CHASE

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February 22, 2011

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

Re: Proposed Regulation II; Docket No. R-1404

Dear Ms. Johnson:

The Board of Governors of the Federal Reserve System (the "Board") has requested comments on its proposed Regulation II, implementing the amendments to the Electronic Fund Transfer act (the "EFTA") set forth in Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (commonly known as the "Durbin Amendment"), mandating new restrictions on debit card interchange fees and new requirements for debit card network access and routing (the "Proposal"). JPMorgan Chase & Co., on behalf of JPMorgan Chase Bank, N.A., a major debit card issuer, Chase Paymentech Solutions, LLC, a major merchant acquirer, and its other subsidiaries, appreciates the opportunity to submit this response.

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For ease of reference, we have organized this letter into sections, summarized in the table below and highlighted by section headings throughout the letter.

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A. Introduction

Chase recognizes the Durbin Amendment imposes significant challenges upon the Board and we acknowledge the Board's efforts to take a thoughtful approach to the Proposal. Nevertheless, as discussed in more detail below, Chase believes the Proposal is fundamentally flawed and respectfully urges the Board to make significant revisions before issuing a final regulation. In this letter Chase explains why we believe:

(i) the Proposal reflects a misinterpretation of the Durbin Amendment's interchange provisions and imposes a more rigid and problematic price control approach than the Durbin Amendment requires;

(ii) even if the Board correctly interpreted the Durbin Amendment regarding interchange, the Proposal implements the Durbin Amendment incorrectly by precluding a debit issuer from recovering actual costs and realizing a reasonable return;

(iii) the Proposal would result in significant negative and unintended consequences to consumers, small businesses, the payment system and the U.S. economy; and

(iv) the Proposal's timelines are unrealistic and must be extended to allow for further study and successful implementation.

In addition, we will comment on the Proposal's network exclusivity and routing provisions and certain other operational questions the Board posed when releasing the Proposal.

B. Executive Summary

Debit cards are an extremely convenient, efficient and popular payment device for consumers and merchants, millions of whom benefit every day from the ease and security debit cards offer. As a result, over the past decade U.S. debit transactions have grown from 8 billion in 2000 to 38 billion in 2009. Merchants have received tremendous benefit from the wide use of debit cards, which has enabled many to change their business model to lower costs and increase sales. In fact, entire categories of merchants, such as internet retailers and airlines, depend almost exclusively on debit, and credit, cards. The Proposal, however, would materially undermine the debit card as a viable payment vehicle for countless consumers, merchants and issuers.

As described in the Proposal, the Durbin Amendment sets forth three new directives specific to debit cards and directs the Board to issue implementing regulations consistent with those directives:

(i) subject to certain important exceptions, the interchange fee for a debit transaction shall be reasonable and proportional to an issuer's cost with respect to the transaction;

(ii) card issuers and networks must allow debit card transactions conducted with a particular card to be processed on one of at least two unaffiliated networks; and

(iii) card issuers and networks must allow merchants to select the network, of those enabled on a particular card, over which to route a transaction.

The Durbin Amendment affords the Board discretion and flexibility to establish standards for whether an interchange fee is "reasonable" and "proportional to cost," and determine what costs can be recovered through interchange. Implicit in the statutory language is that the Board should include all costs *and* allow for a reasonable return. However, the Proposal takes a much more narrow approach, and imposes stringent price controls, thus creating inconsistencies between the Proposal and the Durbin Amendment.

In particular, the Proposal fails to establish any standards for assessing whether an interchange fee is reasonable and proportional to cost, instead imposing specific prices capped at a gross underestimate of cost, with no reasonable return allowed. Further, when determining those costs, the Proposal adopts the mistaken view that debit transactions and checks are functionally equivalent, and that merchants incur little cost to accept checks. As a consequence of this misguided attempt to treat debit the same as a check, the Proposal excludes numerous issuer debit costs when the statute contains no such limits. Finally, the Proposal not only limits interchange to cost, and the wrong cost at that, but it actually seeks to regulate and reduce costs despite an absence of any statutory directive to do so.

As a result, based on the Board's recent issuer cost study, the Proposal would limit interchange to only 17% of the issuer's actual cost of a debit card transaction. This is neither reasonable nor proportional to cost incurred, and it is not consistent with the Durbin Amendment's directive to "establish standards for assessing" whether interchange is reasonable and proportional to actual costs.

By fixing debit pricing artificially low and precluding debit card issuers from recovering their actual costs and earning a reasonable return, the Proposal would have significant negative and unintended consequences, harming consumers, small businesses, the U.S. payment system and the broader U.S. economy. In particular:

- Overall banking costs for consumers and small businesses will increase significantly. Because the Proposal precludes issuers from recovering all their costs associated with debit card programs through interchange, they will seek to recover these costs elsewhere. See Appendix 1, Estimated Industry Costs to Support Debit Cards.

- Many consumers will not be able or willing to pay for higher cost banking services and likely will be forced out of the mainstream banking system. These customers most likely will be forced to resort to more expensive and less regulated alternative financial services providers, such as check cashers and payday lenders. See Appendix 2, Consumers Exiting the Banking System.

- Issuers and networks likely will restrict debit card usage at certain merchant types or for certain transactions, and/or cap the maximum purchase amount to reduce fraud losses, creating a burden on the consumer, merchant and payment system as a whole. See Appendix 3, Fraud Costs vs. Transaction Size and Merchant.

- Smaller merchants incurring increased costs associated with greater cash and check volume likely will see decreased sales and suffer reduced profitability, forcing them to increase prices and/or curtail marketing, expansion hiring, etc.

- Price-fixing will reduce innovation, and lead to a less safe and secure payment system. Fixing prices at 15% to 20% of current rates will stifle future investment and innovation that benefits consumers and merchants (e.g., mobile payments, fraud protections, photo cards, account alerts, contactless payments).

- The Durbin Amendment tries to exempt small banks and credit unions from its interchange price-fixing provisions. However, in practice, interchange fees will be significantly reduced for all banks, including small banks and credit unions, resulting in further increased costs for consumers and small to mid-size businesses.

With respect to debit network exclusivity and transaction routing, any approach that requires more than one Signature and one PIN network on a card will dramatically increase complexity and costs for the payment system, including both issuers and acquirers, but is unlikely to bring meaningful benefit to merchants and cardholders. Furthermore, such an approach could not be implemented for several years given the enormous payment system infrastructure modifications required.

The Proposal's net effect would be a massive annual windfall for the very largest retailers at the expense of consumers. According to First Annapolis Consulting, just 125 merchants account for over 50% of U.S. debit card spend and only 1.5% of merchants account for 80% of U.S. debit card spend. Since neither the Durbin Amendment nor the Proposal has any provision to measure whether consumers have benefited from lower prices, not to mention a requirement that merchants pass along any savings, it is unlikely that consumers will see lower prices for goods and services.

