BASEL III - THE LIQUIDITY RULES AND REGULATIONS

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JPMC fully supports the Committee's objectives of strengthening global liquidity standards

- Thresholds for liquidity requirements prior to the economic crisis were too low
  - We believe this was one key cause of the crisis
- Higher, proper liquidity requirements for financial institutions are one of the most important changes that should result from financial regulatory reform
  - Objective should be to ensure financial institutions are prepared to operate effectively in stressed environments
- This has always been an objective that was paramount to JPMC's liquidity management approach
  - Ability to maintain surplus levels of liquidity through economic cycles is crucial
  - Funding strategies must ensure liquidity and diversity of funding sources to meet actual and contingent liabilities in all cycles
  - JPMC has rigorously managed its liquidity profile and disclosed its excess liquidity on a quarterly basis
- Proposed mechanical framework for Liquidity Coverage Ratio ("LCR") is strong, very similar to the approach JPMC currently utilizes in assessing the adequacy of its liquidity profile

However, stronger standards must be calibrated properly and logically to avoid adverse consequences to the market and consumers

- Appropriate calibrations and assumptions are critical to achieving the goal of strengthening the liquidity of financial institutions
- Setting requirements incorrectly can:
  - Impede economic growth
  - Negatively impact both retail and wholesale bank customers
  - Direct traditional banking activities away from regulated financial institutions, into market sectors that are less regulated
  - Increase reliance on central banks
- JPMC has suggested several enhancements to the current LCR calibrations that we believe are more consistent with historical market behavior, including that experienced during the most recent financial crisis
  - We believe these enhancements are appropriate and will help mitigate the risk of adverse consequences

Summary of proposed enhancements

- The LCR rules, as written, require banks to manage liquidity in a resolution based scenario
  - All worst case liquidity outflows occur simultaneously within 30 days to a financial institution
- Liquid asset buffer eligibility and liquidity outflow assumptions are inconsistent with historical market behavior (including that experienced during the recent financial crisis)
  - Liquid Asset Buffer
    - Certain asset classes should be at least partially included in the liquid asset buffer based on liquidity characteristics throughout economic cycles
    - Examples include Gold, US Agencies / Agency MBS, Munis and Equities
  - Liquidity Outflow Factors
    - Historical data and bank experience suggest LCR factors for certain outflow categories are too aggressively calibrated
    - Examples include Correspondent bank deposits, non-operational deposits, undrawn commitments, and certain secured financing transactions
- Level 2 Cap is not necessary if liquid asset buffer calibration is appropriate
  - Appropriate factors (i.e., haircuts) already make “liquidity value” consistent across asset classes
- Unencumbered trading hedges
  - Derivatives and securities purchased as hedges of market risk are considered encumbered despite the ability to be monetized
- The LCR rules should not entirely discount the role of Central Banks during a market stress environment

