Dear Fellow Shareholders,

The past two years have been among the most extraordinary and challenging in recent history for JPMorgan Chase, the financial services industry and the global economy. We have endured a once-in-a-generation economic, political and social storm, the impact of which will continue to be felt for years or even decades to come. As we see signs of recovery and the debates about financial reform wage on, it's easy for us to forget the fear and panic we felt a year ago. The market was down an astonishing 50% from its 2008 highs to its low on March 9, 2009. More important, as I write this letter, our country has lost 8.4 million jobs in what has turned out to be a more serious, sustained economic crisis than most of us have ever experienced before — or may experience again.

For JPMorgan Chase, these past two years have been part of a challenging, yet defining, decade. We began it as three separate companies: Bank One, Chase and J.P. Morgan, with each facing serious strategic and competitive challenges. Today, our strategic position is clear, and JPMorgan Chase is a leader in all of its businesses. If you had been a Bank One shareholder from 2000 to year-end 2009 (this represents approximately 40% of the current company) and you held on to your stock, you would have received a total return on your investment of 131%. Over the same time period, if you were a Chase or J.P. Morgan shareholder, your returns would have been 12% and 70%, respectively. By comparison, the Standard & Poor's 500 Index was down 9% over the same period.

Throughout this decade, we made and executed on many transformative decisions. When the global financial crisis unfolded in 2008, the people of JPMorgan Chase understood the vital role our firm needed to play and felt a deep responsibility to our many stakeholders. It is this sense of responsibility that enables us to move beyond the distractions of the moment and stay focused on what really matters: taking care of our clients, helping the communities in which we operate and protecting our company.

It is because of this focus — even amid the daunting and ongoing challenges — that we are able to weather this economic crisis and continue to play a central, if sometimes misunderstood, role in rebuilding the U.S. economy. This is a testimony to the collective strength of character and commitment of our people. Since those first chaotic days in early 2008, many of our people have worked around the clock, seven days a week, for months on end.

Jamie Dimon,
Chairman and
Chief Executive Officer

On March 16, 2008, we announced our acquisition of Bear Stearns at the request of the U.S. government; on September 25, 2008, 10 days after the collapse of Lehman Brothers, we bought Washington Mutual. We loaned $70 billion in the global interbank market when it was needed the most. With markets in complete turmoil, we were the only bank willing to commit to lend $4 billion to the state of California, $2 billion to the state of New Jersey and $1 billion to the state of Illinois. Additionally – and, frequently, when no one else would – we loaned or raised for our clients $1.3 trillion, providing more than $100 billion to local governments, municipalities, schools, hospitals and not-for-profits over the course of 2009.

Our industry and our country are continuing to face some serious challenges, but we believe that the strengths of our nation – our resiliency, ability to reform and innovate, work ethic and culture – will put us on the right track again to global financial soundness. JPMorgan Chase will remain focused, and we will continue doing our part.

In the following sections of this letter, I'll talk about a range of issues that bear on our company, our industry and our country:

I. How our company fared in 2009 – with a focus on what we *actually* do as a bank to serve our clients and customers and what we did to respond to the crisis and help the communities in which we operate
II. How we manage our people – JPMorgan Chase's most valuable asset
III. Our support of financial reform that will strengthen the financial system
IV. Our responsibility and America's success

Overall results — performance improved from 2008 but still was not great

Our revenue this year was a record $100 billion, up from $67 billion in 2008. The large increase in revenue was due primarily to the inclusion for the full year of Washington Mutual (WaMu) and the dramatic turnaround in revenue in our Investment Bank. Profits were $12 billion, up from $6 billion in the prior year but down from $15 billion in the year before that. While these results represent a large improvement over 2008, they still are an inadequate return on capital – a return on tangible equity of only 10%. Relative to our competition, our company fared extremely well. We did not suffer a loss in any single quarter over the two-year crisis (we may have been one of the few major global financial firms to achieve this). In absolute financial terms, however, our results were mediocre.

Maintaining our fortress balance sheet and commenting on our dividend

During this difficult year, the strategic imperatives that have defined and distinguished our company continued to serve us well. We maintained our focus on risk management; high-quality capital; strong loan loss reserves; honest, transparent reporting; and appropriately conservative accounting. We maintained an extremely strong Tier 1 Common ratio, which stood at 8.8% at year-end. We also increased our loan loss reserves over the course of the year from $23.2 billion to $31.6 billion, an extremely strong 5.5% of total loans outstanding. Our relentless focus on our balance sheet has always enabled us to prevail through tough times and seize opportunities while continuing to invest in our businesses. It served us extremely well over this period.

Early in 2009, we cut our annual dividend from $1.52 to $0.20 per share – a drastic move premised on the need to be prepared for a prolonged and potentially terrible economy. We hope to be able to increase the dividend to an annual range of $0.75 to $1.00 per share. To do so, we would like to see three specific things happen: several months of actual improvement in U.S. employment; a significant reduction in consumer charge-offs (which improves earnings and diminishes the need for additional loan loss reserves); and more certainty around the regulatory requirements for bank capital levels. Possible changes in capital and liquidity requirements as well as some tax proposals are creating uncertainty around our future capital needs. We hope there will be more clarity regarding these issues soon.

Many companies had to measurably dilute their shareholders because of this crisis. We did not. The only time we issued a material amount of stock was when we did it offensively to finance the WaMu purchase (and maintain our very high capital ratios). We also hope to be in a position to resume stock buybacks in the near future. But our first priority is – and always has been – to invest our capital to grow our businesses organically and, secondarily, to make valuable acquisitions. We buy back stock only when we think it is a good value for our shareholders relative to the value of other opportunities. And if we use our stock in an acquisition, we do so because we believe the value we're getting is at least equal to the value we're giving.

Increasing our efficiency

Overall, we are a far more efficient company than we were five years ago, following the JPMorgan Chase-Bank One merger. Since then, we've consolidated virtually all of our operating platforms, networks and data centers, and we have excellent technology and best-in-class financial and risk systems. We also have exceptional legal, finance, compliance, risk, human resources and audit staff. Today,

the cost of this improved level of operation and service per dollar of revenue is significantly lower than in the past. To give just one example, our total technology and operations and corporate overhead costs would be more than $9 billion higher today if they were running at the same cost per dollar of revenue as in 2005.

Continuing to invest

Through the worst of the past two years, we never stopped investing. This has included acquisitions, foremost among them Bear Stearns and Washington Mutual; investments in infrastructure, including systems and technology; new products, for example in Card Services; and the addition of bankers and branches around the world. These investments set us up for continued organic growth.

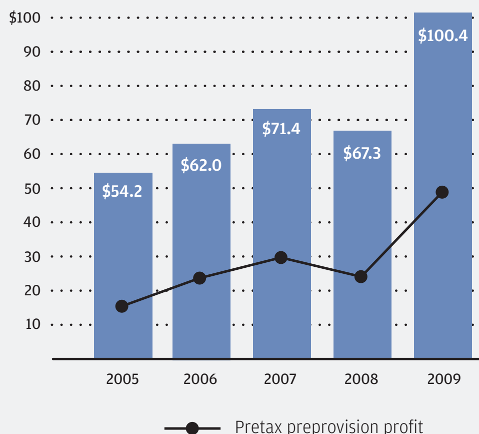
Preparing for tougher global competition

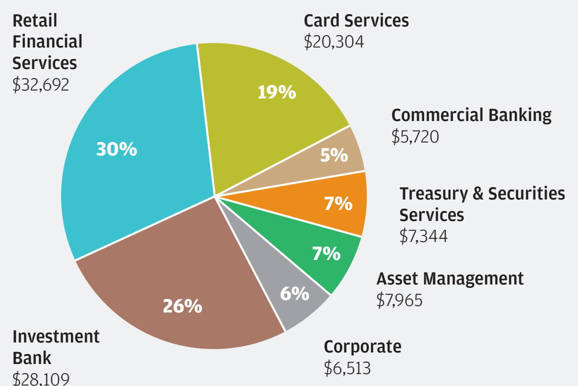
The competitive landscape is rapidly changing. Many companies did not make it or had to be dramatically restructured. We expect this trend to continue in both the United States and Europe. We and others who survived benefited from market share gains (in fact, we gained market share in virtually all of our businesses). But we must be prepared for all of our competitors to come roaring back. With certain competitors and in certain parts of the world, this already is happening. We do not take this lightly.

Protecting the company in uncertain times

You read about it every day: continued global trade imbalances, higher fiscal deficits run by governments around the world, uncertain interest rate movements and potential regulatory changes, among other issues. I could go on for pages. Rest assured, we are paying very close attention to the difficult issues we still face.

Following is a recap of our line of business results. In this section, I will focus on describing what we as a bank *actually* do, which seems to be so often misunderstood. As you read these results, I hope you will feel as I do – that we have excellent franchises, focused on doing a great job for our customers (even though we do make mistakes), and that we have been continuously and deliberately investing for future growth.





* For a discussion of managed basis presentation and a reconciliation to reported net revenue, see pages 58-59 of this Annual Report.

Results by line of business: Great leadership amid great challenges

The Investment Bank reported net income of $6.9 billion with an ROE of 21%

Overall results

The Investment Bank (IB) delivered record performance across the board: net income of $6.9 billion on revenue of $28.1 billion. These results were led by best-ever Global Markets revenue of $22 billion and record investment banking fees of $7.2 billion. The IB generated a return on equity of 21% on $33 billion of allocated capital, our best result in five years. We clearly benefited from higher bid-offer spreads and higher volumes as the industry consolidated and vulnerable companies were distracted. In terms of market share, we achieved a #1 ranking in every major global capital-raising league table category. We do not, however, take this position for granted and understand that maintaining and growing our market share will undoubtedly be tough going forward. We believe our success was due to the dedication of our 25,000 employees, who were working hard to serve our clients every day.

What we do in Corporate Finance

Globally, we have more than 2,000 investment bankers, who serve the corporate finance needs of 5,000 institutions around the world. More than 1,000 of these clients are sovereign governments, state and municipal governments, international quasi-government agencies, hospitals, schools and not-for-profits; the others are generally corporations and financial institutions. Our job is to help these clients find appropriate financing, make strategic acquisitions or divestitures, and help manage their balance sheets and other exposures – such as exposure to interest rates, foreign exchange or commodity prices.

In 2009, among their many activities, our investment bankers:

- Advised on 322 mergers and acquisitions globally – more than any other bank.
- Loaned or syndicated loans of more than $200 billion to 295 companies, helping them grow and create jobs.
- Raised $620 billion of equity or bonds in public markets for clients around the world.
- Raised $178 billion for the financial industry, or nearly 10% of the capital needed to rebuild the financial system.
- Raised $102 billion for states, municipalities, hospitals, schools and not-for-profits – to help build roads and bridges, improve social services, renovate local hospitals and train people for employment. This financing included $19 billion to educational organizations and $14 billion to healthcare organizations.
- Committed to provide financing when others were not able to do so; for example:
  – $4 billion to California;
  – $2 billion to New Jersey; and
  – $1 billion to Illinois.
- Arranged $60 billion to restructure stressed companies and help them recover (and keep their employees at work).
- Invested in 58 U.S. wind farms spread across 16 states. This portfolio can produce 5,843 megawatts of capacity – enough energy to power some 1.6 million U.S. homes. We also are a leader in sourcing, developing and trading emission-reduction credits, primarily through our investments in ClimateCare and EcoSecurities.

In difficult times, extending this level and type of credit is exceedingly risky and costly. For example, in 2008 and 2009, we wrote off or reserved for approximately $8.9 billion of credit-related losses related to IB lending activities.

Key earnings metrics

(in millions, except for ratio and per share data)

	2005	2006	2007	2008	2009
Investment Bank	$ 3,673	$ 3,674	$ 3,139	$ (1,175)	$ 6,899
Retail Financial Services	3,427	3,213	2,925	880	97
Card Services	1,907	3,206	2,919	780	(2,225)
Commercial Banking	951	1,010	1,134	1,439	1,271
Treasury & Securities Services	863	1,090	1,397	1,767	1,226
Asset Management	1,216	1,409	1,966	1,357	1,430
Corporate*	(3,554)	842	1,885	557	3,030
Total net income	$ 8,483	$ 14,444	$ 15,365	$ 5,605	$ 11,728
Return on tangible equity	15%	24%	22%	6%	10%
Earnings per share – diluted	$ 2.35	$ 4.00	$ 4.33	$ 1.35	$ 2.26

* Includes extraordinary gains and merger costs. For more details on the Corporate sector, see page 82.

