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A BREAKDOWN IN RISK MANAGEMENT: WHAT WENT WRONG AT JPMORGAN CHASE?

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

ON

EXAMINING WHAT WENT WRONG AT JPMORGAN CHASE

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A BREAKDOWN IN RISK MANAGEMENT: WHAT WENT WRONG AT JPMORGAN CHASE?

WEDNESDAY, JUNE 13, 2012

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 9:58 a.m., in room SD–G50, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

Senator REED [presiding]. On behalf of Chairman Johnson, I would like to call the hearing to order, and we will suspend the hearing until the Chairman arrives.

[Pause.]

Senator REED. The Chairman—the hearing has been called to order. We are suspending until the Sergeant at Arms and the Capitol Police restore order. This is a hearing in which we will ask people to cooperate so that we can conduct a serious inquiry into this matter.

Thank you.

[Pause.]

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON [presiding]. This hearing will come to order. I ask the Capitol Police to please remove anyone in the audience who is interrupting the hearing. Before we proceed, I will remind my audience that any interruption of the hearing will not be permitted and you will be escorted out of the room. We will now proceed.

This hearing is part of the Banking Committee's ongoing oversight of the massive trading loss announced by JPMorgan Chase and the implications for risk management, bank supervision, and the Wall Street Reform Act. Since the announcement of the loss in early May, this Committee has heard from the OCC and the Fed, which are the primary regulators for JPMorgan, as well as the SEC, the CFTC, and other relevant officials to review and learn from these events. Several members of the Committee have asked to hear from Mr. Dimon, and after due diligence conducted together by my staff and Ranking Member Shelby's staff, I decided to invite Mr. Dimon.

Last week, the regulators informed the Committee that there was a breakdown in the risk management involved with these trades, despite the fact that the trades were reportedly designed to reduce the bank's risk. As they continue to look into the matter, officials have assured our Committee that the firm's solvency and the stability of our financial system are not in jeopardy at this time. While this is welcome news, questions remain that must be answered if we want our largest banks to better manage their risks to maintain financial stability, as I believe we do.

Today marks the 2-month anniversary of Mr. Dimon's "tempest in a teapot" comments where he downplayed concerns from initial media reports of the company's Chief Investment Office trades. We later learned, however, it was an out-of-control trading strategy with little to no risk controls that cost the company billions of dollars.

I have said before no financial institution is immune from bad judgment. In Mr. Dimon's own words, he later explained, "We made a terrible egregious mistake. There is almost no excuse for it . . . We know we were sloppy. We know we were stupid. We know there was bad judgment . . . [I]n hindsight, we took far too much risk. The strategy we had was badly vetted. It was badly monitored. It should never have happened."

So what went wrong? For a bank renowned for its risk management, where were the risk controls? How can a bank take on "far too much risk" if the point of the trades was to reduce risk in the first place? Or was the goal really to make money? Should any hedge result in billions of dollars of net gains or losses, or should it be focused solely on reducing a bank's risks? As the saying goes, you cannot have your cake and eat it, too.

As for the policy implications, some of my colleagues complain that Wall Street reform micromanages the operation of large banks and that regulators cannot keep up with bank innovation. I disagree that less supervision and less regulation will magically make the system less risky. While risk cannot be eliminated from our economy, we can, and must, demand that banks take risk management seriously and maintain strong controls. We must also demand that regulators do their job well. After all, banking is an important but risk-filled business that needs careful scrutiny and oversight so that mismanagement or unsafe and unsound practices do not threaten the stability of our economy.

Some also suggest that capital is the silver bullet in financial regulation. While capital does and must play an important role as a backstop, we should not rely only on capital. Any well-capitalized bank can fail and threaten financial stability if it is not well managed or well regulated. Our financial system will be safer and stronger with multiple and well-calibrated lines of defense, which Wall Street reform requires in addition to higher capital standards. We need our regulators to finalize these Wall Street reform rules, and Congress should fund them with sufficient resources so that they can effectively monitor the financial system.

Again, it has been 2 months since he first publicly acknowledged the trades, so I expect Mr. Dimon to be able to answer tough but fair questions today. A full accounting of these events will help this Committee better understand the policy implications for a safer and stronger financial system going forward.

I now recognize Ranking Member Shelby for his opening statement.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

Today the Committee will hear from the chief executive officer, president, and chairman of JPMorgan Chase, Mr. Jamie Dimon. Mr. Dimon is here today because JPMorgan Chase lost more than $2 billion on derivatives trades.

Normally, it is not and I believe it should not be the role of Congress to second-guess decisions by private sector businesses. However, because the Federal Government guarantees bank deposits, this Committee has a responsibility to ensure that banks do not unnecessarily put taxpayers at risk. Congress has in large part delegated the responsibility of oversight to our financial regulators. They are supposed to be monitoring the activities of banks like JPMorgan Chase to ensure that they operate in a safe and sound manner.

As we learned from the most recent financial crisis and this particular incident, regulators do not always meet our expectations. Banks take risks because that is what they do. Usually, those risks are beneficial because they enable Americans to buy homes, attend college, and save for retirement. When banks fail to prudently manage those risks, however, serious problems can arise.

For example, in the years leading up to the financial crisis, some banks claimed that they could safely provide mortgages to borrowers with no documentation and small downpayments. Advances in risk management supposedly enable them to lend to riskier borrowers without threatening the bank's safety and soundness.

We now know that this was false. These banks were not applying better risk management techniques. They were simply foregoing time-tested underwriting standards. The result was a failure of some of the Nation's largest financial institutions, including Countrywide and Fannie Mae and Freddie Mac.

Certainly, there were many bankers that did not make these mistakes, and by most accountable, our witness today was one of them. Yet, as the financial crisis shows, poor risk management of even a single large bank can have profound consequences.

Congress and bank regulators must always watch for risks that could, if improperly managed, threaten the banking system. Accordingly, we should examine the facts and circumstances surrounding JPMorgan's $2 billion plus loss. As we do so, I believe that there are two key questions that need to be answered: First, did the losses from these trades threaten the safety and soundness of JPMorgan? And, second, could it happen again?

Last week, the Committee heard from the bank regulators that supervised JPMorgan. They answered the first question when they told us that the $2 billion plus loss did not threaten the bank's solvency because the bank has strong earnings and sufficient capital. This conclusion shows once again why the single best way to protect taxpayers from bailouts is to ensure that banks are properly capitalized. Strong capital requirements provide a valuable buffer against unexpected losses arising from the inevitable missteps by banks and bank regulators. And although capital should be the first line of defense against taxpayer bailouts, it should not be the only defense. Banks also need to have good risk management. Although JPMorgan enjoyed a strong reputation for effective risk management, something obviously went very wrong.

Regrettably, the Comptroller of the Currency, the Federal Reserve, and the FDIC were unable to tell us what happened last week despite having more than 100 onsite examiners at JPMorgan. Hopefully, Mr. Dimon today can fill in the details.

In particular, I hope Mr. Dimon can explain here why these trades were made and why they produced such large losses. I also hope to learn the extent to which Mr. Dimon and other JPMorgan senior executives were involved in the decisions that permitted these trades. Mr. Dimon has long been recognized for his effective management of a very successful institution, yet it appears in this particular case things perhaps got away from him. Why? Did Mr. Dimon put too much faith in the company's risk models? Or did he ignore them?

It has been reported that officials at JPMorgan may have dismissed warnings that the bank was not instituting appropriate risk management practices. If that happened, was Mr. Dimon aware of these warnings? If so, did he respond or did he disregard them?

It has also been reported that the office responsible for these trades may have had contradictory mandates. And while the stated goal of the office may have been to reduce risk, employees of the office apparently believe that they were expected to turn these trades into a profit. Bank employees reportedly referred to this profit as "the icing on the cake."

What were Mr. Dimon's expectations for this office? Was he incentivizing them to manage risk or to maximize profits? If it was the latter, were the incentives to profit consistent with proper risk management? Moreover, what did the Board of Directors of JPMorgan Chase know about how Mr. Dimon was managing risk? It has been reported that JPMorgan's risk committee may not have had the expertise necessary to oversee such a large bank. I hope to learn not only about Mr. Dimon's role in selecting the members of the risk committee but how the committee oversaw the firm's risk management.

Finally, I hope today's hearing can reveal what lessons Mr. Dimon and JPMorgan and others have learned. This hearing will have served a valuable purpose if it helps banks and bank regulators avoid repeating the mistakes of JPMorgan. In this regard, I believe it is unfortunate that the Committee has not held similar hearings with the heads of other financial institutions. And although the Committee is hearing from Mr. Dimon, who bank lost $2 billion or more of its own money, it has never heard here testimony from executives of Fannie Mae and Freddie Mac who have lost nearly $200 billion of taxpayers' dollars. Perhaps the Committee could turn its attention to the GSEs' massive public losses when it completes its review of the relative private losses thus far of JPMorgan Chase.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you, Senator Shelby.

This morning's opening statements will be limited to the Chairman and the Ranking Member to allow more time for questions from the Committee Members. I will note that Senator Warner as a valuable Member of this Committee is absent to attend his daughter's graduation, but he will be submitting a statement and questions for the record.

I want to remind my colleagues that the record will be open for the next 7 days for opening statements and any other materials you would like to submit.

Now I will introduce our witness. Mr. Jamie Dimon is the chairman of the board, president, and chief executive officer of JPMorgan Chase & Company.

Mr. Dimon, your full written statement will be included in the hearing record. Please begin your testimony.

STATEMENT OF JAMES DIMON, CHAIRMAN OF THE BOARD, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, JPMORGAN CHASE & CO.

Mr. DIMON. Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I am appearing today to discuss recent losses in a portfolio held by JPMorgan Chase's Chief Investment Office. These losses have generated considerable attention, and while we are still reviewing the facts, I will explain everything I can to the extent possible.

JPMorgan Chase's six lines of business provide a broad array of financial products and services to individuals, small and large businesses, Governments, and not-for-profit institutions. These include deposit accounts, loans, credit cards, mortgages, capital markets advice in fundraising, mutual funds, and other investments.

Let me start by explaining what the Chief Investment Office does.

Like many banks, we have more deposits than loans. At quarter end, we held approximately $1.1 trillion in deposits and $700 billion in loans. CIO, along with our Treasury unit, invests excess cash in a portfolio that includes Treasuries, agencies, mortgage-backed securities, high-quality securities, corporate debt, and other domestic and overseas assets. It portfolio serves as an important vehicle for managing the assets and liabilities of the consolidated entity. In short, the bulk of CIO's responsibility is to manage an approximately $350 billion portfolio in a conservative manner.

While the CIO's primary purpose is to invest excess liabilities and manage long-term interest rate and currency exposure, it also maintains a smaller synthetic credit portfolio whose original intent was to protect—or "hedge"—the company against a systemic event, like the financial crisis or the eurozone situation.

So what happened?

In December 2011, as part of a firmwide effort in anticipation of new Basel capital requirements, we instructed CIO to reduce risk-weighted assets and associated risk. To achieve this in the synthetic credit portfolio, the CIO could have simply reduced its existing positions; instead, starting in mid-January, it embarked on a complex strategy that entailed adding positions that it did believe would offset the existing ones. This strategy, however, ended up creating a portfolio that was larger and ultimately resulted in even more complex and hard-to-manage risks.

This portfolio morphed into something that, rather than protect the firm, created new and potentially larger risks. As a result, we have let a lot of people down, and we are very sorry for it.

Now let me tell you how it went wrong. These are not excuses. These are reasons.

We believe now that a series of events led to the difficulties in the synthetic credit portfolio. These are detailed in my written testimony, but I would highlight the following:

CIO's strategy for reducing the synthetic credit portfolio was poorly conceived and vetted.

In hindsight, the CIO's traders did not have the requisite understanding of the new risks they took.

The risk limits for the synthetic credit portfolio should have been specific to that portfolio and much more granular, i.e., only allowing lower limits of risk on each specific risk being taken.

CIO, particularly the synthetic credit portfolio, should have gotten more scrutiny from both senior management—and I include myself in that—and the firmwide risk control function.

In response to this incident, we have already taken a number of important actions to guard against any recurrence.

