CHASE

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Via Email: regs.comments@federalreserve.gov

September 30, 2011

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

RE: Regulation II Interim Final Rule – Fraud-Prevention Adjustment: Docket No. R-1404 and RIN No. 7100 AD 63

Dear Ms. Johnson:

The Board of Governors of the Federal Reserve System (the "Board") has requested comment on its interim final rule setting forth Regulation II's fraud-prevention adjustment provisions (the "Interim Final Rule"). JPMorgan Chase & Co., on behalf of JPMorgan Chase Bank, N.A., a major debit card issuer, Chase Paymentech Solutions, LLC, a major card acquirer, and its other subsidiaries, appreciates the opportunity to submit this response.

JPMorgan Chase & Co. (NYSE: JPM) ("Chase") 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, small business and commercial banking, merchant acquiring, financial transaction processing, asset management and private equity. A component of the Dow Jones Industrial Average, JPMorgan Chase & Co. serves millions of consumers in the United States and many of the world's most prominent corporate, institutional and government clients under its J.P. Morgan and Chase brands. Information about JPMorgan Chase & Co. is available at www.jpmorganchase.com.

A. Executive Summary

Chase supports the Interim Final Rule's non-prescriptive fraud-prevention adjustment model. A non-prescriptive approach best serves the debit card payment system by allowing issuers to implement fraud-prevention policies and strategies that meet their unique needs. In addition, a non-prescriptive approach fosters a robust yet diverse debit network that reduces the potential for industry-wide vulnerabilities, benefitting all payment system participants.

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. Domestic debit card transactions have grown over the past decade from 8 billion in 2000 to 38 billion in 2009 (Nilson Reports 865 (September 2006) and 961 (September 2010)). Given the key role debit cards play in the U.S. payment system, it is important that the debit card industry maintain a vibrant, flexible and efficient fraud-prevention infrastructure.

However, while Chase supports the Interim Final Rule's general framework, we believe the amount of the fraud-prevention adjustment should be increased to cover a greater percentage of actual fraud-prevention costs issuers incur. We recommend that the Board conduct a new cost study of issuer fraud-prevention expenses, taking into account several categories of current costs not included in the 2010 survey and costs that might be reasonably anticipated in the near future. A higher fraud-prevention adjustment will promote continued investment in fraud-prevention capabilities and help ensure stability of this important payment system.

B. Discussion

Fraud-Prevention Adjustment Model: Chase supports the Board's interim fraud-prevention adjustment model and recommends that this model continue.

Non-Prescriptive is Preferable: The non-prescriptive model is far superior to the technology-specific approach. A non-prescriptive approach affords issuers the flexibility to implement fraud-prevention policies and procedures that meet their business needs, considering their respective technical and operational environments and unique customer segments. In addition, the non-prescriptive approach promotes fraud-prevention system diversity across the industry, which helps ensure the integrity and stability of the entire debit card payment system by reducing the risk of industry-wide security vulnerabilities. The non-prescriptive model helps ensure that fraud compromises are isolated to specific points within the payment system.

Issuer Standards are Appropriate: The issuer standards set forth in Regulation II Section 235.4(b) are reasonable and appropriate as written. They provide clear direction as to what is required, while enabling issuers to customize fraud-prevention strategies.

The Fraud-Prevention Adjustment Should Apply to All Transactions: The Interim Final Rule appropriately applies the fraud-prevention adjustment to all transactions (PIN and Signature). With only 25% of merchant locations accepting PINs and many merchant segments unable to accept PINs (e.g., internet and telephone merchants), Signature transactions will continue to be a significant portion of the transactions processed through the debit card payment system well into the future. Given this reality, issuers should continue to invest heavily in Signature transaction fraud-prevention. Providing issuers with a fraud-prevention adjustment for all transactions will motivate continued fraud-prevention investment with respect to all debit activity.

Conversely, a PIN-only model would negatively impact the overall debit payment system by prompting issuers to discourage Signature transactions, adversely affecting the internet and other card-not-present segments of the U.S. economy.

