Steven B. Groppi
Senior Vice President

13 February 2004

European Commission
Directorate General Internal Market, C107 01/04,
B – 1049 Brussels.

Dear Sir/ Madam,

Re: **JPMORGAN CHASE RESPONSE TO THE: -**
COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT CONCERNING A NEW LEGAL FRAMEWORK FOR PAYMENTS IN THE INTERNAL MARKET

JPMorgan is a leading payments bank globally. Within the current and soon to be enlarged EU, our business brings a unique perspective in managing payments across borders. Internally, we operate common platforms and services across Europe, offering our clients direct or indirect access to manage their payment activity across 23 countries. A measure of the significance of this business is that J.P.Morgan AG is, by value. the 2nd largest clearer in RTGSplus, arguably the largest euro RTGS, and 7th by volume.

For several years we have focused on providing the largest corporations, government agencies and financial institutions with pan european cash management solutions, positioning us with a deep and broad insight into the needs for, and challenges of the Single Euro Payments Area (SEPA). In addition JPMorgan is the number one bank in the US FED, CHIPS and ACH systems providing an in-depth experience in continent wide payment solutions. JPMorgan has been heavily involved with the development of SEPA through our activity in various banking forums and clearing associations, as well as research and education activity with our clients. We therefore welcome the opportunity to comment on the New Legal Framework proposals.

We have reviewed the proposed New Legal Framework from the perspective of our payments operations across the European Union, as well as our global payment practice. We provide the following views based on our past experience, and understanding of practice related to payment services (domestic and cross border) in a variety of domiciles. A further basis for comment is a recent study conducted by JPMC of its corporate clients and their issues and preferences regarding homogeneous, transparent payment services across the European Union. From this effort, and from other sources, it is clear to us that realization of the vision for a Single Euro Payment Area is as important to corporations as it is to consumers. Efficient, accurate, timely, reliable, and secure Euro payment services are an integral part of successful commercial operations in the EuroZone.

We have been pleased to participate in a bank industry response, through APACS. In addition, we provide this comment to you directly, as below, for those issues that we believe could benefit from further emphasis.

JPMorgan Chase Bank • Trinity Tower, 9 Thomas More Street, London, E1W 1YT
Telephone: 020 7777 6601 • Facsimile: 020 7777 5645
steven.groppi@jpmorgan.com

We hope you find this of assistance. Please do not hesitate to contact me if I may be of further assistance, or if any points require clarification. JPMC would welcome the opportunity to further contribute to this process as it evolves.

General Comments

A number of points relevant to the proposals as a whole deserve comment:

Retail versus Wholesale Focus - The proposals focus on retail payments, but are not sufficiently specific to avoid addressing wholesale payments. Businesses and their banking providers have different needs and concerns to retail consumers and their banking providers. While work needs to be done to achieve a Single Euro Payments Area from both retail and wholesale perspectives, we prefer that each subject be given separate, discrete focus. We recommend that the scope of intended application of all rules is made explicit to the retail customer segment, and that the different complex needs of other customer segments be considered separately.

Definition of Retail Based on Participant Type, Not Principal Value of the Payment - We understand the proposals in their current form are intended to apply to any type of non cash/cheque funds transfer for an amount under 50,000 Euros irrespective of the type of customer involved. We prefer a definition of retail payment that recognizes the nature of the client, consumer or business, rather than the principal value of the transaction. We believe this approach would better reflect a retail environment and would avoid regulations being imposed on payments made by businesses, corporations and institutions, where the real aim is to protect consumers. Furthermore, as we have found with the Cross Border Credit Transfers Directive and Regulation, the technical and operational challenges around managing rules based on value mean in some cases we are likely to have to apply the changes to all payments not just to payments below a certain size.

Proposed rules do not clearly define "customer" or "consumer" or "Payment Service User" - Rules defined for a retail relationship, by differentiating on amount, can have unplanned reach. Retail rules may conflict with established and negotiated practice between banks, corporations, government agencies, and transfer agents. The definition of the intended reach of rules must be very clear. The definition of retail customers must be clear and systematically manageable. We believe it would make sense for consumers to be defined in a similar way as in the E-Commerce Directive i.e. as natural persons (being primarily individuals) who are not acting in the course of their business.