We have appointed entirely new leadership for CIO. Importantly, our team has made real progress in aggressively analyzing, managing, and reducing our risk going forward. While this does not reduce the losses already incurred and does not preclude future losses, it does reduce the probability and magnitude of potential future losses.

We are also conducting an extensive review of this incident, which our board of directors is independently overseeing. When we make mistakes, we take them seriously, and we are often our own toughest critic. In the normal course of business, we apply lessons learned to the entire firm. While we can never say we will not make mistakes—in fact, we know we will make mistakes—we do believe that this was an isolated event.

We will not make light of these losses, but they should be put into perspective. We will lose some of our shareholders' money—and for that, we feel terrible—but no client, customer, or taxpayer money was impacted by this event.

Our fortress balance sheet remains intact. As of quarter end, we held $190 billion in equity and well over $30 billion in loan loss reserves. We maintain extremely strong capital ratios which remain far in excess of regulatory capital standards. As of March 31, 2012, our Basel I Tier 1 common ratio was 10.4 percent; our estimated Basel III Tier 1 common ratio is at 8.2 percent. Both are among the highest levels in the banking sector. We expect both these numbers to be higher by the end of the year.

All of our lines of business remain profitable and continue to serve consumers and businesses. And while there are still 2 weeks left in our second quarter, we expect our quarter to be solidly profitable.

In short, our strong capital position and diversified business model did what they were supposed to do: cushion us against an unexpected loss in one area of our business.

While this incident is embarrassing, it should not and will not detract our employees from our main mission: to serve clients—consumers and companies—and communities around the globe.

During 2011, JPMorgan Chase raised capital and provided credit of over $1.8 trillion for consumer and commercial customers, up 18 percent from the prior year. We also provided more than $17 billion of credit to U.S. small businesses, up 52 percent over the prior year. And over the past 3 years, in the face of significant economic headwinds, we made a decision not to retrench—but to step up—as we did with markets in turmoil when we were the only bank willing to commit to lend billions of dollars to the States of California, New Jersey, and Illinois.

All of these activities come with risk. And just as we have remained focused on serving our clients, we have also remained focused on managing the risks of our business, particularly given today's considerable global economic and financial volatility.

We will learn from this incident, and my conviction is that we will emerge from this moment a stronger, smarter, and better company.

I would also like to speak directly for a moment to our 260,000 employees, many of whom are watching this hearing today. I want them all to know how proud I am of JPMorgan Chase, the company, and proud of all of what they do every day for their clients and their communities.

Thank you, and I would welcome any questions you might have.

Chairman JOHNSON. Thank you, Mr. Dimon, for your testimony.

As we begin questions, I ask the clerk to put 5 minutes on the clock for each Member.

Mr. Dimon, there was clearly a breakdown in risk management at your firm. What did you know when you made your "tempest in a teapot" comment? Why were you willing to be so definitive a month before publicly announcing the losses when it appears you did not have a full understanding of the trading strategy?

Mr. DIMON. Let me first say, when I made that statement, I was dead wrong. I had been on the road. I called Ina Drew, who ran the CIO. I had spoken to our risk officers, our CFO. They were looking into it. There were some issues with CIO before April 13th when we announced earnings. I was assured by them—and I have the right to rely on them—that they thought this was an isolated, small issue and that it was not a big problem. They look at things like how bad can it get, they stress it, and under no event did it look like it would be getting nearly as bad as it got after April 13th.

Chairman JOHNSON. Mr. Dimon, there were reports that the CIO had scrapped a risk limit that would have required traders to exit positions if losses exceeded $20 million. Is this true? If yes, did you approve this? And why was the limit removed?

Mr. DIMON. There was no loss limit of $20 billion.

Chairman JOHNSON. $20 million.

Mr. DIMON. How much?

Chairman JOHNSON. $20 million.

Senator SHELBY. Million.

Mr. DIMON. Billion.

Chairman JOHNSON. With an "M."

Mr. DIMON. Oh, million.

Chairman JOHNSON. Yes.

Mr. DIMON. No, I am unaware of a $20 million loss limit. CIO had its own limits around credit risk and exposure. At one point in March, some of those limits were triggered. The CIO at that point did ask the traders to reduce taking risk, and she started to look very heavily into the area, which was the proper thing to do. Sometimes triggers on limits do get hit, and what should happen afterwards is people focus on it, think about it, and decide what to do about it.

Chairman JOHNSON. There have been concerns raised about the change made in the CIO's risk model. When were regulators notified? Why was the risk model changed? Did this change mask the true risks of the trading activity?

Mr. DIMON. So what I am aware of is that sometime in 2011 the CIO had asked to update their models, partially to get them updated to be compliant with the new Basel rules. Model reviews are done by an independent model review group. They started the process 6 months earlier, and in January they did, in fact, put in a new model.

I should note that models are changed all the time, always being adjusted to try to be better, inform yourself from the past and try to make models get better. The models were run, were approved by the model review group, were implemented in January, and did effectively increase the amount of risk this unit was able to take.

On April 13th, we were still unaware that the model might have contributed to the problem, so when we found out later on, we went back to the old model. So the old model was more accurate in hindsight than the new model—than we thought it was going to be.

Chairman JOHNSON. Reports suggest there were multiple warnings of weak controls at the CIO that were ignored, and your testimony states that your trading strategy was not reviewed outside CIO. Did you, Mr. Dimon, make the decision to exempt the CIO from any review of risk controls outside of the unit? Why was no one watching?

Mr. DIMON. I think the first error we made was that the CIO unit had done so well for so long that I think there was a little bit of complacency about what was taking place there, and maybe overconfidence. It did have its own risk committee. That risk committee was supposed to properly overview and vet all the risks. I think that risk committee itself, while independent, was not independent-minded enough and should have challenged more frequently and more rigorously this particular synthetic credit portfolio.

I think the second related risk is that the synthetic credit portfolio itself always should have had more scrutiny. It was higher risk. It was mark to market. It should have had more scrutiny and different limits right from the start.

Chairman JOHNSON. Mr. Dimon, did the pay structure for the employees at the CIO incentivize risky behavior that led to the massive trading loss instead of rewarding those who reduced the bank's risks? Were there bonuses for generating profits out of the CIO? Will you seek claw backs from traders, management, and executives involved in this trading debacle?

Mr. DIMON. So I think let me just give the big picture about compensation at JPMorgan. To start with, we have not had for 5 or 6 years special severance packages for executives, change of control, parachutes. There was no one in CIO who was paid on a formula. The management of the CIO portfolio was subordinated to the rest of the company. They were not allowed to do what they want. They could not invest very long. They could not take too much high-yield exposure, et cetera. They were paid for what they did for the whole company, and when we pay people, everyone, we look at their performance, the unit's performance, the company's performance, and their performance includes recruiting, training, integrity, sharing with senior management, all the things that we need to do to make it a better company. So I do not believe that the compensation made this problem worse, but—and like I said, none of these folks were paid on a formula.

Oh, your second question was claw backs. When the board finishes a review, which I think is the appropriate time to actually make those final decisions—I think it would be inappropriate to make those decisions before you finish your final review. You can expect it will take proper corrective action, and I would say it is likely, though this is subject to the board, but it is likely there will be claw backs.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Mr. Dimon, so that we would have some idea of what happened, could you explain a little further what really happened without divulging your proprietary interests? We do not want you to do that. And could you tell us a little more? In other words, you were managing risk. What were you managing of it?

Mr. DIMON. The biggest part of—remember, the biggest risk we take is credit, loans, the $700 billion in loans. The excess deposits, we have a $350 billion portfolio. That is the biggest part of CIO. Its average rating in AA-plus. It is conservatively managed. It has an unrealized profit of $7 billion. In addition, I should also point out in terms of risk management, we also have $150 billion in cash today pretty much invested at central banks around the world. So we try to be a very conservative company.

Senator SHELBY. We understand that, but this particular occasion that brought these losses on, explain to us, without getting into your proprietary area, what you were doing and what went wrong? We do not really know yet.

Mr. DIMON. The synthetic credit portfolio originally had been designed——

Senator SHELBY. And by "synthetic credit portfolio," what do you mean?

Mr. DIMON. Index, swaps, derivatives, credit-related. They are traded. Some are very actively traded in the markets.

Senator SHELBY. You took a position in them, right?

Mr. DIMON. We took a position in them, and if you look at the position, what it was meant to do was to earn—in benign environments, maybe make a little money. But if there was a crisis, like Lehman, like eurozone, it would actually reduce risk dramatically by making money. That was the original intent of the portfolio. In fact, during 2008 and 2009, it did actually accomplish some of those objectives.

Senator SHELBY. Were you investing or were you hedging, or was it a combination of both?

Mr. DIMON. No, I would call this hedging at that point in time.

Senator SHELBY. OK.

Mr. DIMON. This was hedging the risk to the company. They would protect the company in the event things got really bad. They did get really bad at one point, and it did have some of that protection.

Senator SHELBY. Had the credit went bad, is that the index——

Mr. DIMON. Yes, if credit went really bad, this would do better—this would do well. That was the original intent.

In January, February, and March, we had asked them to reduce this risk, and you can reduce shorts by going long or just by selling the positions you have. And they actually created a far larger portfolio. It had far more risks in it. They were far more complex risks. And on April 13th, we were not aware of that. But soon after we were, we made a public announcement because we thought we owed our shareholders that. And since then we have been managing, analyzing, and reducing that risk.

Senator SHELBY. To detail what really happened—here we are talking in general terms now—would you feel better in a closed hearing? Or would you not like to divulge things because you still have a position proprietary interest in——

Mr. DIMON. No, I think I would prefer not to divulge things because it protects the company right now. We have told our shareholders that on July 13th we intend to make far more disclosures about what happened and specific disclosures about this portfolio, what happened to this portfolio, and what we have done to reduce the risk in the portfolio.

Senator SHELBY. I guess the question comes up: Is this hedging or proprietary trading? According to some press reports, there is disagreement about whether the Chief Investment Office, which executed these trades, was supposed to be hedging risk or earning a profit? It has been reported that this office contributed more than $4 billion of net income in 3 years, which is about 10 percent of your overall profit. What was your expectation for this unit, the CIO unit? Was it supposed to hedge, was it supposed to earn profits, or some of both?

Mr. DIMON. The whole CIO unit invests money and earns income, and like I said, that is invested across a broad array of diversified investments, and that income is used to pay depositors, open branches, pay our people. So, yes, it is supposed to earn revenue. This particular synthetic credit portfolio was intended to earn a lot of revenue if there was a crisis. I considered that a hedge. It was protecting the downside risks to the company and, in fact, the biggest risks of the company. The biggest risks to—there are two major risks to the JPMorgan face: dramatically rising interest rates and a global type of credit crisis. Those are the two biggest risks we face. So the hedge was intended to improve our safety and soundness, not to make it worse.

Senator SHELBY. Was what went wrong, was it the way the hedge was contrived? Or was it events beyond your control?

Mr. DIMON. I think it was the way it was contrived between January, February, and March. It changed into something that I cannot publicly defend.

Senator SHELBY. Lessons learned. What have you as the CEO of JPMorgan, which is our largest bank, what have you learned from this problem, this debacle?

Mr. DIMON. I think that no matter how good you are, how competent people are, never, ever get complacent in risk. Challenge everything. Make sure people on risk committees are always asking questions, sharing information, and that you have very, very granular limits when you are taking risk. A granular limit says you can take no more than X risk in Y, no more than this risk in a name, no more than this risk in a market, including things like liquidity risks so that you are controlled. In the rest of the company, we have those disciplines in place. We did not have it here, and that is what caused the problem.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Schumer.

Senator SCHUMER. Thank you. Good morning and thank you for coming.

My first question is about risk committees. I was a proponent in the Dodd-Frank of increasing corporate governance and fought to have included in Dodd-Frank a provision, 165(h), requiring all banks with over $10 billion in assets and all nonbank financial firms supervised by the Fed to have a separate risk committee on the board that includes "at least one risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms."

As you know, some questions have been raised about the oversight provided by your risk committee. You already had one, so obviously you did not need the legislation to do it. But what went wrong with the risk committee? And what can you suggest to the regulators as they formulate rules about risk committees? Why didn't it do its job? Why didn't they, say, find out that this is the one area that did not have the limits that were in place elsewhere?