What we do in Sales and Trading

Trading is perhaps the least understood area of our investment banking activities. We have 6,500 professionals on approximately 120 trading desks in 25 trading centers around the world; these professionals include more than 800 research analysts who educate investors on nearly 4,000 companies and provide insight on 40 developed and emerging markets. The job of our sales and trading professionals is to provide 16,000 investor clients globally with research expertise, advice and execution capabilities to help them buy and sell securities and other financial instruments. These investors range from state and municipal pension plans to corporations and governments. We have experienced specialists who are prepared to buy or sell large amounts of stocks and bonds, foreign currencies or commodities for clients and to give them immediate cash or liquidity when they need it – something we *never stopped* doing even at the most trying moments of the financial crisis. Additionally, we help organizations manage and hedge their risk through providing a range of derivatives products.

Although we run our sales and trading business to support clients, it is a risky business. We execute approximately 2 million trades and buy and sell close to $2.5 trillion of cash and securities each day. On an average day, we own, for our account, approximately $440 billion in securities – to us this is akin to the inventory of a store. We hold the securities so we can meet client demand. Our sales and trading functions not only play a critical role in helping to maintain large, liquid and well-functioning markets, but they are indispensable to institutions of all types seeking to raise capital in the first place.

As more clients chose to work with us in 2009, our sales and trading teams gained market share. We estimate that our market share of the top 10 players in Fixed Income and Equity Markets combined grew from approximately 9% in 2008 to more than 12% in 2009. Deservedly, these groups also received a lot of accolades – most gratifyingly, from client-based surveys.

How we intend to grow

In 2010, we will continue to focus on the fundamentals of investment banking: advising companies and investors, raising capital, making markets and executing for our clients worldwide. If we do this well, we are helping not only our clients but the global economic recovery as well.

We also are aggressively and organically growing many parts of our business. For example, the Prime Services business we acquired from Bear Stearns – which provides mostly large investors with custody, financing

and trade execution – largely was concentrated in the United States. We now are growing this business in Europe and Asia. Across the business, we will continue to invest in enhancing our technology, spending $1 billion this year on upgrades and innovations. We also are expanding our coverage in key markets, including China, India and Brazil – essentially by adding investment banking and trading professionals and providing them with the corresponding support they need (i.e., credit and systems) to cover more corporate and investor clients in these markets. For example, in the last five years in India, we have gone from covering 36 companies to 180 companies. We will simply grow with the emerging economies.

Cazenove

At the end of 2009, we announced that our U.K. joint venture with Cazenove Group Limited would become a wholly owned part of J.P. Morgan. Our initial investment in Cazenove in 2005 was extremely successful – among other things, it increased our U.K. investment banking market share* from 5% to 13%. We welcome all of these employees to J.P. Morgan – Cazenove's long tradition of integrity and client service sets a standard for all of us.

Commodities

We continue to build out our Commodities franchise. Price fluctuations in commodities like oil, gas and electricity affect many companies throughout the world. We help our corporate clients manage this risk by enhancing our trading and warehousing capacity. Since 2006, our Commodities business has more than doubled its revenue from serving clients. In February 2010, we announced our agreement to purchase a portion of RBS Sempra's commodities business for $1.7 billion. This acquisition will give us the ability in Europe to trade oil, gas and electricity far more extensively than we can now; it will enhance all of our prior U.S. capabilities; and it will add a capability to warehouse metals for clients. It also will nearly double the number of corporate clients we serve in Commodities, to more than 2,000.

Retail Financial Services reported net income of $97 million with an ROE of 0%

Overall results

Retail Financial Services (RFS) continued to be a tale of two cities. Retail Banking, which includes Consumer and Business Banking, earned $3.9 billion, primarily by serving customers through bank branches in 23 states. Consumer Lending lost $3.8 billion because of continued high charge-offs in the home lending business.

In our fastest conversion ever, we upgraded 1,800 Washington Mutual branches and more than 40 million accounts to Chase's systems, products and branding. As a result of these conversions, customers today have full access to 5,154 Chase branches across the country (from New York and Florida to California). Former WaMu customers have received greater access to better systems and products, and we did it at greatly reduced cost to the firm (approximately $2 billion firmwide). We now have one of the most attractive franchises in the country, with enormous opportunities to grow.

What we do in Retail Banking

Last year, our 61,000 people in 5,154 Chase branches in 23 states served more than 30 million U.S. consumers and small businesses by providing checking and savings accounts and investments, as well as home, business, auto and student loans. For our RFS professionals, 2009 was a year of numerous accomplishments:

- Retail operations teams processed 700 million teller transactions, 3.5 billion debit card purchases, 100 million ATM deposits, close to 6 billion checks and more than 1.3 billion statements.
- Investment advisors oversaw $120 billion in assets under management to help consumers toward their goals.
- We added 4.2 million mobile banking customers and another 5.2 million new online banking customers.

* Market share as measured in total fees.

- We also added 2,400 branch sales staff last year – personal and business bankers, mortgage officers and investment representatives – to better serve our customers.

In addition, we are revamping our overdraft policies to meet regulatory requirements, to make them clearer and simpler, and to give customers more control. Customers now can choose if they want overdraft services for their debit cards, and they will have a real-time ability to see their balances over the course of the day. These changes are ongoing and complex. We hope to complete them with minimal disruption and maximum consumer satisfaction. While costly (we estimate these changes will reduce our after-tax income by approximately $500 million annually), we believe these moves will strengthen our long-term relationship with our customers.

What we do in Small Business Banking

In 2009, our nearly 2,000 business bankers provided approximately $2.3 billion in new loans (our total outstanding loans are $17 billion) and other services to help 2 million business owners nationwide manage their businesses. Loan origination in 2009 was down 58%, as customer demand decreased significantly and our underwriting standards became more disciplined. We expect a substantial turnaround in 2010, and, in fact, we already are seeing increased demand from more qualified customers.

We are renewing our efforts to get more credit into the marketplace, including adding 375 small business bankers to our current workforce. In late 2009, we committed to boosting lending to small businesses by $4 billion in 2010 (to a total of $10 billion) through increased access to working capital, term loans for expansion, commercial mortgages, lines of credit and business credit cards.

What we do in Consumer Lending

Our Consumer Lending business includes home and auto loans for consumers. In terms of overall results, it was another difficult year for Consumer Lending, with losses of $3.8 billion, driven by increased charge-offs and additions to loan loss reserves in our home lending portfolios. As discussed last year, these losses were the result of departures from our traditional (and well-tested) underwriting standards, sharply falling home prices and the deepening recession. While there has been some improvement in delinquencies and home prices in some markets, we believe that significant improvement will depend largely on an improving economy.

As expected, charge-offs in Home Lending continued to rise during 2009, and we added $5.2 billion in reserves to our portfolio. We anticipate that this portfolio will continue to lose money for the next three years (excluding reserve changes) as we work through a backlog of problem loans. The losses come not only from charge-offs but from the costs of managing delinquencies and foreclosures (though we were able to reduce the number of homes that we own from 12,700 in 2008 to 7,400 in 2009).

More positively, we took a leadership role in helping American homeowners through the most difficult housing market of a generation. We added 6,000 people just to help homeowners through modification programs and other actions to prevent foreclosure. We also opened 34 Chase Homeownership Centers to allow struggling borrowers to talk with loan counselors face to face and have begun opening 17 more in early 2010. These efforts have allowed us to begin the mortgage modification process for nearly 600,000 homeowners (approximately one-third of which are modifications under the government's new Home Affordable Modification Program, or HAMP).

The mortgage business essentially has returned to the more disciplined underwriting of many years ago: 80% loan-to-value ratios and income verification. In 2009, we originated more than $150 billion in new home

loans, much of it refinancing that allowed homeowners to lower their payments by taking advantage of historically low interest rates. Most of the loans that we originate are sold to Fannie Mae, Freddie Mac or Ginnie Mae. We still underwrite jumbo loans (those with loan amounts larger than those permitted in government programs), but we have been very cautious. The home lending business will one day return to being a good business – it certainly is critical to the proper functioning of America's financial markets – and we intend to be a leader in it.

In 2009, we also became the largest U.S. auto lender, financing more than 1.1 million auto loans for consumers, up 25% from 2008. Our auto loans outstanding totaled $46 billion at the end of 2009.

How we intend to grow

To provide better service to our millions of customers, we plan to *add* 2,700 personal bankers and more than 400 investment sales representatives in 2010. These efforts should help us earn new customers and broaden our relationships with existing customers beyond checking accounts and other basic services. In addition, we expect to open at least 120 more branches in 2010 and to ramp up our pace of openings in 2011 and 2012 – especially in California and Florida, two of the fastest-growing U.S. markets, which were introduced to us through the WaMu acquisition.

Card Services reported a net loss of $2.2 billion

Overall results

By all measures, 2009 was a terrible year for our credit card business. The economic environment drove charge-off rates to all-time highs. Card Services lost $2.2 billion (compared with last year's profit of $780 million). While I don't want to diminish the negative overall results, there were some positives. We were able to grow market share in terms of accounts and customer spending; and our credit loss performance – 8.5% on Chase cards – while poor, was better than our competitors' performance.

What we do in Card Services

Our 23,000 Card Services employees around the world provide financial flexibility and convenience to customers who, in 2009, used Chase credit cards to meet more than $328 billion of their spending needs. With more than 145 million cards in circulation held by approximately 50 million customers with $163.4 billion in loan outstandings, Chase is among the largest U.S. card issuers, with a wide variety of general purpose credit cards for individual consumers and small businesses. We also issue cards with a number of partner organizations, such as the American Association of Retired Persons (AARP), Continental Airlines, Marriott, Southwest Airlines, United Airlines and Walt Disney.

How we dealt with new regulation

In 2009, in addition to the terrible environment, the U.S. credit card business faced fairly dramatic changes because of a new law enacted by Congress in May. The new law restricts issuers' ability to change rates and prohibits certain practices that were not considered consumer-friendly. These changes alone are expected to reduce our after-tax income by approximately $500 million to $750 million – but this could possibly change as both consumers and competitors change their behavior.

We believe that many, but not all, of the changes made were completely appropriate. In fact, we had voluntarily eliminated certain of the targeted practices – like double-cycle billing, which resulted in greater interest charges for customers who revolve a balance for the first time (2007); and universal default pricing, in which creditors consider credit histories with other lenders in setting rates (2008). However, because the new law makes it harder to raise rates on customers who have become far riskier and because all payments now must go toward reducing users' highest-rate balances (vs. lower-rate balances), we and other competitors have had to make some fairly drastic changes in the business:

- We have substantially reduced very low introductory or promotional balance transfers. This change alone reduced our outstanding balances by $20 billion.
- In the future, we no longer will be offering credit cards to approximately 15% of the customers to whom we currently offer them. This is mostly because we deem them too risky in light of new regulations restricting our ability to make adjustments over time as the client's risk profile changes.
- We reduced limits on credit lines, and we canceled credit cards for customers who had not done business with us over an extended period.

In fact, the industry as a whole reduced limits from a peak of $4.7 trillion to $3.3 trillion. While we believe this was proper action to protect both consumers and card issuers, doing so in the midst of a recession did reduce a source of liquidity for some people. Ultimately, however, the change may make the card business a more stable and better business.

How we intend to grow

Aggressive product innovation is fundamental to the development of the credit card business. Even through the recent tumultuous times, we never stopped investing in new products and services to meet our customers' needs. In 2009, Chase launched more products at one time than any other issuer. New products and services included two Chase-branded card programs, a rewards platform, and a new feature to help better manage spending and borrowing. Here are some of the highlights:

- The Chase Sapphire℠ card was developed from the ground up to address the needs of affluent consumers, with premium rewards and exceptional service.
- Ink℠ from Chase is a suite of business cards offering flexible payment options and resources for small business owners.
- Our new Ultimate Rewards℠ program offers countless redemption options through a single website: www.ultimaterewards.com.
- Blueprint℠ is an industry-first set of features to improve the way Chase customers manage their spending and borrowing, with tools to help consumers take charge of their finances, pay down balances and manage spending.