Whilst we appreciate that the drafting of proposed legislative changes has been prepared for discussion and illustrative purposes at this stage, it is important not to underestimate the detailed work needed if some of the proposals are to result in the simplification that the Commission are looking for. We are concerned that many of the draft legal provisions would as currently drafted have unintended and far reaching consequences. Also, the relationship between any new legislation and existing legislation was not always clear from the proposals. Any new legislation would need to be carefully integrated with existing laws at EU wide and Member State level to avoid duplication and inconsistency.

Comments by Annex

Annex 2 - Information requirements

Based on our experience of implementing the information requirements in the Cross-Border Credit Transfers Directive and the E-Commerce Directive, we question the value of the additional information requirements envisaged in this Annex for some types of customer (particularly for multinational corporate and institutional customers) when set against the costs and burdens of compliance for payment service providers. With these cases, we found that the amount of useful

information given to customers was minimal whilst the time and cost required to ensure proper compliance with legal requirements was considerable.

If it is thought to be helpful for certain customers such as retail consumers to be given additional information about their payments, we think that there should be flexibility over the way in which payment service providers can make this information available to consumers and that a requirement to incorporate the additional information into legal terms and conditions should be avoided.

Annex 8 - Information on the originator of payment (SRVII of FATF)

We fully support the proposed concept of "domestic" and "international" transfers with the full information regime applying to the latter only.

It is questionable whether the required information is actually available in all instances and whether current clearing systems are all capable of including all the required data. Further, the practicality and implications of including batch transfers within the EU proposal should be carefully considered.

The adoption of a threshold within a single payment environment is not likely to be of any benefit as most banks will not differentiate systematically due to the processing impact.

If the scope of "credit transfers" is not better defined it is likely that member states will find a need to prepare exemption lists reflecting local conditions or existing legislation, such as data protection and privacy. Also, clarification should be made that financial institution to financial institution transfers (SWIFT MT 2XX message types) are outside the scope of the article, in line with SRVII.

We believe that there should be a level playing field amongst the types of financial institution that will be subject to these rules. In particular broker dealers should be required to comply with the rules as well as banks.

Annex 10 - Revocability of a payment order

We have concerns with wording and scope and do not believe that an EU wide rule along the lines being discussed would lead to greater efficiency or clarity for customers. We support the comments of APACS with regard to the need to assess definition for each payment instrument separately, and wish to clarify further the complexity and risks of definition within a payment instrument. We have given further examples below of the factors for credit transfers.

Timing, mechanics and the efficiencies of payment revocation will vary greatly by payment type. Payments that are processed in “real-time” may occur immediately upon instruction. The opportunity for revocation in this situation is minimal.

Account debiting may need further definition if it is to be used. The final record that forms the official records for a client’s statement may be debited after the funds have been transmitted and therefore the paying agent has no assurance of recoverability of funds. Credit to the beneficiary’s account is not appropriate where there is no absolute guarantee of return of funds from all participants in many countries - this will lead to many potential disputes. A reasonable period of time must be provided for a revocation request received in to a service desk to be acted on and to reach the system/operating environment where payments are released. In a high straight through environment, even allowing revocation up to the point of transaction initiation may be insufficient.

For credit transfers that are individually requested by the ordering party, we would appreciate clearer guidance on the specific issues to be addressed by revocability and the period in which service providers must effect revocation. If the primary aim is consumer protection, further

research may be required on the costs of implementing systems to support revocation. Overall a right of refund may reduce industry costs for instance in a fixed period for small amounts, allowing service providers to establish less time critical procedures to recall funds.

Annex 11 - The role of the payment service provider in the case of a customer / merchant - dispute in distance commerce

We believe that the concerns expressed here are only relevant in the context of distance commerce transactions undertaken by consumers (defined, as we have suggested above as being natural persons/individuals not acting in the course of business).

If applied, any provisions should be limited to credit card transactions undertaken by consumers for the purposes of distance commerce. Whilst retail credit card schemes involve arrangements between card suppliers and merchants, banks are not involved in the underlying reasons for their customers making credit transfers. There is therefore no relationship between the payment service providers and their customers' counterparties or suppliers.

Annex 12 - Non-Execution or defective execution

We are strongly opposed to the additional regulation envisaged in this Annex, in part for the reasons stated by Payment Systems Council to the effect that there is an existing body of law on the execution of payments, and there does not appear to be a significant economic or social gap arising from the current legal environment

We would question whether the type of liability being discussed in Annex 12 would enhance the efficient functioning of a Single Euro Payments Area particularly as such an extension of liability would lead to increased costs for payment service providers and ultimately their customers. It is questionable whether these proposals would contribute significantly to there being a level playing field in the Internal Market as liability issues are not in practice used to competitive advantage by payment service providers.