Mr. DIMON. The risk committee does a lot of work in conjunction with the audit committee and the full board to talk about the main risks to the company. I think it is a little unrealistic to expect the risk committee to capture something like this, so they spend an awful lot of time—it is hard to do that. I would point out this risk committee took this company through the most difficult financial crisis of all time with flying colors. So the risk committee did a great job. This is a flaw that I would completely blame on management, certainly not on the risk committee, since recently we have added two new directors who also have extensive experience in financial markets.

Senator SCHUMER. OK. So you feel the risk committee, this was too small an item for them? Just give me a little more context for this.

Mr. DIMON. I think the risk committee reviews a lot of issues, regulations, requirements. They meet a lot of management. They talk to risk committees. They make sure that there is governing in place. I just think it would have been hard for them to capture this if management did not capture it. To the extent we were misinformed, we were misinforming them.

Senator SCHUMER. OK. The second question goes to the broader context. I think what frightens most people about what happened is not the effect on JPMorgan. As you said, it is a large institution, well capitalized, and the shareholders lost, but the taxpayers and customers did not. But I think the question that bothers most people is: What is to stop this from happening again, maybe being a larger loss of the same type, but particularly at a weaker or less well capitalized institution? It was institutions smaller than JPMorgan that caused all—you know, that started the catapult in the financial system, firms like Lehman Brothers. So were we just lucky that we found out about this one when we did? What is your assessment, as somebody who knows the financial industry, about the danger of this type of thing happening in other institutions that are not as well capitalized as JPMorgan and the effect on our financial system?

Mr. DIMON. We were not just lucky to capture it. We did have limits in place that captured it. They should have been much smaller in this particular activity.

I think one of the things that regulators can and do do is disseminate and promulgate best practices everywhere. I do think that since the crisis—and you should have comfort in this—banks are better capitalized. They have more liquidity. There is more transparency. Their boards are more engaged. Risk committees are more engaged. There are no off-balance-sheet vehicles. So a lot of the strengthening has happened across companies across America.

Senator SCHUMER. What about nonbanking institutions that do this that do not have the same requirements but are engaged in similar activities that could cause problems for the system?

Mr. DIMON. I think the regulators are currently deciding which of the nonbanks are going to be part of systemic risk oversight, and I will leave that to them at this point in time.

Senator SCHUMER. OK. A final point. The Chairman asked this, but it is about claw backs. I was glad to hear that there is a claw back policy. It seems to me that that is an appropriate thing to do. When people make tens of millions of dollars for taking risks and they do it poorly, if there is a claw back it may be a good internal incentive to be a little more careful, if you will, not just to have an upside but to have a downside in their own personal compensation. Can you tell us a little bit about the policy that you have for claw backs? I know you do not want to talk about individual cases because the investigation is not done, but tell us how it works, how widespread it is, how mandatory it is, that kind of thing.

Mr. DIMON. There are several layers, but for senior people, which most of these people are, we can claw back even for things like bad judgments. We can claw back any unvested stock. We can even claw back things like cash bonuses. So it is pretty extensive, the ability to claw back.

I was in favor of the claw back system. I think that one of the legitimate complaints was that after the crisis, a lot of people walked away from companies that went bankrupt with a lot of money. Some of that was inappropriate. In this particular case, the board will review at the end of this every single person involved, what they did, what they did not do, and what is appropriate.

Remember, a lot of these people have been in the company and been very successful for a long period of time.

Senator SCHUMER. Is there a limit to how much the claw back is or anything else in your policy or it is discretionary? And a second and final question: Has it been used thus far in your bank over the years you have had the policy?

Mr. DIMON. These new policies have not been used thus far.

Senator SCHUMER. And are there limits?

Mr. DIMON. Well, there are limits essentially to what you have been paid the last—it is somewhat limited to what you have been paid over the last 2 years.

Senator SCHUMER. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman and Mr. Dimon.

Last week, in the testimony that we were presented by the regulators, one of the tensions that we face here is we want to be sure that we are adequately regulating our financial institutions, but we want to be sure also that we basically do not have the regulators running our private sector institutions. In that testimony last week, Comptroller Curry from the OCC indicated that there are approximately 65 onsite examiners from the OCC who are full-time onsite at JPMorgan. Is that correct?

Mr. DIMON. I believe so, yes.

Senator CRAPO. And, again, what should the function of the regulators be? Many people say our primary focus from our perspective in terms of policy should be to make sure that the banks are properly capitalized. Should that be our primary focus? And what other areas of oversight would be the most effective for us in terms of our regulatory structure?

Mr. DIMON. So the regulators—I have been in regulated businesses my whole life, and regulators look at many things we do. They audit it, they criticize it. I think it is important to recognize that I think there have been improvements in companies, including JPMorgan, because of their audit and criticism. So I think you have to give regulators realistic objectives. I do not think realistically they can actually stop something like this from happening. It is purely management's mistake. And, again, if we are misinformed a little bit, we are, not purposely, but misinforming them, too.

So I think the most important things regulators can do is high capital, good liquidity standards, proper disclosures, proper governance, proper functioning risk committees. All those things will not stop mistakes. They will just make them smaller and fewer and far between. And I do think in implementing all the new regulations from Dodd-Frank to Basel, you are going to accomplish some of those things.

Senator CRAPO. Well, thank you. In terms of the capital structure, and to give it a little context here, one of the other things we learned was that during the stress test that was applied to JPMorgan, it was assumed that JPMorgan could deal with losses of around $80 billion and still be adequately capitalized. Is that correct?

Mr. DIMON. We would still be adequately capitalized, but I would not be the person standing in—sitting in front of you right now.

Senator CRAPO. My understanding——

Mr. DIMON. We are great believers in stress tests. The Fed put us through what I would call a very severe stress test, and if I remember correctly, it was like 13 percent unemployment, home prices going down another 10 or 20 percent, crisis in Europe, and markets as bad as what you saw after the Lehman crisis. And we came through that, in my opinion, with flying colors. And we actually stressed hundreds of other scenarios because there were plenty of other scenarios which you could say could affect a company like a bank. And in all of those, we wanted to make sure we have adequate capital and adequate liquidity, so much so to the extent that you never question JPMorgan.

Senator CRAPO. Well, thank you. And——

Mr. DIMON. We believe we have that kind of capital.

Senator CRAPO. And your current Tier 1 capital is approximately $128 billion?

Mr. DIMON. I do not know the number offhand, but approximately, yes.

Senator CRAPO. Thank you. I would like to conclude with a discussion of the Volcker Rule. Some have said that it is not possible to distinguish between proprietary trading and hedging. Clearly that is what the Volcker Rule contemplates, and it is what, if we implement it, is going to be imposed on banks like yours.

Could you discuss for a moment whether we can distinguish between proprietary trading and hedging and, if so, how we make that distinction?

Mr. DIMON. I think it is going to be very hard to make a bright-line distinction between proprietary trading and hedging, because you can look at almost anything we do and call it one or the other. Every loan we make is proprietary. If we lose money, the firm loses money. If we buy Treasury bonds and they lose money, we lose money. So I have a hard time distinguishing it.

I do understand the intent of the Volcker Rule. If the intent is to reduce activities that can jeopardize and threaten a big financial company, I completely understand that. I think the devil is going to be in the detail in how these rules are written that allow the good of our capital markets and not the bad. And I would be happy to talk more about our capital markets.

Senator CRAPO. Tell me for a minute how you would describe what is a proper hedge in the context of the Volcker Rule distinction that we are trying to make.

Mr. DIMON. So portfolio hedging, which I think should be allowed, is something to protect the company in bad outcomes. And you can analyze that. Sometimes you—it does not mean you are always going to be exactly right, but you can analyze that. So I do believe you should be allowed to do portfolio hedging, and there are ways and methods and analytics to make sure you think it protects the company in a bad outcome.

Senator CRAPO. And that would be something like going short in the——

Mr. DIMON. Going short credit, if you think there might be a credit crisis, would be one way of doing that, yes.

Senator CRAPO. Well, thank you very much.

Mr. DIMON. You are welcome.

Chairman JOHNSON. Senator Reed.

Senator REED. Well, thank you very much, Mr. Chairman. I think this is a very important hearing because the issues that have been raised go right to the capability of large, complex international financial institutions to manage risk, and complementing that is the ability of regulators to oversee the management of the risk by those corporations. And I think it also is a strong case, in my view, for a very clear but very strong Volcker Rule, and also for standing up finally a Director at the Office of Financial Research. I know I have been talking to Chairman Johnson and also Ranking Member Shelby about that.

But let me ask a question. This goes to risk management. In your proxy materials, risk management seems to be the responsibility of the Office of Risk Management, which is an individual different than the CIO. Was this individual—and I know there were several changes—monitoring and supervising the CIO, the Chief Investment Officer, on a regular basis? Did he or she approve the change in modeling for the VaR?

Mr. DIMON. So every business we have has a risk committee. Those risk committees and the head of those businesses report to the head of risk of the company, and there are periodic conversations between the risk committees and the head of risk of the company and our senior operating group about major exposure we are taking. Obviously, that chain of command did not work in this case either because we missed a bunch of these things. So you can blame it on anyone in that chain, that if we had been paying a little more attention to why there were not more granular limits here, we could actually have caught this and stopped that at this point.

There is an independent model review group that looks at changes in models, and we do change models all the time. Models are constantly being changed for new facts. I would just caution you. Models are backward-looking. You know, the future is not the past. And they never are totally adequate in capturing changes in businesses, concentration, liquidity, or geopolitics or things like that. So we are constantly improving them. I also do not think model—we do not run the business of models. Models, VaR, they are one input. You should be looking at lots of other things to make sure you are managing your risk properly.

Senator REED. Did you share with or did the OCC inquire about the change in the modeling? And for the record, this change was just in the Chief Investment Office, correct? It was not——

Mr. DIMON. There was a change in the Office of Investment in January. A new model was put in place, and we took it out and put the old model back in sometime in——

Senator REED. Why didn't you change the model firmwide?

Mr. DIMON. Well, the firm has hundreds of models. This model was very specific to that synthetic credit portfolio.

Senator REED. Let me get back to my question about OCC. Were they aware of the change? Did you bring it to their attention?

Mr. DIMON. I do not know. You know, we generally are open kimono with the regulators and tell them what they want to know. They often look at models. Some models they actually do in extensive detail. I do not know particularly in this one.

Senator REED. Going to the proxy, if the Chief Investment Office is responsible for measuring, monitoring, reporting, and managing the firm's liquidity, interest rates, and foreign exchange risk and other structural risks, which basically is essentially—at least the implication is their job is risk management, not generating profits by investing deposits. It seems that their model, their VaR model, was loosened up considerably, giving them the opportunity to engage in more risky activities. Is that your conclusion?

Mr. DIMON. Half. In January, the new models put in place that allowed them to take more risk and they contributed to what happened. We do not as of today believe it was done for nefarious purposes. We believe it was done properly by the independent model review group. There may be flaws in how it was implemented, but once we realized that the new model did not more accurately reflect reality, we went back to the old model.

Senator REED. Let me ask, it appears from looking at some published reports that essentially these credit default swaps were first made to protect your loans outstanding, particularly in Europe, and that was in the 2007–08 time period, which is a classic hedging. You have extended credits to corporations. If those credits go bad, you want to be able on the side to insure yourself against that.

But then in 2011 and 2012 at some point, the bet was switched, and now you started, rather than protecting your credit exposures, taking the other side of the transaction, selling credit protection, which seems to me to be a bet on the direction of the market unrelated to your actual sort of credit exposure in Europe, which looks a lot like proprietary trading designed to generate as much profit as you could generate, which seems to be inconsistent, again, if this is simply a risk operation and you are hedging a portfolio. How can you be on both sides of the transaction and claim that you are hedging?

Mr. DIMON. I think I have been clear, which is the original intent I think was good. What it has morphed into I am not going to try to defend.

Senator REED. So——

Mr. DIMON. Under any name, whatever you call it, I will not defend it. It violated common sense, in my opinion. I do believe the people doing it thought that they were maintaining a short against high-yield credit that would benefit the company in a crisis. And we now know they were wrong.

