."

The original discount on the Senior Notes amounted to $4.0 million and is being amortized over the life of the debt. Interest is payable semi-annually on May 1 and November 1 of each year. The debt indenture (the "Indenture") includes covenants that limit our ability to grant liens on its facilities and enter into sale and leaseback transactions, subject to certain allowances under which certain sale and leaseback transactions are not restricted. As of June 30, 2015, we were in compliance with all of the covenants under the Indenture associated with the Senior Notes.

Debt Issuance - Credit Facility (Term Loans and Unfunded Revolving Credit Facility):

In November 2014, we entered into $750 million of five-year senior unsecured prepayable term loans and a $500 million unfunded revolving credit facility (collectively, the "Credit Facility") under the Credit Agreement. The interest under the Credit Facility will be payable on the borrowed amounts at the London Interbank Offered Rate ("LIBOR") plus a spread, which is currently 125 bps, and this spread is subject to adjustment in conjunction with our credit rating downgrades or upgrades by Moody's and S&P. The spread ranges from 100 bps to 175 bps based on the then effective credit rating. We are also obligated to pay an annual commitment fee of 15 bps on the daily undrawn balance of the revolving credit facility, which is also subject to an adjustment in conjunction with our credit rating downgrades or upgrades. The annual commitment fee ranges from 10 bps to 25 bps on the daily undrawn balance of the revolving credit facility, depending upon the then effective credit rating. Principal payments with respect to the term loans will be made on the last day of each calendar quarter and any unpaid principal balance of the term loans, including accrued interest, shall be payable on November 14, 2019 (the "Maturity Date"). We may prepay the term loans and unfunded revolving credit facility at any time without a prepayment penalty. During the fourth quarter of fiscal year ended June 30, 2015, the Company prepaid additional principal of $20.0 million in addition to the scheduled quarterly payments for the term loans.

Future principal payments for the term loans (without giving effect for any prepayments made) as of June 30, 2015, are as follows:

Fiscal Quarters Ending	Quarterly Payment

	(in thousands)
June 30, 2015 through December 31, 2016	$9,375
March 31, 2017 through December 31, 2017	$14,063
March 31, 2018 through September 30, 2019	$18,750
December 31, 2019	$487,500

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The Credit Facility requires us to maintain an interest expense coverage ratio as described in the Credit Agreement, on a quarterly basis, covering the trailing four consecutive fiscal quarters of no less than 3.50 to 1.00. In addition, we are required to maintain the maximum leverage ratio as described in the Credit Agreement, on a quarterly basis, covering the trailing four consecutive fiscal quarters for the fiscal quarters as described below.

Fiscal Quarters Ending	Maximum Leverage Ratio
June 30, 2015	4.25:1.00
September 30, 2015 and December 31, 2015	4.00:1.00
March 31, 2016 through September 30, 2016	3.75:1.00
December 31, 2016 and March 31, 2017	3.50:1.00
Thereafter	3.00:1.00

We were in compliance with the financial covenants under the Credit Agreement as of June 30, 2015 (the interest expense coverage ratio was 7.93 to 1.00 and the leverage ratio was 3.82 to 1.00) and had no outstanding borrowings under the unfunded revolving credit facility. Considering our current liquidity position, short-term financial forecasts and ability to prepay the term loans, if necessary, we expect to continue to be in compliance with our financial covenants at the end of our first quarter of fiscal year ending June 30, 2016.

Debt Redemption:

In December 2014, we redeemed the $750 million aggregate principal amount of 2018 Senior Notes. The redemption resulted in a pre-tax net loss on extinguishment of debt of $131.7 million for the three months ended December 31, 2014, which includes $1.2 million of gain upon the termination of the non-designated forward contract described below.

In addition, in November 2014, we entered into a non-designated forward contract to lock the treasury rate to be used for determining the redemption amount in connection with our redemption of the then outstanding 2018 Senior Notes that occurred during the three months ended December 31, 2014. The notional amount of the non-designated forward contract was $750 million. For additional details, refer to Note 16, “Derivative Instruments and Hedging Activities.”

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Contractual Obligations

The following is a schedule summarizing our significant obligations to make future payments under contractual obligations as of June 30, 2015:

	Fiscal year ending June 30,							
(In thousands)	Total	2016	2017	2018	2019	2020	2021 and thereafter	Others
Debt obligations(1)	$3,211,250	$17,500	$46,875	$315,625	$75,000	$756,250	$2,000,000	$—
Interest payment associated with all debt obligations(2)	1,060,852	119,117	118,606	114,796	110,711	100,310	497,312	—
Purchase commitments(3)	298,717	296,908	1,347	337	63	—	62	—
Income taxes payable(4)	76,939	—	—	—	—	—	—	76,939
Operating leases	21,381	8,008	5,818	3,964	1,815	1,220	556	—
Cash long-term incentive program (5)	124,972	42,962	39,624	27,839	14,547	—	—	—
Pension obligations	21,546	3,034	1,348	1,570	1,559	1,413	12,622	—
Executive Deferred Savings Plan(6)	167,886	—	—	—	—	—	—	167,886
Other(7)	42,002	22,173	9,599	6,985	3,245	—	—	—
Total contractual cash obligations	$5,025,545	$509,702	$223,217	$471,116	$206,940	$859,193	$2,510,552	$244,825

(1) In November 2014, we issued $750 million aggregate principal amount of term loans due in fiscal year 2020 (outstanding balance of $711.3 million as of June 30, 2015) and $2.50 billion aggregate principal amount of Senior Notes due from fiscal year 2018 to fiscal year 2035.

(2) The interest payments associated with the Senior Notes obligations included in the table above are based on the principal amount multiplied by the applicable coupon rate for each series of Senior Notes. Our future interest payments are subject to change if our then effective credit rating is below investment grade as discussed above. The interest payments under the term loans are payable on the borrowed amounts at the LIBOR plus 125 bps. As of June 30, 2015, we utilized the existing interest rates to project our estimated term loans interest payments for the next five years. The interest payment under the revolving credit facility for the undrawn balance is payable at 15 bps as a commitment fee based on the daily undrawn balance and we utilized the existing rate for the projected interest payments included in the table above. Our future interest payments for the term loans and the revolving credit facility are subject to change due to future fluctuations in the LIBOR rates as well as any upgrades or downgrades to our then effective credit rating.

(3) Represents an estimate of significant commitments to purchase inventory from our suppliers as well as an estimate of significant purchase commitments associated with other goods and services in the ordinary course of business. Our liability under these purchase commitments is generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecasted time-horizon can vary among different suppliers. Actual expenditures will vary based upon the volume of the transactions and length of contractual service provided. In addition, the amounts paid under these arrangements may be less in the event the arrangements are renegotiated or canceled. Certain agreements provide for potential cancellation penalties.

(4) Represents the estimated income tax payable obligation related to uncertain tax positions as well as related accrued interest. We are unable to make a reasonably reliable estimate of the timing of payments in individual years due to uncertainties in the timing of tax audit outcomes.

(5) Represents the amount committed under our cash long-term incentive program. The expected payment after estimated forfeitures is approximately $101.8 million.

(6) Represents the amount committed under our non-qualified executive deferred compensation plan. We are unable to make a reasonably reliable estimate of the timing of payments in individual years due to the uncertainties in the timing around participant’s separation and any potential changes that participants may decide to make to the previous distribution elections.

(7) Represents the amount committed for accrued dividends payable, substantially all of which are for the special cash dividend for the unvested restricted stock units as of the dividend record date as well as restricted stock units granted with dividend equivalent rights. For additional details, refer to Note 8, “Equity and Long-term Incentive Compensation Plans”.

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Starting in fiscal year 2013 we adopted a cash-based long-term incentive (“Cash LTI”) program for many of our employees as part of our employee compensation program. Cash LTI awards issued to employees under the Cash Long-Term Incentive Plan (“Cash LTI Plan”) generally vest in four equal installments, with 25% of the aggregate amount of the Cash LTI award vesting on each yearly anniversary of the grant date over a four-year period. In order to receive payments under the Cash LTI Plan, participants must remain employed by us as of the applicable award vesting date.

We have agreements with financial institutions to sell certain of our trade receivables and promissory notes from customers without recourse. In addition, we periodically sell certain letters of credit (“LCs”), without recourse, received from customers in payment for goods.

The following table shows total receivables sold under factoring agreements and proceeds from sales of LCs for the indicated periods:

	Year ended June 30,		
(In thousands)	2015	2014	2013
Receivables sold under factoring agreements	$137,285	$116,292	$144,307
Proceeds from sales of LCs	$6,920	$8,323	$3,808

Factoring and LC fees for the sale of certain trade receivables were recorded in other expense (income), net and were not material for the periods presented.

We maintain guarantee arrangements available through various financial institutions for up to $22.5 million, of which $19.0 million had been issued as of June 30, 2015, primarily to fund guarantees to customs authorities for value-added tax (“VAT”) and other operating requirements of our subsidiaries in Europe and Asia.

We maintain certain open inventory purchase commitments with our suppliers to ensure a smooth and continuous supply for key components. Our liability under these purchase commitments is generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecasted time-horizon can vary among different suppliers. Our open inventory purchase commitments were approximately $298.7 million as of June 30, 2015 and are primarily due within the next 12 months. Actual expenditures will vary based upon the volume of the transactions and length of contractual service provided. In addition, the amounts paid under these arrangements may be less in the event that the arrangements are renegotiated or canceled. Certain agreements provide for potential cancellation penalties.

We provide standard warranty coverage on our systems for 40 hours per week for 12 months, providing labor and parts necessary to repair the systems during the warranty period. We account for the estimated warranty cost as a charge to costs of revenues when revenue is recognized. The estimated warranty cost is based on historical product performance and field expenses. The actual product performance and/or field expense profiles may differ, and in those cases we adjust our warranty accruals accordingly. The difference between the estimated and actual warranty costs tends to be larger for new product introductions as there is limited historical product performance to estimate warranty expense; our warranty charge estimates for more mature products with longer product performance histories tend to be more stable. Non-standard warranty coverage generally includes services incremental to the standard 40-hours per week coverage for 12 months. See Note 13, “Commitments and Contingencies” to the Consolidated Financial Statements for a detailed description.

Working Capital:

Working capital was $2.90 billion as of June 30, 2015, which was a decrease of $787.7 million compared to our working capital as of June 30, 2014. The decrease in working capital is primarily attributable to payment of a special cash dividend of approximately $2.72 billion, payment of regular quarterly cash dividends of $324.8 million, payment for the redemption of the 2018 Senior Notes of $877.4 million, payment for stock repurchases of $602.9 million, payment of principal amount and prepayment of term loans and interest with respect to Senior Notes, term loans and unfunded revolving credit facility aggregating to $98.3 million, payment of interest up to the redemption date with respect to our 2018 Senior Notes of $32.8 million, partially offset by the aggregate of net proceeds of $3.22 billion from the issuance of Senior Notes and borrowings under our prepayable term loans. As of June 30, 2015, our principal sources of liquidity consisted of $2.39 billion of cash, cash equivalents and marketable securities. Our liquidity is affected by many factors, some of which are based on the normal ongoing operations of the business, and others of which relate to the uncertainties of global and regional economies and the semiconductor and the semiconductor equipment industries. Although cash requirements will fluctuate based on the timing and extent of these factors, we believe that cash generated from operations, together with the liquidity provided by existing cash and cash equivalents balances and our $500 million unfunded revolving credit facility, will be sufficient to satisfy our liquidity requirements associated with working capital needs, capital expenditures, dividends, stock repurchases and other contractual obligations, including repayment of outstanding debt, for at least the next 12 months.

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Our credit ratings and outlooks as of June 30, 2015 are summarized below:

Rating Agency	Rating	Outlook
Fitch	BBB-	Stable
Moody’s	Baa2	Stable
Standard & Poor’s	BBB	Stable

Factors that can affect our credit ratings include changes in our operating performance, the economic environment, conditions in the semiconductor and semiconductor equipment industries, our financial position and changes in our business strategy.

Off-Balance Sheet Arrangements

Under our foreign currency risk management strategy, we utilize derivative instruments to protect our interests from unanticipated fluctuations in earnings and cash flows caused by volatility in currency exchange rates. This financial exposure is monitored and managed as an integral part of our overall risk management program, which focuses on the unpredictability of financial markets and seeks to reduce the potentially adverse effects that the volatility of these markets may have on our operating results. We continue our policy of hedging our current and forecasted foreign currency exposures with hedging instruments having tenors of up to 18 months (see Note 16, “Derivative Instruments and Hedging Activities” to the Consolidated Financial Statements for a detailed description). Our outstanding hedge contracts, with maximum maturity of 16 months, were as follows:

	As of June 30,	
(In thousands)	2015	2014
Cash flow hedge contracts		
Purchase	$32,775	$6,066
Sell	$88,800	$33,999
Other foreign currency hedge contracts		
Purchase	$64,012	$108,901
Sell	$123,091	$106,322

In October 2014, in anticipation of the issuance of the Senior Notes, we entered into a series of forward contracts (“Rate Lock Agreements”) to lock the benchmark rate on a portion of the Senior Notes. The objective of the Rate Lock Agreements was to hedge the risk associated with the variability in interest rates due to the changes in the benchmark rate leading up to the closing of the intended financing, on the notional amount being hedged. The Rate Lock Agreements had a notional amount of $1 billion in aggregate which matured in the second quarter of the fiscal year ended June 30, 2015. We designated each of the Rate Lock Agreements as a qualifying hedging instrument and accounted for as a cash flow hedge, under which the effective portion of the gain or loss on the close out of the Rate Lock Agreements was initially recognized in accumulated other comprehensive income (loss) as a reduction of total stockholders’ equity and subsequently amortized into earnings as a component of interest expense over the term of the underlying debt. The ineffective portion, if any, was recognized in earnings immediately. The Rate Lock Agreements were terminated on the date of pricing of the $1.25 billion of 4.650% Senior Notes due in 2024 and we recorded the fair value of a $7.5 million receivable as a gain within accumulated other comprehensive income (loss) as of December 31, 2014. For the fiscal year ended June 30, 2015, we recognized $0.5 million for the amortization of the gain recognized in accumulated other comprehensive income (loss), which amount reduced the interest expense. We did not record any ineffectiveness for the fiscal year ended June 30, 2015. The cash proceeds of $7.5 million from the settlement of the Rate Lock Agreements were included in the cash flows from operating activities in the consolidated statements of cash flows for the fiscal year ended June 30, 2015 because the designated hedged item was classified as interest expense in the cash flows from operating activities in the consolidated statements of cash flows.

In addition, in November 2014, we entered into a non-designated forward contract to lock the treasury rate used to determine the redemption amount of the 2018 Senior Notes that occurred during the three months ended December 31, 2014. The objective of the forward contract was to hedge the risk associated with the variability of the redemption amount due to changes in interest rates through the redemption of the existing 2018 Senior Notes. The forward contract had a notional amount of $750 million. The forward contract was terminated in December 2014 and the resulting fair value of $1.2 million receivable was included in the loss on extinguishment of debt and other, net line in the consolidated statements of operations, partially offsetting the loss on redemption of the debt during the three months ended December 31, 2014. The cash proceeds from the forward contract were included in the cash flows from financing activities in the consolidated statements of cash flows for the fiscal year ended June 30, 2015, partially offsetting the cash outflows for the redemption of the 2018 Senior Notes.

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Indemnification Obligations. Subject to certain limitations, we are obligated to indemnify our current and former directors, officers and employees with respect to certain litigation matters and investigations that arise in connection with their service to us. These obligations arise under the terms of our certificate of incorporation, our bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify generally means that we are required to pay or reimburse the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. For example, we have paid or reimbursed legal expenses incurred in connection with the investigation of our historical stock option practices and the related litigation and government inquiries by a number of our current and former directors, officers and employees. Although the maximum potential amount of future payments we could be required to make under the indemnification obligations generally described in this paragraph is theoretically unlimited, we believe the fair value of this liability, to the extent estimable, is appropriately considered within the reserve we have established for currently pending legal proceedings.

We are a party to a variety of agreements pursuant to which we may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in connection with contracts and license agreements or the sale of assets, under which we customarily agree to hold the other party harmless against losses arising from, or provide customers with other remedies to protect against, bodily injury or damage to personal property caused by our products, non-compliance with our product performance specifications, infringement of third-party intellectual property rights used in our products and a breach of warranties, representations and covenants related to matters such as title to assets sold, validity of certain intellectual property rights, non-infringement of third-party rights, and certain income tax-related matters. In each of these circumstances, payment by us is typically subject to the other party making a claim to and cooperating with us pursuant to the procedures specified in the particular contract. This usually allows us to challenge the other party's claims or, in case of breach of intellectual property representations or covenants, to control the defense or settlement of any third-party claims brought against the other party. Further, our obligations under these agreements may be limited in terms of amounts, activity (typically at our option to replace or correct the products or terminate the agreement with a refund to the other party), and duration. In some instances, we may have recourse against third parties and/or insurance covering certain payments made by us.

In addition, we may in limited circumstances enter into agreements that contain customer-specific commitments on pricing, tool reliability, spare parts stocking levels, service response time and other commitments. Furthermore, we may give these customers limited audit or inspection rights to enable them to confirm that we are complying with these commitments. If a customer elects to exercise its audit or inspection rights, we may be required to expend significant resources to support the audit or inspection, as well as to defend or settle any dispute with a customer that could potentially arise out of such audit or inspection. To date, we have made no accruals in our consolidated financial statements for this contingency. While we have not in the past incurred significant expenses for resolving disputes regarding these types of commitments, we cannot make any assurance that we will not incur any such liabilities in the future.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of our obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by us under these agreements have not had a material effect on our business, financial condition, results of operations or cash flows.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates and marketable equity security prices. To mitigate these risks, we utilize derivative financial instruments, such as foreign currency hedges. All of the potential changes noted below are based on sensitivity analyses performed on our financial position as of June 30, 2015. Actual results may differ materially.

As of June 30, 2015, we had an investment portfolio of fixed income securities of $1.65 billion. These securities, as with all fixed income instruments, are subject to interest rate risk and will decline in fair value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 100 bps from levels as of June 30, 2015, the fair value of the portfolio would have declined by $18.1 million.

In November 2014, we issued $2.50 billion aggregate principal amount of fixed rate senior, unsecured long-term notes (collectively referred to as "Senior Notes") due in various fiscal years ranging from 2018 to 2035. The fair market value of long-term fixed interest rate notes is subject to interest rate risk. Generally, the fair market value of fixed interest rate notes will increase as interest rates fall and decrease as interest rates rise. As of June 30, 2015, the book value of our Senior Notes of $2.50 billion approximates the fair value. Additionally, the interest expense for the Senior Notes is subject to interest rate adjustments following a downgrade of our credit ratings below investment grade by the credit rating agencies. Following a rating change below investment grade, the stated interest rate for each series of Senior Notes may increase between 25 bps to 100 bps based on the adjusted credit rating. Refer to Note 7, "Debt" to the Consolidated Financial Statements in Part II, Item 8 and Management's Discussion and Analysis of Financial Condition and Results of Operations, "Liquidity and Capital Resources," in Part II, Item 7 for additional details. Factors that can affect our credit ratings include changes in our operating performance, the economic environment, conditions in the semiconductor and semiconductor equipment industries, our financial position, and changes in our business strategy. As of June 30, 2015, if our credit rating was downgraded below investment grade by Moody's and S&P, the maximum potential increase to our annual interest expense on the Senior Notes, considering a 200 bps increase to the stated interest rate for each series of our Senior Notes, is estimated to be approximately $50.0 million.

In November 2014, we entered into $750 million aggregate principal amount of floating rate senior, unsecured prepayable term loans due in 2019 and a $500 million unfunded revolving credit facility. The interest rates for the term loans are based on LIBOR plus a fixed spread and this spread is subject to adjustment in conjunction with our credit rating downgrades or upgrades. The spread ranges from 100 bps to 175 bps based on the adjusted credit rating. The fair value of the term loans is subject to interest rate risk only to the extent of the fixed spread portion of the interest rates which does not fluctuate with change in interest rates. As of June 30, 2015, the difference between book value and fair value of our term loans was immaterial. We are also obligated to pay an annual commitment fee of 15 bps on the daily undrawn balance of the unfunded revolving credit facility which is also subject to an adjustment in conjunction with our credit rating downgrades or upgrades. The annual commitment fee ranges from 10 bps to 25 bps on the daily undrawn balance of the revolving credit facility, depending upon the then effective credit rating. As of June 30, 2015, if LIBOR-based interest rates increased by 100 bps, the change would increase our annual interest expense annually by approximately $6.3 million as it relates to our borrowings under the term loans. Additionally, as of June 30, 2015, if our credit rating was downgraded to be below investment grade, the maximum potential increase to our annual interest expense for the term loans and the revolving credit facility, using the highest range of the ranges discussed above, is estimated to be approximately $4.1 million.

See Note 4, "Marketable Securities" to the Consolidated Financial Statements in Part II, Item 8; Management's Discussion and Analysis of Financial Condition and Results of Operations, "Liquidity and Capital Resources," in Part II, Item 7; and Risk Factors in Part I, Item 1A of this Annual Report on Form 10-K for a description of recent market events that may affect the value of the investments in our portfolio that we held as of June 30, 2015.

As of June 30, 2015, we had net forward and option contracts to sell $115.1 million in foreign currency in order to hedge certain currency exposures (see Note 16, "Derivative Instruments and Hedging Activities" to the Consolidated Financial Statements for a detailed description). If we had entered into these contracts on June 30, 2015, the U.S. dollar equivalent would have been $115.1 million. A 10% adverse move in all currency exchange rates affecting the contracts would decrease the fair value of the contracts by $23.9 million. However, if this occurred, the fair value of the underlying exposures hedged by the contracts would increase by a similar amount. Accordingly, we believe that, as a result of the hedging of certain of our foreign currency exposure, changes in most relevant foreign currency exchange rates should have no material impact on our income or cash flows.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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KLA-TENCOR CORPORATION
Consolidated Balance Sheets

(In thousands, except par value)	As of June 30, 2015	2014
ASSETS		
Current assets:		
Cash and cash equivalents	$838,025	$630,861
Marketable securities	1,549,086	2,521,776
Accounts receivable, net	585,494	492,863
Inventories	617,904	656,457
Deferred income taxes	236,253	215,676
Other current assets	77,814	68,462
Total current assets	3,904,576	4,586,095
Land, property and equipment, net	314,591	330,263
Goodwill	335,263	335,355
Purchased intangibles, net	11,895	27,697
Other non-current assets	259,687	256,436
Total assets	$4,826,012	$5,535,846
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$103,342	$103,422
Deferred system profit	148,691	147,923
Unearned revenue	71,335	59,176
Current portion of long-term debt	16,981	—
Other current liabilities	661,414	585,090
Total current liabilities	1,001,763	895,611
Non-current liabilities:		
Long-term debt	3,173,435	745,101
Unearned revenue	47,145	57,500
Other non-current liabilities	182,230	168,288
Total liabilities	4,404,573	1,866,500
Commitments and contingencies (Notes 13 and 14)		
Stockholders' equity:		
Preferred stock, $0.001 par value, 1,000 shares authorized, none outstanding	—	—
Common stock, $0.001 par value, 500,000 shares authorized, 259,007 and 257,542 shares issued, 157,851 and 165,448 shares outstanding, as of June 30, 2015 and June 30, 2014, respectively	158	165
Capital in excess of par value	474,216	1,220,339
Retained earnings (accumulated deficit)	(12,362)	2,479,113
Accumulated other comprehensive income (loss)	(40,573)	(30,271)
Total stockholders' equity	421,439	3,669,346
Total liabilities and stockholders' equity	$4,826,012	$5,535,846

See accompanying notes to consolidated financial statements.

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KLA-TENCOR CORPORATION
Consolidated Statements of Operations

	Year ended June 30,		
(In thousands, except per share amounts)	2015	2014	2013
Revenues:			
Product	$2,125,396	$2,286,437	$2,247,147
Service	688,653	642,971	595,634
Total revenues	2,814,049	2,929,408	2,842,781
Costs and expenses:			
Costs of revenues	1,215,229	1,232,962	1,237,452
Engineering, research and development	530,616	539,469	487,832
Selling, general and administrative	406,864	384,907	387,812
Loss on extinguishment of debt and other, net	131,669	—	—
Interest expense	106,009	53,812	54,176
Other expense (income), net	(10,469)	(16,203)	(15,112)
Income before income taxes	434,131	734,461	690,621
Provision for income taxes	67,973	151,706	147,472
Net income	$366,158	$582,755	$543,149
Net income per share:			
Basic	$2.26	$3.51	$3.27
Diluted	$2.24	$3.47	$3.21
Cash dividends declared per share (including a special cash dividend of $16.50 per share declared during the three months ended December 31, 2014)	$18.50	$1.80	$1.60
Weighted-average number of shares:			
Basic	162,282	166,016	166,089
Diluted	163,701	168,118	169,260

See accompanying notes to consolidated financial statements.

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KLA-TENCOR CORPORATION
Consolidated Statements of Comprehensive Income

	Year ended June 30,		
(In thousands)	2015	2014	2013
Net income	$366,158	$582,755	$543,149
Other comprehensive income (loss):			
Currency translation adjustments:			
Change in currency translation adjustments	(20,740)	6,428	(11,298)
Change in income tax benefit or expense	8,086	(1,232)	(750)
Net change related to currency translation adjustments	(12,654)	5,196	(12,048)
Cash flow hedges:			
Change in net unrealized gains or losses	13,745	1,641	4,929
Reclassification adjustments for net gains or losses included in net income	(6,615)	(4,145)	(1,483)
Change in income tax benefit or expense	(2,565)	898	(1,233)
Net change related to cash flow hedges	4,565	(1,606)	2,213
Net change related to unrecognized losses and transition obligations in connection with defined benefit plans	(147)	(617)	(2,255)
Available-for-sale securities:			
Change in net unrealized gains or losses	(1,069)	7,212	(2,953)
Reclassification adjustments for net gains or losses included in net income	(2,119)	(2,084)	(2,287)
Change in income tax benefit or expense	1,122	(1,726)	1,827
Net change related to available-for-sale securities	(2,066)	3,402	(3,413)
Other comprehensive income (loss)	(10,302)	6,375	(15,503)
Total comprehensive income	$355,856	$589,130	$527,646

See accompanying notes to consolidated financial statements.

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KLA-TENCOR CORPORATION
Consolidated Statements of Stockholders' Equity

(In thousands, except per share amounts)	Common Stock and Capital in Excess of Par Value Shares	Amount	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances as of June 30, 2012	166,710	$1,089,480	$2,247,258	$(21,143)	$3,315,595
Net income	—	—	543,149	—	543,149
Other comprehensive loss	—	—	—	(15,503)	(15,503)
Net issuance under employee stock plans	4,099	96,989	—	—	96,989
Repurchase of common stock	(5,374)	(107,973)	(165,281)	—	(273,254)
Cash dividends declared ($1.60 per share)	—	—	(265,893)	—	(265,893)
Stock-based compensation expense	—	70,084	—	—	70,084
Tax benefit for equity awards	—	10,985	—	—	10,985
Balances as of June 30, 2013	165,435	1,159,565	2,359,233	(36,646)	3,482,152
Net income	—	—	582,755	—	582,755
Other comprehensive income	—	—	—	6,375	6,375
Net issuance under employee stock plans	3,848	60,320	—	—	60,320
Repurchase of common stock	(3,835)	(76,839)	(164,004)	—	(240,843)
Cash dividends declared ($1.80 per share)	—	—	(298,871)	—	(298,871)
Stock-based compensation expense	—	60,940	—	—	60,940
Tax benefit for equity awards	—	16,518	—	—	16,518
Balances as of June 30, 2014	165,448	1,220,504	2,479,113	(30,271)	3,669,346
Net income	—	—	366,158	—	366,158
Other comprehensive loss	—	—	—	(10,302)	(10,302)
Net issuance under employee stock plans	1,658	16,186	—	—	16,186
Repurchase of common stock	(9,255)	(26,891)	(581,965)	—	(608,856)
Cash dividends declared ($18.50 per share including a special cash dividend of $16.50 per share declared during the three months ended December 31, 2014)	—	(807,391)	(2,275,668)	—	(3,083,059)
Stock-based compensation expense	—	55,302	—	—	55,302
Tax benefit for equity awards	—	16,664	—	—	16,664
Balances as of June 30, 2015	157,851	$474,374	$(12,362)	$(40,573)	$421,439

See accompanying notes to consolidated financial statements.

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KLA-TENCOR CORPORATION
Consolidated Statements of Cash Flows

(In thousands)	Year Ended June 30, 2015	2014	2013
Cash flows from operating activities:			
Net income	$ 366,158	$ 582,755	$ 543,149
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	80,536	83,072	87,534
Asset impairment charges	2,126	1,374	1,327
Loss on extinguishment of debt and other, net	131,669	—	—
Net gain on sale of assets	—	—	(1,160)
Non-cash stock-based compensation expense	55,302	60,940	70,084
Deferred income taxes	(24,245)	17,176	4,532
Excess tax benefit from equity awards	(15,403)	(20,554)	(14,198)
Net gain on sale of marketable securities and other investments	(2,119)	(5,920)	(2,287)
Changes in assets and liabilities, net of impact of acquisition of business:			
Decrease (increase) in accounts receivable, net	(118,520)	32,591	159,245
Decrease (increase) in inventories	27,500	(26,173)	14,787

	Maturity profile[c]				Ratings profile			
At June 30, 2010 (in billions, except ratios)	Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years	Total	Investment-grade ("IG") AAA/Aaa to BBB-/Baa3	Noninvestment-grade BB+/Ba1 & below	Total	Total % of IG
Loans	**32%**	**39%**	**29%**	**100%**	**$140**	**$ 73**	**$213**	**66%**
Derivative receivables	**7**	**45**	**48**	**100**	**63**	**17**	**80**	**79**
Lending-related commitments	**39**	**59**	**2**	**100**	**260**	**64**	**324**	**80**
Total excluding loans held-for-sale and loans at fair value	**33%**	**51%**	**16%**	**100%**	**$463**	**$ 154**	**$617**	**75%**

Loans held-for-sale and loans at fair value[a]							**4**	
Receivables from customers							**23**	
Interests in purchased receivables							**2**	
Total exposure							**$646**	
Net credit derivative hedges notional[b]	**31%**	**53%**	**16%**	**100%**	**$ (32)**	**$**	**$ (32)**	**100%**

At December 31, 2009 (in billions, except ratios)	Maturity profile[c] Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years	Total	Ratings profile Investment-grade ("IG") AAA/Aaa to BBB-/Baa3	Noninvestment-grade BB+/Ba1 & below	Total	Total % of IG
Loans	29%	40%	31%	100%	$ 118	$ 82	$ 200	59%
Derivative receivables	12	42	46	100	61	19	80	76
Lending-related commitments	41	57	2	100	281	66	347	81
Total excluding loans held-for-sale and loans at fair value	34%	50%	16%	100%	$ 460	$ 167	$ 627	73%
Loans held-for-sale and loans at fair value[a]							4	
Receivables from customers							16	
Interests in purchased receivables							3	
Total exposure							$ 650	
Net credit derivative hedges notional[b]	49%	42%	9%	100%	$ (48)	$	$ (48)	100%

(a) Loans held-for-sale and loans at fair value relate primarily to syndicated loans and loans transferred from the retained portfolio.

(b) *Represents the net notional amounts of protection purchased and sold of single-name and portfolio credit derivatives used to manage the credit exposures; these derivatives do not qualify for hedge accounting under U.S. GAAP.*

(c) *The maturity profile of loans and lending-related commitments is based on the remaining contractual maturity. The maturity profile of derivative receivables is based on the maturity profile of average exposure. For further discussion of average exposure, see Derivative receivables marked to market on pages 102-103 of JPMorgan Chase s 2009 Annual Report.*

Wholesale credit exposure selected industry concentrations

The Firm focuses on the management and diversification of its industry concentrations, with particular attention paid to industries with actual or potential credit concerns.

Exposures deemed criticized generally represent a ratings profile similar to a rating of CCC+ / Caa1 and lower, as defined by S&P and Moody s, respectively. The total criticized component of the portfolio, excluding loans held-for-sale and loans at fair value, decreased to $26.5 billion at June 30, 2010, from $33.2 billion at year-end 2009. The decrease was primarily related to net repayments and loan sales.

	June 30, 2010				December 31, 2009			
	Total credit exposure		Criticized exposure		Total credit exposure		Criticized exposure	
(in millions, except ratios)	Credit exposure[c]	% of portfolio	Criticized	% of criticized portfolio	Credit exposure[c]	% of portfolio	Criticized	% of criticized portfolio
Top 25 industries[a]								
Real estate	**$ 63,730**	**10%**	**$10,821**	**41%**	$ 68,509	11%	$11,975	36%
Banks and finance companies	**57,134**	**9**	**1,036**	**4**	54,053	9	2,053	6
Healthcare	**37,529**	**6**	**398**	**2**	35,605	6	329	1
State and municipal governments	**33,940**	**5**	**181**	**1**	34,726	5	466	1
Asset managers	**29,134**	**5**	**660**	**2**	24,920	4	680	2
Consumer products	**26,882**	**4**	**608**	**2**	27,004	4	515	2
Utilities	**25,385**	**4**	**1,107**	**4**	27,178	4	1,238	4
Oil and gas	**22,928**	**4**	**405**	**2**	23,322	4	386	1
Retail and consumer services	**20,272**	**3**	**699**	**3**	20,673	3	782	2
Technology	**13,066**	**2**	**543**	**2**	14,169	2	1,288	4
Machinery and equipment manufacturing	**12,254**	**2**	**205**	**1**	12,759	2	350	**1**
Securities firms and exchanges	**11,908**	**2**	**49**		10,832	2	145	
Metals/mining	**11,650**	**2**	**634**	**2**	12,547	2	639	2
Business services	**11,546**	**2**	**239**	**1**	10,667	2	344	1
Chemicals/plastics	**11,349**	**2**	**477**	**2**	9,870	2	611	2
Insurance	**11,329**	**2**	**481**	**2**	13,421	2	599	2
Central government	**11,181**	**2**			9,557	1		
Telecom Services	**10,800**	**2**	**193**	**1**	11,265	2	251	1
Media	**10,535**	**2**	**1,579**	**6**	12,379	2	1,692	5
Building materials/construction	**10,106**	**2**	**1,154**	**4**	10,448	2	1,399	4
Holding companies	**9,784**	**2**	**104**		16,018	3	110	
Automotive	**9,028**	**1**	**368**	**1**	9,357	1	1,240	4
Transportation	**8,608**	**1**	**515**	**2**	9,749	1	588	2
Agriculture/paper manufacturing	**7,530**	**1**	**312**	**1**	5,801	1	500	2
Leisure	**5,847**	**1**	**1,065**	**4**	6,822	1	1,798	5
All other[b]	**134,299**	**22**	**2,678**	**10**	135,791	22	3,205	10

Subtotal	**$617,754**	**100%**	**$26,511**	**100%**	$627,442	100%	$33,183	100%
Loans held-for-sale and loans at fair value	**3,839**		**920**		4,098		1,545	
Receivables from customers	**22,966**				15,745			
Interest in purchased receivables	**1,836**				2,927			
Total	**$646,395**		**$27,431**		$650,212		$34,728	

(a) Rankings are based on exposure at June 30, 2010. The ranking to industries presented in the table as of December 31, 2009, are based on the rankings of the corresponding exposures at June 30, 2010, not the actual rankings of such exposure at December 31, 2009.

(b) For more information on exposures to SPEs included in all other, see Note 15 on pages 151-163 of this Form 10-Q.

(c) Credit exposure is net of risk participations and excludes the benefit of credit derivative hedges and collateral held against

derivative receivables or loans.

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The following table presents additional information on the wholesale real estate industry at June 30, 2010, and December 31, 2009.

As of the six months ended June 30, 2010 (in millions, except ratios)	Credit exposure	% of credit portfolio	Criticized exposure	Nonperforming loans	% of nonperforming loans to total loans[(b)]	Net charge-offs/ (recoveries)[(c)]	Average annual net charge-off rate[(b)]
Commercial real estate subcategories							
Multi-family	**$31,246**	**49%**	**$ 4,056**	**$ 1,316**	**4.34%**	**$ 110**	**0.73%**
Commercial lessors	**18,063**	**28**	**3,982**	**652**	**4.60**	**352**	**5.00**
Commercial construction and development	**5,608**	**9**	**1,129**	**327**	**7.89**	**37**	**1.80**
Other[(a)]	**8,813**	**14**	**1,654**	**561**	**11.91**	**29**	**1.24**
Total commercial real estate	**$63,730**	**100%**	**$10,821**	**$ 2,856**	**5.35%**	**$ 528**	**1.99%**

As of the twelve months ended December 31, 2009 (in millions, except ratios)	Credit exposure	% of credit portfolio	Criticized exposure	Nonperforming loans	% of nonperforming loans to total loans[(b)]	Net charge-offs/ (recoveries)[(d)(e)]	Average annual net charge-off rate[(b)(d)]
Commercial real estate subcategories							
Multi-family	$32,073	47%	$ 3,986	$ 1,109	3.57%	$ 287	0.92%
Commercial lessors[(d)]	18,689	27	4,194	687	4.53	169	1.11
Commercial construction and development	6,593	10	1,518	313	6.81	101	2.20
Other[(a)(d)]	11,154	16	2,277	779	12.27	131	2.06
Total commercial real estate	$68,509	100%	$11,975	$ 2,888	5.05%	$ 688	1.20%

(a) *Other includes lodging, Real estate investment trusts (REITs), single family, homebuilders and other real* *estate.*

(b) *Ratios were calculated using end-of-period retained loans of $53.4 billion and $57.2 billion for the periods ended June 30, 2010, and December 31, 2009, respectively.*

(c) *Net charge-offs are presented for the six months ended June 30, 2010.*

(d) *Prior periods have been reclassed to conform to current presentation.*

(e) *Net charge-offs are presented for the twelve months ended December 31, 2009.*

Loans

The following table presents wholesale loans and nonperforming assets by business segment as of June 30, 2010, and December 31, 2009.

	June 30, 2010							
	Loans			Nonperforming		Assets acquired in loan satisfactions		
(in millions)	Retained	Held-for-sale and fair value	Total	Loans	Derivatives	Real estate owned	Other	Nonperforming assets
Investment Bank	**$ 54,049**	**$ 3,221**	**$ 57,270**	**$ 2,260**	**$ 315**	**$ 151**	**$**	**$ 2,726**
	95,090	**446**	**95,536**	**3,077**		**207**	**1**	**3,285**

Commercial Banking								
Treasury & Securities Services	**24,513**		**24,513**	**14**				**14**
Asset Management	**38,744**		**38,744**	**309**		**3**	**25**	**337**
Corporate/Private Equity	**591**	**172**	**763**					
Total	**$212,987**	**$ 3,839**	**$216,826**	**$5,660***(a)*	**$ 315***(b)*	**$ 361**	**$ 26**	**$ 6,362**

	December 31, 2009							
	Loans			Nonperforming		Assets acquired in loan satisfactions		
(in millions)	Retained	Held-for-sale and fair value	Total	Loans	Derivatives	Real estate owned	Other	Nonperforming assets
Investment Bank	$ 45,544	$ 3,567	$ 49,111	$3,504	$ 529	$ 203	$	$ 4,236
Commercial Banking	97,108	324	97,432	2,801		187	1	2,989
Treasury & Securities Services	18,972		18,972	14				14
Asset Management	37,755		37,755	580		2		582
Corporate/Private Equity	698	207	905	5				5
Total	$200,077	$ 4,098	$204,175	$6,904*(a)*	$ 529*(b)*	$ 392	$ 1	$ 7,826

(a) The Firm held allowance for loan losses of $1.3 billion and $2.0 billion related to nonperforming retained loans resulting in allowance coverage ratios of 25% and 31%, at June 30, 2010, and December 31, 2009, respectively. Wholesale nonperforming

loans represent 2.61% and 3.38% of total wholesale loans at June 30, 2010, and December 31, 2009, respectively.

(b) *Nonperforming derivatives represent less than 1.0% of the total derivative receivables net of cash collateral at both June 30, 2010, and December 31, 2009.*

In the normal course of business, the Firm provides loans to a variety of customers, from large corporate and institutional clients to high-net-worth individuals.

Retained wholesale loans were $213.0 billion at June 30, 2010, compared with $200.1 billion at December 31, 2009. The $12.9 billion increase was primarily related to the January 1, 2010, adoption of new consolidation guidance related to VIEs. Upon adoption of the new guidance, $15.1 billion of wholesale loans associated with Firm-administered multi-seller conduits were added to the Consolidated Balance Sheets. Excluding the effect of the adoption of the new consolidation guidance, loans decreased by $2.2 billion. Loans held-for-sale and loans at fair value relate primarily to syndicated loans and loans transferred from the retained portfolio. Held-for-sale loans and loans carried at fair value were in aggregate $3.8 billion and $4.1 billion at June 30, 2010, and December 31, 2009, respectively.

The Firm actively manages wholesale credit exposure through sales of loans and lending-related commitments. During the first six months of 2010 the Firm sold $4.6 billion of loans and commitments, recognizing gains of $31 million. In the first six months of 2009, the Firm sold $879 million of loans and commitments, recognizing net losses of $23 million. These results include gains or losses on sales of nonperforming loans, if any, as discussed on pages 74-75 of this Form 10-Q. These activities are not related to the Firm s securitization activities. For further discussion of securitization activity, see Liquidity Risk Management and Note 15 on pages 65-67 and 151-163 respectively, of this Form 10-Q.

Nonperforming wholesale loans were $5.7 billion at June 30, 2010, a decrease of $1.2 billion from December 31, 2009, reflecting primarily net repayments and loan sales.

The following table presents the geographic distribution of wholesale loans and nonperforming loans as of June 30, 2010, and December 31, 2009. The geographic distribution of the wholesale portfolio is determined based predominantly on the domicile of the borrower.

Loans and nonperforming loans, U.S. and Non-U.S.

Wholesale	**June 30, 2010**		December 31, 2009	
(in millions)	Loans	Nonperforming loans	Loans	Nonperforming loans
U.S.	**$155,737**	**$ 4,699**	$149,085	$ 5,844
Non-U.S.	**61,089**	**961**	55,090	1,060
Ending balance	**$216,826**	**$ 5,660**	$204,175	$ 6,904

The following table presents the change in the nonperforming loan portfolio during the six months ended June 30, 2010 and 2009.

Nonperforming loan activity

Wholesale	Six months ended June 30,	
(in millions)	**2010**	2009
Beginning balance	**$ 6,904**	$2,382
Additions	**4,150**	6,063
Reductions:		
Paydowns and other	**2,857**	1,510
Gross charge-offs	**1,162**	903
Returned to performing	**113**	70
Sales	**1,262**	

Total reductions	**5,394**	2,483
Net additions (reductions)	**(1,244)**	3,580
Ending balance	**$ 5,660**	$5,962

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The following table presents net charge-offs, which are defined as gross charge-offs less recoveries, for the three and six months ended June 30, 2010 and 2009. A nonaccrual loan is charged off to the allowance for loan losses when it is highly certain that a loss has been realized; this determination considers many factors, including the prioritization of the Firm s claim in bankruptcy, expectations of the workout/restructuring of the loan, and valuation of the borrower s equity. The amounts in the table below do not include gains from sales of nonperforming loans.

Net charge-offs

Wholesale (in millions, except ratios)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Loans reported				
Average loans retained	**$209,016**	$229,105	**$210,300**	$233,871
Net charge-offs	**231**	679	**1,190**	870
Average annual net charge-off rate	**0.44%**	1.19%	**1.14%**	0.75%

Derivatives

Derivative contracts

In the normal course of business, the Firm uses derivative instruments to meet the needs of customers; to generate revenue through trading activities; to manage exposure to fluctuations in interest rates, currencies and other markets; and to manage the Firm s credit exposure. For further discussion of these contracts, see Notes 5 and 22 on pages 128-136 and 170-174 of this Form 10-Q and Notes 5 and 32 on pages 167-175 and 224-235 of JPMorgan Chase s 2009 Annual Report.

The following table summarizes the net derivative receivables MTM for the periods presented.

Derivative receivables marked to market (in millions)	Derivative receivables MTM **June 30, 2010**	Derivative receivables MTM December 31, 2009
Interest rate[(a)]	**$ 42,268**	$ 33,733
Credit derivatives[(a)]	**8,346**	11,859
Foreign exchange	**19,586**	21,984
Equity	**5,523**	6,635
Commodity	**4,492**	5,999
Total, net of cash collateral	**80,215**	80,210
Liquid securities collateral held against derivative receivables	**(19,276)**	(15,519)
Total, net of all collateral	**$ 60,939**	$ 64,691

(a) In the first quarter of 2010, cash collateral netting reporting was enhanced. Prior periods have been revised to

conform to the current presentation. The effect resulted in an increase to interest rate derivative receivables, and a corresponding decrease to credit derivative receivables, of $7.0 billion as of December 31, 2009.

The amounts of derivative receivables reported on the Consolidated Balance Sheets were $80.2 billion at both June 30, 2010, and December 31, 2009. These are the amounts of the MTM or fair value of the derivative contracts after giving effect to legally enforceable master netting agreements, cash collateral held by the Firm and CVA. These amounts reported on the Consolidated Balance Sheets represent the cost to the Firm to replace the contracts at current market rates should the counterparty default. Derivative receivables were flat and reflected the offsetting effect of declining interest rates and increased levels of foreign exchange-rate volatility, with declining equity valuations and lower energy and base metal commodity prices. However, in management s view, the appropriate measure of current credit risk should also reflect additional liquid securities held as collateral by the Firm of $19.3 billion and $15.5 billion at June 30, 2010, and December 31, 2009, respectively, resulting in total exposure, net of all collateral, of $60.9 billion and $64.7 billion, respectively.

The Firm also holds additional collateral delivered by clients at the initiation of transactions, as well as collateral related to contracts that have a non-daily call frequency and collateral that the Firm has agreed to return but has not yet settled as of the reporting date. Though this collateral does not reduce the balances noted in the table above, it is available as security against potential exposure that could arise should the MTM of the client s derivative transactions move in the Firm s favor. As of June 30, 2010, and December 31, 2009, the Firm held $16.1 billion and $16.9 billion, respectively, of this additional collateral. The derivative receivables MTM, net of all collateral, also does not include other credit enhancements in the form of letters of credit. The following table summarizes the ratings profile of the Firm s derivative receivables MTM, net of all collateral, for the dates indicated.

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Ratings profile of derivative receivables MTM

Rating equivalent (in millions, except ratios)	June 30, 2010 Exposure net of all collateral	% of exposure net of all collateral	December 31, 2009 Exposure net of all collateral	% of exposure net of all collateral
AAA/Aaa to AA-/Aa3	**$25,328**	**42%**	$25,530	40%
A+/A1 to A-/A3	**12,876**	**21**	12,432	19
BBB+/Baa1 to BBB-/Baa3	**7,179**	**12**	9,343	14
BB+/Ba1 to B-/B3	**12,757**	**21**	14,571	23
CCC+/Caa1 and below	**2,799**	**4**	2,815	4
Total	**$60,939**	**100%**	$64,691	100%

The Firm actively pursues the use of collateral agreements to mitigate counterparty credit risk in derivatives. The percentage of the Firm s derivatives transactions subject to collateral agreements excluding foreign exchange spot trades, which are not typically covered by collateral agreements due to their short maturity was 97% as of June 30, 2010, up from 89% at December 31, 2009. The Firm posted $70.7 billion and $56.7 billion of collateral at June 30, 2010, and December 31, 2009, respectively.

Certain derivative and collateral agreements include provisions that require the counterparty and/or the Firm, upon specified downgrades in the respective credit ratings of their legal entities, to post collateral for the benefit of the other party. At June 30, 2010, the impact of a single-notch and six-notch ratings downgrade to JPMorgan Chase & Co., and its subsidiaries, primarily JPMorgan Chase Bank, N.A., would have required $1.5 billion and $5.0 billion, respectively, of additional collateral to be posted by the Firm. Certain derivative contracts also provide for termination of the contract, generally upon a downgrade to a specified rating of either the Firm or the counterparty, at the then-existing fair value of the derivative contracts.

Credit derivatives

For a more detailed discussion of credit derivatives, including types of derivatives, see Note 5, Credit derivatives, on pages 135-136 of this Form 10-Q, and Credit derivatives on pages 103-104 and Note 5, Credit derivatives, on pages 173-175 of JPMorgan Chase s 2009 Annual Report. The following table presents the Firm s notional amounts of credit derivatives protection purchased and sold as of June 30, 2010, and December 31, 2009.

Credit derivative positions

	Notional amount				
	Dealer/client		Credit portfolio		
(in billions)	Protection purchased[(a)]	Protection sold	Protection purchased[(a)(b)]	Protection sold	**Total**
June 30, 2010	**$2,666**	**$2,654**	**$32**	**$**	**$5,352**
December 31, 2009	2,997	2,947	49	1	5,994

(a) *Included $2.6 trillion and $3.0 trillion at June 30, 2010, and December 31,* *2009, respectively, of notional exposure where the Firm had protection sold with identical underlying reference instruments.*

(b) *Included $8.5 billion and $19.7 billion at June 30, 2010, and December 31, 2009, respectively, that represented the notional amount for structured portfolio protection; the Firm retains the first risk of loss on this portfolio.*

Dealer/client

For a further discussion of the dealer/client business related to credit protection, see Dealer/client business on page 104 of JPMorgan Chase s 2009 Annual Report. At June 30, 2010, the total notional amount of protection purchased and sold in the dealer/client business decreased by $624 billion from year-end 2009, primarily as a result of continuing industry efforts to reduce offsetting trade activity.

Credit portfolio activities

Use of single-name and portfolio credit derivatives	Notional amount of protection purchased and sold	
(in millions)	**June 30, 2010**	December 31, 2009
Credit derivatives used to manage:		
Loans and lending-related commitments	**$ 17,271**	$ 36,873
Derivative receivables	**15,165**	11,958
Total protection purchased[(a)]	**32,436**	48,831
Total protection sold	**426**	455
Credit derivatives hedges notional	**$ 32,010**	$ 48,376

(a) *Included $8.5 billion and*

$19.7 billion at June 30, 2010, and December 31, 2009, respectively, that represented the notional amount for structured portfolio protection; the Firm retains the first risk of loss on this portfolio.

The credit derivatives used by JPMorgan Chase for credit portfolio management activities do not qualify for hedge accounting under U.S. GAAP; these derivatives are reported at fair value, with gains and losses recognized in principal transactions revenue. In contrast, the loans and lending-related commitments being risk-managed are accounted for on an accrual basis. This asymmetry in accounting treatment, between loans and lending-related commitments and the credit derivatives used in credit portfolio management activities, causes earnings volatility that is not representative, in the Firm s view, of the true changes in value of the Firm s overall credit exposure. The MTM value related to the Firm s credit derivatives used for managing credit exposure, as well as the MTM value related to the CVA (which reflects the credit quality of derivatives counterparty exposure), are included in the gains and losses realized on credit derivatives disclosed in the table below. These results can vary from period to period due to market conditions that affect specific positions in the portfolio. For a discussion of CVA related to derivative contracts, see Derivative receivables MTM on pages 102-103 of JPMorgan Chase s 2009 Annual Report.

(in millions)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Hedges of lending-related commitments[(a)]	**$ 60**	$(1,512)	**$ (60)**	$(2,064)
CVA and hedges of CVA[(a)]	**(289)**	1,196	**(290)**	1,319
Net gains/(losses)	**$(229)**	$ (316)	**$(350)**	$ (745)

(a) *These hedges do not qualify for hedge accounting under U.S. GAAP.*

Lending-related commitments

JPMorgan Chase uses lending-related financial instruments, such as commitments and guarantees, to meet the financing needs of its customers. The contractual amount of these financial instruments represents the maximum possible credit risk should the counterparties draw down on these commitments or the Firm fulfills its obligation under these guarantees, and the counterparties subsequently fail to perform according to the terms of these contracts.

Wholesale lending-related commitments were $324.6 billion at June 30, 2010, compared with $347.2 billion at December 31, 2009. The decrease reflected the January 1, 2010, adoption of new consolidation guidance related to VIEs. Upon adoption of the new consolidation guidance, $24.2 billion of lending-related commitments between the Firm and its administered multi-seller conduits were eliminated in consolidation. This decrease in lending-related commitments was partially offset by the addition of $6.5 billion of unfunded commitments between the consolidated multi-seller conduits and their clients.

In the Firm s view, the total contractual amount of these wholesale lending-related commitments is not representative of the Firm s actual credit risk exposure or funding requirements. In determining the amount of credit risk exposure the Firm has to wholesale lending-related commitments, which is used as the basis for allocating credit risk capital to these commitments, the Firm has established a loan-equivalent amount for each commitment; this amount represents the portion of the unused commitment or other contingent exposure that is expected, based on average portfolio historical experience, to become drawn upon in an event of a default by an obligor. The loan-equivalent amounts of the Firm s lending-related commitments were $166.7 billion and $179.8 billion as of June 30, 2010, and December 31, 2009, respectively.

Country Exposure

The Firm s wholesale portfolio includes country risk exposures to both developed and emerging markets. The Firm seeks to diversify its country exposures, including its credit-related lending, trading and investment activities, whether cross-border or locally funded.

Country exposure under the Firm s internal risk management approach is reported based on the country where the assets of the obligor, counterparty or guarantor are located. Exposure amounts, including resale agreements, are adjusted for collateral and for credit enhancements (e.g., guarantees and letters of credit) provided by third parties; outstandings supported by a guarantor located outside the country or backed by collateral held outside the country are assigned to the country of the enhancement provider. In addition, the effect of credit derivative hedges and other short credit or equity trading positions are reflected. Total exposure measures include activity with both government and private-sector entities in a country.

The Firm also reports country exposure for regulatory purposes following FFIEC guidelines, which are different from the Firm s internal risk management approach for measuring country exposure. For additional information on the FFIEC exposures, see Cross-border outstandings on page 264 of JPMorgan Chase s 2009 Annual Report.

In recent months, several European countries, including Greece, Portugal, Spain, Italy and Ireland, have been subject to credit deterioration due to weaknesses in their economic and fiscal situations. The Firm is closely monitoring its exposures to these five countries. Aggregate net exposures to these five countries as measured under the Firm s internal approach was less than $20.0 billion at June 30, 2010; no individual country represented a majority of the net exposure and sovereign exposure represented less than half the aggregate net exposure. The Firm currently believes its exposure to these five countries is modest relative to the Firm s overall risk exposures and is manageable given the size and types of exposures to each of the countries and the diversification of the aggregate exposure. The Firm continues to conduct business and support client activity in these countries and, therefore, the Firm s aggregate net exposures may vary over time.

As part of its ongoing country risk management process, the Firm monitors exposure to emerging market countries, and utilizes country stress tests to measure and manage the risk of extreme loss associated with a sovereign crisis. There is no common definition of emerging markets, but the Firm generally includes in its definition those countries whose sovereign debt ratings are equivalent to A+ or lower. The table below presents the Firm s exposure to its top ten emerging markets countries based on its internal measurement approach. The selection of countries is based solely on the Firm s largest total exposures by country and does not represent its view of any actual or potentially adverse credit conditions.

Top 10 emerging markets country exposure

At June 30, 2010		Cross-border				**Total**
(in billions)	Lending*(a)*	Trading*(b)*	Other*(c)*	Total	Local*(d)*	**exposure**
South Korea	**$3.6**	**$ 1.5**	**$1.4**	**$6.5**	**$3.3**	**$9.8**
India	**2.1**	**3.8**	**1.3**	**7.2**	**0.7**	**7.9**
Brazil	**2.7**	**(0.1)**	**1.0**	**3.6**	**4.1**	**7.7**
China	**3.1**	**0.9**	**0.7**	**4.7**	**0.6**	**5.3**
Hong Kong	**1.8**	**1.5**	**1.1**	**4.4**		**4.4**
Mexico	**1.6**	**1.5**	**0.4**	**3.5**		**3.5**
Taiwan	**0.3**	**1.0**	**0.4**	**1.7**	**1.7**	**3.4**
Malaysia	**0.2**	**2.4**	**0.3**	**2.9**	**0.2**	**3.1**
Chile	**0.9**	**1.0**	**0.4**	**2.3**		**2.3**
Turkey	**0.8**	**0.8**	**0.1**	**1.7**	**0.2**	**1.9**

At December 31, 2009		Cross-border				**Total**
(in billions)	Lending*(a)*	Trading*(b)*	Other*(c)*	Total	Local*(d)*	**exposure**
South Korea	$2.7	$ 1.7	$1.3	$5.7	$3.3	$9.0
India	1.5	2.7	1.1	5.3	0.3	5.6
Brazil	1.8	(0.5)	1.0	2.3	2.2	4.5
China	1.8	0.4	0.8	3.0		3.0
Taiwan	0.1	0.8	0.3	1.2	1.8	3.0
Hong Kong	1.1	0.2	1.3	2.6		2.6
Mexico	1.2	0.8	0.4	2.4		2.4
Chile	0.8	0.6	0.5	1.9		1.9
Malaysia	0.1	1.3	0.3	1.7	0.2	1.9
South Africa	0.4	0.8	0.5	1.7		1.7

(a) Lending includes loans and

accrued interest receivable, interest-bearing deposits with banks, acceptances, other monetary assets, issued letters of credit net of participations, and undrawn commitments to extend credit.

(b) *Trading includes: (1) issuer exposure on cross-border debt and equity instruments, held both in trading and investment accounts and adjusted for the impact of issuer hedges, including credit derivatives; and (2) counterparty exposure on derivative and foreign exchange contracts, as well as security financing trades (resale agreements and securities borrowed).*

(c) *Other represents mainly local exposure funded cross-border, including capital investments in local entities.*

(d)

Local exposure is defined as exposure to a country denominated in local currency and booked locally. Any exposure not meeting these criteria is defined as cross-border exposure.

CONSUMER CREDIT PORTFOLIO

JPMorgan Chase s consumer portfolio consists primarily of residential mortgages, home equity loans, credit cards, auto loans, student loans and business banking loans. Included within the portfolio are home equity loans and lines of credit secured by junior liens, and mortgage loans with interest-only payment options to predominantly prime borrowers, as well as certain payment-option loans acquired from Washington Mutual that may result in negative amortization. The Firm s primary focus is on serving the prime consumer credit market. The Firm has never originated option ARMs.

A substantial portion of the consumer loans acquired in the Washington Mutual transaction were identified as credit-impaired based on an analysis of high-risk characteristics, including product type, LTV ratios, FICO scores and delinquency status. These purchased credit-impaired loans are accounted for on a pool basis, and the pools are considered to be performing. At the time of the acquisition, these loans were recorded at fair value, including an estimate of losses that were expected to be incurred over the estimated remaining lives of the loan pools. Therefore, no allowance for loan losses was recorded for these loans as of the transaction date. As part of its ongoing assessment of these loans, management evaluates whether higher expected future credit losses for certain pools of the purchased credit-impaired portfolio would result in a decrease in expected future principal cash flows for these pools. No allowance was added in the second quarter of 2010. The total allowance for loan losses on the purchased credit-impaired portfolio added since the beginning of the third quarter of 2009 is $2.8 billion.