If additional consumer protection is thought to be necessary in these circumstances, any additional protection would need to be carefully targeted to ensure that only retail consumers requiring additional protection would benefit and that the significant costs and burdens of additional liability are not imposed too widely upon the banking community.

We do not think that a general rule on liability for delayed or defective execution should be imposed because the responsibilities and relationships between banks making payments differ depending on the way in which payments are made. For example, in the case of credit or wire transfers, the payment service provider acting for the originator of the payment has no control over or recourse to the bank acting for the beneficiary of the payment or an intermediary bank appointed by the beneficiary or the beneficiary's bank. We therefore do not support any proposals that banks should be held strictly liable for failed or delayed execution, irrespective of whether such failures or delays have resulted from the bank's own errors or negligence, or from the acts or omissions of another bank in the chain over which it has no control and to which it has no recourse.

We note that under the UK implementation of the Cross Border Payments Directive a bank is not obliged to make reimbursements where the delay is due to the acts of other banks not nominated by it e.g. in case of an originator's bank, intermediary or beneficiary banks. Also in the US where there is a statutory payments code for wholesale credit transfers under the US Uniform Commercial Code, the originator's bank is not liable where there has been defective execution on the part of some intermediary banks or any beneficiary banks.

Any compensation by a payment service provider in these circumstances should be limited, at most, to the principal amount of the payment and interest only. Whilst the Commission acknowledges that there is no appetite for banks to be held liable for consequential loss, the draft legal provisions which refer to liability including the amount of the payment order, charges and interest would not be sufficient to exclude consequential loss liability.

We should also like to point out that a force majeure exemption should be sufficiently broadly drafted to exclude matters beyond a payment service provider's control. We note that the definition in the Cross Border Credit Transfers Directive is very narrow and refers to abnormal and unforeseeable circumstances only.

Annex 13 - Obligations and liabilities of the contractual parties related to unauthorised transactions

We are also strongly opposed to additional regulation as envisaged by the draft legal provisions in Annex 13. We believe that these provisions would in practice lead to banks shouldering the burden of losses arising from fraud and hacking, even where there have been security failures at the customer's end. Again if it is considered to be important to extend liability for consumer protection reasons, it is very important that such protection is precisely targeted to cover only a specific category of individual consumers.

We are particularly concerned that if the customer makes a claim that the transaction is unauthorised, the onus shifts to the bank to provide evidence that the transaction was properly authorised. It is difficult to see how the bank can provide evidence that its customer has in fact authorised a payment, particularly as the draft provisions state that the use of a payment instrument or personal code is not of itself sufficient to show that the payment was authorised where the customer provides information "which would allow the presumption that he could not have authorised the payment."

The above provisions are directly contrary to the position often taken in banking documentation whereby a bank can rely on a payment which passes the appropriate security procedures as having been authorised by the customer. Furthermore in other jurisdictions which have similar legislation, such as under the US Uniform Commercial Code Article 4A, a payment order is binding on a customer where the bank executes the order in accordance with mutually agreed, commercially reasonable security procedures. The onus is on the customer to prove that the order was not caused by a person acting on behalf of the customer, the rationale being that there is public benefit in banks being able to rely on their deployment and use of commercially reasonable security procedures.

We do not believe that the obligations imposed upon the customer by the draft provisions adequately apportion risk between the customer and the payment service provider. Nor do they reduce the risk of payment service providers being liable for fraud:
- committed by customers, or
- caused by the failure of the customer to take adequate security measures.

In particular the gross negligence/ fraud standard of liability for customers is very high and would be difficult for payment service providers to establish in practice. Furthermore the 150 Euro limit on a customer's liability for failing to notify the provider of the loss of a payment instrument is very low.

Annex 15 - Execution times for credit transfers

Further progress on transparency can still be made in the pan euro environment, to ensure an urgent payment offering, along side the standard offering, is available to payment service users as in domestic markets. The success of CREDEURO suggests that with focus self regulation is an

appropriate tool. However Credeuro is not sufficient alone. The requirement here is one of options on the certainty of availability of funds to the beneficiary not value dates for interest purposes dealt with in Annex 4.

Annex 16 – Direct Debiting

We would like to restate APACS comments here, encouraging reliance on and assistance to the EPC to further its work in this area.