Senator REED. But that leaves us in a situation of how do we build in, because our responsibility—build in rules and regulations that prevent, as you would say, well-intentioned, extremely bright people from doing things that are very detrimental? First of all, you have lost several billions of dollars, which this activity was located in the bank, and, frankly, it was deposits that are insured by the Federal Government. And, second, you have lost a significant amount of your market value to your shareholders. And the irony to me is that if there was a good Volcker Rule in place, they might not have been able to do this because it clearly does not seem to be hedging customer risk or even the overall exposure of the bank's portfolio.

Mr. DIMON. I do not know what the Volcker Rule is. It has not been written yet. It is very complicated. It may very well have stopped parts of what this portfolio morphed into.

Senator REED. So there is a possibility, in fact, if it is done correctly and proposed, which I hope it is, that it could have avoided this situation?

Mr. DIMON. It is possible. I just do not know.

Senator REED. Thank you very much.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman, for having the hearing and, Mr. Dimon, for being here. I wish we had had these kinds of hearings prior to the passage of financial regulation, and I think one of the good things that has come out of this is a lot of folks on this Committee have really focused in on issues that are relevant, and, again, I think that part of this has been positive.

Mr. Dimon, you mentioned the biggest risk a bank takes is making loans. Is that correct?

Mr. DIMON. Yes.

Senator CORKER. That is the largest risk a bank—and you have $700 billion in loans outstanding. Is that correct?

Mr. DIMON. Yes.

Senator CORKER. What would happen in an institution like yours if you had $700 billion in loans, the riskiest business you do, what would happen if you did not have the ability to hedge that risk in ways that made sense, not the way you did it?

Mr. DIMON. I think there are two things. One is smaller, which is you might reduce the amount of risk you are taking, so if everyone——

Senator CORKER. You mean less loans?

Mr. DIMON. You might make less loans just under the circumstance that if things got bad, you could still handle it. That might change the price of loans in the marketplace if all banks did that. But I think more than that is you would not be able to protect the company from a systemic event. We want to be able to protect JPMorgan from systemic events. We know they happen, and so to me, I want to survive good times and bad times.

You know, JPMorgan's balance sheet and capital allowed us to do good things in 2008 and 2009 for clients. If we could not protect ourselves, I think we would have a hard time serving our clients.

Senator CORKER. So I think you have made it clear, and I know numbers of people in the last hearing were talking to regulator about why they could not catch something like this. There is really no way for a regulator to catch this type of activity. Would you agree?

Mr. DIMON. I think it would be very hard for them to do. I would look at regulations like you want to have continuous improvement, always get better, clarity, cleaner. But I think you cannot—it is hard to have the unrealistic expectation you can just capture things like this. If you try to set up rules to capture this, I think——

Senator CORKER. A banker is always going to be ahead of a regulator, basically, and you are giving them the information they are using to regulate. So there is just not really realistic to think that a regulator is going to catch this.

So a lot of people think that—as a matter of fact, one of your peers at one of the large, large institutions was in yesterday talking about the fact that Dodd-Frank just really missed the mark. I mean, we had this huge amount of regulation taking place at the institutions, and what we should have done is looked at regulating the markets themselves. Much of what happens in the markets takes place outside of the regulated entities.

Let me just ask you this question. Has Dodd-Frank more than marginally made our banking system safer?

Mr. DIMON. You know, we supported some elements——

Senator CORKER. I know what you supported. Has it made our financial system safer?

Mr. DIMON. I think parts of it in conjunction with higher capital liquidity, the financial system is safer today than it was in 2007.

Senator CORKER. I am talking about the—I understand we have larger capital and all banks are doing—the boards are causing that to happen. I am talking about the regulatory regime that Congress put in place. Has it made our system safer?

Mr. DIMON. I do not know.

Senator CORKER. OK. One of your peers, not quite as well known as you, believes not, and as I look back, you know, we looked at the 20 largest institutions in the world. Since the 1990s, the Japanese meltdown that occurred, 16 of the 20 are either Government owned or have had taxpayer money injected into them. And so you look at what we have done, and many people obviously are coming out with all kinds of models now. You have got the Hoenig model, the Behr model; Glass-Steagall is being talked about.

Would you share with the Committee the purpose of a highly complex institution, what societal good an institution like yours is, and what our financial system would be like if we did not have these highly complex institutions? And, second, you are obviously renowned, rightfully so, I think, as being one of the most—you know, one of the best CEOs in the country for financial institutions. You missed this. It is a blip on the radar screen. But are these institutions today just too complex to manage? And the fact that 16 of the 20 have had injections, what does that say about a highly complex institution like yours?

Mr. DIMON. So we have a hugely complex economic ecosystem. From small companies to large companies, there are 27 million businesses. A thousand of the top businesses employ 30 million people. The other folks in the private sector are employed by all the other 26 million companies or so. There is a place for large companies and for small companies.

For people like us, we bank some of the largest global multinationals in America and around the world. We can bank companies in 40 different countries. We do trade finance. We give intraday lines of billions of dollars to some of the biggest companies. We can do $5 billion revolvers or raise money for America's Fortune 100 companies in a day or two when they need it to do something.

We are the largest banker to banks. We extend something like $23 billion of credit to smaller banks, and they need some of that. There is a great role for community banks. We cannot do all the things that community banks can do in their communities.

So I look at it you need all these things. You know, there are some negatives to size, so size brings you economies of scale, brings you diversification. Our diversification was a source of strength in the crisis. It was not a source of weakness. It allows you to invest huge sums of money in data centers, cybersecurity, some of the things you all want us to do.

There are some negatives to size, you know, greed, arrogance, hubris, lack of attention to detail. But if you do a good job, your clients are being served, and you win their business. And so if we were not doing some of these things for the large global American companies, somebody else would. That is all. These are services they need. They buy them because they need them. They do not buy them because we want them to buy them. We provide huge credit lines to them.

Senator CORKER. My last question. You basically—you believe that a highly complex institution is necessary, and if you were not doing what you were doing, other people in the world some other place would be. You also are unsure whether Dodd-Frank has made our system any safer, especially at the top level. We are here quizzing you. If you were sitting on this side of the dais, what would you do to make our system safer than it is and still meet the needs of a global economy like we have?

Mr. DIMON. The biggest disappointment I have had is that we never actually sat down, Republicans, Democrats, businesses, and had real detailed conversations about what went wrong, what needs to be fixed, to focus on what actually needs to be fixed. You know, we still have not fixed the mortgage markets, which is critical to the United States of America. We still have not fixed some of the other credit markets. The markets have already fixed a lot of things. There are no CMVS, there are no subprime, there are no Alt-A, there are not SIVs, there are no off-balance-sheet vehicles. And we could have a great financial system. The American business machine is the best in the world. It is the best in the world. We are all blessed to have it, and we should focus on getting it working again as opposed to being constantly just shooting at each other all the time.

Senator CORKER. I hope we will do that, and, Mr. Chairman, I thank you for calling the hearing, and I thank you for being here.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

You know, I listen to this, and I paraphrase Shakespeare: A hedge or not a hedge, that is the real question. And it seems to me that you call these trades that lost anywhere between $2 and $4 billion “economic hedges,” “a tempest in a teapot,” which I now understand you regret, and when on to say that it “morphed.” But, really, a hedge, as I understand it, does not create a loss without a corresponding gain. That is why you are hedging. And what seems to me that happened here is that you were pursuing a synthetic loan portfolio, selling CDSs, which in essence was a toxic instrument that caused a big part of our challenges in 2008, the crisis of 2008. And so really, you know, when you reduce a hedge or hedge a hedge, isn't that really gambling?

Mr. DIMON. I do not believe so, no.

Senator MENENDEZ. So this transaction that you said morphed, what did it morph into? Russian roulette?

Mr. DIMON. It morphed into something I cannot justify, that was just too risky for our company.

Senator MENENDEZ. And that is the real concern here: too risky for your company, which is one of the Nation's finest, largest, well-capitalized banks. If it is too risky for your company, what stops it from being in the future too risky where you lose not $2 to $4 billion but $50 billion, create a size that ultimately creates a risk on the bank that takes that bank into the possibility of a run, and then ultimately becomes the collective responsibility of each and every American? That is what we are trying to prevent here.

So I have heard you talk about the fortress balance sheet, and I am glad to hear you say to Senator Schumer that we should take comfort that banks are more collateralized. But in saying so, one way to think about this is I wonder what your views—do you regret calling the efforts to require banks to hold more money "un-American" and "putting the nail in our coffin." Today you cite the fortress balance sheet of your bank as a way to prevent against the challenges, yet you railed against us when we were, in fact, trying to pursue greater capitalization of these banks. Is that a regret you have of those comments then?

Mr. DIMON. No, I do not think what you said is true. I supported parts of regulation and reform. I supported higher capital and higher liquidity. We supported an oversight committee. We supported standardized derivatives going to clearinghouses. We supported proper transparency. We supported most—a lot of the things that you requested. And we did not fight everything. We only—when I mentioned the anti-American thing, I was talking about between Dodd-Frank and Basel, things which were being skewed against American banks. And American banks cannot have preferred stock like foreign banks can have. American banks cannot do qualified mortgages——

Senator MENENDEZ. But did you not specifically say, as part of your "un-American" comment, that the requirement for banks to hold more money was un-American?

Mr. DIMON. I did not.

Senator MENENDEZ. Well, you know, I would be happy to look at that again. I think you might want to review that, because what you criticized then and what your bank has been lobbying extensively against is the very types of protections that at the end of the day can guarantee that the American taxpayer does not become responsible.

I think about the fortress balance sheet you talk about, and I would like to remind you that fortress balance sheet has a moat that was dug by taxpayers to the tune of $25 billion in bailout money and more than $450 billion in loans from the Fed. So it seems to me that the American people are a big part of helping to make your bank healthy. And the one thing that they would seek in return is to ensure that you are not working against the very essence of what are legitimate efforts to control the risk so that you can prosper and your shareholders can prosper, but at the same time it does not become the collective risk of the taxpayers of this country.

Do you not think that is a fair ask of the American people?

Mr. DIMON. I want a strong financial system like you do. We have supported a lot. There are thousands of rules and regulations. We do not fight them all. We are giving informed advice on some of them. There are some that we think do not make sense, and we think we are entitled to the ones to tell you the things that do not make sense.

Senator MENENDEZ. Well, I think you are entitled to tell us the things that do not make sense. I also think that the American people, after making major investments in your bank and other institutions, are entitled to ensure that they do not have to reach into their pocket again.

Chairman JOHNSON. Senator DeMint.

Senator DEMINT. Thank you, Mr. Chairman. Thank you, Mr. Dimon. I really appreciate you voluntarily coming in to talk with us. It is important that we talk about things happening in the industry. It will, I think, advise us, help us as we look forward, and hopefully it will contribute to a best practice scenario in the industry. And I appreciate your emphasis on continuous quality improvement.

We can hardly sit in judgment of your losing $2 billion. We lose twice that every day here in Washington and plan to continue to do that every day. It is comforting to know that even with a $2 billion loss in a trade last year, your company still, I think, had a $19 billion profit. During that same period, we lost over $1 trillion. So if we had a claw back provision, none of us would be getting paid here. So the intent today is really not to sit in judgment but to maybe understand better what happened.

My concern—and some of the questions have been very helpful. As you can tell, there is a temptation here every time something goes amiss that we want to add a regulation, and we have surrounded the banking industry with so many regulations, and we still seem to have problems here and there.

I think we do need to recognize that you are a very big bank, the biggest in the world. You have got very big profits. Periodically you are going to have big losses. We need to look at that as part of doing business, but also in the context of making sure, as the Senator just said, that we do not create additional risks for the taxpayer, which you appear to be in much better fiscal shape than we are as a country.

We know risk is required to make a profit. You are dealing with a lot of capital that you have to put to work, which certainly is going to experience profits and losses, and generally you have done pretty well. But I do want to follow up on Senator Corker asking about the Dodd-Frank regulation, which a lot of us are concerned about. I think a lot of us are frustrated bank managers and want to manage your business for you. And as I have mentioned, we are not capable of doing that for what we have been given to manage. But I would like to come away from the hearing today with some ideas on what you think we need to do, what we maybe need to take apart that we have already done to allow the industry to operate better, and at the same time not put the American taxpayer at risk.