The credit performance of the consumer portfolio across the entire product spectrum appears to have stabilized but remains under stress, as high unemployment and weak overall economic conditions continue to put pressure on the number of loans charged off, and weak housing prices continue to negatively affect the severity of loss recognized on real estate loans that default. Delinquencies and nonperforming loans remain elevated, but the delinquency trend is showing continued stability or improvement, with improvement continuing in early-stage delinquencies (30-89 days delinquent) across most products. Late-stage real estate delinquencies (150+ days delinquent) remain elevated. The elevated level of these credit quality metrics is due, in part, to loss-mitigation activities currently being undertaken and elongated foreclosure processing timelines. Losses related to these loans continued to be recognized in accordance with the Firm s standard charge-off practices, but some delinquent loans that would have otherwise been foreclosed upon remain in the mortgage and home equity loan portfolios.

Since mid-2007, the Firm has taken actions to reduce risk exposure to consumer loans by tightening both underwriting and loan qualification standards, as well as eliminating certain products and channels for residential real estate lending. The tightening of underwriting criteria for auto loans has resulted in the reduction of both extended-term and high LTV financing. In addition, new originations of private student loans are limited to school-certified loans, the majority of which include a qualified co-borrower.

As a further action to reduce risk associated with lending-related commitments, the Firm has reduced or canceled certain lines of credit as permitted by law. For example, the Firm may reduce or close home equity lines of credit when there are significant decreases in the value of the underlying property or when there has been a demonstrable decline in the creditworthiness of the borrower. Also, the Firm typically closes credit card lines when the borrower is 60 days or more past due. Finally, certain inactive credit card lines have been closed, and a number of active credit card lines have been reduced for risk management purposes.

The following tables present managed consumer credit-related information (including RFS, CS and residential real estate loans reported in the Corporate/Private Equity segment) for the dates indicated. For further information about the Firm s nonaccrual and charge-off accounting policies, see Note 13 on pages 145-150 of this Form 10-Q.

Consumer credit-related information

(in millions, except ratios)	Credit exposure		Nonperforming loans[j][k]		90 days or more past due and still accruing[k]	
	June 30, 2010	December 31, 2009	**June 30, 2010**	December 31, 2009	**June 30, 2010**	December 31, 2009
Consumer loans excluding purchased credit-impaired loans and loans held-for-sale						
Home equity senior lien[a]	**$ 25,856**	$ 27,376	**$ 461**	$ 477	**$**	$
Home equity junior lien[b]	**68,905**	74,049	**750**	1,188		
Prime mortgage[c]	**66,429**	66,892	**4,653**	4,355		
Subprime mortgage[c]	**12,597**	12,526	**3,115**	3,248		
Option ARMs[c]	**8,594**	8,536	**409**	312		
Auto loans[c][d]	**47,548**	46,031	**155**	177		
Credit card reported[d][e][f]	**142,994**	78,786	**3**	3	**3,952**	3,481
All other loans[c]	**32,399**	31,700	**973**	900	**447**	542
Total consumer loans	**405,322**	345,896	**10,519**	10,660	**4,399**	4,023
Consumer loans purchased credit-impaired						
Home equity	**25,471**	26,520	**NA**	NA	**NA**	NA
Prime mortgage	**18,512**	19,693	**NA**	NA	**NA**	NA
Subprime mortgage	**5,662**	5,993	**NA**	NA	**NA**	NA
Option ARMs	**27,256**	29,039	**NA**	NA	**NA**	NA
Total consumer loans purchased credit-impaired	**76,901**	81,245	**NA**	NA	**NA**	NA
Total consumer loans retained	**482,223**	427,141	**10,519**	10,660	**4,399**	4,023
Loans held-for-sale	**434**	2,142				
Total consumer loans reported	**482,657**	429,283	**10,519**	10,660	**4,399**	4,023
Credit card securitized[c][g]	**NA**	84,626	**NA**		**NA**	2,385
Total consumer loans managed[c]	**482,657**	513,909	**10,519**	10,660	**4,399**	6,408
Total consumer loans managed excluding	**405,756**	432,664	**10,519**	10,660	**4,399**	6,408

purchased credit-impaired loans(c)						
Consumer lending-related commitments:						
Home equity senior lien(g)(h)	**18,320**	19,246				
Home equity junior lien(h)(h)	**33,985**	37,231				
Prime mortgage	**958**	1,654				
Subprime mortgage						
Option ARMs						
Auto loans	**6,029**	5,467				
Credit card(h)	**550,442**	569,113				
All other loans	**10,207**	11,229				
Total lending-related commitments	**619,941**	643,940				
Total consumer credit portfolio	**$1,102,598**	$1,157,849				
Memo: Credit card managed(c)	**$ 142,994**	$ 163,412	**$ 3**	$ 3	**$3,952**	$5,866

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	Three months ended June 30,				Six months ended June 30,			
	Net charge-offs		Average annual net charge-off rate[l]		Net charge-offs		Average annual net charge-off rate[l]	
(in millions, except ratios)	**2010**	2009	**2010**	2009	**2010**	2009	**2010**	2009
Consumer loans excluding purchased credit-impaired loans								
Home equity senior lien[a]	**$ 70**	$ 65	**1.06%**	0.91%	**$ 139**	$ 99	**1.05%**	0.69%
Home equity junior lien[b]	**726**	1,200	**4.16**	5.91	**1,783**	2,264	**5.05**	5.52
Prime mortgage[c]	**268**	483	**1.59**	2.76	**730**	795	**2.16**	2.26
Subprime mortgage[c]	**282**	410	**8.63**	11.50	**739**	774	**11.12**	10.69
Option ARMs[c]	**22**	15	**1.03**	0.66	**45**	19	**1.04**	0.43
Auto loans[c]	**58**	146	**0.49**	1.36	**160**	320	**0.68**	1.51
Credit card reported[d]	**3,721**	2,689	**10.20**	12.03	**8,233**	4,718	**10.99**	10.15
All other loans[c]	**336**	332	**4.13**	3.99	**605**	556	**3.67**	3.30
Total consumer loans excluding purchased credit-impaired loans[i]	**5,483**	5,340	**5.34**	5.79	**12,434**	9,545	**5.98**	5.11
Total consumer loans reported	**5,483**	5,340	**4.49**	4.69	**12,434**	9,545	**5.03**	4.15
Credit card securitized[c][g]	**NA**	1,664	**NA**	7.91	**NA**	3,128	**NA**	7.42
Total consumer loans managed[c]	**5,483**	7,004	**4.49**	5.20	**12,434**	12,673	**5.03**	4.65
Total consumer loans managed excluding purchased credit-impaired loans[c][i]	**5,483**	7,004	**5.34**	6.18	**12,434**	12,673	**5.98**	5.53
Memo: Credit card managed[c]	**$3,721**	$4,353	**10.20%**	10.03%	**$ 8,233**	$ 7,846	**10.99%**	8.85%

(a) Represents loans where JPMorgan Chase holds the first security interest on the property.

(b) Represents loans where JPMorgan Chase holds a

security interest that is subordinate in rank to other liens.

(c) Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon the adoption of the new guidance, the Firm consolidated its Firm-sponsored credit card securitization trusts and certain other consumer loan securitization entities, primarily mortgage-related. As a result, related receivables are now recorded as loans on the Consolidated Balance Sheet. As a result of the consolidation of the securitization trusts, reported and managed basis are equivalent for periods beginning after January 1, 2010. For further discussion, see Explanation and Reconciliation of the Firm s Use of Non-GAAP Financial Measures on pages 15-19 of this Form 10-Q.

(d)

Excluded operating lease-related assets of $3.4 billion and $2.9 billion at June 30, 2010, and December 31, 2009, respectively.

(e) *Includes $1.0 billion of loans at December 31, 2009, held by the WMMT, which were consolidated onto the Firm s Consolidated Balance Sheets at fair value during the second quarter of 2009. Such loans had been fully repaid or charged off as of June 30, 2010. See Note 15 on pages 198-205 of JPMorgan Chase s 2009 Annual Report.*

(f) *Includes billed finance charges and fees net of an allowance for uncollectible amounts.*

(g) *Loans securitized are defined as loans that were sold to nonconsolidated securitization trusts and were not included in reported loans. For a further discussion of* *credit card securitizations, see CS on pages 36-40 of this Form 10-Q.*

(h) The credit card and home equity lending-related commitments represent the total available lines of credit for these products. The Firm has not experienced, and does not anticipate, that all available lines of credit would be used at the same time. For credit card commitments and home equity commitments (if certain conditions are met), the Firm can reduce or cancel these lines of credit by providing the borrower prior notice or, in some cases, without notice as permitted by law.

(i) Charge-offs are not recorded on purchased credit-impaired loans until actual losses exceed estimated losses that were recorded as purchase accounting adjustments at the time of acquisition. To

date, no charge-offs have been recorded for these loans.

(j) *At June 30, 2010, and December 31, 2009, nonperforming loans exclude: (1) mortgage loans insured by U.S. government agencies of $10.1 billion and $9.0 billion, respectively, that are 90 days past due and accruing at the guaranteed reimbursement rate; and (2) student loans that are 90 days past due and still accruing, which are insured by U.S. government agencies under the FFELP, of $447 million and $542 million, respectively. These amounts are excluded as reimbursement of insured amounts is proceeding normally. In addition, the Firm s policy is generally to exempt credit card loans from being placed on nonaccrual status as permitted by regulatory guidance. Under guidance issued by the FFIEC,* *credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), whichever is earlier.*

(k) Excludes purchased credit-impaired loans that were acquired as part of the Washington Mutual transaction, which are accounted for on a pool basis. Since each pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, the past due status of the pools, or that of individual loans within the pools, is not meaningful. Because the Firm is recognizing interest income on each pool of loans, they are all considered to be performing.

(l) Average consumer loans held-for-sale and loans at fair value were

\$1.9 billion and \$2.8 billion for the quarters ended June 30, 2010 and 2009, respectively, and \$2.4 billion and \$2.9 billion for year-to-date 2010 and 2009, respectively. These amounts were excluded when calculating the net charge-off rates.

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The following table presents consumer nonperforming assets by business segment as of June 30, 2010, and December 31, 2009.

Consumer nonperforming assets

	June 30, 2010				December 31, 2009			
		Assets acquired in loan satisfactions				Assets acquired in loan satisfactions		
(in millions)	Nonperforming loans	Real estate owned	Other	Nonperforming assets	Nonperforming loans	Real estate owned	Other	Nonperforming assets
Retail Financial Services[(a)(b)]	**$10,457**	**$1,207**	**$67**	**$11,731**	$10,611	$1,154	$99	$11,864
Card Services[(a)]	**3**			**3**	3			3
Corporate/Private Equity	**59**	**1**		**60**	46	2		48
Total	**$10,519**	**$1,208**	**$67**	**$11,794**	$10,660	$1,156	$99	$11,915

(a) *At June 30, 2010, and December 31, 2009, nonperforming loans and assets excluded: (1) mortgage loans insured by U.S. government agencies of $10.1 billion and $9.0 billion, respectively, that are 90 days past due and accruing at the guaranteed reimbursement rate; (2) real estate owned insured by U.S. government agencies of $1.4 billion and $579 million, respectively; and (3) student loans that are 90 days past due* *and still accruing, which are insured by U.S. government agencies under the FFELP, of $447 million and $542 million, respectively. These amounts are excluded as reimbursement of insured amounts is proceeding normally. In addition, the Firm s policy is generally to exempt credit card loans from being placed on nonaccrual status as permitted by regulatory guidance. Under guidance issued by the FFIEC, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), whichever is earlier.*

(b)

Excludes purchased credit-impaired loans that were acquired as part of the Washington Mutual transaction, which are accounted for on a pool basis. Since each pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, the past-due status of the pools, or that of individual loans within the pools, is not meaningful. Because the Firm is recognizing interest income on each pool of loans, they are all considered to be performing.

Effective January 1, 2010, the Firm adopted new guidance that amended the accounting for consolidation of VIEs. Upon adoption of the new guidance, the Firm consolidated its Firm-sponsored credit card securitization trusts and certain other consumer loan securitization entities. The following table summarizes the impact on consumer loans at adoption.

Reported loans

(in millions)	January 1, 2010
Prime mortgage	$ 1,477
Subprime mortgage	1,758
Option ARMs	381
Auto loans	218
Student loans	1,008
Credit card[(a)]	84,663

Total increase in consumer loans	$ 89,505

(a) *Represents the impact of adoption of the new consolidation standard related to VIEs on reported loans for Firm-sponsored credit card securitization trusts. As a result of the consolidation of the securitization trusts, reported and managed basis are equivalent for periods beginning after January 1, 2010. For further discussion, see Explanation and Reconciliation of the Firm s Use of Non-GAAP Financial Measures on pages 15-19 of this Form 10-Q.*

Portfolio analysis

The following discussion relates to the specific loan and lending-related categories within the consumer portfolio. Purchased credit-impaired loans are excluded from individual loan product discussions and are addressed separately below.

Home equity: Home equity loans at June 30, 2010, were $94.8 billion, compared with $101.4 billion at December 31, 2009. The decrease primarily reflected loan paydowns and charge-offs. Both senior lien and junior lien nonperforming loans decreased from year-end as a result of continuing improvement in early-stage delinquencies. Junior lien net charge-offs have declined from the prior year, but remain extremely high. Delinquencies continued to show improvement, albeit at a slower pace than the prior quarter, but remain elevated. In addition to delinquent accounts, the Firm monitors current junior lien loans where the borrower has a first mortgage loan which is either delinquent or has been modified. The portfolio contained an estimated $4.0 billion of such junior lien loans which are considered to be at higher risk for delinquency and this risk has been considered in establishing the allowance for loan losses at June 30, 2010.

Mortgage: Mortgage loans at June 30, 2010, which include prime mortgages, subprime mortgages, option ARMs acquired in the Washington Mutual transaction and mortgage loans held-for-sale, were $87.9 billion, compared with $88.3 billion at December 31, 2009. The decrease is due to portfolio runoff, partially offset by the addition of loans to the balance sheet as a result of the adoption of the new consolidation guidance related to VIEs. Net charge-offs have decreased from the prior year; however, losses continue to remain elevated.

Prime mortgages were $66.7 billion, compared with $67.3 billion at December 31, 2009. The decrease was due to paydowns and charge-offs on delinquent loans, partially offset by the addition of loans as a result of the adoption of the new consolidation guidance related to VIEs. Delinquencies continued to show improvement; however, nonperforming assets remain elevated as a result of ongoing trial modification activity and foreclosure processing delays.

Subprime mortgages were $12.6 billion, relatively flat compared with December 31, 2009, due to the addition of loans as a result of the adoption of the new consolidation guidance related to VIEs, offset by paydowns and charge-offs on delinquent loans. Both early-stage and late-stage delinquencies are showing improvement but remain elevated.

Option ARMs were $8.6 billion, relatively flat compared with December 31, 2009, due to the addition of loans as a result of the adoption of the new consolidation guidance related to VIEs, offset by paydowns in the portfolio. The option ARM portfolio represents less than 5% of the non-purchased credit-impaired residential real estate loans and is primarily comprised of loans with low LTV ratios and high borrower FICOs. Accordingly, the Firm currently expects substantially lower losses on this portfolio when compared with the purchased credit-impaired option ARM portfolio. As of June 30, 2010, approximately 62% of option ARM borrowers elected to make an interest-only or minimum payment. The cumulative amount of unpaid interest added to the unpaid principal balance due to negative amortization of option ARMs was $68 million and $78 million at June 30, 2010, and December 31, 2009, respectively. Assuming current market interest rates, the Firm would expect the following balance of current loans to experience a payment recast: $721 million in 2010, $375 million in 2011 and $611 million in 2012. New originations of option ARMs were discontinued by Washington Mutual prior to the date of JPMorgan Chase s acquisition of the banking operations of Washington Mutual.

Auto loans: As of June 30, 2010, auto loans were $47.5 billion, compared with $46.0 billion at December 31, 2009. Delinquent loans were lower than in the prior year, while provision expense decreased due to favorable loss severities as a result of higher used-car prices nationwide. The auto loan portfolio reflects a high concentration of prime quality credits.

Credit card: Credit card receivables (which include receivables in its Firm-sponsored credit card securitization trust that were not reported on the Consolidated Balance Sheets prior to January 1, 2010) were $143.0 billion at June 30, 2010, a decrease of $20.4 billion from year-end 2009, due to the decline in lower-yielding promotional balances and the Washington Mutual portfolio runoff.

The 30-day delinquency rate decreased to 4.96% at June 30, 2010, from 6.28% at December 31, 2009, while the net charge-off rate increased to 10.20% for the second quarter of 2010, from 10.03% for the second quarter of 2009. Charge-offs were negatively affected by the current weak economic environment, especially in metropolitan statistical areas (MSAs) experiencing the greatest housing price depreciation and highest unemployment, and by the credit performance of loans acquired in the Washington Mutual transaction. The delinquency trend is showing improvement, especially within early stage delinquencies. Provision expense reflected a $1.5 billion decrease in the allowance for loan losses in the second quarter of 2010, reflecting lower estimated losses, primarily related to the improvement in the delinquent loan trend and lower levels of outstandings. The credit card portfolio continues to reflect a well-seasoned, largely rewards-based portfolio that has good U.S. geographic diversification.

Credit card receivables, excluding the Washington Mutual portfolio, were $127.4 billion at June 30, 2010, compared with $143.8 billion at December 31, 2009. The 30-day delinquency rate was 4.48% at June 30, 2010, down from 5.52% at December 31, 2009; the net charge-off rate, excluding the Washington Mutual portfolio, increased to 9.02% for the second quarter of 2010 from 8.97% in the second quarter of 2009. Excluding the impact of the payment holiday program offered in the second quarter of 2009, the net charge-off rate is down from the prior two quarters.

Credit card receivables in the Washington Mutual portfolio were $15.6 billion at June 30, 2010, compared with $19.7 billion at December 31, 2009. The Washington Mutual portfolio s 30-day delinquency rate was 8.86% at June 30, 2010, compared with 12.72% at December 31, 2009; the latter excludes the impact at December 31, 2009, of the consolidation of the WMMT in the second quarter of 2009 as a result of certain actions taken at that time. The net charge-off rate in the second quarter of 2010 was 19.53%, compared with 19.17% in the second quarter of 2009, excluding the impact of the purchase accounting adjustments related to the consolidation of the WMMT in the second quarter of 2009.

All other: All other loans primarily include business banking loans (which are highly collateralized loans, often with personal loan guarantees), student loans, and other secured and unsecured consumer loans. As of June 30, 2010, other loans, including loans held-for-sale, were $32.6 billion, compared with $33.6 billion at December 31, 2009.

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Purchased credit-impaired: Purchased credit-impaired loans were $76.9 billion at June 30, 2010, compared with $81.2 billion at December 31, 2009. This portfolio represents loans acquired in the Washington Mutual transaction that were recorded at fair value at the time of acquisition. The fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, and therefore no allowance for loan losses was recorded for these loans as of the acquisition date.

The Firm regularly updates the amount of expected loan principal and interest cash flows to be collected for these loans. Probable decreases in expected loan principal cash flows trigger the recognition of impairment through the provision for loan losses. Probable and significant increases in expected loan principal cash flows would first trigger the reversal of any allowance for loan losses. Any remaining increase in the expected principal cash flows would be recognized prospectively in interest income over the remaining lives of the underlying loans.

During the second quarter of 2010, the Firm did not recognize any impairment as a result of updating its assessment of expected cash flows for these purchased credit-impaired pools. As a result of impairment recognized in prior periods, the Firm maintains an allowance for loan losses for the prime mortgage and option ARM purchased credit-impaired pools of $1.8 billion and $1.0 billion, respectively, at June 30, 2010. The credit performance of the other pools has generally been consistent with the estimate of losses at the acquisition date. Accordingly, no impairment for these other pools has been recognized.

Concentrations of credit risk consumer loans other than purchased credit-impaired loans

Following is tabular information and, where appropriate, supplemental discussions about certain concentrations of credit risk for the Firm s consumer loans, other than purchased credit-impaired loans, including:

- Geographic distribution of loans, including certain residential real estate loans with high LTV ratios; and

- Loans that are 30+ days past due.

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The following tables present the geographic distribution of managed consumer credit outstandings by product as of June 30, 2010, and December 31, 2009, excluding purchased credit-impaired loans.

Consumer loans by geographic region

June 30, 2010 (in billions)	Home equity-senior lien	Home equity-junior lien	Prime mortgage	Subprime mortgage	Option ARMs	Total home loan portfolio	Auto	Card-reported	All other loans	Total consumer loans-reported	Card loans-securitized(b)	Total consumer loans-managed
California	$ 3.5	$ 15.7	$ 16.9	$ 1.9	$ 3.9	$ 41.9	$ 4.4	$ 19.4	$ 1.9	$ 67.6	NA	$ 67.6
New York	3.3	11.8	8.4	1.5	0.8	25.8	3.8	11.1	4.2	44.9	NA	44.9
Texas	3.9	2.5	2.1	0.3	0.2	9.0	4.5	10.7	3.7	27.9	NA	27.9
Florida	1.1	3.8	4.8	1.8	0.9	12.4	1.8	8.4	1.1	23.7	NA	23.7
Illinois	1.7	4.5	3.0	0.6	0.3	10.1	2.5	7.9	2.3	22.8	NA	22.8
Ohio	2.2	1.7	0.5	0.3		4.7	3.1	5.7	2.7	16.2	NA	16.2
New Jersey	0.7	3.6	1.8	0.6	0.3	7.0	1.8	5.8	1.0	15.6	NA	15.6
Michigan	1.3	1.7	1.0	0.3		4.3	2.3	4.5	2.3	13.4	NA	13.4
Arizona	1.6	3.2	1.2	0.3	0.1	6.4	1.5	3.3	1.6	12.8	NA	12.8
Pennsylvania	0.2	1.1	0.4	0.4	0.1	2.2	2.1	5.2	0.8	10.3	NA	10.3
Washington	0.8	2.3	1.7	0.3	0.4	5.5	0.7	2.6	0.3	9.1	NA	9.1
Colorado	0.4	1.5	1.5	0.2	0.2	3.8	1.0	3.4	0.9	9.1	NA	9.1
All other(a)	5.2	15.5	23.4	4.1	1.4	49.6	18.0	55.0	9.8	132.4	NA	132.4
Total	$ 25.9	$ 68.9	$ 66.7	$ 12.6	$ 8.6	$ 182.7	$ 47.5	$ 143.0	$ 32.6	$ 405.8	NA	$ 405.8

December 31, 2009 (in billions)	Home equity-senior lien	Home equity-junior lien	Prime mortgage	Subprime mortgage	Option ARMs	Total home loan portfolio	Auto	Card-reported	All other loans	Total consumer loans-reported	Card loans-securitized(b)	Total consumer loans-managed
California	$ 3.6	$ 16.9	$ 18.7	$ 1.7	$ 3.8	$ 44.7	$ 4.4	$ 11.0	$ 1.8	$ 61.9	$ 11.4	$ 73.3
New York	3.4	12.4	8.7	1.5	0.9	26.9	3.8	6.0	4.2	40.9	6.7	47.6
Texas	4.2	2.7	1.4	0.4	0.2	8.9	4.3	5.6	3.8	22.6	6.5	29.1
Florida	1.2	4.1	4.9	1.9	0.7	12.8	1.8	5.2	0.9	20.7	4.8	25.5
Illinois	1.8	4.8	2.9	0.6	0.4	10.5	2.4	3.9	2.4	19.2	4.9	24.1
Ohio	2.3	1.9	0.4	0.3		4.9	3.2	3.1	2.9	14.1	3.4	17.5
New Jersey	0.8	3.8	1.9	0.6	0.3	7.4	1.8	3.0	0.9	13.1	3.6	16.7
Michigan	1.3	1.9	0.9	0.3		4.4	2.1	2.4	2.5	11.4	2.9	14.3
Arizona	1.6	3.6	1.3	0.3	0.1	6.9	1.5	1.7	1.6	11.7	2.1	13.8
Pennsylvania	0.2	1.2	0.5	0.4	0.1	2.4	2.0	2.8	0.8	8.0	3.2	11.2
Washington	0.9	2.4	1.7	0.3	0.4	5.7	0.6	1.5	0.4	8.2	1.5	9.7
Colorado	0.4	1.7	1.6	0.2	0.2	4.1	1.0	1.6	0.8	7.5	2.1	9.6
All other(a)	5.7	16.6	22.4	4.0	1.4	50.1	17.1	31.0	10.6	108.8	31.5	140.3
Total	$ 27.4	$ 74.0	$ 67.3	$ 12.5	$ 8.5	$ 189.7	$ 46.0	$ 78.8	$ 33.6	$ 348.1	$ 84.6	$ 432.7

(a) *Includes prime mortgage loans repurchased from Ginnie Mae pools, which are insured by U.S. government agencies, of $12.0 billion and $10.4 billion at June 30, 2010, and December 31, 2009, respectively. Prior period amounts have been revised to conform to the current period presentation. See further discussion of loans repurchased from Ginnie Mae pools in Repurchase liability on pages 58-60 of this Form 10-Q.*

(b) *Loans securitized are defined as loans that were sold to nonconsolidated securitization trusts and were not included in reported loans at December 31, 2009. For further discussion of credit card securitizations, see Note 15 on pages 151-163 of this Form 10-Q.*

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The following table presents the geographic distribution of certain residential real estate loans with current estimated LTV ratios in excess of 100% as of June 30, 2010, and December 31, 2009, excluding purchased credit-impaired loans acquired in the Washington Mutual transaction. The estimated collateral values used to calculate the current estimated LTV ratios in the following table were derived from a nationally recognized home price index measured at the MSA level. Because home price indices can have wide variability, and such derived real estate values do not represent actual appraised loan-level collateral values, the resulting ratios are necessarily imprecise and should therefore be viewed as estimates.

Geographic distribution of residential real estate loans with current estimated LTVs > 100%[(a)]

June 30, 2010 (in billions, except ratios)	Home equity-junior lien[(c)]	Prime mortgage[(d)]	Subprime mortgage	Total	% of total loans[(e)]
California	**$ 6.0**	**$ 5.0**	**$ 0.8**	**$ 11.8**	**34%**
New York	**1.8**	**0.3**	**0.2**	**2.3**	**11**
Arizona	**2.1**	**0.6**	**0.2**	**2.9**	**62**
Florida	**2.2**	**2.4**	**0.9**	**5.5**	**53**
Michigan	**1.2**	**0.4**	**0.2**	**1.8**	**60**
All other	**6.6**	**1.7**	**1.2**	**9.5**	**15**
Total LTV >100%	**$ 19.9**	**$ 10.4**	**$ 3.5**	**$ 33.8**	**25%**
As a percentage of total loans	**29%**	**19%**	**28%**	**25%**	
Total portfolio average LTV at origination	**73**	**70**	**78**		
Total portfolio average current estimated LTV[(b)]	**90**	**81**	**90**		

December 31, 2009 (in billions, except ratios)	Home equity-junior lien[(c)]	Prime mortgage[(d)]	Subprime mortgage	Total	% of total loans[(e)]
California	$ 6.7	$ 5.7	$ 1.0	$ 13.4	36%
New York	1.7	0.3	0.2	2.2	10
Arizona	2.4	0.7	0.2	3.3	63
Florida	2.5	2.5	1.2	6.2	57
Michigan	1.3	0.4	0.2	1.9	61
All other	6.9	1.6	1.3	9.8	15
Total LTV >100%	$ 21.5	$ 11.2	$ 4.1	$ 36.8	26%
As a percentage of total loans	29%	20%	33%	26%	
Total portfolio average LTV at origination	74	71	79		
Total portfolio average current estimated LTV[(b)]	90	81	95		

(a) Home equity junior lien, prime mortgage and subprime mortgage loans with current estimated LTVs greater than 80% up to and including 100% were $16.7 billion, $13.4 billion and $3.3 billion, respectively, at June 30, 2010, and $17.9 billion, $15.0 billion and $3.7 billion, respectively, at December 31, 2009.

(b) The average current estimated LTV ratio reflects the outstanding balance at the balance sheet date, divided by the estimated current property value. Current property values are estimated based on home valuation models utilizing nationally recognized home price index valuation estimates.

(c) Represents combined LTV, which considers all available

lien positions related to the property. All other products are presented without consideration of subordinate liens on the property. Prior period amounts have been revised to conform to the current period presentation.

(d) *Excludes mortgage loans insured by the U.S. government agencies of $6.8 billion and $5.0 billion at June 30, 2010, and December 31, 2009, respectively. Prior period amounts have been revised to conform to the current period presentation.*

(e) *Represents total loans of the product types noted in this table by geographic location, excluding mortgage loans insured by U.S. government agencies.*

The consumer credit portfolio is geographically diverse. The greatest concentration of loans is in California. Excluding mortgage loans insured by U.S. government agencies, California represents 17% of total managed consumer loans and 25% of total residential real estate loans at both June 30, 2010, and December 31, 2009. Of the total managed consumer loan portfolio, excluding mortgage loans insured by U.S. government agencies, $162.4 billion, or 41%, is concentrated in California, New York, Arizona, Florida and Michigan at June 30, 2010, compared with $174.5 billion, or 41%, at December 31, 2009.

Declining home prices have had a significant impact on the collateral value underlying the Firm s residential real estate loan portfolio. In general, the delinquency rate for loans with high LTV ratios is greater than the delinquency rate for loans in which the borrower has equity in the collateral. While a large portion of the loans with estimated LTV ratios greater than 100% continue to pay and are current, the continued willingness and ability of these borrowers to pay remains uncertain. Nonperforming loans in the residential real estate portfolio totaled $9.4 billion at June 30, 2010, of which 76% were greater than 150 days past due; this compared with total residential real estate nonperforming loans of $9.6 billion at December 31, 2009, of which 64% were greater than 150 days past due. In the aggregate, the unpaid principal balance of these loans has been charged down by approximately 32% and 36% to estimated collateral value at June 30, 2010, and December 31, 2009, respectively.

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Consumer 30+ day delinquency information

(in millions, except ratios)	30+ day delinquent loans June 30, 2010	30+ day delinquent loans December 31, 2009	30+ day delinquency rate June 30, 2010	30+ day delinquency rate December 31, 2009
Consumer loans excluding purchased credit-impaired loans*(a)*				
Home equity senior lien	**$ 725**	$ 833	**2.80%**	3.04%
Home equity junior lien	**1,746**	2,515	**2.53**	3.40
Prime mortgage	**5,221***(d)*	5,532*(d)*	**7.84***(f)*	8.21*(f)*
Subprime mortgage	**3,349**	4,232	**26.59**	33.79
Option ARMs	**550**	438	**6.40**	5.13
Auto loans	**446**	750	**0.94**	1.63
Credit card reported*(b)*	**7,087**	6,093	**4.96**	7.73
All other loans	**1,324***(e)*	1,306*(e)*	**4.06**	3.91
Total consumer loans excluding purchased credit-impaired loans reported	**$20,448**	$ 21,699	**5.04%**	6.23%
Credit card securitized*(b)(c)*	**NA**	4,174	**NA**	4.93
Total consumer loans excluding purchased credit-impaired loans managed*(b)*	**$20,448**	$ 25,873	**5.04%**	5.98%
Memo: Credit card managed*(b)*	**$ 7,087**	$ 10,267	**4.96%**	6.28%

(a) The delinquency rate for purchased credit-impaired loans, which is based on the unpaid principal balance, was 27.91% and 27.79% at June 30, 2010, and December 31, 2009, respectively.

(b) Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon the adoption of the new guidance, the

Firm consolidated its Firm-sponsored credit card securitization trusts and certain other consumer loan securitization entities, primarily mortgage-related. As a result, related assets are now recorded as loans on the Consolidated Balance Sheet. As a result of the consolidation of the credit card securitization trusts, reported and managed basis are equivalent for periods beginning after January 1, 2010. For further discussion, see Explanation and Reconciliation of the Firm s Use of Non-GAAP Financial Measures on pages 15-19 of this Form 10-Q.

(c) Loans securitized are defined as loans that were sold to nonconsolidated securitization trusts and were not included in reported loans at December 31, 2009. For a further discussion of credit card securitizations, see CS on pages 36-40 of this Form 10-Q.

(d) *Excludes 30+ day delinquent mortgage loans that are insured by U.S. government agencies of $10.9 billion and $9.7 billion at June 30, 2010, and December 31, 2009, respectively. These amounts are excluded as reimbursement of insured amounts is proceeding normally.*

(e) *Excludes 30+ day delinquent loans that are 30 days or more past due and still accruing, which are insured by U.S. government agencies under the FFELP, of $988 million and $942 million at June 30, 2010, and December 31, 2009, respectively. These amounts are excluded as reimbursement of insured amounts is proceeding normally.*

(f) *The denominator for the calculation of the 30+ day delinquency rate includes: (1) residential real estate loans reported in the Corporate/Private Equity segment;*

and (2) mortgage loans insured by U.S. government agencies. The 30+ day delinquency rate excluding these loan balances was 11.24% at both June 30, 2010, and December 31, 2009.

Consumer 30+ day delinquencies have decreased to 5.04% of the consumer loan portfolio at June 30, 2010, compared with 5.98% at December 31, 2009, driven predominantly by a $3.2 billion decrease in CS delinquencies as well as a $2.0 billion decrease in residential real estate delinquencies. While early stage delinquencies (30-89 days delinquent) in the residential real estate portfolios have shown improvement since December 31, 2009, late stage delinquencies (150+ days delinquent) remain elevated, due in part to loss mitigation activities and elongated foreclosure processing timelines. Losses related to the residential real estate portfolio continue to be recognized in accordance with the Firm s normal charge-off practices; as such, these loans are reflected at their estimated collateral value.

Concentrations of credit risk purchased credit-impaired loans

The following table presents the current estimated LTV ratio, as well as the ratio of the carrying value of the underlying loans to the current estimated collateral value, for purchased credit-impaired loans. Because such loans were initially measured at fair value, the ratio of the carrying value to the current estimated collateral value will be lower than the current estimated LTV ratio, which is based on the unpaid principal balance. The estimated collateral values used to calculate these ratios were derived from a nationally recognized home price index measured at the MSA level. Because home price indices can have wide variability, and such derived real estate values do not represent actual appraised loan-level collateral values, the resulting ratios are necessarily imprecise and should therefore be viewed as estimates.

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LTV ratios and ratios of carrying values to current estimated collateral values purchased credit-impaired

June 30, 2010 (in billions, except ratios)	Unpaid principal balance(a)	Current estimated LTV ratio(b)	Carrying value(d)	Ratio of carrying value to current estimated collateral value
Option ARMs	**$ 34.6**	**112%**	**$ 27.3**	**85%**(e)
Home equity	**30.4**	**114**(c)	**25.5**	**96**
Prime mortgage	**20.4**	**105**	**18.5**	**86**(e)
Subprime mortgage	**8.5**	**109**	**5.6**	**73**

December 31, 2009 (in billions, except ratios)	Unpaid principal balance(a)	Current estimated LTV ratio(b)	Carrying value(d)	Ratio of carrying value to current estimated collateral value
Option ARMs	$ 37.4	113%	$ 29.0	86%(e)
Home equity	32.9	115(c)	26.5	93
Prime mortgage	22.0	106	19.7	90(e)
Subprime mortgage	9.0	110	6.0	73

(a) Represents the contractual amount of principal owed at June 30, 2010, and December 31, 2009.

(b) Represents the aggregate unpaid principal balance of loans divided by the estimated current property value. Current property values are estimated based on home valuation models utilizing nationally recognized

home price index valuation estimates.

(c) Represents current estimated combined LTV, which considers all available lien positions related to the property. All other products are presented without consideration of subordinate liens on the property. Prior period amounts have been revised to conform to the current period presentation.

(d) Carrying values include the effect of fair value adjustments that were applied to the consumer purchased credit-impaired portfolio at the date of acquisition.

(e) As of June 30, 2010, and December 31, 2009, the ratios of the carrying value to current estimated collateral value are net of the allowance for loan losses of

$1.8 billion and $1.1 billion for the prime mortgage pool, respectively, and $1.0 billion and $491 million for the option ARM pool, respectively.

Purchased credit-impaired loans in the states of California and Florida represented 54% and 11%, respectively, of total purchased credit-impaired loans at both June 30, 2010, and December 31, 2009. The current estimated LTV ratios were 117% and 133% for California and Florida loans, respectively, at June 30, 2010, compared with 118% and 136%, respectively, at December 31, 2009. Loan concentrations in California and Florida, as well as the continued pressure on housing prices in those states, have contributed negatively to both the current estimated LTV ratio and the ratio of carrying value to current collateral value for loans in the purchased credit-impaired portfolio. While the carrying value of the purchased credit-impaired loans is below the current estimated collateral value of the loans, the ultimate performance of this portfolio is highly dependent on the borrowers behavior and ongoing ability and willingness to continue to make payments on homes with negative equity as well as the cost of alternative housing.

Option ARM and prime purchased credit-impaired pools: Approximately 56% of option ARM borrowers elected to make an interest-only or minimum payment at June 30, 2010. The cumulative amount of unpaid interest added to the unpaid principal balance of option ARMs was $1.6 billion and $1.9 billion at June 30, 2010, and December 31, 2009, respectively. Assuming current market interest rates, the Firm would expect the following balance of current option ARM loans to experience a payment recast: $2.1 billion in 2010, $3.4 billion in 2011 and $4.6 billion in 2012. The option ARM and prime purchased credit-impaired pools continue to show some signs of stabilization and are performing within management s revised expectations. Accordingly, no impairment was recognized for the purchased credit-impaired prime mortgage or option ARM pools during the second quarter of 2010. Previously, management concluded as part of the Firm s regular assessment of these pools that it was probable that higher expected principal credit losses for the prime mortgage and option ARM purchased credit-impaired pools would result in a decrease in expected cash flows. As a result, an allowance for loan losses for impairment of the prime mortgage and option ARM pools has been recognized. As of June 30, 2010, the total allowance for loan losses for the prime mortgage and option ARM purchased credit-impaired pools was $1.8 billion and $1.0 billion, respectively.

Other purchased credit-impaired pools: The credit performance of the home equity and subprime purchased credit-impaired pools has generally been consistent with the estimate of losses at the acquisition date. Accordingly, no impairment for these pools has been recognized.

The following table provides a summary of lifetime principal loss estimates included in both the nonaccretable difference and the allowance for loan losses. Principal charge-offs will not be recorded on these portfolios until the nonaccretable difference has been fully depleted.

	Lifetime loss estimates[a]		LTD liquidation losses[b][c]	
(in millions)	**June 30, 2010**	December 31, 2009	**June 30, 2010**	December 31, 2009
Option ARMs	**$11,350**	$ 10,650	**$ 2,680**	$ 1,744
Home equity	**13,138**	13,138	**7,701**	6,060
Prime mortgage	**5,020**	4,240	**1,158**	794
Subprime mortgage	**3,842**	3,842	**1,048**	796
Total	**$33,350**	$ 31,870	**$ 12,587**	$ 9,394

(a) Includes the original nonaccretable difference established in purchase accounting of $30.5 billion for principal losses only. The remaining nonaccretable difference for principal losses only is $17.9 billion and $21.1 billion at June 30, 2010, and December 31, 2009, respectively. All increases in principal losses subsequent to the purchase date are reflected in the allowance for loan losses.

(b)

Realization of loss upon loan resolution.

(c) *If charge-offs were reported comparable to the non-purchased credit-impaired portfolio, life-to-date (LTD) principal charge-offs would have been $20.8 billion and $16.7 billion at June 30, 2010, and December 31, 2009, respectively.*

Loan modification activities

For additional information about consumer loan modification activities, including consumer loan modifications accounted for as troubled debt restructurings, see Note 13 on pages 145-150 of this Form 10-Q, and Note 13 on pages 192-196 of JPMorgan Chase s 2009 Annual Report.

Residential real estate loans: For both the Firm s on-balance sheet loans and loans serviced for others, more than 880,000 mortgage modifications have been offered to borrowers and nearly 245,000 have been approved since the beginning of 2009. Of these, approximately 193,000 have achieved permanent modification as of June 30, 2010.

The Firm is participating in the U.S. Treasury s MHA programs while continuing to expand its other loss-mitigation efforts for financially distressed borrowers who do not qualify for the U.S. Treasury s programs. The MHA programs include the Home Affordable Modification Program (HAMP) and the Second Lien Modification Program (2MP); these programs mandate standard modification terms across the industry and provide incentives to borrowers, servicers and investors who participate. All of the Firm s loan-modification activities are intended to minimize economic loss to the Firm, while providing the borrower with an alternative to foreclosure and an affordable loan payment.

In July 2009, following the introduction of MHA, the Firm began to offer modifications under standard programs; prior to that time, residential real estate loan modifications were evaluated and offered on a case-by-case basis rather than being based on a standardized framework comparable to HAMP. The Firm completed its first permanent modifications under HAMP in September 2009. HAMP, as well as the Firm s other loss-mitigation programs, generally provide various concessions to financially troubled borrowers, including, but not limited to, term or payment extensions, interest rate reductions, and deferral of principal payments that would have otherwise been required under the terms of the original agreement. In certain limited circumstances, loan modifications include principal forgiveness, which has been minimal to-date.

In addition, JPMorgan Chase announced in March 2010 that it would be joining 2MP, with implementation occurring in phases beginning in May 2010. Under 2MP, homeowners will be offered a way to modify their second mortgages to make them more affordable when their first mortgage has been modified under HAMP. For amortizing second lien loans modified under 2MP, the interest rate will be reduced to 1%; the interest rate on interest-only second lien loans will be reduced to 2%. After five years, the interest rate on these modified second lien loans will reset to the then-current interest rate on the HAMP-modified first-lien.

When the Firm modifies home equity lines of credit in troubled debt restructurings, future lending commitments related to the modified loans are canceled as part of the terms of the modification. Except for home equity loans modified under 2MP where the borrower is current, borrowers must make at least three payments under the revised contractual terms during a trial modification and be successfully re-underwritten with income verification before a mortgage or home equity loan can be permanently modified.

For the 21,700 on-balance sheet loans modified under HAMP and the Firm s other loss-mitigation programs since July 1, 2009, 68% of permanent loan modifications have included interest rate reductions, 51% have included term or payment extensions and 14% have included principal deferment. The sum of the percentages of the types of loan modifications exceeds 100% because, in some cases, the modification of an individual loan includes more than one type of concession.

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The ultimate success of these modification programs and their impact on reducing credit losses remains uncertain given the short period of time since modification. The primary indicator used by management to monitor the success of these programs is the rate at which the modified loans redefault. Modification redefault rates are affected by a number of factors, including the type of loan modified, the borrower s overall ability and willingness to repay the modified loan, the LTV ratio of the property and other macroeconomic factors. Modifications of serviced mortgage loans completed after July 1, 2009, whether under HAMP or under the Firm s other modification programs, differ from modifications completed under prior programs in that they are fully underwritten after a successful trial payment period of at least 3 months. More than 85% of the modifications completed since July 1, 2009 were completed in 2010 with 41% completed as recently as the second quarter. Performance metrics to date show redefault rates of 20-30%. While these rates compare favorably to equivalent metrics for modifications completed under prior programs, ultimate redefault rates will remain uncertain until modified loans have seasoned.

The following table presents information as of June 30, 2010, and December 31, 2009, relating to restructured on-balance sheet residential real estate loans for which concessions have been granted to borrowers experiencing financial difficulty. Modifications of purchased credit-impaired loans continue to be accounted for and reported as purchased credit-impaired loans, and the impact of the modification is incorporated into the Firm s quarterly assessment of whether a probable and/or significant change in estimated future cash flows has occurred. Modifications of loans other than purchased credit-impaired loans are generally accounted for and reported as troubled debt restructurings.

Restructured residential real estate loans

	June 30, 2010		December 31, 2009	
(in millions)	On-balance sheet loans	Nonperforming on-balance sheet loans(d)	On-balance sheet loans	Nonperforming on-balance sheet loans(d)
Restructured residential real estate loans excluding purchased credit-impaired loans(a)(b)				
Home equity senior lien	**$ 220**	**$ 46**	$ 168	$ 30
Home equity junior lien	**253**	**34**	222	43
Prime mortgage	**1,421**	**567**	634	243
Subprime mortgage	**2,575**	**986**	1,998	598
Option ARMs	**65**	**19**	8	6
Total restructured residential real estate loans excluding purchased credit-impaired loans	**$ 4,534**	**$ 1,652**	$ 3,030	$ 920
Restructured purchased credit-impaired loans(c)				
Home equity	**$ 436**	**NA**	$ 453	NA
Prime mortgage	**2,276**	**NA**	1,526	NA
Subprime mortgage	**2,934**	**NA**	1,954	NA
Option ARMs	**4,839**	**NA**	2,972	NA
Total restructured purchased credit-impaired loans	**$ 10,485**	**NA**	$ 6,905	NA

(a) Amounts represent the carrying value

of restructured residential real estate loans.

(b) *Excludes $1.7 billion and $296 million of loans at June 30, 2010, and December 31, 2009, respectively, that were repurchased from Ginnie Mae pools and modified subsequent to repurchase. When such loans reperform subsequent to modification they are generally sold back into Ginnie Mae loan pools. Modified loans that do not reperform will become subject to foreclosure.*

(c) *Amounts represent the unpaid principal balance of restructured purchased credit-impaired loans.*

(d) *Nonperforming loans modified in a troubled debt restructuring may be returned to accrual status when repayment* *is reasonably assured and the borrower has made a minimum of six payments under the new terms.*

Excluding purchased credit-impaired loans, 21% of restructured residential real estate loans are greater than 30 days delinquent, which is within the Firm s expectations.

Credit card loans: JPMorgan Chase has also modified the terms of credit card loan agreements with borrowers who have experienced financial difficulty. Such modifications typically include reducing the interest rate on the card and, in most cases, involve placing the customer on a fixed payment plan not exceeding 60 months; in substantially all cases, the Firm cancels the customer s available line of credit on the credit card. If the cardholder does not comply with the modified payment terms, the credit card loan agreement generally reverts back to its original payment and interest rate terms, resulting in the loan being excluded from modified loans. Assuming that those borrowers do not begin to perform in accordance with those original payment terms, the loans continue to age and become subject to the Firm s standard charge-off policies. Substantially all modifications of credit card loans performed under the Firm s existing modification programs are considered to be troubled debt restructurings. At June 30, 2010, and December 31, 2009, the Firm had $9.3 billion and $5.1 billion, respectively, of on-balance sheet credit card loans outstanding for borrowers enrolled in a credit card modification program. The increase in modified credit card loans outstanding from December 31, 2009, to June 30, 2010, is primarily attributable to previously-modified loans held in Firm-sponsored credit card securitization trusts being consolidated as a result of adopting the new consolidation guidance. Consistent with the Firm s policy, all credit card

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loans typically remain on accrual status. Based on the Firm s historical experience, the Firm expects that a significant portion of the borrowers will not ultimately comply with the modified payment terms.

Real estate owned (REO)

As part of the residential real estate foreclosure process, loans are written down to the fair value of the underlying real estate asset, less costs to sell, at acquisition. Typically, any further gains or losses on REO assets are recorded as part of other income. In those instances where the Firm gains ownership and possession of individual properties at the completion of the foreclosure process, these REO assets are managed for prompt sale and disposition at the best possible economic value. Operating expense, such as real estate taxes and maintenance, are charged to other expense. REO assets were up slightly compared with December 31, 2009. It is anticipated that REO assets will increase over the next several quarters, as loans moving through the foreclosure process are expected to increase.

Portfolio transfers

The Firm regularly evaluates market conditions and overall economic returns and makes an initial determination as to whether new originations will be held-for-investment or sold within the foreseeable future. The Firm also periodically evaluates the expected economic returns of previously originated loans under prevailing market conditions to determine whether their designation as held-for-sale or held-for-investment continues to be appropriate. When the Firm determines that a change in this designation is appropriate, the loans are transferred to the appropriate classification. Since the second half of 2007, all new prime mortgage originations that cannot be sold to U.S. government agencies and U.S. government-sponsored enterprises have been designated as held-for-investment. Prime mortgage loans originated with the intent to sell are accounted for at fair value and classified as trading assets on the Consolidated Balance Sheets.

ALLOWANCE FOR CREDIT LOSSES

JPMorgan Chase s allowance for loan losses covers the wholesale (risk-rated) and consumer (primarily scored) loan portfolios and represents management s estimate of probable credit losses inherent in the Firm s loan portfolio. Management also computes an allowance for wholesale lending-related commitments using a methodology similar to that used for the wholesale loans.

Determining the appropriateness of the allowance is complex and requires judgment about the effect of matters that are inherently uncertain. Assumptions about unemployment rates, housing prices and overall economic conditions could have a significant impact on the Firm s assessment of loan quality. Subsequent evaluations of the loan portfolio, in light of then-prevailing factors, may result in significant changes in the allowances for loan losses and lending-related commitments in future periods. At least quarterly, the allowance for credit losses is reviewed by the Chief Risk Officer, the Chief Financial Officer and the Controller of the Firm, and discussed with the Risk Policy and Audit Committees of the Board of Directors of the Firm. As of June 30, 2010, JPMorgan Chase deemed the allowance for credit losses to be appropriate (i.e., sufficient to absorb losses inherent in the portfolio, including those not yet identifiable).

For a further discussion of the allowance for credit losses, see Critical Accounting Estimates Used by the Firm on page 100 and Note 14 on pages 150-151 of this Form 10-Q, and Allowance for Credit Losses on page 115, Critical Accounting Estimates Used by the Firm on pages 127-131, and Note 14 on pages 196-198 of JPMorgan Chase s 2009 Annual Report.

The allowance for credit losses was $36.7 billion at June 30, 2010, an increase of $4.2 billion from $32.5 billion at year-end 2009. The increase was primarily due to the Firm s adoption of new consolidation guidance related to VIEs. As a result of the consolidation of certain securitization entities, the Firm established an allowance for loan losses of $7.5 billion at January 1, 2010, primarily related to the receivables that had been held in such securitization trusts.

The consumer allowance for loan losses increased predominately due to the aforementioned impact of new consolidation guidance. Excluding the effect of this adoption, the consumer allowance decreased by $1.2 billion from December 31, 2009. The decrease reflects a $2.5 billion reduction in the allowance in CS, reflecting lower estimated losses primarily related to improved delinquency trends as well as lower levels of outstandings. This decrease was partly offset by a $1.2 billion allowance increase in RFS during the first quarter, related to further estimated deterioration in the Washington Mutual prime and option ARM purchased credit-impaired pools. While RFS delinquencies and credit losses improved as compared to the prior quarter, they remain at elevated levels and a growing series of environmental, regulatory, and legislative challenges continue to present significant risk to credit performance, primarily in the Home Lending portfolio. After consideration of these factors, the RFS allowance for loan losses was essentially flat to the prior quarter.

The wholesale allowance for loan losses was down by $2.0 billion from December 31, 2009. The decrease was primarily due to net repayments, loan sales, refinements to credit loss estimates, and improvement in the credit quality of the commercial and industrial portfolio.

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The allowance for lending-related commitments for both wholesale and consumer, which is reported in other liabilities, was $912 million and $939 million at June 30, 2010, and December 31, 2009. The decrease primarily reflects lower wholesale commitment levels.

The credit ratios in the table below are based on retained loan balances, which exclude loans held-for-sale and loans accounted for at fair value. As of June 30, 2010 and 2009, wholesale retained loans were $213.0 billion and $224.1 billion, respectively; and consumer retained loans were $482.2 billion and $447.0 billion, respectively. For the six months ended June 30, 2010 and 2009, average wholesale retained loans were $210.3 billion and $233.9 billion, respectively; and average consumer retained loans were $498.5 billion and $464.1 billion, respectively. Excluding held-for-sale loans, loans carried at fair value, and purchased credit-impaired consumer loans, the allowance for loan losses represented 5.34% of loans at June 30, 2010, compared with 5.01% at June 30, 2009.

Summary of changes in the allowance for credit losses

	2010			2009		
Six months ended June 30, (in millions)	Wholesale	Consumer	Total	Wholesale	Consumer	Total
Allowance for loan losses						
Beginning balance at January 1,	**$7,145**	**$24,457**	**$31,602**	$6,545	$16,619	$23,164
Cumulative effect of change in accounting principles[(a)]	**14**	**7,480**	**7,494**			
Gross charge-offs[(a)]	**1,278**	**13,374**	**14,652**	903	10,034	10,937
Gross (recoveries)[(a)]	**(88)**	**(940)**	**(1,028)**	(33)	(489)	(522)
Net charge-offs[(a)]	**1,190**	**12,434**	**13,624**	870	9,545	10,415
Provision for loan losses[(a)]	**(812)**	**11,183**	**10,371**	2,692	13,848	16,540
Other[(b)]	**(9)**	**2**	**(7)**	25	(242)	(217)
Ending balance at June 30	**$5,148**	**$30,688**	**$35,836**	$8,392	$20,680	$29,072
Components:						
Asset-specific[(c)(d)]	**$1,324**	**$ 1,161**	**$ 2,485**	$2,108	$ 801	$ 2,909
Formula-based[(a)(e)]	**3,824**	**26,716**	**30,540**	6,284	19,879	26,163
Purchased credit-impaired		**2,811**	**2,811**			
Total allowance for loan losses	**$5,148**	**$30,688**	**$35,836**	$8,392	$20,680	$29,072
Allowance for lending-related commitments						
Beginning balance at January 1,	**$ 927**	**$ 12**	**$ 939**	$ 634	$ 25	$ 659
Cumulative effect of change in accounting principles[(a)]	**(18)**		**(18)**			
Provision for lending-related commitments[(a)]	**4**	**(2)**	**2**	82	5	87
Other	**(11)**		**(11)**	3	(3)	

Ending balance at June 30	**$ 902**	**$ 10**	**$ 912**	$ 719	$ 27	$ 746
Components:						
Asset-specific	**$ 248**	**$**	**$ 248**	$ 111	$	$ 111
Formula-based	**654**	**10**	**664**	608	27	635
Total allowance for lending-related commitments	**$ 902**	**$ 10**	**$ 912**	$ 719	$ 27	$ 746
Total allowance for credit losses	**$6,050**	**$30,698**	**$36,748**	$9,111	$20,707	$29,818
Credit ratios						
Allowance for loan losses to retained loans	**2.42%**	**6.36%**	**5.15%**	3.75%	4.63%	4.33%
Allowance for loan losses to retained nonperforming loans(f)	**97**	**292**	**227**	144	234	198
Allowance for loan losses to retained nonperforming loans excluding credit card	**97**	**154**	**135**	144	134	138
Net charge-off rates(g)	**1.14**	**5.03**	**3.88**	0.75	4.15	3.01
Credit ratios excluding home lending purchased credit-impaired loans and loans held by the Washington Mutual Master Trust						
Allowance for loan losses to retained loans(h)	**2.42**	**6.88**	**5.34**	3.75	5.80	5.01
Allowance for loan losses to retained nonperforming loans(f)(h)	**97**	**265**	**209**	144	234	198
Allowance for loan losses to retained nonperforming loans excluding credit card(f)(h)	**97**	**127**	**117**	144	134	138

(a) Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon the adoption of the new guidance, the Firm consolidated its Firm-sponsored credit card securitization

trusts, its Firm-administered multi-seller conduits and certain other consumer loan securitization entities, primarily mortgage-related. As a result $7.4 billion, $14 million and $127 million of allowance for loan losses were recorded on-balance sheet associated with the Firm-sponsored credit card securitization trusts, Firm-administered multi-seller conduits, and

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certain other consumer loan securitization entities, primarily mortgage-related, respectively. For further discussion, see Note 15 on pages 151-153 of this Form 10-Q.

(b) *Other predominantly includes a reclassification in 2009 related to the issuance and retention of securities from the Chase Issuance Trust.*

(c) *Relates to risk-rated loans that have been placed on nonaccrual status and loans that have been modified in a troubled debt restructuring.*

(d) *The asset-specific consumer allowance for loan losses includes troubled debt restructuring reserves of $946 million and $603 million at June 30, 2010 and 2009, respectively. Prior-period amounts have been reclassified from formula-based to* *conform with the current period presentation.*

(e) *Includes all of the Firm s allowance for loan losses on credit card loans, including those for which the Firm has modified the terms of the loans for borrowers experiencing financial difficulty.*

(f) *The Firm s policy is generally to exempt credit card loans from being placed on nonaccrual status as permitted by regulatory guidance issued by the FFIEC, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), whichever is earlier. The allowance for loan losses on credit card loans was $14.5 billion and $8.8 billion as of June 30, 2010 and 2009, respectively.*

(g)

Charge-offs are not recorded on purchased credit-impaired loans until actual losses exceed estimated losses recorded as purchase accounting adjustments at the time of acquisition. To date, no charge-offs have been recorded for any of these loans.

(h) Excludes the impact of home lending purchased credit-impaired loans acquired as part of the Washington Mutual transaction. The allowance for loan losses on home lending purchased credit-impaired loans was $2.8 billion and zero as of June 30, 2010 and 2009, respectively.

For more information on home lending purchased credit-impaired loans, see pages 87-89 and Note 13 on pages 149-150 of this Form 10-Q and pages 116-117 of JPMorgan Chase s 2009 Annual Report.

The calculation of the allowance for loan losses to total retained loans, excluding home lending purchased credit-impaired loans and loans held by the WMMT, is presented below.

June 30, (in millions, except ratios)	**2010**	2009
Allowance for loan losses	**$ 35,836**	$ 29,072
Less: Allowance for purchased credit-impaired loans	**2,811**	
Adjusted allowance for loan losses	**$ 33,025**	$ 29,072
Total loans retained	**$695,210**	$671,116
Less: Firmwide purchased credit-impaired loans	**76,995**	90,628

Adjusted loans	**$618,215**	$580,488
Allowance for loan losses to ending loans, excluding purchased credit-impaired loans and loans held by the Washington Mutual Master Trust	**5.34%**	5.01%

The following table presents the allowance for credit losses by business segment at June 30, 2010, and December 31, 2009.