This is a particularly complex and challenging area. Direct debit services differ considerably on a country by country basis in the EU. Key areas of focus are on:

1) Standards for the initial creditor / debtor authorisations including consistency of parties in the scheme i.e. creditor, debtor, debtor bank; electronic alternatives.
2) Alternatives to lifting fee add back on returned items
3) Definitive reasonable time frames for the return by debtors of unauthorised debits.
4) For all items, the return of all original transaction information
5) Electronic delivery of all related transaction activity.
6) Provision of more accurate return reason codes to better enable creditors to determine next appropriate action i.e. re-presentment for insufficient funds.
7) Continued and increased usage of direct debits via the internet is also to be encouraged.

A common EuroZone standard will lead to greater client acceptance.

Annex 21 - Breakdown of a payment network

We recommend that liability not be imposed on the payment service provider in these circumstances.

In the example provided by the Commission, i.e. that a customer cannot make a payment because an Internet banking website is not working, the customer would have alternative methods of contacting the bank in order to send payments. A more general network/systems failure is very likely to involve networks outside the bank's control given the variety of third party providers and networks involved in clearing payments so it would not be reasonable to impose liability on banks in these circumstances.

Contingency of payment infrastructure is an important contributor to financial stability. Euro wide guidelines regarding contingency, audits, and other techniques could contribute to the strength of payment infrastructure and would help to minimize outages contributing to the risks and liabilities discussed in the New Legal Framework Consultative Document. In the event there is a breakdown, responsibilities should occur consistently. We acknowledge the concerns here and seek further self-regulatory work with the ECB.

All participants in the commercial value chain have a responsibility to invest in the continuity of their operations under a variety of circumstances. Shifting the burden of compensation solely to one participant, risks weakening the whole system. Under the economic principle of moral hazard, it is rational that parties protected by compensation will focus less on maintaining contingent options, with investment and risk concentrated on the payment service provider. In turn, this will increase cost, investment, and probably ultimately pricing for these services.

Our Goal

The legal framework addresses retail payments. While many of the issues affecting retail payments also affect wholesale payments, the two payment types are fundamentally different in some key

attributes, e.g. means of origination, size, risk, liability, as well as the nature of the counterparties. We believe that in its current form, the New Legal Framework should be applied to clearly and exclusively address retail payments (versus wholesale payments), and that a separate process may be required to address the issues affecting wholesale payments.

From work performed with leading corporations, we note there remains considerable concern at the inefficiencies that individual countries payment format and technical standards create. Whilst on a country level they are highly efficient as payors, when organizing for business on a pan EU basis, the multiple standards and differences in payment systems and practice inhibit efficiencies. The associated economic costs cannot be eliminated without concerted effort to define a common set of standards, promote buy in to these and ensure enforcement of a practical migration plan, as their adoption will entail high investment across all sectors of the economy. We believe the market must set these standards but there is room for leadership for the EU or ECB to sponsor this work as a spin off of NLF support to self or co-regulation.

Our view of the corporate payments landscape indicates that the task ahead remains huge and highly complex. With no single body in place to co-ordinate the restructuring across the numerous parties involved, including corporations, government agencies, payable and collections systems, software providers, banks, regulators and clearing systems, the risk of failure and inefficiency remains high, the likelihood of success in the distant future.

One way forward could be for banks, consultants, regulators and corporate treasurers to second experts to a body (Commission or ECB sponsored or EBA, ECBS, EPC) for a fixed period to:

- Establish objectives
- Formalise the full impact of changes across the economic chain
- Set and publicise a migration plan, and
- Secure support, and ensure enforcement amongst all players.

We have a reservation that stakeholders are focusing on setting new pan euro practices for payments crossing national borders, whilst generally preserving the existing national legal and payments environments. Under such a scenario migration to an efficient single euro payments environment will continue to take many years, and during that time is likely to be challenged by the many different "domestic" definitions of effective payment systems. The leading national payment systems have scale of use and richness of functionality, which would challenge any efforts to supercede them. The features and relative capabilities of domestic, regional cross-border and global cross border payment systems need to be thoughtfully addressed in order to satisfy the various requirements.

The debate over the framework could be used to widen participation in work being led by the EPC, and establish a more definitive pathway to SEPA across the many stakeholders impacted, both wholesale and retail. In turn this will support the momentum from self-regulation.

Yours faithfully

Steven B. Groppi
Senior Vice President