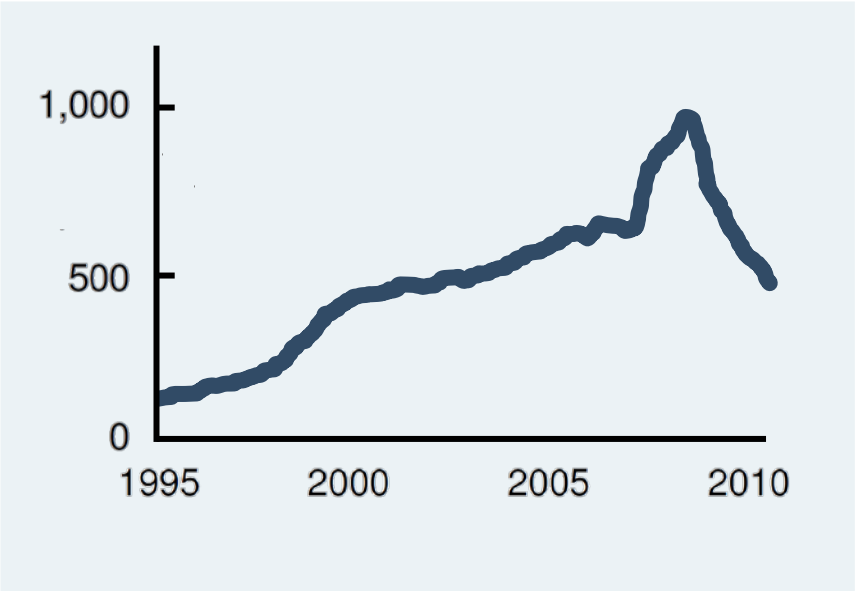
Liquid Asset Buffer

	Current LCR Rules	JPMC View – Liquid Asset Buffer should recognize as:
FHLB Capacity	0%	■ A source of liquidity during the crisis by 1st loss / equity owners
Gold	0%	■ Flight-to-quality asset; strong bid for gold during recent crisis
US Agency / Agency MBS	85%	■ Behaving similarly to treasuries, which are included at 100%
Investment Grade Munis	0%	■ Demonstrating, on average, better liquidity during the crisis than US corporate bonds
AAA ABS	0%	■ Behaving similarly to covered bonds, which are included in the liquid asset buffer
Listed Equities	0%	■ A liquid market that exists in all environments for most stocks ■ Daily pricing and transparency

Liquid Asset Buffer: FHLB

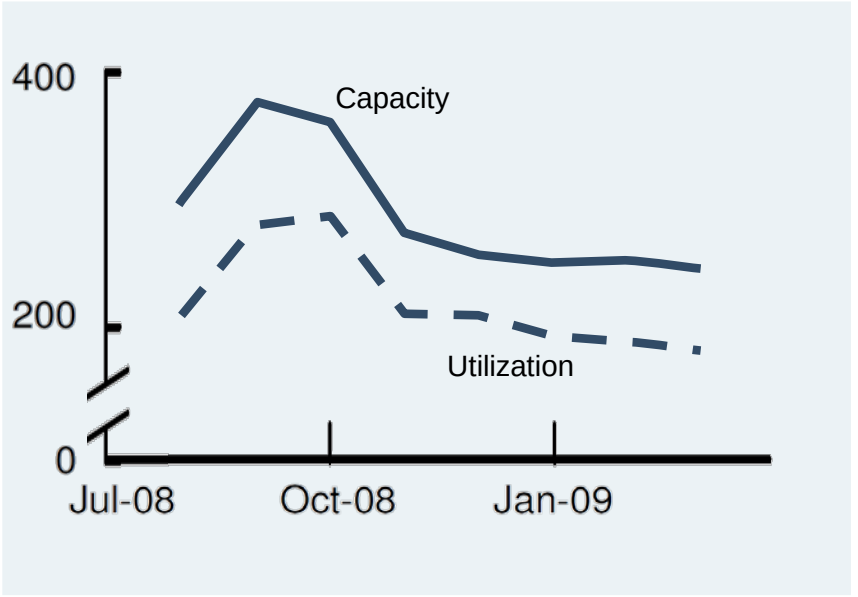
Banks drew on FHLB capacity during the crisis

Quarterly FHLB advances 1995–2010 ($B)



- FHLB continued to provide liquidity even during the crisis

FHLB capacity and utilization ($B), TCH members



- Capacity and utilization increased during the crisis while excess capacity remained relatively constant

Source: Fed Flow of Funds; The Clearing House LLC member banks' supplemental data

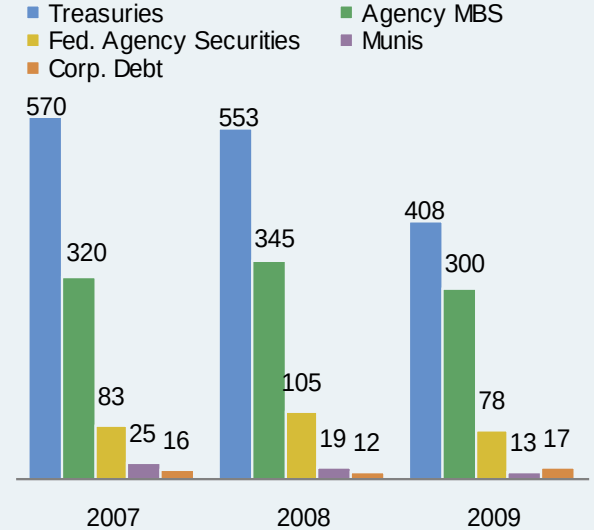
Liquid Asset Buffer: Other asset classes