	Allowance for credit losses					
	June 30, 2010			December 31, 2009		
(in millions)	Loan losses	Lending-related commitments	Total	Loan losses	Lending-related commitments	Total
Investment Bank[(a)]	**$ 2,149**	**$ 564**	**$ 2,713**	$ 3,756	$ 485	$ 4,241
Commercial Banking	**2,686**	**267**	**2,953**	3,025	349	3,374
Treasury & Securities Services	**48**	**68**	**116**	88	84	172
Asset Management	**250**	**3**	**253**	269	9	278
Corporate/Private Equity	**15**		**15**	7		7
Total Wholesale	**5,148**	**902**	**6,050**	7,145	927	8,072
Retail Financial Services[(a)]	**16,152**	**10**	**16,162**	14,776	12	14,788
Card Services[(a)]	**14,524**		**14,524**	9,672		9,672
Corporate/Private Equity	**12**		**12**	9		9
Total Consumer	**30,688**	**10**	**30,698**	24,457	12	24,469
Total	**$35,836**	**$ 912**	**$36,748**	$31,602	$ 939	$32,541

(a) Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon the adoption of the new guidance, the Firm consolidated its Firm-sponsored credit card securitization trusts, its Firm-administered multi-seller conduits and certain other consumer loan securitization entities, primarily

mortgage-related. As a result, related receivables are now recorded in loans on the Consolidated Balance Sheet. As a result, $7.4 billion, $14 million and $127 million of allowance for loan losses were recorded on-balance sheet associated with the Firm-sponsored credit card securitization trusts, Firm-administered multi-seller conduits, and certain other consumer loan securitization entities, primarily mortgage-related, respectively. For further discussion, see Note 15 on pages 151-163 of this Form 10-Q.

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Provision for credit losses

The provision for credit losses was $3.4 billion for the three months ended June 30, 2010, down by $6.3 billion or 65% from the prior-year provision. The total consumer provision for credit losses was $3.9 billion, compared with $8.5 billion in the prior year, reflecting a reduction in the allowance for credit losses as a result of improved delinquency trends and reduced net charge-offs across most consumer portfolios. The wholesale provision for credit losses was a benefit of $572 million, compared with an expense of $1.2 billion, reflecting a reduction in the allowance for credit losses due to net repayments, loan sales, refinements to credit loss estimates, and improvement in the credit quality of the commercial and industrial portfolio.

	Provision for loan losses		Provision for lending-related commitments		Total provision for credit losses	
Three months ended June 30, (in millions)	**2010**	2009	**2010**	2009	**2010**	2009
Investment Bank[a]	**$ (418)**	$ 815	**$ 93**	$ 56	**$ (325)**	$ 871
Commercial Banking	**(143)**	280	**(92)**	32	**(235)**	312
Treasury & Securities Services	**(8)**	(20)	**(8)**	15	**(16)**	(5)
Asset Management	**15**	59	**(10)**		**5**	59
Corporate/Private Equity	**(1)**	7			**(1)**	7
Total wholesale	**(555)**	1,141	**(17)**	103	**(572)**	1,244
Retail Financial Services[a]	**1,715**	3,841		5	**1,715**	3,846
Card Services reported[a]	**2,221**	2,939			**2,221**	2,939
Corporate/Private Equity	**(1)**	2			**(1)**	2
Total consumer	**3,935**	6,782		5	**3,935**	6,787
Total provision for credit losses reported	**3,380**	7,923	**(17)**	108	**3,363**	8,031
Credit card securitized[a][b]	**NA**	1,664	**NA**		**NA**	1,664
Total provision for credit losses managed[a]	**$ 3,380**	$ 9,587	**$ (17)**	$ 108	**$ 3,363**	$ 9,695

	Provision for loan losses		Provision for lending-related commitments		Total provision for credit losses	
Six months ended June 30, (in millions)	**2010**	2009	**2010**	2009	**2010**	2009
Investment Bank[a]	**$ (895)**	$ 2,089	**$ 108**	$ (8)	**$ (787)**	$ 2,081
Commercial Banking	**61**	543	**(82)**	62	**(21)**	605
Treasury & Securities Services	**(39)**	(40)	**(16)**	29	**(55)**	(11)
Asset Management	**46**	93	**(6)**	(1)	**40**	92
Corporate/Private Equity	**15**	7			**15**	7
Total wholesale	**(812)**	2,692	**4**	82	**(808)**	2,774

Retail Financial Services*(a)*	**5,450**	7,718	**(2)**	5	**5,448**	7,723
Card Services reported*(a)*	**5,733**	6,128			**5,733**	6,128
Corporate/Private Equity		2				2
Total consumer	**11,183**	13,848	**(2)**	5	**11,181**	13,853
Total provision for credit losses reported	**10,371**	16,540	**2**	87	**10,373**	16,627
Credit card securitized*(a)(b)*	**NA**	3,128	**NA**		**NA**	3,128
Total provision for credit losses managed*(a)*	**$10,371**	$19,668	**$ 2**	$ 87	**$10,373**	$19,755

(a) Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon the adoption of the new guidance, the Firm consolidated its Firm-sponsored credit card securitization trusts, its Firm-administered multi-seller conduits and certain other consumer loan securitization entities, primarily mortgage-related. As a result of the consolidation of the credit card securitization trusts, reported and managed basis are comparable for periods beginning after January 1, 2010. For further discussion, see Explanation and Reconciliation of the Firm s Use of Non-GAAP Financial Measures on pages

15-19 of this Form 10-Q.

(b) *Loans securitized are defined as loans that were sold to unconsolidated securitization trusts and were not included in reported loans. For further discussion of credit card securitizations, see Note 15 on pages 151-163 of this Form 10-Q.*

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MARKET RISK MANAGEMENT

For discussion of the Firm s market risk management organization, major market risk drivers and classification of risks, see pages 118-124 of JPMorgan Chase s 2009 Annual Report.

Value-at-risk (VaR)

JPMorgan Chase s primary statistical risk measure, VaR, estimates the potential loss from adverse market moves in a normal market environment and provides a consistent cross-business measure of risk profiles and levels of diversification. VaR is used for comparing risks across businesses, for monitoring limits and as an input to economic-capital calculations. Each business day, as part of its risk management activities, the Firm undertakes a comprehensive VaR calculation that includes the majority of its market risks. These VaR results are reported to senior management.

To calculate VaR, the Firm uses historical simulation, based on a one-day time horizon and an expected tail-loss methodology, which measures risk across instruments and portfolios in a consistent and comparable way. The simulation is based on data for the previous 12 months. This approach assumes that historical changes in market values are representative of future changes; this assumption may not always be accurate, particularly when there is volatility in the market environment. For certain products, such as syndicated lending facilities and some mortgage-related securities for which price-based time series are not readily available, market-based data are used in conjunction with sensitivity factors to estimate the risk. It is likely that using an actual price-based time series for these products, if available, would affect the VaR results presented. In addition, certain risk parameters, such as correlation risk among certain instruments, are not fully captured in VaR.

The following section describes JPMorgan Chase s VaR measure using a 95% confidence level.

95% Confidence Level VaR

Total IB trading VaR by risk type, credit portfolio VaR and other VaR

	Three months ended June 30,								Six months ended June 30,	
	2010			2009			At June 30,		Average	
(in millions)	Avg.	Min	Max	Avg.	Min	Max	**2010**	2009	**2010**	2009
IB VaR by risk type:										
Fixed income	**$ 64**	**$ 33**	**$ 95**	$ 179	$ 144	$ 207	**$ 87**	$ 186	**$ 66**	$ 168
Foreign exchange	**10**	**7**	**18**	16	10	27	**11**	12	**12**	19
Equities	**20**	**12**	**32**	50	13	132	**23**	36	**22**	73
Commodities and other	**20**	**12**	**32**	22	15	30	**12**	17	**18**	21
Diversification benefit to IB trading VaR	**(42)**[a]	**NM**[b]	**NM**[b]	(97)[a]	NM[b]	NM[b]	**(42)**[a]	(87)[a]	**(46)**[a]	(101)[a]
IB trading VaR	**$ 72**	**$ 40**	**$ 107**	$ 170	$ 149	$ 213	**$ 91**	$ 164	**$ 72**	$ 180
Credit portfolio VaR	**27**	**18**	**40**	68	36	99	**29**	38	**23**	77
Diversification benefit to IB trading and credit portfolio VaR	**(9)**[a]	**NM**[b]	**NM**[b]	(60)[a]	NM[b]	NM[b]	**(9)**[a]	(44)[a]	**(9)**[a]	(62)[a]
Total IB trading and credit	**$ 90**	**$ 50**	**$ 128**	$ 178	$ 139	$ 231	**$ 111**	$ 158	**$ 86**	$ 195

portfolio VaR										
Mortgage Banking VaR	**24**	**12**	**42**	43	31	66	**19**	40	**25**	75
Chief Investment Office (CIO) VaR	**72**	**55**	**79**	111	98	125	**55**	102	**71**	116
Diversification benefit to total other VaR	**(14)**[(a)]	**NM**[(b)]	**NM**[(b)]	(29)[(a)]	NM[(b)]	NM[(b)]	**(12)**[(a)]	(26)[(a)]	**(14)**[(a)]	(45)[(a)]
Total other VaR	**$ 82**	**$ 55**	**$ 97**	$125	$110	$144	**$ 62**	$116	**$ 82**	$ 146
Diversification benefit to total IB and other VaR	**(79)**[(a)]	**NM**[(b)]	**NM**[(b)]	(89)[(a)]	NM[(b)]	NM[(b)]	**(59)**[(a)]	(92)[(a)]	**(73)**[(a)]	(91)[(a)]
Total IB and other VaR	**$ 93**	**$ 66**	**$133**	$214	$172	$263	**$114**	$182	**$ 95**	$ 250

(a) *Average VaR and period-end VaR were less than the sum of the VaR of the components described above, which is due to portfolio diversification. The diversification effect reflects the fact that the risks were not perfectly correlated. The risk of a portfolio of positions is therefore usually less than the sum of the risks of the positions themselves.*

(b) *Designated as not meaningful (NM), because the minimum and maximum may occur on different days for different risk components, and hence it is not meaningful to compute a portfolio-diversification effect.*

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VaR Measurement

The Firm s IB trading and other VaR measure above includes substantially all trading activities in IB, as well as syndicated lending facilities that the Firm intends to distribute. Credit portfolio VaR includes VaR on derivative CVA, hedges of the CVA and MTM hedges of the retained loan portfolio, which are all reported in principal transactions revenue. Credit portfolio VaR does not include the retained loan portfolio, which is not MTM. In addition, IB and other VaR measure include certain positions used as part of the Firm s risk management function within the CIO and in the Mortgage Banking businesses. The CIO VaR includes positions, primarily in debt securities and credit products, used to manage the Firm s risk concentrations, including interest rate and credit risks arising from the Firm s ongoing business activities. The Mortgage Banking VaR includes the Firm s mortgage pipeline and warehouse loans, MSRs and all related hedges.

The VaR measure excludes the DVA taken on certain structured liabilities and derivatives to reflect the credit quality of the Firm. It also excludes certain activities such as Private Equity and principal investing (e.g., mezzanine financing, tax-oriented investments, etc.), as well as structural interest rate risk-management positions, capital management positions, and longer-term investments managed by the CIO. These longer-term positions are managed through the Firm s earnings-at-risk and other cash flow-monitoring processes rather than by using a VaR measure. Principal investing activities and Private Equity positions are managed using stress and scenario analysis.

2010 and 2009 second-quarter and year-to-date VaR results

As presented in the table on the previous page, total average IB and other VaR for the second quarter and first half of 2010 was $93 million and $95 million, respectively, compared with $214 million in the second quarter and $250 million in the first half of 2009. The decrease in average VaR for the second quarter and first half of 2010 was driven by a decline in the impact of the market volatility experienced in early 2009, as well as a reduction in exposures primarily in IB. Average total IB trading and credit portfolio VaR for the second quarter of 2010 was $90 million, compared with $178 million for the same prior year period. The decrease in IB trading VaR for the second quarter and first half of 2010 was driven by a decline in the impact of market volatility, as well as a reduction in exposures, primarily in the fixed income and equities risk components. CIO VaR averaged $72 million for the second quarter of 2010, compared with $111 million for the same prior year period. Mortgage Banking VaR averaged $24 million for the current quarter, compared with $43 million for the same prior year period. Decreases for the second quarter and first half of 2010 were again driven by the decline in market volatility.

Average IB and other VaR diversification benefit was 46% of the sum for the second quarter of 2010, compared with 29% of the sum for the second quarter of 2009. The Firm experienced a gain in diversification benefit as the market crisis receded, markets started to recover and positions changed such that correlations decreased. In general, over the course of the year, VaR exposures can vary significantly as positions change, market volatility fluctuates and diversification benefits change.

VaR back-testing

To evaluate the soundness of its VaR model the Firm conducts daily back-testing of VaR against the Firm s market risk-related revenue, which is defined as: the change in value of principal transactions revenue for IB and CIO; trading-related net interest income for IB, CIO and Mortgage Banking; IB brokerage commissions, underwriting fees or other revenue; revenue from syndicated lending facilities that the Firm intends to distribute; and mortgage fees and related income for the Firm s mortgage pipeline and warehouse loans, MSRs, and all related hedges. The daily firmwide market risk-related revenue excludes gains and losses from DVA and from longer-term corporate investments and Private Equity losses.

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The following histogram illustrates the daily market risk-related gains and losses for IB, CIO and Mortgage Banking positions for the first six months of 2010. The chart shows that the Firm posted market risk-related gains on 121 out of 129 days in this period, with 10 days exceeding $200 million. The inset graph looks at those days on which the Firm experienced losses and depicts the amount by which the 95% confidence level VaR exceeded the actual loss on each of those days. Losses were sustained on eight days during the six months ended June 30, 2010, none of which exceeded the VaR measure.

The following table provides information about the gross sensitivity of DVA to a one-basis-point increase in JPMorgan Chase s credit spreads. This sensitivity represents the impact from a one-basis-point parallel shift in JPMorgan Chase s entire credit curve. As credit curves do not typically move in a parallel fashion, the sensitivity multiplied by the change in spreads at a single maturity point may not be representative of the actual revenue recognized.

Debit valuation adjustment sensitivity

(in millions)	Change in revenue based upon a 1-basis-point increase in JPMorgan Chase credit spread
June 30, 2010	**$33**
December 31, 2009	39

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Economic value stress testing

While VaR reflects the risk of loss due to adverse changes in normal markets, stress testing captures the Firm s exposure to unlikely but plausible events in abnormal markets. The Firm conducts economic-value stress tests using multiple scenarios that assume credit spreads widen significantly, equity prices decline and significant changes in interest rates across the major currencies. Other scenarios focus on the risks predominant in individual business segments and include scenarios that focus on the potential for adverse movements in complex portfolios. Scenarios were updated more frequently in 2009 and, in some cases, redefined to reflect the significant market volatility which began in late 2008. Along with VaR, stress testing is important in measuring and controlling risk. Stress testing enhances the understanding of the Firm s risk profile and loss potential, and stress losses are monitored against limits. Stress testing is also utilized in one-off approvals and cross-business risk measurement, as well as an input to economic capital allocation. Stress-test results, trends and explanations based on current market risk positions are reported to the Firm s senior management and to the lines of business to help them better measure and manage risks and to understand event risk-sensitive positions.

Earnings-at-risk stress testing

The VaR and stress-test measures described above illustrate the total economic sensitivity of the Firm s Consolidated Balance Sheets to changes in market variables. The effect of interest-rate exposure on net income for the Firm s core nontrading business activities is also important. For further discussion on the effect of interest rate exposure, see page 123 of JPMorgan Chase s 2009 Annual Report.

The Firm conducts simulations of changes in net interest income from its nontrading activities under a variety of interest rate scenarios. Earnings-at-risk tests measure the potential change in the Firm s net interest income, and the corresponding impact to the Firm s pretax earnings, over the following 12 months. These tests highlight exposures to various rate-sensitive factors, such as the rates themselves (e.g., the prime lending rate), pricing strategies on deposits, optionality and changes in product mix. The tests include forecasted balance sheet changes, such as asset sales and securitizations, as well as prepayment and reinvestment behavior.

Immediate changes in interest rates present a limited view of risk, and so a number of alternative scenarios are also reviewed. These scenarios include the implied forward curve, nonparallel rate shifts and severe interest rate shocks on selected key rates. These scenarios are intended to provide a comprehensive view of JPMorgan Chase s earnings at risk over a wide range of outcomes. JPMorgan Chase s 12-month pretax earnings sensitivity profiles as of June 30, 2010, and December 31, 2009, were as follows.

	Immediate change in rates			
(in millions)	+200bp	+100bp	-100bp	-200bp
June 30, 2010	**$ 1,276**	**$ 947**	**NM**[(a)]	**NM**[(a)]
December 31, 2009	(1,594)	(554)	NM[(a)]	NM[(a)]

(a) Downward 100- and 200-basis-point parallel shocks result in a Fed Funds target rate of zero and negative three- and six-month treasury rates. The earnings-at-risk results of such a

low-probability scenario are not meaningful.

The change in earnings at risk from December 31, 2009, resulted from investment portfolio repositioning, assumed higher levels of deposit balances and reduced levels of fixed-rate loans. The Firm s risk to rising rates was largely the result of widening deposit margins, which are currently compressed due to very low short-term interest rates. Additionally, under another interest rate scenario used by the Firm, involving a steeper yield curve, with long-term rates rising by 100 basis points and short-term rates staying at current levels, would result in a 12-month pretax earnings benefit of $605 million. The increase in earnings under this scenario would be due to reinvestment of maturing assets at the higher long-term rates, with funding costs remaining unchanged.

PRIVATE EQUITY RISK MANAGEMENT

For a discussion of Private Equity Risk Management, see page 124 of JPMorgan Chase s 2009 Annual Report. At June 30, 2010, and December 31, 2009, the carrying value of the Private Equity portfolio was $8.1 billion and $7.3 billion, respectively, of which $873 million and $762 million, respectively, represented securities with publicly available market quotations.

OPERATIONAL RISK MANAGEMENT

For a discussion of JPMorgan Chase s Operational Risk Management, see page 125 of JPMorgan Chase s 2009 Annual Report.

REPUTATION AND FIDUCIARY RISK MANAGEMENT

For a discussion of the Firm s Reputation and Fiduciary Risk Management, see page 126 of JPMorgan Chase s 2009 Annual Report.

SUPERVISION AND REGULATION

The following discussion should be read in conjunction with the Supervision and Regulation section on pages 1-4 of JPMorgan Chase s 2009 Form 10-K. On July 21, 2010, President Obama signed into law the Dodd-Frank Act which will make significant structural reforms to the financial services industry. For additional information regarding the Dodd-Frank Act, please see Part II Other Information, Item 1A Risk Factors on pages 196-197 of this Form 10-Q.

Dividends

At June 30, 2010, JPMorgan Chase s bank subsidiaries could pay, in the aggregate, $6.8 billion in dividends to their respective bank holding companies without the prior approval of their relevant banking regulators.

CRITICAL ACCOUNTING ESTIMATES USED BY THE FIRM

JPMorgan Chase s accounting policies and use of estimates are integral to understanding its reported results. The Firm s most complex accounting estimates require management s judgment to ascertain the value of assets and liabilities. The Firm has established detailed policies and control procedures intended to ensure that valuation methods, including any judgments made as part of such methods, are well-controlled, independently reviewed and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. The Firm believes its estimates for determining the value of its assets and liabilities are appropriate. The following is a brief description of the Firm s critical accounting estimates involving significant valuation judgments.

Allowance for credit losses

JPMorgan Chase s allowance for credit losses covers the retained wholesale and consumer loan portfolios, as well as the Firm s portfolio of lending-related commitments. The allowance for loan losses is intended to adjust the value of the Firm s loan assets to reflect probable credit losses as of the balance sheet date. For a further discussion of the methodologies used in establishing the Firm s allowance for credit losses, see Note 14 on pages 196-198 of JPMorgan Chase s 2009 Annual Report. The methodology for calculating the allowance for loan losses and the allowance for lending-related commitments involves significant judgment. For a further description of these judgments, see Allowance for Credit Losses on pages 127-128 of JPMorgan Chase s 2009 Annual Report; for amounts recorded as of June 30, 2010 and 2009, see Allowance for Credit Losses on pages 91-94 and Note 14 on pages 150-151 of this Form 10-Q.

As noted on page 127 of JPMorgan Chase s 2009 Annual Report, many factors can affect estimates of loss, including volatility of loss given default, probability of default and rating migrations. The Firm uses a risk-rating system to determine the credit quality of its wholesale loans. The Firm s wholesale allowance is sensitive to the risk rating assigned to a loan. As of June 30, 2010, assuming a one-notch downgrade in the Firm s internal risk ratings for its entire wholesale portfolio, the allowance for loan losses for the wholesale portfolio would increase by approximately $1.2 billion. This sensitivity analysis is hypothetical and intended to provide an indication of the impact of risk ratings on the estimate of the allowance for loan losses for wholesale loans. In the Firm s view, the likelihood of a one-notch downgrade for all wholesale loans within a short timeframe is remote, and it is not intended to imply management s expectation of future deterioration in risk ratings. Given the process the Firm follows in determining the risk ratings of its loans, management believes the risk ratings currently assigned to wholesale loans are appropriate.

The allowance for credit losses for the consumer portfolio is sensitive to changes in the economic environment, delinquency status, FICO scores, the realizable value of collateral, borrower behavior and other risk factors. The credit performance of the consumer portfolio across the entire consumer credit product spectrum appears to have stabilized but remains under stress, as high unemployment and weak overall economic conditions continue to result in a high level of delinquencies, while continued weak housing prices continue to result in elevated loss severities. Significant judgment is required to estimate the ultimate duration and severity of the current economic downturn, as well as its impact on housing prices and the labor market. While the allowance for credit losses is highly sensitive to both home prices and unemployment rates, in the current market it is difficult to estimate how potential changes in one or both of these factors might impact the allowance for credit losses. For example, while both factors are important determinants of overall allowance levels, changes in one factor or the other may not occur at the same rate, or improvement in one factor may offset deterioration in the other. In addition, changes in these factors would not necessarily be consistent across geographies or product types. Finally, it is difficult to predict the extent to which changes in both or either of these factors would ultimately impact the frequency or severity of losses, and overall loss rates are a function of both the frequency and severity of individual loan losses.

Fair value of financial instruments, MSRs and commodities inventory

JPMorgan Chase carries a portion of its assets and liabilities at fair value. The majority of such assets and liabilities are measured at fair value on a recurring basis. Certain assets and liabilities are measured at fair value on a nonrecurring basis, including loans accounted for at the lower of cost or fair value that are only subject to fair value adjustments under certain circumstances.

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Assets measured at fair value

The following table includes the Firm s assets measured at fair value and the portion of such assets that are classified within level 3 of the valuation hierarchy.

	June 30, 2010		December 31, 2009	
(in billions)	Total at fair value	Level 3 total	Total at fair value	Level 3 total
Trading debt and equity instruments[a]	**$ 317.3**	**$ 35.2**	$ 330.9	$ 35.2
Derivative receivables gross	**1,810.3**	**45.8**	1,565.5	46.7
Netting adjustment	**(1,730.1)**		(1,485.3)	
Derivative receivables net	**80.2**	**45.8**[d]	80.2	46.7[d]
AFS securities	**312.0**	**12.7**	360.4	13.2
Loans	**2.4**	**1.1**	1.4	1.0
MSRs	**11.9**	**11.9**	15.5	15.5
Private equity investments	**8.1**	**7.2**	7.3	6.6
Other[b]	**44.9**	**4.3**	44.4	9.5
Total assets measured at fair value on a recurring basis	**776.8**	**118.2**	840.1	127.7
Total assets measured at fair value on a nonrecurring basis[c]	**6.6**	**1.7**	8.2	2.7
Total assets measured at fair value	**$ 783.4**	**$ 119.9**[e]	$ 848.3	$ 130.4[e]
Total Firm assets	**$ 2,014.0**		$ 2,032.0	
Level 3 assets as a percentage of total Firm assets		**6%**		6%
Level 3 assets as a percentage of total Firm assets at fair value		**15**		15

(a) Includes physical commodities generally carried at the lower of cost or fair value.

(b) Includes certain securities purchased under resale agreements, securities borrowed, assets within accrued interest

and other investments.

(c) *Predominantly includes delinquent mortgage and home equity loans, where impairment is based on the fair value of the underlying collateral, and on leveraged lending loans carried on the Consolidated Balance Sheets at the lower of cost or fair value.*

(d) *Derivative receivable and derivative payable balances, and the related cash collateral received and paid, are presented net on the Consolidated Balance Sheets where there is a legally enforceable master netting agreement in place with counterparties. For purposes of the table above, the Firm does not reduce derivative receivable and derivative payable* *balances for netting adjustments, either within or across the levels of the fair value hierarchy, as such an adjustment is not relevant to a presentation that is based on the transparency of inputs to the valuation of an asset or liability. Therefore, the derivative balances reported in the fair value hierarchy levels are gross of any counterparty netting adjustments. However, if the Firm were to net such balances within level 3, the reduction in the level 3 derivative receivable and payable balances would be $19.0 billion and $16.0 billion at June 30, 2010, and December 31, 2009, respectively, exclusive of the netting benefit associated with cash collateral, which would* *further reduce the level 3 balances.*

(e) *Included in the table above at June 30, 2010, and December 31, 2009, are $77.5 billion and $80.0 billion, respectively, of level 3 assets, consisting of recurring and nonrecurring assets carried by IB.*

Valuation

For instruments classified within level 3 of the hierarchy, judgments used to estimate fair value may be significant. In arriving at an estimate of fair value for an instrument within level 3, management must first determine the appropriate model to use. Second, due to the lack of observability of significant inputs, management must assess all relevant empirical data in deriving valuation inputs including, but not limited to, yield curves, interest rates, volatilities, equity or debt prices, foreign exchange rates and credit curves. In addition to market information, models also incorporate transaction details, such as maturity. Finally, management judgment must be applied to assess the appropriate level of valuation adjustments to reflect counterparty credit quality, the Firm s creditworthiness, constraints on liquidity and unobservable parameters, where relevant. The judgments made are typically affected by the type of product and its specific contractual terms, as well as the level of liquidity for the product or within the market as a whole. For further discussion of changes in level 3 assets, see Note 3 on pages 110-124 of this Form 10-Q.

Imprecision in estimating unobservable market inputs can affect the amount of revenue or loss recorded for a particular position. Furthermore, while the Firm believes its valuation methods are appropriate and consistent with those of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. For a detailed discussion of the determination of fair value for individual financial instruments, see Note 3 on pages 148-152 of JPMorgan Chase s 2009 Annual Report. In addition, for a further discussion of the significant judgments and estimates involved in the determination of the Firm s mortgage-related exposures, see Mortgage-related exposures carried at fair value in Note 3 on pages 161-162 of JPMorgan Chase s 2009 Annual Report.

Purchased credit-impaired loans

In connection with the Washington Mutual transaction, JPMorgan Chase acquired certain loans with evidence of deterioration of credit quality since origination and for which it was probable, at acquisition, that the Firm would be unable to collect all contractually required payments receivable. These purchased credit-impaired loans are accounted for on a pool basis, and the pools are considered to be performing. At the time of the acquisition, these loans were recorded at fair value, including an estimate of losses that were expected to be incurred over the estimated remaining lives of the loan pools. Many of the assumptions and estimates underlying the estimation of the initial fair value and the ongoing updates to management s expectation of future cash flows are both significant and subjective, particularly considering the current economic environment. The level of future home price declines, the duration and severity of the current economic downturn, the impact of various government programs and actions, uncertainties about borrower behavior, and the lack of market liquidity and transparency are factors that have influenced, and may continue to affect, these assumptions and estimates.

In accounting for these loans on an ongoing basis, probable decreases in expected loan principal cash flows trigger the recognition of impairment, while probable and significant increases in expected principal cash flows would first trigger the reversal of any previously recorded allowance for loan losses; any remaining increases would be recognized prospectively as yield adjustments. The impact of (i) prepayments, (ii) changes in variable interest rates and (iii) any other changes in the timing of expected cash flows would be recognized prospectively as yield adjustments. The process to determine which changes in cash flows trigger the recognition of impairment, and which changes in cash flows should be recognized as yield adjustments, requires the application of judgment. As of June 30, 2010, a 1% decrease in expected future principal cash payments for the entire portfolio of purchased credit-impaired loans would result in the recognition of an allowance for loan losses for these loans of approximately $730 million. For additional information on purchased credit-impaired loans, including the significant assumptions, estimates and judgment involved, see Purchased credit-impaired loans on pages 129 130 of JPMorgan Chase s 2009 Annual Report and Note 13 on pages 149-150 of this Form 10-Q.

Goodwill impairment

Management applies significant judgment when testing goodwill for impairment. For a description of the significant valuation judgments associated with goodwill impairment, see Goodwill impairment on page 130 of JPMorgan Chase s 2009 Annual Report.

During the six months ended June 30, 2010, the Firm updated the discounted cash flow valuations of certain consumer lending businesses in RFS and CS, which continue to have elevated risk for goodwill impairment due to their exposure to U.S. consumer credit risk and the effects of regulatory and legislative changes. The assumptions used in the valuation of these businesses include a) estimates of future cash flows for the business (which are dependent on portfolio outstanding balances, net interest margin, operating expenses, credit losses and the amount of capital necessary given the risk of business activities and to meet regulatory capital requirements), and b) the cost of equity used to discount those cash flows to a present value. Each of these factors require significant judgment and the assumptions used are based on management s best and most current projections, including the anticipated effects of regulatory and legislative changes, derived from the Firm s business forecasting process reviewed with senior management. These projections are consistent with the short-term estimates addressed in the Business Outlook on pages 9-10 of this Form 10-Q, and in the longer term, incorporate a set of macroeconomic assumptions (for example, allowing for relatively high but gradually declining unemployment rates for the next few years) and the Firm s best estimates of long-term growth of its businesses. Where possible, the Firm uses third-party and peer data to benchmark its assumptions and estimates.

In addition, for its other businesses, the Firm reviewed current conditions (including the estimated effects of regulatory and legislative changes) and prior projections of business performance. Based upon the updated valuations for its consumer lending businesses and reviews of its other businesses, the Firm concluded that goodwill allocated to all of its reporting units was not impaired at June 30 and March 31, 2010. However, the fair value of the credit card lending business within CS and a consumer lending business within RFS exceeded their carrying values by narrow margins at June 30 and March 31, 2010 ranging from 3-15%. Deterioration in economic market conditions, increased estimates of the effects of recent regulatory or legislative changes, or additional regulatory or legislative changes may result in declines in projected business performance beyond management s expectations. For example, in CS, such declines could result from deterioration in economic conditions such as increased unemployment claims or bankruptcy filings that result in increased credit losses, changes in customer behavior that cause decreased account activity or receivable balances, or unanticipated effects of regulatory or legislative changes. In RFS, such declines could result

from deterioration in economic conditions that result in increased credit losses, including decreases in home prices beyond management expectations.
Such declines in business performance, or increases in the estimated cost of equity, could cause the estimated fair values of the Firm s reporting units or their associated goodwill to decline, which may result in a material impairment charge to earnings in a future period related to some portion of the associated goodwill.
For additional information on goodwill, see Note 16 on pages 164-167 of this Form 10-Q.
Income taxes
For a description of the significant assumptions, judgments and interpretations associated with the accounting for income taxes, see Income taxes on page 131 of JPMorgan Chase s 2009 Annual Report.

ACCOUNTING AND REPORTING DEVELOPMENTS

Accounting for transfers of financial assets and consolidation of variable interest entities

Effective January 1, 2010, the Firm implemented new accounting guidance that amends the accounting for the transfers of financial assets and the consolidation of VIEs. Upon adoption of the new guidance, the Firm consolidated its Firm-sponsored credit card securitization trusts, Firm-administered multi-seller conduits and certain mortgage and other consumer loan securitization entities. The Financial Accounting Standards Board (FASB) deferred the requirements of the new consolidation guidance for VIEs for certain investment funds, including mutual funds, private equity funds and hedge funds, until the FASB and the International Accounting Standards Board (IASB) complete a joint consolidation project that would provide consistent accounting guidance for these funds. For additional information about the impact of the adoption of the new consolidation guidance on January 1, 2010, see Note 15 on pages 151-163 of this Form 10-Q.

Fair value measurements and disclosures

In January 2010, the FASB issued guidance that requires new disclosures, and clarifies existing disclosure requirements, about fair value measurements. The clarifications and the requirement to separately disclose transfers of instruments between level 1 and level 2 of the fair value hierarchy are effective for interim reporting periods beginning after December 15, 2009; the Firm adopted this guidance in the first quarter of 2010. For additional information about the impact of the adoption of the new fair value measurements guidance, see Note 3 on pages 110-124 of this Form 10-Q. In addition, a new requirement to provide purchases, sales, issuances and settlements in the level 3 rollforward on a gross basis is effective for fiscal years beginning after December 15, 2010. Early adoption of the guidance is permitted.

Subsequent events

In May 2009, the FASB issued guidance that established general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The guidance was effective for interim or annual financial periods ending after June 15, 2009. In February 2010, the FASB amended the guidance by eliminating the requirement for SEC filers to disclose the date through which it evaluated subsequent events. The Firm adopted the amended guidance in the first quarter of 2010. The application of the guidance had no effect on the Firm s Consolidated Balance Sheets or results of operations.

Accounting for certain embedded credit derivatives

In March 2010, the FASB issued guidance clarifying the circumstances in which a credit derivative embedded in a beneficial interest in securitized financial assets is required to be separately accounted for as a derivative instrument. The guidance is effective for the first fiscal quarter beginning after June 15, 2010, with early adoption permitted. Upon adoption, the new guidance permits the election of the fair value option for any beneficial interest in securitized financial assets. Adoption of the new guidance will not have a material impact on the Firm s Consolidated Balance Sheets or results of operations.

Accounting for modifications of purchased credit-impaired loans that are part of a pool

In April 2010, the FASB issued guidance that amends the accounting for modifications of purchased credit-impaired loans accounted for within a pool. The guidance clarifies that modified purchased credit-impaired loans should not be removed from a pool even if the modification would otherwise be considered a troubled debt restructuring. Additionally, the guidance clarifies that the impact of modifications should be included in evaluating whether a pool of loans is impaired. The guidance is effective for modifications of purchased credit-impaired loans occurring in interim and annual reporting periods ending on or after July 15, 2010, and is to be applied prospectively. Early adoption is permitted. The guidance is consistent with the Firm s current accounting practice and, therefore, will have no impact on the Firm s Consolidated Balance Sheets or results of operations.

Disclosures about the credit quality of financing receivables and the allowance for credit losses

In July 2010, the FASB issued guidance that will require enhanced disclosures surrounding the credit characteristics of the Firm s loan portfolio. Under the new guidance, the Firm will be required to disclose its accounting policies, the methods it uses to determine the components of the allowance for credit losses, and qualitative and quantitative information about the credit risk inherent in the loan portfolio, including additional information on certain types of loan modifications. For the Firm, the new disclosures are effective for the 2010 Annual Report. The new disclosures on the rollforward of the allowance for credit losses and the new disclosures about troubled-debt modifications are effective for the first quarter 2011 Form 10-Q. The adoption of this guidance will only affect JPMorgan Chase s disclosures of financing receivables and not its Consolidated Balance Sheets or results of operations.

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JPMORGAN CHASE & CO.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in millions, except per share data)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Revenue				
Investment banking fees	**$ 1,421**	$ 2,106	**$ 2,882**	$ 3,492
Principal transactions	**2,090**	3,097	**6,638**	5,098
Lending- and deposit-related fees	**1,586**	1,766	**3,232**	3,454
Asset management, administration and commissions	**3,349**	3,124	**6,614**	6,021
Securities gains[(a)]	**1,000**	347	**1,610**	545
Mortgage fees and related income	**888**	784	**1,546**	2,385
Credit card income	**1,495**	1,719	**2,856**	3,556
Other income	**585**	10	**997**	60
Noninterest revenue	**12,414**	12,953	**26,375**	24,611
Interest income	**15,719**	16,549	**32,564**	34,475
Interest expense	**3,032**	3,879	**6,167**	8,438
Net interest income	**12,687**	12,670	**26,397**	26,037
Total net revenue	**25,101**	25,623	**52,772**	50,648
Provision for credit losses	**3,363**	8,031	**10,373**	16,627
Noninterest expense				
Compensation expense	**7,616**	6,917	**14,892**	14,505
Occupancy expense	**883**	914	**1,752**	1,799
Technology, communications and equipment expense	**1,165**	1,156	**2,302**	2,302
Professional and outside services	**1,685**	1,518	**3,260**	3,033
Marketing	**628**	417	**1,211**	801
Other expense	**2,419**	2,190	**6,860**	3,565
Amortization of intangibles	**235**	265	**478**	540
Merger costs		143		348
Total noninterest expense	**14,631**	13,520	**30,755**	26,893
Income before income tax expense	**7,107**	4,072	**11,644**	7,128
Income tax expense	**2,312**	1,351	**3,523**	2,266
Net income	**$ 4,795**	$ 2,721	**$ 8,121**	$ 4,862
Net income applicable to common stockholders	**$ 4,363**	$ 1,072	**$ 7,335**	$ 2,591

Net income per common share data

Basic earnings per share	**$ 1.10**	$ 0.28	**$ 1.84**	$ 0.68
Diluted earnings per share	**1.09**	0.28	**1.83**	0.68
Weighted-average basic shares	**3,983.5**	3,811.5	**3,977.0**	3,783.6
Weighted-average diluted shares	**4,005.6**	3,824.1	**4,000.2**	3,791.4
Cash dividends declared per common share	**$ 0.05**	$ 0.05	**$ 0.10**	$ 0.10

(a) The following other-than-temporary impairment losses are included in securities gains for the periods presented.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	**2010**	2009
Total losses	**$**	$ (882)	**$ (94)**	$ (887)
Losses recorded in/(reclassified from) other comprehensive income		696	**(6)**	696
Total credit losses recognized in income	**$**	$ (186)	**$ (100)**	$ (191)

The Notes to Consolidated Financial Statements (unaudited) are an integral part of these statements.

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JPMORGAN CHASE & CO.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in millions, except share data)	June 30, 2010	December 31, 2009
Assets		
Cash and due from banks	**$ 32,806**	$ 26,206
Deposits with banks	**39,430**	63,230
Federal funds sold and securities purchased under resale agreements (included $22,750 and $20,536 at fair value at June 30, 2010, and December 31, 2009, respectively)	**199,024**	195,404
Securities borrowed (included $11,924 and $7,032 at fair value at June 30, 2010, and December 31, 2009, respectively)	**122,289**	119,630
Trading assets (included assets pledged of $44,708 and $38,315 at June 30, 2010, and December 31, 2009, respectively)[(a)]	**397,508**	411,128
Securities (included $311,992 and $360,365 at fair value at June 30, 2010, and December 31, 2009, respectively, and assets pledged of $87,424 and $100,931 at June 30, 2010, and December 31, 2009, respectively)	**312,013**	360,390
Loans (included $2,362 and $1,364 at fair value at June 30, 2010, and December 31, 2009, respectively)[(a)]	**699,483**	633,458
Allowance for loan losses	**(35,836)**	(31,602)
Loans, net of allowance for loan losses	**663,647**	601,856
Accrued interest and accounts receivable (included zero and $5,012 at fair value at June 30, 2010, and December 31, 2009, respectively)	**61,295**	67,427
Premises and equipment	**11,267**	11,118
Goodwill	**48,320**	48,357
Mortgage servicing rights	**11,853**	15,531
Other intangible assets	**4,178**	4,621
Other assets (included $18,425 and $19,165 at fair value at June 30, 2010, and December 31, 2009, respectively)[(a)]	**110,389**	107,091
Total assets[(a)]	**$ 2,014,019**	$ 2,031,989
Liabilities		
Deposits (included $4,890 and $4,455 at fair value at June 30, 2010, and December 31, 2009, respectively)	**$ 887,805**	$ 938,367
Federal funds purchased and securities loaned or sold under repurchase agreements (included $6,013 and $3,396 at fair value at June 30, 2010, and December 31, 2009, respectively)	**237,455**	261,413
Commercial paper	**41,082**	41,794
Other borrowed funds (included $7,403 and $5,637 at fair value at June 30, 2010, and December 31, 2009, respectively)	**44,431**	55,740
Trading liabilities	**134,882**	125,071
Accounts payable and other liabilities (included the allowance for lending-related commitments of $912 and $939, respectively, at June 30, 2010, and December 31, 2009, and $450 and $357 at fair value at June 30, 2010, and	**160,478**	162,696

December 31, 2009, respectively)		
Beneficial interests issued by consolidated variable interest entities (included $2,057 and $1,410 at fair value at June 30, 2010, and December 31, 2009, respectively)[(a)]	**88,148**	15,225
Long-term debt (included $41,928 and $48,972 at fair value at June 30, 2010, and December 31, 2009, respectively)	**248,618**	266,318
Total liabilities[(a)]	**1,842,899**	1,866,624
Commitments and contingencies (see Note 21 of this Form 10-Q)		
Stockholders equity		
Preferred stock ($1 par value; authorized 200,000,000 shares at June 30, 2010, and December 31, 2009; issued 2,538,107 shares at June 30, 2010, and December 31, 2009)	**8,152**	8,152
Common stock ($1 par value; authorized 9,000,000,000 shares at June 30, 2010, and December 31, 2009; issued 4,104,933,895 shares at June 30, 2010, and December 31, 2009)	**4,105**	4,105
Capital surplus	**96,745**	97,982
Retained earnings	**65,465**	62,481
Accumulated other comprehensive income/(loss)	**2,404**	(91)
Shares held in RSU Trust, at cost (1,527,326 and 1,526,944 shares at June 30, 2010, and December 31, 2009, respectively)	**(68)**	(68)
Treasury stock, at cost (129,122,833 and 162,974,783 shares at June 30, 2010, and December 31, 2009, respectively)	**(5,683)**	(7,196)
Total stockholders equity	**171,120**	165,365
Total liabilities and stockholders equity	**$ 2,014,019**	$ 2,031,989

(a) The following table presents information on assets and liabilities related to VIEs that are consolidated by the Firm at June 30, 2010, and December 31, 2009. The difference between total VIE assets and liabilities represents the Firm s interests in those entities, which were eliminated in

consolidation.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

Assets		
Trading assets	**$ 7,525**	$ 6,347
Loans	**111,965**	13,004
All other assets	**4,869**	5,043
Total assets	**$124,359**	$24,394
Liabilities		
Beneficial interests issued by consolidated variable interest entities	**$ 88,148**	$15,225
All other liabilities	**2,524**	2,197
Total liabilities	**$ 90,672**	$17,422

The assets of the consolidated VIEs are used to settle the liabilities of those entities. At June 30, 2010, the Firm provided limited program-wide credit enhancement of $2.0 billion related to its Firm-administered multi-seller conduits. For further discussion, see Note 15 on pages 151-162 of this Form 10-Q.

Notes to Consolidated Financial Statements (unaudited) are an integral part of these statements.

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JPMORGAN CHASE & CO.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (UNAUDITED)

	Six months ended June 30,	
(in millions, except per share data)	**2010**	2009
Preferred stock		
Balance at January 1	**$ 8,152**	$ 31,939
Accretion of preferred stock discount on issuance to the U.S. Treasury		1,213
Redemption of preferred stock issued to the U.S. Treasury		(25,000)
Balance at June 30	**8,152**	8,152
Common stock		
Balance at January 1	**4,105**	3,942
Issuance of common stock		163
Balance at June 30	**4,105**	4,105
Capital surplus		
Balance at January 1	**97,982**	92,143
Issuance of common stock		5,589
Shares issued and commitments to issue common stock for employee stock-based compensation awards, and related tax effects	**36**	(70)
Other	**(1,273)**	
Balance at June 30	**96,745**	97,662
Retained earnings		
Balance at January 1	**62,481**	54,013
Cumulative effect of change in accounting principle	**(4,391)**	
Net income	**8,121**	4,862
Dividend declared:		
Preferred stock	**(325)**	(1,003)
Accelerated amortization from redemption of preferred stock issued to the U.S. Treasury		(1,112)
Common stock ($0.10 per share in each period)	**(421)**	(405)
Balance at June 30	**65,465**	56,355
Accumulated other comprehensive income/(loss)		
Balance at January 1	**(91)**	(5,687)
Cumulative effect of change in accounting principle	**(129)**	
Other comprehensive income/(loss)	**2,624**	2,249
Balance at June 30	**2,404**	(3,438)
Shares held in RSU Trust		

Balance at January 1	**(68)**	(217)
Reissuance from RSU Trust		131
Balance at June 30	**(68)**	(86)
Treasury stock, at cost		
Balance at January 1	**(7,196)**	(9,249)
Purchase of treasury stock	**(135)**	
Reissuance from treasury stock	**1,648**	1,284
Share repurchases related to employee stock-based compensation awards		(19)
Balance at June 30	**(5,683)**	(7,984)
Total stockholders equity	**$ 171,120**	$ 154,766
Comprehensive income		
Net income	**$ 8,121**	$ 4,862
Other comprehensive income/(loss)	**2,624**	2,249
Comprehensive income	**$ 10,745**	$ 7,111

The Notes to Consolidated Financial Statements (unaudited) are an integral part of these statements.

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JPMORGAN CHASE & CO.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in millions)	Six months ended June 30, **2010**	2009
Operating activities		
Net income	**$ 8,121**	$ 4,862
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for credit losses	**10,373**	16,627
Depreciation and amortization	**1,926**	1,209
Amortization of intangibles	**478**	540
Deferred tax benefit	**(567)**	(2,276)
Investment securities gains	**(1,610)**	(545)
Stock-based compensation	**1,774**	1,672
Originations and purchases of loans held-for-sale	**(14,259)**	(9,850)
Proceeds from sales, securitizations and paydowns of loans held-for-sale	**18,374**	16,212
Net change in:		
Trading assets	**19,789**	140,934
Securities borrowed	**(2,620)**	(5,282)
Accrued interest and accounts receivable	**9,270**	(441)
Other assets	**(18,675)**	17,722
Trading liabilities	**19,396**	(61,751)
Accounts payable and other liabilities	**(1,066)**	(14,854)
Other operating adjustments	**(3,149)**	(1,520)
Net cash provided by operating activities	**47,555**	103,259
Investing activities		
Net change in:		
Deposits with banks	**23,866**	76,177
Federal funds sold and securities purchased under resale agreements	**(3,343)**	43,374
Held-to-maturity securities:		
Proceeds	**4**	5
Available-for-sale securities:		
Proceeds from maturities	**57,012**	47,129
Proceeds from sales	**77,754**	67,472
Purchases	**(102,291)**	(249,770)
Proceeds from sales and securitizations of loans held-for-investment	**5,539**	17,897
Other changes in loans, net	**13,449**	37,593
Net cash used in business acquisitions or dispositions	**(6)**	(18)
Net purchases of asset-backed commercial paper guaranteed by the FRBB		(3,257)
All other investing activities, net	**1,690**	(337)
Net cash provided by investing activities	**73,674**	36,265
Financing activities		
Net change in:		

Deposits	**(46,179)**	(173,304)
Federal funds purchased and securities loaned or sold under repurchase agreements	**(24,023)**	107,281
Commercial paper and other borrowed funds	**(11,986)**	(53,690)
Beneficial interests issued by consolidated variable interest entities	**(18,297)**	(1,835)
Proceeds from long-term debt and trust preferred capital debt securities	**17,964**	38,079
Payments of long-term debt and trust preferred capital debt securities	**(30,275)**	(34,924)
Excess tax benefits related to stock-based compensation	**21**	1
Redemption of preferred stock issued to the U.S. Treasury		(25,000)
Proceeds from issuance of common stock		5,756
Treasury stock purchased	**(135)**	
Dividends paid	**(745)**	(2,681)
All other financing activities, net	**(497)**	(931)
Net cash used in financing activities	**(114,152)**	(141,248)
Effect of exchange rate changes on cash and due from banks	**(477)**	(38)
Net increase (decrease) in cash and due from banks	**6,600**	(1,762)
Cash and due from banks at the beginning of the year	**26,206**	26,895
Cash and due from banks at the end of the period	**$ 32,806**	$ 25,133
Cash interest paid	**$ 6,363**	$ 8,463
Cash income taxes paid	**5,361**	3,837

Note: Effective January 1, 2010, the Firm adopted new guidance that amended the accounting for the transfer of financial assets and the consolidation of VIEs. Upon adoption of the new guidance, the Firm consolidated noncash assets and liabilities of $87.7 billion and $92.2 billion, respectively.

The Notes to Consolidated Financial Statements (unaudited) are an integral part of these statements.

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See Glossary of Terms on pages 181-184 of this Form 10-Q for definitions of terms used throughout the Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 1 BASIS OF PRESENTATION

JPMorgan Chase & Co. (JPMorgan Chase or the Firm), a financial holding company incorporated under Delaware law in 1968, is a leading global financial services firm and one of the largest banking institutions in the United States of America (U.S.), with operations worldwide. The Firm is a leader in investment banking, financial services for consumers and businesses, financial transaction processing and asset management. For a discussion of the Firm s business segment information, see Note 23 on pages 174-178 of this Form 10-Q.

The accounting and financial reporting policies of JPMorgan Chase and its subsidiaries conform to accounting principles generally accepted in the United States of America (U.S. GAAP). Additionally, where applicable, the policies conform to the accounting and reporting guidelines prescribed by bank regulatory authorities. The unaudited consolidated financial statements prepared in conformity with U.S. GAAP require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expense, and the disclosures of contingent assets and liabilities. Actual results could be different from these estimates. In the opinion of management, all normal recurring adjustments have been included for a fair statement of this interim financial information. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes thereto included in JPMorgan Chase s Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the U.S. Securities and Exchange Commission (the 2009 Annual Report).

Certain amounts in prior periods have been reclassified to conform to the current presentation.

Consolidation

The Consolidated Financial Statements include the accounts of JPMorgan Chase and other entities in which the Firm has a controlling financial interest. All material intercompany balances and transactions have been eliminated. The Firm determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity (VIE).

Voting Interest Entities

Voting interest entities are entities that have sufficient equity and provide the equity investors voting rights that enable them to make significant decisions relating to the entity s operations. For these types of entities, the Firm s determination of whether it has a controlling interest is primarily based on the amount of voting equity interests held. Entities in which the Firm has a controlling financial interest, through ownership of the majority of the entities voting equity interests, or through other contractual rights that give the Firm control, are consolidated by the Firm.

Investments in companies that are considered to be voting interest entities in which the Firm has significant influence over operating and financing decisions (but does not own a majority of the voting equity interests) are accounted for (i) in accordance with the equity method of accounting (which requires the Firm to recognize its proportionate share of the entity s net earnings), or (ii) at fair value if the fair value option was elected at the inception of the Firm s investment. These investments are generally included in other assets, with income or loss included in other income.

Firm-sponsored asset management funds are generally structured as limited partnerships or limited liability companies and are typically considered voting interest entities. For the significant majority of these entities, for which the Firm is the general partner or managing member of the limited partnership or limited liability company (LLC), the non-affiliated partners or members have the substantive ability to remove the Firm as the general partner or managing member without cause (i.e., kick-out rights), based on a simple unaffiliated majority vote, or the non-affiliated partners or members have substantive participating rights. Accordingly, the Firm does not consolidate these funds. In limited cases where the non-affiliated partners or members do not have substantive kick-out or participating rights, the Firm consolidates the underlying funds.

Private equity investments, which are recorded in other assets on the Consolidated Balance Sheets, include investments in buyouts, growth equity and venture opportunities. These investments are accounted for under investment company guidelines and accordingly, irrespective of the percentage of equity ownership interests held, are carried on the Consolidated Balance Sheets at fair value.

Variable Interest Entities

VIEs are entities that, by design, either (1) lack sufficient equity to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) have equity investors that do not have the ability to make significant decisions relating to the entity s operations through voting rights, or do not have the obligation to absorb the expected losses, or do not have the right to receive the residual returns of the entity.

The most common type of VIE is a special purpose entity (SPE). SPEs are commonly used in securitization transactions in order to isolate certain assets and distribute the cash flows from those assets to investors. SPEs are an important part of the financial markets, including the mortgage- and asset-backed securities and commercial paper markets, as they provide market liquidity by facilitating investors access to specific portfolios of assets and risks. SPEs may be organized as trusts, partnerships or corporations and are typically established for a single, discrete purpose. SPEs are not typically operating entities and usually have a limited life and no employees. The basic SPE structure involves a company selling assets to the SPE; the SPE funds the purchase of those assets by issuing securities to investors. The legal documents that govern the transaction specify how the cash earned on the assets must be allocated to the SPE s investors and other parties that have rights to those cash flows. SPEs are generally structured to insulate investors from claims on the SPE s assets by creditors of other entities, including the creditors of the seller of the assets.

On January 1, 2010, the Firm implemented new consolidation accounting guidance related to VIEs. The new guidance eliminates the concept of qualified special purpose entities (QSPEs) that were previously exempt from consolidation, and introduces a new framework for determining the primary beneficiary of a VIE. The primary beneficiary of a VIE is required to consolidate the assets and liabilities of the VIE. Under the new guidance, the primary beneficiary is the party that has both (1) the power to direct the activities of an entity that most significantly impact the VIE s economic performance; and (2) through its interests in the VIE, the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

To assess whether the Firm has the power to direct the activities of a VIE that most significantly impact the VIE s economic performance, the Firm considers all facts and circumstances, including its role in establishing the VIE and its ongoing rights and responsibilities. This assessment includes, first, identifying the activities that most significantly impact the VIE s economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE (such as asset managers, collateral managers, servicers, or owners of call options or liquidation rights over the VIE s assets) or have the right to unilaterally remove those decision-makers are deemed to have the power to direct the activities of a VIE.

To assess whether the Firm has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, the Firm considers all of its economic interests, including debt and equity investments, servicing fees, and derivative or other arrangements deemed to be variable interests in the VIE. This assessment requires that the Firm apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; relative share of interests held across various classes within the VIE s capital structure; and the reasons why the interests are held by the Firm.

The Firm performs on-going reassessments of: 1) whether any entities previously evaluated under the majority voting-interest framework have become VIEs, based on certain events, and therefore subject to the VIE consolidation framework; and 2) whether changes in the facts and circumstances regarding the Firm s involvement with a VIE cause the Firm s consolidation conclusion regarding the VIE to change.

For further details regarding the Firm s application of the new accounting guidance effective January 1, 2010, see Note 15 on pages 151-163 of this Form 10-Q. For a description of the accounting guidance applied to periods ending prior to January 1, 2010, see Note 1 on page 142 of JPMorgan Chase s 2009 Annual Report.

In February 2010, the Financial Accounting Standards Board (FASB) issued an amendment which defers the requirements of the new consolidation accounting guidance for certain investment funds, including mutual funds, private equity funds and hedge funds. For funds to which the amendment applies, the consolidation guidance will be deferred until the completion of the FASB and International Accounting Standards Board (IASB) joint consolidation project. For the funds to which the amendment applies, the Firm continues to apply other existing authoritative guidance to determine whether such funds should be consolidated.

Assets held for clients in an agency or fiduciary capacity by the Firm are not assets of JPMorgan Chase and are not included in the Consolidated Balance Sheets.

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NOTE 2 BUSINESS CHANGES AND DEVELOPMENTS

Purchase of remaining interest in J.P. Morgan Cazenove

On January 4, 2010, JPMorgan Chase purchased the remaining interest in J.P. Morgan Cazenove, an investment banking business partnership formed in 2005 which resulted in an adjustment to the Firm s capital surplus of approximately $1.3 billion.

Subsequent events

RBS Sempra transaction

On July 1, 2010, JPMorgan Chase completed the acquisition of RBS Sempra Commodities global oil, global metals and European power and gas businesses for approximately $1.6 billion. This acquisition almost doubled the number of clients the Firm s commodities business can serve and will enable the Firm to offer them more products in more regions of the world.

Redemption of Series E, F and G cumulative preferred stock

On July 16, 2010, JPMorgan Chase announced that it will redeem at stated redemption value on August 20, 2010, all outstanding shares of its 6.15% Cumulative Preferred Stock, Series E, 5.72% Cumulative Preferred Stock, Series F and 5.49% Cumulative Preferred Stock, Series G. For a further discussion of preferred stock, see Note 23 on pages 222-223 of JPMorgan Chase s 2009 Annual Report.

NOTE 3 FAIR VALUE MEASUREMENT

For a further discussion of the Firm s valuation methodologies for assets, liabilities and lending-related commitments measured at fair value and the fair value hierarchy, see Note 3 on pages 148-165 of JPMorgan Chase s 2009 Annual Report.

During the first six months of 2010, no changes were made to the Firm s valuation models that had, or are expected to have, a material impact on the Firm s Consolidated Balance Sheets or results of operations.

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The following table presents the assets and liabilities measured at fair value as of June 30, 2010, and December 31, 2009, by major product category and by the fair value hierarchy.