These new products* and programs would be considered major innovations at any time; but the fact that we launched them in one of the worst-ever U.S. consumer environments is especially noteworthy. By delivering convenience, customization and great service, we will build stronger customer relationships. Even as the credit card business has seen more than its share of difficulties during the past year, we believe our new products will help us rebuild trust with our customers. It's a process that will take time, but if we focus on delivering useful products and making financing easier for our customers, Card Services will return to being a business that is good for our customers and profitable for our company.

* If you would like to review any of our new products, go to our website: www.chase.com.

Commercial Banking reported net income of $1.3 billion with an ROE of 16%

Overall results

In 2009, Commercial Banking overcame many challenges to deliver exceptional financial performance. Even as substantially higher credit costs negatively affected quarterly results, the business exceeded its annual plan by focusing on client selection, marketing its business aggressively, managing risks and expenses, and excelling in client service. Highlights included a 20% boost in revenue to $5.7 billion; a 25% improvement in operating margin to $3.5 billion; double-digit increases in both average liability balances, up 10%, and average loan balances, up 30%; and a 20% jump in gross investment banking revenue to $1.2 billion – a full 25% above plan. These were *fabulous* results in any environment.

What we do in Commercial Banking

More than 1,400 bankers help fulfill the financing needs of nearly 25,000 clients and over 30,000 real estate investors and owners. The average length of a Commercial Banking client relationship with us is more than 18 years. In 2009, we added over 1,700 new Commercial Banking clients and expanded more than 7,600 relationships. With a team of banking, treasury and client service professionals situated in local markets coast to coast and around the world, Commercial Banking delivers financial services while steadfastly supporting communities. Last year, Commercial Banking extended more than $73 billion in new financing, which included nearly $8 billion to the government, not-for-profit and healthcare (GNPH) and education sectors. For example:

- We helped finance the construction of a $22.3 million healthcare center in the Bronx, New York, to serve an additional 18,000 patients per year.
- As part of more than $384 million in new and renewed commitments to GNPH and educational entities in Ohio, we provided Kent State University with needed financing.
- We assisted Children's Memorial Hospital in Chicago in financing the construction of a new $915 million building with a $196 million credit facility.

How we intend to grow

Having successfully completed the conversion of commercial client accounts acquired through Washington Mutual, Commercial Banking is well-positioned to grow. The business already is taking advantage of Chase's retail branch network to expand its offerings into five new states – California, Washington, Oregon, Georgia and Florida. We'll now cover these new markets by supporting a full range of clients, from middle market companies to large corporations. We are achieving this by hiring exceptional commercial bankers – more than 50 employees by the end of 2010 alone – to serve these additional markets. Several years from now, when this expansion ultimately is completed, we expect it will generate hundreds of millions of dollars in additional profits annually.

On another front, when JPMorgan Chase and Bank One merged, we set a target of more than $1 billion in revenue from investment banking products sold to Commercial Banking clients (up from $552 million). This year, we exceeded the goal and are poised to continue growing this business.

Treasury & Securities Services reported net income of $1.2 billion with an ROE of 25%

Overall results

Treasury & Securities Services (TSS) delivered solid but lower results, producing 2009 profits of $1.2 billion vs. $1.8 billion in the prior year. The business delivered net revenue of $7.3 billion, down 10% from the previous year. We describe TSS as our "Warren Buffett-style" business because it grows with our clients and with inflation; delivers excellent margins and high returns on capital; and is hard for would-be competitors to replicate because of its global scale, long-term client relationships and complex technology.

Our 2009 performance largely was driven by weakened market conditions and lower interest rates. Securities lending and foreign exchange volumes and spreads, in particular, saw significant declines. TSS also saw deposits level off after an exceptional period in late 2008 and early 2009, when we were a huge beneficiary of the markets' flight to quality. Despite the headwinds of 2009, the underlying business drivers remained strong: International electronic funds transfer volumes grew 13%, assets under custody increased 13% and the number of wholesale cards issued grew 19%.

What we do in Treasury & Securities Services

More than 6,000 TSS bankers serve more than 40,000 clients from all of our other lines of business in 60 locations around the world. TSS provides clients with critical products and services, including global custody in more than 90 global markets, holding nearly $15 trillion in assets; corporate cash management, moving an astounding $10 trillion a day of cash transactions around the world for clients; corporate card services, providing 27 million cards to more than 5,000 corporate clients and government agencies; and trade services, guaranteeing international payments for our clients, who are many of the world's largest global companies. Following are some specific examples of how TSS supports a range of clients:

- We delivered unemployment and other benefits to more than 12 million individuals in 2009, as the national leader in bringing electronic banking services to low-income households through electronic benefits transfer and debit and stored-value cards.
- We were selected by the Federal Reserve to serve as custodian for its program to purchase up to $1.25 trillion in mortgage-backed securities in order to provide support to the mortgage and housing markets.
- We are the leading cash management provider to the U.S. Postal Service, providing cash and check depository services to nearly one-third of the U.S. Postal Service's 80 districts.

How we intend to grow

TSS essentially grows by following its clients around the world, which means opening new branches and constantly improving products. In 2009, TSS opened new branches in China, Denmark, Finland, Norway and Sweden; launched new services in Tokyo, South Korea, Brazil and Mexico; and expanded capabilities in Australia, India, Europe, the Middle East and Africa. We will continue this expansion for the foreseeable future.

In addition, more than three years ago, TSS and the Investment Bank formed a joint venture to create our Global Corporate Bank. With a team of more than 100 corporate bankers, the Global Corporate Bank serves multinational clients by giving them access to TSS products and services and certain IB products, including derivatives, foreign exchange and debt. We intend to expand the Global Corporate Bank aggressively over the next several years by opening 20-30 locations and adding 150 corporate bankers, allowing us to cover approximately 1,000 new clients (3,100 total, up from 2,100).

Asset Management reported net income of $1.4 billion with an ROE of 20%

Overall results

Asset Management, with assets under supervision of $1.7 trillion, saw earnings increase by 5% in a year that began with strong negative headwinds and finished with a market rally. Overall, the year's results reflected several trends, including strong investment performance, continued growth in Private Banking, excellent investment performance from Highbridge Capital Management and a breakout year for our U.S. retail mutual funds business. All of these trends reflected an improving story from the challenges of the past two years.

What we do in Asset Management

Our Asset Management franchise consists of two primary businesses. The first is Investment Management, in which 6,500 employees help institutions and retail investors worldwide manage their cash; provide equity, fixed income and alternative investment strategies; and administer 401(k) services for large and mid-size U.S. employers. Overall, we manage more than $1.2 trillion in assets for our clients.

Our second primary business is Private Banking. Our 1,900 private bankers help the world's wealthiest individuals and families grow, manage and sustain their wealth with investing, portfolio structuring, capital advisory, philanthropy and banking services.

Throughout 2009, our Asset Management professionals advised institutions on how to strengthen pension plans for the benefit of their employees; advised more than 1.6 million 401(k) participants on achieving a secure retirement; executed comprehensive financial plans for family enterprises and business owners; distributed more than $100 million to charities on behalf of fiduciary clients; and brought market insight and top-performing products to financial advisors who guide millions of individual investors worldwide.

Within Asset Management, our Fixed Income group solidified its position as the #1 provider of global liquidity (we manage $590 billion), and our U.S. Equity platform had 82% of assets under management in the top two quartiles of peer fund group investment performance over five years. Our U.S. retail business had an exceptional year despite clients' broadly based risk aversion, bringing in record net asset flows and ranking third in net new long-term flows in the industry – due principally to the sale of strong-performing fixed income products.

Private Banking experienced record revenue due to inflows from clients and solid investing, lending and banking activity, as well as the addition of nearly 100 client advisors and five new Private Wealth Management offices (in Miami, Philadelphia, San Francisco, Seattle and Washington, D.C.).

In mid-2009, J.P. Morgan assumed 100% ownership of Highbridge Capital Management, one of the largest alternative asset managers in the United States, with $21 billion in client assets. We acquired Highbridge in 2004 to augment our alternative investment offerings for clients. Highbridge delivered the best investment performance in its history in 2009, and just five years into our partnership, its assets have grown threefold.

Importantly, rigorous risk management enabled Asset Management to provide valuable support to our clients and avoid many of the negative developments that surfaced during the financial crisis and damaged an untold number of investors.

How we intend to grow

Our Investment Management business is developing new global strategies, including funds focused on maritime investments, commodities, distressed debt and China. We also plan to enhance Investment Management's global distribution with the addition of more than 200 employees and increased budgets for marketing and client outreach.

In 2010, we plan to expand Private Banking globally by adding more than 500 bankers, investors and client service employees. In addition, we intend to continue to invest in the growth of the brokerage business we acquired from Bear Stearns. We anticipate a slowly improving but volatile investment environment in 2010 – yet, nonetheless, we expect Asset Management to continue to thrive by helping millions of individuals, families and institutions achieve their financial goals.

The Corporate sector reported net income of $3.7 billion

Our Corporate sector, excluding merger-related items, produced net income of $3.7 billion compared with $768 million in the prior year. The Corporate sector comprises three segments: Private Equity, unallocated corporate expenses and our corporate investment portfolio. Our Private Equity segment reported a net loss of $78 million vs. a net loss of $690 million in 2008. Remember, however, in 2007, we had an outstanding year with pretax Private Equity gains of more than $4 billion. We know that Private Equity returns, by their nature, are lumpy, but we expect to average 20% returns over the years.

Our corporate investment portfolio, which we own in order to manage excess cash, our collateral needs and interest rate exposure, grew from a low of $91 billion in March 2008 to an average of $324 billion in 2009. Our investment portfolio produced exceptional performance, the result of both managing interest rate exposures and buying securities that we thought were extremely safe investments and were trading at large discounts to fair value (e.g., mortgage ABS, Triple-A credit card ABS and Triple-A CLOs). The pretax unrealized gain of this portfolio went from a loss of $3.4 billion at the beginning of 2009 to a gain of $3.3 billion at year-end. It's important to note that your company manages its interest rate exposure extremely carefully and believes that taking this exposure is fundamentally not how we make our money. Any investor can take on interest rate exposure – we do not consider that a business. We do not borrow "cheap" from the Federal Reserve or any other source; we borrow at market rates, like everyone else does.

We may realize some of these Corporate investment gains in 2010, but we do not expect these exceptional results to continue. Over the course of the year, Corporate quarterly net income (excluding Private Equity, merger-related items and any significant nonrecurring items) is expected to decline to approximately $300 million.

II. HOW WE MANAGE OUR PEOPLE – JPMORGAN CHASE'S MOST VALUABLE ASSET

Nothing is more vital to the long-term growth of JPMorgan Chase than our ability to attract and retain talented and dedicated employees. Ours is a complicated business. Managing it requires complex systems, extensive quantitative skills and risk discipline. The pressure can be enormous and wide-ranging – from a trader dealing with large positions to a call center employee helping a customer modify a mortgage loan that no longer is affordable. Being smart is not enough; it also takes a high level of social intelligence and skill to handle all types of customers facing all kinds of challenging circumstances.

Success at our firm requires that employees treat clients and customers respectfully and fairly and stay true to the values embedded in our culture: personal commitment, honesty, teamwork, diversity and community awareness.

Ensuring we have the best people, training and leadership requires that we do many things right, from recruiting and training to recognizing, rewarding and developing leaders. This is what enables us to attract, retain and develop the best people.

Recruiting and training talent

The breadth, complexity and variety in the work our people do are impressive by any measure but are not well-understood. We have 220,000 employees around the world. While some of us have high-profile jobs and receive great attention – not always for the better these days – many others are not in the public eye. These individuals are essential to our global operations and include:

- Nineteen thousand programmers, application developers and information technology employees who tirelessly keep our 80 data centers, 55,000 servers, 225,000 desktops and global network up and running – and who were a major part of completing the Bear Stearns and WaMu conversions in record time.
- Eighty thousand employees fulfilling operations functions globally and thousands of customer service colleagues. In 2009, they responded to more than 245 million phone calls – to help customers stay in their homes, understand credit card payment plans and avoid financial problems during these difficult times.
- Thirteen thousand people in Legal & Compliance, Risk, Audit, Human Resources and Finance in 60 countries who rigorously analyze facts and figures, thoughtfully review the policies we have and address the issues we face. For example, we rely upon hundreds of credit risk officers to manage our various exposures, including $2 billion of new loans we make on average every day.
- Thousands more of our colleagues working behind the scenes to keep our operations safe and efficient, including mailroom attendants, mechanics and engineers, executive assistants, receptionists, security personnel and those who manage our facilities worldwide.