I am really honestly looking for some ideas as we look over the next year and hopefully in a position where we can make some positive changes.

Mr. DIMON. The only real suggestion I have is, you know, I believe in strong regulation, not always more. It is not more or less. It is good. What we set up was a system with more and more regulators. We do not actually know who has jurisdiction over many of the issues we are dealing with anymore. So when something happens, we are dealing with four or five different regulators. I would have preferred a simple, clean, strong regulatory system with real intelligent design, and that is not what we did. We created a really complex, hard to figure out who is responsible, no one could adjudicate between all the various regulatory agencies, and it is not clear to me who has the responsibility or the authority.

Senator DEMINT. In a lot of the industries that I have worked in, they get together as peer groups to evaluate best practices, to share information with each other. Is that something that you regularly do with your peers, other banks around the world, of how you deal with risk or how these committees should work, what the failures are? Is that going on in a way that——

Mr. DIMON. We used to do a lot more. We have constant conversations. The regulators are constantly asking for feedback and rules. We send them a lot of analysis and detail and stuff like that. There is less collaboration either among banks and among regulators and among legislators than there used to be. It has become much more adversarial.

Senator DEMINT. Because obviously, as we have seen, the laws and regulations are not necessarily improving things, and some of the things you have done voluntarily, and other banks, like capital requirements, I think a best practice—if we could do anything to encourage the industry to develop a lot of its own voluntary rules, that would guide us a lot better. So I guess if I could just leave you with any one thing, if you could come back this time next year and talk about how the industry has put together large-scale best practice committees, that would help us keep banking as a private enterprise rather than as a Government institution.

Mr. DIMON. I would be happy to do it.

Senator DEMINT. Thank you.

Chairman JOHNSON. Senator Brown.

Senator BROWN. Thank you, Mr. Chairman. Thank you, Mr. Dimon, for being here today. You have some 19,000 employees in the Columbus area who are also my constituents, so we have a mutual interest in your institution running safely and soundly. I do not want to see consumer lenders in Columbus losing their jobs because cowboys in London make too many risky best, so I want to ask you a series of brief questions. I have 5 minutes, as others, and if you can possibly give a yes or no answer when appropriate or a short answer, I would appreciate that.

To start with—and the Chairman touched on this earlier—if you could just give a yes or no, did you personally approve of the Chief Investment Office's trading strategy?

Mr. DIMON. No. I was aware of it, but I did not approve it.

Senator BROWN. Did you personally monitor the Chief Investment Office?

Mr. DIMON. Generally, yes.

Senator BROWN. OK. Thank you.

Last week, I asked at a hearing about these issues a series of questions of the OCC about their oversight or lack of oversight of the trades in question. I finally got their answer this morning. Their response was, "OK, but a bit inadequate." They say they have five examiners in London who essentially divide part of their time examining your operations. The portfolio of assets in question is reportedly about $200 million, which is bigger than the vast majority of banks in the United States, as you know.

In April, one of your executives told investors that the trades in question were "fully transparent to the regulators as part of our normalized reporting." The OCC letter says, though, that OCC examiners were unaware of the level of risk occurring at your Chief Investment Office until April. Here is my series of questions.

Was the OCC told about the trades taking place in your CIO office prior to the April 6 media reports?

Mr. DIMON. We try to be very open-kimono regulators. We give them reports. They do get some reports. We give them what they want. We give them the information they want.

In this particular case, I think that since we were a little misinformed, we probably have them misinformed. The mistake we made we passed on to them. But the second we found out, the first people we got on the phone with was our regulators to explain: We have a problem, we want to describe it to you. And, of course, they have been deeply engaged since then.

Senator BROWN. That was April 6th. April 13th—thank you for that answer. The April 13th earnings call, were they told about the trades prior to the earnings call? Was OCC?

Mr. DIMON. I do not know. Like I said, they get some of our reports, but we probably had them—since we were misinformed, we probably continued to misinform them. I think the important thing is once we found out, among the first people we called were our board and then the regulators—and probably not even in that order.

Senator BROWN. The issue is partly your side, partly the OCC's side. Did you know if OCC inquired about trades as the regulators, these five regulators, or maybe regulators back in New York? Did they inquire about the trades prior to the earnings call?

Mr. DIMON. I do not know.

Senator BROWN. You do not know the answer to that?

Mr. DIMON. I do not know.

Senator BROWN. Can you tell us at what point did OCC take steps to challenge the trades?

Mr. DIMON. I think the second that they understood the significance of the trades, they started to challenge it every day, and they continued to.

Senator BROWN. Is five regulators in London enough?

Mr. DIMON. I do not know the answer, but I would say that, you know, in this modern day and age they get all the reports from London, they get all the reports. They can do it by tele-presence. So physical location is not as important.

I should point out, by the way, that the 19,000 employees in Columbus serve global clients. They serve 30 million Americans. They are the largest middle-market lender. They serve a lot of middle-market companies. They innovate. We run a lot of call centers there. They process our credit cards, which we ship around the country. So those employees are not just doing Ohio-based business.

Senator BROWN. I understand that. I certainly appreciate that. A couple other points. Since 2007, your Chief Investment Office has grown from $76 to $370 billion. OCC says, and I will quote, that "your activities were not historically considered to be high risk," but they go on to say that, "A similar level of activity or situation, large hedges that are illiquid and otherwise very complex, is not present in other national banks. Other large banks do not conduct activity with synthetic credit derivatives to the extent in size or complexity that JPMC has in this situation."

My question is: Should OCC have been more focused on trades of synthetic derivatives that they admit now in hindsight were larger and more complex than any other banking system?

Mr. DIMON. I think we should have, and if they were and they stopped folks from having this problem, I would have been very happy with that.

Senator BROWN. If your bank did not have $2.3 trillion in assets, would your CIO need to be that $370 billion?

Mr. DIMON. Yes, most of that represents deposits, and a lot of that increase would because we bought WaMu. When we bought WaMu, we had a lot more cash in the door, and I assume you wanted us to buy WaMu, and what we are doing now is we have had like a thousand small business bankers in the States where WaMu was. So we have become one of the largest small business lenders in California and Florida. So investing in the assets, and conservatively, other than this one thing, is what we do.

Senator BROWN. Senator Corker made a statement a moment ago or offered the assessment or the question or the observation—I am not sure exactly where he was going—that just raised the possibility that this may be—that JPMorgan Chase may be too complex to manage, which also begs the question: Is it too complex and too large to regulate? And I just want to lay out a couple of—and then finish, Mr. Chairman.

JPMorgan Chase in 13 years has quadrupled in size from $667 billion in assets in 1999 to $2.3 trillion today. There are six American banks that are $800 billion and above. Over the last 5 years alone, you have grown by $400 billion, from what you have just cited. This case demonstrates that, as a practical matter, neither you nor the OCC could monitor what was happening in a $370 billion Chief Investment Office that would, if it were standing alone, be the eighth largest bank in the United States. When you have a $2.3 trillion bank with 559 subsidiaries in 37 countries, executives and regulators, it appears—from listening to you and your comments, from watching what has happened, in talking to the regulators, in seeing the OCC response, it appears that executives and regulators simply cannot understand what is happening in all of these offices at once. It demonstrates to me that too-big-to-fail banks are, frankly, too big to manage and too big to regulate.

Mr. Chairman, I yield back. Thanks.

Chairman JOHNSON. Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman.

Mr. Dimon, let me just start out and say thank you for being here today. I have listened to the various questions about the trade, and I think to summarize everything, you have acknowledged it definitely was a dumb move. The loss is unfortunate. You have apologized for that. You have kind of walked us all through that. So what I want to do is ask you about some things maybe at a 25,000–30,000-foot level, if I could.

Starting out, how many regulators do you have onsite in your organization from some Federal entity?

Mr. DIMON. I believe there are hundreds.

Senator JOHANNS. Hundreds?

Mr. DIMON. Yes. And it is across multiple regulators.

Senator JOHANNS. Right. When something like this pops up, are the channels clear anymore as to who you deal with and who is regulating what and who you need to be paying attention to? How do you deal with that?

Mr. DIMON. Look, we are always going to treat the regulators the way they deserve to be treated. Whatever the system is, we have to deal with it. But we have people who are assigned specifically to deal with regulators—the FDIC, the OCC, the Fed, now the CFPB—and we deal with all of them. On this particular issue, the first three are all engaged—the OCC, the Fed, and FDIC.

Senator JOHANNS. How much have your regulatory costs increased as a result of Dodd-Frank, the Volcker Rule, whatever it is?

Mr. DIMON. You know, I have estimated it, but I recall a rough estimate that we are talking about probably about $1 billion a year, and it is across systems, technology, risk, credit, compliance. It cuts across everything, maybe 8,000 programs we run. So we have to accommodate rules. These are rules not just of the U.S. The rules come out of Brussels and the rules come of out the U.K., et cetera. So we are going to do all those things, meet all the requirements, but it will be a little costly.

Senator JOHANNS. One of the things that I have maintained in many hearings as we have examined Dodd-Frank before and after its passage is that there is just a point at which it is economically better business to do business elsewhere than the United States. Do we run that risk with Dodd-Frank, that literally we have made life so complicated, so hard to navigate through, that you have enterprises who decide, look, I will just go to Singapore or wherever to do business?

Mr. DIMON. We are going to be fine ourselves. We will be able to navigate all that. I talk to a lot of business people, and I do hear a lot of people saying it is easier to be overseas, and several companies have moved overseas recently.

Senator JOHANNS. My concern is it does not stop there. What I saw about Dodd-Frank, you know, we started out with, I think, a laudable purpose. Let us try to figure out what happened in 2007–08 and how do we fix it. And then all of a sudden farmers' co-ops were showing up in my office and saying to me, "What are you doing?" And I am thinking, "Well, how did a farmers' co-op have anything to do with what happened in 2007 or 2008?"

I have not verified this because somebody just told me this last night—and maybe you are aware of it—but somebody who worked with this Banking Committee mentioned last night at an event I was at that there had not been a single bank charter last year in the United States, and it had been 78 years since that had happened. Do you have any information on that?

Mr. DIMON. I was unaware of that.

Senator JOHANNS. Mr. Dimon, it further occurs to me that at an enterprise as big and as powerful as yours, you have got a lot of fire power, and you are just huge. We will find a way to navigate what has happened here. What I worry about, though, you are not located in my State, and I doubt that you are probably considering locating in my State, although it would be a great place for you to do business.

Mr. DIMON. We would hope to be there one day.

Senator JOHANNS. Yes. What I suspect is happening is that our medium to small banks are now trying to navigate through this very complex legislation. These are banks where maybe they employ a dozen people or two dozen people, and they are just going to give up. What is your impression of that opinion?

Mr. DIMON. Like I said, we bank a lot of smaller banks, and I think some of these things are harder on smaller banks than they are on some of the larger banks, unfortunately.

Senator JOHANNS. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Tester.

Senator TESTER. Yes, I want to thank you, Mr. Chairman. I appreciate you holding this important hearing. Thank you, Mr. Dimon, for being here. I think it gives us a better chance to understand how and why JPMorgan, in your words, committed egregious and self-inflicted mistakes from an ineffective, poorly monitored, poorly constructed hedging strategy.

I would like to focus, however, on JPMorgan's role in the days leading up to MF Global's bankruptcy, resulting in the loss of about $1.6 billion of client funds when MF Global was obligated by law to segregate and protect.

In its final days of operation, MF Global shuffled hundreds of millions of dollars around from account to account in what MF Global treasurer Edith O'Brien described as a "shell game." MF Global customers, including many Montana farmers and ranchers, saw their funds wiped away overnight in this so-called shell game and the firm's failure to segregate these funds.

Though MF Global's commodity customers have received about 72 cents on the dollar back, the fundamental trust that many farmers and ranchers have in the commodity futures system has been broken because of the firm's violation of a law as well as their failure to segregate client funds, which is a bedrock of commodities trading.

We have new information on the release of MF Global trustee James Giddens' investigation and recommendations last week, and we absolutely need to get to the bottom of this issue to ensure that Montana farmers and ranchers and others see their funds returned and that those responsible for the breach of segregated customer funds are held accountable.