Recommendations

As discussed below, Chase recommends that the Board reconsider its proposed approach to the Durbin Amendment and make the following fundamental revisions to the final regulation to more closely align with the letter and spirit of the law:

1. Remove the specific prices set forth in the Proposal and instead craft standards that recognize both the true cost to an issuer of providing debit card services and the immense value these services create for merchants and consumers. In particular:

    A. Include all costs an issuer incurs with respect to debit card transactions when establishing standards for determining whether a particular interchange fee is reasonable and proportional, including fraud losses, fraud prevention and detection costs, network fees, customer service costs, claims processing costs, risk management costs, card production costs, debit program administration costs, costs to implement the new network exclusivity and routing rules, capital costs and compliance costs.

    B. Structure permissible debit interchange standards to allow issuers to earn a reasonable return on investment, in addition to recovering all costs, by adhering to the statutory provisions that differentiate between costs and fees.

    C. To the extent the Board does not include fraud prevention costs in the total costs issuers may recover through interchange fees, the Board should develop reasonable standards for adjusting interchange fees to recover fraud prevention costs, allow sufficient time for comment before implementing and ensure the adjustment is effective at the same time as the new interchange fee limitations.

2. Delay mandatory compliance with the interchange rules until at least July 31, 2013 and until at least July 31, 2015, if the Board adopts Alternative B for network exclusivity and routing. The tremendous complexity and inherent implementation challenges associated with the final regulation, warrant re-visiting all implementation dates.

C. <u>Interchange Discussion</u>

The Durbin Amendment specifies that debit interchange "shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction" but the law does not mandate a specific interchange amount, nor does it limit interchange to cost, define cost, exclude any costs or preclude a reasonable return (see EFTA Sec. 920(a)(2)). Yet, despite the statutory language, the Proposal would impose price caps, exclude significant actual costs from the amount issuers can recover through interchange and effectively preclude issuers from earning a reasonable return on their significant debit card business investment.

1. The Proposal Is Inconsistent With The Durbin Amendment

a. *The Durbin Amendment Does Not Require Price Caps*

Based on the data recently collected by the Board's staff and summarized in the Proposal, the Proposal would limit interchange to only 17% of the issuer's actual cost for a debit card transaction. This is neither reasonable nor proportional to cost incurred. For example, as the Proposal notes, in 2009 the industry incurred approximately $1.4 billion in actual fraud losses related to debit card transactions. See 75 Fed. Reg. 81722 at 81740. However, under the Proposal issuers would not be able to recover any of these costs through interchange fees. Further, the Proposal precludes issuers from earning a return on their significant investment in their debit programs and the debit payment system even though the law permits a reasonable return that is proportional to the issuer's cost and despite the tremendous value debit cards provide to merchants and consumers. In these respects, the Proposal is inconsistent with both the letter and spirit of the statute. If Congress intended to limit interchange to cost, it easily could have done so. For example, Congress could have specified that "interchange shall be no more than the cost …" Clearly, Congress did no such thing.

b. *The Proposal Fails To Provide Standards As The Durbin Amendment Requires*

The Durbin Amendment directs the Board to "establish standards for assessing" whether the debit interchange an issuer charges or receives is "reasonable and proportional to the cost incurred by the issuer with respect to that transaction." See EFTA Sec. 920(a)(3)(A). In a further inconsistency, the Proposal does not establish standards but instead sets specific pricing regardless of and, in fact, well below actual costs. "Assessing" implies an element of judgment and/or discretion, which is absent from the Proposal. If Congress intended to limit interchange to a specified amount it would have done so, or would have specifically directed the Board to do so, and there would be no reason for an assessment.

The Durbin Amendment also directs the Board, when establishing interchange standards, to <u>consider</u> issuer incremental cost for "authorization, clearance or settlement of a particular transaction" and <u>not</u> <u>consider</u> issuer costs not specific to a particular transaction. See EFTA Sec. 920(a)(4)(B). Respectfully, we believe the Board has misinterpreted this provision to mean interchange must not reflect any costs other than for authorization, clearance or settlement. However, there is a significant difference between "considering" certain costs and mandating that only those costs are permissible, despite the multitude of costs associated with debit transactions. And there is a significant difference between "not considering" other costs and prohibiting issuers from recovering them. The Board itself recognizes this distinction between considering and mandating, noting in the Proposal release that, while the Durbin Amendment "requires only the consideration of these factors, the Board believes that they are indicative of Congressional intent ..." See 75 Fed. Reg. 81722 at 81734. Respectfully, Chase submits that there is no need to divine Congressional intent on this point; the Durbin Amendment is clear as written.

We believe a more standards-based approach to assessing whether interchange fees are reasonable and proportional to the issuer's cost is far more appropriate and consistent with the plain meaning of the Durbin Amendment. Accordingly, Chase recommends that the Board promulgate true standards setting forth:

- Specific permissible cost types **reflecting all actual costs** issuers typically incur with respect to their debit card programs.
- How interchange fees may be **structured to account for the variation in risk** associated with different merchant and transaction types.
- How to determine a reasonable rate of return.
- Parameters for how and when networks should gather issuer cost data and determine permissible interchange fees.

c. ***Debit Is Not The Same As A Check***

The Durbin Amendment directs the Board to "consider the functional similarity" between debit transactions and checking transactions that clear at par when prescribing its regulations. See EFTA Sec. 920(a)(4)(A). The statute does not mandate that debit and checks be treated as functional equivalents, which is understandable since clearly they are not. While both debit cards and checks are methods of payment that transfer funds from the payor's account, the Board mistakenly excluded debit's payment guarantee and other significant differences between checks and debit cards, including debit's speed, efficiency and convenience for both the merchant and the consumer; and the merchant's and the bank's lower respective costs to process those payments. In addition, debit cards are accepted payment methods at numerous merchant locations where checks are not (e.g., gasoline station pumps and other self-service sales devices, and online sales).

Merchants have benefitted enormously from the value that banks and credit unions have created in debit card networks by fully embracing and accepting the widespread use of debit cards and enjoying the higher sales generated by the proliferation of debit cards. Merchants are not required to accept debit cards but have chosen to do so because of these many benefits. The Proposal, however, essentially ignores the benefits to merchants of debit over checks as well as the significant differences between debit and checks and the corresponding lack of functional similarity. Instead, the Proposal redefines debit to be substantially the same as checks.

The Durbin Amendment does not limit interchange to the cost a merchant would incur to accept a check for the same transaction. This, of course, is appropriate since checks and debit cards are not functional equivalents. However, assuming for argument's sake the statute is so interpreted, the Board, while identifying some similarities between debit and check processing, did not consider all merchant costs for accepting checks or how those costs compare to debit interchange. As a result, the Proposal reflects a grossly understated estimate of merchant costs to accept checks. In reality, merchants incur numerous costs associated with checks, including theft and loss, transportation, security and insurance, longer customer checkout times, and cost for verification and/or guaranty services. Debit cards enable merchants to significantly reduce or even avoid many of these costs.