To fill these jobs, we hire thousands of employees each year, all of whom must be trained in our products, services and procedures in order to do their jobs well. Annually, we hire 1,800 people with advanced degrees (including M.B.A.s and Ph.D.s). Thousands of our people have advanced degrees in math, science and physics. While many of these people work in the Investment Bank, others work in Asset Management, Credit and Risk Analysis, Consumer Lending and Treasury & Securities Services, as well as in data centers across the firm.

Employees of JPMorgan Chase receive ongoing training and development to ensure they are well-equipped to manage the complex systems, risk management disciplines and client relationships that are critical to our franchise. Additionally, many are prepared to assume managerial and leadership roles over time. Our company has 94 management develop-

ment programs and more than 20,000 training programs (including online courses) that enable our people to hone and expand their skills in a rapidly changing business.

Ongoing assessment and development

At JPMorgan Chase, we are fortunate to attract world-class talent. We owe it to our employees, our customers and our shareholders to create an environment in which our people can do their best work. Toward this end, we believe in assessing their strengths and weaknesses and regularly giving them honest and thorough feedback. Additionally, we know that in order to sustain our strong competitive position, we must focus on developing exceptional leaders. This starts with a clear and shared understanding about the attributes we value most in senior managers. These qualities must be intentionally fostered and reinforced through a rigorous talent assessment process. This process now is embedded as part of how we operate. We also are developing a general management program for M.B.A. students to help us add to our bench and build general management talent on an ongoing basis.

Encouraging mobility and multiple careers

Talent mobility and optimization are key to our long-term success. We have to clearly outline what people need to do to move to the next level at JPMorgan Chase. We are working to do away with statements such as, "My boss won't let me go … or my boss won't let me look at positions in other divisions." People have the right to explore different career opportunities and follow their dreams. While it's also an individual's responsibility to manage his or her own career, it's our job to help facilitate that. We strive to be proactive and thoughtful in that regard.

Intense focus on succession

We need to be honest and thoughtful about potential successors, particularly for senior jobs. We have redoubled our efforts to ensure that we have people in the pipeline who are capable of assuming senior levels of responsibility three, five or even seven years out or right away if necessary (the "hit by a truck" emergency scenario). This is true for my job as well.

Poor CEO succession has destroyed many a company. CEO and management succession often seems more like a psychological drama or a Shakespearean tragedy than the reasoned and mature process it should be. It is in our best interest to avoid such drama.

I want to assure you, our shareholders, that your Board believes that we have within the organization some outstanding people who could do my job today; and we will continue to rotate some of our senior people across the business to ensure that others are fully developed to take my job in the future. The Board of Directors not only believes that this is a priority but that it is of the utmost importance. And you can rest assured that your Board members are on the case. They personally know all of the Operating Committee members of the company (and many others), and the Board members periodically review – with and without me – your company's key succession plans.

Getting compensation right

Compensation is one of the most complex issues we confront – it is important to our employees, our company, our shareholders and, increasingly, the public at large. A poorly conceived compensation strategy can devastate a company by attracting the wrong people and incenting them to do the wrong things for the wrong reasons. At JPMorgan Chase, we put a great deal of time and thought into designing compensation plans that attract and motivate good people and reward good behavior. Of course, compensation aside, we always expect our people to do the right thing. A badly designed compensation plan never is an excuse for bad behavior.

Many people are concerned and angry about compensation practices across the financial services industry – and many of these concerns are quite legitimate. Senior leaders at some companies made a great deal of

money while their companies failed and, in the process, helped contribute to the crisis in our country. This angers me, too. But not all companies were reckless – and not all companies had bad compensation practices.

In this section, I'm going to describe how our overall 2009 compensation related to other industries, present some overall principles that guide us and explain how we apply these principles in compensating our people.

Comparing JPMorgan Chase with other industries

In 2009, JPMorgan Chase's total expenses were $52 billion. The total compensation (salaries and benefits and incentives) your company paid out was $27 billion.

JPMorgan Chase compensation — 2009

	Total (in billions)	**Average per employee** (in thousands)
Salaries	$ 12.5	$ 56
Benefits*	3.9	18
Incentive compensation**	10.6	46
Total compensation and benefits***	$ 27.0	$ 120

As seen above, we paid salaries and benefits of approximately $74,000 per person and incentive compensation on average of $46,000 per person for a total of $120,000 per person. These salary and benefit numbers are generally in line with other major companies – financial and non-financial.

The incentive awards come in various forms (cash, commissions, restricted stock, options, etc.). Approximately 32% of the incentive compensation for 2009 was in restricted stock and options that vest over a number of years. At JPMorgan Chase, the use of stock options is very restricted – we only use stock options for approximately 500 people a year – and represents just 1%-2% of the company's total compensation expense.

Many commentators, in an attempt to measure fairness and reasonableness of a company's compensation payouts, have looked at total compensation as a percentage of revenue. On this basis, JPMorgan Chase's total compensation (salaries, benefits and bonuses) was 27% for 2009; this number averaged 33% over the previous several years. For our Investment Bank alone – the part of the company receiving the most scrutiny – compensation was 33% of revenue, down from an average of 44% over the last five years.

The chart on the next page compares these same percentages with a wide mix of businesses. For the average U.S. business, total compensation as a percentage of revenue is approximately 16%. In general, at businesses that are people-intensive and not capital- or intellectual property-intensive, such as professional services companies, a high percentage of the company's revenue is paid out to the employees. Law firms, for example (which are not included in the following table), pay out more than 80% of their revenue to their employees. In highly capital-intensive companies, like telecommunications or certain manufacturing companies, payout ratios are considerably lower.

Some commentators also have looked at total compensation as a percent of profits. Here you see a similarly wide range of results.

Essentially, the financial dynamics and structures of various businesses are very different, and looking at these ratios always will produce divergent conclusions – they alone do not reveal very much.

It also is important to point out that at many companies, a significant amount of incentive compensation generally is paid regardless of whether or not the overall company does well. Many companies pay certain individuals based on their specific performance (sales and service employees) and not necessarily on the performance of the company.

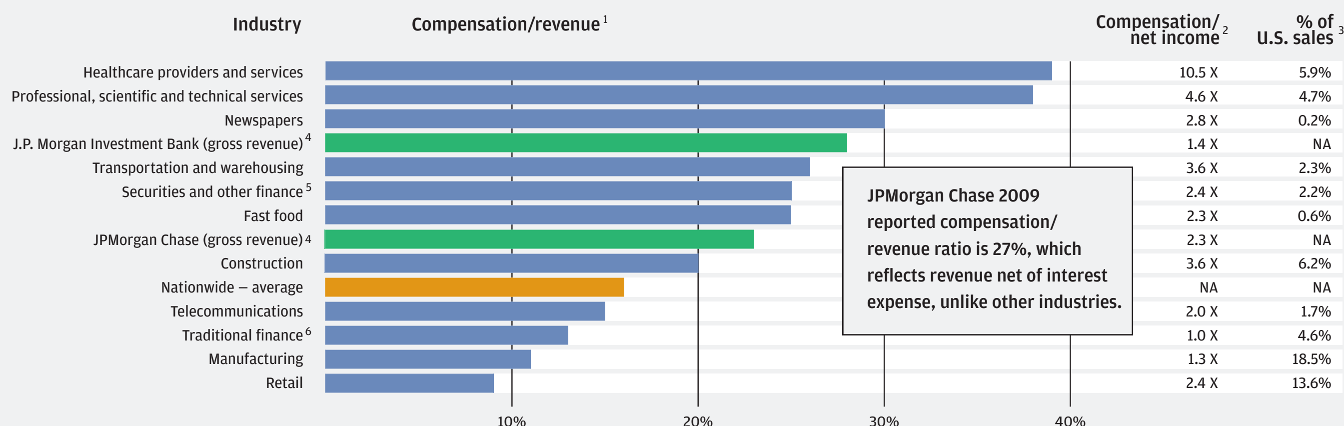
JPMorgan Chase does employ a number of highly compensated individuals, probably more than in many other industries – but not

* This includes what JPMorgan Chase contributes to various benefits programs (i.e., 401(k) match, pension, health and welfare, etc.) and employment-related taxes.

** Represents 2009 expense based on U.S. GAAP.

*** While we have 220,000 employees, our health plan covers 400,000 people, which includes covered family members.

Compensation ratios by industry



The industry compensation ratios in the table above reflect 2007 information contained in U.S. Census Bureau data, Capital IQ Compustat records and company filings and are based on revenue before deducting interest expense, whereas JPMorgan Chase and other financial services firms report their compensation ratios based on revenue net of interest expense.

1 Compensation/revenue based on U.S. data only; JPMorgan Chase data based on worldwide totals.

2 Net income margin based on 2004-2008 average for S&P 500 companies and adjusted for exceptional losses/gains.

3 Compensation/sales based on U.S. Census Bureau data.

4 Revenue based on 2009 gross revenue before interest expense.

5 Includes investment banks, asset management firms, capital markets firms and other non-lending financial institutions.

6 Includes regional banks, credit card companies and other credit/ lending institutions.

NA – Not applicable.

all. We are unable to find real comparisons. Much of the anger about highly compensated individuals at banks relates to the argument that all of these companies would have failed, which we do not believe is true (more detail on this in the next section). Finally, the more highly paid the individual is at JPMorgan Chase, the higher the percentage of compensation awarded in restricted stock and options.

Before we speak specifically about how we compensate individuals at JPMorgan Chase, it's appropriate to outline our principles.

Some key compensation principles at JPMorgan Chase

We believe the compensation principles we use are best practices and compare favorably with those outlined by outside authorities, such as the G-20, the Financial Services Authority, the Financial Stability Board, the Federal Reserve and the U.S. Treasury. Our principles are as follows:

- Pay a significant percentage of our incentive compensation in stock: at least 67% for the Operating Committee members and approximately 50% for the remainder of our senior management team.
- Structure the stock we grant – restricted stock units or options – to vest over multiple years.
- Require Operating Committee members to retain and hold approximately 75% of the stock they receive from the company after the stock vests.
- Generally do not provide multi-year guarantees to new hires and almost never to current employees.
- Institute meaningful recoupment policies, some of which we enhanced in 2008 and 2009 and are progressively more stringent at higher levels of management. For all employees, if anyone causes material financial or reputational harm to the firm or its business activities, we can recoup the employee's incentives, including stock.
- For approximately 500 senior individuals, unvested stock also can be recouped for failure to properly identify, raise or assess, in a timely manner and as reasonably expected, material risks to the firm.
- For the Operating Committee and for me, unvested stock or options can be recouped not only for the reasons mentioned above but also if reasonable progress toward personal and company goals is not met. This is at the discretion of the Board of Directors.

- Pay our people for performing well over multiple years and for helping to build enduring performance.
- Ensure that financial results – a key metric (but not the only one) we use to pay our people – always include profits adjusted for risk; that is, the more capital a business uses, the more it is assessed a charge for that capital.
- Recognize revenue for complex and long-dated trades or products over multiple years to properly reflect the risk. Try to be as conservative as possible regarding accounting – aiming not to recognize profits at all when we think doing so is inappropriate.