Over 100 of my constituents had their accounts raided by MF Global to cover the firm's institutional losses, and if anybody was complicit in this, I want to know about it.

Mr. Dimon, on May 18th, Mr. Giddens announced JPMorgan's return of approximately $168 million in cash, proceeds of excess collateral that your firm held at the time of MF Global's liquidation more than 7 months ago. The funds rightfully belong to MF Global customers, including hundreds of farmers and ranchers. Why did it take your firm 7 months to return these funds?

Mr. DIMON. We were a bank to MF Global, and the second they had problems, we immediately went to the trustees and the courts, told them exactly what we had and what we did not have, and we have been waiting for them to finish their work before we released anything. There was no hiding anything. We have cooperated every step of the way with the authorities.

Senator TESTER. Well, there was money released initially, I believe, when MF Global started down this path by your firm, but there was $168 million, I believe, that was held 7 months. Why? If it was their dough, it should have went to them.

Mr. DIMON. I think we were waiting for the guidance of the court and the trustee.

Senator TESTER. OK.

Mr. DIMON. We were not deliberately withholding the money.

Senator TESTER. OK. I note that Mr. Giddens' investigation singled your company out. It highlighted your ongoing negotiations with Mr. Giddens and potential litigation that he may bring against JPMorgan Chase. It is clear that in the final days before MF Global's bankruptcy, JPMorgan had significant concerns about the health of the firm, MF Global, and its compliance with regulations guiding the protection of customer funds. Your firm was intensely focused on whether collateral proposed by MF Global on October 28 and 29 was paid with customer segregate funds.

According to Mr. Giddens' investigation, your firm took steps to protect itself and its exposure to MF Global, placing MF Global on debit alert, limiting the transactions the firm could take, and increasing collateral requirements.

Mr. Dimon, despite repeated attempts by very senior risk management officials at your firm, including Mr. Barry Zubrow, to determine whether collateral for MF Global's $175 million transfer request on October 28th was in compliance with the rules regarding the segregated funds account, MF Global did not sign a confirmatory letter that your firm demanded. And yet without this confirmation, and your suspicions, JPMorgan Chase ultimately transferred the funds and accepted the collateral.

Were you aware of the effort by senior risk management officers at your firm to seek compliance confirmation from MF Global?

Mr. DIMON. Not at the time I was not, no.

Senator TESTER. So why did JPMorgan Chase relent on efforts to secure signatures of the letter and allow the transfer without written assurance?

Mr. DIMON. I think the transfer had been made, and we were doing a follow-up letter, which was not required. We were asking them to make sure that they had done the right thing.

Senator TESTER. So what you are saying is that even though you had placed MF Global on debit alert and you increased collateral requirements, when they asked you to transfer the money, there was no conversation about whether this money was segregated funds, you just transferred it?

Mr. DIMON. They transferred it to us, yes.

Senator TESTER. It was within your institution, they requested it transferred?

Mr. DIMON. Right. It was covering overdraft from the prior day or something, yes.

Senator TESTER. So the question is, the real question here is: You guys were concerned about MF Global. You guys know the industry better than anybody sitting up here. You guys knew what was going down with MF Global because you put them on debit alert. They had requested money to be pulled out of—that was in your facility to be sent to another facility. There was some question by senior management officials in your firm whether this was segregated money, money that farmers were hedging with, and in your words, hedging was to protect a company in bad outcomes, from bad outcomes.

Can you tell me if JPMorgan had any obligation to protect those funds?

Mr. DIMON. My lawyers just gave me a note saying they gave oral confirmation and then went bankrupt.

Senator TESTER. OK. So you got oral confirmation on this. Is that general operating procedure?

Mr. DIMON. No. The general operation procedure is you do not have to ask at all.

Senator TESTER. OK.

Mr. DIMON. It is their responsibility to make sure they have customer funds in——

Senator TESTER. Even when——

Mr. DIMON. We were using an excess of precaution.

Senator TESTER. Even when a company is going belly up?

Mr. DIMON. Yes, even when a company is going belly up. That is why we were trying to make sure—and we were also trying to help them at that point in time. It was a debit alert.

Senator TESTER. I appreciate that. My concern here is because there were a lot of farmers that hedged to protect themselves from bad outcomes, and if this money was transferred and it was segregated money, there is a real problem there. That is all. Just looking out for my folks.

Mr. DIMON. I hope they are going to get all their money back. I still believe they will, by the way.

Senator TESTER. OK. Well, I just want to make sure that the individuals are held responsible.

I want to thank the Chairman for his flexibility on the time, and I want to thank Mr. Dimon for being here, and thank you for the hearing, Mr. Chairman.

Chairman JOHNSON. Senator Moran.

Senator MORAN. Mr. Chairman, thank you very much.

Mr. Dimon, thank you for voluntarily being here. You responded to someone's question earlier, describing the things that are good about smaller institutions and things that create problems in larger institutions. I do not have that list in my memory yet, but "hubris" stands out, "arrogance." How do you manage a company the size of JPMorgan and overcome that list of adjectives that you described are just a natural occurrence within a large organization?

Mr. DIMON. Well, they can occur in smaller organizations, too. Look, we hope we have very good people——

Senator MORAN. You are not talking about the Senate, surely.

Mr. DIMON. No.

Senator MORAN. OK.

Mr. DIMON. Definitely not. Not now.

[Laughter.]

Mr. DIMON. Look, I think all companies want to have great employees, open, you know, always analyze things, always challenging yourself, always learning from your mistakes, that people are very honest all the time, that you share reports. So I think there are ways you can avoid the negatives of being a big company. So hopefully we foster the right kind of culture at JPMorgan.

At JPMorgan we do believe we are in business to serve clients. That is job number one, and we do it every day around the world in 2,000 communities around the world, and we hope our people believe that and that it is in their hearts to do the right thing every day the right way. We ask them to treat people the way you would treat, you know, your friends or your parents. We ask them, if you see a problem where things are going wrong, raise your hand and call the right people. And we have constantly tried to improve our products and services. Sometimes there—and we try to acknowledge legitimate complaints. There have been a lot of legitimate complaints about some banking products and services. We try to acknowledge them and fix them.

Senator MORAN. Well, Mr. Dimon, how you manage at JPMorgan really is the business of your board of directors, your shareholders, but it does have consequences to those of us who believe in a free market system, its value, its merits, and I hope that that—I have the sense, and I hope that it is the case, that that is a responsibility that you understand. In protecting this American free enterprise system, how JPMorgan and every other company, large or small, conducts themselves, what behavior they exhibit really matters in our ability to be an advocate for a free market system that creates jobs and economic opportunity and allows Americans to pursue the American dream. Anything I am missing here?

Mr. DIMON. I could not agree more.

Senator MORAN. Let me ask a more specific question. Our Ranking Member, Mr. Shelby, Senator Shelby, talks often about sufficient capital as the greatest deterrent toward too big to fail, toward systemic risk, and I certainly agree with that.

One of the other components that is involved, I think, in trying to make certain that the taxpayers are not responsible for the demise of a company like yours, a financial institution like yours, is the living will, so-called living will. Would you describe to me what process JPMorgan has gone through to develop that living will, how transparent it is, what role the regulators play? What evidence, if we saw the living will developed for JPMorgan, would give me or others satisfaction that your company can be dissolved without a call upon taxpayer dollars?

Mr. DIMON. I think I would agree with most of the people here. We have to get rid of anything that looks like too big to fail. We have to allow our big institutions to fail. It is part of the health of the system, and we should not prop them up. We have to allow them to fail. And I would go one step further. You want to be sure that they can fail and not damage the American economy and the American public.

So a big bank, you want to be in a position where a big bank can be allowed to fail. I would not call it "resolution." I think that is the wrong name. I think we should call it "bankruptcy." Personally

I call it "bankruptcy for big, dumb banks." I think when you have bankruptcy, I would have claw backs. I would fire the management. I would fire the board. I would wipe out the equity and the unsecured should only recover whatever they recover in a normal bankruptcy. This resolution authority, which starts to put the structure in place, and the living will, to me what it means is doing—giving information to regulators that they know how to do it. We do operate around the world. It is a little more complex.

Remember, the FDIC has taken down a lot of large banks without damaging the American public, including WaMu, many years ago Continental Illinois, you may remember American Savings Bank. It is a little more complex now. We have to update it.

So they need to know what happens to this legal entity, what happens to that legal entity, what are you going to do if this thing happens. And we have actually filed recently an analysis and report how they would go about dismantling JPMorgan that did not cost the taxpayer.

We are also in favor of one other thing, by the way, which is if the FDIC ever puts money into this bank—but I think the bank should be dismantled after that and the name should be buried in disgrace. So there is a little Old Testament justice here. But after, even if it ever cost the FDIC money, like today, that should be charged back to the other big banks. So today we pay for the—I know it is a Government program. It is paid for 100 percent by JPMorgan. During this crisis we will pay them $5 billion. So we are paying the FDIC.

I also think it puts a hell of an incentive on the other big banks to collaborate and make sure rules are in place that we do not jeopardize each other.

Senator MORAN. If JPMorgan became a big, dumb bank and was in serious financial difficulty, is your sense that it would be—you do not want to use the word "dissolved." That the circumstance would be concluded with JPMorgan's demise and no cost to the taxpayer?

Mr. DIMON. Yes.

Senator MORAN. Thank you.

Mr. DIMON. That is the objective, yes.

Chairman JOHNSON. Senator Kohl.

Senator KOHL. Thank you, Mr. Chairman.

Mr. Dimon, I understand that JPMorgan is lending more money to businesses, and I appreciate that. However, it appears that your bank's lending is not keeping pace with the deposits that you are taking in. Last year, JPMorgan reported that it had $1.1 trillion in deposits. This, of course, is more deposits than any other bank in the United States. But the other big banks reported loan-to-deposit ratios that are 10 to 20 percent higher than your bank's. It seems like lending to American businesses would be less risky than what was being done in the London office.

Is your loan-to-deposit ratio lower than your peer banks because you are perhaps prioritizing these risky trading activities over lending? Can we hope that you are going to focus more on lending in the American market?

Mr. DIMON. So we are making all the good loans we can in all due haste. We are a global money center bank, and what that means is we have deposits from Governments around the world, from sovereign entities, from large corporations that can be taken out tomorrow. So we do have to keep what we call liquidity. We have several hundred billion dollars right now invested, like I said, in central banks around the world in case the biggest companies call us up and say, "Send me the $5 billion." So we are bank for people who can take—so we need huge liquidity funds.

Senator KOHL. But I understand, and I think the records indicate, that your reported loan-to-deposit ratios—your other big banks, their reported loan-to-deposit ratios are 10 to 20 percent higher than yours. That would seem to not square with your statements that you are wanting to lend but you do not have the customers to lend to?

Mr. DIMON. No, our middle-market loans are up something like 12 percent on average the last 8 quarters. Our small business loans are up 52 percent. Large corporate loans change all the time because corporations have a lot of choices out there. Our mortgages I think last quarter was $40 billion, which was a huge number of new mortgages.

What I am saying is we need—we are not like all other banks. We do need to keep a lot of cash around to deal with immediate cash demands of the people who leave it with us. When you are talking about some of the biggest companies in the world, they can move $5 or $10 billion in a day.

Senator KOHL. I appreciate that. Just one final comment. Again, the biggest banks with whom you are competing are generally described in the same way you just described yours, and their loan-to-deposit ratios are higher than yours.

Mr. DIMON. They are all different for historical reasons.

Senator KOHL. Mr. Dimon, Senate offices like ours often hear from constituents who are trying to get a modification on their home loans or to stave off foreclosures. They typically come to us because they are having trouble getting through to their lender. Sadly, it is all too common for our constituents to say that the bank lost their paperwork. And 4 years since the crisis began, we are still hearing about these mix-ups. As a constituent, and just one of many, I am sure, who had a loan with JPMorgan noted recently, "I do not want to lose my house because they cannot keep their paperwork straight."

So the question is: Why have banks been unable to sort out these paperwork problems, Mr. Dimon?

Mr. DIMON. I would agree with the constituent. They should not lose a home because we failed in their paperwork, so I would love you to send that to me, and I will follow up on that one right away. We have hired 20,000 people to deal with default modifications. We have offered modifications of 1.2 million loans. We have offered alternatives to foreclosure to 700,000 loans. We are doing it better, we are doing it faster today. We have put in more systems to deal with it.