For instance, studies have shown it costs merchants 75-150 basis points to accept checks. See, for example, "The Move Toward a Cashless Society: Calculating the Costs and Benefits" published in Review of Network Economics, Volume 5, Issue 2 (June 2006). This amounts to $0.29 - 0.58 for the average $38.58 debit transaction referenced in the Proposal (75 Fed. Reg. 81722 at 81725). One study indicates that in 2009 merchants paid on average 92 basis points per check (equal to $0.35 for the average debit card transaction) just for electing to purchase guaranty services, which are included in today's interchange fees (see Nilson Report #953, July 2010). So, while checks do clear through the Federal Reserve system at par, they are not cost-free to the merchant; if a merchant will even accept a check, most of the costs simply are paid outside the technical check clearing process.

2. The Proposal Incorrectly Defines and Limits Costs

As discussed above, Chase firmly opposes the Proposal's fee cap approach, which is inconsistent with the statute. Regulation II should reflect all costs as the Durbin Amendment contemplates. Instead, based on the Board's misinterpretation of the statute, the Proposal would limit permissible costs to only variable costs incurred just in the authorization, clearance or settlement of a particular electronic debit transaction. In doing so, the Proposal excludes many very significant fixed as well as variable costs issuers incur in connection with debit transactions, even those necessary to enable a transaction to occur.

In particular, the Proposal does not consider such costs as funding and capital; overdraft losses; fraud losses; fraud prevention and detection; billing and collection; customer service; claims processing; cardholder account posting; chargeback and dispute handling; technology and data processing; protection of consumer data; risk management; network fees; card production and distribution; statement production and distribution; costs to implement the new network exclusivity and routing rules; software development, maintenance and licensing; program administration and support; marketing; occupancy; and compliance.

While some of these costs may not be specifically attributable to any one particular debit transaction, an issuer would not incur these costs but for the fact the issuer processes one or more debit transactions. Further, if the issuer did not incur these costs, most if not all debit card transactions could not be initiated or processed. Accordingly, the costs unquestionably are incurred "with respect to the transaction" as specified in the Durbin Amendment even if the amount attributable to the transaction is not readily ascertainable. It is, therefore, clear that even assuming the statute did call for caps, the Proposal's caps are much too low.

However, if, as the Board suggests, Congress did intend to exclude costs that are not specifically attributable to a particular debit transactions, the Proposal would incorrectly implement this intent. The Proposal would prohibit issuers from recovering through interchange many significant costs that are indeed specific to a particular transaction such as actual fraud losses, network fees, customer service costs, and claims processing costs. Apparently, the Board took this approach on the theory that such costs are not incurred for authorization, clearance or settlement of the transaction. As discussed above, we believe that is not the correct interpretation of the statute, and many of these costs are incurred as part of the authorization, clearance or settlement processes. But there is no need for debate. As the Proposal notes, the Durbin Amendment does not address issuer costs that are specific to a particular transaction but not incurred for authorization, clearance and settlement. Had Congress intended to limit costs in this fashion it surely could and would have done so. Since Congress did not and the statute is silent, standard statutory construction principles should apply and, therefore, no such prohibition should be inferred.

Finally, in yet another departure from the Durbin Amendment, the Proposal seeks to incent issuers to reduce costs. While arguably a laudable goal, it simply is without any statutory basis. The Durbin Amendment regulates interchange, not costs. In any event, issuers need little incentive and certainly no regulatory mandate to reduce costs. However, some costs, such as fraud losses and compliance costs, simply are not entirely within an issuer's control. See Appendices 1 and 3.

Chase urges the Board to follow the clear language of the Durbin Amendment by including all costs an issuer incurs with respect to debit card transactions when determining whether a particular interchange fee is reasonable and proportional.

3. <u>Commentary on Interchange Fee Alternatives 1 and 2</u>

The Durbin Amendment did not authorize the Board to impose price caps but instead directed the Board to establish standards. Therefore, Chase strongly advocates the adoption of standards for determining debit interchange fees consistent with the Durbin Amendment's directive to establish rates that are "reasonable and proportional to the cost incurred by the issuer with respect to that transaction." See EFTA Sec. 920(a)(2). Both proposed alternatives are significantly flawed in this regard. The standards should consider:

- A broader definition of allowable costs, including allowances for fraud prevention and actual fraud costs incurred.
- A floating rate structure that accounts for the significant variation risks across different merchants, transaction types, transaction sizes.
- A process for networks to periodically gather cost data and evaluate/adjust the interchange fee structure.

That said, if the Board does proceed with the flawed approach contemplated in the Proposal, Chase believes Alternative 2, albeit with a cap significantly higher than $0.12 per transaction, is better than Alternative 1. As between Alternatives 1 and 2, and with an appropriately calculated cap, Alternative 2 would allow interchange fees that are reasonable and proportional to the true actual cost of debit card transactions. Any cap also should include a variable component to address fraud losses since these losses increase with transaction size and vary by transaction and merchant type. This component should be calculated using a basis point factor to accurately compensate issuers for actual fraud losses. In addition, this higher cap also should take into consideration the significant additional costs issuers will incur to implement the final regulation's network exclusivity provisions.

On the other hand, Alternative 1 would be complex, burdensome and expensive to implement and maintain. Alternative 1 would require implementation of ever-changing issuer-specific interchange rates, representing a significant change to the payment system infrastructure. The modifications that payment system participants, including issuers, processors, networks and acquirers, would have to make to implement Alternative 1 would be even more extensive than those required to implement Alternative 2. It is important to note that, while reaping all the benefits with no obligation to pass on any benefits to their customers, merchants would bear relatively little of these costs and burdens.

In addition, Alternative 1 would impose a significant level of operational complexity to monitor specified costs on an ongoing basis to satisfy new regulatory reporting burdens. This would subject all payment system participants to unnecessary operational costs that are not readily recoverable. Assuming a more reasonable and realistic cap, Alternative 2 would impose far fewer ongoing operational and administrative costs and burdens than Alternative 1.

If the Board does choose either of the proposed alternatives, Chase urges the Board to delay implementation of the new interchange fees until at least July 31, 2013 for a rule similar to Alternative 2; an even longer implementation period would be required for a rule similar to Alternative 1. These time periods are necessary to allow the networks sufficient time to implement the necessary issuer/product tiered interchange fee schedules. If the Board fails to provide sufficient time to implement the final regulation, we believe all issuers and program sponsors, including state governments and payroll card issuers exempted from the Durbin Amendment's interchange provisions, effectively will be subject to the new interchange rate because networks and acquirers likely would not have time to make the system modifications necessary to vary the interchange rate for issuers and, therefore, would implement the lower interchange structure applicable to larger issuers for all debit transactions. This will force some of these exempt issuers and program sponsors to either exit the business or implement measures that will negatively impact consumers such as loss of services or utility, and higher fees.