Fraud-Prevention Adjustment Amount: While Chase supports the Interim Final Rule's fraud-prevention adjustment approach, Chase believes the defined fraud-prevention adjustment amount of $0.01 per transaction should be increased to cover a greater percentage of, if not all, fraud-prevention costs. Chase recommends that the Board conduct a separate fraud-prevention cost survey that captures a broader array of issuers' actual fraud-prevention costs and, thereafter, establish a higher fraud-prevention adjustment amount more reflective of these actual costs.

Conduct Additional Fraud-Prevention Cost Study: Chase recommends that the Board conduct a fraud-prevention cost study to comprehensively inventory issuer costs incurred in preventing fraud. This cost study should include the fraud-prevention costs identified in the Board's 2010 cost study as well as costs related to:

- adopting and using new fraud-prevention technology and systems
- plastic card fraud prevention technology
- data security/protection
- customer inquiries about fraudulent activity

Going forward, we recommend the Board include the full spectrum of fraud-prevention expenses in its planned biannual cost survey to help ensure these expenses are more fully understood, and reflected in the adjustment amount, as they evolve over time.

Unintended Consequences: If the fraud-prevention amount is not increased to reflect the costs outlined above, the Interim Final Rule will under-compensate issuers for fraud-prevention activities, which may result in several adverse unintended consequences:

- **Development of innovative new fraud-prevention capabilities could be hampered.** When new fraud-prevention capabilities are first conceived, issuers do not know how they will perform in practice. Therefore, if issuers cannot recover more of their actual development cost, they will be less inclined to make new technology investments given the uncertain return. Conversely, a fraud-prevention adjustment amount that more fully reimburses issuers will incent greater investment in new fraud-prevention capabilities.

- **Issuers may implement more restrictive authorization policies, impacting customers and merchants.** To the extent the fraud-prevention adjustment does not cover the full cost of preventing fraud, issuers may seek to reduce costs by developing and implementing less complex and less costly authorization models. These more simple models likely will accept less risk in authorizing debit card transactions, resulting in more declined transactions and negatively impacting merchants and customers in the process.

- **Debit card services may be reduced and/or fees increased, negatively impacting consumers.** Faced with reduced reimbursement for actual fraud-prevention costs, issuers may seek to control costs and/or increase revenue by reducing services, raising existing fees or implementing new fees.

We respectfully encourage the Board to use the fraud-prevention adjustment as a tool to promote continuous investment in fraud-prevention capabilities, which will benefit all debit card payment system participants. Ensuring issuers can recover most, if not all, of their investment in fraud-prevention tools will go a long way toward this end.

C. Other Comments

More Specific Definition of Fraud: Chase agrees with the Board that fraud methods are ever-changing and, therefore, must be evaluated on a case-by-case basis. To this end, Chase recommends that the Board not establish a specific definition of fraud. Debit payment technology and fraud schemes both are evolving very rapidly and a specific fraud definition would require constant modification to avoid becoming outdated.

Periodic Review of Activities Incenting Authorization Method: The Board requested comment on whether it should require issuers to periodically assess whether their respective rewards or other programs incent use of authorization methods that are less effective in preventing fraud. Chase recommends that the Board not implement such a rule. Since Section 920 of the Electronic Fund Transfer Act established interchange rate limitations that apply across all authorization methods, issuers have no incentive to encourage any one type of authorization. Requiring issuers to conduct a periodic review would create unnecessary operational costs and administrative burden with no clear benefit.

Define Certification Procedures: The Board requested comment on whether it should define a specific issuer certification process. Chase recommends that the Board not define a specific process or reporting requirement and retain the approach adopted in the Interim Final Rule. Each issuer's fraud-prevention environment is unique and a Board-defined certification process might be difficult for all issuers to employ uniformly. Regulation II Section 235.4 (b) sets forth clear standards for issuers to develop their own certification processes based on their detailed knowledge of their particular fraud-prevention environment, which their respective regulators then can review during examinations.

Thank you again for the opportunity to comment. If you have any questions about the foregoing please contact Michael Lipsitz at 312-732-4223.

Very truly yours,

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