Some of our other compensation principles go beyond what regulators have asked for but, we believe, are equally important. For example:

- We do not have change-of-control agreements, special executive retirement plans or golden parachutes, or special severance packages for senior executives.
- We do not pay bonuses for completing a merger, which we regard as part of the job. When the merger has proved to be successful, compensation might go up.
- We feel strongly that financial outcomes alone do not represent a comprehensive picture of performance. Broader contributions – such as continually honing leadership skills; maintaining integrity and compliance; recruiting and training a diverse, outstanding workforce; building better systems; and fostering innovation, to name just some important qualities – matter a great deal. In fact, in our business, basing compensation solely on financial or quantitative measures, and ignoring qualitative measures, can be disastrous. Good performance in a particular year does not necessarily indicate that the individual did a good job.
- We are mindful that a rising tide lifts all boats so we take into account how much a strong market, as opposed to the initiative of the individual or group, contributed to the results.
- We must be highly competitive on compensation, which is absolutely crucial to being a great company. While we aim to be a company that pays its employees well, it should be because we have been a well-performing company.
- We want our employees to be shareholders. All of the policies described above have been effective in this regard: Our employees own 488 million shares and options, a significant portion of which is unvested – i.e., of no value to the individual if he or she were to leave the company for a competitor. Ownership does not guarantee that our employees will act like owners, but it certainly improves the odds.

How we pay individuals

Our starting point when it comes to compensation is, as it should be, risk-adjusted financial performance. We keep thousands of profit-and-loss statements (by branch, by trading desk, etc.). While we don't maintain incentive compensation pools at such a granular level, we do have hundreds of such pools; we try to maintain a very disciplined approach to relate compensation as closely as possible to performance.

However, we do not stop there. We make adjustments based on our own judgments about how the company is doing (in absolute and in competitive terms) and for very specific business decisions, such as additions to staff or large, new investments that affect profits. In some cases, the impact of these sorts of discretionary factors will be negligible. In other cases, the discretion we exercise may have a significant effect on the size of an incentive compensation pool. If we feel the pool amount was not earned, we do not pay it.

Some individuals are paid incentive compensation based on very specific metrics; for example, people in our call centers, retail branches and operating centers. These metrics may be increased or reduced somewhat by the company's performance. There also are a few senior people who are paid on specific metrics. For example, bankers who manage money for our clients have their compensation tightly tied to the kind of job they did for their clients. I think you would agree that this is completely appropriate.

Most of our senior people are *not* paid by formula – we use multiple metrics to assess performance and then apply a great deal of judgment. In general, the more senior the executive, the more the compensation should relate to the company's performance overall. This is especially true for the leadership team of each business.

When it comes to an individual, we look at his or her performance, the unit results and the overall performance of the company. Since we generally know these individuals well, we evaluate their performance over a multi-year period. It is important that we recognize our best people – many of those in senior positions have generally proved themselves over many, many years.

We also are keenly aware of our competition and know what it would take to replace a person if we had to hire someone new. We cannot operate in a vacuum.

Our most senior people – members of our Operating Committee – have their compensation tightly tied to the company's performance, and they also are evaluated on their leadership skills. In 2008, when the company's earnings were down 64%, your senior management's compensation was down 67% (this doesn't include me; I received no year-end incentive).

We know there are people in this industry who have been extraordinarily well-paid – and, in some cases, overpaid. Some of these people have benefited from profits that turned out to be ephemeral or were the result of excessive leverage in the system. Some benefited from extreme competition for their specific talents, often from hedge funds and other such businesses. While no firm can claim it gets compensation right every time, we at JPMorgan Chase do think we have generally been disciplined when it comes to our decisions. We believe we have the right compensation practices, but that is only one part of building a great company. The most important part is developing great leaders.

Developing leaders

Earlier in this section, I mentioned that my number one priority is to put a healthy and productive succession process in place. As I will be increasingly focused on this process, I would like to share my thoughts about the essential qualities a leader must have, particularly as they relate to a large multinational corporation like JPMorgan Chase.

Leadership is an honor, a privilege and a deep obligation. When leaders make mistakes, a lot of people can get hurt. Being true to oneself and avoiding self-deception are as important to a leader as having people to turn to for thoughtful, unbiased advice. I believe social intelligence and "emotional quotient," or EQ, matter in management. EQ can include empathy, clarity of thought, compassion and strength of character.

Good people want to work for good leaders. Bad leaders can drive out almost anyone who's good because they are corrosive to an organization; and since many are manipulative and deceptive, it often is a challenge to find them and root them out.

At many of the best companies throughout history, the constant creation of good leaders is what has enabled the organizations to stand the true test of greatness – the test of time.

Below are some essential hallmarks of a good leader. While we cannot be great at all of these traits – I know I'm not – to be successful, a leader needs to get most of them right.

Discipline

This means holding regular business reviews, talent reviews and team meetings and constantly striving for improvement – from having a strong work ethic to making lists and doing real, detailed follow-up. Leadership is like exercise; the effect has to be sustained for it to do any good.

Fortitude

This attribute often is missing in leaders: They need to have a fierce resolve to act. It means driving change, fighting bureaucracy and politics, and taking ownership and responsibility.

High standards

Abraham Lincoln said, "Things may come to those who wait ... but only the things left by those who hustle." Leaders must set high standards of performance all the time, at a detailed level and with a real sense of urgency. Leaders must compare themselves with the best. Huge institutions have a tendency toward slowing things down, which demands that leaders push forward constantly. True leaders must set the highest standards of integrity – those standards are not embedded in the business but require conscious choices. Such standards demand that we treat customers and employees the way we would want to be treated ourselves or the way we would want our own mother to be treated.

Ability to face facts

In a cold-blooded, honest way, leaders emphasize the negatives at management meetings and focus on what can be improved (of course, it's okay to celebrate the successes, too). All reporting must be accurate, and all relevant facts must be reported, with full disclosure and on one set of books.

Openness

Sharing information all the time is vital – we should debate the issues and alternative approaches, not the facts. The best leaders kill bureaucracy – it can cripple an organization – and watch for signs of politics, like sidebar meetings after the real meeting because people wouldn't speak their mind at the right time. Equally important, leaders get out in the field regularly so as not to lose touch. Anyone in a meeting should feel free to speak his or her mind without fear of offending anyone else. I once heard someone describe the importance of having "at least one truth-teller at the table." Well, if there is just one truth-teller at the table, you're in trouble – *everyone* should be a truth-teller.

Setup for success

An effective leader makes sure all the right people are in the room – from Legal, Systems and Operations to Human Resources, Finance and Risk. It's also necessary to set up the right structure. When tri-heads report to co-heads, all decisions become political – a setup for failure, not success.

Morale-building

High morale is developed through fixing problems, dealing directly and honestly with issues, earning respect and winning. It does not come from overpaying people or delivering sweet talk, which permits the avoidance of hard decision making and fosters passive-aggressive behaviors.

Loyalty, meritocracy and teamwork

While I deeply believe in loyalty, it often is misused. Loyalty should be to the principles for which someone stands and to the institution: Loyalty to an individual frequently is another form of cronyism. Leaders demand a lot from their employees and should be loyal to them – but loyalty and mutual respect are two-way streets. Loyalty to employees does not mean that a manager owes them a particular job. Loyalty to employees means building a healthy, vibrant company; telling them the truth; and giving them meaningful work, training and opportunities. If employees fall down, we should get them the help they need. Meritocracy and teamwork also are critical but frequently misunderstood. Meritocracy means putting the best person in the job, which promotes a sense of justice in the organization rather than the appearance of cynicism: "Here they go again, taking care of their friends." Finally, while teamwork is important and often

code for "getting along," equally important is an individual's ability to have the courage to stand alone and do the right thing.

Fair treatment

The best leaders treat all people properly and respectfully, from clerks to CEOs. Everyone needs to help everyone else at the company because everyone's collective purpose is to serve clients. When strong leaders consider promoting people, they pick those who are respected and ask themselves, *Would I want to work for him? Would I want my kid to report to her?*

Humility

Leaders need to acknowledge those who came before them and helped shape the enterprise – it's not all their own doing. There's a lot of luck involved in anyone's success, and a little humility is important. The overall goal must be to help build a great company – then we can do more for our employees, our customers and our communities.

The grey area of leadership

There are many aspects of the leadership process that are open for interpretation. This grey area contributes to the complexity of the challenges that leaders – and those who govern them – face. I would like to share with you where I stand with regard to a few of these issues.

Successful leaders are hard to find

There are examples of individuals who have been thrust, wholly unprepared, into positions of leadership and actually perform well – I think of President Harry Truman, among others. I would submit, however, that relying on luck is a risky proposition. History shows that bad or inexperienced leaders can produce disastrous results. While there are possibly innate and genetic parts of leadership (perhaps broad intelligence and natural energy), other parts are deeply embedded in the internal values of an individual; for example, work ethic, integrity, knowledge and good judgment. Many leaders have worked their entire lives to get where they are, and while perhaps some achieved their stature through accident or politics, that is not true for most. Anyone on a sports team, in government or in virtually any other endeavor knows when he or she encounters the rare combination of emotional skill, integrity and knowledge that makes a leader.

Successful leaders are working to build something

Most leaders I know are working to build something of which they can be proud. They usually work hard, not because they must but because they want to do so; they set high standards because as long as leaders are going to do something, they are going to do the best they can. They believe in things larger than themselves, and the highest obligation is to the team or the organization. Leaders demand loyalty, not to themselves but to the cause for which they stand.

Nonetheless, compensation does matter

While I agree that money should not be the primary motivation for leaders, it is not realistic to say that compensation should not count at any level. People have responsibilities to themselves and to their families. They also have a deep sense of "compensation justice," which means they often are upset when they feel they are not fairly compensated against peers both within and outside the company. There are markets for talent, just like products, and a company must pay a reasonable price to compete.

Big business needs entrepreneurs, too

The popular perception is that entrepreneurs – those who believe in free enterprise – exist only in small companies and that entrepreneurs in small companies should be free to pursue happiness or monetary gain as appropriate. Free enterprise, entrepreneurship and the pursuit of happiness also exist in most large enterprises. And you, our shareholders, should insist on it. Without the capacity to innovate, respond to new and rapidly changing markets, and anticipate enormous challenges, large companies would cease to exist. The people who achieve these objectives want to be compensated fairly, just as they would be if they had built a successful start-up.

Performance isn't always easy to judge

Managers responsible for businesses must necessarily evaluate individuals along a spectrum of factors. Did these individuals act with integrity? Did they hire and train good people? Did they build the systems and products that will strengthen the company, not just in the current year but in future years? Did they develop real management teams? In essence, are they building something with sustainable, long-term value? Making these determinations requires courage and judgment.

Sometimes leaders should be supported and paid even when a unit does poorly

If a company's largest, and perhaps most important, business unit is under enormous stress and strain, unlikely to earn money regardless of who is running it, a manager might ask his best leader to take on the job. This may be the toughest job in the company, one that will take years to work through before the ship has been righted. When the manager asks a leader to take on the responsibility, she quite appropriately will want to know whether she will be supported in the toughest of times: "Will you make sure the organization doesn't desert me?" "Will you stop the politics of people using my unit's poor performance against me?" "Will you compensate me fairly?" My answer to all of these questions would be yes. And as long as I thought she were doing the job well, I would want to pay her like our best leaders, profits aside. Conversely, we all know that a rising tide lifts all boats. When that's the case, paying that leader too much is possibly the worst thing one can do – because it teaches people the wrong lesson.

Evaluating the CEO

The CEO should be held strictly accountable by the Board of Directors. The Board should continually review the CEO's performance and give feedback (and coaching). The Board alone should determine the compensation for the CEO. At every regularly scheduled Board meeting at JPMorgan Chase, the directors also have a private meeting without me. Compensation committees and the Board need to be independent thinkers – and yours are. They review lots of data to evaluate the performance of the company, including reviewing competitors' performance and their compensation practices. Our Board members do not rely on compensation consultants to make decisions for them. The Board members believe that determining how to compensate the CEO (and all of our senior management) is their responsibility and cannot be outsourced.

In two of the last 10 years, I received no bonus, which I thought was absolutely appropriate. In 2000, Bank One was in terrible shape – we had to lay off approximately 10,000 people, and I thought it completely inappropriate that I take a bonus. That year, my first at Bank One, I had a guarantee – I gave it up. The second time was in 2008, and our financial results were just too mediocre to contemplate a bonus for the CEO. Since we did pay many other people in those two years, we also lived by the principle that the CEO does not have to be the highest paid person in the company.

In all the years I've worked at this company, much of my compensation (approximately 65%) has been in stock. I've never sold a share and do not intend to do so as long as I'm in this job. In fact, when I joined Bank One, I bought a lot of stock outright, not because I thought it was cheap (in fact, I thought it was overvalued) but because I wanted to be tethered tightly to the company and its performance.