4. A Fraud Prevention Cost Adjustment is Imperative But Not Sufficient

As discussed above, the Proposal would fix debit pricing artificially low and preclude debit card issuers from recovering their actual costs and earning a reasonable return. Specifically, fraud detection and prevention, and actual fraud losses, are very significant actual costs directly associated with every debit card transaction. While the Durbin Amendment contemplates an adjustment to the interchange fee limitations to allow issuers to recover costs incurred in preventing debit-related fraud (see EFTA Sec. 920(a)(5)), the Proposal did not include any such adjustment. We recognize the complexity inherent in determining this adjustment but it is imperative the final regulation provide for it. Moreover, it is imperative that the fraud adjustment be implemented at the same time as the new interchange fee limitations to ensure issuers are able to recover these significant costs, as the Durbin Amendment contemplates. Failure to implement these provisions simultaneously likely will result in additional debit card restrictions and/or new or increased banking fees.

Chase strongly recommends that the Board implement a fraud prevention cost adjustment that enhances the overall security and viability of the payment system by encouraging all participants in the system to combat fraud. To that end, issuers should be compensated for all expenses associated with fraud prevention and detection, data security management and related research and development.

Chase also strongly recommends that the Board adopt a non-prescriptive approach to the fraud prevention cost adjustment because it creates a model that most effectively manages fraud exposure across the industry. On the other hand, forcing all issuers to adopt a technology-specific approach, even with “paradigm shifting” technologies as discussed in the Proposal, would create greater risk to the payment system. Unfortunately, standardized technology creates an opportunity for fraudsters by allowing a single vulnerability to be exploited across the entire industry. The non-prescriptive approach, by definition, creates a diverse fraud detection topology that isolates vulnerabilities to specific issuers, maintaining the macro-integrity of the overall payment system.

When determining the fraud prevention cost adjustment, we recommend the Board take a comprehensive view of fraud prevention and detection, and data security costs, including costs across the entire lifecycle of an account (i.e., account origination to close). The adjustment should be sufficient to reimburse the issuer for all of its costs related to current fraud prevention and data security activities and not just fraud prevention activities that benefit merchants. In addition, the adjustment also should include a component for research and development of new fraud prevention techniques. Experience has shown that fraud schemes constantly evolve, requiring constant investment in new strategies and technologies.

Chase believes the fraud prevention cost adjustment should be determined based on standards promulgated by the Board, consistent with the Durbin Amendment. See EFTA Sec. 920(a)(5)(B)(i). However, if the Board insists on a specific dollar amount instead, Chase recommends the adjustment not be issuer-specific to minimize added complexity and increased operating costs. Annually, the Board could gather fraud prevention, data security and research and development expenses from issuers and recalculate the adjustment to be used for the next year.

Chase also recommends the Board establish a single fraud prevention cost adjustment that would be applied to both PIN and Signature transactions. Although the Board's debit cost study excluded ATM losses, it is important to note that, while debit card account numbers and PINs often are compromised in the merchant environment, losses often are incurred through fraudulent ATM transactions when the fraudsters use the compromised information to withdraw cash from an ATM. PIN POS and ATM fraud cannot be viewed independently. Chase's ATM fraud losses are three times its PIN POS losses. When taking this holistic view, debit card fraud losses across PIN and Signature transactions are more comparable; therefore, separate PIN and Signature fraud prevention cost adjustments are not warranted.

While it is critical that issuers be able to receive interchange fees adjusted to include fraud prevention costs, that only partially helps the industry proactively manage fraud losses. Fraud losses affect the entire industry and all participants must be incented to contribute to its management. For example, as noted in the Proposal, in 2009 the industry incurred approximately $1.4 billion in actual fraud losses related to debit card transactions. See 75 Fed. Reg. 81722 at 81740. The Proposal imposes all fraud risk upon issuers and provides merchants with no motivation to actively contribute to fraud loss management. To that end, Chase again encourages the Board to expand the scope of costs allowed in the final interchange fee rule to include fraud losses. As discussed above, fraud losses are costs directly attributable to the debit transaction and, therefore, are within even the narrowest interpretation of the Durbin Amendment's scope. In addition, the fraud component of the interchange fee should be defined in terms of basis points rather than a fixed amount. Fraud losses scale with transaction size, vary by transaction type, and vary by merchant location, mandating that at least this component of the interchange fee be adjusted accordingly. Merchants would benefit from reduced fraud losses when the Board refreshes the interchange fee periodically and would, therefore, be motivated to participate actively in fraud management efforts.

5. The Proposal's Price-Fixing Will Have Significant Negative Consequences

a. *Negative Impacts on Consumers*

The Proposal's interchange fee limitations in both Alternative 1 and Alternative 2 will cause issuers to lose money on nearly every transaction. Given this economic model, issuers will be forced to make their debit products more restrictive, impairing consumer access to their own money. Debit may not be available, at least not without new or increased fees, for accounts or customers that do not generate sufficient revenue to help issuers offset the costs associated with providing the account and related debit services. Furthermore, debit may not be available for higher dollar transactions or certain merchant or transaction types due to the inherent higher fraud cost.

Further, overall consumer banking costs will increase as issuers seek to recover costs associated with debit. Existing fees will increase, and new fees are likely for many services and features that are available to consumers today at no cost, such as checking accounts without monthly service fees, free branch access, free ATMs, free online banking, free bill pay, free mobile banking and other consumer banking staples. In fact, in anticipation of the final regulation, many of the largest U.S. banks, including Chase, already have had to implement new or increased monthly service charges on checking accounts for customers who do not meet certain qualifications.

A reduced use of checking accounts would be an inevitable consequence of caps on debit interchange rates. The Federal Reserve's triennial Survey of Consumer Finance shows that the percentage of U.S. families with a checking account was 5% higher in 2007 than in 1995, which coincides with the growth of debit cards and free or reduced cost checking. As low cost checking options disappear, the downward trend in unbanked families will reverse. See Appendix 2.

Consumers of modest means will be most affected by these changes. For example, a common fee waiver qualification is a specified minimum balance, which ensures the bank earns sufficient net interest income to help cover the cost of providing and servicing the account. By definition, customers with the most limited financial resources will be the most affected by minimum balance requirements. The initial customer response to Chase's recent entry-level checking product and fee changes suggest that a large percentage of the population is unwilling to pay monthly service charges. Based on current attrition rates, we expect 50-60% of the Chase customers who are likely to be subject to a monthly service charge under our new product structure to leave Chase within the next year, which is markedly higher than previous periods.