Assets and liabilities measured at fair value on a recurring basis

	Fair value hierarchy				
June 30, 2010 (in millions)	Level 1[j]	Level 2[j]	Level 3[j]	Netting adjustments	Total fair value
Federal funds sold and securities purchased under resale agreements	$	$ 22,750	$	$	$ 22,750
Securities borrowed		11,924			11,924
Trading assets:					
Debt instruments:					
Mortgage-backed securities:					
U.S. government agencies[a]	21,086	8,841	176		30,103
Residential nonagency[b]		2,369	804		3,173
Commercial nonagency[b]		1,075	1,739		2,814
Total mortgage-backed securities	21,086	12,285	2,719		36,090
U.S. Treasury and government agencies[a]	14,513	11,826			26,339
Obligations of U.S. states and municipalities		3,983	2,008		5,991
Certificates of deposit, bankers acceptances and commercial paper		2,858			2,858
Non-U.S. government debt securities	31,081	34,966	608		66,655
Corporate debt securities	1	41,761	4,551		46,313
Loans[c]		16,767	14,889		31,656
Asset-backed securities		2,130	8,143		10,273
Total debt instruments	66,681	126,576	32,918		226,175
Equity securities	74,316	2,973	1,822		79,111
Physical commodities[d]	9,651	363			10,014
Other		1,582	411		1,993
Total debt and equity instruments[e]	150,648	131,494	35,151		317,293
Derivative receivables:					
Interest rate	2,510	1,394,382	5,586	(1,360,210)	42,268
Credit[f]		126,631	28,710	(146,995)	8,346
Foreign exchange	1,871	156,502	3,244	(142,031)	19,586
Equity	51	50,915	7,132	(52,575)	5,523
Commodity	93	31,573	1,095	(28,269)	4,492
Total derivative receivables[g]	4,525	1,760,003	45,767	(1,730,080)	80,215
Total trading assets	155,173	1,891,497	80,918	(1,730,080)	397,508

Available-for-sale securities:

Mortgage-backed securities:					
U.S. government agencies[a]	**120,595**	**19,782**			**140,377**
Residential nonagency[b]		**31,609**	**5**		**31,614**
Commercial nonagency[b]		**4,836**	**104**		**4,940**
Total mortgage-backed securities	**120,595**	**56,227**	**109**		**176,931**
U.S. Treasury and government agencies[a]	**3,894**	**13,940**			**17,834**
Obligations of U.S. states and municipalities	**37**	**8,397**	**255**		**8,689**
Certificates of deposit		**2,238**			**2,238**
Non-U.S. government debt securities	**11,283**	**8,275**			**19,558**
Corporate debt securities	**1**	**55,243**			**55,244**
Asset-backed securities:					
Credit card receivables		**9,380**			**9,380**
Collateralized loan obligations		**135**	**11,972**		**12,107**
Other		**7,391**	**362**		**7,753**
Equity securities	**2,211**	**1**	**46**		**2,258**
Total available-for-sale securities	**138,021**	**161,227**	**12,744**		**311,992**
Loans		**1,297**	**1,065**		**2,362**
Mortgage servicing rights			**11,853**		**11,853**
Other assets:					
Private equity investments[h]	**78**	**795**	**7,246**		**8,119**
All other	**5,950**	**48**	**4,308**		**10,306**
Total other assets	**6,028**	**843**	**11,554**		**18,425**
Total assets measured at fair value on a recurring basis[i]	**$299,222**	**$2,089,538**	**$118,134**	**$(1,730,080)**	**$776,814**

	Fair value hierarchy				
June 30, 2010 (in millions)	Level 1[j]	Level 2[j]	Level 3[j]	Netting adjustments	Total fair value
Deposits	**$**	**$ 4,006**	**$ 884**	**$**	**$ 4,890**
Federal funds purchased and securities loaned or sold under repurchase agreements		**6,013**			**6,013**
Other borrowed funds		**7,112**	**291**		**7,403**
Trading liabilities:					
Debt and equity instruments[e]	**55,672**	**19,069**	**4**		**74,745**
Derivative payables:					
Interest rate	**2,361**	**1,355,358**	**2,539**	**(1,340,217)**	**20,041**
Credit[f]		**130,026**	**18,924**	**(144,630)**	**4,320**
Foreign exchange	**1,956**	**166,748**	**3,193**	**(147,705)**	**24,192**
Equity	**41**	**46,556**	**8,782**	**(46,847)**	**8,532**
Commodity	**149**	**30,998**	**1,512**	**(29,607)**	**3,052**
Total derivative payables[g]	**4,507**	**1,729,686**	**34,950**	**(1,709,006)**	**60,137**
Total trading liabilities	**60,179**	**1,748,755**	**34,954**	**(1,709,006)**	**134,882**
Accounts payable and other liabilities		**1**	**449**		**450**
Beneficial interests issued by consolidated VIEs		**665**	**1,392**		**2,057**
Long-term debt		**26,166**	**15,762**		**41,928**
Total liabilities measured at fair value on a recurring basis	**$60,179**	**$1,792,718**	**$53,732**	**$(1,709,006)**	**$197,623**

	Fair value hierarchy				
December 31, 2009 (in millions)	Level 1	Level 2	Level 3	Netting adjustments	Total fair value
Federal funds sold and securities purchased under resale agreements	$	$ 20,536	$	$	$ 20,536
Securities borrowed		7,032			7,032
Trading assets:					
Debt instruments:					
Mortgage-backed securities:					
U.S. government agencies[(a)]	33,092	8,373	260		41,725
Residential nonagency[(b)]		2,284	1,115		3,399
Commercial nonagency[(b)]		537	1,770		2,307
Total mortgage-backed securities	33,092	11,194	3,145		47,431
U.S. Treasury and government agencies[(a)]	13,701	9,559			23,260
Obligations of U.S. states and municipalities		5,681	1,971		7,652
Certificates of deposit, bankers acceptances and commercial paper		5,419			5,419
Non-U.S. government debt securities	25,684	32,487	734		58,905
Corporate debt securities		48,754	5,241		53,995
Loans[(c)]		18,330	13,218		31,548
Asset-backed securities		1,428	7,975		9,403
Total debt instruments	72,477	132,852	32,284		237,613
Equity securities	75,053	3,450	1,956		80,459
Physical commodities[(d)]	9,450	586			10,036
Other		1,884	926		2,810
Total debt and equity instruments[(e)]	156,980	138,772	35,166		330,918
Derivative receivables[(g)]	2,344	1,516,490	46,684	(1,485,308)	80,210
Total trading assets	159,324	1,655,262	81,850	(1,485,308)	411,128
Available-for-sale securities:					
Mortgage-backed securities:					
U.S. government agencies[(a)]	158,957	8,941			167,898
Residential nonagency[(b)]		14,773	25		14,798
Commercial nonagency[(b)]		4,590			4,590
Total mortgage-backed securities	158,957	28,304	25		187,286
U.S. Treasury and government agencies[(a)]	405	29,592			29,997

Obligations of U.S. states and municipalities		6,188	349		6,537
Certificates of deposit		2,650			2,650
Non-U.S. government debt securities	5,506	18,997			24,503
Corporate debt securities	1	62,007			62,008
Asset-backed securities:					
Credit card receivables		25,742			25,742
Collateralized loan obligations		5	12,144		12,149
Other		6,206	588		6,794
Equity securities	2,466	146	87		2,699
Total available-for-sale securities	167,335	179,837	13,193		360,365
Loans		374	990		1,364
Mortgage servicing rights			15,531		15,531
Other assets:					
Private equity investments[(h)]	165	597	6,563		7,325
All other[(k)]	7,241	90	9,521		16,852
Total other assets	7,406	687	16,084		24,177
Total assets measured at fair value on a recurring basis[(i)]	$334,065	$1,863,728	$127,648	$(1,485,308)	$840,133

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	Fair value hierarchy				
December 31, 2009 (in millions)	Level 1	Level 2	Level 3	Netting adjustments	Total fair value
Deposits	$	$ 3,979	$ 476	$	$ 4,455
Federal funds purchased and securities loaned or sold under repurchase agreements		3,396			3,396
Other borrowed funds		5,095	542		5,637
Trading liabilities:					
Debt and equity instruments(e)	50,577	14,359	10		64,946
Derivative payables(f)(g)	2,038	1,481,813	35,332	(1,459,058)	60,125
Total trading liabilities	52,615	1,496,172	35,342	(1,459,058)	125,071
Accounts payable and other liabilities		2	355		357
Beneficial interests issued by consolidated VIEs		785	625		1,410
Long-term debt		30,685	18,287		48,972
Total liabilities measured at fair value on a recurring basis	$52,615	$1,540,114	$55,627	$(1,459,058)	$189,298

(a) Includes total U.S. government-sponsored enterprise obligations of $144.3 billion and $195.8 billion at June 30, 2010, and December 31, 2009, respectively, which were predominantly mortgage-related.

(b) For further discussion of residential and commercial mortgage-backed securities (MBS), see the Mortgage-related exposures carried at fair value section of Note 3 on pages 161-162 of JPMorgan Chase s 2009 Annual Report.

(c)

Included within trading loans at June 30, 2010, and December 31, 2009, respectively, are \$20.1 billion and \$20.7 billion of residential first-lien mortgages and \$3.8 billion and \$2.7 billion of commercial first-lien mortgages. Residential mortgage loans include conforming mortgage loans originated with the intent to sell to U.S. government agencies of \$10.6 billion and \$11.1 billion, respectively, and reverse mortgages of \$3.9 billion and \$4.5 billion, respectively. For further discussion of residential and commercial loans carried at fair value or the lower of cost or fair value, see the Mortgage-related exposures carried at fair value section of Note 3 on pages 161-162 of JPMorgan Chase s 2009 Annual Report.

(d) *Physical commodities inventories are generally accounted for at the lower of cost or fair value.*

(e) *Balances reflect the reduction of securities owned (long positions) by the amount of securities sold but not yet purchased (short positions) when the* *long and short positions have identical Committee on Uniform Security Identification Procedures (CUSIPs).*

(f) *The level 3 amounts for derivative receivables and derivative payables related to credit primarily include structured credit derivative instruments. For further information on the classification of instruments within the valuation hierarchy, see Note 3 on pages 148-152 of JPMorgan Chase s 2009 Annual Report.*

(g) *As permitted under U.S. GAAP, the Firm has elected to net derivative receivables and derivative payables and the related cash collateral received and paid when a legally enforceable master netting agreement exists. For purposes of the tables above, the Firm does not reduce derivative receivables and derivative payables balances for this netting adjustment, either within or across the levels of the fair value hierarchy, as such netting is not relevant to a presentation based on the transparency of inputs to the valuation of an asset or liability. Therefore, the balances* *reported in the fair value hierarchy table are gross of any counterparty netting adjustments. However, if the Firm were to net such balances within level 3, the reduction in the level 3 derivative receivable and payable balances would be $19.0 billion and $16.0 billion at June 30, 2010, and December 31, 2009, respectively, exclusive of the netting benefit associated with cash collateral which would further reduce the level 3 balances.*

(h) Private equity instruments represent investments within the Corporate/Private Equity line of business. The cost basis of the private equity investment portfolio totaled $9.7 billion and $8.8 billion at June 30, 2010, and December 31, 2009, respectively.

(i) At June 30, 2010, and December 31, 2009, balances included investments valued at net asset value of $13.2 billion and $16.8 billion, respectively, of which $7.0 billion and $9.0 billion, respectively, were classified in level 1, $2.1 billion and $3.2 billion, respectively, in level 2 and $4.1 billion and

$4.6 billion in level 3.

(j) *In the three and six months ended June 30, 2010, the transfers between levels 1, 2 and 3 were not significant.*

(k) *Includes assets within accrued interest receivable and other assets at December 31, 2009.*

Changes in level 3 recurring fair value measurements

The following tables include a rollforward of the balance sheet amounts (including changes in fair value) for financial instruments classified by the Firm within level 3 of the fair value hierarchy for the three and six months ended June 30, 2010 and 2009. When a determination is made to classify a financial instrument within level 3, the determination is based on the significance of the unobservable parameters to the overall fair value measurement. However, level 3 financial instruments typically include, in addition to the unobservable or level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources); accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology. Also, the Firm risk-manages the observable components of level 3 financial instruments using securities and derivative positions that are classified within level 1 or 2 of the fair value hierarchy; as these level 1 and level 2 risk management instruments are not included below, the gains or losses in the following tables do not reflect the effect of the Firm s risk management activities related to such level 3 instruments.

Three months ended June 30, 2010 (in millions)	Fair value, April 1, 2010	Total realized/ unrealized gains/(losses)	Purchases, issuances settlements, net	Transfers into and/or out of level 3(f)	Fair value, June 30, 2010	Change in unrealized gains/(losses) related to financial instruments held at June 30, 2010
	Fair value measurements using significant unobservable inputs					
Assets:						
Trading assets:						
Debt instruments:						
Mortgage-backed securities:						
U.S. government agencies	**$ 215**	**$ 19**	**$ (55)**	**$ (3)**	**$ 176**	**$**
Residential nonagency(g)	**841**	**61**	**(36)**	**(62)**	**804**	**56**
Commercial nonagency(g)	**1,673**	**80**	**(11)**	**(3)**	**1,739**	**66**
Total mortgage-backed securities	**2,729**	**160**	**(102)**	**(68)**	**2,719**	**122**
Obligations of U.S. states and municipalities	**1,975**	**15**	**18**		**2,008**	**1**
Non-U.S. government debt securities	**713**	**(43)**	**(62)**		**608**	**(43)**
Corporate debt securities	**4,947**	**(53)**	**(177)**	**(166)**	**4,551**	**(34)**
Loans	**15,776**	**41**	**(943)**	**15**	**14,889**	**49**
Asset-backed securities	**8,078**	**(185)**	**310**	**(60)**	**8,143**	**(177)**
Total debt instruments	**34,218**	**(65)**	**(956)**	**(279)**	**32,918**	**(82)**
Equity securities	**1,716**	**101**	**1**	**4**	**1,822**	**154**
Other	**425**	**19**	**(33)**		**411**	**29**
Total debt and equity instruments	**36,359**	**55***(b)*	**(988)**	**(275)**	**35,151**	**101***(b)*
Derivative receivables:						
Interest rate	**2,464**	**1,021**	**(534)**	**96**	**3,047**	**911**
Credit	**9,186**	**2,003**	**(1,410)**	**7**	**9,786**	**2,349**
Foreign exchange	**329**	**(513)**	**236**	**(1)**	**51**	**(452)**
Equity	**(1,291)**	**(333)**	**46**	**(72)**	**(1,650)**	**(172)**
Commodity	**(281)**	**(241)**	**70**	**35**	**(417)**	**(288)**
Derivative receivables, net of derivative liabilities	**10,407**	**1,937***(b)*	**(1,592)**	**65**	**10,817**	**2,348***(b)*
Available-for-sale securities:						
Asset-backed securities	**12,571**	**(39)**	**(198)**		**12,334**	**(51)**

Other	**363**	**10**	**(67)**	**104**	**410**	**(2)**
Total available-for-sale securities	**12,934**	**(29)***(c)*	**(265)**	**104**	**12,744**	**(53)***(c)*
Loans	**1,140**	**(12)***(b)*	**(79)**	**16**	**1,065**	**(32)***(b)*
Mortgage servicing rights	**15,531**	**(3,584)***(d)*	**(94)**		**11,853**	**(3,584)***(d)*
Other assets:						
Private equity investments	**6,385**	**(12)***(b)*	**992**	**(119)**	**7,246**	**(19)***(b)*
All other	**4,352**	**(40)***(e)*	**80**	**(84)**	**4,308**	**(20)***(e)*

	Fair value measurements using significant unobservable inputs					
Three months ended June 30, 2010 (in millions)	Fair value, April 1, 2010	Total realized/ unrealized (gains)/losses	Purchases, issuances settlements, net	Transfers into and/or out of level 3[f]	Fair value, June 30, 2010	Change in unrealized (gains)/losses related to financial instruments held at June 30, 2010
Liabilities[g]**:**						
Deposits	$ **440**	$ **15***(b)*	$ **95**	$ **334**	$ **884**	$ **10***(b)*
Other borrowed funds	**452**	**(48)***(b)*	**(103)**	**(10)**	**291**	**(37)***(b)*
Trading liabilities:						
Debt and equity instruments	**32**	**2***(b)*	**(30)**		**4**	*(b)*
Accounts payable and other liabilities	**328**	**(17)***(b)*	**138**		**449**	**(5)***(b)*
Beneficial interests issued by consolidated VIEs	**1,817**	**(26)***(b)*	**(399)**		**1,392**	**(68)***(b)*
Long-term debt	**17,518**	**(632)***(b)*	**(1,219)**	**95**	**15,762**	**(365)***(b)*

Three months ended June 30, 2009 (in millions)	Fair value, April 1, 2009	Total realized/ unrealized gains/(losses)	Purchases, issuances settlements, net	Transfers into and/or out of level 3[f]	Fair value, June 30, 2009	Change in unrealized gains/(losses) related to financial instruments held at June 30, 2009
Assets:						
Trading assets:						
Debt instruments:						
Mortgage-backed securities:						
U.S. government agencies	$ 288	$ (23)	$ (10)	$ 2	$ 257	$ (23)
Residential nonagency[a]	2,469	(183)	563	(17)	2,832	(197)
Commercial nonagency[a]	1,890	(11)	(29)		1,850	(48)
Total mortgage-backed securities	4,647	(217)	524	(15)	4,939	(268)
Obligations of U.S. states and municipalities	2,482	32	(98)		2,416	(8)
Non-U.S. government debt securities	737	21	(32)		726	4
Corporate debt securities	6,144	(21)	(752)	111	5,482	(44)
Loans	16,046	362	(866)	(334)	15,208	351
Asset-backed securities	6,488	887	490	(182)	7,683	828
Total debt instruments	36,544	1,064	(734)	(420)	36,454	863
Equity securities	963	29	(98)	615	1,509	17
Other	1,200	(20)	47	42	1,269	(9)
Total debt and equity instruments	38,707	1,073[b]	(785)	237	39,232	871[b]
Derivative receivables, net of derivative liabilities	19,148	(5,707)[b]	759	4,148	18,348	(3,932)[b]
Available-for-sale securities:						
Asset-backed securities	11,078	767	89		11,934	767
Other	1,385	(60)	346	6	1,677	50
Total available-for-sale securities	12,463	707[c]	435	6	13,611	817[c]
Loans	2,987	(73)[b]	(1,112)	(46)	1,756	(116)[b]
Mortgage servicing rights	10,634	3,831[d]	135		14,600	3,831[d]
Other assets:						

Private equity investments	6,245	(135)[b]	20	(1)	6,129	(145)[b]
All other[h]	7,704	(304)[e]	1,829	(301)	8,928	(308)[e]

Fair value measurements using significant unobservable inputs

Three months ended June 30, 2009 (in millions)	Fair value, April 1, 2009	Total realized/ unrealized (gains)/losses	Purchases, issuances settlements, net	Transfers into and/or out of level 3[f]	Fair value, June 30, 2009	Change in unrealized (gains)/losses related to financial instruments held at June 30, 2009
Liabilities[g]:						
Deposits	$ 928	$ 9[b]	$ (310)	$	$ 627	$ 9[b]
Other borrowed funds	47	9[b]	40	38	134	8[b]
Trading liabilities:						
Debt and equity instruments	257	(4)[b]	(200)		53	(9)[b]
Accounts payable and other liabilities	6	(2)[b]	433		437	(4)[b]
Beneficial interests issued by consolidated VIEs	502	161[b]	(482)	879	1,060	160[b]
Long-term debt	16,657	883[b]	(1,233)	1,166	17,473	1,077[b]

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Fair value measurements using significant unobservable inputs

Six months ended June 30, 2010 (in millions)	Fair value, January 1, 2010	Total realized/ unrealized gains/(losses)	Purchases, issuances settlements, net	Transfers into and/or out of level 3[f]	Fair value, June 30, 2010	Change in unrealized gains/(losses) related to financial instruments held at June 30, 2010
Assets:						
Trading assets:						
Debt instruments:						
Mortgage-backed securities:						
U.S. government agencies	**$ 260**	**$ 24**	**$ (105)**	**$ (3)**	**$ 176**	**$ (10)**
Residential nonagency[a]	**1,115**	**77**	**(340)**	**(48)**	**804**	**44**
Commercial nonagency[a]	**1,770**	**116**	**(144)**	**(3)**	**1,739**	**30**
Total mortgage-backed securities	**3,145**	**217**	**(589)**	**(54)**	**2,719**	**64**
Obligations of U.S. states and municipalities	**1,971**	**(27)**	**(78)**	**142**	**2,008**	**(42)**
Non-U.S. government debt securities	**734**	**(90)**	**(36)**		**608**	**(18)**
Corporate debt securities	**5,241**	**(331)**	**(467)**	**108**	**4,551**	**(5)**
Loans	**13,218**	**(290)**	**2,043**	**(82)**	**14,889**	**(358)**
Asset-backed securities	**7,975**	**(89)**	**241**	**16**	**8,143**	**(233)**
Total debt instruments	**32,284**	**(610)**	**1,114**	**130**	**32,918**	**(592)**
Equity securities	**1,956**	**81**	**(231)**	**16**	**1,822**	**213**
Other	**926**	**40**	**(633)**	**78**	**411**	**35**
Total debt and equity instruments	**35,166**	**(489)**[b]	**250**	**224**	**35,151**	**(344)**[b]
Derivative receivables:						
Interest rate	**2,040**	**1,441**	**(575)**	**141**	**3,047**	**671**
Credit	**10,350**	**1,399**	**(1,961)**	**(2)**	**9,786**	**1,669**
Foreign exchange	**1,082**	**(893)**	**156**	**(294)**	**51**	**(861)**
Equity	**(1,791)**	**(70)**	**(18)**	**229**	**(1,650)**	**76**
Commodity	**(329)**	**(652)**	**472**	**92**	**(417)**	**(267)**
Derivative receivables, net of derivative liabilities	**11,352**	**1,225**[b]	**(1,926)**	**166**	**10,817**	**1,288**[b]

Available-for-sale securities:						
Asset-backed securities	**12,732**	**(105)**	**(293)**		**12,334**	**(96)**
Other	**461**	**(67)**	**(89)**	**105**	**410**	**(95)**
Total available-for-sale securities	**13,193**	**(172)**[c]	**(382)**	**105**	**12,744**	**(191)**[c]
Loans	**990**	**(11)**[b]	**78**	**8**	**1,065**	**(48)**[b]
Mortgage servicing rights	**15,531**	**(3,680)**[d]	**2**		**11,853**	**(3,680)**[d]
Other assets:						
Private equity investments	**6,563**	**136**[b]	**931**	**(384)**	**7,246**	**11**[b]
All other	**9,521**	**(58)**[e]	**(5,060)**	**(95)**	**4,308**	**(111)**[e]

	Fair value measurements using significant unobservable inputs					
Six months ended June 30, 2010 (in millions)	Fair value, January 1, 2010	Total realized/ unrealized (gains)/losses	Purchases, issuances settlements, net	Transfers into and/or out of level 3[f]	Fair value, June 30, 2010	Change in unrealized (gains)/losses related to financial instruments held at June 30, 2010
Liabilities[g]**:**						
Deposits	$ **476**	$ **5**[b]	$ **94**	$ **309**	$ **884**	$ **(32)**[b]
Other borrowed funds	**542**	**(100)**[b]	**92**	**(243)**	**291**	**(110)**[b]
Trading liabilities:						
Debt and equity instruments	**10**	**4**[b]	**(33)**	**23**	**4**	**1**[b]
Accounts payable and other liabilities	**355**	**(40)**[b]	**134**		**449**	**(13)**[b]
Beneficial interests issued by consolidated VIEs	**625**	**(33)**[b]	**800**		**1,392**	**(105)**[b]
Long-term debt	**18,287**	**(1,035)**[b]	**(1,887)**	**397**	**15,762**	**(513)**[b]

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	Fair value measurements using significant unobservable inputs					
Six months ended June 30, 2009 (in millions)	Fair value, January 1, 2009	Total realized/ unrealized gains/(losses)	Purchases, issuances settlements, net	Transfers into and/or out of level 3[f]	Fair value, June 30, 2009	Change in unrealized gains/(losses) related to financial instruments held at June 30, 2009
Assets:						
Trading assets:						
Debt instruments:						
Mortgage-backed securities:						
U.S. government agencies	$ 163	$ (35)	$ 56	$ 73	$ 257	$ (34)
Residential nonagency[a]	3,339	(548)	567	(526)	2,832	(590)
Commercial nonagency[a]	2,487	(241)	(245)	(151)	1,850	(97)
Total mortgage-backed securities	5,989	(824)	378	(604)	4,939	(721)
Obligations of U.S. states and municipalities	2,641	53	(278)		2,416	(25)
Non-U.S. government debt securities	707	25	(40)	34	726	2
Corporate debt securities	5,280	(164)	(3,102)	3,468	5,482	(88)
Loans	17,091	(1,188)	(954)	259	15,208	(1,117)
Asset-backed securities	7,106	669	128	(220)	7,683	574
Total debt instruments	38,814	(1,429)	(3,868)	2,937	36,454	(1,375)
Equity securities	1,380	(247)	(359)	735	1,509	(171)
Other	1,226	(107)	94	56	1,269	80
Total debt and equity instruments	41,420	(1,783)[b]	(4,133)	3,728	39,232	(1,466)[b]
Derivative receivables, net of derivative liabilities	9,507	(4,938)[b]	(2,233)	16,012	18,348	(4,870)[b]
Available-for-sale securities:						
Asset-backed securities	11,447	(138)	450	175	11,934	(331)
Other	944	(60)	247	546	1,677	50
Total available-for-sale securities	12,391	(198)[c]	697	721	13,611	(281)[c]
Loans	2,667	(478)[b]	(1,309)	876	1,756	(433)[b]
Mortgage servicing rights	9,403	5,141[d]	56		14,600	5,141[d]
Other assets:						
Private equity investments	6,369	(473)[b]	163	70	6,129	(459)[b]
All other[h]	8,114	(651)[e]	1,806	(341)	8,928	(655)[e]

Six months ended June 30, 2009 (in millions)	Fair value, January 1, 2009	Total realized/ unrealized (gains)/losses	Purchases, issuances settlements, net	Transfers into and/or out of level 3[f]	Fair value, June 30, 2009	Change in unrealized (gains)/losses related to financial instruments held at June 30, 2009
	Fair value measurements using significant unobservable inputs					
Liabilities[g]:						
Deposits	$ 1,235	$ 23[b]	$ (693)	$ 62	$ 627	$ 36[b]
Other borrowed funds	101	(86)[b]	76	43	134	5[b]
Trading liabilities:						
Debt and equity instruments	288	58[b]	(290)	(3)	53	(2)[b]
Accounts payable and other liabilities		(4)[b]	441		437	(4)[b]
Beneficial interests issued by consolidated VIEs		161[b]	20	879	1,060	160[b]
Long-term debt	16,548	41[b]	(2,551)	3,435	17,473	464[b]

(a) *For further discussion of residential and commercial MBS, see the Mortgage-related exposures carried at fair value section of Note 3 on pages 161-162 of JPMorgan Chase s 2009 Annual Report.*

(b) *Predominantly reported in principal transactions revenue, except for changes in fair value for Retail Financial Services (RFS) mortgage loans originated with the intent to sell, which are reported in mortgage fees and related income.*

(c) *Realized gains and losses on available-for-sale (AFS) securities, as* *well as other-than-temporary impairment (OTTI) losses that are recorded in earnings, are reported in securities gains. Unrealized gains and losses are reported in other comprehensive income.*

(d) *Changes in fair value for RFS mortgage servicing rights are reported in mortgage fees and related income.*

(e) *Predominantly reported in other income.*

(f) *All transfers into and/or out of level 3 are assumed to occur at the beginning of the reporting period.*

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(g) *Level 3 liabilities as a percentage of total Firm liabilities accounted for at fair value (including liabilities measured at fair value on a nonrecurring basis) were 27% and 29% at June 30, 2010, and December 31, 2009, respectively.*

(h) *Includes assets within accrued interest receivable and other assets at June 30, 2009.*

Assets and liabilities measured at fair value on a nonrecurring basis

Certain assets, liabilities and unfunded lending-related commitments are measured at fair value on a nonrecurring basis; that is, they are not measured at fair value on an ongoing basis but are subject to fair value adjustments only in certain circumstances (for example, when there is evidence of impairment). The following tables present the assets and liabilities carried on the Consolidated Balance Sheets by caption and level within the valuation hierarchy as of June 30, 2010, and December 31, 2009, for which a nonrecurring change in fair value has been recorded during the reporting period.

	Fair value hierarchy			
June 30, 2010(in millions)	Level 1(d)	Level 2(d)	Level 3(d)	Total fair value
Loans retained(a)	$	$ 4,207	$ 946	$ 5,153
Loans held-for-sale(b)		607	437	1,044
Total loans		4,814	1,383	6,197
Other real estate owned		36	353	389
Other assets			1	1
Total other assets		36	354	390
Total assets at fair value on a nonrecurring basis	$	$ 4,850	$ 1,737	$ 6,587

Accounts payable and other liabilities[(c)]	**$**	**$ 82**	**$ 16**	**$ 98**
Total liabilities at fair value on a nonrecurring basis	**$**	**$ 82**	**$ 16**	**$ 98**

	Fair value hierarchy			
December 31, 2009 (in millions)	Level 1	Level 2	Level 3	Total fair value
Loans retained[(a)]	$	$ 4,544	$ 1,137	$ 5,681
Loans held-for-sale[(b)]		601	1,029	1,630
Total loans		5,145	2,166	7,311
Other real estate owned		307	387	694
Other assets			184	184
Total other assets		307	571	878
Total assets at fair value on a nonrecurring basis	$	$ 5,452	$ 2,737	$ 8,189
Accounts payable and other liabilities[(c)]	$	$ 87	$ 39	$ 126
Total liabilities at fair value on a nonrecurring basis	$	$ 87	$ 39	$ 126

(a) Reflects mortgage, home equity and other loans where the carrying value is based on the fair value of the underlying collateral.

(b) Predominantly includes leveraged lending loans carried on the Consolidated Balance Sheets at the lower of cost or fair value.

(c) Represents, at June 30, 2010, and December 31, 2009, fair value adjustments

associated with $501 million and $648 million, respectively, of unfunded held-for-sale lending-related commitments within the leveraged lending portfolio.

(d) *In the three and six months ended June 30, 2010, the transfers between levels 1, 2 and 3 were not significant.*

The method used to estimate the fair value of impaired collateral-dependent loans, and other loans where the carrying value is based on the fair value of the underlying collateral (e.g., residential mortgage loans charged off in accordance with regulatory guidance), depends on the type of collateral (e.g., securities, real estate, and nonfinancial assets). Fair value of the collateral is estimated based on quoted market prices, broker quotes or independent appraisals, or by using a DCF model. For further information, see Note 14 on pages 150-151 of this Form 10-Q.

Nonrecurring fair value changes

The following table presents the total change in value of assets and liabilities for which a fair value adjustment has been included in the Consolidated Statements of Income for the three and six months ended June 30, 2010 and 2009, related to financial instruments held at those dates.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Loans retained	**$ (978)**	$ (1,008)	**$ (2,052)**	$ (1,622)
Loans held-for-sale	**(3)**	(339)	**65**	(705)
Total loans	**(981)**	(1,347)	**(1,987)**	(2,327)
Other assets	**11**	(154)	**29**	(250)
Accounts payable and other liabilities		16	**5**	47
Total nonrecurring fair value gains/(losses)	**$ (970)**	$ (1,485)	**$ (1,953)**	$ (2,530)

Level 3 analysis

Level 3 assets at June 30, 2010, principally include derivative receivables, mortgage servicing rights (MSRs), trading loans, and collateralized loan obligations (CLOs) held within the available-for-sale securities portfolio. For further discussion of JPMorgan Chase s valuation methodologies for assets and liabilities measured at fair value, see Note 3 on pages 148-165 of JPMorgan Chase s 2009 Annual Report.

Derivative receivables included $45.8 billion of interest rate, credit, foreign exchange, equity and commodity contracts classified within level 3 at June 30, 2010. Included within this balance were $21.3 billion of structured credit derivatives with corporate debt underlying. In assessing the Firm s risk exposure to structured credit derivatives, the Firm believes consideration should also be given to derivative liabilities with similar, and therefore, offsetting risk profiles. At June 30, 2010, there were $12.1 billion of level 3 derivative liabilities with risk characteristics similar to those of the derivative receivable assets that were classified in level 3. Both derivative receivables and payables are modeled and valued the same way with the same parameters and inputs. In addition, the counterparty credit risk and market risk exposure of all level 3 derivatives is partially hedged with instruments, for which the inputs are largely observable, that are largely liquid, and that are classified within level 2 of the valuation hierarchy.

Mortgage servicing rights represent the fair value of future cash flows for performing specified mortgage servicing activities for others (predominantly with respect to residential mortgage loans). For a further description of the MSR asset, interest rate risk management and the valuation methodology used for MSRs, including valuation assumptions and sensitivities, see Note 16 on pages 164-167 of this Form 10-Q and Note 17 on pages 214-217 of JPMorgan Chase s 2009 Annual Report.

CLOs of $12.0 billion are securities backed by corporate loans, and they are held in the Firm s AFS securities portfolio. For these securities, external pricing information is not available. They are therefore valued using market-standard models to model the specific collateral composition and cash flow structure of each deal; key inputs to the model are market spread data for each credit rating, collateral type and other relevant contractual features. Substantially all of these securities are rated AAA, AA and A and have an average credit enhancement of 29%. Credit enhancement in CLOs is primarily in the form of overcollateralization, which is the excess of the par amount of collateral over the par amount of the securities. For further discussion, see Note 11 on pages 139-144 of this Form 10-Q.

Trading loans principally include $6.5 billion of commercial mortgage loans and nonagency residential mortgage whole loans held in the Investment Bank (IB) for which there is limited price transparency; and $3.9 billion of reverse mortgages for which the principal risk sensitivities are mortality risk and home prices. The fair value of the commercial and residential mortgage loans is estimated by projecting expected cash flows, considering relevant borrower-specific and market factors, and discounting those cash flows at a rate reflecting current market liquidity. Loans are partially hedged by level 2 instruments, including credit default swaps and interest rate derivatives, which are observable and liquid.

Consolidated Balance Sheets changes

Level 3 assets (including assets measured at fair value on a nonrecurring basis) were 6% of total Firm assets at June 30, 2010. The following describes significant changes to level 3 assets during the quarter.

For the three months ended June 30, 2010

Level 3 assets were $119.9 billion at June 30, 2010, reflecting a decrease of $2.0 billion from the first quarter. The decrease is mainly due to:

$3.7 billion decrease in MSRs. For a further discussion of the change, refer to Note 16 on pages 164-167 of this Form 10-Q.

$887 million decrease in trading loans driven by loans securitizations and loan sales; and

$2.0 billion increase in derivative receivables, predominantly due to widening of credit spreads.

For the six months ended June 30, 2010

Level 3 assets decreased by $10.5 billion in the first six months of 2010, due to the following:

- $3.7 billion decrease in MSRs. For a further discussion of the change, refer to Note 16 on pages 164-167 of this Form 10-Q.
- A net decrease of $3.5 billion due to the adoption of new consolidation guidance related to VIEs. As a result of the adoption of the new guidance, there was a decrease of $5.0 billion in accrued interest and accounts receivable related to retained securitization interests in Firm-sponsored credit card securitization trusts that were eliminated upon consolidation, partially offset by an increase of $1.5 billion in trading debt and equity instruments; and
- $917 million decrease in derivative receivables due to changes in credit spreads.

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Gains and Losses

Included in the tables for the three months ended June 30, 2010

$1.9 billion of net gains on derivatives, primarily related to the widening of credit spreads

$632 million in gains related to long-term structured note liabilities, primarily due to volatility in the equity markets

$3.6 billion of losses on MSRs

Included in the tables for the three months ended June 30, 2009

$3.8 billion in gains on MSRs

$1.1 billion in gains on trading-debt and equity instruments, primarily from certain asset-backed securities

$5.7 billion of net losses on derivatives primarily related to changes in credit spreads

$883 million of losses related to long-term structured note liabilities, primarily due to volatility in the equity markets

Included in the tables for the six months ended June 30, 2010

$3.7 billion of losses on MSRs

$1.2 billion of gains in net derivatives receivables

$1.0 billion of gains related to long-term structured note liabilities primarily due to volatility in the equity markets

Included in the tables for the six months ended June 30, 2009

$5.1 billion of gains on MSRs

$4.9 billion of net losses on derivatives, primarily related to changes in credit spreads and changes in interest rates

$2.5 billion of losses on trading debt and equity instruments, primarily related to residential and commercial loans and mortgage-backed securities and principally driven by markdowns and sales; these losses were partially offset by $669 million in gains on certain asset-backed securities

$850 million of losses on leveraged loans, which are primarily classified as held-for-sale and measured at the lower of cost or fair value and therefore included in nonrecurring fair value assets

Credit adjustments

When determining the fair value of an instrument, it may be necessary to record a valuation adjustment to arrive at an exit price under U.S. GAAP. Valuation adjustments include, but are not limited to, amounts to reflect counterparty credit quality and the Firm s own creditworthiness. The market s view of the Firm s credit quality is reflected in credit spreads observed in the credit default swap market. For a detailed discussion of the valuation adjustments the Firm considers, see Note 3 on pages 148-165 of JPMorgan Chase s 2009 Annual Report.

The following table provides the credit adjustments, excluding the effect of any hedging activity, reflected within the Consolidated Balance Sheets as of the dates indicated.

(in millions)	**June 30, 2010**	December 31, 2009
Derivative receivables balance	**$ 80,215**	$ 80,210
Derivatives CVA[(a)]	**(4,611)**	(3,697)
Derivative payables balance	**60,137**	60,125
Derivatives DVA	**(1,132)**	(841)[(d)]
Structured notes balance[(b)(c)]	**54,221**	59,064
Structured notes DVA	**(1,381)**	(685)[(d)]

(a) Derivatives credit valuation adjustments (CVA), gross of

hedges, includes results managed by credit portfolio and other lines of business within IB.

(b) *Structured notes are recorded within long-term debt, other borrowed funds or deposits on the Consolidated Balance Sheets, based on the tenor and legal form of the note.*

(c) *Structured notes are measured at fair value based on the Firm s election under the fair value option. For further information on these elections, see Note 4 on pages 125-127 of this Form 10-Q.*

(d) *The prior period has been revised.*

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The following table provides the impact of credit adjustments on earnings in the respective periods, excluding the effect of any hedging activity.

(in millions)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Credit adjustments:				
Derivative CVA[(a)]	**$ (1,070)**	$ 3,522	**$ (914)**	$ 4,399
Derivative DVA	**397**	(793)	**291**	(379)
Structured note DVA[(b)]	**588**	(1,099)	**696**	(461)

(a) Derivatives CVA, gross of hedges, includes results managed by credit portfolio and other lines of business within IB.

(b) Structured notes are measured at fair value based on the Firm s election under the fair value option. For further information on these elections, see Note 4 on pages 125-127 of this Form 10-Q.

Additional disclosures about the fair value of financial instruments (including financial instruments not carried at fair value)

U.S. GAAP requires disclosure of the estimated fair value of certain financial instruments, and the methods and significant assumptions used to estimate their fair value. Financial instruments within the scope of these disclosure requirements are included in the following table. Additionally, certain financial instruments and all nonfinancial instruments are excluded from the scope. Accordingly, the fair value disclosures provided in the following table include only a partial estimate of the fair value of JPMorgan Chase. For example, the Firm has developed long-term relationships with its customers through its deposit base and credit card accounts, commonly referred to as core deposit intangibles and credit card relationships. In the opinion of management, these items, in the aggregate, add significant value to JPMorgan Chase, but their fair value is not disclosed in this Note.

Financial instruments for which carrying value approximates fair value

Certain financial instruments that are not carried at fair value on the Consolidated Balance Sheets are carried at amounts that approximate fair value, due to their short-term nature and generally negligible credit risk. These instruments include cash and due from banks; deposits with banks, federal funds sold; securities purchased under resale agreements and securities borrowed with short-dated maturities; short-term receivables and accrued interest receivable; commercial paper; federal funds purchased; securities loaned and sold under repurchase agreements with short-dated maturities; other borrowed funds (excluding advances from Federal Home Loan Banks (FHLBs); accounts payable; and accrued liabilities. In addition, U.S. GAAP requires that the fair value for deposit liabilities with no stated maturity (i.e., demand, savings and certain money market deposits) be equal to their carrying value; recognition of the inherent funding value of these instruments is not permitted.

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The following table presents the carrying value and estimated fair value of financial assets and liabilities.

	June 30, 2010			December 31, 2009		
(in billions)	Carrying value	Estimated fair value	Appreciation/ (depreciation)	Carrying value	Estimated fair value	Appreciation/ (depreciation)
Financial assets						
Assets for which fair value approximates carrying value	**$ 72.2**	**$ 72.2**	**$**	$ 89.4	$ 89.4	$
Accrued interest and accounts receivable (included zero and $5.0 at fair value at June 30, 2010, and December 31, 2009, respectively)	**61.3**	**61.3**		67.4	67.4	
Federal funds sold and securities purchased under resale agreements (included $22.8 and $20.5 at fair value at June 30, 2010, and December 31, 2009, respectively)	**199.0**	**199.0**		195.4	195.4	
Securities borrowed (included $11.9 and $7.0 at fair value at June 30, 2010, and December 31, 2009, respectively)	**122.3**	**122.3**		119.6	119.6	
Trading assets	**397.5**	**397.5**		411.1	411.1	
Securities (included $312.0 and $360.4 at fair value at June 30, 2010, and December 31, 2009, respectively)	**312.0**	**312.0**		360.4	360.4	
Loans (included $2.4 and $1.4 at fair value at June 30, 2010, and December 31, 2009, respectively)(a)	**663.6**	**663.3**	**(0.3)**	601.9	598.3	(3.6)
Mortgage servicing rights at fair value	**11.9**	**11.9**		15.5	15.5	
Other (included $18.4 and $19.2 at fair value at June 30, 2010, and December 31, 2009, respectively)	**70.7**	**70.6**	**(0.1)**	73.4	73.2	(0.2)
Total financial assets	**$1,910.5**	**$1,910.1**	**$ (0.4)**	$1,934.1	$1,930.3	$ (3.8)
Financial liabilities						
Deposits (included $4.9 and $4.5 at fair value at June 30, 2010, and December 31, 2009, respectively)	**$ 887.8**	**$ 888.9**	**$ (1.1)**	$ 938.4	$ 939.5	$ (1.1)
	237.5	**237.5**		261.4	261.4	

Federal funds purchased and securities loaned or sold under repurchase agreements (included $6.0 and $3.4 at fair value at June 30, 2010, and December 31, 2009, respectively)						
Commercial paper	**41.1**	**41.1**		41.8	41.8	
Other borrowed funds (included $7.4 and $5.6 at fair value at June 30, 2010, and December 31, 2009, respectively)	**44.4**	**44.4**		55.7	55.9	(0.2)
Trading liabilities	**134.9**	**134.9**		125.1	125.1	
Accounts payable and other liabilities (included $0.5 and $0.4 at fair value at June 30, 2010, and December 31, 2009, respectively)	**131.6**	**131.6**		136.8	136.8	
Beneficial interests issued by consolidated VIEs (included $2.1 and $1.4 at fair value at June 30, 2010, and December 31, 2009, respectively)	**88.1**	**88.7**	**(0.6)**	15.2	15.2	
Long-term debt and junior subordinated deferrable interest debentures (included $41.9 and $49.0 at fair value at June 30, 2010, and December 31, 2009, respectively)	**248.6**	**247.8**	**0.8**	266.3	268.4	(2.1)
Total financial liabilities	**$1,814.0**	**$1,814.9**	**$ (0.9)**	$1,840.7	$1,844.1	$ (3.4)
Net (depreciation)/appreciation			**$ (1.3)**			$ (7.2)

(a) Fair value is typically estimated using a discounted cash flow model that incorporates the characteristics of the underlying loans (including principal, customer rate and contractual fees) and key inputs including expected lifetime credit losses, interest rates, prepayment rates and primary origination or secondary market spreads. For a further discussion of the Firm s methodologies for estimating the fair value of loans and lending-related commitments see Note 3 on pages 148-152 of JPMorgan Chase s 2009 Annual Report.

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The majority of the Firm s unfunded lending-related commitments are not carried at fair value on a recurring basis on the Consolidated Balance Sheets, nor are they actively traded. The carrying value and estimated fair value of the Firm s wholesale lending-related commitments were as follows for the periods indicated.

	June 30, 2010		December 31, 2009	
(in billions)	Carrying value(a)	Estimated fair value	Carrying value(a)	Estimated fair value
Wholesale lending-related commitments	**$ 0.9**	**$ 1.9**	$ 0.9	$ 1.3

(a) Represents the allowance for wholesale unfunded lending-related commitments. Excludes the current carrying values of the guarantee liability and the offsetting asset, each recognized at fair value at the inception of guarantees.

The Firm does not estimate the fair value of consumer lending-related commitments. In many cases, the Firm can reduce or cancel these commitments by providing the borrower prior notice or, in some cases, without notice as permitted by law. For a further discussion of the valuation of lending-related commitments, see Note 3 on pages 149-150 of JPMorgan Chase s 2009 Annual Report.

Trading assets and liabilities average balances

Average trading assets and liabilities were as follows for the periods indicated.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Trading assets debt and equity instruments(a)	**$ 340,612**	$ 308,951	**$ 336,212**	$ 311,883
Trading assets derivative receivables	**79,409**	114,096	**79,048**	128,092
Trading liabilities debt and equity instruments(a)(b)	**77,492**	54,587	**74,205**	54,726
Trading liabilities derivative payables	**62,547**	78,155	**60,809**	86,503

(a) Balances reflect the reduction of securities owned (long positions) by the amount of securities sold, but not yet

purchased (short positions) when the long and short positions have identical CUSIPs.

(b) *Primarily represent securities sold, not yet purchased.*

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NOTE 4 FAIR VALUE OPTION

For a discussion of the primary financial instruments for which fair value elections have been made, including the determination of instrument-specific credit risk for these items and the basis for those elections, see Note 4 on pages 165-167 of JPMorgan Chase s 2009 Annual Report.

2010 Elections

In connection with the adoption of the new consolidation guidance related to VIEs, effective January 1, 2010, the fair value option was elected for long-term beneficial interests related to securitization trusts within IB that were consolidated where the underlying assets are carried at fair value.

Changes in fair value under the fair value option election

The following table presents the changes in fair value included in the Consolidated Statements of Income for the three and six months ended June 30, 2010 and 2009, for items for which the fair value election was made. The profit and loss information presented below only includes the financial instruments that were elected to be measured at fair value; related risk management instruments, which are required to be measured at fair value, are not included in the table.

	Three months ended June 30,					
	2010			2009		
(in millions)	Principal transactions	Other income	Total changes in fair value recorded	Principal transactions	Other income	Total changes in fair value recorded
Federal funds sold and securities purchased under resale agreements	**$ 261**	**$**	**$ 261**	$ (269)	$	$ (269)
Securities borrowed	**27**		**27**	(12)		(12)
Trading assets:						
Debt and equity instruments, excluding loans	**40**	**(12)**[(c)]	**28**	244	22[(c)]	266
Loans reported as trading assets:						
Changes in instrument-specific credit risk	**389**	**28**[(c)]	**417**	8	(115)[(c)]	(107)
Other changes in fair value	**(299)**	**1,217**[(c)]	**918**	977	495[(c)]	1,472
Loans:						
Changes in instrument-specific credit risk	**32**		**32**	124		124
Other changes in fair value	**(44)**		**(44)**	(19)		(19)
Other assets		**(49)**[(d)]	**(49)**		(187)[(d)]	(187)
Deposits[(a)]	**(103)**		**(103)**	(21)		(21)
Federal funds purchased and securities loaned or sold under repurchase agreements	**(56)**		**(56)**	61		61
Other borrowed funds[(a)]	**838**		**838**	(180)		(180)
Trading liabilities				(13)		(13)
	(14)		**(14)**	(139)		(139)

Beneficial interests issued by consolidated VIEs					
Other liabilities	**(19)**	**14***(d)*	**(5)**	5	5
Long-term debt:					
Changes in instrument-specific credit risk*(a)*	**534**		**534**	(1,038)	(1,038)
Other changes in fair value*(b)*	**1,332**		**1,332**	(2,978)	(2,978)

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	Six months ended June 30,					
	2010			2009		
(in millions)	Principal transactions	Other income	Total changes in fair value recorded	Principal transactions	Other income	Total changes in fair value recorded
Federal funds sold and securities purchased under resale agreements	**$ 280**	**$**	**$ 280**	$ (495)	$	$ (495)
Securities borrowed	**39**		**39**	(19)		(19)
Trading assets:						
Debt and equity instruments, excluding loans	**196**	**(11)**(c)	**185**	304	19(c)	323
Loans reported as trading assets:						
Changes in instrument-specific credit risk	**798**	**22**(c)	**820**	(472)	(165)(c)	(637)
Other changes in fair value	**(683)**	**1,972**(c)	**1,289**	712	1,432(c)	2,144
Loans:						
Changes in instrument-specific credit risk	**79**		**79**	(329)		(329)
Other changes in fair value	**(71)**		**(71)**	(126)		(126)
Other assets		**(102)**(d)	**(102)**		(588)(d)	(588)
Deposits(a)	**(292)**		**(292)**	(186)		(186)
Federal funds purchased and securities loaned or sold under repurchase agreements	**(65)**		**(65)**	94		94
Other borrowed funds(a)	**912**		**912**	(146)		(146)
Trading liabilities	**(3)**		**(3)**	(15)		(15)
Beneficial interests issued by consolidated VIEs	**32**		**32**	(124)		(124)
Other liabilities	**4**	**14**(d)	**18**	4		4
Long-term debt:						
Changes in instrument-specific credit risk(a)	**585**		**585**	(394)		(394)
Other changes in fair value(b)	**1,558**		**1,558**	(1,771)		(1,771)

(a) *Total changes in instrument-specific credit risk related* *to structured notes were \$588 million and \$(1.1) billion for the three months ended June 30, 2010 and 2009, respectively, and \$696 million and \$(461) million for the six months ended June 30, 2010 and 2009, respectively. Those totals include adjustments for structured notes classified within deposits and other borrowed funds, as well as long-term debt.*

(b) *Structured notes are debt instruments with embedded derivatives that are tailored to meet a client s need for derivative risk in funded form. The embedded derivative is the primary driver of risk. Although the risk associated with the structured notes is actively managed, the gains reported in this table do not include the income statement impact of such risk management instruments.*

(c) *Reported in mortgage fees and related income.*

(d) *Reported in other income.*

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Difference between aggregate fair value and aggregate remaining contractual principal balance outstanding

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding as of June 30, 2010, and December 31, 2009, for loans, long-term debt and long-term beneficial interests for which the fair value option has been elected.

	June 30, 2010			December 31, 2009		
(in millions)	Contractual principal outstanding	Fair value	Fair value over/(under) contractual principal outstanding	Contractual principal outstanding	Fair value	Fair value over/(under) contractual principal outstanding
Loans						
Performing loans 90 days or more past due						
Loans reported as trading assets	**$**	**$**	**$**	$	$	$
Loans						
Nonaccrual loans						
Loans reported as trading assets	**6,240**	**1,834**	**(4,406)**	7,264	2,207	(5,057)
Loans	**954**	**94**	**(860)**	1,126	151	(975)
Subtotal	**7,194**	**1,928**	**(5,266)**	8,390	2,358	(6,032)
All other performing loans						
Loans reported as trading assets	**35,806**	**29,822**	**(5,984)**	35,095	29,341	(5,754)
Loans	**3,160**	**2,045**	**(1,115)**	2,147	1,000	(1,147)
Total loans	**$46,160**	**$33,795**	**$(12,365)**	$45,632	$32,699	$(12,933)
Long-term debt						
Principal protected debt	**$21,862***(b)*	**$22,152**	**$ 290**	$26,765*(b)*	$26,378	$ (387)
Nonprincipal protected debt*(a)*	**NA**	**19,776**	**NA**	NA	22,594	NA
Total long-term debt	**NA**	**$41,928**	**NA**	NA	$48,972	NA
Long-term beneficial interests						
Principal protected debt	**$ 60**	**$ 60**	**$**	$ 90	$ 90	$
Nonprincipal protected debt*(a)*	**NA**	**1,997**	**NA**	NA	1,320	NA
Total long-term beneficial interests	**NA**	**$ 2,057**	**NA**	NA	$ 1,410	NA

(a) Remaining contractual principal is not

applicable to nonprincipal-protected notes. Unlike principal-protected notes, for which the Firm is obligated to return a stated amount of principal at the maturity of the note, nonprincipal-protected notes do not obligate the Firm to return a stated amount of principal at maturity, but to return an amount based on the performance of an underlying variable or derivative feature embedded in the note.

(b) Where the Firm issues principal-protected zero-coupon or discount notes, the balance reflected as the remaining contractual principal is the final principal payment at maturity.

NOTE 5 DERIVATIVE INSTRUMENTS

For a further discussion of the Firm s use and accounting policies regarding derivative instruments, see Note 5 on pages 167 175 of JPMorgan Chase s 2009 Annual Report.

Notional amount of derivative contracts

The following table summarizes the notional amount of derivative contracts outstanding as of June 30, 2010, and December 31, 2009.

	Notional amounts[b]	
(in billions)	**June 30, 2010**	December 31, 2009
Interest rate contracts		
Swaps	**$43,448**	$ 47,663
Futures and forwards	**9,484**	6,986
Written options	**4,143**	4,553
Purchased options	**4,013**	4,584
Total interest rate contracts	**61,088**	63,786
Credit derivatives[a]	**5,352**	5,994
Foreign exchange contracts		
Cross-currency swaps	**2,251**	2,217
Spot, futures and forwards	**4,166**	3,578
Written options	**742**	685
Purchased options	**730**	699
Total foreign exchange contracts	**7,889**	7,179
Equity contracts		
Swaps	**97**	81
Futures and forwards	**41**	45
Written options	**575**	502
Purchased options	**495**	449
Total equity contracts	**1,208**	1,077
Commodity contracts		
Swaps	**206**	178
Spot, futures and forwards	**156**	113
Written options	**221**	201
Purchased options	**216**	205
Total commodity contracts	**799**	697
Total derivative notional amounts	**$76,336**	$ 78,733

(a) Primarily consists of

credit default swaps. For more information on volumes and types of credit derivative contracts, see the Credit derivatives discussion on pages 135 136 of this Note.

(b) *Represents the sum of gross long and gross short third-party notional derivative contracts.*

While the notional amounts disclosed above give an indication of the volume of the Firm s derivative activity, the notional amounts significantly exceed, in the Firm s view, the possible losses that could arise from such transactions. For most derivative transactions, the notional amount is not exchanged; it is used simply as a reference to calculate payments.

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Impact of derivatives on the Consolidated Balance Sheets

The following tables summarize information on derivative fair values that are reflected on the Firm s Consolidated Balance Sheets as of June 30, 2010, and December 31, 2009, by accounting designation (e.g., whether the derivatives were designated as hedges or not) and contract type.

Free-standing derivatives[(a)]

	Derivative receivables			Derivative payables		
June 30, 2010 (in millions)	Not designated as hedges	Designated as hedges	Total derivative receivables	Not designated as hedges	Designated as hedges	Total derivative payables
Trading assets and liabilities						
Interest rate	**$1,395,286**	**$ 7,192**	**$ 1,402,478**	**$1,359,547**	**$ 711**	**$ 1,360,258**
Credit	**155,341**		**155,341**	**148,950**		**148,950**
Foreign exchange[(b)]	**159,181**	**2,436**	**161,617**	**171,274**	**623**	**171,897**
Equity	**58,098**		**58,098**	**55,379**		**55,379**
Commodity	**32,277**	**484**	**32,761**	**32,472**	**187**[(d)]	**32,659**
Gross fair value of trading assets and liabilities	**$1,800,183**	**$ 10,112**	**$ 1,810,295**	**$1,767,622**	**$ 1,521**	**$ 1,769,143**
Netting adjustment[(c)]			**(1,730,080)**			**(1,709,006)**
Carrying value of derivative trading assets and trading liabilities on the Consolidated Balance Sheets			**$ 80,215**			**$ 60,137**

	Derivative receivables			Derivative payables		
December 31, 2009 (in millions)	Not designated as hedges	Designated as hedges	Total derivative receivables	Not designated as hedges	Designated as hedges	Total derivative payables
Trading assets and liabilities						
Interest rate	$1,148,901	$ 6,568	$ 1,155,469	$1,121,978	$ 427	$ 1,122,405
Credit	170,864		170,864	164,790		164,790
Foreign exchange[(b)]	141,790	2,497	144,287	137,865	353	138,218
Equity	57,871		57,871	58,494		58,494
Commodity	36,988	39	37,027	35,082	194[(d)]	35,276
	$1,556,414	$ 9,104	$ 1,565,518	$1,518,209	$ 974	$ 1,519,183

Gross fair value of trading assets and liabilities		
Netting adjustment[(c)]	(1,485,308)	(1,459,058)
Carrying value of derivative trading assets and trading liabilities on the Consolidated Balance Sheets	$ 80,210	$ 60,125

(a) Excludes structured notes for which the fair value option has been elected. See Note 4 on pages 125 127 of this Form 10-Q and Note 4 on pages 165 167 of JPMorgan Chase s 2009 Annual Report for further information.

(b) Excludes $36 million of foreign currency-denominated debt designated as a net investment hedge at June 30, 2010. The Firm did not use foreign currency-denominated debt as a hedging instrument in 2009, and therefore there was no impact as of December, 31, 2009.

(c) U.S. GAAP permits the netting of derivative receivables and payables, and the related cash collateral received and paid when a legally enforceable master netting agreement exists between the Firm and a derivative counterparty.

(d) Excludes $1.3 billion related to separated commodity derivatives used as fair value hedging instruments that are recorded in the line item of the host contract (other borrowed funds) for both June 30, 2010, and December 31, 2009.

Derivative receivables and payables mark-to-market

The following table summarizes the fair values of derivative receivables and payables, including those designated as hedges by contract type after netting adjustments as of June 30, 2010, and December 31, 2009.

	Trading assets-Derivative receivables		Trading liabilities-Derivative payables	
(in millions)	**June 30, 2010**	December 31, 2009	**June 30, 2010**	December 31, 2009
Contract type:				
Interest rate[(a)]	**$ 42,268**	$ 33,733	**$ 20,041**	$ 19,688
Credit[(a)]	**8,346**	11,859	**4,320**	6,036
Foreign exchange	**19,586**	21,984	**24,192**	19,818
Equity	**5,523**	6,635	**8,532**	11,554
Commodity	**4,492**	5,999	**3,052**	3,029
Total	**$ 80,215**	$ 80,210	**$ 60,137**	$ 60,125

(a) In the first quarter of 2010, cash collateral netting reporting was enhanced. Prior periods have been revised to conform to the current presentation. The revision resulted in an increase to interest rate derivative receivables and a corresponding decrease to credit derivative receivables of

$7.0 billion, and an increase to interest rate derivative payables and a corresponding decrease to credit derivative payables of $4.5 billion as of December 31, 2009.

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Impact of derivatives and hedged items on the income statement and on other comprehensive income
The following tables summarize the total pretax impact of JPMorgan Chase s derivative-related activities on the Firm s Consolidated Statements of Income and Other Comprehensive Income for the three and six months ended June 30, 2010 and 2009, respectively, by accounting designation.

Consolidated Statements of Income

	Derivative-related gains/(losses)					
Three months ended June 30, (in millions)	Fair value hedges[(a)]	Cash flow hedges	Net investment hedges[(b)]	Risk management activities	Trading activities[(a)]	Total
2010	**$ 28**	**$15**	**$(32)**	**$ 3,712**	**$(1,667)**	**$2,056**
2009	363	55	(21)	(4,624)	6,054	1,827

Consolidated Statements of Income

	Derivative-related gains/(losses)					
Six months ended June 30, (in millions)	Fair value hedges[(a)]	Cash flow hedges	Net investment hedges[(b)]	Risk management activities	Trading activities[(a)]	Total
2010	**$ 93**	**$ 15**	**$(73)**	**$ 3,689**	**$ 556**	**$4,280**
2009	470	142	(30)	(5,389)	10,125	5,318

Other Comprehensive Income/(loss)

	Derivative-related net changes in other comprehensive income					
Three months ended June 30, (in millions)	Fair value hedges	Cash flow hedges	Net investment hedges[(b)]	Risk management activities	Trading activities	Total
2010	**NA**	**$135**	**$ 431**	**NA**	**NA**	**$ 566**
2009	NA	(82)	(208)	NA	NA	(290)

Other Comprehensive Income/(loss)

	Derivative-related net changes in other comprehensive income					
Six months ended June 30, (in millions)	Fair value hedges	Cash flow hedges	Net investment hedges[(b)]	Risk management activities	Trading activities	Total
2010	**NA**	**$277**	**$757**	**NA**	**NA**	**$1,034**
2009	NA	168	(27)	NA	NA	141

(a)

Includes the hedge accounting impact of the hedged item for fair value hedges and includes cash instruments within trading activities.

(b) *Includes $2 million and $43 million of foreign currency transaction gain related to foreign currency-denominated debt designated as a net investment hedge for the three and six months ended June 30, 2010. The Firm did not use foreign currency-denominated debt as a hedging instrument in 2009 and therefore there was no impact for the three and six months ended June 30, 2009.*

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The tables that follow reflect more detailed information regarding the derivative-related income statement impact by accounting designation for the three and six months ended June 30, 2010 and 2009, respectively.