III. OUR SUPPORT OF FINANCIAL REFORM THAT WILL STRENGTHEN THE FINANCIAL SYSTEM

We need rational policies based on facts and analysis

The recent financial crisis has caused great distress across the country and around the world, but it also has provided us with a path for going forward. The era of bailouts must end, and the oversight of system-wide risk must increase, among other changes. David Hume said, "Reason is … slave of the passions …" But if we rewrite the rules for banks out of anger or populism, we'll end up with the wrong solutions and put barriers in the way of future economic growth. Good policy and financial reform must be based on facts and analysis and need to be comprehensive, coordinated, consistent and relevant.

As *New York Times* columnist Thomas L. Friedman noted earlier this year, "We need a new banking regulatory regime that reduces recklessness without reducing risk-taking, which is the key to capitalism." In striking this regulatory balance, the details matter. We should focus on building good regulation – not simply more or less of it. The last thing we need is to enact new policies that over-regulate and work at cross-purposes without reducing system-wide risk. None of us can afford the costs of unnecessary or bad regulation.

While we acknowledge that making good decisions takes time, we think it is important to complete financial reform this year. The lack of regulatory clarity is creating problems for banks and for the entire economy. Businesses need confidence and certainty to grow (and to create jobs). Passing sensible financial reforms will provide some of the certainty the business sector needs. With this in mind, I would like to discuss the critical lessons learned and how they are central to getting regulatory reform right.

The crisis had many causes

In my 2008 letter to shareholders, I discussed the fundamental causes and contributors to the financial crisis. I won't repeat them in detail here, but, broadly speaking, they were as follows:

- The burst of a major housing bubble, caused by bad mortgage underwriting, a somewhat unregulated mortgage business and some misguided government policies.
- Excessive, pervasive leverage across the system, including banks, investment banks, hedge funds, consumers and the shadow banking system.
- The dramatic growth of structural risks and the unanticipated damage they caused (the flaws of money market funds and the repo system). Remember, we had a "run" on the capital markets.
- Regulatory lapses and mistakes: Basel capital rules that required too little capital and didn't account for liquidity and relied too much on rating agencies; the Securities and Exchange Commission allowing U.S. investment banks to get too leveraged; and poor regulation of Fannie Mae and Freddie Mac, among many elements of an archaic, siloed regulatory system. However, we should not and do not blame regulators for the failures of individual companies, ever – management is solely to blame.
- The pro-cyclical nature of virtually all policies, actions and events (e.g., loan loss reserving, capital requirements and the market itself).
- The impact of huge trade and financing imbalances on interest rates, consumption and speculation levels.

The heart of the problem – across all sectors – was bad risk management. Many market participants improperly used value-at-risk (VaR) measurements; they did not run stress tests to be prepared for the possibility of a highly stressed environment; they excessively relied on rating agencies; they stretched too much for current earnings; and they didn't react quickly when markets got bad.

At JPMorgan Chase, we never overly relied on VaR, and we regularly ran stress tests to make sure we were prepared for bad environments. Our goal was and is to remain profitable every quarter.

While it is tempting to identify a scapegoat – banks, businesses, the government or consumers – it is pretty obvious that no one was solely to blame and that no one should be completely absolved from blame.

Yes, we made mistakes ...

... and we have identified and described them in great detail in prior years' chairman's letters. Our two largest mistakes were making too many leveraged loans and lowering our mortgage underwriting standards. While our mortgage underwriting was considerably better than many others', we did underwrite some high loan-to-value mortgages based on stated, not verified, income. We accept complete responsibility for any and all mistakes we made or may have made.

There also are many mistakes that we did not make, among them: structured investment vehicles (SIVs), extreme leverage, excessive reliance on short-term funding, collateralized debt obligations and improper management of our derivatives book.

Some of the mistakes we made may have contributed to the crisis. For those, of course, we are sorry – to both the public and our shareholders. However, it would be a huge stretch to say that these mistakes *caused* the crisis. In fact, at the height of the crisis, we aggressively took actions that we believed helped mitigate some of the fallout from the crisis and contributed to the stabilization and recovery (e.g., our purchase of Bear Stearns and WaMu and our interbank lending; that is, loans that banks make directly to each other).

Yes, we should thank the government for its extraordinary actions

As noted in last year's letter, we think the government acted boldly and urgently in dealing with a complex and rapidly changing situation. Without many of these actions, we believe the outcome could have been much worse. A great number of the actions that the Treasury and the Federal Reserve took, directly and indirectly, benefited a number of institutions and may have saved many from failure and bankruptcy.

Without these actions, however, not all banks would have failed

The premise that all banks would have failed had it not been for the government's actions is incorrect. This premise is behind much of the anger toward banks and some of the policy recommendations that are meant to punish banks. We should acknowledge that the worst offenders among financial companies no longer are in existence. And while it is true that some of the surviving banks would not, or might not, have survived, not all banks would have failed. I know I speak for a number of banks when I say that some of us accepted the Troubled Asset Relief Program (TARP) capital not because we needed it to survive but because we believed we were doing the right thing to help the country and the economy. We were told the government wanted even the healthy banks to take TARP to set an example for all banks and to make it easier for the weaker institutions to accept the capital without being stigmatized. JPMorgan Chase and many other banks were in a position to try to help, and that is what we did.

At the worst point in the crisis, we aggressively provided credit

Throughout the financial crisis, JPMorgan Chase never posted a quarterly loss. We served as a safe haven for depositors, worked closely with the federal government and remained an active lender.

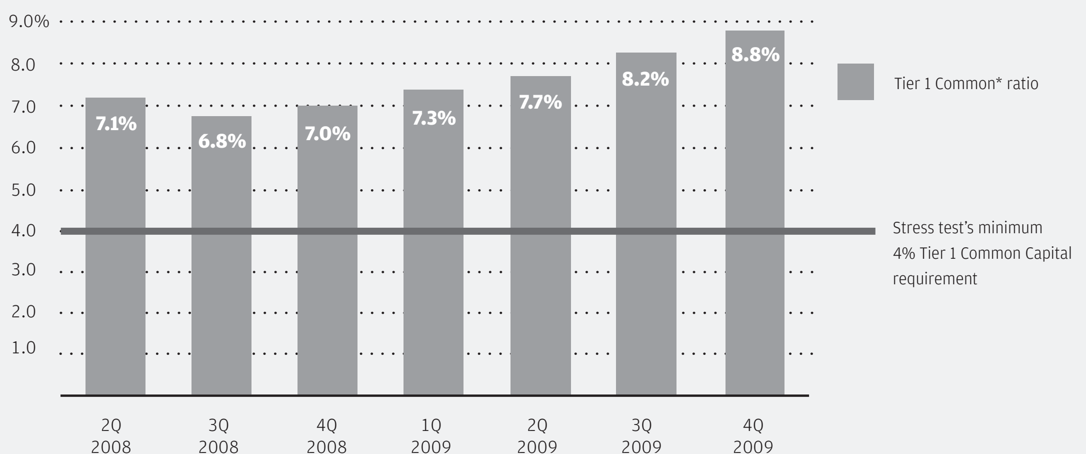
Our fortress balance sheet enabled us to buy Bear Stearns in March 2008, adding $289 billion in assets; then we acquired Washington Mutual just six months later, adding a further $264 billion of assets. Through it all, JPMorgan Chase absorbed the stress of higher consumer and wholesale credit losses while maintaining high liquidity and acceptable growth in our capital. We acquired Washington Mutual *just 10 days after* Lehman Brothers' collapse on September 15, 2008, and, in order to maintain our fortress balance sheet, immediately sold $11.5 billion in common stock the following morning. The takeover of Bear Stearns and WaMu provided essential credit and support to the system and minimized a potentially disastrous disruption that could have resulted from their failures. In the several months after Lehman's failure, our interbank lending grew from almost nothing to as high as $70 billion, and our average lending was approximately $100 billion per month, even higher than it had been in the prior months. We also purchased, at one point, a net $250 billion of securities, which helped facilitate much-needed liquidity in the marketplace.

We consistently maintained extremely high capital levels

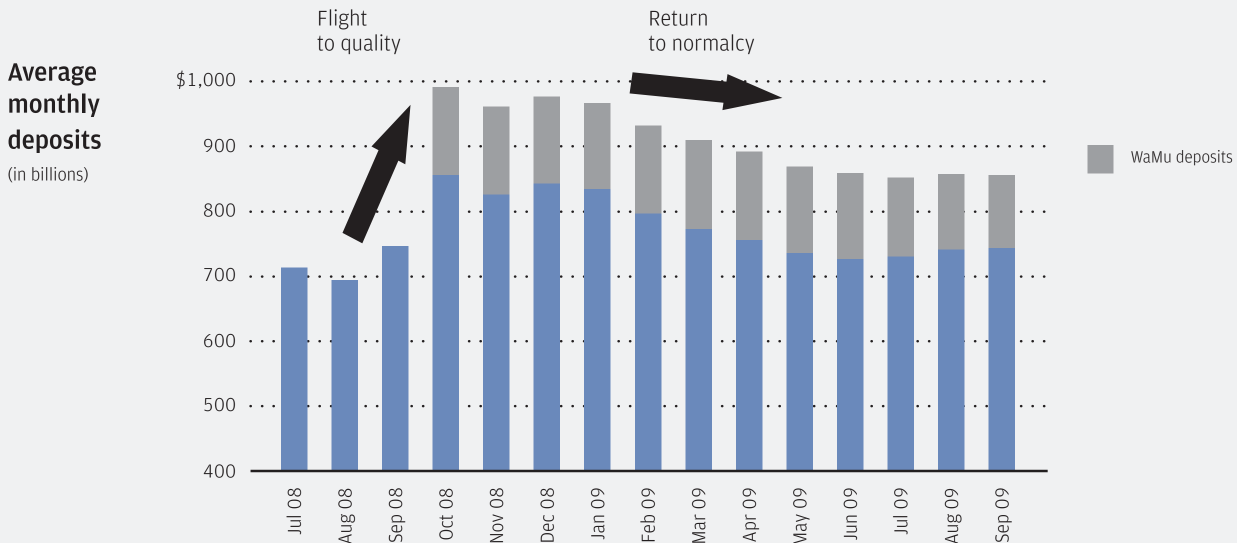
As the chart below shows, we ended 2008 with Tier 1 Common Capital of 7.0% (the critical measure used by the Federal Reserve for its bank stress tests), and we ended 2009 with Tier 1 Common Capital of 8.8%.

In May 2009, the U.S. government ran a stress test on 19 banks. The test assumed an adverse environment of 10.4% unemployment and a 48% peak-to-trough decline in the housing price index across a two-year time span. Upon completion of the test, the results required 10 banks to raise common equity to maintain 4% Tier 1 Common Capital through the end of the stress scenarios. Under the government's test, JPMorgan Chase always had common equity of $40 billion *in excess* of the 4% minimum (for the record, the $25 billion of TARP capital we accepted was preferred stock and, therefore, never was part of this calculation). The bottom line is that we passed the stress test with flying colors.

Quarterly capital levels



* The Tier 1 Common ratio is Tier 1 Common Capital divided by risk-weighted assets. Tier 1 Common Capital is predominantly Tier 1 Capital less preferred equity, noncontrolling interests and trust preferred capital debt securities. Tier 1 Common Capital is the first element of capital to absorb losses. See page 90 for further discussion.



We kept our liquidity extremely high

As we entered the most tumultuous financial markets since the Great Depression, we experienced the opposite of a "run on the bank" as deposits flowed in (in a two-month period, $150 billion flowed in – we barely knew what to do with it). At JPMorgan Chase, our deposits always exceeded our loans; deposits always have been considered one of the safest sources of funding for a bank. The average bank has loans that are generally greater than 110% of its deposits. For JPMorgan Chase, loans were approximately 75% of deposits. In fact, our excess deposits greatly reduced the need to finance ourselves in riskier wholesale markets.

In the long-term wholesale unsecured markets, we borrowed on average $270 billion. Only $40 billion was borrowed unsecured in the short-term credit markets – an extraordinarily low amount for a company of our size. When we borrow in the secured markets, we do so under the assumption that we would have access to some, not all, of that funding in a crisis.