Ultimately, these consumers may be priced out of mainstream banking services entirely and migrate to alternative products and providers such as payday lenders, check cashers, and non-bank managed general purpose reloadable cards, which are more expensive and subject to less oversight than banks and bank products. Experience following enactment of the Credit CARD Act of 2009 is telling in this regard. While the CARD Act limited credit card fees and interest rates, it also has reduced the availability of unsecured credit, particularly to Americans with poor or limited credit histories. See "Mixed blessing: credit card reform may shock some," Associated Press, February 21, 2010. Many of these customers have turned instead to payday lenders and pawn brokers for their credit needs. The CFO of Advance America, one of the largest payday lenders in the U.S., recently was quoted to say the company was "starting to see a benefit of a general reduction in consumer credit, particularly … subprime credit cards." See "Payday Lenders Go Hunting," The Wall Street Journal, December 24, 2010.

b. *Risk to Payment System and Economy*

The Proposal is likely to drive significant change in consumer, merchant, issuer and network behaviors but, given the lack of meaningful study, the ultimate outcomes are unknown. These changes and, we believe, the uncertainty itself, will introduce risks to the overall payment system and negatively impact the U.S. economy. First, consumers paying more for banking services and burdened by limited access to debit products likely will spend less, hurting merchant profitability and possibly risking the economic recovery. Even where consumers do not forgo purchases, because debit cards will become less widely available, more limited in functionality and/or more expensive to use, many consumers likely will be compelled to use cash and checks for the purchases instead of debit. As a result, merchants, banks and the Federal Reserve System will need to handle more cash and checks, and incur the higher associated costs and compliance risks. In addition, merchants incurring increased costs associated with greater cash and check volume likely will suffer reduced profitability, which may force them to increase prices and/or curtail marketing activities, expansion initiatives and/or new hiring. Finally, an issuer's inability to earn a reasonable return will result in reduced investment in basic systems maintenance and upgrades, leading to an eventual degradation of the debit card payment system's stability and reliability.

c. *Innovation Stifled*

The Proposal will have a significant negative effect on innovation in the U.S. payment system. First, no significant participant in the payment system will have much incentive to innovate. Issuers, unable to recover costs much less generate a profit, will have little incentive to develop and deploy new fraud prevention and detection tools, resulting in fewer transaction approvals as issuers seek to reduce risk, or new payment devices and methods. Large retailers, reaping the benefits of lower costs without bearing responsibility for fraud losses, or any obligation to invest in the payment system, will have no incentive to ensure or even contribute to continued payment system development, innovation and efficiency.

While new product innovation is of significant concern, when issuers are unable to cover their costs other areas of the payment business also will be affected. For example, basic transaction processing infrastructure will suffer from underinvestment and issuers will become dependent on older, slower and less stable technology, impairing system reliability, efficiency and capacity. As a result, more transactions will be declined and, over time, the payment system will become more expensive and, possibly, less secure.

In addition, fraud technology investment will suffer as issuers choose not to invest in new technologies that promote increased transaction approval rates. Instead, issuers will scale back fraud detection capabilities, replacing them with more conservative, simplified rules (e.g., decline all internet purchase transactions). Merchants will experience lower sales and/or be forced to accept other less efficient and secure forms of payment (e.g., cash and check). Customers will be forced to use more cash and checks, as well as more credit.

Finally, the Proposal's implications likely will transcend issuers and merchants as others, such as large metropolitan commuter services, are investing heavily in infrastructure that relies on payment innovations to drive efficiencies.

D. Network Exclusivity/Routing Discussion

a. Alternative A Is Better Than Alternative B

The Durbin Amendment prohibits issuers and networks from restricting debit transactions to fewer than two unaffiliated networks, effectively requiring issuers to enable two unaffiliated networks on every debit card. The Board has proposed implementing this aspect of the Durbin Amendment through one of two alternative approaches. Chase strongly recommends Alternative A because it provides the network choice the Durbin Amendment calls for in a manner consistent with existing payment system architecture.

Alternative B would go well beyond the plain words of the statute by requiring two unaffiliated networks for each method of authorization (i.e., supporting two competing Signature debit brands as well as PIN). Moreover, as the Proposal itself notes, payment system architecture cannot currently support the Alternative B approach, especially with respect to multiple Signature debit networks for a particular debit transaction. Alternative B would require issuers, networks, acquirers and merchants to design, develop and implement extensive, costly and time-consuming hardware and software modifications to build the necessary systems capability. This unprecedented industry technical infrastructure investment could actually increase payment costs since the infrastructure investment would be so large.

The Durbin Amendment did not specify a particular implementation deadline for the network exclusivity and routing provisions, leaving it to the Board to determine what is reasonable. We urge the Board to study more fully the challenges and risks associated with implementing these provisions before proposing definitive deadlines and timeframes. In any event, though, the timeframes set forth in the Proposal simply are inadequate.

Alternative A

The Board suggested an October 1, 2011 implementation date for Alternative A. Based on our experience as a major debit card issuer, Chase believes this deadline is unrealistic and, in fact, it would take 24 months from the effective date of the final regulation to implement Alternative A. This view reflects the following key implementation activities and timeframes:

• Network selection process	3 months
• Negotiate contract	3 - 6 months
• Develop system/programming requirements	1 month
• Design system/operations	1 month
• Build system, including telecom installation	3 months
• Test	2 months
• Pilot	1 month
• Implementation	1 month
• Network resource constraint allowance	6 months

Since a significant number of issuers would need to add additional unaffiliated networks to their current programs at the same time, the networks are likely to have significant contention for contract, technical and project management resources. This would create a bottleneck at the networks and prevent a large number of issuers from complying in a shorter timeframe. Accordingly, Chase recommends that any implementation schedule include an additional six months to address this anticipated resource issue.

The proposed implementation date for Alternative A also is unrealistic from a merchant acquiring perspective. Merchant acquirers must implement the ability for individual merchants to designate customized transaction routing rules. This is an extensive change to the existing merchant processing environment. Merchant acquirers also will need 24 months to bring their systems into compliance.

Given all the challenges, it seems clear the Board should not require an implementation date for Alternative A any earlier than July 2013.

Alternative B

For Alternative B the Board suggested January 1, 2013 implementation date. This deadline is even more unrealistic. Supporting this functionality would require significant software development for networks, issuers, acquirers and merchants, including reprogramming millions of merchant terminals. Changes required would touch the entire payment system from end-to-end including authorizations, settlement, risk detection and management, disputes processing, card production, and cardholder servicing platforms. Therefore, enabling multiple Signature debit networks on a debit card requires further study to determine its practicality and realistic implementation timeline and Chase urges the Board to delay consideration of this alternative until the Board fully understands the real constraints on the industry. While Chase does not know the timeframe requirements of all debit payments industry participants, given the extent of the changes Alternative B would require, we believe it could take approximately four years for all participants in the debit payment process to be able to safely and securely implement Alternative B.

b. Network Mergers/Acquisitions

The Board also asked for comment on whether a 90-day period was sufficient for issuers to implement a new network relationship should a network acquisition occur that changes a network's status from "unaffiliated" to "affiliated". Chase believes 90 days would be grossly insufficient and that the 24-month timeline suggested above would apply in this situation as well. To comply with the "two unaffiliated networks" rule, an issuer would need to select the appropriate network, negotiate a new contract and do the necessary technical and operational implementation work. It also is likely that the receiving networks would become bottlenecks as they attempt to deal with a large volume of issuers needing to establish a new network relationship simultaneously. At minimum, the Board should provide 24 months from the time the network merger/acquisition closes.

E. <u>Other Comments</u>

Chase respectfully offers the following comments on various aspects of the Proposal that are not otherwise discussed in detail above.