Fair value hedge gains and losses

The following tables present derivative instruments, by contract type, used in fair value hedge accounting relationships, as well as pretax gains/(losses) recorded on such derivatives and the related hedged items for the three and six months ended June 30, 2010 and 2009, respectively. The Firm includes gains/(losses) on the hedging derivative and the related hedged item in the same line item in the Consolidated Statements of Income.

Three months ended June 30, 2010 (in millions)	Gains/(losses) recorded in income Derivatives	Hedged items	Total income statement impact[d]	Income statement impact due to: Hedge ineffectiveness[e]	Excluded components[f]
Contract type					
Interest rate[a]	**$1,345**	**$(1,100)**	**$ 245**	**$ 96**	**$ 149**
Foreign exchange[b]	**3,841**	**(3,865)**	**(24)**		**(24)**
Commodity[c]	**139**	**(332)**	**(193)**		**(193)**
Total	**$5,325**	**$(5,297)**	**$ 28**	**$ 96**	**$ (68)**

Three months ended June 30, 2009 (in millions)	Gains/(losses) recorded in income Derivatives	Hedged items	Total income statement impact[d]	Income statement impact due to: Hedge ineffectiveness[e]	Excluded components[f]
Contract type					
Interest rate[a]	$(3,122)	$ 3,176	$ 54	$ (190)	$ 244
Foreign exchange[b]	(893)	1,217	324		324
Commodity[c]	(39)	24	(15)		(15)
Total	$(4,054)	$ 4,417	$ 363	$ (190)	$ 553

Six months ended June 30, 2010 (in millions)	Gains/(losses) recorded in income Derivatives	Hedged items	Total income statement impact[d]	Income statement impact due to: Hedge ineffectiveness[e]	Excluded components[f]
Contract type					

Interest rate[a]	**$1,977**	**$(1,598)**	**$ 379**	**$ 124**	**$ 255**
Foreign exchange[b]	**5,488**	**(5,522)**	**(34)**		**(34)**
Commodity[c]	**(316)**	**64**	**(252)**		**(252)**
Total	**$7,149**	**$(7,056)**	**$ 93**	**$ 124**	**$ (31)**

Six months ended June 30, 2009 (in millions)	Gains/(losses) recorded in income			Income statement impact due to:	
	Derivatives	Hedged items	Total income statement impact[d]	Hedge ineffectiveness[e]	Excluded components[f]
Contract type					
Interest rate[a]	$(3,623)	$ 3,946	$ 323	$ (484)	$ 807
Foreign exchange[b]	(1,594)	1,754	160		160
Commodity[c]	(195)	182	(13)		(13)
Total	$(5,412)	$ 5,882	$ 470	$ (484)	$ 954

(a) *Primarily consists of hedges of the benchmark (e.g., London Interbank Offered Rate (LIBOR)) interest rate risk of fixed-rate long-term debt and AFS securities. Gains and losses were recorded in net interest income.*

(b) *Primarily consists of hedges of the foreign currency risk of long-term debt and AFS securities for changes in spot foreign currency rates. Gains and* *losses related to the derivatives and the hedged items, due to changes in spot foreign currency rates, were recorded in principal transactions revenue.*

(c) *Consists of overall fair value hedges of physical gold and base metal inventory. Gains and losses were recorded in principal transactions revenue.*

(d) *Total income statement impact for fair value hedges consists of hedge ineffectiveness and any components excluded from the assessment of hedge effectiveness.*

(e) *Hedge ineffectiveness is the amount by which the gain or loss on the designated derivative instrument does not exactly offset the gain or loss on the hedged item attributable to* *the hedged risk.*

(f) *Certain components of hedging derivatives are permitted to be excluded from the assessment of hedge effectiveness, such as forward points on a futures or forwards contract. Amounts related to excluded components are recorded in current-period income.*

Cash flow hedge gains and losses

The following tables present derivative instruments, by contract type, used in cash flow hedge accounting relationships, and the pretax gains/(losses) recorded on such derivatives, for the three and six months ended June 30, 2010 and 2009, respectively. The Firm includes the gain/(loss) on the hedging derivative in the same line item as the offsetting change in cash flows on the hedged item in the Consolidated Statements of Income.

	Gains/(losses) recorded in income and other comprehensive income/(loss)				
Three months ended June 30, 2010 (in millions)	Derivatives effective portion reclassified from AOCI to income	Hedge ineffectiveness recorded directly in income[d]	Total income statement impact	Derivatives effective portion recorded in OCI	Total change in OCI for period
Contract type					
Interest rate[a]	**$ 33**[c]	**$ 8**	**$ 41**	**$ 98**	**$ 65**
Foreign exchange[b]	**(23)**	**(3)**	**(26)**	**47**	**70**
Total	**$ 10**	**$ 5**	**$ 15**	**$ 145**	**$ 135**

	Gains/(losses) recorded in income and other comprehensive income/(loss)				
Three months ended June 30, 2009 (in millions)	Derivatives effective portion reclassified from AOCI to income	Hedge ineffectiveness recorded directly in income[d]	Total income statement impact	Derivatives effective portion recorded in OCI	Total change in OCI for period
Contract type					
Interest rate[a]	$ (26)[c]	$ 1	$ (25)	$ (343)	$ (317)
Foreign exchange[b]	80		80	315	235
Total	$ 54	$ 1	$ 55	$ (28)	$ (82)

	Gains/(losses) recorded in income and other comprehensive income/(loss)				
Six months ended	Derivatives effective portion	Hedge ineffectiveness recorded directly in		Derivatives	Total change in OCI

June 30, 2010 (in millions)	reclassified from AOCI to income	income[d]	Total income statement impact	effective portion recorded in OCI	for period
Contract type					
Interest rate[a]	**$ 82**[c]	**$ 11**	**$ 93**	**$ 349**	**$ 267**
Foreign exchange[b]	**(75)**	**(3)**	**(78)**	**(65)**	**10**
Total	**$ 7**	**$ 8**	**$ 15**	**$ 284**	**$ 277**

Six months ended June 30, 2009 (in millions)	Gains/(losses) recorded in income and other comprehensive income/(loss) Derivatives effective portion reclassified from AOCI to income	Hedge ineffectiveness recorded directly in income[d]	Total income statement impact	Derivatives effective portion recorded in OCI	Total change in OCI for period
Contract type					
Interest rate[a]	$ (69)[c]	$ 2	$ (67)	$ (299)	$ (230)
Foreign exchange[b]	209		209	607	398
Total	$ 140	$ 2	$ 142	$ 308	$ 168

(a) *Primarily consists of benchmark interest rate hedges of LIBOR-indexed floating-rate assets and floating-rate liabilities. Gains and losses were recorded in net interest income.*

(b) *Primarily consists of hedges of the foreign currency risk of non U.S. dollar denominated revenue and expense. The income statement classification of gains and losses follows the hedged* *item primarily net interest income, compensation expense and other expense.*

(c) *In the second quarter of 2010, the Firm reclassified a $25 million loss from accumulated other comprehensive income (AOCI) to earnings because the Firm determined that it is probable that forecasted interest payment cash flows related to certain wholesale deposits will not occur. The Firm did not experience forecasted transactions that failed to occur during the three and six months ended June 2009, respectively.*

(d) *Hedge ineffectiveness is the amount by which the cumulative gain or loss on the designated derivative instrument exceeds the present value of the cumulative expected change in cash flows on the hedged item attributable to the hedged risk.*

Over the next 12 months, the Firm expects that $296 million (after-tax) of net losses recorded in AOCI at June 30, 2010, related to cash flow hedges will be recognized in income. The maximum length of time over which forecasted transactions are hedged is 10 years, and such transactions primarily relate to core lending and borrowing activities.

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Net investment hedge gains and losses

The following tables present hedging instruments, by contract type, that were used in net investment hedge accounting relationships, and the pretax gains/(losses) recorded on such instruments for the three and six months ended June 30, 2010 and 2009, respectively.

	Gains/(losses) recorded in income and other comprehensive income/(loss)			
	2010		2009	
Three months ended June 30, (in millions)	Excluded components recorded directly in income(a)	Effective portion recorded in OCI	Excluded components recorded directly in income(a)	Effective portion recorded in OCI
Contract type				
Foreign exchange derivatives	**$ (32)**	**$ 429**	$ (21)	$ (208)
Foreign currency denominated debt		**2**	NA	NA
Total	**$ (32)**	**$ 431**	$ (21)	$ (208)

	Gains/(losses) recorded in income and other comprehensive income/(loss)			
	2010		2009	
Six months ended June 30, (in millions)	Excluded components recorded directly in income(a)	Effective portion recorded in OCI	Excluded components recorded directly in income(a)	Effective portion recorded in OCI
Contract type				
Foreign exchange derivatives	**$ (73)**	**$ 714**	$ (30)	$ (27)
Foreign currency denominated debt		**43**	NA	NA
Total	**$ (73)**	**$ 757**	$ (30)	$ (27)

(a) Certain components of derivatives used as hedging instruments are permitted to be excluded from the assessment of hedge effectiveness, such as forward

points on a futures or forwards contract. Amounts related to excluded components are recorded in current-period income. There was no ineffectiveness for net investment hedge accounting relationships during the three and six months ended June 30, 2010 and 2009.

Risk management derivatives gains and losses (not designated as hedging instruments)

The following table presents nontrading derivatives, by contract type, that were not designated in hedge relationships, and the pretax gains/(losses) recorded on such derivatives for the three and six months ended June 30, 2010 and 2009, respectively. These derivatives are risk management instruments used to mitigate or transform the risk of market exposures arising from banking activities other than trading activities, which are discussed separately below.

	Derivatives gains/(losses) recorded in income			
	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Contract type				
Interest rate*(a)*	**$3,672**	$(3,047)	**$3,812**	$(3,200)
Credit*(b)*	**60**	(1,512)	**(59)**	(2,028)
Foreign exchange*(c)*	**(20)**	(82)	**(41)**	(151)
Equity				
Commodity*(b)*		17	**(23)**	(10)
Total	**$3,712**	$(4,624)	**$3,689**	$(5,389)

(a) Gains and losses were recorded in principal transactions revenue, mortgage fees and related income, and net interest income.

(b) *Gains and losses were recorded in principal transactions revenue.*

(c) *Gains and losses were recorded in principal transactions revenue and net interest income.*

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Trading derivative gains and losses

The following table presents trading derivatives gains and losses, by contract type, that are recorded in principal transactions revenue in the Consolidated Statements of Income for the three and six months ended June 30, 2010 and 2009, respectively. The Firm has elected to present derivative gains and losses related to its trading activities together with the cash instruments with which they are risk managed.

	Gains/(losses) recorded in principal transactions revenue			
	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Type of instrument				
Interest rate	**$ (37)**	$1,373	**$ 70**	$ 3,758
Credit	**1,287**	2,332	**3,412**	1,683
Foreign exchange	**(3,035)**	2,052	**(4,279)**	3,126
Equity	**85**	(62)	**907**	798
Commodity	**33**	359	**446**	760
Total	**$(1,667)**	$6,054	**$ 556**	$10,125

Credit risk, liquidity risk and credit-related contingent features

Derivative payables expose the Firm to liquidity risk, as the derivative contracts typically require the Firm to post cash or securities collateral with counterparties as the mark-to-market (MTM) moves in the counterparties favor, or upon specified downgrades in the Firm s or its subsidiaries respective credit ratings. At June 30, 2010, the impact of a single-notch and six-notch ratings downgrade to JPMorgan Chase & Co. and its subsidiaries, primarily JPMorgan Chase Bank, National Association (JPMorgan Chase Bank, N.A.) would have required $1.5 billion and $5.0 billion, respectively, of additional collateral to be posted by the Firm. Certain derivative contracts also provide for termination of the contract, generally upon a downgrade of either the Firm or the counterparty, at the fair value of the derivative contracts. At June 30, 2010, the impact of single-notch and six-notch ratings downgrades to JPMorgan Chase & Co. and its subsidiaries, primarily JPMorgan Chase Bank, N.A., related to contracts with termination triggers would have required the Firm to settle trades with a fair value of $349 million and $6.3 billion, respectively. The aggregate fair value of net derivative payables that contain contingent collateral or termination features triggered upon a downgrade was $37.0 billion at June 30, 2010, for which the Firm has posted collateral of $30.2 billion in the normal course of business.

The following tables show the current credit risk of derivative receivables after netting adjustments and collateral received, and the current liquidity risk of derivative payables after netting adjustments and collateral posted, as of June 30, 2010, and December 31, 2009, respectively.

June 30, 2010(in millions)	Derivative receivables	Derivative payables
Gross derivative fair value	**$ 1,810,295**	**$ 1,769,143**
Netting adjustment offsetting receivables/payables	**(1,660,105)**	**(1,660,105)**
Netting adjustment cash collateral received/paid	**(69,975)**	**(48,901)**
Carrying value on Consolidated Balance Sheets	**$ 80,215**	**$ 60,137**

December 31, 2009 (in millions)

	Derivative receivables	Derivative payables
Gross derivative fair value	$ 1,565,518	$ 1,519,183
Netting adjustment offsetting receivables/payables	(1,419,840)	(1,419,840)
Netting adjustment cash collateral received/paid	(65,468)	(39,218)
Carrying value on Consolidated Balance Sheets	$ 80,210	$ 60,125

In addition to the collateral amounts reflected in the tables above, at June 30, 2010, and December 31, 2009, the Firm had received liquid securities collateral in the amount of $19.3 billion and $15.5 billion, respectively, and posted $12.0 billion and $11.7 billion, respectively. The Firm also receives and delivers collateral at the initiation of derivative transactions, which is available as security against potential exposure that could arise should the fair value of the transactions move in the Firm s or client s favor, respectively. Furthermore, the Firm and its counterparties hold collateral related to contracts that have a non-daily call frequency for collateral to be posted, and collateral that the Firm or a counterparty has agreed to return but has not yet settled as of the reporting date. At June 30, 2010, and December 31, 2009, the Firm had received $16.1 billion and $16.9 billion, respectively, and delivered $9.7 billion and $5.8 billion, respectively, of such additional collateral. These amounts were not netted against the derivative receivables and payables in the tables above, because, at an individual counterparty level, the collateral exceeded the fair value exposure at both June 30, 2010, and December 31, 2009.

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Credit derivatives

For a more detailed discussion of credit derivatives, including a description of the different types used by the Firm, see Note 5 on pages 167 175, of JPMorgan Chase s 2009 Annual Report.

The following tables present a summary of the notional amounts of credit derivatives and credit-related notes the Firm sold and purchased as of June 30, 2010, and December 31, 2009. Upon a credit event, the Firm as a seller of protection would typically pay out only a percentage of the full notional amount of net protection sold, as the amount actually required to be paid on the contracts takes into account the recovery value of the reference obligation at the time of settlement. The Firm manages the credit risk on contracts to sell protection by purchasing protection with identical or similar underlying reference entities. As such, other purchased protection referenced in the following tables include credit derivatives bought on related, but not identical, reference positions; these include indices, portfolio coverage and other reference points. The Firm does not use notional amounts as the primary measure of risk management for credit derivatives, because the notional amount does not take into account the probability of the occurrence of a credit event, the recovery value of the reference obligation, or related cash instruments and economic hedges.

Total credit derivatives and credit-related notes

		Maximum payout/Notional amount		
June 30, 2010		Protection purchased with identical	Net protection	Other protection
(in millions)	Protection sold	underlyings[(b)]	(sold)/purchased[(c)]	purchased[(d)]
Credit derivatives				
Credit default swaps	**$(2,620,672)**	**$ 2,601,815**	**$ (18,857)**	**$ 28,970**
Other credit derivatives[(a)]	**(34,066)**	**33,303**	**(763)**	**33,607**
Total credit derivatives	**(2,654,738)**	**2,635,118**	**(19,620)**	**62,577**
Credit-related notes	**(2,426)**		**(2,426)**	**2,388**
Total	**$(2,657,164)**	**$ 2,635,118**	**$ (22,046)**	**$ 64,965**

		Maximum payout/Notional amount		
December 31, 2009		Protection purchased with identical	Net protection	Other protection
(in millions)	Protection sold	underlyings[(b)]	(sold)/purchased[(c)]	purchased[(d)]
Credit derivatives				
Credit default swaps	$(2,937,442)	$ 2,978,044	$ 40,602	$ 28,064
Other credit derivatives[(a)]	(10,575)	9,290	(1,285)	30,473
Total credit derivatives	(2,948,017)	2,987,334	39,317	58,537
Credit-related notes	(4,031)		(4,031)	1,728
Total	$(2,952,048)	$ 2,987,334	$ 35,286	$ 60,265

(a) Primarily consists of total

return swaps and credit default swap options.

(b) *Represents the total notional amount of protection purchased where the underlying reference instrument is identical to the reference instrument on protection sold; the notional amount of protection purchased for each individual identical underlying reference instrument may be greater or lower than the notional amount of protection sold.*

(c) *Does not take into account the fair value of the reference obligation at the time of settlement, which would generally reduce the amount the seller of protection pays to the buyer of protection in determining settlement value.*

(d) *Represents single-name and index credit default swap protection the Firm purchased.*

The following tables summarize the notional and fair value amounts of credit derivatives and credit-related notes as of June 30, 2010, and December 31, 2009, where JPMorgan Chase is the seller of protection. The maturity profile is based on the remaining contractual maturity of the credit derivative contracts. The ratings profile is based on the rating of the reference entity on which the credit derivative contract is based. The ratings and maturity profile of protection purchased are comparable to the profile reflected below.

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Protection sold credit derivatives and credit-related notes ratings[(a)]/maturity profile

June 30, 2010(in millions)	<1 year	1 - 5 years	>5 years	Total notional amount	Fair value[(b)]
Risk rating of reference entity					
Investment-grade	**$(172,090)**	**$(1,041,476)**	**$(249,712)**	**$(1,463,278)**	**$ (22,100)**
Noninvestment-grade	**(142,851)**	**(800,690)**	**(250,345)**	**(1,193,886)**	**(92,142)**
Total	**$(314,941)**	**$(1,842,166)**	**$(500,057)**	**$(2,657,164)**	**$(114,242)**

December 31, 2009 (in millions)	<1 year	1 - 5 years	>5 years	Total notional amount	Fair value[(b)]
Risk rating of reference entity					
Investment-grade	$(215,580)	$(1,140,133)	$(367,015)	$(1,722,728)	$ (16,607)
Noninvestment-grade	(150,122)	(806,139)	(273,059)	(1,229,320)	(90,410)
Total	$(365,702)	$(1,946,272)	$(640,074)	$(2,952,048)	$(107,017)

(a) *The ratings scale is based on the Firm s internal ratings, which generally correspond to ratings as defined by S&P and Moody s.*

(b) *Amounts are shown on a gross basis, before the benefit of legally enforceable master netting agreements and cash collateral held by the Firm.*

NOTE 6 OTHER NONINTEREST REVENUE

For a discussion of the components of and accounting policies for the Firm s other noninterest revenue, see Note 6 on pages 175 176 of JPMorgan Chase s 2009 Annual Report.

The following table presents the components of investment banking fees.

(in millions)	Three months ended June 30, **2010**	2009	Six months ended June 30, **2010**	2009
Underwriting:				
Equity	**$ 354**	$ 949	**$ 767**	$1,257
Debt	**711**	766	**1,462**	1,369
Total underwriting	**1,065**	1,715	**2,229**	2,626
Advisory[(a)]	**356**	391	**653**	866
Total investment banking fees	**$1,421**	$2,106	**$2,882**	$3,492

(a) Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon the adoption of the guidance, the Firm consolidated its Firm-administered multi-seller conduits. The consolidation of the conduits did not significantly change the Firm s net income as a whole; however, it did affect the classification of items on the Firm s Consolidated Statements of Income. As a result, certain advisory fees were eliminated, which were offset by an increase in lending- and deposit-related fees.

The following table presents principal transactions revenue.

(in millions)	Three months ended June 30, **2010**	2009	Six months ended June 30, **2010**	2009

Trading revenue	**$2,010**	$3,155	**$6,396**	$5,644
Private equity gains/(losses)[(a)]	**80**	(58)	**242**	(546)
Principal transactions	**$2,090**	$3,097	**$6,638**	$5,098

(a) Includes revenue on private equity investments held in the Private Equity business within Corporate/Private Equity, and those held in other business segments.

The following table presents components of asset management, administration and commissions.

(in millions)	Three months ended June 30, **2010**	2009	Six months ended June 30, **2010**	2009
Asset management:				
Investment management fees	**$1,317**	$1,172	**$2,644**	$2,255
All other asset management fees	**116**	78	**225**	159
Total asset management fees	**1,433**	1,250	**2,869**	2,414
Total administration fees[(a)]	**531**	498	**1,022**	953
Commission and other fees:				
Brokerage commissions	**753**	762	**1,456**	1,449
All other commissions and fees	**632**	614	**1,267**	1,205
Total commissions and fees	**1,385**	1,376	**2,723**	2,654
Total asset management, administration and commissions	**$3,349**	$3,124	**$6,614**	$6,021

(a) Includes fees for custody, securities lending, funds services and securities clearance.

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NOTE 7 INTEREST INCOME AND INTEREST EXPENSE

Details of interest income and interest expense were as follows.

(in millions)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Interest income(a)				
Loans	**$ 9,969**	$ 9,825	**$ 20,526**	$ 20,333
Securities	**2,517**	3,178	**5,421**	6,038
Trading assets	**2,574**	2,954	**5,334**	6,168
Federal funds sold and securities purchased under resale agreements	**398**	368	**805**	1,018
Securities borrowed	**32**	(96)	**61**	(10)
Deposits with banks	**92**	246	**187**	689
Other assets(b)	**137**	74	**230**	239
Total interest income(c)	**15,719**	16,549	**32,564**	34,475
Interest expense(a)				
Interest-bearing deposits	**883**	1,165	**1,727**	2,851
Short-term and other liabilities(d)	**583**	876	**1,284**	1,967
Long-term debt	**1,260**	1,781	**2,520**	3,525
Beneficial interests issued by consolidated VIEs	**306**	57	**636**	95
Total interest expense(c)	**3,032**	3,879	**6,167**	8,438
Net interest income	**12,687**	12,670	**26,397**	26,037
Provision for credit losses	**3,363**	8,031	**10,373**	16,627
Net interest income after provision for credit losses	**$ 9,324**	$ 4,639	**$ 16,024**	$ 9,410

(a) Interest income and expense include the current-period interest accruals for financial instruments measured at fair value, except for financial instruments containing embedded derivatives that would be separately accounted for in

accordance with U.S. GAAP absent the fair value option election; for those instruments, all changes in fair value, including any interest elements, are reported in principal transactions revenue.

(b) *Predominantly margin loans.*

(c) *Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon the adoption of the new guidance, the Firm consolidated its Firm-sponsored credit card securitization trusts, its Firm-administered multi-seller conduits and certain other consumer loan securitization entities, primarily mortgage-related. The consolidation of these VIEs did not significantly change the Firm s total net income. However, it did affect the classification of items on the Firm s Consolidated Statements of Income; as a result of the adoption of* *the new guidance, certain noninterest revenue was eliminated, offset by the recognition of interest income, interest expense, and provision for credit losses.*

(d) *Includes brokerage customer payables.*

NOTE 8 PENSION AND OTHER POSTRETIREMENT EMPLOYEE BENEFIT PLANS

For a discussion of JPMorgan Chase s pension and other postretirement employee benefit (OPEB) plans, see Note 8 on pages 176 183 of JPMorgan Chase s 2009 Annual Report.

The following table presents the components of net periodic benefit cost reported in the Consolidated Statements of Income for the Firm s U.S. and non-U.S. defined benefit pension and OPEB plans.

	Defined benefit pension plans					
	U.S.		Non-U.S.		OPEB plans	
Three months ended June 30, (in millions)	**2010**	2009	**2010**	2009	**2010**	2009
Components of net periodic benefit cost						
Benefits earned during the period	**$ 58**	$ 80	**$ 6**	$ 7	**$ 1**	$ 1
Interest cost on benefit obligations	**117**	128	**77**	30	**13**	13
Expected return on plan assets	**(185)**	(146)	**(75)**	(28)	**(24)**	(24)
Amortization:						
Net loss	**56**	77	**13**	11		
Prior service cost (credit)	**(11)**	1			**(4)**	(3)
Net periodic defined benefit cost for material plans	**35**	140	**21**	20	**(14)**	(13)
Net periodic defined benefit cost for individually immaterial plans	**3**	4	**1**	4	NA	NA
Total net periodic defined benefit cost for all plans	**38**	144	**22**	24	**(14)**	(13)
Total cost for defined contribution plans	**84**	76	**67**	63	NA	NA
Total pension and OPEB cost included in compensation expense	**$ 122**	$ 220	**$ 89**	$ 87	**$(14)**	$(13)

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	Defined benefit pension plans					
	U.S.		Non-U.S.		OPEB plans	
Six months ended June 30, (in millions)	**2010**	2009	**2010**	2009	**2010**	2009
Components of net periodic benefit cost						
Benefits earned during the period	**$ 116**	$ 157	**$ 13**	$ 14	**$ 1**	$ 2
Interest cost on benefit obligations	**234**	256	**63**	56	**28**	31
Expected return on plan assets	**(371)**	(292)	**(62)**	(52)	**(48)**	(48)
Amortization:						
Net loss	**112**	153	**27**	21		
Prior service cost (credit)	**(22)**	2			**(7)**	(7)
Net periodic defined benefit cost for material plans	**69**	276	**41**	39	**(26)**	(22)
Net periodic defined benefit cost for individually immaterial plans	**7**	7	**5**	8	**NA**	NA
Total net periodic defined benefit cost for all plans	**76**	283	**46**	47	**(26)**	(22)
Total cost for defined contribution plans	**147**	154	**132**	122	**NA**	NA
Total pension and OPEB cost included in compensation expense	**$ 223**	$ 437	**$178**	$169	**$(26)**	$(22)

The fair value of plan assets for the U.S. defined benefit pension and OPEB plans and for the material non-U.S. defined benefit pension plans were $11.0 billion and $2.3 billion, respectively, as of June 30, 2010, and $11.5 billion and $2.4 billion, respectively, as of December 31, 2009. See Note 20 on pages 168 169 of this Form 10-Q for further information on unrecognized amounts (i.e., net loss and prior service costs/(credit)) reflected in AOCI for the six months ended June 30, 2010 and 2009.

The amount, if any, of 2010 potential contributions for the U.S. qualified defined benefit pension plans is not reasonably estimable at this time. The 2010 potential contributions for the Firm s U.S. non-qualified defined benefit pension plans are estimated to be $42 million and for the non-U.S. defined benefit pension and OPEB plans are estimated to be $171 million and $2 million, respectively.

NOTE 9 EMPLOYEE STOCK-BASED INCENTIVES

For a discussion of the accounting policies and other information relating to employee stock-based incentives, see Note 9 on pages 184 186 of JPMorgan Chase s 2009 Annual Report.

The Firm recognized noncash compensation expense related to its various employee stock-based incentive plans of $832 million and $884 million for the three months ended June 30, 2010 and 2009, respectively, and $1.8 billion and $1.7 billion for the six months ended June 30, 2010 and 2009, respectively, in its Consolidated Statements of Income. For the three months ended June 30, 2010 and 2009, these amounts included expense of $645 million and $692 million, respectively, related to the cost of prior grants of restricted stock units (RSUs) and stock appreciation rights (SARs) that are amortized over their applicable vesting periods, and expense of $187 million and $192 million, respectively, related to the accrual of estimated costs of RSUs and SARs to be granted in future periods to full-career eligible employees. For the six months ended June 30, 2010, and 2009, these amounts included expense of $1.4 billion and $1.4 billion, respectively, related to the cost of prior grants of RSUs and SARs that are amortized over their applicable vesting periods, and expense of $440 million and $332 million, respectively, related to the accrual of estimated costs of RSUs and SARs to be granted in future periods to full-career eligible employees.

In the first quarter of 2010, the Firm granted 71 million RSUs, with a weighted average grant date fair value of $43.12 per RSU, in connection with its annual incentive grant.

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NOTE 10 NONINTEREST EXPENSE

The following table presents the components of noninterest expense.

(in millions)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Compensation expense[(a)]	**$ 7,616**	$ 6,917	**$ 14,892**	$ 14,505
Noncompensation expense:				
Occupancy expense	**883**	914	**1,752**	1,799
Technology, communications and equipment expense	**1,165**	1,156	**2,302**	2,302
Professional and outside services	**1,685**	1,518	**3,260**	3,033
Marketing	**628**	417	**1,211**	801
Other expense[(b)(c)(d)]	**2,419**	2,190	**6,860**	3,565
Amortization of intangibles	**235**	265	**478**	540
Total noncompensation expense	**7,015**	6,460	**15,863**	12,040
Merger costs		143*(e)*		348*(e)*
Total noninterest expense	**$ 14,631**	$ 13,520	**$ 30,755**	$ 26,893

(a) *The second quarter and year-to-date of 2010 include a payroll tax expense related to the United Kingdom (U.K.) Bank Payroll Tax on certain compensation awarded from December 9, 2009, to April 5, 2010, to relevant banking employees.*

(b) *Includes litigation expense of $792 million and $3.7 billion for the three and six months ended June 30, 2010, compared with $14 million and a net benefit of $256 million for* *the three and six months ended June 30, 2009, respectively.*

(c) *Includes foreclosed property expense of $244 million and $547 million for the three and six months ended June 30, 2010, respectively, compared with $294 million and $619 million for the three and six months ended June 30, 2009, respectively. For additional information regarding foreclosed property, see Note 13 on page 196 of JPMorgan Chase s 2009 Annual Report.*

(d) *The second quarter of 2009 includes a $675 million Federal Deposit Insurance Corporation (FDIC) special assessment.*

(e) *Includes $61 million and $203 million for compensation expense, $15 million and $20 million for occupancy expense and $67 million and $125 million for technology and communications* *and other expense for the three and six months ended June 30, 2009, respectively. With the exception of occupancy- and technology-related write-offs, all of the costs required the expenditure of cash.*

NOTE 11 SECURITIES

Securities are classified as AFS, held-to-maturity (HTM) or trading. For additional information regarding AFS and HTM securities, see Note 11 on pages 187 191 of JPMorgan Chase s 2009 Annual Report. Trading securities are discussed in Note 3 on pages 110 124 of this Form 10-Q.

Securities gains and losses

The following table presents realized gains and losses and credit losses that were recognized in income from AFS securities.

(in millions)	Three months ended June 30, **2010**	2009	Six months ended June 30, **2010**	2009
Realized gains	**$1,130**	$ 743	**$1,882**	$1,153
Realized losses	**(130)**	(210)	**(172)**	(417)
Net realized gains[(a)]	**1,000**	533	**1,710**	736
Credit losses included in securities gains[(b)]		(186)	**(100)**	(191)
Net securities gains	**$1,000**	$ 347	**$1,610**	$ 545

(a) *Proceeds from securities sold were within approximately 3% of amortized cost.*

(b) *Includes OTTI losses recognized in income on certain prime mortgage-backed securities and obligations of U.S. states and municipalities for the six months ended June 30, 2010, and on* *certain subprime and prime mortgage-backed securities, and obligations of U.S. states and municipalities for the three and six months ended June 30, 2009, respectively.*

The amortized costs and estimated fair values of AFS and HTM securities were as follows for the dates indicated.

(in millions)	**June 30, 2010** Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value	December 31, 2009 Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Available-for-sale debt securities								
Mortgage-backed securities:								
U.S. government agencies[(a)]	**$135,374**	**$5,005**	**$ 2**	**$140,377**	$166,094	$2,412	$ 608	$167,898
Residential:								
Prime and Alt-A	**3,217**	**107**	**420**[(d)]	**2,904**	5,234	96	807[(d)]	4,523
Subprime					17			17
Non-U.S.	**28,551**	**330**	**171**	**28,710**	10,003	320	65	10,258
Commercial	**4,555**	**390**	**5**	**4,940**	4,521	132	63	4,590
Total mortgage-backed securities	**171,697**	**5,832**	**598**	**176,931**	185,869	2,960	1,543	187,286
U.S. Treasury and government agencies[(a)]	**17,614**	**228**	**8**	**17,834**	30,044	88	135	29,997
Obligations of U.S. states and municipalities	**8,331**	**370**	**12**	**8,689**	6,270	292	25	6,537
Certificates of deposit	**2,236**	**2**		**2,238**	2,649	1		2,650
Non-U.S. government debt securities	**19,484**	**180**	**106**	**19,558**	24,320	234	51	24,503
Corporate debt securities[(b)]	**55,022**	**578**	**356**	**55,244**	61,226	812	30	62,008
Asset-backed securities:								
Credit card receivables	**9,017**	**367**	**4**	**9,380**	25,266	502	26	25,742
Collateralized loan obligations	**11,911**	**458**	**262**	**12,107**	12,172	413	436	12,149
Other	**7,626**	**145**	**18**	**7,753**	6,719	129	54	6,794
Total available-for-sale debt securities	**302,938**	**8,160**	**1,364**[(d)]	**309,734**	354,535	5,431	2,300[(d)]	357,666
Available-for-sale equity securities	**2,122**	**141**	**5**	**2,258**	2,518	185	4	2,699
Total available-for-sale securities	**$305,060**	**$8,301**	**$1,369**[(d)]	**$311,992**	$357,053	$5,616	$2,304[(d)]	$360,365
Total held-to-maturity securities[(c)]	**$ 21**	**$ 2**	**$**	**$ 23**	$ 25	$ 2	$	$ 27

(a) Includes total U.S. government-sponsored enterprise obligations

with fair values of $113.8 billion and $153.0 billion at June 30, 2010, and December 31, 2009, respectively, which were predominantly mortgage-related.

(b) *Consists primarily of bank debt including sovereign government guaranteed bank debt.*

(c) *Consists primarily of mortgage-backed securities issued by U.S. government-sponsored enterprises.*

(d) *Includes a total of $206 million and $368 million (before tax) of unrealized losses not related to credit reported in AOCI on prime mortgage-backed securities for which credit losses have been recognized in income at June 30, 2010, and December 31, 2009, respectively.*

Securities impairment

The following tables present the fair value and gross unrealized losses for AFS securities by aging category at June 30, 2010, and December 31, 2009.

	Securities with gross unrealized losses					
	Less than 12 months		12 months or more			
June 30, 2010(in millions)	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Total fair value	Total gross unrealized losses
Available-for-sale debt securities						
Mortgage-backed securities:						
U.S. government agencies	**$**	**$**	**$ 254**	**$ 2**	**$ 254**	**$ 2**
Residential:						
Prime and Alt-A			**1,769**	**420**	**1,769**	**420**
Subprime						
Non-U.S.	**17,427**	**135**	**1,019**	**36**	**18,446**	**171**
Commercial	**172**	**2**	**51**	**3**	**223**	**5**
Total mortgage-backed securities	**17,599**	**137**	**3,093**	**461**	**20,692**	**598**
U.S. Treasury and government agencies	**2,833**	**8**			**2,833**	**8**
Obligations of U.S. states and municipalities	**638**	**12**			**638**	**12**
Certificates of deposit						
Non-U.S. government debt securities	**5,323**	**85**	**1,258**	**21**	**6,581**	**106**
Corporate debt securities	**18,131**	**354**	**621**	**2**	**18,752**	**356**
Asset-backed securities:						
Credit card receivables			**393**	**4**	**393**	**4**
Collateralized loan obligations			**7,406**	**262**	**7,406**	**262**
Other	**1,623**	**9**	**276**	**9**	**1,899**	**18**
Total available-for-sale debt securities	**46,147**	**605**	**13,047**	**759**	**59,194**	**1,364**
Available-for-sale equity securities	**2**	**1**	**2**	**4**	**4**	**5**
Total securities with gross unrealized losses	**$46,149**	**$606**	**$13,049**	**$763**	**$59,198**	**$1,369**

	Securities with gross unrealized losses					
	Less than 12 months		12 months or more			
December 31, 2009 (in millions)	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Total fair value	Total gross unrealized losses

Available-for-sale debt securities						
Mortgage-backed securities:						
U.S. government agencies	$43,235	$603	$ 644	$ 5	$43,879	$ 608
Residential:						
Prime and Alt-A	183	27	3,032	780	3,215	807
Subprime						
Non-U.S.	391	1	1,773	64	2,164	65
Commercial	679	34	229	29	908	63
Total mortgage-backed securities	44,488	665	5,678	878	50,166	1,543
U.S. Treasury and government agencies	8,433	135			8,433	135
Obligations of U.S. states and municipalities	472	11	389	14	861	25
Certificates of deposit						
Non-U.S. government debt securities	2,471	46	835	5	3,306	51
Corporate debt securities	1,831	12	4,634	18	6,465	30
Asset-backed securities:						
Credit card receivables			745	26	745	26
Collateralized loan obligations	42	1	7,883	435	7,925	436
Other	767	8	1,767	46	2,534	54
Total available-for-sale debt securities	58,504	878	21,931	1,422	80,435	2,300
Available-for-sale equity securities	1	1	3	3	4	4
Total securities with gross unrealized losses	$58,505	$879	$21,934	$1,425	$80,439	$2,304

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Other-than-temporary impairment (OTTI)
The following table presents credit losses that are included in the securities gains and losses table above.

(in millions)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Debt securities the Firm does not intend to sell that have credit losses				
Total losses[(a)]		$ (880)	**$ (94)**	$ (880)
Losses recorded in/(reclassified from) other comprehensive income		696	**(6)**	696
Credit losses recognized in income on debt securities the Firm does not intend to sell[(b)]		(184)	**(100)**	(184)
Credit losses recognized in income on debt securities the Firm intends to sell		(2)[(c)]		(7)[(c)]
Total credit losses recognized in income		$ (186)	**$ (100)**	$ (191)

(a) *For initial OTTI, represents the excess of the amortized cost over the fair value of AFS debt securities. For subsequent impairments of the same security, represents additional declines in fair value subsequent to previously recorded OTTI, if applicable.*

(b) *Represents the credit loss component of certain prime mortgage-backed securities and obligations of U.S. states and municipalities that the Firm* *does not intend to sell. Subsequent credit losses may be recorded on securities without a corresponding further decline in fair value if there has been a decline in expected cash flows.*

(c) *Includes OTTI losses recognized in income on certain subprime mortgage-backed securities. These securities were sold during the third quarter of 2009.*

Changes in the credit loss component of credit-impaired debt securities

The following table presents a rollforward for the three and six months ended June 30, 2010 and 2009, of the credit loss component of OTTI losses that have been recognized in income, related to debt securities that the Firm does not intend to sell.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Balance, beginning of period	**$ 660**	$	**$ 578**	$
Additions:				
Increase in losses on previously credit-impaired securities		184	**94**	184
Losses reclassified from other comprehensive income on previously credit-impaired securities			**6**	
Reductions:				
Sales of credit-impaired securities	**(20)**		**(23)**	
Impact of new consolidation guidance related to VIEs			**(15)**	
Balance, end of period	**$ 640**	$ 184	**$ 640**	$ 184

Unrealized losses have generally decreased since December 31, 2009, due primarily to market spread improvement and increased liquidity, driving asset prices higher. Unrealized losses on certain securities have increased, including on corporate debt securities which included government-guaranteed positions that experienced credit spread widening. As of June 30, 2010, the Firm does not intend to sell the securities with a loss position in AOCI, and it is not likely that the Firm will be required to sell these securities before recovery of their amortized cost basis. Except for the securities reported in the table above for which credit losses have been recognized in income, the Firm believes that the securities with an unrealized loss in AOCI are not other-than-temporarily impaired as of June 30, 2010.

Following is a description of the Firm s main security investments with the most significant unrealized losses as of June 30, 2010, and the key assumptions used in its estimate of the present value of the cash flows most likely to be collected from these investments.

Mortgage-backed securities Prime and Alt-A nonagency

As of June 30, 2010, gross unrealized losses related to prime and Alt-A residential mortgage-backed securities issued by private issuers were $420 million, all of which related to securities that have been in an unrealized loss position for 12 months or more. Overall losses have decreased since December 31, 2009, due to increased market stabilization, resulting from increased demand for higher-yielding asset classes and U.S. government programs. Approximately one-fifth of these positions (by amortized cost) are currently rated AAA. The remaining four-fifths have experienced downgrades since purchase, and approximately half of the downgraded positions are currently rated below investment-grade. Despite significant downgrades experienced in the portfolio, most of these are senior positions and possess adequate credit enhancement to absorb future expected losses. In analyzing prime and Alt-A residential mortgage-backed securities for potential credit losses, the Firm utilizes a methodology that focuses on loan-level detail to estimate future cash flows, which are then applied to the various tranches of issued securities based on their respective contractual provisions of the securitization trust. The loan-level analysis considers prepayment, home price, default rate and loss severity assumptions. Given this level of granularity, the underlying assumptions vary significantly taking into consideration such factors as the financial condition of the borrower, loan-to-value (LTV) ratio, loan type and geographical location of the underlying property. The weighted average underlying default rate on the positions was 23% and the related weighted average loss severity was 50%. Based on this analysis, the Firm has not recognized any additional OTTI losses in earnings during the second quarter of 2010; however, an OTTI loss of $6 million was

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recognized in the first quarter of 2010 related to securities that experienced increased delinquency rates associated with specific collateral types and origination dates. The unrealized loss of $420 million is considered temporary, based on management s assessment that the credit enhancement levels for those securities remain sufficient to support the Firm s investment.

Asset-backed securities Collateralized loan obligations

As of June 30, 2010, gross unrealized losses related to CLOs were $262 million, all of which related to securities that were in an unrealized loss position for 12 months or more. Overall losses have decreased since December 31, 2009, mainly as a result of lower default forecasts and spread tightening across various asset classes. Substantially all of these securities are rated AAA, AA and A and have an average credit enhancement of 29%. Credit enhancement in CLOs is primarily in the form of overcollateralization, which is the excess of the par amount of collateral over the par amount of securities. The key assumptions considered in analyzing potential credit losses were underlying loan and debt security defaults and loss severity. Based on current default trends, the Firm assumed collateral default rates of 5% for the second quarter 2010 and thereafter. Further, loss severities were assumed to be 50% for loans and 80% for debt securities. Losses on collateral were estimated to occur approximately 24 months after default.

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Contractual maturities and yields

The following table presents the amortized cost and estimated fair value at June 30, 2010, of JPMorgan Chase s AFS and HTM securities by contractual maturity.

		June 30, 2010			
By remaining maturity (in millions)	Due in one year or less	Due after one year through five years	Due after five years through 10 years	Due after 10 years[(c)]	Total
Available-for-sale debt securities					
Mortgage-backed securities[(a)]					
Amortized cost	$ 67	$ 1,605	$ 4,888	$165,137	$171,697
Fair value	67	1,747	5,187	169,930	176,931
Average yield[(b)]	5.40%	5.20%	4.71%	4.06%	4.09%
U.S. Treasury and government agencies[(a)]					
Amortized cost	$ 2,481	$ 6,129	$ 9,004	$	$ 17,614
Fair value	2,494	6,248	9,092		17,834
Average yield[(b)]	0.89%	2.83%	3.24%		2.77%
Obligations of U.S. states and municipalities					
Amortized cost	$ 17	$ 140	$ 304	$ 7,870	$ 8,331
Fair value	17	148	321	8,203	8,689
Average yield[(b)]	4.97%	4.30%	5.38%	5.13%	5.13%
Certificates of deposit					
Amortized cost	$ 2,236	$	$	$	$ 2,236
Fair value	2,238				2,238
Average yield[(b)]	5.65%				5.65%
Non-U.S. government debt securities					
Amortized cost	$ 5,704	$ 12,751	$ 954	$ 75	$ 19,484
Fair value	5,714	12,822	943	79	19,558
Average yield[(b)]	1.05%	2.26%	3.32%	1.51%	1.96%
Corporate debt securities					
Amortized cost	$ 5,111	$ 46,289	$ 3,583	$ 39	$ 55,022
Fair value	5,135	46,590	3,480	39	55,244
Average yield[(b)]	2.39%	2.12%	4.71%	5.14%	2.32%
Asset-backed securities					
Amortized cost	$ 1,505	$ 6,992	$ 9,091	$ 10,966	$ 28,554
Fair value	1,525	7,316	9,186	11,213	29,240
Average yield[(b)]	0.75%	1.96%	1.47%	1.58%	1.59%
Total available-for-sale debt securities					
Amortized cost	$17,121	$ 73,906	$ 27,824	$184,087	$302,938
Fair value	17,190	74,871	28,209	189,464	309,734

Average yield[b]	2.02%	2.26%	3.13%	3.96%	3.36%
Available-for-sale equity securities					
Amortized cost	$	$	$	$ 2,122	$ 2,122
Fair value				2,258	2,258
Average yield[b]				0.27%	0.27%
Total available-for-sale securities					
Amortized cost	$17,121	$ 73,906	$ 27,824	$186,209	$305,060
Fair value	17,190	74,871	28,209	191,722	311,992
Average yield[b]	2.02%	2.26%	3.13%	3.92%	3.34%
Total held-to-maturity securities					
Amortized cost	$	$ 6	$ 13	$ 2	$ 21
Fair value		6	15	2	23
Average yield[b]		6.98%	6.85%	6.49%	6.85%

(a) *U.S. government agencies and U.S. government-sponsored enterprises were the only issuers whose securities exceeded 10% of JPMorgan Chase s total stockholders equity at June 30, 2010.*

(b) *Average yield was based on amortized cost balances at the end of the period and did not give effect to changes in fair value reflected in accumulated other comprehensive income/(loss). Yields are derived by dividing interest/dividend income (including the effect of related derivatives on AFS securities and the amortization of premiums and accretion of discounts)* *by total amortized cost. Taxable-equivalent yields are used where applicable.*

(c) Includes securities with no stated maturity. Substantially all of the Firm s residential mortgage-backed securities and collateralized mortgage obligations are due in 10 years or more, based on contractual maturity. The estimated duration, which reflects anticipated future prepayments based on a consensus of dealers in the market, is approximately four years for agency residential mortgage-backed securities, three years for agency residential collateralized mortgage obligations and five years for nonagency residential collateralized mortgage obligations.

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NOTE 12 SECURITIES FINANCING ACTIVITIES

For a discussion of accounting policies relating to securities financing activities, see Note 12 on page 192 of JPMorgan Chase s 2009 Annual Report. For further information regarding securities borrowed and securities lending agreements for which the fair value option has been elected, see Note 4 on pages 125-127 of this Form 10-Q.

The following table details the Firm s repurchase agreements, resale agreements, securities borrowed transactions and securities loaned transactions, all of which are accounted for as collateralized financings during the periods presented.

(in millions)	June 30, 2010	December 31, 2009
Securities purchased under resale agreements[(a)]	**$198,825**	$ 195,328
Securities borrowed[(b)]	**122,289**	119,630
Securities sold under repurchase agreements[(c)]	**$222,018**	$ 245,692
Securities loaned	**10,505**	7,835

(a) Includes resale agreements of $22.8 billion and $20.5 billion accounted for at fair value at June 30, 2010, and December 31, 2009, respectively.

(b) Includes securities borrowed of $11.9 billion and $7.0 billion accounted for at fair value at June 30, 2010, and December 31, 2009, respectively.

(c) Includes repurchase agreements of $6.0 billion and $3.4 billion accounted for at fair value at

June 30, 2010,
and
December 31,
2009,
respectively.

The amounts reported in the table above have been reduced by $135.2 billion and $121.2 billion at June 30, 2010, and December 31, 2009, respectively, as a result of the agreements having met the specified conditions for net presentation under applicable accounting guidance.

JPMorgan Chase pledges certain financial instruments it owns to collateralize repurchase agreements and other securities financings. Pledged securities that can be sold or repledged by the secured party are identified as financial instruments owned (pledged to various parties) on the Consolidated Balance Sheets.

At June 30, 2010, the Firm received securities as collateral that could be repledged, delivered or otherwise used with a fair value of approximately $623.3 billion. This collateral was generally obtained under resale agreements, securities borrowing agreements and customer margin loans. Of these securities, approximately $439.0 billion were repledged, delivered or otherwise used, generally as collateral under repurchase agreements, securities lending agreements or to cover short sales.

NOTE 13 LOANS

The accounting for a loan may differ based on whether it is originated or purchased and whether the loan is used in an investing or trading strategy. The measurement framework for loans in the Consolidated Financial Statements is one of the following:

At the principal amount outstanding, net of the allowance for loan losses, unearned income, unamortized discounts and premiums, and any net deferred loan fees or costs, for loans held-for-investment (other than purchased credit-impaired loans);

At the lower of cost or fair value, with valuation changes recorded in noninterest revenue, for loans that are classified as held-for-sale;

At fair value, with changes in fair value recorded in noninterest revenue, for loans classified as trading assets or risk managed on a fair value basis; or

Purchased credit-impaired loans held-for-investment are initially measured at fair value, which includes estimated future credit losses. Accordingly, an allowance for loan losses related to these loans is not recorded at the acquisition date.

For a detailed discussion of the accounting policies relating to loans, see Note 13 on pages 192-196 of JPMorgan Chase s 2009 Annual Report. See Note 4 on pages 125-127 of this Form 10-Q for further information on the Firm s elections of fair value accounting under the fair value option. See Note 3 on pages 110-124 of this Form 10-Q for further information on loans carried at fair value and classified as trading assets.

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The composition of the Firm s aggregate loan portfolio at each of the dates indicated was as follows.

(in millions)	**June 30, 2010**	December 31, 2009
U.S. wholesale loans:		
Commercial and industrial	**$ 47,431**	$ 49,103
Real estate	**51,409**	54,968
Financial institutions[(a)]	**13,143**	13,372
Government agencies	**5,626**	5,634
Other[(a)]	**36,488**	23,383
Loans held-for-sale and at fair value	**1,640**	2,625
Total U.S. wholesale loans	**155,737**	149,085
Non-U.S. wholesale loans:		
Commercial and industrial	**17,043**	19,138
Real estate	**1,980**	2,227
Financial institutions[(a)]	**17,248**	11,755
Government agencies	**267**	1,707
Other[(a)]	**22,352**	18,790
Loans held-for-sale and at fair value	**2,199**	1,473
Total non-U.S. wholesale loans	**61,089**	55,090
Total wholesale loans:[(b)]		
Commercial and industrial	**64,474**	68,241
Real estate[(c)]	**53,389**	57,195
Financial institutions[(a)]	**30,391**	25,127
Government agencies	**5,893**	7,341
Other[(a)]	**58,840**	42,173
Loans held-for-sale and at fair value[(d)]	**3,839**	4,098
Total wholesale loans	**216,826**	204,175
Consumer loans:[(e)]		
Home equity senior lien[(f)]	**25,856**	27,376
Home equity junior lien[(g)]	**68,905**	74,049
Prime mortgage[(a)]	**66,429**	66,892
Subprime mortgage[(a)]	**12,597**	12,526
Option ARMs[(a)]	**8,594**	8,536
Auto loans[(a)]	**47,548**	46,031
Credit card[(a)(h)(i)]	**142,994**	78,786
Other	**32,399**	31,700
Loans held-for-sale[(j)]	**434**	2,142
Total consumer loans excluding purchased credit-impaired loans	**405,756**	348,038
Consumer loans purchased credit-impaired loans	**76,901**	81,245

Total consumer loans	**482,657**	429,283
Total loans[(a)(k)]	**$699,483**	$ 633,458

(a) *Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon adoption of the new guidance, the Firm consolidated $84.7 billion of loans associated with Firm-sponsored credit card securitization trusts; $15.1 billion of wholesale loans; and $4.8 billion of loans associated with certain other consumer securitization entities, primarily mortgage-related. For further information, see Note 15 on pages 151-163 of this Form 10-Q.*

(b) *Includes IB, Commercial Banking (CB), Treasury & Securities Services (TSS), Asset Management (AM) and Corporate/Private Equity.*

(c) *Represents credit extended for real estate-related purposes to* *borrowers who are primarily in the real estate development or investment businesses, and for which the repayment is predominantly from the sale, lease, management, operations or refinancing of the property.*

(d) *Includes loans for commercial and industrial, real estate, financial institutions and other of $1.7 billion, $206 million, $1.3 billion and $661 million, respectively, at June 30, 2010, and $3.1 billion, $44 million, $278 million and $715 million, respectively, at December 31, 2009.*

(e) *Includes RFS, Card Services (CS) and the Corporate/Private Equity segment.*

(f) *Represents loans where JPMorgan Chase holds the first security interest placed upon the property.*

(g) *Represents loans where JPMorgan*

Chase holds a security interest that is subordinate in rank to other liens.

(h) *Includes billed finance charges and fees net of an allowance for uncollectible amounts.*

(i) *Includes $1.0 billion of loans at December 31, 2009 held by the Washington Mutual Master Trust, which were consolidated onto the Firm s balance sheet at fair value during the second quarter of 2009. Such loans had been fully repaid or charged off as of June 30, 2010. See Note 15 on pages 198-205 of JPMorgan Chase s 2009 Annual Report.*

(j) *Includes loans for prime mortgages and other (largely student loans) of $185 million and $249 million, respectively, at June 30, 2010, and $450 million and $1.7 billion, respectively, at December 31, 2009.*

(k)

Loans (other than purchased credit-impaired loans and those for which the fair value option has been elected) are presented net of unearned income, unamortized discounts and premiums, and net deferred loan costs of $1.7 billion and $1.4 billion at June 30, 2010, and December 31, 2009, respectively.

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The following table reflects information about the Firm s loan sales.

(in millions)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Net gains/(losses) on sales of loans (including lower of cost or fair value adjustments)(a)	**$ 149**	$ 306	**$ 258**	$ 13

(a) Excludes sales related to loans accounted for at fair value.

Impaired loans

For further discussion of impaired loans, including the nature of such loans and the related accounting policies, and certain troubled debt restructurings, see Note 13 on pages 192-196 of JPMorgan Chase s 2009 Annual Report.

The tables below set forth information about the Firm s impaired loans, excluding both purchased credit-impaired loans and modified credit card loans, which are discussed separately below.

(in millions)	June 30, 2010	December 31, 2009
Impaired loans with an allowance:		
Wholesale	**$ 4,318**	$ 6,216
Consumer(a)	**4,880**	3,840
Total impaired loans with an allowance	**9,198**	10,056
Impaired loans without an allowance:(b)		
Wholesale	**1,343**	760
Consumer(a)	**748**	138
Total impaired loans without an allowance	**2,091**	898
Total impaired loans	**$ 11,289**	$ 10,954
Allowance for impaired loans:		
Wholesale	**$ 1,324**	$ 2,046
Consumer	**1,161**	996
Total allowance for impaired loans(c)	**$ 2,485**	$ 3,042

(in millions)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Average balance of impaired loans:				
Wholesale	**$ 4,801**	$4,375	**$ 5,244**	$3,639
Consumer	**5,406**	3,479	**4,998**	3,042

Total impaired loans	**$10,207**	$7,854	**$10,242**	$6,681
Interest income recognized on impaired loans:				
Wholesale	**$ 3**	$	**$ 6**	$
Consumer	**37**	37	**88**	67
Total interest income recognized on impaired loans during the period	**$ 40**	$ 37	**$ 94**	$ 67

(a) *Consumer impaired loans without an allowance includes loans considered to be collateral-dependent based on regulatory guidance, which are charged off to the fair value of the underlying collateral. These loans are considered collateral-dependent because they involve modifications where a significant portion of principal is deferred or an interest-only period is provided. Prior period amounts have been reclassified from impaired loans with an allowance.*

(b) *When the discounted cash flows, collateral value or market price equals or exceeds the recorded investment in the loan, then the loan does not require an allowance.*

(c) *The allowance for impaired loans is included in JPMorgan Chase s asset-specific allowance for loan* *losses.*

Loan modifications

Certain loan modifications are made in conjunction with the Firm s loss mitigation activities. Through the modification, JPMorgan Chase grants one or more concessions to a borrower who is experiencing financial difficulty in order to minimize the Firm s economic loss, avoid foreclosure or repossession of the collateral and to ultimately maximize payments received by the Firm from the borrower. The concessions granted vary by program and by borrower-specific characteristics, and may include interest rate reductions, payment deferrals, or the acceptance of equity or other assets in lieu of payments. In certain limited circumstances, loan modifications include principal forgiveness, which has been minimal to-date. All such modifications are accounted for and reported as troubled debt restructurings.

A loan that has been modified in a troubled debt restructuring is generally considered to be impaired until its maturity, regardless of whether the borrower performs under the modified terms. In certain limited cases, the concession granted relates solely to principal adjustments or other noninterest-rate concessions, and the effective interest rate applicable to the modified loan is at or above the current market rate at that time. In such circumstances, the loan is disclosed as impaired and as a troubled debt restructuring only during the year of the modification; in subsequent years, the loan is not disclosed as impaired or as a troubled debt restructuring if repayment of the restructured loan on its modified terms is reasonably assured.

It is the Firm s general policy to place loans, other than credit card loans, on nonperforming status when the loan is modified in a troubled debt restructuring. In most cases, residential real estate and commercial loans modified in a troubled debt restructuring were considered nonperforming prior to their modification. These loans may be returned to performing status (resuming the accrual of interest) if the criteria set forth in the Firm s accounting policy are met. These criteria generally include (a) performance under the modified terms for a minimum of six months and/or six payments, and (b) an expectation that repayment of the modified loan is reasonably assured based on, for example, the borrower s debt capacity and level of future earnings, collateral values, LTV ratios, and other current market considerations. The Firm s policy exempts credit card loans, including modified credit card loans, from being placed on nonperforming status as permitted by regulatory guidance. However, the Firm has separately established an allowance for the portion of earned interest and fees on such modified credit card loans that it estimates to be uncollectible.

The allowance for loan losses for loans modified in troubled debt restructurings is determined based on the same methodology used to estimate the Firm s asset-specific allowance component for as long as the loan continues to be reported as an impaired loan, regardless of whether the loan has returned to performing status. For further discussion of the methodology used to estimate the Firm s asset-specific allowance, see Note 14 on pages 196-198 of JPMorgan Chase s 2009 Annual Report.

Wholesale

As of June 30, 2010, and December 31, 2009, wholesale loans modified in troubled debt restructurings were $1.1 billion for both periods. These modifications generally provided interest rate concessions to the borrower or deferral of principal repayments. Of these loans, $524 million and $491 million were classified as nonperforming at June 30, 2010, and December 31, 2009, respectively.

Consumer

For detailed discussions on the U.S. Treasury Making Home Affordable (MHA) programs and the Firm s other loss-mitigation programs, see Note 13, Impaired loans, on pages 194-195 of JPMorgan Chase s 2009 Annual Report. Substantially all of the modifications made under these programs are accounted for and reported as troubled debt restructurings.