We always maintained excess liquidity at the bank holding company. We had and continue to have enough cash or cash equivalents on hand to fund ourselves for more than two years, even in the event that we are unable to borrow from the unsecured credit markets at all.

We were prepared for things to get even worse

While the economic environment had become as bad as any of us had ever seen, we reluctantly prepared for the situation to get worse, with a possible U.S. unemployment rate of 15% or higher. Such an adverse environment would have required drastic actions: a large headcount reduction, elimination of marketing and other investments, and a decrease in lending to preserve capital. Steps like these would have saved more than $12 billion in expenses and created considerable additional capital. However, it also would have imposed deep hardship on many of our employees, suppliers and customers. Fortunately, we never had to execute such a drastic plan. This was precisely what the government was trying to avoid, and I believe its actions helped prevent many companies from taking steps like those mentioned above.

Government programs were a mixed blessing

While we deeply appreciate the government's actions – and they clearly had benefits for the system and for JPMorgan Chase – they also were a mixed blessing.

In June 2009, we paid back the TARP capital in full. The $25 billion we borrowed for eight months cost us money, because we never were able to lend the $25 billion and earn a rate

higher than the 5% coupon we were paying on the preferred shares. In addition, we gave the government warrants worth almost $1 billion – a direct cost to our shareholders.

We did participate in the Federal Deposit Insurance Corporation (FDIC) guarantee program, under which we issued $40 billion of debt with an FDIC guarantee. Many banks that used this program would not have had access to the capital markets without this guarantee and possibly could have failed. For JPMorgan Chase, it was not a question of access or need – to the extent we needed it, the markets always were open to us – but the program did save us money. As part of this program, we have paid the FDIC $1.3 billion, and, after paying the FDIC, it will save us a significant amount of money over the next few years.

Our company was highly criticized for accepting the TARP capital and for using the FDIC program. After April 1, 2009, even though we were eligible to continue using the FDIC program, we stopped using it. There were many other government programs (with acronyms such as TALF and PPIP) that we believe were beneficial to the capital markets, but that we did not need and chose not to use, so as to avoid the stigma. (We did use the Term Auction Facility (TAF), a special government-sponsored depository facility, but this was done at the request of the Federal Reserve to help motivate others to use the system.)

While no one knows what would have happened in the absence of all these government programs, there is a strong argument that those that entered the crisis in a position of strength may have gathered huge benefits at the expense of failing competitors – but it is hard to argue that this would have been good for the country.

We did not anticipate the anger or backlash the acceptance of TARP capital would evoke from the public, politicians and the media – but, even with hindsight, I think we would have had to accept TARP capital because doing so was in the best interest of the country. I do wish it would have been possible to distinguish between the healthy and unhealthy banks in a way that didn't damage the success of the program – so as not to create a situation where the public was left with the impression that all banks were bailed out. Last, I do regret having used the FDIC guarantee because we didn't need it, and it just added to the argument that all banks had been bailed out and fueled the anger directed toward banks.

The government runs the FDIC, but the banks pay for it

While the FDIC is a government institution that insures bank deposits, our shareholders should know that the costs associated with failed banks are borne in full by the banks, not by taxpayers. We think this is completely appropriate. Even if the FDIC's special Temporary Liquidity Guarantee Program (TLGP) had lost money, those losses would have been charged back to the surviving banks. Therefore, it is these surviving banks that have paid for the cost to the FDIC of the approximately 200 bank failures since the beginning of 2008.

Of those failures, the largest one, WaMu (with assets exceeding $260 billion), has cost the FDIC nothing. That is because JPMorgan Chase bought WaMu. All of the other banks that have failed were far smaller (the next largest failure was IndyMac, with $32 billion). All of these failures combined have cost the FDIC an estimated $55 billion.

Between deposit insurance and TLGP funding for 2008 and 2009, plus estimates for our share of assessments over the next three years, JPMorgan Chase alone will have given the FDIC a total of approximately $6 billion to cover the cost of failed banks.

Banks are lending — a little less but more responsibly

A great deal of media attention recently has focused on what it will take to get banks lending again. The reality is that banks never have stopped lending: As of the end of February 2010, according to the latest data from the regulatory reports, total loans held by commercial banks stood at $6.5 trillion – higher than at the end of June 2007 and more than 30% higher than in 2004.

How is it that businesses and consumers clearly feel they have less access to bank credit while the banks claim they are still lending? This disconnect can be explained as follows:

1. The flow of non-bank lending, which has accounted for 65% of the credit supplied in the United States, dried up. Many non-bank lenders (think of the shadow banking system, SIVs, the asset-backed commercial paper market and the securitization markets) virtually collapsed. These sources of credit alone – and they were funded by insurance companies, pension plans, and corporate and foreign investors – reduced the credit they were providing to the system by nearly half a trillion dollars.
2. Bank lending did go up in the months immediately after Lehman's collapse, but during the course of 2009, bank lending started to decline in total. While more than 100 banks, including JPMorgan Chase, stepped up and acquired failing banks, they could not and did not fully replace the extension of credit the failing banks had been providing. For example, at JPMorgan Chase, we did not continue the subprime lending and option-ARM mortgages that WaMu had been providing.
3. Many banks also tightened their loan standards, which further reduced new loans.
4. Additionally, customer demand for loans decreased across large and small businesses. In fact, at JPMorgan Chase alone, loans to large companies dropped (from $85 billion to $50 billion). This was not due to our reluctance to make the loans but rather to large companies taking advantage of the ability to finance at lower rates in the reopened capital markets.

Banks have a responsibility to make sound loans. Bad loans are one of the things that got us into this mess in the first place. And, unfortunately, making good loans often means declining applications for loans that do not meet safe and sound lending criteria. While it may not seem obvious at the time, turning down an application that fails to meet these criteria actually may be in both our and our client's best interest. We have a responsibility to lend only to those who can handle the debt. Unlike many other businesses, this puts us in the unpopular position of saying no to some of our customers.

Banks are not fighting regulation

We at JPMorgan Chase and at other banks have consistently acknowledged the need for proper regulatory reform, and I also spoke about this topic in great detail in last year's letter.

Looking back, one of the surprising aspects about the recent crisis is that most of the specific problems associated with it (global trade imbalances, the housing bubble, excessive leverage, money market funds, etc.) were individually well-known and discussed. But no one, as far as I know, put together all of the factors and predicted the toxic combination it would become – and the crisis it would cause.

So what can we do to help fix the situation going forward? We must focus on the problem: bad risk management. This not only caused financial institutions to fail, but it also revealed fundamental flaws in the system itself. These flaws existed at both a macro level, where the interplay of the numerous critical factors was missed, and a micro level: for example, the failure to prevent AIG from taking excessive, one-sided positions in trading derivatives and the failure to limit mortgages to families who could afford them and to keep loan-to-value ratios to a more reasonable 80%-90%.

Over the last 50 years, we have allowed our regulatory system to become dangerously outdated. The structure is archaic and leaves huge gaps in the system. Today, in America, banks account for only one-third of the credit outstanding, with all kinds of non-banks taking and trading risks and providing credit to the system. So the idea that banking is confined to deposit-holding entities is inaccurate and deceptive. The failure of so many firms in a range of sizes and categories – from Bear Stearns and Lehman Brothers to IndyMac and WaMu to Fannie Mae, Freddie Mac and AIG, as well as local community banks – proves that regulation needs to be administered by product and economic substance, not by legal entity. We have a chance to simplify and strengthen our regulatory system, and, if we do it right, it will not only be able to handle the complex challenges we face today but will be able to do so in a way that will be flexible enough to continuously adapt to our changing world.

We support a systemic regulator

Going forward, we will need a systemic regulator charged with effectively monitoring the spread and level of risk across the financial system in its entirety. Think of it as a "super risk" regulator. Such a regulator would not eliminate all future problems, but it would be able to mitigate them. If we had eliminated just *some* of the problems, it might have stopped the crisis from getting this bad. Congress appears to be well on its way to creating just such a regulator, and we hope it succeeds.

Some issues the systemic risk regulator should keep in mind are the following:

- Focusing the process on managing risk. This should not be a political process. It should function like a strong risk management committee.
- Eliminating gaps and overlaps in the system. For example, mortgages were regulated by multiple entities, some of which did a terrible job, causing a "race to the bottom" as even good companies started to do bad things to maintain market share.
- Analyzing areas like the mortgage market and other elements of the consumer-finance system to ensure that when new rules are written, they create a sound, safe, effective and consumer-friendly mortgage market.
- Carefully tracking new products, as they often are the source of many problems.
- Reviewing credit across the whole system – including "hidden" extensions of credit, such as enhanced money market funds and SIVs.
- Aggressively monitoring financial markets and potential excesses, or bubbles. It may be hard to detect bubbles, and it may be inadvisable, once detected, to exert a direct influence on them with macro economic policy. However, it is appropriate to try to minimize the collateral damage bubbles can cause. It also would be appropriate to try to manage bubbles, not by using monetary policy but by restricting credit on specific markets (i.e., it would have been appropriate to ask lenders to reduce loan-to-value ratios in mortgages or to minimize speculation in the financial markets by reducing the leverage used in the repo markets).
- Recognizing distortions as they develop in the broader economy (fiscal deficits, trade imbalances, structural state budget deficits) and forcing policy bodies to anticipate the problems that may result.
- Encouraging international coordination as much as possible – not only so companies compete on a level playing field but also because crises don't stop at national borders.

These are just some of the ways a systemic regulator could help fix the flaws in our regulatory framework and create a system that *continually adapts and improves itself.*

We support an enhanced resolution authority — and the elimination of "too big to fail"

Even if we achieve the primary goal of regulating financial firms to prevent them from failing, we still have to get government out of the business of rescuing poorly managed firms. All firms should be allowed to fail no matter how big or interconnected they are to other firms. That's why we at JPMorgan Chase have argued for an enhanced resolution authority that would let regulators wind down failing firms in a controlled way that minimizes damage to the economy and will never cost the taxpayer anything. Fixing the "too big to fail" problem alone would go a long way toward solving many of the issues at the heart of the crisis. Just giving regulators this authority, in and of itself, would reduce the likelihood of failure as managements and boards would recognize there is no safety net. Think of this enhanced resolution as "specialized bankruptcy" for financial companies. The principles of such a system would be as follows:

- A failure should be based on a company's inability to finance itself.
- The regulator (or specialized bankruptcy court) should be able to terminate managements and boards.
- Shareholders *should* be wiped out when a bank fails – just like in a bankruptcy.
- The regulator could operate the company both to minimize damage to the company and to protect the resolution fund.
- The regulator could liquidate assets or sell parts of the company as it sees fit.
- Unsecured creditors *should* recover money only after everyone else is paid – like in a bankruptcy. (In fact, the resolution authority should keep a significant amount of the recovery to pay for its efforts and to fund future resolutions.)
- In essence, secured creditors should be treated like they are treated in a bankruptcy.
- The resolution fund should be paid for by the financial industry (like the FDIC is today).
- All institutions under this regime should live with *the exact same rules.*
- Regulators should make sure that companies have enough equity and unsecured debt to prevent the resolution fund from ever running out of money. To give an example, while Lehman had $26 billion in equity, it also had $128 billion in unsecured debt. A resolution regulator, in my opinion, would clearly have been able to let Lehman meet its obligations, wind it down and/or sell it off and still have plenty of money left over to return some money to the unsecured creditors. Had this been done wisely, the economy would have been better off.
- If a firm fails, there should be enough clarity about the financial, legal and tax structures of that firm to allow regulators, cooperating across international boundaries, to wind it down in a controlled manner – what some refer to as "living wills."
- While there is no argument about who should pay for the resolution (i.e., banks), there are some technical issues about how it should be funded. The resolution regulator does need to be able to fund these companies while they are being wound down, and there are plenty of appropriate ways to accomplish this.

Once it is established that any firm can fail, firms of all sizes and shapes should be allowed to thrive. It is wrong to assume that big firms inherently are risky. Banks shouldn't be big for the sake of being big, but scale can create value for shareholders and for consumers who are beneficiaries of better products that are delivered more quickly and less expensively. These benefits extend beyond individuals to include businesses that are bank clients, particularly those that are global in scale and reach, and the economy as a whole.

Many banks' capabilities, size and diversity enabled them to withstand the crisis and emerge from it as stronger firms. This strength, in turn, made it possible for many firms to acquire weaker firms at the government's request and help to alleviate potential damage to the economy.