Should network fees be included in allowable costs when assessing whether interchange fees are reasonable and proportional?

As discussed above, Chase strongly recommends that the Board include all costs an issuer incurs when determining whether interchange fees are reasonable and proportional. Network fees unquestionably <u>are</u> costs incurred by the issuer with respect to debit transactions and, therefore, should be included. Further, while Chase does not believe costs should be limited in this way, network fees clearly are incurred in the authorization, clearance or settlement of a particular debit transaction. Excluding network fees would be wholly inconsistent with the Durbin Amendment's plain language and impose an unfair burden on issuers, as well as acquirers, particularly since networks themselves are not subject to limitations on the fees they can charge.

If, however, issuers cannot include network fees in cost they should be permitted to receive net compensation from networks; alternatively, if the net compensation prohibition remains, the issuer should be allowed to include network fees as a cost. To do otherwise unfairly limits issuers at both ends of the equation by not allowing cost recovery (i.e., increasing net cost) while simultaneously eliminating an opportunity to realize value inherent in their cardholder base since networks are willing to pay for the opportunity to process those cardholders' transactions.

Should interchange fees be limited to authorization cost?

As noted above, Chase believes the Durbin Amendment clearly does not limit what costs can be recovered through interchange fees. But if, despite the Durbin Amendment's plain language, the Board insists on interpreting the statute's directive that it consider certain costs as a requirement to limit interchange to such costs, it is clear from even the most narrow reading of the statute that Congress intended for issuers to recover through interchange those costs associated with "authorization, clearance, or settlement of a particular electronic debit transaction". There is no conceivable argument to impose an even more restrictive limit and allow only authorization costs. Accordingly, Chase concurs with the Board's view that interchange fees should not be limited to just authorization costs.

Should the Board define separate interchange fees for PIN and Signature transactions?

Chase recommends that the Board establish a single fee that applies to both Signature and PIN transactions. Separate PIN and Signature fee structures represent additional systems and operational complexity. A single rate will be less costly to maintain and help issuers reduce overall costs.

Should the Board establish a maximum interchange fee but allow issuers or networks to implement unique transaction based interchange fees that average, in aggregate, to the Board defined fee?

As indicated previously, Chase believes the Durbin Amendment requires the Board to establish standards and not specific fees. If, however, the Board pursues the specified fee approach, defining a fee level and then letting issuers or networks implement transaction specific rates that, for that issuer or network, average to the Board defined fee is not a prudent approach. Chase believes that would add unnecessary complexity and expense to the payment system. In addition, with merchants controlling transaction routing, issuers and networks are unlikely to ever be able to obtain the desired average.

Is the Board's "net compensation" approach appropriate for managing the circumvention and evasion provisions of the statute? In addition, how should signing bonuses paid by networks to issuers be treated?

The Durbin Amendment authorizes the Board to prescribe regulations to prevent circumvention or evasion of the interchange fee restrictions. The Board has proposed that circumvention or evasion occurs if compensation related to debit transactions provided by a network to an issuer, such as per-transaction rebates, incentives and payments, exceeds the total amount of fees paid by the issuer to the network related to debit transactions during that calendar year.

Chase concurs with the Board that circumvention or evasion must be assessed on a case by case basis. Financial arrangements between issuers and networks vary and can involve compensation for activities unrelated to processing debit transactions, such as developing new payment services. Accordingly, there are many situations where net compensation from a network to an issuer will be appropriate and justified, and should not be prohibited. Any Board prohibition of net compensation should be narrowly tailored to compensation for processing debit transactions and allow for suitable discretion to determine whether a particular compensation arrangement is, in fact, related to debit transaction processing. In addition, any limitation on net compensation from a network to an issuer should explicitly exclude payments related to contracts executed prior to the effective date of the final regulation, even if those payments related to processing debit transactions. Issuers made business decisions related to card reissuance, routing and branding based on the terms of existing contracts. These issuers, who clearly had no intent to circumvent or evade a regulation that does not yet exist, would be significantly and unjustifiably harmed if they could not realize the expected benefits over the remaining life of existing contracts.

As the Proposal noted, networks may offer signing bonuses to attract new issuers, assist issuers who may incur an early termination penalty with an existing network, assist issuers with technical transition costs or motivate existing issuers to renew contracts. Chase agrees with the Board that such bonuses do not circumvent or evade the interchange transaction fee restrictions because they do not compensate issuers for electronic debit transactions that have been processed over the network. The final regulation should provide explicitly that there is no limitation on signing bonuses.

As noted above, if issuers cannot include network fees in permissible cost they should be permitted to receive net compensation from networks; alternatively, if the net compensation prohibition remains, the issuer should be able to include network fees as a cost when determining whether an interchange fee is reasonable and proportional. To do otherwise would unfairly preclude issuers from recovering cost while simultaneously eliminating an opportunity to realize value inherent in their cardholder base.

Should business debit cards be subject to the final regulation?

Chase believes the Durbin Amendment does not apply to business debit cards and, therefore, that the Board should clarify in the final regulation that they are excluded. While the Durbin Amendment's definition of "debit card" notes parenthetically that the purpose for which the asset account the card debits is not relevant (see EFTA Sec. 920(c)(2)(A)), the EFTA itself applies only to accounts established primarily for personal, family or household purposes (see EFTA Sec. 903(2)). Since business asset accounts and their associated debit cards are not subject to the EFTA and it is not clear what the referenced statutory parenthetical means or how it was intended to apply to the rest of EFTA, Chase believes the final regulation should exclude business debit cards.

Should the Board establish a consistent certification and reporting process for exempting small issuers from the interchange fee provisions?

Chase recommends the Board not establish a specific certification process for issuers claiming the small bank exemption but instead define the reporting and certification timeframes and the specific requirements the issuers must satisfy to qualify for the exemption. With these parameters clearly defined, the respective networks can establish processes and schedules that are workable for the networks and their participating small bank issuers. Each issuer's primary regulator would then assess compliance in the ordinary course of its oversight.

Should the Board establish the process, reporting and timeframes for certifying exempt government administered programs?

Chase recommends the Board not establish a specific certification process for government-administered programs but instead define the certification criteria and the specific requirements a government program must satisfy to qualify for the exemption. With these parameters clearly defined, the respective networks can establish processes and schedules that are workable for the networks and their participating governmental program issuers.

Chase further recommends that certification for a government-administered program occur at program inception, or within a reasonable timeframe after the final regulation becomes effective for programs already established as of that date, and that, generally, there not be a periodic recertification process. Since these programs are ongoing and generally stable, periodic recertification would create an unnecessary burden and expense with little benefit. The Board, however, should specify program change characteristics that would trigger a recertification. Each issuer's primary regulator would assess compliance in the ordinary course of its oversight.

Should the Board define specific process, reporting and timeframes for certifying an exempt prepaid program?

Chase recommends the Board not establish a specific certification process for exempt prepaid programs but instead define the reporting and certification timeframes and the specific requirements the issuers must satisfy to qualify for the exemption. With these parameters clearly defined, the respective networks can establish processes and schedules that are workable for the networks and their participating exempt prepaid program issuers. Each issuer's primary regulator would assess compliance in the ordinary course of its oversight.