Gold:
Price of Gold vs. S&P index

Source: FactSet

- Gold is considered a flight-to-quality asset. Strong bid usually occurs during a crisis
  - During the last crisis, Gold appreciated by ~35% between 3Q07 and 1Q09
- Gold is a deep and liquid market According to the WGC (World Gold Council) at YE 2009:
  - Total value of the gold market was estimated at $5.2T+
  - ~$1.8T is thought to be in the hands of private investors and official institutions
  - Avg. daily turnover in the gold market is ~$100B

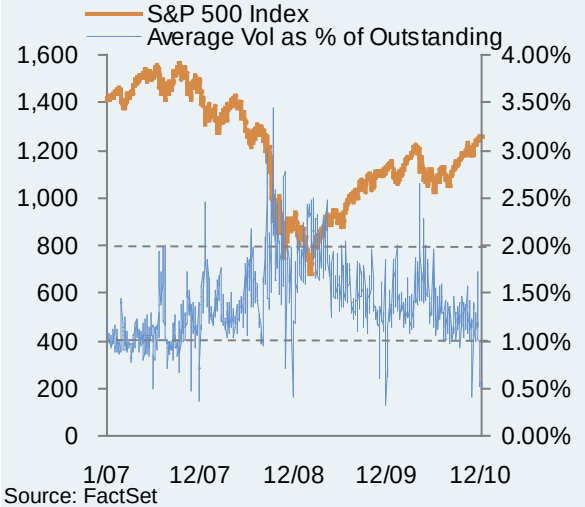
Agency / Agency MBS & Munis:
US bond market avg. trading volume ($B)



Source: SIFMA

- Agency MBS: large, highly liquid market (around $300B+ of agency MBS trades each day) that maintained liquidity throughout the recent crisis
- Munis: even though munis trading volumes dropped during crisis (from ~$23-25B average daily trading volumes in 2006/07), trading volumes remained sizeable ($13-19B daily trading volumes from 2008/10; ~$3T munis outstanding) and higher in comparison to US corporate bonds ($12-16B daily trading volumes from 2008-10)

Listed Equities:
Avg. trading vol. as a % of outstanding



Source: FactSet
Note: Low points are typically due to seasonal events (e.g. the day before Christmas)

- Most stocks maintained very high liquidity during the crisis
- Diversified equity positions tend to hold their value even during major crises
- Equity financing is available in times of distress
  - Futures markets – which are a form of equity financing – showed increased activity during the crisis
  - The tri-party repo market remained sizeable and fluid during the recent crisis

Liquidity Outflow Factors

	Current LCR Rules	JPMC View
Correspondent Bank Deposits	100% / 75% FI / Non-FI	■ Deposits have similar characteristics to operational deposits and are typically operationally complex and logistically difficult to move within 30 days
Non-Operational Deposits (excl. govts)	100% / 75% FI / Non-FI	■ During the recent crisis the worst 30-day non-operational deposit run-off was well below 50%[1] for both FIs and Non-FIs (excluding governments)
Liquidity Commitment Drawdowns	100%	■ During the recent crisis the worst 30-day liquidity drawdowns were below 10%[1] ■ Current LCR rules do not provide any benefit to banks for liquidity lines available to them from other banks ■ Draws tend to be driven by the liquidity needs of the client as opposed to in reaction to an idiosyncratic event of the liquidity or credit providers ■ Current LCR factor covers a range of situations and a standardized 100% run-off factor across all types of commitments might lead to an overly aggressive calibration
■ **Non-FI, synd.**	NA	
■ **Non-FI, non-syndicated**	NA	
■ **FI, syndicated**	NA	
■ **FI, non-synd.**	NA	
Dollar Roll	Treated similar to repos	■ Liquidity of this funding market and other evidence suggests that this source of funding continuously "rolls"

[1] Source: Study conducted by McKinsey and Company on behalf of The Clearing House LLC based on 10 U.S. based banks representing ~55% of total U.S. banking assets