Closing comments on regulation

While we support the general principles behind enhanced regulation of derivatives, securitizations and enhanced consumer protections, we do not support each and every part of what is being recommended. The devil is in the details, and it is critical that the reforms actually provide the important safeguards without unnecessarily disrupting the health of the overall financial system.

We also believe there are some serious ideas that need attention if the system is to be made more fail-safe:

- Repo markets could be better structured, monitored and controlled.
- Loan reserving could be made far less pro-cyclical.
- Securitization markets could be fixed so that both originators and distributors have skin in the game.
- A system could be put into place to prevent a "run" on money market funds.
- The ability to buy shareholder or creditor voting rights without owning and being exposed to the risks of owning the underlying securities should be extremely limited. Investors should not have the ability to vote the capital securities actually owned if the investors are voting for the failure of the company and stand to gain more on their short positions than on their long positions.
- Finally, we support strong controls on so-called "naked short selling."

During the past year's discussion among regulators and legislators, many other ideas have been proposed or recommended – from the Volcker Rule to new bank taxes to changes in Basel capital. These ideas are all in varying stages of development and are too undefined to comment on here. What we would urge our regulators and legislators to do is proceed with clarity and purpose and avoid broadly penalizing all firms alike – regardless of whether they were reckless or prudent.

IV. OUR RESPONSIBILITY AND AMERICA'S SUCCESS

As we grapple with the enormity of the issues facing the nation, we must not lose sight of our strengths. America has successfully brought these strengths to bear on crises in the past – some much bigger than the current one – and I am optimistic about our ability to do so again.

America's success as a nation requires a strong and growing economy. A strong and growing economy requires the right kind of government policies and a private sector that is innovative as well as responsible. Responsible businesses can be both small and large – and, in a global economy, it behooves America to have large multinational companies that are operating on a global stage. Creating a culture that ties it all together requires a greater sense of shared responsibility.

America's success is not a God-given right – it is something we always must work hard to achieve.

The need for a strong economy and good government

America's success depends upon many things, including good government (and the strength of our exceptional military). But it cannot succeed without a healthy and vibrant economy. That is what allows us to share the rewards of success, defend our nation, educate our children and build a better future.

A strong U.S. economy, one with the ability to continually improve and reform itself, depends on good government. Bureaucracy is lethal, and we cannot let it drain the energy, talent, creativity, drive and goodwill of our citizens – or those we encourage through our example, many of whom come to work and innovate in America. To thrive, our country and our economy need:

- Legal clarity and consistency.
- The fair application and steadfast enforcement of the rule of law.
- Trade policies conducive to growing the American economy and the global competitiveness of U.S. companies.
- Immigration policies that allow America to attract the world's best and brightest – an essential ingredient of our success as a nation.
- Sensible and effective regulation that protects investors and the public.
- A strong and efficient infrastructure (from highways and bridges to electrical grids, etc.).
- The proactive promotion of economic growth and rules that foster U.S. capital accumulation.
- Policies facilitating job growth, as opposed to those that inadvertently make it harder to hire.

Countries can have different social values and objectives (though I believe most countries and most citizens would like to reduce poverty and suffering). But countries should not confuse values and objectives with maintaining a strong economy.

Healthy and growing countries can do wonderful things for their people. And countries that fail to create healthy economies frequently relegate their people to increasing levels of pain and suffering. Many countries have professed wanting to help their people but, instead, have damaged their countries and hurt their people. Maybe the intentions were real, but, even if they were, the road to hell is often paved with good intentions.

Brazil is an example of a country that seems to be successfully using pro-growth policies to expand its economy while using the wealth from that economic growth to finance important social programs. Over the last 20 years, Brazil has adopted many policies that dramatically strengthened its economy. It also bolstered its institutions, privatized its businesses, improved the rule of law, left the bulk of capital allocation to the private capital markets and developed world-class companies.

Eight years ago, Brazil elected a left-leaning president, but he continued policies to strengthen the economy. He also used some of the wealth to start a program called Bolsa Familia that gave Brazil's poorest citizens vaccinations, education and $80 a month for food.

The lesson is clear: Good policies and economic growth are not the enemy of social progress – they are the fuel for progress.

Businesses need to be responsible — and healthy and vibrant

At JPMorgan Chase, we feel a deep responsibility to build a company that benefits our customers, our employees, our shareholders and the communities in which we operate around the world. The best companies don't make decisions for short-term profits. Contrary to public opinion, corporations are not in business solely to maximize quarterly earnings but rather to serve clients and earn their trust over a long period of time and, in so doing, earn a fair profit. Profits in any one year, in effect, are a reflection of decisions that may go back decades.

We always have been deeply committed to being good corporate citizens and adhering to the following practices:

- Treating our customers and employees with the respect they deserve.
- Building safe and useful products.
- Maintaining ethical and responsible business practices.
- Meeting our fiduciary responsibilities and creating real value for shareholders.
- Developing a company for the long run – one that stands the test of time.
- Making a meaningful difference through philanthropic endeavors in supporting our communities.
- Acknowledging our mistakes (which are a natural part of doing business), fixing them and learning from them.
- Supporting the economies in which we work through job creation and appropriate tax payments. JPMorgan Chase, on average, pays more than $12 billion a year in taxes to governments around the world.

Building a great company allows investment in the future, provides opportunities to employees, builds better products for customers and serves communities. Companies that are not healthy and vibrant cannot do these things.

Businesses — small to large — are one of America's key strengths

A healthy business sector is fundamental to our economic strength: Of the 130 million people who go to work every day in the United States, nearly 110 million are employed by private businesses. These private businesses are and always have been the nation's primary drivers of job creation and innovation.

The strength of the business sector is rooted in its diversity, from the smallest start-up or family-owned firm to the largest multinational corporation.

Indeed, the relationship between larger and smaller businesses is symbiotic. Studies show that for every one job created at a larger business, five jobs are created at smaller businesses that provide supporting goods and services. At JPMorgan Chase, in particular, we spend more than $15 billion per year with approximately 40,000 vendors, who provide jobs to millions of employees.

We need global flagship companies — including banks

In the current political environment, size in the business community has been demonized, but the fact is that some businesses require size in order to make necessary investments, take extraordinary risks and provide vital support globally. America's largest companies operate around the world and employ millions of people. This includes companies that can make huge investments – as much as $10 billion to $20 billion a year – and compete in as many as 50 to 100 countries to assure Amer-

ica's long-term success. Combined, big and small businesses spend $1.5 trillion per year on capital expenditures and $300 billion on research and development. It is estimated that more than 70% of the capital expenditures are made by large companies.

The productivity of our workers and the huge economies of scale of our corporations (generated from years of investing and innovating) are what ultimately drive our economy and income growth. Employees at large companies share in that productivity: Compensation and benefits for employees at large companies are substantially higher than at small firms.*

It is estimated that large enterprises and large foreign multinationals active in the United States have accounted for the majority of U.S. productivity growth since 1995.

Companies such as Ford, Boeing, Pfizer, Caterpillar, Apple, Microsoft and Google are exemplars of initiative and innovation worldwide. Cutting-edge companies like Hewlett-Packard underpin vibrant networks of small and mid-size suppliers and vendors. Academic research shows that these investments abroad actually create more jobs in the United States.

Large companies such as the ones mentioned above need banking partners with large enough balance sheets to finance transactions around the world. And it's not just multinational corporations that rely on such scale: States and municipalities also depend on the capital that a firm like JPMorgan Chase can provide. To be sure, smaller banks play a vital role in our nation's economy but cannot always provide the type of service, capital, breadth of products and speed of execution that clients need. Only large banks have the scale and resources to connect markets around the globe, in places like China, India, Brazil, South Africa and Russia; to execute diverse and large-scale transactions; to offer a range of products and services, from loan underwriting and risk management to local lines of credit; to process terabytes of financial data; and to provide financing in the billions.

U.S. banks actually are less consolidated than those in the rest of the world, and our financial system is less dominated by large banks than that of almost any other nation. For example, in 2007, the three largest U.S. banks held 34% of total U.S. bank assets – the second-lowest figure among Organisation for Economic Co-operation and Development (OECD) nations, just ahead of Luxembourg; the average for the rest of the OECD nations was more than double, at 69%. Not only is our banking system not particularly concentrated, but our large banks are not relatively large compared with the size of the U.S. economy. The arguments that "big is bad" and that "too consolidated is bad" are refuted by many examples of countries with large, consolidated banking systems that did not have problems at all (e.g., Canada).

Capping the size of America's largest banks won't change the needs of big business. Instead, it will force these companies to turn to foreign banks that won't face the same restrictions. JPMorgan Chase's capabilities, size and diversity were essential to withstanding the financial crisis in 2008 and emerging as a stronger firm.

Everyone needs to be responsible

America was built on the principles of rugged individualism and self-responsibility. We need to continue to foster a sense of responsibility in all participants in the economy. Bad outcomes are not always someone else's fault – we need to cultivate an environment where consumers, lenders, borrowers, businesses and investors all take responsibility for their actions and don't look for someone else to blame. We have to stop slipping into a cacophony of finger-pointing and blame. And while bad actors always should be punished, we also should note that not all who got into trouble were irresponsible. We fully acknowledge, for example, that many individuals found themselves in a difficult position that was caused by a medical condition or loss of employment beyond their control, and they should be treated fairly and respectfully.

The crisis of the past couple of years has had far-reaching consequences, among them the declining public image of banks and bankers.

* The U.S. Bureau of Labor Statistics shows that employees of large firms (with 500 or more employees) have average hourly earnings ($25/hour, including wages and salaries) 46% higher than employees of small firms (with fewer than 50 employees). Similarly, large firms provide 88% of their employees access to medical benefits compared with 55% at small firms.

While JPMorgan Chase certainly made its share of mistakes in this tumultuous time, our firm always has remained focused on the fundamentals of banking and the part we can play to support our clients and communities. Our 220,000 people go to work every day to do a great job serving clients, whose trust we have to earn over many years. The vast majority of our people, customers, operations and shareholders are far from Wall Street – they actually are part of the everyday life of Main Street, in virtually every part of the country. And they are active and contributing members of society in communities around the world.

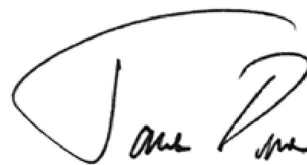
Very often, when the public or politicians take punitive efforts against banks like ours, they think they are punishing only the senior management team, when, in fact, they are punishing ordinary shareholders as well. Contrary to popular perception, Main Street owns our biggest banks and corporations through savings and retirement funds. Our shareholders represent a true cross section of America, including teachers, retirees and public employees. When we reduce the debate over responsibility and regulation to simplistic and inaccurate notions, such as Main Street vs. Wall Street, big business vs. small business or big banks vs. small banks, we are indiscriminately blaming the good and the bad – this is simply another form of ignorance and prejudice.

By extension, when we vilify whole industries or all of the business community, we are denigrating ourselves and much of what made this country successful. We also should refrain from indiscriminate blame of any whole group of people, including politicians or the media. We need to focus a bit less on daily media and polls and more on the books that will be written after this crisis subsides. We all should ask ourselves whether we, in a time of stress, did the right things the right way for the right reasons.

Conclusion

The United States faces many challenges. In the short run, overcoming this economic crisis and getting our unemployed back to work are most important. In the long run, we must confront our health and education systems; develop a real, substantive energy policy; and build the infrastructure for the future. We also must confront the large U.S. deficit, being honest about the facts and being fiscally responsible for ourselves – it is dangerous to wait for the global markets to pressure us into that discipline. These are all serious challenges, but, if we work together, we can fix them.

Your company continues to do everything it can, in every community in which we work, to help the world recover as quickly as possible. In 2009, as they have so many times before, our people rose to the challenge, working amid tremendous uncertainty in a fragile economic and political environment. They also have coped with the anger directed toward the financial services industry. Through it all, they did not lose focus on why we are all here: to serve clients and, therefore, our communities around the world. On behalf of JPMorgan Chase and its management and shareholders, I express my deepest gratitude to our people. I am proud to be their partner.



Jamie Dimon
Chairman and Chief Executive Officer

March 26, 2010