Chase believes that if the final regulation requires issuer-specific interchange fees and adopts an approach similar to Alternative 1 (although, again, Chase believes Alternative 2 would be better), it is reasonable to require issuers with costs above the safe harbor to report their costs to the network. However, Chase does not believe the Board should prescribe the deadline for issuers to report. Rather, the Board should define the minimum frequency that an eligible issuer should report (e.g., not less than annually), but not the actual deadlines. The networks should be allowed to define the schedule upon which they will accept issuer-specific interchange fee changes and make the necessary system updates.

Chase agrees that issuers should not be required to provide cost reporting to any network it uses that does not support issuer-specific interchange fees.

Chase believes that using 2009 data as the baseline for interchange calculation is reasonable.

Should ATM transactions and networks be subject to Regulation II?

Chase recommends that ATM transactions and networks be excluded explicitly from the final regulation. The Durbin Amendment clearly was intended to address debit card purchases. Extending Regulation II to include ATM transactions and networks would exceed the statute's scope and including them would be harmful to the industry. Price fixing disrupts the marketplace and will result in reductions in availability of the service, reduction in overall services provided and a stifling of innovation.

Should Three Party Systems be subject to Regulation II?

Chase concurs with the Board's assessment that applying the interchange fee restriction and the network exclusivity/routing rules to Three Party Systems would be difficult and disruptive. Including Three Party Systems within the final regulation's scope would impair the financial viability of these systems and likely would result in reduced or eliminated investment. This would limit innovation in this space and deprive consumers of new payment services and benefits.

From a practical implementation perspective, including these systems does not make sense in two respects:

1. Three Party Systems do not currently support the concept of interchange. To comply with the Proposal, these systems would need to implement infrastructure that arbitrarily forces compliance. Doing so would add unnecessary complexity to these systems, increasing their overall cost. This increase in cost would then equate to higher fees for merchants and/or cardholders, or a reduction in services.

2. Three Party Systems, by definition, operate on a single network. Requiring these systems to support alternate network routing options is contrary to the basic construction of these systems. Members of a Three Party System participate by choice and, therefore, do not need alternate routing options. In addition, forcing multiple

network choices would, again, raise the complexity and cost of these systems, resulting in higher fees and/or reduction in services.

Accordingly, Chase recommends the Board explicitly exclude Three Party Systems from the final regulation.

Non-traditional or emerging payment systems

To help avoid inadvertently inhibiting payment system innovation, Chase recommends that the Board exclude non-traditional or emerging payment systems from the definition of the "payment card network" and from the proposed interchange fee, routing and network exclusivity provisions. The payment system, like the broader U.S. economy, depends on continuous innovation and needs constant investment to develop the next generation of payment services. By subjecting non-traditional and emerging payment systems, including those that do not yet exist, to Regulation II, the Board would be unnecessarily burdening payment solutions that can benefit consumers, merchants and the U.S. economy overall. Applying the proposed rules to emerging payments and new payment devices will significantly impair or eliminate debit payment system and payment system device technology innovation in the U.S.

New and emerging payment methods require explicit effort and investment from the merchant. For example, merchants must accept new codes (e.g., mobile text payments), new point-of-sale hardware (e.g., contactless payments), and new online payment methods (e.g., online payments based on emails and other aliases such as PayPal). Merchants that adopt these new payment acceptance forms do so because they identify a net benefit after paying interchange rates set by market competition.

Therefore, only payments completed via the traditional debit cards should be subject to interchange and network exclusivity limitations. All other payment options should be exempt regardless of which entity (e.g., an emerging payment systems provider or an established issuer) issues the payment code or device and then processes them to debit an asset account.

For purposes of the Board's future collection of cost data, is March 31 of the reporting year a reasonable deadline?

Chase believes that it is reasonable to require issuers to provide prior year cost data by March 31st of a reporting year.

All prepaid cards should be exempt from Regulation II

The Board posed a variety of questions regarding potential differences between prepaid products and debit cards. Chase believes there are fundamental differences between the two. Any final regulation that does not recognize and account for these differences will cause issuer compliance costs to increase significantly, resulting in either a higher price to the consumer or issuers choosing to exit the product offering, reducing competition and consumer choice. Chase offers the following specific comments:

1. The Proposal acknowledges that prepaid cards have an inherently higher cost structure. Prepaid cards use standalone components with lower economies of scale, the costs of these standalone and specialized components are fully allocated to prepaid cards, outsourcing is very common and third party processors appropriately pass along their fixed costs in the variable pricing to the issuer. Given this higher underlying cost, it would be prudent for the Board to exempt all prepaid cards from the proposed interchange fee provisions. However, in the event that the Board does not exempt all prepaid cards it should implement a different, higher interchange fee for non-exempt prepaid cards.

2. Chase also recommends that the Board exclude prepaid products from the network exclusivity provision, including government benefit cards for programs that do not permit cash access, health benefit cards, rebate cards and gift cards. Many prepaid products are Signature only to mitigate fraud risk and prevent cash access. Preventing cash access is vital to many targeted use prepaid programs (e.g., food stamps, qualified medical expenses). Since debit networks cannot restrict cash access at the point of sale, requiring PIN debit network participation would open up this capability. For many health benefit cards, PIN networks do not support the delivery of regulatory required healthcare data with the transaction. Healthcare cards, including certain healthcare flexible spending account and Heath Savings Account cards, are, therefore, Signature only. Adding PIN network access to these card programs also would impose significant cost and customer inconvenience. Many Signature only cards are single load products (e.g., gift cards, rebate cards) where it is impractical to require the recipient to define and remember a PIN.

3. Although the Proposal appears to exclude healthcare benefit cards, such as those associated with Health Savings Accounts and healthcare Flexible Spending Accounts, Chase recommends that the Board clarify this point in the final regulation.

It is important to note that PIN network costs for Signature only prepaid products were not included in the costs originally submitted in response to the Board's issuer cost survey as they are not current costs. If the Board insists on requiring additional network participation for these products, the Board should increase the proposed interchange fee to include these additional costs.

F. Conclusion

Finally, in addition to the significant inconsistencies with the Durbin Amendment and likely negative consequences to consumers, small businesses, the payment system and the U.S. economy discussed above, the Proposal simply is contrary to many longstanding Board public policy imperatives:

Promoting Efficient Payment Systems. Debit card usage will be restricted due to changes the banks must make to cover expenses. This will reduce debit transaction volume, shifting it to cash and checks.

Reducing the Unbanked Population. The total volume of unbanked customers will rise as customers are pushed out of the banking system by higher banking fees.

Facilitating Economic Growth. To avoid losses, issuers will limit debit card usage, either by transaction size or merchant category. This will reduce sales at selective merchant categories or channels, undercutting merchant sales growth and the overall growth of the U.S. economy.