I have to confess we were not very good at it when the problems really started. We were overwhelmed, yes.

Senator KOHL. Mr. Dimon, we, I am sure, all agree that the CIO office carries out very complicated transactions and that you employ some of the very smartest people in the industry to work for you. Your bank undertakes such complicated business on the one hand, but on the other hand, oftentimes you and other banks of your size cannot seem to do something as simple as straighten out your own paperwork promptly.

Does the plight of the American homeowner have the same attention or should it have the same attention that the bank gives to its CIO office?

Mr. DIMON. Yes, it should. We should do it properly, and for anyone in this room, if they have issues that we are not following up on probably your constituent, send it to me or send it to our Government Affairs staff, and we will take care of it right away.

Senator KOHL. Thank you, Mr. Dimon.

Mr. DIMON. You are welcome.

Senator KOHL. Mr. Chairman, thank you.

Chairman JOHNSON. Senator Wicker.

Senator WICKER. Thank you, Mr. Chairman, and thank you, Mr. Dimon. I think this has been very instructive to the public and to the Members of the Committee.

I think you told Senator Shelby that the purpose of hedging is to earn a lot of revenue in the event of a crisis, and I think you said that hedging worked to an extent in 2008 for your company. Can you quantify the extent to which hedging worked in 2008?

Mr. DIMON. I do not recall the 2008 year, but this synthetic credit portfolio did earn several billion dollars of income in the 3 or 4 years before it just lost some of it.

Senator WICKER. OK, so——

Mr. DIMON. We can follow up and give you more specific detail.

Senator WICKER. OK. Well, I think that is probably what we need to do.

Would the Volcker Rule—I think you also said you did not really know what the Volcker Rule is.

Mr. DIMON. Yes.

Senator WICKER. Boy, if you do not, we do not either. But I think you know how it is being drafted, and as it is currently drafted, how would that have affected the CIO's ability to do that hedging in 2008 and prevent several billion dollars' worth of losses?

Mr. DIMON. I think you are allowed to portfolio hedge under the current construction of Volcker. I think you should be allowed to. What it morphed into, I do not know what the current rule would do. I think we should just step back for 1 second. I think the Senators will agree with me. The really important part about the Volcker Rule is not portfolio hedging. It is the ability to actively make markets. It is the ability to actively raise capital for companies and clients and investors. And we have the widest, best, deepest, and most transparent capital markets in the world. The capital markets of America are part of the great American economic business engine. We have the best in the world.

We had some problems. We should recognize we have the best. We do not want to throw the baby out with the bath water. How does it benefit you all that we have the best capital markets? The cost of buying or selling a share of stock is a tenth of what it was years ago. The cost of doing a corporate bond is a tenth of what it was years ago. The cost of doing an interest rate swap is a tenth what it was years ago. The benefit is anyone, investors who buy or sell securities, does it at a cheaper price, which means they—so Fidelity or PIMCO, the people they invest for, are doing things cheaper. That is a good thing for them. It also allows corporations to issue debt cheaper and quicker. So when a large corporation wants to issue $5 billion, it can be done in a day around the world. They get a better deal at a cheaper price than they otherwise would have gotten.

The liquidity in the markets keep the spread low and benefits both investors and issuers. But secondary markets and the primary markets are directly related. If the costs are low here, if consumers and investors are educated about companies—and we spend, you know, $1 billion a year educating people about companies—then these issuers can do it. Remember, the investor is not Fidelity. It is the person that Fidelity is investing for. And those are retirees, mothers, veterans, State and municipal plans. It is a good thing.

The Volcker Rule, when it came out, has so many pieces to it, all we have been urging people is do not think of it as binary more or less; think of it as traffic laws. Some cars should go 65, some should not. Some streets should be different; some lights should be bright. Things should be done right.

We have the widest, deepest, and best capital markets in the world. It would be a shame to shed that out of anger or something like that.

And, remember, all these securities are different. If we are going to make markets in liquid securities, we need to own that for a while. We cannot turn them over very quickly. We need to buy securities in anticipation of investor demand. We need to buy securities from you that we may not be able to sell tomorrow but you want to sell right now, and you are our client, and we make a little bit of money every time it happens. Not a lot. We do not take a lot of speculation in these areas.

So all we would ask when it comes to Volcker is go through the detail to make sure we get it right, that we end up with the widest, best, deepest capital markets in the world. I do not want to be sitting here in 20 years trying to figure out why it is elsewhere.

Senator WICKER. Thank you. I hope you can appreciate that I only have 5 minutes.

[Laughter.]

Senator WICKER. And it is doubtful——

Mr. DIMON. I have been waiting to say it. I am sorry. I took up your 5 minutes.

Senator WICKER. It is doubtful I will get a second round here. I think you told Senator Corker that the financial system is safer today and you cannot say that Dodd-Frank has helped at all. But I think then you went on to say that actually the regulation regime is not necessarily stronger today, but it is more complex and you do not really know what the jurisdiction is. Have I paraphrased your testimony correctly?

Mr. DIMON. I think some of the things of Dodd-Frank and other things made it safer, but the most important thing was higher capital, higher liquidity, better risk management, and a lot of the things that caused the problem do not exist anymore. And that was not because of regulations. That was because of markets, like off-balance-sheet vehicles and subprime mortgages.

Senator WICKER. And you said something else that really sort of caught me by surprise, and that was this testimony about that nobody got all the parties in a room with people in your industry—Democrats, Republicans, and folks affected—and talked about what was needed and what really needed to be fixed. Did I hear you correctly there?

Mr. DIMON. Yes.

Senator WICKER. Did you volunteer to be part of that conversation?

Mr. DIMON. Yes. I and lots of other folks will do whatever you want. We will even get apartments down here. Let us go through in detail. We spoke to lots of people, so a lot of people are interested, and our folks did a lot of analysis and research. But, you know, it lacked, I think, the real collaboratives that should have taken place. I do not know if it was it was in a rush. I know the anger led to that. But I think it would have been better had there been more collaboration and at the end of the day we could all shake hands, new system in place, and move forward.

Senator WICKER. And I am going to follow up with a question for the record, but let me ask this question about the living will. Are you telling this Committee that JPMorgan Chase has a living will that has been approved by Government regulators?

Mr. DIMON. No. It has been drafted and circulated and given to some of the regulators. They will be responding to this. I think it will take several iterations to get it right. And they have to coordinate it with foreign entities, so it is going to take a little bit of time.

Senator WICKER. Thank you.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and thank you for coming before the Committee, Mr. Dimon.

In 2008 and 2009, your company benefited from half a trillion dollars in low-cost Federal loans; $25 billion in TARP loans, of TARP funds; untold billions indirectly through the bailout of AIG that helped address your massive exposure in repurchase agreements and derivatives.

With all of that in mind, wouldn't JPMorgan have gone down without the massive Federal intervention, both directly and indirectly, in 2008 or 2009?

Mr. DIMON. I think you were misinformed, and I think that misinformation is leading to a lot of the problems we are having today. JPMorgan took TARP because we were asked to by the Secretary of the Treasury of the United States of America, with the FDIC in the room; the head of the New York Fed, Tim Geithner; the Chairman of the Federal Reserve, Ben Bernanke. We did not at that point need TARP. We were asked to because we were told, I think correctly so, that if the nine banks there—and some may have needed it—take this TARP, we can get it to all these other banks and stop the system from going down. We did not——

Senator MERKLEY. I am going to cut you——

Mr. DIMON. We did not borrow from the Federal Reserve except when they asked us to. They said, "Please use these facilities because it makes it easier for other people to do it."

Senator MERKLEY. We would all like to be asked——

Mr. DIMON. And we were not bailed out by AIG. OK? If AIG itself—we would have had a direct loss of maybe $1 billion or $2 billion when AIG went down, and we would have been OK.

Senator MERKLEY. Then you have a difference of opinion with many analysts of the situation who felt the AIG bailout did benefit you enormously. And I am not going to carry that argument——

Mr. DIMON. Well, they are factually——

Senator MERKLEY. Sir——

Mr. DIMON. They are factually wrong.

Senator MERKLEY. Sir, this is not your hearing. I am asking you to respond to questions. And I also only have 5 minutes. So let us agree to disagree, but I think that many analysts would reach the conclusion that if you would apply that Old Testament justice in 2008 and 2009, JPMorgan would have been gone down and you would have been out of a job. And it goes to the enormous frustration of how many companies in the history of the planet have been offered half a trillion dollars in low interest rate loans? Not many. But the basic concept behind the Volcker firewall is that banks are in the lending business, not in the hedge fund business.

Do you share that kind of basic philosophical orientation?

Mr. DIMON. We are not in the hedge fund business.

Senator MERKLEY. OK. Well, I wanted to turn to the Bloomberg report of a few days ago, and it reports that Jamie Dimon "created the CIO, elevated Drew from treasurer to chief investment officer, had her report directly to him [and] encouraged her department, which had invested mostly previously in Government-backed securities, to seek profit by speculating on higher-yielding assets such as credit derivatives, according to [more than] half a dozen former executives of the company."

That sounds like operating a hedge fund and doing so at your direction with Government-insured deposits.

Mr. DIMON. Senator, here are the facts: We have $350 billion of assets in CIO. The average rating is AA-plus. The average maturity has a duration of 3 years, not 20 or 30. The average yield is 2.7 percent. Those characteristics are of a very conservative portfolio.

One of the other Senators mentioned—and in addition to that, we have $150 billion sitting in central banks around the world. The other Senator just pointed out that we do not make enough loans. Less loans to deposits is considered conservative, not aggressive.

Senator MERKLEY. So you would disagree——

Mr. DIMON. In this other area, yes, I think there is a legitimate complaint, debtor credit, yes.

Senator MERKLEY. OK. So David Olsen, former head of credit trading, said, "We want to ramp up the ability to generate profit for the firm. This is Jamie's new vision for the company." But you would fundamentally disagree that that was your instruction in building the CIO unit?

Mr. DIMON. I do not believe everything I read. I hope you do not either.

Senator MERKLEY. You disagree?

Mr. DIMON. I do not know what he means, but I would have to have more details of the conversation.

Senator MERKLEY. OK. Well, here is the general picture which emerges: It is one in which the assets in the CIO were expanded dramatically fivefold over a 4-year period. Numerous executives of your firm testified that at your personal direction they were to invest in higher-yielding assets rather than traditional Government-backed securities. And yet when those bets go bad, instead of taking responsibility for it, you blame it on the unit that you set up. Shouldn't you take personal responsibility since they were following the game plan that you personally laid out?

Mr. DIMON. The $350 billion portfolio is conservative and has an unrealized gain of $7 or $8 billion. I have already said the synthetic credit, that is why I am here. We made a mistake. I am absolutely responsible. The buck stops with me.

Senator MERKLEY. The heart of the Volcker Rule addresses liquidity management and says that the funds that are in between loans, if you will, should be invested in either Treasuries or Government-backed instruments. Taking those same deposits and putting them into high-risk investments and credit derivatives is a fundamentally different strategy than laid out in the Volcker Rule. Therefore, I am puzzled by your comment early on that you are not sure whether or not the vision laid out by the Volcker firewall between hedge funds and banking would have prevented the type of operation that you set up in London.

Mr. DIMON. The $350 billion was very conservatively done and I—and is allowed under Volcker, and you want us to have a nice conservative portfolio. I have already confessed to the sins of the synthetic credit side. We will not do something like that again.

It does not stop us from doing the good stuff, the 350 we are making into $700 billion of loans. We are doing what a bank is supposed to do. We do it every single day.

Senator MERKLEY. So I hear from what you are saying that your game plan going forward is when you have surplus deposits and you are managing them, you are going to return to the strategy of relatively safe, relatively liquid investments rather than operating, if you will, in the derivatives world.

Mr. DIMON. The current strategy is relatively safe and relative liquid.

Senator MERKLEY. Thank you very much.

Mr. DIMON. You are very welcome.

Chairman JOHNSON. I understand that we have two votes beginning at noon.

Mr. DIMON. Please take your time.

[Laughter.]