Liquidity Outflow Factors: Wholesale Deposits

- The operational factors appear reasonable to slightly conservative given historical experience
  - During any 30-day period (I.e., monthly) of the crisis, regardless of deposit source, no survey participant experienced an operational deposit outflow greater than 23%, and the median outflow was 13% compared to the LCR factor of 25%
- The non-financial & financial non-operational factors appear overly conservative given historical experience
  - During any 30-day period of the crisis, no survey participant experienced a non-operational deposit outflow …
    - … from non-financial depositors greater than 41%, and the median outflow was 10% as compared to the LCR factor of 75%
    - …from a financial depositors greater than 38%, and the median outflow was 8% as compared to the LCR factor of 100%

Wholesale deposits: LCR factors vs. crisis experience

			Worst 30-day runoff for	
		LCR factor	…any survey participant[1]	…the median survey participant[1]
Operational wholesale deposits	Non-financial	25%	16%	11%
	Financial	25%	23%	13%
	Government	25%	15%	5%
Non-operational wholesale deposits	Non-financial	75%	41%	10%
	Financial	100%	38%	8%
	Government	75%	60%	11%

[1] The Clearing House LLC survey participants represented ~30% of financial and ~45% of non-financial wholesale deposit balances overall. Peak 30-day deposit outflows were tracked in FY 2008 and 2009

Source: Study conducted by McKinsey and Company on behalf of The Clearing House LLC based on 10 U.S. based banks representing ~55% of total U.S. banking assets

Liquidity Outflow Factors: Credit & Liquidity Lines

- The credit line factors appear reasonable given historic experience
  - During any 30-day period of the crisis, regardless of client type source, no survey participant experienced a draw down greater than 10%, and the median outflow was 2% equal to the LCR factor of 10%
- The liquidity line factors appear overly conservative given historic experience
  - During any 30-day period of the crisis, no survey participant experienced a liquidity line draw down …
    - … from financial clients greater than 9%, and the median outflow was 3% as compared to the LCR factor of 100%.
    - …from a all other clients greater than 10%, and the median outflow was 2% as compared to the LCR factor of 100%

Credit and liquidity lines: LCR factors vs. crisis experience

			Worst 30-day runoff for	
		LCR factor	…any survey participant[1]	…the median survey participant[1]
Credit lines	Non-financial corporates	10%[2]	10%	2%
	Retail clients	5%	4%	4%
Liquidity lines	Financial clients	100%	9%	3%
	All other liquidity lines	100%	10%	2%

[1] The Clearing House LLC survey participants represented ~30% of financial and ~45% of non-financial wholesale deposit balances overall. Peak 30-day deposit outflows were tracked in FY 2008 and 2009

[2] LCR factor for non-financial corporates is 10%; for SME's, it is 5%

Source: Study conducted by McKinsey and Company on behalf of The Clearing House LLC based on 10 U.S. based banks representing ~55% of total U.S. banking assets

Potential consequences of current LCR rules

Potential impact of LCR mis-calibration

Liquid Asset Buffer

- Higher issuance costs and ongoing financing for corporate and municipal bonds
- Contraction of CP and ABCP markets due to lack of liquidity support
- Reduction in mortgage availability and increased costs
- Knock-on impact on how banks manage their interest rate risk

Net Outflows

- Higher costs and reduced availability of commitments for clients
- Increased costs of funding for banks of all sizes
- Narrower, more restrictive set of products
- Increased near-term reliance on central banks
- Potential movements of liquidity outside of the regulated banking system

Wrap-up

- Stronger liquidity standards for banks are necessary
- The mechanics of the LCR calculation provide an effective framework for introducing a shorter-term liquidity metric
- Appropriate calibration is necessary to ensure a meaningful measure and prevent adverse consequences
- Enhancements to both the Liquid Asset Buffer and Liquidity Outflow factors should be considered to appropriately reflect the correct liquidity behavior of assets and liabilities
- While we recognize banks benefited from government support during the crisis, some calibrations are still overly conservative
  - Clarity is required on what economic scenario the LCR is meant to cover