Encouraging Innovative Payment Systems. In an effort to reduce costs, banks will significantly reduce investment in payment system innovation.

Encouraging Free and Open Markets. Price controls directly conflict with the principles of a free and open market philosophy by reducing competition and, ultimately, the choices available to consumers.

JPMorgan Chase & Co. appreciates the opportunity to comment on the Regulation II Proposal. We urge the Board to issue a final regulation that is consistent with the Durbin Amendment's plain meaning, corrects the Proposal's fundamental flaws and strives to avoid the significant negative consequences the Proposal otherwise would cause. If you would like to discuss any of our comments in more detail, please contact Michael Lipsitz at (312) 732-4223.

Very truly yours,

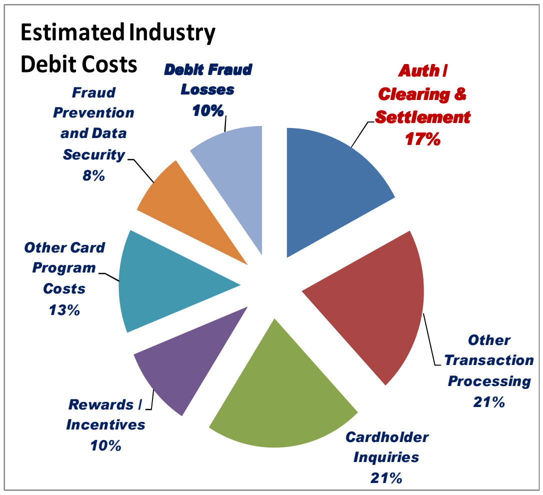
Ryan W McInerney

Ryan M. McInerney
Chief Executive Officer, Consumer Banking

Appendix 1

Estimated Industry Costs to Support Debit Cards

Based on the data the Board itself recently collected, the proposed rules would fix interchange to only 17% of the issuer's actual cost of a debit card transaction.



Sources: Industry estimated costs

WHAT WAS INCLUDED:	17%

- Variable cost of authorizing transactions
- Variable cost of clearing transactions
- Variable cost of settling transactions

WHAT WAS EXCLUDED:	83%

Other Transaction Processing Costs:	21%

- Fixed costs for Auth, Clearing and Settlement
- System maintenance and upgrades for Auth, Clearing and Settlement
- Cardholder account posting
- Chargeback and error processing
- Network transaction processing fees

Cardholder Inquiries:	21%

- Call center technology
- Call center personnel
- Back office servicing operational support

Rewards/Incentives:	10%

- Operational and systems/processing
- Rewards/Incentive value

Other Card Program Costs:	13%

- Card production and delivery
- Research and development (i.e., innovation)
- Nonsufficient funds handling
- Compliance
- Debit program administration

Fraud Prevention and Data Security	8%

- Fraud prevention, identification and administration
- Data security policy, technology and administration
- Research and development (i.e., innovation)

Fraud Losses:	10%

- Zero liability support
- Losses on fraudulent transactions

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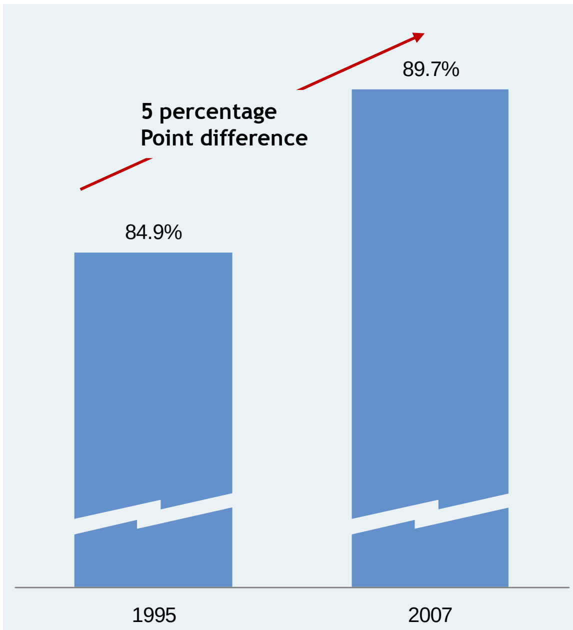
Appendix 2

Consumers Exiting the Banking System

Percent of U.S. families with a checking account



Source: Federal Reserve Survey of Consumer Finance

Impact on consumers

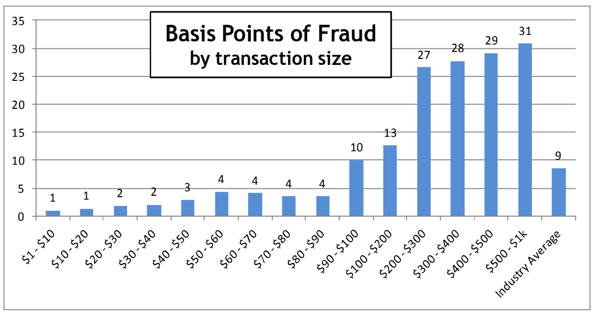
- Since "free checking" became widely available an additional 5% of US families have entered banking system
- If unable to qualify for free checking in the future these families may go unbanked
- Chase's recent experience confirms that the impact will be meaningful:
  - ~15% of customers are in less affluent households who will no longer qualify for free checking
  - Based on current attrition rates, we expect 50% to 60% of these customers to leave Chase within the next year
  - If half of these customers leave the banking system = 5% +/- of customers becoming unbanked

Appendix 3

Fraud Costs vs. Transaction Size and Merchant

In 2009 the industry incurred approximately $1.4 billion in actual fraud losses related to debit card transactions, but will not be able to recover any of these costs under new fixed interchange fees.

Fraud rates vary significantly with transaction size, therefore at a fixed rate of cost recovery, issuers may have to impose transaction limits



Source: Chase experience data

- At $.07 of cost recovery and industry average fraud rates at 8.5bps, fraud costs alone would be equal to interchange received for transactions over $80 ($.07/.00085 bps of Fraud =~$80)
- 15% of Chase debit transactions are greater than $80

When you look at specific merchants, the authorization restrictions may be more extensive…

Merchant	Average Transaction Size	Fraud Rate per Transaction (vs. $.07 FRB cost recovery)	Breakeven Transaction Size Based on Fixed Rate Recovery	% of Chase Sales At Retailer Impacted
Top 5 Discount Retailer - 1	$51	$.10	$35	80%
Top 5 Discount Retailer - 2	$46	$.16	$20	92%
Top 5 Electronics Retailer	$94	$.25	$25	93%
Top 5 Pharmacy Retailer	$23	$.05	$30	57%
Top 5 Grocery Chain	$38	$.06	$45	62%

Source: Chase experience data - Transaction Cap = fixed rate of cost recovery ($.07) / actual merchant fraud rate (bps)

- **Likely outcomes include:**
  - Merchant specific limits – hurting merchant sales volume
  - Elimination of merchant guaranteed payment - increasing bad transaction costs for merchant
  - Charging fees to customers for debit transactions over certain dollar thresholds or at specific merchants

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