Consumer loans, other than credit card loans and certain home loans repurchased from the Government National Mortgage Association (Ginnie Mae), with balances of approximately $4.9 billion and $3.1 billion have been permanently modified and accounted for as troubled debt restructurings as of June 30, 2010, and December 31, 2009, respectively. Of these loans, $1.9 billion and $966 million were classified as nonperforming at June 30, 2010, and December 31, 2009, respectively.

At June 30, 2010, and December 31, 2009, $1.7 billion and $296 million, respectively, of loans modified subsequent to repurchase from Ginnie Mae were excluded from loans accounted for as troubled debt restructurings. When such loans perform subsequent to modification they are generally sold back into Ginnie Mae loan pools. Modified loans that do not re-perform become subject to foreclosure. Substantially all amounts due under the terms of these loans continue to be insured and, where applicable, reimbursement of insured amounts is proceeding normally.

Credit Card

For a detailed discussion of the modification of the terms of credit card loan agreements, see Note 13 on pages 192-196 of JPMorgan Chase s 2009 Annual Report. Substantially all modifications of credit card loans performed under the Firm s existing modification programs are considered to be troubled debt restructurings. At June 30, 2010, and December 31, 2009, the Firm had $9.3 billion and $5.1 billion, respectively, of on-balance sheet credit card loans outstanding for borrowers who are experiencing financial difficulty and who were then enrolled in a credit card modification program. The increase in modified credit card loans outstanding from December 31, 2009 to June 30, 2010, is primarily attributable to previously-modified loans held in Firm-sponsored credit card securitization trusts being consolidated as a result of adopting the new consolidation guidance related to VIEs. These modified loan amounts exclude loans to borrowers who have not complied with the modified payment terms, thereby causing the loan agreement to revert back to its original payment terms. Assuming that those borrowers do not begin to perform in

accordance with the original payment terms, those loans will continue to age and will ultimately be charged-off in accordance with the Firm s accounting policies.
Consistent with the Firm s policy, all credit card loans typically remain on accrual status.
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The consumer formula-based allowance for loan losses includes \$3.6 billion and \$2.2 billion at June 30, 2010, and December 31, 2009, specifically attributable to credit card loans in loan modification programs. This component of the allowance for loan losses has been determined based on the present value of cash flows expected to be received over the estimated lives of the underlying loans.

Purchased credit-impaired loans

In connection with the Washington Mutual transaction, JPMorgan Chase acquired certain loans that it deemed to be credit-impaired. For a detailed discussion of purchased credit-impaired loans, including the related accounting policies, see Note 13 on pages 192-196 of JPMorgan Chase s 2009 Annual Report.

The table below sets forth the accretable yield activity for purchased credit-impaired consumer loans for the three and six months ended June 30, 2010 and 2009.

Accretable yield activity	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Beginning balance	**\$ 20,571**	\$ 29,114	**\$ 25,544**	\$ 32,619
Accretion into interest income	**(787)**	(1,106)	**(1,673)**	(2,365)
Changes in interest rates on variable-rate loans	**(333)**	(1,045)	**(727)**	(3,291)
Other changes in expected cash flows[(a)]	**170**		**(3,523)**	
Ending balance	**\$ 19,621**	\$ 26,963	**\$ 19,621**	\$ 26,963
Accretable yield percentage	**4.20%**	5.13%	**4.39%**	5.46%

(a) *Other changes in expected cash flows may vary from period to period as the Firm continues to refine its cash flow model and periodically updates model assumptions. For the six months ended June 30, 2010, other changes in expected cash flows are principally driven by changes in prepayment assumptions, as well as reclassifications to the nonaccretable* *difference. Such changes are expected to have an insignificant impact on the accretable yield percentage.*

The factors that most significantly affect estimates of gross cash flows expected to be collected, and accordingly the accretable yield balance, include: (i) changes in the benchmark interest rate indices upon which customer rates are based for products such as option ARM and home equity loans; and (ii) changes in prepayment assumptions.

To date, the decrease in the accretable yield percentage has been primarily related to a decrease in interest rates on variable rate loans and, to a lesser extent, extended loan liquidation periods. Certain events, such as extended loan liquidation periods, affect the timing of expected cash flows but not the amount of cash expected to be received (i.e., the accretable yield balance). Extended loan liquidation periods reduce the accretable yield percentage because the same accretable yield balance is recognized against a higher than expected loan balance over a longer than expected period of time.

The purchased credit-impaired portfolio primarily impacts the Firm s results of operations through: (i) contribution to net interest margin; and (ii) expense related to defaults and servicing resulting from the liquidation of the loans; and (iii) any provision for loan losses. The purchased credit-impaired loans acquired in the Washington Mutual transaction were funded based on the interest rate characteristics of the loans. For example, variable-rate loans were funded with variable-rate liabilities and fixed-rate loans were funded with fixed-rate liabilities with a similar maturity profile. As a result, the net spread between the purchased credit-impaired loans and the related liabilities should be relatively constant over time, except for any basis risk or other residual interest rate risk that remains and changes in the accretable yield percentage (e.g., from extended loan liquidation periods). The net spread will be earned on a declining loan balance over the estimated remaining weighted-average life of the portfolio, which is 6.6 years as of June 30, 2010.

While the Firm has modified certain purchased credit-impaired loans, such modifications have not yet seasoned and the ongoing performance of these loans is difficult to predict. Accordingly, the Firm has not yet incorporated the potential positive cash flow effects of these modifications into its expected cash flow estimates. The Firm will continue to monitor the success of the modifications and its ability to reliably estimate any related cash flow benefits. If the modifications ultimately result in a probable and significant increase in expected cash flows, the Firm will first consider the reversal of any previously recorded allowance for loan losses. Any remaining increase will be recognized prospectively as interest income (through an increase in accretable yield).

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As of June 30, 2010, and December 31, 2009, an allowance for loan losses of $2.8 billion and $1.6 billion, respectively, was recorded for the prime mortgage and option adjustable-rate mortgage (ARM) pools. The net aggregate carrying amount of the pools that have an allowance for loan losses was $43.0 billion and $47.2 billion, respectively, at June 30, 2010, and December 31, 2009. This allowance for loan losses is reported as a reduction of the carrying amount of the loans in the table below.
The table below provides additional information about these purchased credit-impaired consumer loans.

(in millions)	**June 30, 2010**	December 31, 2009
Outstanding balance[(a)]	**$ 96,079**	$ 103,369
Carrying amount	**74,090**	79,664

(a) Represents the sum of contractual principal, interest and fees earned at the reporting date.

NOTE 14 ALLOWANCE FOR CREDIT LOSSES

For further discussion of the allowance for credit losses and the related accounting policies, see Note 14 on pages 196-198 of JPMorgan Chase s 2009 Annual Report.
The table below summarizes the changes in the allowance for loan losses.

	Six months ended June 30,	
(in millions)	**2010**	2009
Allowance for loan losses at January 1	**$ 31,602**	$ 23,164
Cumulative effect of change in accounting principles[(a)]	**7,494**	
Gross charge-offs[(a)]	**14,652**	10,937
Gross (recoveries)[(a)]	**(1,028)**	(522)
Net charge-offs[(a)]	**13,624**	10,415
Provision for loan losses[(a)]	**10,371**	16,540
Other[(b)]	**(7)**	(217)
Allowance for loan losses at June 30	**$ 35,836**	$ 29,072
Components:		
Asset-specific[(c)(d)]	**$ 2,485**	$ 2,909
Formula-based[(a)(e)]	**30,540**	26,163
Purchased credit-impaired	**2,811**	
Total allowance for loan losses	**$ 35,836**	$ 29,072

(a) Effective January 1, 2010, the Firm adopted

new consolidation guidance related to VIEs. Upon adoption of the new guidance, the Firm consolidated its Firm-sponsored credit card securitization trusts, its Firm-administered multi-seller conduits and certain other consumer loan securitization entities, primarily mortgage-related. As a result, $7.4 billion, $14 million and $127 million of allowance for loan losses were recorded on-balance sheet associated with the Firm-sponsored credit card securitization trusts, Firm-administered multi-seller conduits, and certain other consumer loan securitization entities, primarily mortgage-related, respectively. For further discussion, see Note 15 on pages 151-163 of this Form 10-Q.

(b) The 2009 amount predominantly represents a reclassification related to the issuance and

retention of securities from the Chase Issuance Trust. See Note 15 on pages 198-205 of JPMorgan Chase s 2009 Annual Report.

(c) *Relates to risk-rated loans that have been placed on nonaccrual status and loans that have been modified in a troubled debt restructuring.*

(d) *The asset-specific consumer allowance for loan losses includes troubled debt restructurings reserves of $946 million and $603 million at June 30, 2010 and 2009, respectively. Prior period amounts have been reclassified from formula-based to conform with the current period presentation.*

(e) *Includes all of the Firm s allowance for loan losses on credit card loans, including those for which the Firm has modified the terms of the loans for borrowers who are experiencing financial difficulty.*

The table below summarizes the changes in the allowance for lending-related commitments.

(in millions)	Six months ended June 30, **2010**	2009
Allowance for lending-related commitments at January 1	**$939**	$659
Cumulative effect of change in accounting principles[(a)]	**(18)**	
Provision for lending-related commitments[(a)]	**2**	87
Other	**(11)**	
Allowance for lending-related commitments at June 30	**$912**	$746
Components:		
Asset-specific	**$248**	$111
Formula-based	**664**	635
Total allowance for lending-related commitments	**$912**	$746

(a) Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Upon adoption of the new guidance, the Firm consolidated its Firm-administered multi-seller conduits. As a result, related assets are now primarily recorded in loans and other assets on the Consolidated Balance Sheets.

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Charge-offs for Collateral-dependent loans

Included in gross charge-offs in the table above are $405 million and $140 million of charge-offs related to impaired collateral-dependent loans for the six months ended June 30, 2010 and 2009, respectively. The remaining balance of impaired collateral-dependent loans, measured at fair value of collateral less costs to sell, was $2.5 billion and $2.3 billion as of June 30, 2010 and 2009, respectively.

A loan is collateral-dependent when repayment of the loan is expected to be provided solely by the underlying collateral, rather than by cash flows from the borrower s operations, income or other resources. A collateral-dependent loan is deemed to be impaired when the borrower is unable to repay the loan and the collateral is insufficient to cover principal and interest. Certain impaired collateral-dependent loans (including those to wholesale customers and those modified in troubled debt restructurings) are charged-off to the fair value of the collateral less costs to sell.

The determination of the fair value of the collateral depends on the type of collateral (e.g., securities, real estate, and nonfinancial assets). In cases where the collateral is in the form of liquid securities, the fair value is based on quoted market prices or broker quotes. For illiquid securities or other financial assets, the fair value of the collateral is estimated using a discounted cash flow model.

For residential real estate loans, collateral value is determined using both internal and external valuation sources. Broker opinions of fair value are used to estimate the fair value of the collateral for all properties being evaluated for charge-off. These estimated fair values are reviewed and compared with prior valuations for reasonableness in light of current, geography-specific economic conditions and adjusted, as appropriate, for estimated selling costs. When foreclosure is determined to be probable, a third-party appraisal is obtained as soon as practicable.

For commercial real-estate loans, the collateral value is generally based on appraisals from internal and external valuation services. Appraisals are typically obtained and updated every six to twelve months. The Firm also considers both borrower- and market-specific factors, which may result in obtaining appraisal updates or broker price opinions at more frequent intervals.

See Note 3 on page 119 of this Form 10-Q for further information on the fair value hierarchy for impaired collateral-dependent loans.

NOTE 15 VARIABLE INTEREST ENTITIES

For a further description of JPMorgan Chase s accounting policies regarding consolidation of VIEs, see Note 1 on pages 108-109 of this Form 10-Q. For a more detailed discussion of the Firm s principal involvement with VIEs, see Note 16 on page 206 of JPMorgan Chase s 2009 Annual Report.

The following summarizes the most significant type of Firm-sponsored VIEs by business segment.

Line of Business	*Transaction Type*	*Activity*	*Form 10-Q page reference*
Card Services	Credit card securitization trusts	Securitization of both originated and purchased credit card receivables	152-153
RFS	Mortgage and other securitization trusts	Securitization of originated and purchased residential mortgages, automobile and student loans	153-155
IB	Mortgage and other securitization trusts	Securitization of both originated and purchased residential and commercial mortgages, automobile and student loans	154-155

Multi-seller conduits	Assist clients in accessing the financial markets in a cost-efficient manner and structures transactions to meet investor needs	
Investor intermediation activities:		
Municipal bond vehicles		156-157
Credit-linked note vehicles		157
Asset swap vehicles		158

The Firm also invests in and provides financing and other services to VIEs sponsored by third parties, as described on page 158 of this Note.

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New Consolidation Accounting Guidance for VIEs

On January 1, 2010, the Firm implemented new consolidation accounting guidance related to VIEs. The following table summarizes the incremental impact at adoption.

(in millions)	GAAP assets	GAAP liabilities	Stockholders' equity	Tier 1 capital
As of December 31, 2009	$ 2,031,989	$ 1,866,624	$ 165,365	11.10%
Impact of new accounting guidance for consolidation of VIEs				
Credit card[(a)]	60,901	65,353	(4,452)	(0.30)%
Multi-seller conduits[(b)]	17,724	17,744	(20)	
Mortgage & other[(c)(d)]	9,059	9,107	(48)	(0.04)%
Total impact of new guidance	87,684	92,204	(4,520)	(0.34)%[(e)]
Beginning balance- January 1, 2010	$ 2,119,673	$ 1,958,828	$ 160,845	10.76%

(a) The assets and liabilities of the Firm-sponsored credit card securitization trusts that were consolidated were initially measured at their carrying values, primarily amortized cost, as this method is consistent with the approach that CS utilizes to manage its other assets. These assets are primarily recorded in loans on the Firm s Consolidated Balance Sheet. In addition, CS established an allowance for loan losses of $7.4 billion (pretax), which was reported as a transition

adjustment in stockholders equity. The impact to stockholders equity also includes a decrease to AOCI of $116 million, as a result of the reversal of the fair value adjustments taken on retained AFS securities that were eliminated in consolidation.

(b) *The assets and liabilities of the Firm-administered multi-seller conduits that were consolidated were initially measured at their carrying values, primarily amortized cost, as this method is consistent with the business s intent to hold the assets for the longer-term. The assets are primarily recorded in loans and in other assets on the Firm s Consolidated Balance Sheets.*

(c) *RFS consolidated certain mortgage and other consumer securitizations, which resulted in a net increase in both assets and liabilities of $4.7 billion ($3.5 billion related to* *residential mortgage securitizations and $1.2 billion related to other consumer securitizations). These assets were initially measured at their unpaid principal balance and primarily recorded in loans on the Firm s Consolidated Balance Sheets. This method was elected as a practical expedient.*

(d) *IB consolidated certain mortgage and other consumer securitizations, which resulted in a net increase in both assets and liabilities of $4.3 billion ($3.7 billion related to residential mortgage securitizations and $0.6 billion related to other consumer securitizations). These assets were initially measured at their fair value, as this method is consistent with the approach that IB utilizes to manage similar assets. These assets were primarily recorded in trading assets on the Firm s Consolidated*

Balance Sheets.

(e) *The U.S. GAAP consolidation of these VIEs did not have a significant impact on risk-weighted assets on the adoption date; this was due to the consolidation, for regulatory capital purposes, of the Chase Issuance Trust (the Firm s primary credit card securitization trust) in the second quarter of 2009, which added approximately $40 billion of risk-weighted assets for regulatory capital purposes. For further discussion of the Firm s actions taken in the second quarter of 2009, see Note 15 on pages 198-205 of JPMorgan Chase s 2009 Annual Report. In addition, the U.S. GAAP consolidation of these VIEs did not have a significant regulatory impact because the banking regulatory agencies issued regulatory capital rules relating to the adoption of the new consolidation guidance related to VIEs that permitted* *an optional two-quarter implementation delay for certain VIEs, which permits the deferral of the effect of this accounting guidance on risk-weighted assets and risk-based capital requirements. The Firm elected this regulatory implementation delay, as permitted under these new regulatory capital rules, for its Firm-administered multi-seller conduits and certain mortgage-related and other securitization entities. Once the deferral period is over, the Firm expects the impact of this new consolidation guidance to be negligible on risk-weighted assets and risk-based capital ratios.*

Firm-sponsored variable interest entities

Credit card securitizations

Effective January 1, 2010, the Firm was deemed to be the primary beneficiary of the Firm-sponsored credit card securitization trusts and consolidated the assets and liabilities of these trusts, including its primary card securitization trust, Chase Issuance Trust. The primary beneficiary determination was based on the Firm s ability to direct the activities of these VIEs through its servicing responsibilities and duties, including making decisions as to the receivables that get transferred into those trusts as well as any related modifications and workouts. Additionally, the nature and extent of the Firm s other involvement with the trusts including the retention of an undivided seller s interest in the receivables, retaining certain securities issued by the trust and the maintenance of escrow accounts, obligates the Firm to absorb losses and gives the Firm the right to receive certain benefits from these VIEs that could potentially be significant. For a more detailed description of JPMorgan Chase s principal involvement with credit card securitizations, as well as the accounting treatment applicable under prior accounting rules, see Note 15 on pages 198-205 of JPMorgan Chase s 2009 Annual Report.

Upon consolidation at January 1, 2010, the Firm recorded a net increase in GAAP assets of $60.9 billion on the Consolidated Balance Sheet, which comprised: $84.7 billion of loans; $7.4 billion of allowance for loan losses; $4.4 billion of other assets, partially offset by $20.8 billion of previously recognized assets, consisting primarily of retained AFS securities that were eliminated upon consolidation. In addition, the Firm recognized $65.4 billion of liabilities representing the trusts beneficial interests issued to third parties.

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The following table summarizes the assets and liabilities of the Firm-sponsored credit card securitization trusts at June 30, 2010.

(in billions)	Loans	Other assets	Total assets held by Firm-sponsored credit card securitization trusts	Beneficial interests issued to third parties
June 30, 2010	$82.1	$1.3	$ 83.4	$ 56.0

The underlying securitized credit card receivables and other assets are available only for payment of the beneficial interests issued by the securitization trusts; they are not available to pay the Firm s other obligations or the claims of the Firm s other creditors.

The agreements with the credit card securitization trusts require the Firm to maintain a minimum undivided interest in the credit card trusts (which generally ranges from 4% to 12%). These undivided interests represent the Firm s undivided interests in the receivables transferred to the credit card trusts that have not been securitized. As of June 30, 2010, the Firm held undivided interests in Firm-sponsored credit card securitization trusts of $13.2 billion. The Firm maintained an average undivided interest in principal receivables owned by those trusts of approximately 14% and 17% for the three and six months ended June 30, 2010. The Firm also retained $1.6 billion of senior securities and $9.2 billion of subordinated securities in certain of its credit card securitization trusts as of June 30, 2010. As of January 1, 2010, the Firm s undivided interests in the credit card trusts and securities retained were eliminated in consolidation. The credit card receivables of the trusts underlying the Firm s undivided interests and securities retained are classified within loans.

Firm-sponsored mortgage and other securitization trusts

Effective January 1, 2010, the Firm was deemed to be the primary beneficiary of certain mortgage securitization trusts and the Firm-sponsored automobile and student loan trusts because the Firm has the power to direct the activities of these VIEs through its servicing responsibilities and duties, including making decisions related to loan modifications and workouts. Additionally, the nature and extent of the Firm s continuing economic involvement with the trusts obligates the Firm to absorb losses and gives the Firm the right to receive benefits from the VIEs which could potentially be significant. For a more detailed description of JPMorgan Chase s principal involvement with mortgage and other securitization trusts, as well as the accounting treatment applicable under prior accounting rules, see Note 15 on pages 198-205 of JPMorgan Chase s 2009 Annual Report.

The following table presents the total unpaid principal amount of assets held in JPMorgan Chase-sponsored securitization entities at June 30, 2010, and December 31, 2009, including those that are consolidated by the Firm and those that are not consolidated by the Firm but for which the Firm has continuing involvement. Continuing involvement includes servicing the loans; holding senior interests or subordinated interests; recourse or guarantee arrangements; and derivative transactions. In certain instances, the Firm s only continuing involvement is servicing the loans. In the table below, the amount of beneficial interests held by JPMorgan Chase will not equal the assets held in nonconsolidated VIEs, because the beneficial interests held by third parties are reflected at their current outstanding par amounts, and a portion of the Firm s retained interests (trading assets and AFS securities) are reflected at their fair values. See Securitization activity on pages 160-161 of this Note for further information regarding the Firm s cash flows with and interests retained in nonconsolidated VIEs.

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Firm-sponsored mortgage and other consumer securitization trusts

	Principal amount outstanding			JPMorgan Chase interest in securitized assets in nonconsolidated VIEs(d)(e)(f)(g)(h)			
June 30, 2010(a) (in billions)	Total assets held by securitization VIEs	Assets held in consolidated securitization VIEs	Assets held in nonconsolidated securitization VIEs with continuing involvement	Trading assets	AFS securities	Other assets	Total interests held by JPMorgan Chase
Securitization-related:							
Residential mortgage:							
Prime(b)	**$169.5**	**$ 2.6**	**$ 160.0**	**$0.7**	**$**	**$**	**$ 0.7**
Subprime	**45.3**	**1.9**	**41.1**				
Option ARMs	**38.6**	**0.3**	**38.2**		**0.1**		**0.1**
Commercial and other(c)	**151.5**	**0.7**	**94.5**	**1.8**	**0.8**		**2.6**
Student	**4.7**	**4.7**					
Auto	**0.1**	**0.1**					
Total	**$409.7**	**$ 10.3**	**$ 333.8**	**$2.5**	**$0.9**	**$**	**$ 3.4**

	Principal amount outstanding			JPMorgan Chase interest in securitized assets in nonconsolidated VIEs(d)(e)(f)(g)(h)			
December 31, 2009(a) (in billions)	Total assets held by securitization VIEs	Assets held in consolidated securitization VIEs	Assets held in nonconsolidated securitization VIEs with continuing involvement	Trading assets	AFS securities	Other assets	Total interests held by JPMorgan Chase
Securitization-related:							
Residential mortgage:							
Prime(b)	$183.3	$	$ 171.5	$0.9	$0.2	$	$ 1.1
Subprime	50.0		47.3				
Option ARMs	42.0		42.0		0.1		0.1
Commercial and other(c)	155.3		24.8	1.6	0.8		2.4
Student	4.8	3.8	1.0			0.1	0.1
Auto	0.2		0.2				
Total	$435.6	$ 3.8	$ 286.8	$2.5	$1.1	$0.1	$ 3.7

(a) *Excludes loan sales to government sponsored entities (GSEs). See Securitization activity on pages 160-161 of this Note for information on the Firm s loan sales to GSEs.*

(b) *Includes Alt-A loans.*

(c) *Consists of securities backed by commercial loans (predominantly real estate) and non-mortgage-related consumer receivables purchased from third parties. The Firm generally does not retain a residual interest in its sponsored commercial mortgage securitization transactions. Includes co-sponsored commercial securitizations and, therefore, includes non-JPMorgan Chase-originated commercial mortgage loans.*

(d) *Excludes retained servicing (for a discussion of MSRs, see Note 16 on pages 164-167 of this Form 10-Q) and securities retained from loan sales to Ginnie Mae, Fannie Mae and Freddie Mac.*

(e) *Excludes senior and subordinated*

securities of $208 million and $51 million, respectively, at June 30, 2010, and $729 million and $146 million, respectively, at December 31, 2009, which the Firm purchased in connection with IB s secondary market-making activities.

(f) *Includes investments acquired in the secondary market that are predominantly for held-for-investment purposes, of $182 million and $139 million as of June 30, 2010, and December 31, 2009, respectively. This is comprised of $122 million and $91 million of AFS securities, related to commercial and other; and $60 million and $48 million of investments classified as trading assets-debt and equity instruments, including $59 million and $47 million of residential mortgages, and $1 million and $1 million of commercial and other, all respectively, at June 30, 2010, and December 31, 2009.*

(g) *Excludes interest rate and foreign exchange derivatives primarily* *used to manage the interest rate and foreign exchange risks of the securitization entities. See Note 5 on pages 128-136 of this Form 10-Q for further information on derivatives.*

(h) Includes interests held in re-securitization transactions.

Residential mortgage

The Firm securitizes residential mortgage loans originated by RFS, as well as residential mortgage loans that may be purchased by either RFS or IB. RFS generally retains servicing for all its originated and purchased residential mortgage loans. Additionally, RFS may retain servicing for certain mortgage loans purchased by IB. As servicer, the Firm receives servicing fees based on the securitized loan balance plus ancillary fees.

For Firm-sponsored securitizations serviced by RFS, the Firm is deemed to have the power to direct the significant activities of the VIE, as it is the servicer of the loans and is responsible for decisions related to loan modifications and workouts. For the loans serviced by unrelated third parties, the Firm is not the primary beneficiary, as the power to direct the significant activities resides with the third-party servicer. In a limited number of securitizations, RFS, in addition to having servicing rights, may retain an interest in the VIE that could potentially be significant to the VIE. In these instances, the Firm is deemed to be the primary beneficiary. As of June 30, 2010, due to RFS s servicing arrangements and retained interests, the Firm consolidated approximately $3.3 billion of assets and $3.4 billion of liabilities of Firm-sponsored residential mortgage securitization trusts. As of December 31, 2009, RFS did not consolidate any VIEs in accordance with the accounting treatment under prior accounting rules. Additionally, RFS held retained interests of approximately $245 million and $537 million as of June 30, 2010, and December 31, 2009, respectively, in nonconsolidated securitization entities. See pages 161-163 of this Note for further information on retained interests held in nonconsolidated VIEs; these retained interests are classified as trading assets or AFS securities.

IB may engage in underwriting and trading activities of the securities issued by Firm-sponsored securitization trusts. As a result, IB at times retains senior and/or subordinated interests (including residual interests) in residential mortgage securitizations upon securitization, and/or reacquires positions in the secondary market in the normal course of business. In certain instances as a result of the size of the positions retained or reacquired by IB, when considered together with the servicing arrangements entered into by RFS, the Firm is deemed to be the primary beneficiary of certain trusts. As of June 30, 2010, the Firm consolidated approximately $1.2 billion of VIE assets and $684 million of liabilities due to IB s involvement with such trusts. These entities were not consolidated at December 31, 2009, in accordance with the accounting treatment under prior accounting rules. Additionally, IB held approximately $488 million, and $699 million of senior and subordinated interests as of June 30, 2010, and December 31, 2009, respectively, in nonconsolidated securitization entities. This includes approximately $1 million and $2 million of residual interests as of June 30, 2010, and December 31, 2009, respectively. See pages 161-163 of this Note for further information on interests held in nonconsolidated securitizations. These retained interests are accounted for at fair value and classified as trading assets.

The Firm s mortgage loan sales are primarily nonrecourse, thereby effectively transferring the risk of future credit losses to the purchaser of the mortgage-backed securities issued by the trust. However, for a limited number of loan sales, the Firm is obligated to share a portion of the credit risk associated with the sold loans with the purchaser. See Note 22 on pages 170-174 of this Form 10-Q for additional information on loans sold with recourse, as well as information on indemnifications for breaches of representations and warranties. See page 161 of this Note for further information on loans sold to the GSEs.

Commercial mortgages and other consumer securitizations

IB securitizes commercial mortgage loans that it originates. Additionally, IB may also engage in underwriting and trading of securities issued by the securitization trusts. IB may retain unsold senior and/or subordinated interests in commercial mortgage securitizations at the time of securitization but generally does not service commercial loan securitizations. For loans serviced by unrelated third parties, the Firm generally does not have the power to direct the significant activities of the VIE and, therefore, does not consolidate the VIEs. As of June 30, 2010, the Firm consolidated approximately $637 million of commercial mortgage securitization trusts due to the Firm holding certain subordinated interests that give the Firm the power to direct the activities of these entities. These entities were not consolidated at December 31, 2009, in accordance with the accounting treatment under prior accounting rules. At June 30, 2010, and December 31, 2009, the Firm held $1.8 billion and $1.6 billion, respectively, of retained interests in nonconsolidated commercial mortgage securitizations. This includes approximately $9 million and $22 million of residual interests as of June 30, 2010, and December 31, 2009, respectively.

The Firm also securitizes automobile and student loans originated by RFS, and consumer loans (including automobile and student loans) purchased by IB. The Firm retains servicing responsibilities for all originated and certain purchased student and automobile loans. It also holds a retained interest in these securitizations. As such, the Firm is the primary beneficiary of and consolidates these VIEs as of June 30, 2010. As of June 30, 2010, the Firm consolidated $4.8 billion of assets and $3.5 billion of liabilities of automobile and student loan securitizations. As of December 31, 2009, the Firm held $9 million and $49 million of retained interests in nonconsolidated securitized automobile and student loan securitizations, respectively. These entities were not consolidated at December 31, 2009, in accordance with the accounting treatment under prior accounting rules. In addition, at December 31, 2009, the Firm consolidated $3.8 billion of other student loans.

Re-securitizations

The Firm also engages in certain re-securitization transactions in which debt securities are transferred to a VIE in exchange for new beneficial interests. These transfers occur to both agency (Fannie Mae, Freddie Mac and Ginnie Mae) and nonagency (private-label) sponsored VIEs, which may be backed by either residential or commercial mortgages and are often structured on behalf of clients. As of June 30, 2010, the Firm did not consolidate any agency re-securitizations, as it did not have the power to direct the significant activities of the trust. As of June 30, 2010, the Firm consolidated $522 million of assets and $117 million of liabilities of private-label re-securitizations, as the Firm had both the power to

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direct the significant activities of, and retained an interest that is deemed to be significant in, the trust. For other nonconsolidated private-label re-securitizations, the Firm did not have the sole power to direct the significant activities of the entity. During the three months and six months ended June 30, 2010, respectively, the Firm transferred $7.8 billion and $663 million, respectively, and $14.3 billion and $1.0 billion, respectively, of securities to agency and private-label VIEs. At June 30, 2010, the Firm held approximately $1.7 billion and $23 million of senior and subordinated interests, respectively, in nonconsolidated agency and private-label re-securitization entities. See pages 161-163 of this Note for further information on interests held in nonconsolidated securitization VIEs.

Multi-seller conduits

Effective January 1, 2010, the Firm consolidated its Firm-administered multi-seller conduits, as the Firm had both the power to direct the significant activities of the conduits and a potentially significant economic interest. The Firm directs the economic performance of the conduits as administrative agent and in its role in structuring transactions for the conduits. In these roles, the Firm makes decisions regarding concentration of asset types and credit quality of transactions, and is responsible for managing the commercial paper funding needs of the conduits. The Firm s interests that could potentially be significant to the VIEs include the fees received as administrative agent, liquidity provider and provider of program-wide credit enhancement, as well as the Firm s potential exposure as a result of the liquidity and credit enhancement facilities provided to the conduits.

For a more detailed description of JPMorgan Chase s principal involvement with Firm-administered multi-seller conduits, as well as the accounting treatment applicable under prior accounting rules, see Note 16 on pages 206-209 of JPMorgan Chase s 2009 Annual Report.

Consolidated Firm-administered multi-seller conduits

(in billions)	Loans	Other assets	Total assets held by Firm-administered multi-seller conduits	Commercial paper issued to third parties
June 30, 2010	$20.9	$1.9	$ 22.8	$ 22.8

The Firm provides both deal-specific and program-wide liquidity facilities. Because the majority of the deal-specific liquidity facilities will only fund nondefaulted assets, program-wide credit enhancement is required to absorb losses on defaulted receivables in excess of losses absorbed by any deal-specific credit enhancement. Program-wide credit enhancement may be provided by JPMorgan Chase in the form of standby letters of credit or by third-party surety bond providers. The amount of program-wide credit enhancement required varies by conduit and ranges between 5% and 10% of applicable commercial paper outstanding. The Firm provided $2.0 billion of program-wide credit enhancement at June 30, 2010.

VIEs associated with investor intermediation activities

For a more detailed description of JPMorgan Chase s principal involvement with investor intermediation activities, see Note 16 on pages 209-212 of JPMorgan Chase s 2009 Annual Report.

Municipal bond vehicles

The Firm consolidates municipal bond vehicles if it owns the residual interest. The residual interest generally allows the owner to make decisions that significantly impact the economic performance of the municipal bond vehicle, primarily by directing the sale of the municipal bonds owned by the vehicle. In addition, the residual interest owners have the right to receive benefits and bear losses that could potentially be significant to the municipal bond vehicle. The Firm does not consolidate municipal bond vehicles if it does not own the residual interests, since the Firm does not have the power to make decisions that significantly impact the economic performance of the municipal bond vehicle.

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The Firm s exposure to nonconsolidated municipal bond VIEs at June 30, 2010, and December 31, 2009, including the ratings profile of the VIEs assets, was as follows.

(in billions)	Fair value of assets held by VIEs	Liquidity facilities[(b)]	Excess/(deficit)[(c)]	Maximum exposure
Nonconsolidated municipal bond vehicles[(a)]				
June 30, 2010	**$ 13.9**	**$ 8.7**	**$ 5.2**	**$ 8.7**
December 31, 2009	13.2	8.4	4.8	8.4

	Ratings profile of VIE assets[(d)]						
	Investment-grade				Noninvestment-grade	Fair value of assets held	Wt. avg. expected life
(in billions, except where otherwise noted)	AAA to AAA-	AA+ to AA-	A+ to A-	BBB to BBB-	BB+ and below	by VIEs	of assets (years)
Nonconsolidated municipal bond vehicles[(a)]							
June 30, 2010	**$4.3**	**$ 9.3**	**$ 0.3**	**$**	**$**	**$ 13.9**	**9.0**
December 31, 2009	1.6	11.4	0.2			13.2	10.1

(a) Excluded $2.1 billion and $2.8 billion, as of June 30, 2010, and December 31, 2009, respectively, which were consolidated due to the Firm owning the residual interests.

(b) The Firm may serve as credit enhancement provider to municipal bond vehicles in which it serves as liquidity

provider. The Firm provided insurance on underlying municipal bonds, in the form of letters of credit, of $10 million at both June 30, 2010, and December 31, 2009.

(c) *Represents the excess/(deficit) of the fair values of municipal bond assets available to repay the liquidity facilities, if drawn.*

(d) *The ratings scale is based on the Firm s internal risk ratings and is presented on an S&P-equivalent basis.*

Credit-linked note vehicles

The Firm structures transactions with credit-linked note vehicles in which the VIE purchases highly rated assets, such as asset-backed securities, or enters into a credit derivative contract with the Firm to obtain exposure to a referenced credit which the VIE otherwise does not hold. The VIE then issues CLNs with maturities predominantly ranging from one to ten years in order to transfer the risk of the referenced credit to the VIE s investors. The Firm does not generally consolidate these credit-linked note entities, since the Firm does not have the power to direct the significant activities of these entities and does not have a variable interest that could potentially be significant.

Exposure to nonconsolidated credit-linked note VIEs at June 30, 2010, and December 31, 2009, was as follows.

June 30, 2010 (in billions)	Net derivative receivables	Trading assets[(b)]	Total exposure[(c)]	Par value of collateral held by VIEs[(d)]
Credit-linked notes[(a)]				
Static structure	**$ 1.5**	**$**	**$ 1.5**	**$ 9.9**
Managed structure	**4.0**	**0.1**	**4.1**	**11.5**

Total	**$ 5.5**	**$ 0.1**	**$ 5.6**	**$ 21.4**

December 31, 2009 (in billions)	Net derivative receivables	Trading assets[b]	Total exposure[c]	Par value of collateral held by VIEs[d]
Credit-linked notes[a]				
Static structure	$ 1.9	$ 0.7	$ 2.6	$ 10.8
Managed structure	5.0	0.6	5.6	15.2
Total	$ 6.9	$ 1.3	$ 8.2	$ 26.0

(a) Excluded collateral with a fair value of $244 million and $855 million at June 30, 2010, and December 31, 2009, respectively, which was consolidated, as the Firm, in its role as secondary market-maker, held a majority of the issued credit-linked notes of certain vehicles.

(b) Trading assets principally comprise notes issued by VIEs, which from time to time are held as part of the termination of a deal or to support limited market-making.

(c) On-balance sheet exposure that includes net derivative receivables and trading assets debt and equity instruments.

(d) The Firm s maximum exposure arises through the derivatives executed with the VIEs; the exposure varies over time with changes in the fair value of the derivatives. The Firm relies on the collateral held by the VIEs to pay any amounts due under the derivatives; the vehicles are structured at inception so that the par value of the collateral is expected to be sufficient to pay amounts due under the derivative contracts.

Asset swap vehicles

The Firm structures and executes transactions with asset swap vehicles on behalf of investors. In such transactions, the VIE purchases a specific asset or assets and then enters into a derivative with the Firm in order to tailor the interest rate or currency risk, or both, according to investors requirements. The Firm does not generally consolidate these asset swap vehicles, since the Firm does not have the power to direct the significant activities of these entities and does not have a variable interest that could potentially be significant.

Exposure to nonconsolidated asset swap VIEs at June 30, 2010, and December 31, 2009, was as follows.

(in billions)	Net derivative receivables	Trading assets[b]	Total exposure[c]	Par value of collateral held by VIEs[d]
June 30, 2010[a]	**$ 0.3**	**$**	**$0.3**	**$ 7.3**
December 31, 2009[a]	0.1		0.1	10.2

(a) Excluded the fair value of collateral of $532 million and $623 million at June 30, 2010, and December 31, 2009, respectively, which was consolidated as the Firm, in its role as secondary market-maker, held a majority of the issued notes of certain vehicles.

(b) Trading assets principally comprise notes issued by VIEs, which from time to time are held as part of the termination of a deal or to support limited market-making.

(c) On-balance sheet exposure that includes net derivative receivables and trading assets debt and equity instruments.

(d) The Firm s maximum exposure arises through the derivatives executed with the VIEs; the exposure varies over time with changes in the fair value of the derivatives. The Firm relies upon the collateral held by the VIEs to pay any amounts due under the derivatives; the vehicles are structured at inception so that the par value of the collateral is expected to be sufficient to pay amounts due under the derivative contracts.

VIEs sponsored by third parties

Investment in a third-party credit card securitization trust

The Firm holds two interests in a third-party-sponsored VIE, which is a credit card securitization trust that owns credit card receivables issued by a national retailer. The Firm is not the primary beneficiary of the trust, as the Firm does not have the power to direct the activities of the VIE that most significantly impact the VIE s economic performance. The first note is structured so that the principal amount can float up to 47% of the principal amount of the receivables held by the trust, not to exceed $4.2 billion. The Firm accounts for its investment at fair value within AFS securities. At June 30, 2010, and December 31, 2009, the amortized cost of the note was $3.1 billion and $3.5 billion, respectively, and the fair value was $3.2 billion and $3.5 billion, respectively. The Firm accounts for its other interest, which is not subject to limits, as a loan at amortized cost. This senior loan had an amortized cost and fair value of approximately

$1.0 billion at both June 30, 2010, and December 31, 2009. For more information on AFS securities and loans, see Notes 11 and 13 on pages 139-144 and 145-150, respectively, of this Form 10-Q.

VIE used in FRBNY transaction

In conjunction with the Bear Stearns merger, in June 2008, the Federal Reserve Bank of New York (FRBNY) took control, through an LLC formed for this purpose, of a portfolio of $30.0 billion in assets, based on the value of the portfolio as of March 14, 2008. The assets of the LLC were funded by a $28.85 billion term loan from the FRBNY and a $1.15 billion subordinated loan from JPMorgan Chase. The JPMorgan Chase loan is subordinated to the FRBNY loan and will bear the first $1.15 billion of any losses of the portfolio. Any remaining assets in the portfolio after repayment of the FRBNY loan, repayment of the JPMorgan Chase loan and the expense of the LLC will be for the account of the FRBNY. The extent to which the FRBNY and JPMorgan Chase loans will be repaid will depend on the value of the assets in the portfolio and the liquidation strategy directed by the FRBNY. The Firm does not consolidate the LLC, as it does not have the power to direct the activities of the VIE that most significantly impact the VIE s economic performance.

Other VIEs sponsored by third parties

The Firm enters into transactions with VIEs structured by other parties. These include, for example, acting as a derivative counterparty, liquidity provider, investor, underwriter, placement agent, trustee or custodian. These transactions are conducted at arm s length, and individual credit decisions are based on the analysis of the specific VIE, taking into consideration the quality of the underlying assets. Where the Firm does not have the power to direct the activities of the VIE that most significantly impact the VIE s economic performance, or a variable interest that could potentially be significant, the Firm records and reports these positions on its Consolidated Balance Sheets similarly to the way it would record and report positions from any other third-party transaction.

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Consolidated VIE assets and liabilities

The following table presents information on assets and liabilities related to VIEs that are consolidated by the Firm as of June 30, 2010, and December 31, 2009.

	Assets			
June 30, 2010 (in billions)	Trading assets-debt and equity instruments	Loans	Other[(a)]	Total assets[(b)]
VIE program type				
Firm-sponsored credit card trusts	$	$ 82.1	$1.3	$ 83.4
Firm-administered multi-seller conduits		20.9	1.9	22.8
Mortgage securitization entities	2.3	3.3		5.6
Other	5.2	5.7	1.7	12.6
Total	**$7.5**	**$112.0**	**$4.9**	**$ 124.4**

	Liabilities		
June 30, 2010 (in billions)	Beneficial interests in VIE assets[(c)]	Other[(d)]	Total liabilities
VIE program type			
Firm-sponsored credit card trusts	$56.0	$	$ 56.0
Firm-administered multi-seller conduits	22.8		22.8
Mortgage securitization entities	3.0	1.8	4.8
Other	6.3	0.8	7.1
Total	**$88.1**	**$2.6**	**$ 90.7**

	Assets			
December 31, 2009 (in billions)	Trading assets-debt and equity instruments	Loans	Other[(a)]	Total assets[(b)]
VIE program type				
Firm-sponsored credit card trusts[(e)]	$	$ 6.1	$0.8	$ 6.9
Firm-administered multi-seller conduits		2.2	2.9	5.1
Mortgage securitization entities				
Other	6.4	4.7	1.3	12.4

Total	$6.4	$13.0	$5.0	$ 24.4

December 31, 2009 (in billions)	Liabilities Beneficial interests in VIE assets(c)	Other(d)	Total liabilities
VIE program type			
Firm-sponsored credit card trusts(e)	$ 3.9	$	$ 3.9
Firm-administered multi-seller conduits	4.8		4.8
Mortgage securitization entities			
Other	6.5	2.2	8.7
Total	$15.2	$2.2	$ 17.4

(a) *Included assets classified as cash, resale agreements, derivative receivables, available-for-sale, and other assets within the Consolidated Balance Sheets.*

(b) *The assets of the consolidated VIEs included in the program types above are used to settle the liabilities of those entities. The difference between total assets and total liabilities recognized for consolidated VIEs represents the Firm s interest in the consolidated VIEs for each program type.*

(c) The interest-bearing beneficial interest liabilities issued by consolidated VIEs are classified in the line item on the Consolidated Balance Sheets titled, Beneficial interests issued by consolidated variable interest entities. The holders of these beneficial interests do not have recourse to the general credit of JPMorgan Chase. Included in beneficial interests in VIE assets are long-term beneficial interests of $65.1 billion and $10.4 billion at June 30, 2010, and December 31, 2009, respectively. The maturities of the long-term beneficial interests as of June 30, 2010, were as follows: $22.1 billion under one year, $33.2 billion between one and five years, and $9.8 billion over 5 years.

(d) *Included liabilities classified as other borrowed funds and accounts payable and other liabilities in the Consolidated Balance Sheets.*

(e) *Includes the receivables and related liabilities of the WMM Trust. For further discussion, see Note 15 on pages 198-205 respectively, of JPMorgan Chase s 2009 Annual Report.*

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Supplemental information on loan securitizations

The Firm securitizes and sells a variety of loans, including residential mortgage, credit card, automobile, student and commercial (primarily related to real estate) loans, as well as debt securities. The primary purposes of these securitization transactions are to satisfy investor demand and to generate liquidity for the Firm.

For a discussion of the accounting treatment under prior accounting rules relating to loan securitizations, see Note 1 on pages 142-143 and Note 15 on pages 198-205 of JPMorgan Chase s 2009 Annual Report.

Securitization activity

The following tables provide information related to the Firm s securitization activities for the three and six months ended June 30, 2010 and 2009, related to assets held in JPMorgan Chase-sponsored securitization entities that were not consolidated by the Firm, as sale accounting was achieved based on the accounting rules in effect at the time of the securitization. For the three- and six-month periods ended June 30, 2009, there were no mortgage loans that were securitized, and there were no cash flows from the Firm to the SPEs related to recourse or guarantee arrangements. Effective January 1, 2010, all of the Firm-sponsored credit card, student loan and auto securitization trusts were consolidated as a result of the new consolidation guidance related to VIEs and, accordingly, are not included in the securitization activity tables below for the three and six months ended June 30, 2010 and 2009.

	Three months ended June 30, 2010			
	Residential mortgage			
(in millions)	Prime[f]	Subprime	Option ARMs	Commercial and other
Principal securitized	**$**	**$**	**$**	**$562**
Pretax gains				[g]
All cash flows during the period[a]:				
Proceeds from new securitizations[b]				**$592**
Servicing fees collected	**$89**	**$53**	**$118**	**1**
Other cash flows received[c]				
Purchases of previously transferred financial assets (or the underlying collateral)[d]	**52**	**6**		
Cash flows received on the interests that continue to be held by the Firm[e]	**73**	**9**	**6**	**30**

	Three months ended June 30, 2009			
	Residential mortgage			
(in millions)	Prime[f]	Subprime	Option ARMs	Commercial and other
All cash flows during the period[a]:				
Servicing fees collected	$111	$41	$118	$ 1
Other cash flows received[c]	2	1		
Purchases of previously transferred financial assets (or the underlying collateral)[d]	35		10	
Cash flows received on the interests that continue to be held by the Firm[e]	210	8	16	34

	Six months ended June 30, 2010	
	Residential mortgage	
(in millions)	Prime[f]	Subprime

			Option ARMs	Commercial and other
Principal securitized	$	$	$	**$562**
Pretax gains				*(g)*
All cash flows during the period[(a)]**:**				
Proceeds from new securitizations[(b)]				**$592**
Servicing fees collected	**$164**	**$99**	**$235**	**2**
Other cash flows received[(c)]				
Purchases of previously transferred financial assets (or the underlying collateral)[(d)]	**100**	**6**		
Cash flows received on the interests that continue to be held by the Firm[(e)]	**153**	**19**	**12**	**68**

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(in millions)	Six months ended June 30, 2009 Residential mortgage Prime[f]	Subprime	Option ARMs	Commercial and other
All cash flows during the period[a]:				
Servicing fees collected	$232	$85	$246	$ 8
Other cash flows received[c]	6	2		
Purchases of previously transferred financial assets (or the underlying collateral)[d]	76		13	
Cash flows received on the interests that continue to be held by the Firm[e]	364	13	64	158

(a) Excludes loan sales for which the Firm did not securitize (including loans sold to Ginnie Mae, Fannie Mae and Freddie Mac).

(b) Proceeds were received in the form of securities and were classified in level 2 of the fair value measurement hierarchy. A majority of these securities were sold for cash shortly after securitization.

(c) Includes excess servicing fees and other ancillary fees received.

(d) Includes cash paid by the Firm to reacquire assets from the off-balance sheet, nonconsolidated entities for

example, servicer clean-up calls.

(e) *Includes cash flows received on retained interests including, for example, principal repayments and interest payments.*

(f) *Includes Alt-A loans and re-securitization transactions.*

(g) *As of January 1, 2007, the Firm elected the fair value option for IB warehouse. The carrying value of these loans accounted for at fair value approximated the proceeds received from securitization.*

Loans sold to agencies and other third-party sponsored securitization entities

In addition to the amounts reported in the securitization activity tables above, the Firm, in the normal course of business, sells originated and purchased mortgage loans, predominantly to Ginnie Mae, Fannie Mae, and Freddie Mac, (the Agencies). These loans are sold primarily for the purpose of securitization by the Agencies, which also provide credit enhancement of the loans through certain guarantee provisions. The Firm does not consolidate these securitization vehicles as it is not the primary beneficiary. In connection with these loan sales, the Firm makes certain representations and warranties. For additional information about the Firm s loan sale- and securitization-related indemnifications, see Note 22 on pages 170-174 of this Form 10-Q.

The Firm generally retains the right to service the mortgage loans in accordance with the respective servicing guidelines and standards, which is a form of continuing involvement, and records this right as a servicing asset at the time of sale.

The following table summarizes these loan sale activities.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Carrying value of loans sold[(a)(b)]	**$30,173**	$41,706	**$65,547**	$81,608
Proceeds received from loan sales[(c)]	**29,710**	40,751	**64,416**	79,676
Gains on loan sales	**70**	29	**91**	46

(a)

Predominantly to the Agencies.

(b) *See Note 16 on pages 164-167 of this Form 10-Q for further information on originated MSRs.*

(c) *Predominantly includes securities from the Agencies that are generally sold shortly after receipt.*

JPMorgan Chase s interest in securitized assets held at fair value

The following table summarizes the Firm s nonconsolidated securitization interests which are carried at fair value on the Firm s Consolidated Balance Sheets at June 30, 2010, and December 31, 2009. The risk ratings are periodically reassessed as information becomes available. As of June 30, 2010, and December 31, 2009, 69% and 76%, respectively, of the Firm s retained securitization interests, which are carried at fair value, were risk-rated A or better.

	Ratings profile of interests held [b][c][d]					
	June 30, 2010			December 31, 2009		
(in billions)	Investment-grade	Noninvestment-grade	Retained interests	Investment-grade	Noninvestment-grade	Retained interests[e]
Asset types:						
Residential mortgage:						
Prime[a]	**$0.2**	**$ 0.5**	**$ 0.7**	$0.7	$ 0.4	$ 1.1
Subprime						
Option ARMs	**0.1**		**0.1**	0.1		0.1
Commercial and other	**2.3**	**0.3**	**2.6**	2.2	0.2	2.4
Total	**$2.6**	**$ 0.8**	**$ 3.4**	$3.0	$ 0.6	$ 3.6

(a) *Includes retained interests in Alt-A loans and re-securitization transactions.*

(b) *The ratings scale is presented on an S&P-equivalent basis.*

(c) *Includes $182 million and $139 million of investments acquired in the secondary market, but predominantly held for investment purposes, as of June 30, 2010, and December 31, 2009, respectively. Of this amount, $147 million and $108 million is classified as investment-grade as of June 30,* *2010, and December 31, 2009, respectively.*

(d) *Excludes senior and subordinated securities of $259 million and $875 million at June 30, 2010, and December 31, 2009, respectively, which the Firm purchased in connection with IB s secondary market-making activities.*

(e) *Excludes $49 million of retained interests in student loans at December 31, 2009.*

The table below outlines the key economic assumptions used to determine the fair value as of June 30, 2010, and December 31, 2009, of certain of the Firm s retained interests in nonconsolidated VIEs, other than MSRs, that are valued using modeling techniques. The table below also outlines the sensitivities of those fair values to immediate 10% and 20% adverse changes in assumptions used to determine fair value. For a discussion of MSRs, see Note 16 on pages 164-167 of this Form 10-Q.

June 30, 2010	Residential mortgage			Commercial
(in millions, except rates and where otherwise noted)	Prime[(a)]	Subprime	Option ARMs	and other
JPMorgan Chase interests in securitized assets	**$ 676**	**$ 26**	**$ 112**	**$ 2,562**
Weighted-average life (in years)	**6.1**	**4.3**	**4.3**	**3.2**
Weighted-average constant prepayment rate	**9.2% CPR**	**3.5% CPR**	**16.4% CPR**	**% CPR**
Impact of 10% adverse change	**$ (17)**	**$ (1)**	**$ (2)**	**$**
Impact of 20% adverse change	**(32)**	**(1)**	**(3)**	
Weighted-average loss assumption	**7.0%**	**30.3%**	**4.2%**	**1.8%**
Impact of 10% adverse change	**$ (12)**	**$ (1)**	**$**	**$ (74)**
Impact of 20% adverse change	**(22)**	**(2)**		**(168)**

Weighted-average discount rate	**12.6%**	**13.0%**	**5.9%**	**15.0%**
Impact of 10% adverse change	**$ (28)**	**$ (1)**	**$ (2)**	**$ (73)**
Impact of 20% adverse change	**(57)**	**(1)**	**(3)**	**(133)**

December 31, 2009 (in millions, except rates and where otherwise noted)	Residential mortgage Prime[a]	Subprime	Option ARMs	Commercial and other
JPMorgan Chase interests in securitized assets	$ 1,143	$ 27	$ 113	$ 2,361
Weighted-average life (in years)	8.3	4.3	5.1	3.5
Weighted-average constant prepayment rate	4.9% CPR	21.8% CPR	15.7% CPR	% CPR
Impact of 10% adverse change	$ (15)	$ (2)	$	$
Impact of 20% adverse change	(31)	(3)	(1)	
Weighted-average loss assumption	3.2%	2.7%	0.7%	1.4%
Impact of 10% adverse change	$ (15)	$ (4)	$	$ (41)
Impact of 20% adverse change	(29)	(7)		(100)
Weighted-average discount rate	11.4%	23.2%	5.4%	12.5%
Impact of 10% adverse change	$ (41)	$ (2)	$ (1)	$ (72)
Impact of 20% adverse change	(82)	(4)	(3)	(139)

(a) Includes retained interests in Alt-A loans and re-securitization transactions.

The sensitivity analysis in the preceding table is hypothetical. Changes in fair value based on a 10% or 20% variation in assumptions generally cannot be extrapolated easily, because the relationship of the change in the assumptions to the change in fair value may not be linear. Also, in the table, the effect that a change in a particular assumption may have on the fair value is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another, which might counteract or magnify the sensitivities. The above sensitivities also do not reflect risk management practices the Firm may undertake to mitigate such risks.

Loan delinquencies and net charge-offs

The table below includes information about delinquencies, net charge-offs and components of off-balance sheet securitized financial assets as of June 30, 2010, and December 31, 2009.

	Credit exposure		Nonperforming loans		Net loan charge-offs[e]			
					Three months ended June 30,		Six months ended June 30,	
(in millions)	**June 30, 2010**	Dec. 31, 2009	**June 30, 2010**	Dec. 31, 2009	**2010**	2009	**2010**	2009
Securitized loans:[a]								
Residential mortgage:								
Prime mortgage[b][c]	**$159,991**	$171,547	**$35,008**	$33,838	**$1,696**	$2,395	**$3,385**	$4,591
Subprime mortgage[c]	**41,061**	47,261	**17,558**	19,505	**951**	2,044	**2,116**	4,278
Option ARMs[c]	**38,247**	41,983	**11,301**	10,973	**637**	474	**1,226**	854
Commercial and other[c]	**94,479**	24,799	**5,158**	1,244	**116**	5	**143**	10
Total loans securitized[d]	**$333,778**	$285,590	**$69,025**	$65,560	**$3,400**	$4,918	**$6,870**	$9,733

(a) *There were no loans that were 90 days past due and still accruing at June 30, 2010, and December 31, 2009.*

(b) *Includes Alt-A loans.*

(c) *Total assets held in securitization-related SPEs were $409.7 billion and $435.6 billion at June 30, 2010, and December 31, 2009, respectively. The $333.8 billion and $285.6 billion of loans securitized at June 30, 2010, and December 31, 2009, respectively,* *excludes: $65.6 billion and $145.0 billion of securitized loans in which the Firm has no continuing involvement, zero and $1.2 billion of nonconsolidated auto and student loan securitizations, and $10.3 billion and $3.8 billion of loan securitizations (including automobile and student loans) consolidated on the Firm s Consolidated Balance Sheets at June 30, 2010, and December 31, 2009, respectively.*

(d) *Includes securitized loans that were previously recorded at fair value and classified as trading assets.*

(e) *Net charge-offs represent losses realized upon liquidation of the assets held by off-balance sheet securitization entities.*

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NOTE 16 GOODWILL AND OTHER INTANGIBLE ASSETS

For a discussion of accounting policies related to goodwill and other intangible assets, see Note 17 on pages 214-217 of JPMorgan Chase s 2009 Annual Report.

Goodwill and other intangible assets consist of the following.

(in millions)	**June 30, 2010**	December 31, 2009
Goodwill	**$ 48,320**	$ 48,357
Mortgage servicing rights	**11,853**	15,531
Other intangible assets:		
Purchased credit card relationships	**$ 1,051**	$ 1,246
Other credit card-related intangibles	**629**	691
Core deposit intangibles	**1,041**	1,207
Other intangibles	**1,457**	1,477
Total other intangible assets	**$ 4,178**	$ 4,621

Goodwill

The following table presents goodwill attributed to the business segments.

(in millions)	**June 30, 2010**	December 31, 2009
Investment Bank	**$ 4,963**	$ 4,959
Retail Financial Services	**16,816**	16,831
Card Services	**14,128**	14,134
Commercial Banking	**2,866**	2,868
Treasury & Securities Services	**1,665**	1,667
Asset Management	**7,505**	7,521
Corporate/Private Equity	**377**	377
Total goodwill	**$ 48,320**	$ 48,357

The following table presents changes in the carrying amount of goodwill.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Balance at beginning of period[(a)]	**$ 48,359**	$ 48,201	**$ 48,357**	$ 48,027
Changes during the period from:				
Business combinations	**10**	35	**19**	245
Dispositions			**(19)**	
Other[(b)]	**(49)**	52	**(37)**	16
Balance at June 30,[(a)]	**$ 48,320**	$ 48,288	**$ 48,320**	$ 48,288

(a) *Reflects gross goodwill balances as the Firm has not recognized any impairment losses to date.*

(b) *Includes foreign currency translation adjustments and other tax-related adjustments.*

The $37 million decrease in goodwill from December 31, 2009, was largely due to foreign currency translation adjustments related to the Firm s credit card and merchant businesses, the divestiture of certain non-strategic businesses, as well as tax-related purchase accounting adjustments associated with the Bank One merger.
Goodwill was not impaired at June 30, 2010, or December 31, 2009, nor was any goodwill written off due to impairment during the six month periods ended June 30, 2010 or 2009. During the six months ended June 30, 2010, in addition to reviewing the current conditions and prior projections for all of its reporting units, the Firm updated the discounted cash flow valuations of its consumer lending businesses in RFS and CS, as these businesses continue to have elevated risk for goodwill impairment due to their exposure to U.S. consumer credit risk and the effects of recent regulatory and legislative changes. As a result of this review, the Firm concluded that goodwill for these businesses and the Firm s other reporting units was not impaired at June 30, 2010.

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Mortgage servicing rights

For a further description of the MSR asset, interest rate risk management, and the valuation methodology of MSRs, see Notes 3 and 17 on pages 151-152 and 214-217, respectively, of JPMorgan Chase s 2009 Annual Report.

The following table summarizes MSR activity for the three and six months ended June 30, 2010 and 2009.

