JPMorgan

Susan J. Webb
Executive Vice President

May 27th, 2009

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
Office of the Secretary
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Via Fedex and e-mail (regs.comments@federalreserve.gov)

Re: Federal Reserve Bank Services Private Sector Adjustment Factor
Docket No. OP-1354

Dear Ms. Johnson:

The Board of Governors of the Federal Reserve System (the "Board") has requested comment on proposed modifications ("Modifications") to its method for calculating the private-sector adjustment factor ("PSAF"). J.P.Morgan Chase & Co. ("JPMC"), on behalf of its lead subsidiary bank, J.P.Morgan Chase Bank, National Association and its affiliates, appreciates the opportunity to submit this response.

JPMC is a leading global financial services firm with assets of $2.2 trillion and operations in more than 60 countries. The firm is a leader in investment banking, financial services for consumers and businesses, financial transaction processing, asset and wealth management, and private equity. Under the J.P.Morgan and Chase Manhattan Bank brands, the firm serves millions of consumers in the United States and many of the world's most prominent corporate, institutional and government clients. Information about the firm is available on the Internet at www.jpmorganchase.com.

JPMC fully supports the mandate of the Monetary Control Act of 1980 which requires the Federal Reserve to set fees for services that recover actual costs, including an accurate calculation of imputed costs. However, the Publicly Traded Firm Model for PSAF as put forward by the Federal Reserve Board is open to interpretation due to many of the variables and long term assumptions that have been made. Given the current state of the economy, the use of the "public market" as a benchmark is too broad and not representative of the

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transaction services operating model utilized by the Federal Reserve, correspondent banks and payment processing companies. In addition, the "public market" benchmark includes multiple industries (Oil & Gas, Pharma, and Retail) that differ in financial structure to the payment processing service industry.

The methodology proposed by the Board results in higher imputed costs. This may be directionally correct, based on past industry commentary that FRB costs have not been fully recovered each year. However, we note that the comparative analysis of the three models presented in the request for public comment reveals a wide variation in total PSAF calculations. While the validity of each model is fully assessed, with such divergent results, it is difficult to develop confidence that any one result stands out as being more accurate than the alternatives.

We encourage the Board not only to continue its efforts to develop a viable model for the calculation of the PSAF based on reliable and comparative data, but also to establish a more representative peer-based group for inclusion in the model. We would anticipate that to the extent the relevant cost data is publicly available, this peer-based group would include the transaction processing businesses of large financial institutions, user-owned utilities and corporations in the payment processing business. As an alternative to publicly available cost data, the Board may consider commissioning a peer-group study to benchmark the industry costs relevant to the PSAF calculation.

Irrespective of the model used to calculate the PSAF and related costs, we believe that the Board needs to continue providing quality and competitively priced services to the market place. This necessitates an accurate assessment of what the market will bear for competitively priced services. Clients like JPMC will always look for lower cost processing alternatives wherever possible. The formation of private sector joint ventures where participants elect to leave the "grid" due to the lack of competitive value afforded by the infrastructure operators is a real issue for the payments industry.

Tactically, we think that the Federal Reserve's Retail Payments Office and Wholesale Product Office should continue with their current expense reduction initiatives, as a way to offset the increase in the imputed cost component of total cost and avoid material price increases.

In addition, we suggest that the Federal Reserve consider the 3 ideas outlined below as these would have the effect of creating efficiency and lowering costs in the payment services infrastructure, for the benefit of both the Federal Reserve and the banking industry.

- Deposited Check Truncation (DCT) – a capability which provides the option for a presenting bank to use a "least cost" routing model to make decisions on which payment channel will be used to clear paper checks. The industry has had two unsuccessful attempts at creating a DCT clearing capability, where checks could be converted and cleared through the ACH network. Legal questions (Reg E vs. Reg CC), competing views on image archiving and retrieval and questions about consumer acceptance are factors that have impeded progress. Participation and leadership from the Federal Reserve may help in achieving industry agreement on the best way forward.

- Image Exchange adoption – industry adoption of image exchange has been impressive. By the end of 2009, it is widely expected that well over 90% of the industry will be image-enabled on the receive side. The issue is with the banks that are part of the "last mile" and the timeframe for adoption of image exchange by these banks. Without a firm deadline, as an industry, we will be prolonging inefficiency and incurring additional costs indefinitely. The industry needs a definitive end-date, when all financial institutions must have IE receive capabilities. Here too, we look for leadership from the Federal Reserve to help resolve the "last mile" issues.

- Infrastructure convergence - consolidate both ACH and Image processing onto "a single operating platform", inclusive of technology and operations. The rapid convergence of clients buying behavior renders the legacy silos irrelevant. Moreover, consideration should be given to converting all images to ACH as this would obviate the need to create yet another network and support infrastructure.

Progress on these fronts will create efficiency and cost-reduction benefits for both the Federal Reserve and the banking industry. As the Federal Reserve works to insure ongoing compliance with the mandate of the Monetary Control Act, it will continue to look for enhancements to costing methodology and initiatives that will reduce total costs for priced services. JPMC believes that the industry initiatives described above will increase the use of electronic payment channels and offer participants an opportunity to select the most efficient payment channel available. These scenarios will drive costs down for both the infrastructure providers and the payment system participants.

J.P.Morgan would be pleased to discuss any of the points raised in this letter in more detail. Should you have any questions please contact me at 212-552-4912, or via e-mail at susan.j.webb@chase.com or Roy DeCicco at 212-552-0731, or via e-mail at roy.c.decicco@jpmchase.com.

Sincerely,