	Three months ended June 30,		Six months ended June 30,	
(in millions, except where otherwise noted)	**2010**	2009	**2010**	2009
Fair value at the beginning of the period	**$ 15,531**	$ 10,634	**$ 15,531**	$ 9,403
MSR activity				
Originations of MSRs	**533**	984	**1,222**	1,978
Purchase of MSRs			**14**	2
Disposition of MSRs	**(5)**	(10)	**(5)**	(10)
Total net additions	**528**	974	**1,231**	1,970
Change in valuation due to inputs and assumptions[a]	**(3,584)**	3,831	**(3,680)**	5,141
Other changes in fair value[b]	**(622)**	(839)	**(1,229)**	(1,914)
Total change in fair value of MSRs[c]	**(4,206)**	2,992	**(4,909)**	3,227
Fair value at June 30[d]	**$ 11,853**	$ 14,600	**$ 11,853**	$ 14,600
Change in unrealized gains/(losses) included in income related to MSRs held at June 30	**$ (3,584)**	$ 3,831	**$ (3,680)**	$ 5,141
Contractual service fees, late fees and other ancillary fees included in income	**$ 1,148**	$ 1,221	**$ 2,280**	$ 2,428
Third-party mortgage loans serviced at June 30 (in billions)	**$ 1,064**	$ 1,126	**$ 1,064**	$ 1,126

(a) Represents MSR asset fair value adjustments due to changes in inputs, such as interest rates and volatility, as well as updates to assumptions used in the valuation model. Total realized/unrealized gains/(losses) columns in the Changes in level 3 recurring fair value measurements tables in Note 3 on

pages 115-118 of this Form 10-Q include these amounts.

(b) *Includes changes in MSR value due to modeled servicing portfolio runoff (or time decay). Purchases, issuances, settlements, net columns in the Changes in level 3 recurring fair value measurements tables in Note 3 on pages 115-118 of this Form 10-Q include these amounts.*

(c) *Includes changes related to commercial real estate of $(2) million for the three months ended June 30, 2010 and 2009, and $(4) million for the six months ended June 30, 2010 and 2009.*

(d) *Includes $37 million and $41 million related to commercial real estate at June 30, 2010 and 2009, respectively.*

The following table presents the components of mortgage fees and related income (including the impact of MSR risk management activities) for the three and six months ended June 30, 2010 and 2009.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
RFS mortgage fees and related income				

Production revenue[(a)]	**$ 9**	$ 284	**$ 10**	$ 765
Net mortgage servicing revenue				
Operating revenue:				
Loan servicing revenue	**1,186**	1,279	**2,293**	2,501
Other changes in MSR asset fair value[(b)]	**(620)**	(837)	**(1,225)**	(1,910)
Total operating revenue	**566**	442	**1,068**	591
Risk management:				
Changes in MSR asset fair value due to inputs or assumptions in model[(c)]	**(3,584)**	3,831	**(3,680)**	5,141
Derivative valuation adjustments and other	**3,895**	(3,750)	**4,143**	(4,057)
Total risk management	**311**	81	**463**	1,084
Total RFS net mortgage servicing revenue	**877**	523	**1,531**	1,675
All other[(d)]	**2**	(23)	**5**	(55)
Mortgage fees and related income	**$ 888**	$ 784	**$ 1,546**	$ 2,385

(a) *Losses related to the repurchase of previously-sold loans are recorded as a reduction to production revenue. These losses totaled $667 million and $255 million for the three months ended June 30, 2010 and 2009, respectively, and $1.1 billion and $475 million for the six months ended June 30, 2010 and 2009, respectively.*

(b) *Includes changes in the MSR value due to modeled servicing portfolio runoff (or time decay). Purchases, issuances, settlements, net columns in the Changes in level 3* *recurring fair value measurements tables in Note 3 on pages 115-118 of this Form 10-Q include these amounts.*

(c) *Represents MSR asset fair value adjustments due to changes in inputs, such as interest rates and volatility, as well as updates to assumptions used in the valuation model. Total realized/unrealized gains/(losses) columns in the Changes in level 3 recurring fair value measurements tables in Note 3 on pages 115-118 of this Form 10-Q include these amounts.*

(d) *Primarily represents risk management activities performed by the Chief Investment Office (CIO) in the Corporate sector, including $(2) million and $(4) million related to CB MSRs for the three and six months ended June 30, 2010 and 2009, respectively.*

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The table below outlines the key economic assumptions used to determine the fair value of the Firm s MSRs at June 30, 2010, and December 31, 2009; and it outlines the sensitivities of those fair values to immediate adverse changes in those assumptions, as defined below.

(in millions, except rates)	**June 30, 2010**	December 31, 2009
Weighted-average prepayment speed assumption (CPR)	**16.47%**	11.37%
Impact on fair value of 10% adverse change	**$ (939)**	$ (896)
Impact on fair value of 20% adverse change	**(1,797)**	(1,731)
Weighted-average option adjusted spread	**4.34%**	4.63%
Impact on fair value of 100 basis points adverse change	**$ (444)**	$ (641)
Impact on fair value of 200 basis points adverse change	**(854)**	(1,232)

CPR: Constant prepayment rate.

The sensitivity analysis in the preceding table is hypothetical and should be used with caution. Changes in fair value based on changes in assumptions generally cannot be easily extrapolated, because the relationship of the change in the assumptions to the change in fair value may not be linear. Also, in this table, the effect that a change in a particular assumption may have on the fair value is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

Other intangible assets

For the six months ended June 30, 2010, purchased credit card relationships, other credit card-related intangibles, core deposit intangibles and other intangible assets decreased $443 million, primarily reflecting amortization expense. The components of credit card relationships, core deposits and other intangible assets were as follows.

	June 30, 2010			December 31, 2009		
(in millions)	Gross amount	Accumulated amortization	Net carrying value	Gross amount	Accumulated amortization	Net carrying value
Purchased credit card relationships	**$5,782**	**$4,731**	**$1,051**	$5,783	$4,537	$1,246
Other credit card-related intangibles	**884**	**255**	**629**	894	203	691
Core deposit intangibles	**4,280**	**3,239**	**1,041**	4,280	3,073	1,207
Other intangibles	**2,226**	**769**	**1,457***(a)*	2,200	723	1,477

(a) The decrease from December 31, 2009 includes the elimination of servicing assets for auto and student loans as a result of the adoption

of the new consolidation guidance related to VIEs.

Amortization expense

The Firm s intangible assets with finite lives are amortized over their useful lives in a manner that best reflects the economic benefits of the intangible asset. Intangible assets of approximately $600 million consisting primarily of asset management advisory contracts, were determined to have an indefinite life and are not amortized.

The following table presents amortization expense related to credit card relationships, core deposits and other intangible assets.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Purchased credit card relationships	**$ 97**	$ 108	**$194**	$224
All other intangibles:				
Other credit card-related intangibles	**26**	23	**52**	46
Core deposit intangibles	**83**	99	**166**	198
Other intangibles(a)	**29**	35	**66**	72
Total amortization expense	**$ 235**	$ 265	**$478**	$540

(a) Excludes amortization expense related to servicing assets on securitized automobile loans, which is recorded in lending- and deposit-related fees, of $1 million for the six months ended June 30, 2009. Effective January 1, 2010, the Firm adopted new accounting guidance which resulted in the elimination of those servicing assets.

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Future amortization expense

The following table presents estimated future amortization expense related to credit card relationships, core deposits and other intangible assets.

For the year: (in millions)	Purchased credit card relationships	Other credit card related intangibles	Core deposit intangibles	Other intangibles	**Total**
2010*(a)*	$ 354	$ 102	$ 329	$ 129	$ 914
2011	290	101	284	118	793
2012	251	103	240	114	708
2013	212	103	195	110	620
2014	109	99	103	98	409

(a) Includes $194 million, $52 million, $166 million and $66 million of amortization expense related to purchased credit card relationships, other credit card-related intangibles, core deposit intangibles and other intangibles, respectively, recognized during the first six months of 2010.

NOTE 17 DEPOSITS

For further discussion of deposits, see Note 19 on page 218 in JPMorgan Chase s 2009 Annual Report.

At June 30, 2010, and December 31, 2009, noninterest-bearing and interest-bearing deposits were as follows.

(in millions)	**June 30, 2010**	December 31, 2009
U.S. offices:		
Noninterest-bearing	**$ 208,064**	$ 204,003
Interest-bearing		

Demand[(a)]	**15,786**	15,964
Savings[(b)]	**315,486**	297,949
Time (included $2,453 and $1,463 at fair value at June 30, 2010, and December 31, 2009, respectively)	**102,492**	125,191
Total interest-bearing deposits	**433,764**	439,104
Total deposits in U.S. offices	**641,828**	643,107
Non-U.S. offices:		
Noninterest-bearing	**9,094**	8,082
Interest-bearing		
Demand	**175,636**	186,885
Savings	**645**	661
Time (included $2,437 and $2,992 at fair value at June 30, 2010, and December 31, 2009, respectively)	**60,602**	99,632
Total interest-bearing deposits	**236,883**	287,178
Total deposits in non-U.S. offices	**245,977**	295,260
Total deposits	**$887,805**	$ 938,367

(a) *Represents Negotiable Order of Withdrawal (NOW) accounts.*

(b) *Includes Money Market Deposit Accounts (MMDAs).*

NOTE 18 OTHER BORROWED FUNDS

The following table details the components of other borrowed funds.

(in millions)	**June 30, 2010**	December 31, 2009
Advances from Federal Home Loan Banks[(a)]	**$ 14,324**	$ 27,847
Other	**30,107**	27,893
Total other borrowed funds[(b)]	**$ 44,431**	$ 55,740

(a) *Maturities of advances from the FHLBs are $10.1 billion, $16 million, $3.2 billion, $20* *million, and $12 million in each of the 12-month periods ending June 30, 2011, 2012, 2013, 2014, and 2015, respectively, and $928 million maturing after June 30, 2015.*

(b) *Includes other borrowed funds of $7.4 billion and $5.6 billion accounted for at fair value at June 30, 2010, and December 31, 2009, respectively.*

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NOTE 19 EARNINGS PER SHARE

For a discussion of the computation of basic and diluted earnings per share (EPS), see Note 25 on page 224 of JPMorgan Chase s 2009 Annual Report. The following table presents the calculation of basic and diluted EPS for the three and six months ended June 30, 2010 and 2009.

(in millions, except per share amounts)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Basic earnings per share				
Net income	**$ 4,795**	$ 2,721	**$ 8,121**	$ 4,862
Less: Preferred stock dividends	**163**	473	**325**	1,002
Less: Accelerated amortization from redemption of preferred stock issued to the U.S. Treasury[a]		1,112		1,112
Net income applicable to common equity	**4,632**	1,136	**7,796**	2,748
Less: Dividends and undistributed earnings allocated to participating securities	**269**	64	**461**	157
Net income applicable to common stockholders	**$ 4,363**	$ 1,072	**$ 7,335**	$ 2,591
Total weighted-average basic shares outstanding	**3,983.5**	3,811.5	**3,977.0**	3,783.6
Net income per share[a]	**$ 1.10**	$ 0.28	**$ 1.84**	$ 0.68

(in millions, except per share amounts)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Diluted earnings per share				
Net income applicable to common stockholders	**$ 4,363**	$ 1,072	**$ 7,335**	$ 2,591
Total weighted-average basic shares outstanding	**3,983.5**	3,811.5	**3,977.0**	3,783.6
Add: Employee stock options and SARs[b]	**22.1**	12.6	**23.2**	7.8
Total weighted-average diluted shares outstanding[c]	**4,005.6**	3,824.1	**4,000.2**	3,791.4
Net income per share[a]	**$ 1.09**	$ 0.28	**$ 1.83**	$ 0.68

(a) *The calculation of basic and diluted EPS for the three and six months ended June 30, 2009, includes a one-time noncash reduction of $1.1 billion, or*

$0.27 and $0.28 per share, respectively, resulting from the redemption of the Series K Preferred Stock issued to the U.S. Treasury.

(b) *Excluded from the computation of diluted EPS (due to the antidilutive effect) were options issued under employee benefit plans and warrants originally issued under the U.S. Treasury s Capital Purchase Program to purchase shares of the Firm s common stock aggregating 224 million and 315 million shares for the three months ended June 30, 2010 and 2009, respectively, and 232 million and 339 million shares for the six months ended June 30, 2010 and 2009, respectively.*

(c) *Participating securities were included in the calculation of diluted EPS using the* *two-class method, as this computation was more dilutive than the calculation using the treasury stock method.*

NOTE 20 ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)

Accumulated other comprehensive income/(loss) includes the after-tax change in unrealized gains and losses on AFS securities, foreign currency translation adjustments (including the impact of related derivatives), cash flow hedging activities and net loss and prior service cost/(credit) related to the Firm s defined benefit pension and OPEB plans.

Six months ended June 30, 2010 (in millions)	Unrealized gains/(losses) on AFS securities[b]	Translation adjustments, net of hedges	Cash flow hedges	Net loss and prior service costs/(credit) of defined benefit pension and OPEB plans	Accumulated other comprehensive income/(loss)
Balance at January 1, 2010	**$ 2,032**(c)	**$ (16)**	**$ 181**	**$ (2,288)**	**$ (91)**
Cumulative effect of changes in accounting principles[a]	**(129)**				**(129)**
Net change	**2,339**(d)	**(25)**(e)	**165**(f)	**145**(g)	**2,624**
Balance at June 30, 2010	**$ 4,242**(c)	**$ (41)**	**$ 346**	**$ (2,143)**	**$ 2,404**

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Six months ended June 30, 2009 (in millions)	Unrealized gains/(losses) on AFS securities[b]	Translation adjustments, net of hedges	Cash flow hedges	Net loss and prior service costs/(credit) of defined benefit pension and OPEB plans	Accumulated other comprehensive income/(loss)
Balance at January 1, 2009	$ (2,101)	$ (598)	$ (202)	$ (2,786)	$ (5,687)
Net change	1,576*(d)*	491*(e)*	95*(f)*	87*(g)*	2,249
Balance at June 30, 2009	$ (525)	$ (107)	$ (107)	$ (2,699)	$ (3,438)

(a) Reflects the effect of adoption of new consolidation guidance related to VIEs. The decrease in AOCI is a result of the reversal of the fair value adjustments taken on retained AFS securities that were eliminated in consolidation. For further discussion, see Note 15 on pages 151-163 of this Form 10-Q.

(b) Represents the after-tax difference between the fair value and amortized cost of the AFS securities portfolio and retained interests in securitizations recorded in other assets.

(c) *Includes after-tax unrealized losses of $(126) million and $(226) million not related to credit on debt securities for which credit losses have been recognized in income at June 30, 2010, and December 31, 2009, respectively.*

(d) *The net change for the six months ended June 30, 2010, was due primarily to the narrowing of spreads on mortgage-backed securities and CLOs partially offset by declines in non-U.S. government debt and realization of gains due to portfolio repositioning. The net change for the six months ended June 30, 2009, was due primarily to the narrowing of spreads on U.S. government agency mortgage-backed securities and credit card ABS positions as a result of improvement in the credit environment.*

(e) Includes $(489) million and $509 million at June 30, 2010 and 2009, respectively, of after-tax gains/(losses) on foreign currency translation from operations for which the functional currency is other than the U.S. dollar, partially offset by $464 million and $(18) million, respectively, of after-tax gains/(losses) on hedges. The Firm may not hedge its entire exposure to foreign currency translation on net investments in foreign operations.

(f) The net change for the six months ended June 30, 2010, included $6 million of after-tax gains recognized in income, and $171 million of after-tax gains, representing the net change in derivative fair value that was reported in comprehensive income. The net change for the six months ended

June 30, 2009, included $86 million of after-tax gains recognized in income and $181 million of after-tax gains, representing the net change in derivative fair value that was reported in comprehensive income.

(g) *The net changes for the six months ended June 30, 2010 and 2009, were primarily due to after-tax adjustments based on the final year-end actuarial valuations for the U.S. and non-U.S. defined benefit pension and OPEB plans (for 2009 and 2008, respectively); and the amortization of net loss and prior service credit into net periodic benefit cost. The net change for 2009 also included an offset for a change in tax rates.*

NOTE 21 COMMITMENTS AND CONTINGENCIES

For a discussion of the Firm s commitments and contingencies, see Note 30 on page 230 of JPMorgan Chase s 2009 Annual Report.

Litigation reserve

The Firm maintains litigation reserves for certain of its outstanding litigation. At June 30, 2010, the Firm and its subsidiaries were named as a defendant or were otherwise involved in several thousand legal proceedings, investigations and litigations in various jurisdictions around the world. The Firm s material legal proceedings are described in Item 1: Legal Proceedings on pages 188-196 of this Form 10-Q (the Legal Proceedings section), to which reference is hereby made.

The Firm has established reserves for several hundred of its cases. The Firm accrues for a litigation-related liability when it is probable that such liability has been incurred and the amount of the loss can be reasonably estimated. The Firm evaluates its litigations, proceedings and investigations each quarter to assess its litigation reserves, and makes adjustments in such reserves, upwards or downwards as appropriate, based on management s best judgment after consultation with counsel. During the three and six months ended June 30, 2010, the Firm incurred $792 million and $3.7 billion, respectively, of litigation expense. There is no assurance that the Firm s litigation reserves will not need to be adjusted in the future.

The Firm s legal proceedings range from cases involving a single plaintiff to class action lawsuits with classes involving thousands of plaintiffs. These cases involve each of the various lines of business of the Firm and a wide variety of claims (including common law tort and contract claims and statutory antitrust, securities and consumer protection claims), some of which are at preliminary stages of adjudication and/or present novel factual claims or legal theories. While some cases pending against the Firm specify the damages claimed by the plaintiff, many seek an indeterminate amount of damages or are at very early stages; and even where damages are specified by the plaintiff, such claimed amount may not correlate to reasonably possible losses or those that might be judicially determined to be payable by the Firm.

The Firm does not believe that an aggregate range of reasonably possible losses (defined by the relevant accounting literature to include all potential losses other than those deemed remote) can be determined for asserted and probable unasserted claims as of June 30, 2010. This would require the Firm to make assessments regarding claims, or portion of claims, where actual damages have not been specified by the plaintiffs, or to assess novel claims or claims that are at preliminary stages of adjudication . For those legal matters where damages have been specified by the plaintiff, such claimed damages may, in some instances, provide the upper end of the range of reasonably possible losses as previously defined. Accordingly, to assist the reader s understanding of the potential magnitude of the matters at issue, the Firm has included in its current description of the status of each matter set forth in the Legal Proceedings section, for each particular matter where the information is available, the amount of damages claimed or publicly available information that pertains to the damages claimed where not so specified.

The Firm believes it has meritorious defenses to the claims asserted against it in its currently outstanding litigations, and it intends to defend itself vigorously in all its cases.

Based upon its current knowledge, after consultation with counsel and after taking into consideration its current litigation reserves, the Firm believes that the legal actions, proceedings and investigations currently pending against it should not have a material adverse effect on the Firm s consolidated financial condition. However, in light of the uncertainties involved in such proceedings, actions and investigations, there is no assurance that the ultimate resolution of these matters will not significantly exceed the reserves currently accrued by the Firm; as a result, the outcome of a particular matter may be material to JPMorgan Chase s operating results for a particular period depending on, among other factors, the size of the loss or liability imposed and the level of JPMorgan Chase s income for that period.

NOTE 22 OFF-BALANCE SHEET LENDING-RELATED FINANCIAL INSTRUMENTS, GUARANTEES AND OTHER COMMITMENTS

JPMorgan Chase utilizes lending-related financial instruments (e.g., commitments and guarantees) to meet the financing needs of its customers. The contractual amount of these financial instruments represents the maximum possible credit risk should the counterparty draw upon the commitment or the Firm be required to fulfill its obligation under the guarantee, and the counterparty subsequently fail to perform according to the terms of the contract. These commitments and guarantees often expire without being drawn, and even higher proportions expire without a default. As a result, the total contractual amount of these instruments is not, in the Firm s view, representative of its actual future credit exposure or funding requirements. For a discussion of off-balance sheet lending-related financial instruments and guarantees, and the Firm s related accounting policies, see Note 31 on pages 230-234 of JPMorgan Chase s 2009 Annual Report.

To provide for the risk of loss inherent in wholesale-related contracts, an allowance for credit losses on lending-related commitments is maintained. See Note 14 on pages 150-151 of this Form 10-Q for further discussion regarding the allowance for credit losses on lending-related commitments.

The following table summarizes the contractual amounts and carrying values of off-balance sheet lending-related financial instruments, guarantees and other commitments at June 30, 2010, and December 31, 2009. The amounts in the table below for credit card and home equity lending-related commitments represent the total available credit for these products. The Firm has not experienced, and does not anticipate, that all available lines of credit for these products will be utilized at the same time. The Firm can reduce or cancel these lines of credit by providing the borrower prior notice or, in some cases, without notice as permitted by law.

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Off balance sheet lending-related financial instruments, guarantees and other commitments

	Contractual amount		Carrying value(i)	
(in millions)	**June 30, 2010**	December 31, 2009	**June 30, 2010**	December 31, 2009
Lending-related				
Consumer:				
Home equity senior lien	**$ 18,320**	$ 19,246	**$**	$
Home equity junior lien	**33,985**	37,231		
Prime mortgage	**958**	1,654		
Subprime mortgage				
Option ARMs				
Auto loans	**6,029**	5,467	**5**	7
Credit card	**550,442**	569,113		
All other loans	**10,207**	11,229	**5**	5
Total consumer	**619,941**	643,940	**10**	12
Wholesale:				
Other unfunded commitments to extend credit(a)(b)	**188,093**	192,145	**382**	356
Asset purchase agreements(b)		22,685		126
Standby letters of credit and other financial guarantees(a)(c)(d)	**91,167**	91,485	**879**	919
Unused advised lines of credit	**38,916**	35,673		
Other letters of credit(a)(d)	**6,376**	5,167	**1**	1
Total wholesale	**324,552**	347,155	**1,262**	1,402
Total lending-related	**$944,493**	$991,095	**$1,272**	$ 1,414
Other guarantees and commitments				
Securities lending guarantees(e)	**$161,514**	$170,777	**NA**	NA
Derivatives qualifying as guarantees(f)	**79,259**	87,191	**$ 786**	$ 762
Equity investment commitments(g)	**2,207**	2,374		
Building purchase commitment	**670**	670		
Loan sale and securitization-related indemnifications:				
Repurchase liability(h)	**NA**	NA	**2,332**	1,705
Loans sold with recourse	**11,328**	13,544	**148**	271

(a) At June 30, 2010, and December 31, 2009, represents the contractual amount net of risk participations

totaling $609 million and $643 million, respectively, for other unfunded commitments to extend credit; $23.4 billion and $24.6 billion, respectively, for standby letters of credit and other financial guarantees; and $828 million and $690 million, respectively, for other letters of credit. In regulatory filings with the Federal Reserve these commitments are shown gross of risk participations.

(b) *Upon the adoption of the new consolidation guidance related to VIEs, $24.2 billion of lending-related commitments between the Firm and Firm-administered multi-seller conduits were eliminated upon consolidation. The decrease in lending-related commitments was partially offset by the addition of $6.5 billion of unfunded commitments directly between the multi-seller conduits and clients; these unfunded commitments of the consolidated conduits are now included as off-balance sheet lending-related commitments of the*

Firm.

(c) *At June 30, 2010, and December 31, 2009, includes unissued standby letters of credit commitments of $39.4 billion and $38.4 billion, respectively.*

(d) *At June 30, 2010, and December 31, 2009, JPMorgan Chase held collateral relating to $34.7 billion and $31.5 billion, respectively, of standby letters of credit; and $2.7 billion and $1.3 billion, respectively, of other letters of credit.*

(e) *At June 30, 2010, and December 31, 2009, collateral held by the Firm in support of securities lending indemnification agreements totaled $164.5 billion and $173.2 billion, respectively. Securities lending collateral comprises primarily cash and securities issued by governments that are members of the Organisation for Economic Co-operation and Development (OECD) and U.S. government agencies.*

(f) *Represents notional amounts of*

derivatives qualifying as guarantees. The carrying value at June 30, 2010, and December 31, 2009, reflects derivative payables of $1.0 billion and $981 million, respectively, less derivative receivables of $232 million and $219 million, respectively.

(g) *At June 30, 2010, and December 31, 2009, includes unfunded commitments to third-party private equity funds of $1.2 billion and $1.5 billion respectively. Also includes unfunded commitments for other equity investments of $981 million and $897 million, respectively. These commitments include $1.2 billion and $1.5 billion, respectively, related to investments that are generally fair valued at net asset value as discussed in Note 3 on pages 110-124 of this Form 10-Q.*

(h) *Represents estimated repurchase liability related to indemnifications for breaches of representations and warranties in loan sale and* *securitization agreements. For additional information, see Loan sale and securitization-related indemnifications on pages 173-174 of this Note.*

(i) *For lending-related products, the carrying value represents the allowance for lending-related commitments and the guarantee liability. For derivative-related products, the carrying value represents the fair value. For all other products the carrying value represents the valuation reserve.*

Other unfunded commitments to extend credit
Other unfunded commitments to extend credit include commitments to U.S. states and municipalities, hospitals and other not-for-profit entities to provide funding for periodic tenders of their variable-rate demand bond obligations or commercial paper. Performance by the Firm is required in the event that the variable-rate demand bonds or commercial paper cannot be remarketed to new investors. The amount of commitments related to variable-rate demand bonds and commercial paper of U.S. states and municipalities, hospitals and not-for-profit entities was $19.1 billion and $23.3 billion at June 30, 2010, and December 31, 2009, respectively. Similar commitments exist to extend credit in the form of liquidity facility agreements with nonconsolidated municipal bond VIEs. For further information, see Note 15 on pages 151-163 of this Form 10-Q.
Also included in other unfunded commitments to extend credit are commitments to investment- and noninvestment-grade counterparties in connection with leveraged acquisitions. These commitments are dependent on whether the acquisition by the borrower is successful, tend to be short-term in nature and, in most cases, are subject to certain conditions based on the borrower s financial condition or other factors. The amounts of commitments related to leveraged acquisitions were $2.9 billion at both June 30, 2010, and December 31, 2009. For further information, see Note 3 and Note 4 on pages 110-124 and 125-127 respectively, of this Form 10-Q.
Guarantees
The Firm considers the following off-balance sheet lending-related arrangements to be guarantees under U.S. GAAP: standby letters of credit and financial guarantees, securities lending indemnifications, certain indemnification agreements included within third-party contractual arrangements and certain derivative contracts. For a further discussion of the off-balance sheet lending-related arrangements the Firm considers to be guarantees, and the related accounting policies, see Note 31 on pages 230-234 of JPMorgan Chase s 2009 Annual Report. The amount of the liability related to guarantees recorded at June 30, 2010, and December 31, 2009, excluding the allowance for credit losses on lending-related commitments and derivative contracts discussed below, was $360 million and $475 million, respectively.
Standby letters of credit
Standby letters of credit (SBLC) and other financial guarantees are conditional lending commitments issued by the Firm to guarantee the performance of a customer to a third party under certain arrangements, such as commercial paper facilities, bond financings, acquisition financings, trade and similar transactions. The carrying values of standby and other letters of credit were $880 million and $920 million at June 30, 2010, and December 31, 2009, respectively, which was classified in accounts payable and other liabilities on the Consolidated Balance Sheets; these carrying values include $520 million and $553 million, respectively, for the allowance for lending-related commitments, and $360 million and $367 million, respectively, for the guarantee liability.

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The following table summarizes the types of facilities under which standby letters of credit and other letters of credit arrangements are outstanding by the ratings profiles of the Firm s customers, as of June 30, 2010, and December 31, 2009.

Standby letters of credit and other financial guarantees and other letters of credit

	June 30, 2010		December 31, 2009	
(in millions)	Standby letters of credit and other financial guarantees	Other letters of credit	Standby letters of credit and other financial guarantees	Other letters of credit
Investment-grade[(a)]	**$66,431**	**$4,942**	$66,786	$3,861
Noninvestment-grade[(a)]	**24,736**	**1,434**	24,699	1,306
Total contractual amount[(b)]	**$91,167**[(c)]	**$6,376**	$91,485[(c)]	$5,167
Allowance for lending-related commitments	**$ 519**	**$ 1**	$ 552	$ 1
Commitments with collateral	**34,696**	**2,698**	31,454	1,315

(a) The ratings scale is based on the Firm s internal ratings which generally correspond to ratings as defined by S&P and Moody s.

(b) At June 30, 2010, and December 31, 2009, represents contractual amount net of risk participations totaling $23.4 billion and $24.6 billion, respectively, for standby letters of credit and other financial guarantees; and $828 million

and $690 million, respectively, for other letters of credit. In regulatory filings with the Federal Reserve these commitments are shown gross of risk participations.

(c) *At June 30, 2010, and December 31, 2009, includes unissued standby letters of credit commitments of $39.4 billion and $38.4 billion, respectively.*

Derivatives qualifying as guarantees

In addition to the contracts described above, the Firm transacts certain derivative contracts that meet the characteristics of a guarantee under U.S. GAAP. The total notional value of the derivatives that the Firm deems to be guarantees was $79.3 billion and $87.2 billion at June 30, 2010, and December 31, 2009, respectively. The notional value generally represents the Firm s maximum exposure to derivatives qualifying as guarantees, although exposure to certain stable value derivatives is contractually limited to a substantially lower percentage of the notional value. The fair value of the contracts reflects the probability of whether the Firm will be required to perform under the contract. The fair value related to derivative guarantees were derivative payables of $1.0 billion and $981 million and derivative receivables of $232 million and $219 million at June 30, 2010, and December 31, 2009, respectively. The Firm reduces exposures to these contracts by entering into offsetting transactions, or by entering into contracts that hedge the market risk related to the derivative guarantees.

In addition to derivative contracts that meet the characteristics of a guarantee, the Firm is both a purchaser and seller of credit protection in the credit derivatives market. For a further discussion of credit derivatives, see Note 5 on pages 128-136 of this Form 10-Q, and Note 5 on pages 167-175 of JPMorgan Chase s 2009 Annual Report.

Loan sale- and securitization-related indemnifications

Indemnifications for breaches of representations and warranties

As part of the Firm s loan sale and securitization activities, the Firm generally makes representations and warranties in its loan sale and securitization agreements that the loans sold meet certain requirements. These agreements may require the Firm (including in its roles as a servicer) to repurchase the loan, purchase the property if the loan has already been foreclosed upon, and/or reimburse the purchaser for losses if the foreclosed property has been liquidated (commonly referred to as a make-whole payment) if the Firm is deemed to have breached such representations or warranties. Generally, the maximum amount of future payments the Firm would be required to make for breaches under these representations and warranties would be equal to the unpaid principal balance of such loans that are deemed to have defects sold to purchasers (including securitization-related SPEs) plus, in certain circumstances, accrued and unpaid interest on such loans and certain expense. At June 30, 2010, and December 31, 2009, the Firm had recorded repurchase liabilities of $2.3 billion and $1.7 billion, respectively, which are reported in accounts payable and other liabilities net of probable recoveries from third parties. The Firm does not believe a range of reasonably possible loss (as defined by the relevant accounting literature) related to its repurchase liability can be determined for asserted and probable unasserted claims as of June 30, 2010.

For additional information, see Note 13 and Note 15 on pages 145-150 and 151-163, respectively, of this Form 10-Q, and Note 13 and Note 15 on pages 192-196 and 198-205, respectively, of JPMorgan Chase s 2009 Annual Report.

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Loans sold with recourse

The Firm provides servicing for mortgages and certain commercial lending products on both a recourse and nonrecourse basis. In nonrecourse servicing, the principal credit risk to the Firm is the cost of temporary servicing advances of funds (i.e., normal servicing advances). In recourse servicing, the servicer agrees to share credit risk with the owner of the mortgage loans, such as Fannie Mae or Freddie Mac or a private investor, insurer or guarantor. Losses on recourse servicing predominantly occur when foreclosure sales proceeds of the property underlying a defaulted loan are less than the sum of the outstanding principal balance, plus accrued interest on the loan and the cost of holding and disposing of the underlying property. The Firm s securitizations are predominantly nonrecourse, thereby effectively transferring the risk of future credit losses to the purchaser of the mortgage-backed securities issued by the trust. At June 30, 2010, and December 31, 2009, the unpaid principal balance of loans sold with recourse totaled $11.3 billion and $13.5 billion, respectively. The carrying value of the related liability that the Firm has recorded, which is representative of the Firm s view of the likelihood it will have to perform under this guarantee, was $148 million and $271 million at June 30, 2010, and December 31, 2009, respectively.

Building purchase commitment

In connection with the Bear Stearns merger, the Firm succeeded to an operating lease arrangement for the building located at 383 Madison Avenue in New York City (the Synthetic Lease). Under the terms of the Synthetic Lease, the Firm was obligated to a maximum residual value guarantee of approximately $670 million if the building were sold and the proceeds of the sale were insufficient to satisfy the lessor s debt obligation. The Firm subsequently served notice to the lessor indicating the Firm will purchase the property on the expiration date of the lease, November 1, 2010. Accordingly, the residual value guarantee has been reclassified as a building purchase commitment.

NOTE 23 BUSINESS SEGMENTS

The Firm is managed on a line of business basis. There are six major reportable business segments Investment Bank, Retail Financial Services, Card Services, Commercial Banking, Treasury & Securities Services and Asset Management, as well as a Corporate/Private Equity segment. The business segments are determined based on the products and services provided, or the type of customer served, and they reflect the manner in which financial information is currently evaluated by management. Results of these lines of business are presented on a managed basis. For a definition of managed basis, see the footnotes to the table below. For a further discussion concerning JPMorgan Chase s business segments, see Business Segment Results on page 20 of this Form 10-Q, and pages 53-54 and Note 34 on pages 237-239 of JPMorgan Chase s 2009 Annual Report.

Segment results

The following tables provide a summary of the Firm s segment results for the three and six months ended June 30, 2010, and 2009, on a managed basis. Prior to the January 1, 2010, adoption of the new consolidation guidance related to VIEs, the impact of credit card securitization adjustments had been included in reconciling items so that the total Firm results are on a reported basis. Finally, total net revenue (noninterest revenue and net interest income) for each of the segments is presented on a tax-equivalent basis. Accordingly, revenue from tax-exempt securities and investments that receive tax credits are presented in the managed results on a basis comparable to taxable securities and investments. This approach allows management to assess the comparability of revenue arising from both taxable and tax-exempt sources. The corresponding income tax impact related to these items is recorded within income tax expense/(benefit).

Effective January 1, 2010, the Firm enhanced its line of business equity framework to better align equity assigned to each line of business with the changes anticipated to occur in the business, and in the competitive and regulatory landscape. The lines of business are now capitalized based on the Tier 1 common standard, rather than the Tier 1 capital standard.

Segment results and reconciliation[(a)]

Three months ended June 30, 2010 (in millions, except ratios)	Investment Bank	Retail Financial Services	Card Services[(e)]	Commercial Banking
Noninterest revenue	**$ 4,432**	**$ 2,992**	**$ 861**	**$ 546**
Net interest income	**1,900**	**4,817**	**3,356**	**940**
Total net revenue	**6,332**	**7,809**	**4,217**	**1,486**
Provision for credit losses	**(325)**	**1,715**	**2,221**	**(235)**
Credit reimbursement (to)/from TSS[(b)]				
Noninterest expense[(c)]	**4,522**	**4,281**	**1,436**	**542**
Income/(loss) before income tax expense/(benefit)	**2,135**	**1,813**	**560**	**1,179**
Income tax expense/(benefit)	**754**	**771**	**217**	**486**
Net income/(loss)	**$ 1,381**	**$ 1,042**	**$ 343**	**$ 693**
Average common equity[(d)]	**$ 40,000**	**$ 28,000**	**$ 15,000**	**$ 8,000**
Average assets	**710,005**	**381,906**	**146,816**	**133,309**
Return on average common equity	**14%**	**15%**	**9%**	**35%**
Overhead ratio	**71**	**55**	**34**	**36**

Three months ended June 30, 2010 (in millions, except ratios)	Treasury & Securities Services	Asset Management	Corporate/ Private Equity	Reconciling Items[(e)(f)]	Total
Noninterest revenue	**$ 1,227**	**$ 1,699**	**$ 1,103**	**$ (446)**	**$ 12,414**
Net interest income	**654**	**369**	**747**	**(96)**	**12,687**
Total net revenue	**1,881**	**2,068**	**1,850**	**(542)**	**25,101**
Provision for credit losses	**(16)**	**5**	**(2)**		**3,363**
Credit reimbursement (to)/from TSS[(b)]	**(30)**			**30**	
Noninterest expense[(c)]	**1,399**	**1,405**	**1,046**		**14,631**
Income/(loss) before income tax expense/(benefit)	**468**	**658**	**806**	**(512)**	**7,107**
Income tax expense/(benefit)	**176**	**267**	**153**	**(512)**	**2,312**
Net income	**$ 292**	**$ 391**	**$ 653**	**$**	**$ 4,795**
Average common equity[(d)]	**$ 6,500**	**$ 6,500**	**$ 55,069**	**$**	**$ 159,069**

Average assets	**42,868**	**63,426**	**565,317**	**NA**	**2,043,647**
Return on average common equity	**18%**	**24%**	**NM**	**NM**	**12%**
Overhead ratio	**74**	**68**	**NM**	**NM**	**58**

Three months ended June 30, 2009 (in millions, except ratios)	Investment Bank	Retail Financial Services	Card Services[(e)]	Commercial Banking
Noninterest revenue	$ 4,856	$ 2,940	$ 557	$ 458
Net interest income	2,445	5,030	4,311	995
Total net revenue	7,301	7,970	4,868	1,453
Provision for credit losses	871	3,846	4,603	312
Credit reimbursement (to)/from TSS[(b)]				
Noninterest expense[(c)]	4,067	4,079	1,333	535
Income/(loss) before income tax expense/(benefit)	2,363	45	(1,068)	606
Income tax expense/(benefit)	892	30	(396)	238
Net income/(loss)	$ 1,471	$ 15	$ (672)	$ 368
Average common equity[(d)]	$ 33,000	$ 25,000	$ 15,000	$ 8,000
Average assets	710,825	410,228	193,310	137,283
Return on average common equity	18%	%	(18)%	18%
Overhead ratio	56	51	27	37

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Three months ended June 30, 2009 (in millions, except ratios)	Treasury & Securities Services	Asset Management	Corporate/ Private Equity	Reconciling Items[(e)(f)]	Total
Noninterest revenue	$ 1,245	$ 1,568	$ 1,400	$ (71)	$ 12,953
Net interest income/(loss)	655	414	865	(2,045)	12,670
Total net revenue	1,900	1,982	2,265	(2,116)	25,623
Provision for credit losses	(5)	59	9	(1,664)	8,031
Credit reimbursement (to)/from TSS[(b)]	(30)			30	
Noninterest expense[(c)]	1,288	1,354	864		13,520
Income/(loss) before income tax expense/(benefit)	587	569	1,392	(422)	4,072
Income tax expense/(benefit)	208	217	584	(422)	1,351
Net income/(loss)	$ 379	$ 352	$ 808	$	$ 2,721
Average common equity[(d)]	$ 5,000	$ 7,000	$ 47,865	$	$ 140,865
Average assets	35,520	59,334	573,460	(81,588)	2,038,372
Return on average common equity	30%	20%	NM	NM	3%
Overhead ratio	68	68	NM	NM	53

Six months ended June 30, 2010 (in millions, except ratios)	Investment Bank	Retail Financial Services	Card Services[(e)]	Commercial Banking
Noninterest revenue	**$ 10,623**	**$ 5,744**	**$ 1,619**	**$ 1,046**
Net interest income	**4,028**	**9,841**	**7,045**	**1,856**
Total net revenue	**14,651**	**15,585**	**8,664**	**2,902**
Provision for credit losses	**(787)**	**5,448**	**5,733**	**(21)**
Credit reimbursement (to)/from TSS[(b)]				
Noninterest expense[(c)]	**9,360**	**8,523**	**2,838**	**1,081**
Income/(loss) before income tax expense/(benefit)	**6,078**	**1,614**	**93**	**1,842**
Income tax expense/(benefit)	**2,226**	**703**	**53**	**759**
Net income/(loss)	**$ 3,852**	**$ 911**	**$ 40**	**$ 1,083**
Average common equity[(d)]	**$ 40,000**	**$ 28,000**	**$ 15,000**	**$ 8,000**
Average assets	**693,157**	**387,854**	**151,864**	**133,162**
Return on average common equity	**19%**	**7%**	**1%**	**27%**
Overhead ratio	**64**	**55**	**33**	**37**

Six months ended June 30, 2010 (in millions, except ratios)	Treasury & Securities Services	Asset Management	Corporate/ Private Equity	Reconciling Items[e][f]	Total
Noninterest revenue	**$ 2,373**	**$ 3,473**	**$ 2,384**	**$ (887)**	**$ 26,375**
Net interest income	**1,264**	**726**	**1,823**	**(186)**	**26,397**
Total net revenue	**3,637**	**4,199**	**4,207**	**(1,073)**	**52,772**
Provision for credit losses	**(55)**	**40**	**15**		**10,373**
Credit reimbursement (to)/from TSS[b]	**(60)**			**60**	
Noninterest expense[c]	**2,724**	**2,847**	**3,382**		**30,755**
Income/(loss) before income tax expense/(benefit)	**908**	**1,312**	**810**	**(1,013)**	**11,644**
Income tax expense/(benefit)	**337**	**529**	**(71)**	**(1,013)**	**3,523**
Net income/(loss)	**$ 571**	**$ 783**	**$ 881**	**$**	**$ 8,121**
Average common equity[d]	**$ 6,500**	**$ 6,500**	**$ 53,590**	**$**	**$ 157,590**
Average assets	**40,583**	**62,978**	**571,579**	**NA**	**2,041,177**
Return on average common equity	**18%**	**24%**	**NM**	**NM**	**10%**
Overhead ratio	**75**	**68**	**NM**	**NM**	**58**

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Six months ended June 30, 2009 (in millions, except ratios)	Investment Bank	Retail Financial Services	Card Services[e]	Commercial Banking
Noninterest revenue	$ 10,525	$ 6,537	$ 1,204	$ 880
Net interest income	5,147	10,268	8,793	1,975
Total net revenue	15,672	16,805	9,997	2,855
Provision for credit losses	2,081	7,723	9,256	605
Credit reimbursement (to)/from TSS[b]				
Noninterest expense[c]	8,841	8,250	2,679	1,088
Income/(loss) before income tax expense/(benefit)	4,750	832	(1,938)	1,162
Income tax expense/(benefit)	1,673	343	(719)	456
Net income/(loss)	$ 3,077	$ 489	$ (1,219)	$ 706
Average common equity[d]	$ 33,000	$ 25,000	$ 15,000	$ 8,000
Average assets	721,934	416,813	197,234	140,771
Return on average common equity	19%	4%	(16)%	18%
Overhead ratio	56	49	27	38

Six months ended June 30, 2009 (in millions, except ratios)	Treasury & Securities Services	Asset Management	Corporate/ Private Equity	Reconciling Items[e][f]	Total
Noninterest revenue	$ 2,393	$ 2,868	$ 102	$ 102	$ 24,611
Net interest income	1,328	817	1,854	(4,145)	26,037
Total net revenue	3,721	3,685	1,956	(4,043)	50,648
Provision for credit losses	(11)	92	9	(3,128)	16,627
Credit reimbursement (to)/from TSS[b]	(60)			60	
Noninterest expense[c]	2,607	2,652	776		26,893
Income/(loss) before income tax expense/(benefit)	1,065	941	1,171	(855)	7,128
Income tax expense/(benefit)	378	365	625	(855)	2,266
Net income/(loss)	$ 687	$ 576	$ 546	$	$ 4,862
Average common equity[d]	$ 5,000	$ 7,000	$ 45,691	$	$ 138,691
Average assets	37,092	58,783	562,221	(82,182)	2,052,666
Return on average common equity	28%	17%	NM	NM	4%
Overhead ratio	70	72	NM	NM	53

(a)

In addition to analyzing the Firm s results on a reported basis, management reviews the Firm s lines of business results on a managed basis, which is a non-GAAP financial measure. The Firm s definition of managed basis starts with the reported U.S. GAAP results and includes certain reclassifications that do not have any impact on net income as reported by the lines of business or by the Firm as a whole.

(b) In the second quarter of 2009, IB began reporting a credit reimbursement from TSS as a component of total net revenue, whereas TSS reports the credit reimbursement as a separate line item on its income statement (not part of net revenue). Reconciling items include an

adjustment to offset IB s inclusion of the credit reimbursement in total net revenue.

(c) *Includes merger costs, which are reported in the Corporate/Private Equity segment. Merger costs attributed to the business segments for the three and six months ended June 30, 2010 and 2009, were as follows.*

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Investment Bank	**$**	$ 1	**$**	$ 16
Retail Financial Services		91		184
Card Services		8		36
Commercial Banking		2		5
Treasury & Securities Services		4		7
Asset Management		2		3
Corporate/Private Equity		35		97

(d) *Effective January 1, 2010, the Firm enhanced its line of business equity framework to better align equity assigned to each line of business with the changes anticipated to occur in the business, and in the competitive and regulatory landscape.*

(e) Effective January 1, 2010, the Firm adopted new consolidation guidance related to VIEs. Prior to the adoption of the new guidance, managed results for credit card excluded the impact of credit card securitizations on total net revenue, provision for credit losses and average assets, as JPMorgan Chase treated the sold receivables as if they were still on the balance sheet in evaluating the credit performance of the entire managed credit card portfolio, as operations are funded, and decisions are made about allocating resources, such as employees and capital, based on managed information. These adjustments are eliminated in reconciling items to arrive

at the Firm s reported U.S. GAAP results. The related securitization adjustments were as follows.

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	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Noninterest revenue	**NA**	$ (294)	**NA**	$ (834)
Net interest income	**NA**	1,958	**NA**	3,962
Provision for credit losses	**NA**	1,664	**NA**	3,128
Average assets	**NA**	81,588	**NA**	82,182

(f) Segment managed results reflect revenue on a tax-equivalent basis, with the corresponding income tax impact recorded within income tax expense. These adjustments are eliminated in reconciling items to arrive at the Firm s reported U.S. GAAP results. Tax-equivalent adjustments for the three and six months ended June 30, 2010 and 2009, were as follows.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	**2010**	2009	**2010**	2009
Noninterest revenue	**$ 416**	$ 335	**$ 827**	$ 672
Net interest income	**96**	87	**186**	183
Income tax expense	**512**	422	**1,013**	855

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JPMORGAN CHASE & CO.
CONSOLIDATED AVERAGE BALANCE SHEETS, INTEREST AND RATES
(Taxable-Equivalent Interest and Rates; in millions, except rates)

(in millions, except rates)	**Three months ended June 30, 2010** Average balance	Interest	Rate (annualized)	Three months ended June 30, 2009 Average balance	Interest	Rate (annualized)
Assets						
Deposits with banks	**$ 58,737**	**$ 92**	**0.63%**	$ 68,001	$ 246	1.45%
Federal funds sold and securities purchased under resale agreements	**189,573**	**398**	**0.84**	142,226	368	1.04
Securities borrowed	**113,650**	**32**	**0.11**	122,235	(96)	(0.32)
Trading assets debt instruments	**245,532**	**2,601**	**4.25**	245,444	3,002	4.91
Securities	**327,425**	**2,564**	**3.14**(b)	354,216	3,210	3.64(b)
Loans	**705,189**	**9,991**	**5.68**	697,908	9,832	5.65
Other assets	**34,429**	**137**	**1.60**	36,638	74	0.80
Total interest-earning assets	**$ 1,674,535**	**15,815**	**3.79**	1,666,668	16,636	4.00
Allowance for loan losses	**(37,929)**			(27,384)		
Cash and due from banks	**33,535**			22,816		
Trading assets equity instruments	**95,080**			63,507		
Trading assets derivative receivables	**79,409**			114,096		
Goodwill	**48,348**			48,273		
Other intangible assets:						
Mortgage servicing rights	**14,510**			12,256		
Purchased credit card relationships	**1,102**			1,485		
Other intangibles	**3,163**			3,733		
Other assets	**131,894**			132,922		
Total assets	**$ 2,043,647**			$ 2,038,372		
Liabilities						
Interest-bearing deposits	**$ 668,953**	**$ 883**	**0.53%**	$ 672,350	$ 1,165	0.70%
Federal funds purchased and securities loaned or sold under repurchase agreements	**273,614**	**(49)**(c)	**(0.07)**(c)	289,971	167	0.23
Commercial paper	**37,557**	**18**	**0.19**	37,371	23	0.24
Trading liabilities debt instruments	**72,276**	**449**	**2.49**	43,150	404	3.76
	131,546	**165**	**0.50**	164,339	282	0.69

Other borrowings and liabilities[(a)]						
Beneficial interests issued by consolidated VIEs	**90,085**	**306**	**1.36**	14,493	57	1.59
Long-term debt	**256,089**	**1,260**	**1.97**	274,323	1,781	2.60
Total interest-bearing liabilities	**1,530,120**	**3,032**	**0.79**	1,495,997	3,879	1.04
Noninterest-bearing deposits	**209,615**			199,221		
Trading liabilities equity instruments	**5,216**			11,437		
Trading liabilities derivative payables	**62,547**			78,155		
All other liabilities, including the allowance for lending-related commitments	**68,928**			84,359		
Total liabilities	**1,876,426**			1,869,169		
Stockholders equity						
Preferred stock	**8,152**			28,338		
Common stockholders equity	**159,069**			140,865		
Total stockholders equity	**167,221**			169,203		
Total liabilities and stockholders equity	**$ 2,043,647**			$ 2,038,372		
Interest rate spread			**3.00%**			2.96%
Net interest income and net yield on interest-earning assets		**$ 12,783**	**3.06%**		$ 12,757	3.07%

(a) Includes securities sold but not yet purchased.

(b) For the quarters ended June 30, 2010 and 2009, the annualized rates for AFS securities, based on amortized cost, were 3.19% and 3.62%,

respectively.

(c) *Reflects a benefit from the favorable market environments for dollar-roll financings in the second quarter of 2010.*

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JPMORGAN CHASE & CO.
CONSOLIDATED AVERAGE BALANCE SHEETS, INTEREST AND RATES
(Taxable-Equivalent Interest and Rates; in millions, except rates)

(in millions, except rates)	**Six months ended June 30, 2010** Average balance	Interest	Rate (annualized)	Six months ended June 30, 2009 Average balance	Interest	Rate (annualized)
Assets						
Deposits with banks	**$ 61,468**	**$ 187**	**0.61%**	$ 78,237	$ 689	1.78%
Federal funds sold and securities purchased under resale agreements	**179,858**	**805**	**0.90**	151,554	1,018	1.35
Securities borrowed	**114,140**	**61**	**0.11**	121,498	(10)	(0.02)
Trading assets debt instruments	**246,804**	**5,392**	**4.41**	248,753	6,277	5.09
Securities	**332,405**	**5,508**	**3.34** *(b)*	318,019	6,096	3.87 *(b)*
Loans	**715,108**	**20,567**	**5.80**	712,353	20,349	5.76
Other assets	**31,175**	**230**	**1.49**	32,050	239	1.50
Total interest-earning assets	**$ 1,680,958**	**32,750**	**3.93**	1,662,464	34,658	4.20
Allowance for loan losses	**(38,430)**			(25,407)		
Cash and due from banks	**31,789**			25,003		
Trading assets equity instruments	**89,408**			63,130		
Trading assets derivative receivables	**79,048**			128,092		
Goodwill	**48,445**			48,173		
Other intangible assets:						
Mortgage servicing rights	**14,831**			11,702		
Purchased credit card relationships	**1,149**			1,533		
Other intangibles	**3,136**			3,796		
Other assets	**130,843**			134,180		
Total assets	**$ 2,041,177**			$ 2,052,666		
Liabilities						
Interest-bearing deposits	**$ 673,169**	**$ 1,727**	**0.52%**	$ 704,228	$ 2,851	0.82%
Federal funds purchased and securities loaned or sold under repurchase agreements	**272,779**	**(80)** *(c)*	**(0.06)** *(c)*	258,217	369	0.29
Commercial paper	**37,509**	**35**	**0.19**	35,543	62	0.35
Trading liabilities debt instruments	**68,735**	**992**	**2.91**	41,690	767	3.71
	127,455	**337**	**0.53**	180,309	769	0.86

Other borrowings and liabilities[(a)]						
Beneficial interests issued by consolidated VIEs	**94,072**	**636**	**1.36**	12,138	95	1.58
Long-term debt	**259,279**	**2,520**	**1.96**	266,571	3,525	2.67
Total interest-bearing liabilities	**1,532,998**	**6,167**	**0.81**	1,498,696	8,438	1.14
Noninterest-bearing deposits	**204,871**			198,531		
Trading liabilities equity instruments	**5,470**			13,036		
Trading liabilities derivative payables	**60,809**			86,503		
All other liabilities, including the allowance for lending-related commitments	**71,287**			87,071		
Total liabilities	**1,875,435**			1,883,837		
Stockholders equity						
Preferred stock	**8,152**			30,138		
Common stockholders equity	**157,590**			138,691		
Total stockholders equity	**165,742**			168,829		
Total liabilities and stockholders equity	**$ 2,041,177**			$ 2,052,666		
Interest rate spread			**3.12%**			3.06%
Net interest income and net yield on interest-earning assets		**$ 26,583**	**3.19%**		$ 26,220	3.18%

(a) *Includes securities sold but not yet purchased.*

(b) *For the six months ended June 30, 2010 and 2009, the annualized rates for AFS securities, based on amortized cost, were 3.39% and*

3.84%, respectively.

(c) *Reflects a benefit from the favorable market environments for dollar-roll financings during the six months ended June 30, 2010.*

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GLOSSARY OF TERMS

ACH: Automated Clearing House.

Advised lines of credit: An authorization which specifies the maximum amount of a credit facility the Firm has made available to an obligor on a revolving but non-binding basis. The borrower receives written or oral advice of this facility. The Firm may cancel this facility at any time.

AICPA: American Institute of Certified Public Accountants.

Allowance for loan losses to total loans: Represents period-end Allowance for loan losses divided by retained loans.

Assets under management: Represent assets actively managed by AM on behalf of Institutional, Retail, Private Bank, Private Wealth Management and JPMorgan Securities clients. Includes committed capital not called , on which AM earns fees. Excludes assets managed by American Century Companies, Inc. in which the Firm has a 42% ownership interest as of June 30, 2010.

Assets under supervision: Represent assets under management, as well as custody, brokerage, administration and deposit accounts.

Average managed assets: Refers to total assets on the Firm s Consolidated Balance Sheets plus credit card receivables that have been securitized and removed from the Firm s Consolidated Balance Sheets, for periods ended prior to the January 1, 2010, adoption of new FASB guidance requiring the consolidation of the Firm-sponsored credit card securitization trusts.

Bear Stearns merger: Effective May 30, 2008, JPMorgan Chase merged with The Bear Stearns Companies Inc. (Bear Stearns), and Bear Stearns became a wholly-owned subsidiary of JPMorgan Chase. The final total purchase price to complete the merger was $1.5 billion. For additional information, see Note 2 on pages 143-148 of JPMorgan Chase s 2009 Annual Report.

Beneficial interest issued by consolidated VIEs: Represents the interest of third-party holders of debt/equity securities, or other obligations, issued by VIEs that JPMorgan Chase consolidates. The underlying obligations of the VIEs consist of short-term borrowings, commercial paper and long-term debt. The related assets consist of trading assets, available-for-sale securities, loans and other assets.

Benefit obligation: Refers to the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for OPEB plans.

Combined effective loan-to-value ratio: For residential real estate loans, an indicator of how much equity a borrower has in a secured borrowing based on current estimates of the value of the collateral and considering all lien positions related to the property.

Contractual credit card charge-off: In accordance with the Federal Financial Institutions Examination Council policy, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specific event (e.g., bankruptcy of the borrower), whichever is earlier.

Credit card securitizations: For periods ended prior to the January 1, 2010, adoption of new guidance relating to the accounting for the transfer of financial assets and the consolidation of VIEs, CS results were presented on a managed basis that assumed that credit card loans that had been securitized and sold in accordance with U.S. GAAP remained on the Consolidated Balance Sheets and that earnings on the securitized loans were classified in the same manner as the earnings on retained loans recorded on the Consolidated Balance Sheets. Managed results excluded the impact of credit card securitizations on total net revenue, the provision for credit losses, net charge-offs and loan receivables. Securitization did not change reported net income; however, it did affect the classification of items on the Consolidated Statements of Income and Consolidated Balance Sheets.

Credit derivatives: Contractual agreements that provide protection against a credit event on one or more referenced credits. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence, if any, of a credit event.

Deposit margin: Represents net interest income expressed as a percentage of average deposits.

EITF: Emerging Issues Task Force.
FASB: Financial Accounting Standards Board.
FICO: Fair Isaac Corporation.
Forward points: Represents the interest rate differential between two currencies, which is either added to or subtracted from the current exchange rate (i.e., spot rate) to determine the forward exchange rate.
Headcount-related expense: Includes salary and benefits (excluding performance-based incentives), and other noncompensation costs related to employees.
IASB: International Accounting Standards Board.
Interests in purchased receivables: Represents an ownership interest in cash flows of an underlying pool of receivables transferred by a third-party seller into a bankruptcy-remote entity, generally a trust.
Investment-grade: An indication of credit quality based on JPMorgan Chase s internal risk assessment system. Investment-grade generally represents a risk profile similar to a rating of a BBB- / Baa3 or better, as defined by independent rating agencies.
Managed basis: A non-GAAP presentation of financial results that includes reclassifications to present revenue on a fully taxable-equivalent basis, and for periods ended prior to the January 1, 2010, adoption of new accounting guidance relating to the accounting for the transfer of financial assets and the consolidation of VIEs related to credit card securitizations. Management uses this non-GAAP financial measure at the segment level, because it believes this provides information to enable investors to understand the underlying operational performance and trends of the particular business segment and facilitates a comparison of the business segment with the performance of competitors.
Managed credit card receivables: Refers to credit card receivables on the Firm s Consolidated Balance Sheets plus credit card receivables that have been securitized and removed from the Firm s Consolidated Balance Sheets, for periods ended prior to the January 1, 2010, adoption of new guidance requiring the consolidation of the Firm-sponsored credit card securitization trusts.
Mark-to-market exposure: A measure, at a point in time, of the value of a derivative or foreign exchange contract in the open market. When the MTM value is positive, it indicates the counterparty owes JPMorgan Chase and, therefore, creates credit risk for the Firm. When the MTM value is negative, JPMorgan Chase owes the counterparty; in this situation, the Firm has liquidity risk.
Master netting agreement: An agreement between two counterparties who have multiple derivative contracts with each other that provides for the net settlement of all contracts, as well as cash collateral, through a single payment, in a single currency, in the event of default on or termination of any one contract.
Mortgage product types:
Alt-A
Alt-A loans are generally higher in credit quality than subprime loans but have characteristics that would disqualify the borrower from a traditional prime loan. Alt-A lending characteristics may include one or more of the following: (i) limited documentation; (ii) high combined-loan-to-value (CLTV) ratio; (iii) loans secured by non-owner occupied properties; or (iv) debt-to-income ratio above normal limits. Perhaps the most important characteristic is limited documentation. A substantial proportion of traditional Alt-A loans are those where a borrower does not provide complete documentation of his or her assets or the amount or source of his or her income.
Option ARMs
The option ARM real estate loan product is an adjustable-rate mortgage loan that provides the borrower with the option each month to make a fully amortizing, interest-only or minimum payment. The minimum payment on an option ARM loan is based on the interest rate charged during the introductory period. This introductory rate has usually been significantly below the fully indexed rate. The fully indexed rate is calculated using an index rate plus a margin. Once the introductory period ends, the contractual interest rate charged on the loan increases to the fully indexed rate and adjusts monthly to reflect movements in the index. The minimum payment is typically insufficient to cover interest accrued in the prior month, and any unpaid interest is deferred and added to the principal balance of the loan.

Prime
Prime mortgage loans generally have low default risk and are made to borrowers with good credit records and a monthly income that is at least three to four times greater than their monthly housing expense (mortgage payments plus taxes and other debt payments). These borrowers provide full documentation and generally have reliable payment histories.
Subprime
Subprime loans are designed for customers with one or more high risk characteristics, including but not limited to: (i) unreliable or poor payment histories; (ii) a high LTV ratio of greater than 80% (without borrower-paid mortgage insurance); (iii) a high debt-to-income ratio; (iv) an occupancy type for the loan is other than the borrower s primary residence; or (v) a history of delinquencies or late payments on the loan.
NA: Data is not applicable or available for the period presented.
Net charge-off ratio: Represents net charge-offs (annualized) divided by average retained loans for the reporting period.
Net yield on interest-earning assets: The average rate for interest-earning assets less the average rate paid for all sources of funds.
NM: Not meaningful.
Nonconforming mortgage loans: Mortgage loans that do not meet the requirements for sale to U.S. government agencies and U.S. government-sponsored enterprises. These requirements include limits on loan-to-value ratios, loan terms, loan amounts, down payments, borrower creditworthiness and other requirements.
OPEB: Other postretirement employee benefits.
Overhead ratio: Noninterest expense as a percentage of total net revenue.
Personal bankers: Retail branch office personnel who acquire, retain and expand new and existing customer relationships by assessing customer needs and recommending and selling appropriate banking products and services.
Portfolio activity: Describes changes to the risk profile of existing lending-related exposures and their impact on the allowance for credit losses from changes in customer profiles and inputs used to estimate the allowances.
Preprovision profit: The Firm believes that this financial measure is useful in assessing the ability of a lending institution to generate income in excess of its provision for credit losses.
Pretax margin: Represents income before income tax expense divided by total net revenue, which is, in management s view, a comprehensive measure of pretax performance derived by measuring earnings after all costs are taken into consideration. It is, therefore, another basis that management uses to evaluate the performance of TSS and AM against the performance of their respective competitors.
Principal transactions: Realized and unrealized gains and losses from trading activities (including physical commodities inventories that are accounted for at the lower of cost or fair value) and changes in fair value associated with financial instruments held predominantly by the IB for which the fair value option was elected. Principal transactions revenue also includes private equity gains and losses.
Purchased credit-impaired loans: Acquired loans deemed to be credit-impaired under the FASB guidance for purchased credit-impaired loans. The guidance allows purchasers to aggregate credit-impaired loans acquired in the same fiscal quarter into one or more pools, provided that the loans have common risk characteristics (e.g., FICO score, geographic location). A pool is then accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. Wholesale loans were determined to be credit-impaired if they meet the definition of an impaired loan under U.S. GAAP at the acquisition date. Consumer loans are determined to be purchased credit-impaired based on specific risk characteristics of the loan, including product type, LTV ratios, FICO scores, and past due status.
Real estate investment trust (REIT): A special purpose investment vehicle that provides investors with the ability to participate directly in the ownership or financing of real-estate related assets by pooling their capital to purchase and manage income property (i.e., equity REIT) and/or mortgage loans (i.e., mortgage REIT). REITs can be publicly- or privately-held and they also qualify for certain favorable tax considerations.
Receivables from customers: Primarily represents margin loans to prime and retail brokerage customers which are included in accrued interest and accounts receivable on the Consolidated Balance Sheets for the wholesale lines of

business.

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Reported basis: Financial statements prepared under U.S. GAAP, which excludes the impact of taxable-equivalent adjustments. For periods ended prior to the January 1, 2010, adoption of new guidance requiring the consolidation of the Firm-sponsored credit card securitization trusts, the reported basis included the impact of credit card securitizations.
Retained Loans: Loans that are held for investment excluding loans held-for-sale and loans at fair value.
Risk-layered loans: Loans with multiple high-risk elements.
Sales specialists: Retail branch office personnel who specialize in the marketing of a single product, including mortgages, investments and business banking, by partnering with the personal bankers.
Stress testing: A scenario that measures market risk under unlikely but plausible events in abnormal markets.
Troubled debt restructuring: Occurs when the Firm modifies the original terms of a loan agreement by granting a concession to a borrower that is experiencing financial difficulty.
Unaudited: Financial statements and information that have not been subjected to auditing procedures sufficient to permit an independent certified public accountant to express an opinion.
U.S. GAAP: Accounting principles generally accepted in the United States of America.
U.S. government and federal agency obligations: Obligations of the U.S. government or an instrumentality of the U.S. government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.
U.S. government-sponsored enterprise obligations: Obligations of agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.
Value-at-risk (VaR): A measure of the dollar amount of potential loss from adverse market moves in an ordinary market environment.
Washington Mutual transaction: On September 25, 2008, JPMorgan Chase acquired the banking operations of Washington Mutual Bank (Washington Mutual) from the FDIC for $1.9 billion. The final allocation of the purchase price resulted in the recognition of negative goodwill and an extraordinary gain of $2.0 billion. For additional information, see Note 2 on pages 143-148 of JPMorgan Chase s 2009 Annual Report.

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LINE OF BUSINESS METRICS

Investment Banking

IB s revenue comprises the following:

Investment banking fees include advisory, equity underwriting, bond underwriting and loan syndication fees.

Fixed income markets primarily include client and portfolio management revenue related to market-making across global fixed income markets, including foreign exchange, interest rate, credit and commodities markets.

Equity markets primarily include client and portfolio management revenue related to market-making across global equity products, including cash instruments, derivatives and convertibles.

Credit portfolio revenue includes net interest income, fees and loan sale activity, as well as gains or losses on securities received as part of a loan restructuring, for IB s credit portfolio. Credit portfolio revenue also includes the results of risk management related to the Firm s lending and derivative activities, and changes in the CVA, which is the component of the fair value of a derivative that reflects the credit quality of the counterparty.

Retail Financial Services

Description of selected business metrics within Retail Banking:

Personal bankers Retail branch office personnel who acquire, retain and expand new and existing customer relationships by assessing customer needs and recommending and selling appropriate banking products and services.

Sales specialists Retail branch office personnel who specialize in the marketing of a single product, including mortgages, investments and business banking, by partnering with the personal bankers.

Mortgage banking revenue comprises the following:

Production revenue includes net gains or losses on originations and sales of prime and subprime mortgage loans, other production-related fees and losses related to the repurchase of previously-sold loans.

Net mortgage servicing revenue includes the following components:

(a) Operating revenue comprises:

all gross income earned from servicing third-party mortgage loans, including stated service fees, excess service fees, late fees and other ancillary fees; and

modeled servicing portfolio runoff (or time decay).

(b) Risk management comprises:

changes in MSR asset fair value due to market-based inputs, such as interest rates and volatility, as well as updates to assumptions used in the MSR valuation model; and

derivative valuation adjustments and other, which represents changes in the fair value of derivative instruments used to offset the impact of changes in the market-based inputs to the MSR valuation model.

Mortgage origination channels comprise the following:

Retail Borrowers who are buying or refinancing a home through direct contact with a mortgage banker employed by the Firm using a branch office, the Internet or by phone. Borrowers are frequently referred to a mortgage banker by a banker in a Chase branch, real estate brokers, home builders or other third parties.

Wholesale A third-party mortgage broker refers loan applications to a mortgage banker at the Firm. Brokers are independent loan originators that specialize in finding and counseling borrowers but do not provide funding for loans. The Firm exited the broker channel during 2008.

Correspondent Banks, thrifts, other mortgage banks and other financial institutions that sell closed loans to the Firm.

Correspondent negotiated transactions (CNTs) These transactions occur when mid-to large-sized mortgage lenders, banks and bank-owned mortgage companies sell servicing to the Firm, on an as-originated basis, and exclude purchased bulk servicing transactions. These transactions supplement traditional production channels and provide growth opportunities in the servicing portfolio in stable and periods of rising interest rates.

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Card Services

Description of selected business metrics within CS:

Sales volume Dollar amount of cardmember purchases, net of returns.

Open accounts Cardmember accounts with charging privileges.

Merchant acquiring business A business that processes bank card transactions for merchants.

Bank card volume Dollar amount of transactions processed for merchants.

Total transactions Number of transactions and authorizations processed for merchants.

Commercial Banking

CB Client Segments:

Middle Market Banking covers corporate, municipal, financial institution and not-for-profit clients, with annual revenue generally ranging between $10 million and $500 million.

Mid-Corporate Banking covers clients with annual revenue generally ranging between $500 million and $2 billion and focuses on clients that have broader investment banking needs.

Commercial Term Lending primarily provides term financing to real estate investors/owners for multi-family properties as well as financing office, retail and industrial properties.

Real Estate Banking provides full-service banking to investors and developers of institutional-grade real estate properties.

CB revenue:

Lending includes a variety of financing alternatives, which are primarily provided on a basis secured by receivables, inventory, equipment, real estate or other assets. Products include term loans, revolving lines of credit, bridge financing, asset-based structures and leases.

Treasury services includes a broad range of products and services enabling clients to transfer, invest and manage the receipt and disbursement of funds, while providing the related information reporting. These products and services include U.S. dollar and multi-currency clearing, ACH, lockbox, disbursement and reconciliation services, check deposits, other check and currency related services, trade finance and logistics solutions, commercial card and deposit products, sweeps and money market mutual funds.

Investment banking products provide clients with sophisticated capital-raising alternatives, as well as balance sheet and risk management tools through loan syndications, investment-grade debt, asset-backed securities, private placements, high-yield bonds, equity underwriting, advisory, interest rate derivatives, foreign exchange hedges and securities sales.

CB selected business metrics:

Liability balances include deposits, as well as deposits that are swept to on balance sheet liabilities (e.g., commercial paper, federal funds purchased, time deposits and securities loaned or sold under repurchase agreements) as part of customer cash management programs.

IB revenue, gross represents total revenue related to investment banking products sold to CB clients.

Treasury & Securities Services

Treasury & Securities Services **firmwide metrics** include certain TSS product revenue and liability balances reported in other lines of business related to customers who are also customers of those other lines of business. In order to capture the firmwide impact of Treasury Services and TSS products and revenue, management reviews firmwide metrics such as liability balances, revenue and overhead ratios in assessing financial performance for TSS. Firmwide metrics are necessary, in management s view, in order to understand the aggregate TSS business.

Description of selected business metrics within TSS:

Liability balances include deposits, as well as deposits that are swept to on balance sheet liabilities (e.g., commercial paper, federal funds purchased, time deposits and securities loaned or sold under repurchase agreements) as part of customer cash management programs.

Asset Management

Assets under management Represent assets actively managed by AM on behalf of Institutional, Retail, Private Bank, Private Wealth Management and JPMorgan Securities clients. Includes committed capital not called , on which AM

earns fees. Excludes assets managed by American Century Companies, Inc., in which the Firm has a 42% ownership interest as of June 30, 2010.
Assets under supervision Represents assets under management as well as custody, brokerage, administration and deposit accounts.
Alternative assets The following types of assets constitute alternative investments Hedge funds, currency, real estate and private equity.
AM s client segments comprise the following:
Institutional brings comprehensive global investment services including asset management, pension analytics, asset/liability management and active risk budgeting strategies to corporate and public institutions, endowments, foundations, not-for-profit organizations and governments worldwide.
Retail provides worldwide investment management services and retirement planning and administration through third-party and direct distribution of a full range of investment vehicles.
The Private Bank addresses every facet of wealth management for ultra-high-net-worth individuals and families worldwide, including investment management, capital markets and risk management, tax and estate planning, banking, capital raising and specialty-wealth advisory services.
Private Wealth Management offers high-net-worth individuals, families and business owners in the U.S. comprehensive wealth management solutions, including investment management, capital markets and risk management, tax and estate planning, banking and specialty-wealth advisory services.
JPMorgan Securities provides investment advice and wealth management services to high-net-worth individuals, money managers, and small corporations.

FORWARD-LOOKING STATEMENTS

From time to time, the Firm has made and will make forward-looking statements. These statements can be identified by the fact that they do not relate strictly to historical or current facts. Forward-looking statements often use words such as anticipate, target, expect, estimate, intend, plan, goal, believe, or other words of similar meanin Forward-looking statements provide JPMorgan Chase s current expectations or forecasts of future events, circumstances, results or aspirations. JPMorgan Chase s disclosures in this Form 10-Q contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The Firm also may make forward-looking statements in its other documents filed or furnished with the Securities and Exchange Commission. In addition, the Firm s senior management may make forward-looking statements orally to analysts, investors, representatives of the media and others.
All forward-looking statements are, by their nature, subject to risks and uncertainties, many of which are beyond the Firm s control. JPMorgan Chase s actual future results may differ materially from those set forth in its forward-looking statements. While there is no assurance that any list of risks and uncertainties or risk factors is complete, below are certain factors which could cause actual results to differ from those in the forward-looking statements:

- local, regional and international business, economic and political conditions and geopolitical events;
- changes in financial services regulation;
- changes in trade, monetary and fiscal policies and laws;
- securities and capital markets behavior, including changes in market liquidity and volatility;
- changes in investor sentiment or consumer spending or savings behavior;
- ability of the Firm to manage effectively its liquidity;
- credit ratings assigned to the Firm or its subsidiaries;
- the Firm s reputation;
- ability of the Firm to deal effectively with an economic slowdown or other economic or market difficulty;
- technology changes instituted by the Firm, its counterparties or competitors;
- mergers and acquisitions, including the Firm s ability to integrate acquisitions;
- ability of the Firm to develop new products and services, and the extent to which products or services previously sold by the Firm require the Firm to incur liabilities or absorb losses not contemplated at their initiation or origination;

acceptance of the Firm s new and existing products and services by the marketplace and the ability of the Firm to increase market share;
ability of the Firm to attract and retain employees;
ability of the Firm to control expense;
competitive pressures;
changes in the credit quality of the Firm s customers and counterparties;
adequacy of the Firm s risk management framework;
changes in laws and regulatory requirements;
adverse judicial proceedings;
changes in applicable accounting policies;
ability of the Firm to determine accurate values of certain assets and liabilities;
occurrence of natural or man-made disasters or calamities or conflicts, including any effect of any such disasters, calamities or conflicts on the Firm s power generation facilities and the Firm s other commodity-related activities;
the other risks and uncertainties detailed in Part 1, Item 1A: Risk Factors in the Firm s Annual Report on Form 10-K for the year ended December 31, 2009 and Part II, Item 1A: Risk Factors in this Form 10-Q on pages 196-197.

Any forward-looking statements made by or on behalf of the Firm speak only as of the date they are made, and JPMorgan Chase does not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made. The reader should, however, consult any further disclosures of a forward-looking nature the Firm may make in any subsequent Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, or Current Reports on Form 8-K.

Item 3 Quantitative and Qualitative Disclosures about Market Risk

For a discussion of the quantitative and qualitative disclosures about market risk, see the Market Risk Management section of the Management s discussion and analysis on pages 95-98 of this Form 10-Q.

Item 4 Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Firm s management, including its Chairman and Chief Executive Officer and its Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the Chairman and Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective. See Exhibits 31.1 and 31.2 for the Certification statements issued by the Chairman and Chief Executive Officer, and Chief Financial Officer.

The Firm is committed to maintaining high standards of internal control over financial reporting. Nevertheless, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Part II Other Information

Item 1 Legal Proceedings

The following information updates and restates the disclosures set forth under Part 1, Item 3 Legal Proceedings in the Firm s 2009 Annual Report on Form 10-K, and Part II, Item 1 Legal Proceedings, in the Firm s Quarterly Report on Form 10-Q for the quarterly period ending March 31, 2010 (the Firm s SEC filings).

Bear Stearns Shareholder Litigation and Related Matters. Various shareholders of Bear Stearns have commenced purported class actions against Bear Stearns and certain of its former officers and/or directors on behalf of all persons who purchased or otherwise acquired common stock of Bear Stearns between December 14, 2006 and March 14, 2008 (the Class Period). During the Class Period, Bear Stearns had between 115 and 120 million common shares outstanding, and the price of those securities declined from a high of $172.61 to a low of $30 at the end of the period. The actions, originally commenced in several federal courts, allege that the defendants issued materially false and misleading statements regarding Bear Stearns business and financial results and that, as a result of those false statements, Bear Stearns common stock traded at artificially inflated prices during the Class Period. In connection with these allegations, the complaints assert claims for violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Separately, several individual shareholders of Bear Stearns have commenced or threatened to commence arbitration proceedings and lawsuits asserting claims similar to those in the putative class actions. In addition, Bear Stearns and certain of its former officers and/or directors have also been named as defendants in a number of purported class actions

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commenced in the United States District Court for the Southern District of New York seeking to represent the interests of participants in the Bear Stearns Employee Stock Ownership Plan (ESOP) during the time period of December 2006 to March 2008. These actions allege that defendants breached their fiduciary duties to plaintiffs and to the other participants and beneficiaries of the ESOP by (a) failing to manage prudently the ESOP s investment in Bear Stearns securities; (b) failing to communicate fully and accurately about the risks of the ESOP s investment in Bear Stearns stock; (c) failing to avoid or address alleged conflicts of interest; and (d) failing to monitor those who managed and administered the ESOP. In connection with these allegations, each plaintiff asserts claims for violations under various sections of the Employee Retirement Income Security Act (ERISA) and seeks reimbursement to the ESOP for all losses, an unspecified amount of monetary damages and imposition of a constructive trust.

Bear Stearns, former members of Bear Stearns Board of Directors and certain of Bear Stearns former executive officers have also been named as defendants in two purported shareholder derivative suits, subsequently consolidated into one action, pending in the United States District Court for the Southern District of New York. Plaintiffs are asserting claims for breach of fiduciary duty, violations of federal securities laws, waste of corporate assets and gross mismanagement, unjust enrichment, abuse of control and indemnification and contribution in connection with the losses sustained by Bear Stearns as a result of its purchases of subprime loans and certain repurchases of its own common stock. Certain individual defendants are also alleged to have sold their holdings of Bear Stearns common stock while in possession of material nonpublic information. Plaintiffs seek compensatory damages in an unspecified amount and an order directing Bear Stearns to improve its corporate governance procedures. Plaintiffs later filed a second amended complaint asserting, for the first time, purported class action claims for violation of Section 10(b) of the Securities Exchange Act of 1934, as well as new allegations concerning events that took place in March 2008.

All of the above-described actions filed in federal courts were ordered transferred and joined for pre-trial purposes before the United States District Court for the Southern District of New York. Motions to dismiss have been filed in the purported securities class action, the shareholders derivative action and the ERISA action.

Bear Stearns Hedge Fund Matters. Bear Stearns, certain current or former subsidiaries of Bear Stearns, including Bear Stearns Asset Management, Inc. (BSAM) and Bear Stearns & Co. Inc., and certain current or former Bear Stearns employees are named defendants (collectively the Bear Stearns defendants) in multiple civil actions and arbitrations relating to alleged losses of more than $1 billion resulting from the failure of the Bear Stearns High Grade Structured Credit Strategies Master Fund, Ltd. (the High Grade Fund) and the Bear Stearns High Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd. (the Enhanced Leverage Fund) (collectively, the Funds). BSAM served as investment manager for both of the Funds, which were organized such that there were U.S. and Cayman Islands feeder funds that invested substantially all their assets, directly or indirectly, in the Funds. The Funds are in liquidation.

As a result of the voluntary dismissal of one previously pending derivative lawsuit, currently four civil actions remain pending in the United States District Court for the Southern District of New York relating to the Funds. Two of these actions involve derivative lawsuits brought on behalf of purchasers of partnership interests in the two U.S. feeder funds, alleging that the Bear Stearns defendants mismanaged the Funds and made material misrepresentations to and/or withheld information from investors in the funds. These actions seek, among other things, unspecified compensatory damages based on alleged investor losses. The third action, brought by the Joint Voluntary Liquidators of the Cayman Islands feeder funds, makes allegations similar to those asserted in the derivative lawsuits related to the U.S. feeder funds, and seeks compensatory and punitive damages. Motions to dismiss in these three cases have been granted in part and denied in part, and discovery is ongoing. The fourth action was brought by Bank of America and Banc of America Securities LLC (together BofA) alleging breach of contract and fraud in connection with a May 2007 $4 billion securitization, known as a CDO-squared, for which BSAM served as collateral manager. This securitization was composed of certain collateralized debt obligation (CDO) holdings that were purchased by BofA from the High Grade Fund and the Enhanced Leverage Fund. Bank of America apparently seeks in excess of $3 billion in damages, Defendants motion to dismiss in this action was largely denied; an amended complaint was filed; and discovery is ongoing in this case as well.

Ralph Cioffi and Matthew Tannin, the portfolio managers for the Funds, were tried on, and acquitted of, criminal charges of securities fraud and conspiracy to commit securities and wire fraud brought by the United States Attorney s

Office for the Eastern District of New York. The United States Securities and Exchange Commission (SEC) is proceeding with a civil action against Cioffi and Tannin.

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Municipal Derivatives Investigations and Litigation. The Department of Justice and the SEC have been investigating JPMorgan Chase and Bear Stearns for possible antitrust, securities and tax-related violations in connection with the bidding or sale of guaranteed investment contracts and derivatives to municipal issuers. A group of state attorneys general and the Office of the Comptroller of the Currency (OCC) have opened investigations into the same underlying conduct. The Firm has been cooperating with all of these investigations. The Philadelphia Office of the SEC provided notice to J.P. Morgan Securities Inc. (JPMorgan Securities Inc.) that it intends to recommend that the SEC bring civil charges in connection with its investigations. JPMorgan Securities Inc. has responded to that notice, as well as to a separate notice that that Philadelphia Office of the SEC provided to Bear, Stearns & Co. Inc.

Purported class action lawsuits and individual actions (the Municipal Derivatives Actions) have been filed against JPMorgan Chase and Bear Stearns, as well as numerous other providers and brokers, alleging antitrust violations in the reportedly $100 billion to $300 billion annual market for financial instruments related to municipal bond offerings referred to collectively as municipal derivatives. The Municipal Derivatives Actions have been consolidated in the United States District Court for the Southern District of New York. The court denied in part and granted in part defendants motions to dismiss the purported class and individual actions, permitting certain claims to proceed against the Firm and others under federal and California state antitrust laws and under the California false claims act.

As previously reported, following JPMorgan Securities Inc. s settlement with the SEC in connection with certain Jefferson County, Alabama (the County) warrant underwritings and related swap transactions, the County filed a complaint against the Firm and several other defendants in the Circuit Court of Jefferson County, Alabama. The suit alleges that the Firm made payments to certain third parties in exchange for which it was chosen to underwrite more than $3 billion in warrants issued by the County and chosen as the counterparty for certain swaps executed by the County. In its complaint, Jefferson County alleges that the Firm concealed these third party payments and that, but for this concealment, the County would not have entered into the transactions. The County further alleges that the transactions increased the risks of its capital structure and that, following the downgrade of certain insurers that insured the warrants, the County s interest obligations increased and the principal due on a portion of its outstanding warrants was accelerated. The Court denied the Firm s motion to dismiss the complaint in May 2010. The Firm filed a mandamus petition with the Alabama Supreme Court, seeking immediate appellate review of this decision. The Alabama Supreme Court set a briefing schedule in connection with the petition and stayed all proceedings pending its adjudication.

A putative class action was filed on behalf of sewer ratepayers against JPMorgan Chase and Bear Stearns and numerous other defendants, based on substantially the same conduct described above (the Wilson Action). The plaintiff in the Wilson Action recently filed a sixth amended complaint. The Firm has moved to dismiss the complaint for lack of standing.

Separately, a plaintiff asserting substantially similar claims to those alleged in the Wilson Action was recently granted permission to intervene in a separate action brought by the indenture trustee seeking the appointment of a receiver over Jefferson County s sewer system. The Firm was not a party to the original action brought by the indenture trustee but has been named a party by the intervening plaintiff. After the intervention motion was granted but before the Firm was added as a party, the Court scheduled the case for trial on September 7, 2010. The Firm has sought reconsideration of the motion granting the intervention or, alternatively, severance of the claims against the Firm and consolidation of those claims with the Wilson Action.

Two insurance companies that guaranteed the payment of principal and interest on warrants issued by Jefferson County have filed separate actions against JPMorgan Chase (one of the insurers has also named Jefferson County) in New York state court asserting that defendants fraudulently misled them into issuing the insurance coverage, based upon substantially the same alleged conduct described above and other alleged non-disclosures. One insurer claims that it insured an aggregate principal amount of nearly $1.2 billion in warrants, and seeks unspecified damages in excess of $400 million, as well as unspecified punitive damages. JPMorgan Chase has moved to dismiss the complaint. The other insurer claims that it insured an aggregate principal amount of more than $378 million and seeks recovery of $4 million it alleges it paid under the policies to date as well as any payments it will make in the future and unspecified punitive damages.

The Alabama Public Schools and College Authority (APSCA) brought a declaratory judgment action in the United States District Court for the Northern District of Alabama claiming that certain interest rate swaption transactions entered into with JPMorgan Chase Bank, N.A. are void on the grounds that the APSCA purportedly did not have the authority to enter into the transactions or, alternatively, are voidable at the APSCA s option because of its alleged inability to issue refunding bonds in relation to the swaption. Following the denial of its motion to dismiss the action, JPMorgan Chase Bank, N.A. answered the complaint and filed a counterclaim seeking the amounts due under the swaption transactions. Discovery is ongoing and the trial is scheduled to commence in February 2011.

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Interchange Litigation. A group of merchants have filed a series of putative class action complaints in several federal courts. The complaints allege that VISA and MasterCard, as well as certain other banks and their respective bank holding companies, conspired to set the price of credit card interchange fees, enacted respective association rules in violation of Section 1 of the Sherman Act, and engaged in tying/bundling and exclusive dealing. The complaint seeks unspecified damages and injunctive relief based on the theory that interchange would be lower or eliminated but for the challenged conduct. Based on publicly available estimates, Visa and MasterCard branded payment cards generated approximately $40 billion of interchange fees industry-wide in 2009. All cases have been consolidated in the United States District Court for the Eastern District of New York for pretrial proceedings. The amended consolidated class action complaint extended the claims beyond credit to debit cards. Defendants filed a motion to dismiss all claims that predated January 2004. The Court granted the motion to dismiss those claims. Plaintiffs then filed a second amended consolidated class action complaint. The basic theories of the complaint remain the same, and defendants again filed motions to dismiss. The Court has not yet ruled on the motions. Fact discovery has closed, and expert discovery in the case is ongoing. The plaintiffs have filed a motion seeking class certification, and the defendants have opposed that motion. The Court has not yet ruled on the class certification motion.
In addition to the consolidated class action complaint, plaintiffs filed supplemental complaints challenging the MasterCard and Visa IPOs (the IPO Complaints). With respect to the MasterCard IPO, plaintiffs allege that the offering violated Section 7 of the Clayton Act and Section 1 of the Sherman Act and that the offering was a fraudulent conveyance. With respect to the Visa IPO, plaintiffs are challenging the Visa IPO on antitrust theories parallel to those articulated in the MasterCard IPO pleading. Defendants have filed motions to dismiss the IPO Complaints. The Court has not yet ruled on those motions.
Mortgage-Backed Securities Litigation. JPMorgan Chase and affiliates, heritage Bear Stearns and affiliates and heritage Washington Mutual affiliates have been named as defendants in a number of cases relating to various roles they played in mortgage-backed securities (MBS) offerings. These cases are generally purported class action suits, actions by individual purchasers of securities, or actions by insurance companies that guaranteed payments of principal and interest for particular tranches. Although the allegations vary by lawsuit, these cases generally allege that the offering documents for more than $150 billion of securities issued by dozens of securitization trusts contained material misrepresentations and omissions, including statements regarding the underwriting standards pursuant to which the underlying mortgage loans were issued, the ratings given to the tranches by rating agencies, and the appraisal standards that were used.
Purported class actions are pending against JPMorgan Chase and heritage Bear Stearns, and certain of their affiliates and current and former employees in the United States District Courts for the Eastern and Southern Districts of New York. Defendants have moved to dismiss the action that is pending against JPMorgan Chase entities and certain of their employees in the Eastern District of New York. Heritage Washington Mutual affiliates, Washington Mutual Asset Acceptance Corp. and Washington Mutual Capital Corp., are defendants, along with certain former officers or directors of Washington Mutual Asset Acceptance Corp., in two now-consolidated purported class action cases pending in the Western District of Washington. In addition to allegations as to mortgage underwriting standards and ratings, plaintiffs in these cases allege that defendants failed to disclose Washington Mutual Bank s alleged coercion of or collusion with appraisal vendors to inflate appraisal valuations of the loans in the pools. Defendants have moved to dismiss. In addition to the purported class actions, certain JPMorgan Chase entities and several heritage Bear Stearns entities are defendants in actions filed in state courts in Pennsylvania and Washington brought by the Federal Home Loan Banks of Pittsburgh and Seattle, respectively. These actions relate to each Federal Home Loan Bank s purchases of certificates in MBS offerings. Defendants moved to dismiss the complaint brought by the FHLB of Pittsburgh. Defendants removed the action by FHLB Seattle to federal court, where it was consolidated with 10 other identical lawsuits by that FHLB against other financial services firms. FHLB of Seattle has moved to remand the consolidated cases back to state court.
Heritage Bear entities, JPMorgan Securities Inc. and heritage Washington Mutual affiliates are among the defendants in an individual action filed by Cambridge Place Investment Management Inc. in Massachusetts state court. Cambridge Place asserts claims under state securities laws, alleging that, when selling mortgage-backed securities, the defendants made misrepresentations and omissions related to loan-to-value ratios, appraisals, underwriting standards,

occupancy status, due diligence and credit enhancement.
Heritage Bear entities are also among the defendants named in an individual action filed by The Charles Schwab Corporation (Schwab) in state court in California, which similarly alleges misrepresentations and omissions by defendants in connection with the sales of mortgage-backed securities to Schwab. Pursuant to a tolling agreement, that action has been discontinued as against the heritage Bear entities.
EMC Mortgage Corporation (EMC), a subsidiary of JPMorgan Chase, is currently a defendant in four pending actions commenced by bond insurers that guaranteed approximately $3 billion of payments on certain classes of MBS securitizations sponsored by EMC. An action has been commenced by Assured Guaranty Corp. in the United States District Court for the Southern District of

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New York, involving one securitization sponsored by EMC. Three previously pending actions, commenced respectively by Ambac Assurance Corporation and Syncora Guarantee, Inc., (Syncora) in the United States District Court for the Southern District of New York and CIFG Assurance North America, Inc. (CIFG) in state court in Texas, involve a total of six securitizations sponsored by EMC. In each action, plaintiffs claim the underlying mortgage loans had origination defects that purportedly violate certain representations and warranties given by EMC to plaintiffs and that EMC has breached the relevant agreements between the parties by failing to repurchase allegedly defective mortgage loans. Each action seeks unspecified damages and an order compelling EMC to repurchase those loans. The action that was commenced by Syncora seeking access to certain loan files has been resolved through a joint court order proposed by the parties pursuant to which EMC produced loan files relating to those loans subject to a confidentiality stipulation and protective order, and the action has been terminated and closed.

Currently pending in the United States District Court for the Southern District of New York is an action brought on behalf of purchasers of certificates issued by various MBS securitizations sponsored by affiliates of IndyMac Bancorp (IndyMac Trusts). JPMorgan Securities Inc., along with numerous other underwriters and individuals, is named as a defendant, both in its own capacity and as successor to Bear Stearns & Co. The Court has dismissed claims as to certain securitizations, including all offerings in which no named plaintiff purchased certificates, and allowed claims as to other securitizations to proceed. JPMorgan Chase and JPMorgan Securities Inc. are defendants in an action pending in state court in Pennsylvania brought by FHLB-Pittsburgh, relating to its purchase of a certificate issued by one IndyMac Trust. Defendants have moved to dismiss. JPMorgan Chase and JPMorgan Securities Inc., as alleged successor to Bear Stearns & Co., and other underwriters, along with certain individuals, are defendants in an action pending in state court in California brought by MBIA Insurance Corp. (MBIA) relating to certain certificates issued by three IndyMac trusts, as to two of which Bear Stearns was an underwriter, and as to which MBIA provided guaranty insurance policies. MBIA purports to be subrogated to the rights of the certificate holders, and seeks recovery of sums it has paid and will pay pursuant to those policies. Defendants have moved for judgment on the pleadings on the grounds that plaintiff does not have standing to bring these claims.

Auction-Rate Securities Investigations and Litigation. Beginning in March 2008, several regulatory authorities initiated investigations of a number of industry participants, including the Firm, concerning possible state and federal securities law violations in connection with the sale of auction-rate securities. The market for many such securities had frozen and a significant number of auctions for those securities began to fail in February 2008.

The Firm, on behalf of itself and affiliates, agreed to a settlement in principle with the New York Attorney General s Office which provided, among other things, that the Firm would offer to purchase at par certain auction-rate securities purchased from JPMorgan Securities Inc., Chase Investment Services Corp. and Bear, Stearns & Co. Inc. by individual investors, charities, and small- to medium-sized businesses. The Firm also agreed to a substantively similar settlement in principle with the Office of Financial Regulation for the State of Florida and the North American Securities Administrator Association (NASAA) Task Force, which agreed to recommend approval of the settlement to all remaining states, Puerto Rico and the U.S. Virgin Islands. The Firm finalized the settlement agreements with the New York Attorney General s Office and the Office of Financial Regulation for the State of Florida. The settlement agreements provide for the payment of penalties totaling $25 million to all states. The Firm is currently in the process of finalizing consent agreements with NASAA s member states; more than 35 of these consent agreements have been finalized to date.

The Firm also faces a number of civil actions relating to the Firm s sales of auction-rate securities, including a putative securities class action in the United States District Court for the Southern District of New York that seeks unspecified damages, and individual arbitrations and lawsuits in various forums brought by institutional and individual investors that, together, seek damages totaling more than $200 million relating to the Firm s sales of auction-rate securities. One action is brought by an issuer of auction-rate securities. The actions generally allege that the Firm and other firms manipulated the market for auction-rate securities by placing bids at auctions that affected these securities clearing rates or otherwise supported the auctions without properly disclosing these activities. Some actions also allege that the Firm misrepresented that auction-rate securities were short-term instruments and one action alleges that the Firm failed to satisfy a condition set forth in the relevant offering documents prior to selling the securities to the investor. The Firm s motion to transfer and coordinate before the Southern District all of the active federal auction-rate securities cases was granted by the multi-district panel on June 9, 2010.

Additionally, the Firm was named in two putative antitrust class actions in the United States District Court for the Southern District of New York, which actions allege that the Firm, in collusion with numerous other financial institution defendants, entered into an unlawful conspiracy in violation of Section 1 of the Sherman Act. Specifically, the complaints allege that defendants acted collusively to maintain and stabilize the auction-rate securities market and similarly acted collusively in withdrawing their support for the auction-rate securities market in February 2008. On

January 26, 2010, the District Court dismissed both actions. The appeal is currently pending in the Second Circuit Court of Appeals.

City of Milan Litigation and Criminal Investigation. In January 2009, the City of Milan, Italy (the City) issued civil proceedings against (among others) JPMorgan Chase Bank, National Association and J.P. Morgan Securities Ltd. (together, JPMorgan Chase) in the District Court of Milan. The proceedings relate to (a) a bond issue by the City in June 2005 (the Bond) and (b) an associated swap transaction, which was subsequently restructured on a number of occasions between 2005 and 2007 (the Swap). The City seeks damages and/or other remedies against JPMorgan Chase (among others) on the grounds of alleged fraudulent and deceitful acts and alleged breach of advisory obligations by JPMorgan Chase (among others) in connection with the Swap and the Bond, together with related swap transactions with other counterparties. The civil proceedings continue and no trial date has been set as yet. JPMorgan Chase Bank, N.A. filed a challenge to the Italian Supreme Court s jurisdiction over JPMorgan Chase Bank, N.A. In January 2009, JPMorgan Chase Bank, N.A. also received a notice from the Prosecutor at the Court of Milan placing it and certain current and former JPMorgan Chase personnel under investigation in connection with the above transactions. Since April 2009, JPMorgan Chase Bank, N.A. has been contesting an attachment order obtained by the Prosecutor, purportedly to freeze assets potentially subject to confiscation in the event of a conviction. The original Euro 92 million attachment has been reduced to Euro 44.9 million, and JPMorgan Chase Bank, N.A. s application for a further reduction remains pending. The judge has directed four current and former JPMorgan Chase personnel and JPMorgan Chase Bank, N.A. (as well as other individuals and three other banks) to go forward to a full trial that started in May 2010. Although the Firm is not charged with any crime and does not face criminal liability, if one or more of its employees were found guilty, the Firm could be subject to administrative sanctions, including restrictions on its ability to conduct business in Italy and monetary penalties. In the initial hearings, the City successfully applied to join some of the claims in the civil proceedings against the individuals and JPMorgan Chase Bank, N.A. to the criminal proceedings. In addition, a consumer association has also been given leave to join the criminal proceedings to seek damages from the defendant banks. The trial will resume after the summer recess on September 24, 2010.

Physical Segregation of Assets in U.K. Affiliate. On June 3, 2010, the U.K. Financial Services Authority (the FSA) fined the Firm £33.32 million for failing to hold certain client money in a segregated trust status account with JPMorgan Chase Bank, N.A. as required by FSA rules. The Firm had discovered the violation in July 2009, and took immediate action at the time to rectify the error and notify the FSA. No clients suffered any loss. Subsequently, PricewaterhouseCoopers LLP, whose affiliate had performed audit-related services in respect of client money accounts, agreed to provide up to an aggregate of $12.5 million to the Firm in cash and in credits against fees for audit-related and tax services provided or to be provided to the Firm.

Washington Mutual Litigations. Subsequent to JPMorgan Chase s acquisition from the Federal Deposit Insurance Corporation (FDIC) of substantially all of the assets and certain specified liabilities of Washington Mutual Bank, Henderson Nevada (Washington Mutual Bank), in September 2008, Washington Mutual Bank s parent holding company, Washington Mutual, Inc. (WMI) and its wholly-owned subsidiary, WMI Investment Corp. (together, the Debtors), both commenced voluntary cases under Chapter 11 of Title 11 of the United States Code in the United States Bankruptcy Court for the District of Delaware (the Bankruptcy Case). In the Bankruptcy Case, the Debtors have asserted rights and interests in certain assets. The assets in dispute include principally the following: (a) approximately $4 billion in trust securities contributed by WMI to Washington Mutual Bank (the Trust Securities); (b) the right to tax refunds arising from overpayments attributable to operations of Washington Mutual Bank and its subsidiaries; (c) ownership of and other rights in approximately $4 billion that WMI contends are deposit accounts at Washington Mutual Bank and one of its subsidiaries; and (d) ownership of and rights in various other contracts and other assets (collectively, the Disputed Assets).

JPMorgan Chase commenced an adversary proceeding in the Bankruptcy Case against the Debtors and (for interpleader purposes only) the FDIC seeking a declaratory judgment and other relief determining JPMorgan Chase s legal title to and beneficial interest in the Disputed Assets. The Debtors commenced a separate adversary proceeding in the Bankruptcy Case against JPMorgan Chase, seeking turnover of the $4 billion in purported deposit funds and recovery for alleged unjust enrichment for failure to turn over the funds. The Debtors have moved for summary judgment in the turnover proceeding.

In both JPMorgan Chase s adversary proceeding and the Debtors turnover proceeding, JPMorgan Chase and the FDIC have argued that the Bankruptcy Court lacks jurisdiction to adjudicate certain claims. JPMorgan Chase moved to have the adversary proceedings transferred to United States District Court for the District of Columbia and to withdraw jurisdiction from the Bankruptcy Court to the District Court. That motion is fully briefed. In addition, JPMorgan Chase

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and the FDIC have pending with the United States District Court for the District of Delaware an appeal of the Bankruptcy Court s rulings rejecting the jurisdictional arguments, and that appeal is fully briefed. JPMorgan Chase is also appealing a separate Bankruptcy Court decision holding, in part, that the Bankruptcy Court could proceed with certain matters while the first appeal is pending.

The Debtors submitted claims substantially similar to those submitted in the Bankruptcy Court in the FDIC receivership for, among other things, ownership of certain Disputed Assets, as well as claims challenging the terms of the agreement pursuant to which substantially all of the assets of Washington Mutual Bank were sold by the FDIC to JPMorgan Chase. The FDIC, as receiver, disallowed the Debtors claims and the Debtors filed an action against the FDIC in the United States District Court for the District of Columbia challenging the FDIC s disallowance of the Debtors claims, claiming ownership of the Disputed Assets, and seeking money damages from the FDIC. JPMorgan Chase has intervened in the action. In January 2010, the District Court stayed the action pending developments in the Bankruptcy Court. In connection with the stay, the District Court denied WMI s and the FDIC s motions to dismiss without prejudice.

In addition, JPMorgan Chase has been sued in an action originally filed in the 122nd State District Court of Galveston County, Texas (the Texas Action) by certain holders of WMI common stock and debt of WMI and Washington Mutual Bank who seek unspecified damages alleging that JPMorgan Chase acquired substantially all of the assets of Washington Mutual Bank from the FDIC at an allegedly too low price. The FDIC intervened in the Texas Action and, upon motion by the FDIC and JPMorgan Chase, the District Court transferred the Texas Action to the District of Columbia. Plaintiffs moved to have the FDIC dismissed as a party and to remand the action to the state court, or, in the alternative, dismissed for lack of subject matter jurisdiction. JPMorgan Chase and the FDIC moved to have the entire action dismissed. On April 13, 2010, the United States District Court for the District of Columbia granted JPMorgan Chase s motion to dismiss the complaint, granted the FDIC s parallel motion to dismiss the complaint and denied plaintiffs motion to dismiss the FDIC as a party and to remand the case to Texas state court. On July 19, 2010, the Court denied plaintiffs motion to reconsider its prior ruling, to vacate the judgment in the Texas Action and to permit them to file an amended complaint. On July 20, 2010, the plaintiffs in the Texas Action appealed these decisions to the United States Court of Appeals for the District of Columbia.

Other proceedings related to Washington Mutual s failure also pending before the United States District Court for the District of Columbia include a lawsuit brought by Deutsche Bank National Trust Company against the FDIC seeking more than $6 billion in damages based upon alleged breach of various mortgage securitization agreements and alleged violation of certain representations and warranties given by certain WMI subsidiaries in connection with those securitization agreements. JPMorgan Chase has not been named a party to the Deutsche Bank litigation, but the complaint, and the FDIC s motion to dismiss the complaint, include assertions that JPMorgan Chase may have assumed liabilities relating to the mortgage securitization agreements. Deutsche Bank is scheduled to file an amended complaint on August 30, 2010.

On May 19, 2010, WMI, JPMorgan Chase and the FDIC announced a global settlement agreement among themselves and significant creditor groups (the Global Settlement Agreement). The Global Settlement Agreement is incorporated into WMI s proposed Chapter 11 plan (Plan) that has been submitted to the Bankruptcy Court. If approved by the Bankruptcy Court, the Global Settlement would resolve numerous disputes among WMI, JPMorgan Chase, the FDIC in its capacity as receiver for Washington Mutual Bank and the FDIC in its corporate capacity, as well as those of significant creditor groups, including disputes relating to the Disputed Assets. While the Plan confirmation process is ongoing, the appeals and proceedings before the United States District Courts for the Districts of Delaware and the District of Columbia, are stayed.

Other proceedings related to Washington Mutual s failure are also pending before the Bankruptcy Court. On May 4, 2010, certain WMI creditors who have not agreed to the Global Settlement Agreement filed a motion to convert the Debtors cases to a Chapter 7 liquidation or, in the alternative, for an order to appoint a trustee to administer the Debtors estates. Also, on July 6, 2010, certain holders of the Trust Securities commenced an adversary proceeding in the Bankruptcy Court against JPMorgan Chase, WMI, and other entities seeking, among other relief, a declaratory judgment that WMI and JPMorgan Chase do not have any right, title or interest in the Trust Securities.

In a July 20, 2010 hearing in the Bankruptcy Case, the Bankruptcy Court appointed an examiner to investigate, among other things, the claims and assets that may be property of the Debtors   estates that are proposed to be conveyed, released or otherwise compromised and settled under the Plan and Global Settlement Agreement. The examiner is to prepare a preliminary report for the Bankruptcy Court by September 7, 2010, and a final report by October 8, 2010. The

Bankruptcy Court is scheduled to consider confirmation of the Plan, including the Global Settlement Agreement, beginning on November 1, 2010.

Securities Lending Litigation. JPMorgan Chase Bank N.A. has been named as a defendant in four putative class actions asserting ERISA and non-ERISA claims pending in the United States District Court for the Southern District of New York brought by participants in the Firm s securities lending business. A fifth lawsuit was filed in New York state court by an individual participant in the program. Three of the purported class actions, which have been consolidated, relate to losses of plaintiffs money in medium-term notes of Sigma Finance Inc. (Sigma). Plaintiffs assert claims under both ERISA and state law. Fact discovery is substantially complete. In August 2010, the Court certified a plaintiff class consisting of all securities lending participants that held Sigma medium-term notes on September 30, 2008, including those that held the notes by virtue of participation in the investment of cash collateral through a collective fund, as well as those that held the notes by virtue of the investment of cash collateral through individual accounts. The fourth putative class action, as originally filed, concerned losses of money invested in Lehman Brothers medium-term notes and in asset-backed securities offered by nine other issuers. The Firm moved to dismiss the complaint. Before the court ruled on the motion, the plaintiff requested leave to serve a second amended complaint, which was filed July 15, 2010. The amended complaint includes additional factual allegations regarding Lehman Brothers and eliminates claims regarding the other asset-backed securities. The plaintiff asserts only ERISA claims. The Firm s response to the second amended complaint is due on September 15, 2010 and a stay of discovery is in place until that date. The New York state court action, which is not a class action, concerns the plaintiff s loss of money in both Sigma and Lehman Brothers medium-term notes. The Firm has answered the complaint and has moved to stay this action pending resolution of the proceedings in federal court.

Investment Management Litigation. Four cases have been filed claiming that investment portfolios managed by JPMorgan Investment Management Inc. (JPMIM) were inappropriately invested in securities backed by subprime residential real estate collateral. Plaintiffs claim that JPMIM and related defendants are liable for the loss of more than $1 billion in market value of these securities. The first case was filed by NM Homes One, Inc. in federal court in New York. The United States District Court for the Southern District of New York granted JPMIM s motion to dismiss nine of plaintiff s ten causes of action. The Court granted JPMIM s request for permission to move to dismiss the remaining cause of action. Plaintiff has moved for reconsideration. The second case, filed by Assured Guaranty (U.K.) in New York state court, was dismissed and Assured has appealed the court s decision. In the third case, filed by Ambac Assurance UK Limited in New York state court, the Court granted JPMIM s motion to dismiss in March 2010, and plaintiff has filed a notice of appeal. The fourth case was filed by CMMF LLP in New York state court in December 2009; the Court granted JPMIM s motion to dismiss the claims, other than claims for breach of contract and misrepresentation. Both CMMF and JPMIM have filed notices of appeal. On May 26, 2010, the New York Appellate Division heard arguments on the case.

Lehman Brothers Bankruptcy Proceedings. In March 2010, the Examiner appointed by the Bankruptcy Court presiding over the Chapter 11 bankruptcy proceedings of Lehman Brothers Holdings Inc (LBHI) and several of its subsidiaries (collectively, Lehman) released a report as to his investigation into Lehman s failure and related matters. The Examiner concluded that one common law claim potentially could be asserted against the Firm for contributing to Lehman s failure, though he characterized the claim as not strong. The Examiner also opined that certain cash and securities collateral provided by LBHI to the Firm in the weeks and days preceding LBHI s demise potentially could be challenged under the Bankruptcy Code s fraudulent conveyance or preference provisions, though the Firm is of the view that its right to such collateral is protected by the Bankruptcy Code s safe harbor provisions. On May 26, 2010, LBHI and its Official Committee of Unsecured Creditors filed an adversary proceeding against JPMorgan Chase Bank, N.A. in the United States Bankruptcy Court for the Southern District of New York. The complaint asserts both federal bankruptcy law and state common law claims, and seeks, among other relief, to recover $8.6 billion in collateral that was transferred to JPMorgan Chase Bank, N.A. in the week preceding LBHI s bankruptcy. The complaint also seeks unspecified damages on the grounds that JPMorgan Chase Bank, N.A. s collateral requests hastened LBHI s demise. The Court set the case for trial in April 2012. In addition, the Firm may also face claims in the liquidation proceeding pending before the same Bankruptcy Court under the Securities Investor Protection Act (SIPA) for LBHI s U.S. broker-dealer subsidiary, Lehman Brothers Inc. (LBI). The SIPA Trustee has advised the Firm that certain of the securities and cash pledged as collateral for the Firm s claims against LBI may be customer property free from any security interest in favor of the Firm.

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Enron Litigation. JPMorgan Chase and certain of its officers and directors are involved in several lawsuits that together seek substantial damages arising out of the Firm s banking relationships with Enron Corp. and its subsidiaries (Enron). A number of actions and other proceedings against the Firm previously were resolved, including a class action lawsuit captioned *Newby v. Enron Corp.* and adversary proceedings brought by Enron s bankruptcy estate. The remaining Enron-related actions include individual actions by Enron investors and a purported class action filed on behalf of JPMorgan Chase employees who participated in the Firm s 401(k) plan asserting claims under the Employee Retirement Income Security Act for alleged breaches of fiduciary duties and negligence by JPMorgan Chase, its directors and named officers.

IPO Allocation Litigation. JPMorgan Chase and certain of its securities subsidiaries, including Bear Stearns, were named, along with numerous other firms in the securities industry, as defendants in a large number of putative class action lawsuits filed in the United States District Court for the Southern District of New York alleging improprieties in connection with the allocation of securities in various public offerings, including some offerings for which a JPMorgan Chase entity served as an underwriter. They also claim violations of securities laws arising from alleged material misstatements and omissions in registration statements and prospectuses for the initial public offerings (IPOs) and alleged market manipulation with respect to aftermarket transactions in the offered securities. Antitrust lawsuits based on similar allegations have been dismissed with prejudice. A settlement was reached in the securities cases, which the District Court approved; the Firm s share of the settlement is approximately $62 million. Appeals have been filed in the United States Court of Appeals for the Second Circuit seeking reversal of the decision approving the settlement.

In addition to the various cases, proceedings and investigations discussed above, JPMorgan Chase and its subsidiaries are named as defendants or otherwise involved in a number of other legal actions and governmental proceedings arising in connection with their businesses. The Firm believes it has meritorious defenses to the claims asserted against it in its currently outstanding litigations, investigations and proceedings and it intends to defend itself vigorously in all such matters. Additional actions, investigations or proceedings may be initiated from time to time in the future.

In view of the inherent difficulty of predicting the outcome of legal matters, particularly where the claimants seek very large or indeterminate damages, or where the cases present novel legal theories, involve a large number of parties or are in early stages of discovery, the Firm cannot state with confidence what the eventual outcome of these pending matters will be, what the timing of the ultimate resolution of these matters will be or what the eventual loss, fines, penalties or impact related to each pending matter may be. In addition, the Firm cannot estimate the aggregate range of reasonably possible loss as defined in ASC 450 for asserted and probable asserted claims as of June 30, 2010. JPMorgan Chase believes, based upon its current knowledge, after consultation with counsel and after taking into account its current litigation reserves, that the legal actions, proceedings and investigations currently pending against it should not have a material adverse effect on the Firm s consolidated financial condition. The Firm notes, however, that in light of the uncertainties involved in such proceedings, actions and investigations, there is no assurance that the ultimate resolution of these matters will not significantly exceed the reserves currently accrued by the Firm; as a result, the outcome of a particular matter may be material to JPMorgan Chase s operating results for a particular period, depending on, among other factors, the size of the loss or liability imposed and the level of JPMorgan Chase s income for that period.

Item 1A Risk Factors

For a discussion of certain risk factors affecting the Firm, see Part I, Item 1A: Risk Factors, on pages 4-10 of JPMorgan Chase s 2009 Annual Report on Form 10-K, and Forward-Looking Statements on pages 187-188 of this Form 10-Q.

Financial services legislative and regulatory reforms may, if enacted or adopted, have a significant impact on our business and results of operations and on our credit ratings.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act which will make significant structural reforms to the financial services industry. The legislation will, among other things: establish a Bureau of Consumer Financial Protection having broad authority to regulate providers of credit, savings, payment and other consumer financial products and services, and may narrow the scope of federal preemption of state consumer laws and expand the authority of state attorneys general to bring actions to enforce federal consumer protection legislation; create a structure to regulate systemically important financial companies, and provide regulators with the power to require such companies to sell or transfer assets and terminate activities if the regulators determine that the size or scope of activities of the company pose a threat to the safety and soundness of the company or the financial stability of the United States; require more comprehensive regulation of the over-the-counter derivatives market, including providing for more strict capital and margin requirements, the central clearing of standardized over-the-counter derivatives, and heightened supervision of all over-the-counter derivatives dealers and major market participants, including JPMorgan Chase; potentially require banking entities, such as JPMorgan Chase, to significantly restructure or restrict their derivatives businesses or to change the legal entities through which such businesses are conducted; prohibit banking entities, such as JPMorgan Chase, from engaging in certain proprietary trading activities and restricting their ownership of, investment in or sponsorship of hedge funds and private equity funds; restrict the interchange fees payable on debit card transactions; and give regulators the authority to phase out the treatment of trust preferred capital debt securities as Tier 1 capital for regulatory capital purposes.

These or any other new legislative changes enacted (as well as any rules or regulations issued by U.S. regulators implementing any such legislation, and any actions by legislatures and regulatory bodies in other countries) could result in significant loss of revenue, limit our ability to pursue business opportunities we might otherwise consider engaging in, impact the value of assets that we hold, require us to change certain of our business practices, impose additional costs on us, establish more stringent capital, liquidity and leverage ratio requirements, or otherwise adversely affect our businesses. Accordingly, we cannot provide assurance that any such new legislation or regulation would not have an adverse effect on our business, results of operations or financial condition.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

During the second quarter of 2010, there were no shares of common stock of JPMorgan Chase & Co. issued in transactions exempt from registration under the Securities Act of 1933, pursuant to Section 4(2) thereof.

Under the stock repurchase program authorized by the Firm s Board of Directors, the Firm is authorized to repurchase up to $10.0 billion of the Firm s common stock plus 88 million warrants issued in 2008 as part of the U.S. Treasury s Capital Purchase Program. During the second quarter of 2010, the Firm resumed common stock repurchases, repurchasing a total of 3 million shares for $135 million at an average price of $38.73 per share. The Firm did not repurchase any of the warrants. As of June 30, 2010, $6.1 billion of authorized repurchase capacity remained with respect to the common stock, and all of the authorized repurchase capacity remained with respect to the warrants.

The Firm has determined that it may, from time to time, enter into written trading plans under Rule 10b5-1 of the Securities Exchange Act of 1934 to facilitate the repurchase of common stock and warrants in accordance with the repurchase program. A Rule 10b5-1 repurchase plan allows the Firm to repurchase its equity during periods when it would not otherwise be repurchasing common stock for example during internal trading black-out periods. All purchases under a Rule 10b5-1 plan must be made according to a predefined plan established when the Firm is not aware of material nonpublic information.

For the six months ended June 30, 2010	Total shares repurchased	Average price paid per share[(a)]	Dollar value of remaining authorized repurchase (in millions)[(b)]
First quarter		**$**	**$ 6,221**
April			6,221
May			6,221
June	3,491,900	38.73	6,085
Second quarter	**3,491,900**	**38.73**	**6,085**
Year-to-date	**3,491,900**	**$ 38.73**	**$ 6,085**

(a) Excludes commission costs.

(b) The amount authorized by the Board of

Directors
excludes
commissions
cost.

Participants in the Firm s stock-based incentive plans may have shares withheld to cover income taxes. Shares withheld to pay income taxes are repurchased pursuant to the terms of the applicable plan and not under the Firm s share repurchase program. Shares repurchased pursuant to these plans during the second quarter of 2010 were as follows:

For the six months ended June 30, 2010	Total shares repurchased	Average price paid per share
First quarter	**2,444**	**$ 41.88**
April	46	45.08
May	325	27.29
June	22	38.63
Second quarter	**393**	**30.01**
Year-to-date	**2,837**	**$ 40.23**

Item 3 Defaults Upon Senior Securities

None

Item 4 Submission of Matters to a Vote of Security Holders

Not applicable.

Item 5 Other Information

None

Item 6 Exhibits

31.1 Certification

31.2 Certification

32 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS XBRL Instance Document[(a)(b)]

101.SCH XBRL Taxonomy Extension Schema Document[(b)]

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document[(b)]

101.LAB XBRL Taxonomy Extension Label Linkbase Document[(b)]

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document[(b)]

101.DEF XBRL Taxonomy Extension Definition Linkbase Document[(b)]

(a) Pursuant to Rule 405 of Regulation S-T, includes the following financial information included in the Firm s Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, formatted in

XBRL (eXtensible Business Reporting Language) interactive data files: (i) the Consolidated Statements of Income for the three and six months ended June 30, 2010 and 2009, (ii) the Consolidated Balance Sheets as of June 30, 2010, and December 31, 2009, (iii) the Consolidated Statements of Changes in Stockholders Equity and Comprehensive Income for the six months ended June 30, 2010 and 2009, (iv) the Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009, and (v) the Notes to Consolidated Financial Statements.

(b) Filed herewith.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

JPMORGAN CHASE & CO.

(Registrant)

Date: August 6, 2010	By	/s/ Louis Rauchenberger
		Louis Rauchenberger
		Managing Director and Controller [Principal Accounting Officer]

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INDEX TO EXHIBITS

EXHIBIT NO.	EXHIBITS
31.1	Certification
31.2	Certification
32	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

This exhibit shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section. Such exhibit shall not be deemed incorporated into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

As provided in Rule 406T of Regulation S-T, this information shall not be deemed filed for purposes of Section 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability under those sections.