Chairman JOHNSON. Senator Vitter.

Senator VITTER. Thanks, Mr. Chairman. Thanks very much, Mr. Dimon, for being here and for your testimony.

You made the statement, "The answer is not more regulation. It is smarter, stronger regulation." And I absolutely strongly agree with that. And, unfortunately, I think a lot of Dodd-Frank, most of Dodd-Frank has been more regulation, which in many cases has been more confusing, unhelpful regulation.

Another way I might put it is I think we need more systemic changes, less micromanagement. And the big systemic changes that are under discussion that impact what we are talking about are capital requirements and the Volcker Rule, so I wanted to explore that with you.

Capital requirements. I understood when you criticized previously Basel III that at least part of the criticism was higher capital requirements for bigger banks. Is that correct or not?

Mr. DIMON. No, it was more about the details behind it. When we went through the crisis, we had 7 percent Tier 1 Basel capital. During the worst time ever, we bought Bear Stearns and WaMu, and those capital ratios never went down. Today we have 10 percent Basel I, and all the new rules—now the new G–SIFI will be at 14 percent Basel I. So there is an issue about how much capital is enough. We never argued about having more capital, and we have no problem at 10, 11, 12. But the calculation should be done fairly and properly. Some of them I think make it harder to have proper capital, and I particularly have complaints about how the G–SIFI charges are being done.

Senator VITTER. In general, do you think bigger banks, very big banks, should have clearly higher capital requirements?

Mr. DIMON. I would be fine with that, yes, in general.

Senator VITTER. And compared to the sort of 7-percent floor for a bank as big as yours, where do you think that should be?

Mr. DIMON. I thought they should have—in my own opinion, they should have come in and said, "You all, if you are over a certain size, you can have 8, and we will re-look at it down the road, because 8 is plenty." And it does not create confusion. People do not know what their real requirements are yet because the rules are not in place. It takes years to come in——

Senator VITTER. But your suggestion is just 8, and clearly the requirements are beyond 8.

Mr. DIMON. If it were me, I would say just 8, and let the regulators to have time, if they think that is the wrong number, a couple years from now change it again. This is not a once-in-a-lifetime change. What I was a little worried about was we create what I call capital confusion. People do not know what the capital is, where they are supposed to be, when they are supposed to get there, and how they are going to be evaluated. That is not conducive to lending. That is conducive to people retaining their capital and reducing their balance sheet.

Senator VITTER. Clearly, there are other folks who—for instance, Switzerland is requiring, I think, 19 percent of their two large banks. You think that is clearly overkill?

Mr. DIMON. Yes. The 19 is not comparable to my 10.

Senator VITTER. So what would be an apples-to-apples comparison?

Mr. DIMON. It is much higher, but I do not remember the number. But they have a different problem. Those banks dwarf the size of those countries.

Senator VITTER. OK. The Volcker Rule, is there a true, real version of the Volcker Rule that you think makes sense and should be implemented?

Mr. DIMON. I think we are going to really struggle to get it right because it was written to vaguely that it is going to be hard for the regulators to actually come up with rules that make it easy for market makers and easy for regulators.

Senator VITTER. Well, I guess I am not asking about——

Mr. DIMON. But if you said——

Senator VITTER. ——the current process. I am asking about if we started with a blank sheet of paper, would you support a properly designed but true version of the Volcker Rule? Or would you say there should be no such——

Mr. DIMON. I thought it was unnecessary when it was added on top of all the other stuff.

Senator VITTER. So you think it is basically unnecessary.

Mr. DIMON. I think it is unnecessary, and maybe there are pieces that—if you said the intent is that we do not want companies to take so much risk in their trading books that they sink the company, I think there are ways to do that.

Senator VITTER. And what are the sort of——

Mr. DIMON. But I would not have tried to write the rule as currently constructed. I think it is just too confusing.

Senator VITTER. What are sort of the systemic simple-regulation ways to do that?

Mr. DIMON. This is against trading books. Proper capital, proper liquidity. Make sure that most of it, as appropriate for the product, is done with customers. Make sure that aged inventory is turned over, proper risk measure, proper risk controls.

Senator VITTER. OK. Well, again, I strongly endorse the overall concept of not more regulation but smarter, stronger regulation. I guess what I am concerned about, sort of like the Dodd-Frank reaction to the crisis, I do not think the solution is we are going to have really smart regulators this time instead of just simply smart regulators before. We are going to have more regulators. And, quite frankly, my concern about some of your testimony about the Chase reaction is that I sort of hear that tone in you all's reactions, well, we are going to be smarter about it this time, we are going to get it right this time, we are going to really bear down this time. And I am wondering if there should not be a more systemic change within the company to avoid this.

Mr. DIMON. I understand your point, yes.

Senator VITTER. Are there any more truly systemic changes that have occurred in light of this incident?

Mr. DIMON. In our company?

Senator VITTER. Yes.

Mr. DIMON. No, I do not think—you know, we are going to make sure that there are no other issues like this around the company. But we operate in a risk business. I can never tell you we are not going to make a mistake. I might be here——

Senator VITTER. No, I am not asking you to do that, but have there been more broad-scale systemic changes within the company directly in reaction to this incident?

Mr. DIMON. Just a thorough review of every single thing that happened, and we do think it is isolated.

Senator VITTER. OK. Thank you.

Mr. DIMON. You are welcome.

Chairman JOHNSON. Staff tells me that they will hold up the vote for a few minutes. Senator Hagan.

Senator HAGAN. Thank you, Mr. Chairman. Thank you for holding this hearing. Mr. Dimon, thank you for your forthright testimony and answers to the questions.

I really want to talk in my first question about the trades. I would like to get some perspective about the size of the trade. We saw press reports about the London Whale and investors talking about abnormal movements in swap indexes. How could the position be so large without coming to the attention of management, regulators, and shareholders?

Mr. DIMON. Yes, so, Senator, I am going to have to decline to comment on some of that because my first job is to protect my company and to manage, and I think disclosing certain things could hurt my shareholder, and I do not want to be put in that position.

I would say some of the information that was public was accurate, some was not. It was a complex series of trades. It was not just one single thing. And like I said, we are managing that risk down. I can go through all the same reasons we should have got it earlier, yes, it should never have gotten this size.

Senator HAGAN. Let me talk about VaR. In May, JPMorgan changed how it calculated the amount of money that the firm's Chief Investment Office could lose in a single day. Can you discuss your rationale for making the changes to the Value at Risk models?

Mr. DIMON. Right. So the old model had been effective I think until about January 15th of this year. The new model was put in place. On April 13th, we had no reason to believe the new model was not better, nor did we realize the severity of the problem we already had.

Shortly after that, which is why we went public, we find that the 10-Q was going to be filed on May 4th, which we delayed. We filed it on May 10th. Between the last weeks of April and the first parts of May, we realized the problem we had and the problem in the model. So when we filed the 10-Q on May 10th, we corrected, we made announcements to correct the prior announcements we made that were wrong, and we put the old model back and said because it was, we thought, more accurate than the new model. So we made that disclosure to our shareholders to the best that we could.

Senator HAGAN. Can you explain why the new model failed to predict the magnitude of losses in this case?

Mr. DIMON. You know, I am going to have to give you more detail later, but both these models back-test, and the back-tested better than the old model, is what I believe. And so these are statistical testing of how it would have—what would have been more accurate looking back over the last year or the last 2 years or the last 3 years. So I think I mentioned with models that the future is not the past.

Senator HAGAN. Right.

Mr. DIMON. Things change. Concentration, liquidity, people's views about Europe, credit spreads, high-yield versus investment grade, and the old model was better at predicting some of the things that happened in April and May than the new model.

Senator HAGAN. Some of the banking regulators through their participation on the Basel Committee are considering a move from the VaR to "expected shortfall" models. Would a move to expected shortfall provide regulators and investors more information about the possible losses that a bank could experience?

Mr. DIMON. I do not know because I do not know exactly if we calculated that. Like I said, VaR is one measure. We also look at a lot of stress tests. I think the expected default is more about stress testing it, and I do think it is important that people stress test properly. But managements cannot rely on models to run businesses. They are one input. In addition to that, there is judgment, knowledge, experience, and the general fear you learn when you have survived for 56 years how badly things can go wrong.

Senator HAGAN. Thank you.

In your testimony you indicated that one of the reasons that the Chief Investment Office started adding positions in the synthetic credit portfolio was to reduce risk in anticipation of Basel requirements. Can you explain why these particular positions would be problematic under Basel?

Mr. DIMON. If I remember correctly, under Basel I the risk-weight assets of the positions—I think it was around the fourth quarter of 2011—were about $20 billion. Under Basel III it was estimated to be something like $60 billion. So I think we thought it was ineffective use of risk-weighted assets and the intent was to bring that down over time.

Senator HAGAN. Why didn't the other units at the bank experience similar reductions in risk or similar issues reducing that risk?

Mr. DIMON. There were other parts of the company that we looked at the new Basel III and asked them to start to reduce what I would call ineffective use of Basel III RWA. We still have customers. You cannot always reduce it because sometimes it is driven more by the customer than by our own decisions.

Senator HAGAN. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman, and I would like to thank you and the Ranking Member for holding this hearing.

Mr. Dimon, it is good to see you. Thanks for being here today. And I am last. I suppose there is a second round. And being last is no fun because everybody else has asked all the questions before. Let me try, though.

First of all, I appreciated very much your response to Senator Kohl's observations about the difficulty that borrowers are having with the responsiveness from some of the largest banks. I will take you up on your offer on behalf of Colorado and say to anybody listening to this hearing, who may be listening to it, if they would make the same generous offer, I think all of us would appreciate it on behalf of the people that we represent.

In your written testimony—and you said it again today, I think—you said that while the CIO's primary purpose is to invest excess liabilities and manage long-term interest rate and currency exposure, it also maintains a smaller synthetic credit portfolio whose original intent was to hedge or protect the larger institutions.

Out of curiosity, I just wondered why those two functions were in the same place. Is that something that you are thinking about at all? I know that you hedge all across your lines of business, but I just wondered why those were in the same place.

Mr. DIMON. It did not have to be, but in general, that unit worried about interest rate exposure consolidated, foreign currency exposure consolidated, and some of the credit exposure consolidated. So it was a rational place to put it. There are other parts of the company that hedge credit exposure.

Senator BENNET. As somebody who supports an exemption, a hedging exemption, in the context of the Volcker Rule, which I also support, it just raised in my mind the question of whether having them in separate places might—because the purposes are different, having them in separate places may have a useful value in protecting.

The second question I had just about the trade—and then I am going to move on to something entirely unrelated to this—is you also made the observation in your written testimony that the transaction could have been handled by unwinding, by lessening the degree of exposure. Why wouldn't that have been the thing to do? Why do you think the folks that made this decision made this decision?

Mr. DIMON. What I am told is they thought what they were doing was a more cost-efficient way to reduce the exposure and maintain some of the hedge against fat tail events. That is what I am told they were thinking at the time.

Senator BENNET. Cost-efficient in the sense that the fees were less?

Mr. DIMON. That over time you would not spend as much money getting rid of this than one way versus the other.

Senator BENNET. OK. Since you are here—and, again, Mr. Chairman, with your indulgence, this is unrelated to the topic at hand, but I think you are well aware of my concern about the fiscal condition of this country. And I wonder if you could take the last couple minutes of this time to talk about how you see our relative position vis-a-vis Europe and other places, the political risk of our not accomplishing what we need to do on the fiscal side, and the upside if we could actually come together in a comprehensive way to address the long-term fiscal condition of the United States.

Mr. DIMON. So you are asking one citizen's opinion?

Senator BENNET. Yes.

Mr. DIMON. I would be happy to share it. Europe has serious issues. There is a good reason for the European Union, for political and monetary union, that is just very complex with 17 Nations, et cetera.

The United States has a serious issue. You never fix serious problems unless you actually acknowledge that we have one. And we have several, but, you know, the fiscal cliff I will not go through. The one thing to keep in mind about the fiscal cliff is it may not wait until December 31st. Markets and businesses may start taking actions before that that create a slowdown in the economy, which would be a bad thing. So I personally would not be of the mind it is OK to wait until after the election, until, you know, midnight, December 31st. I think it would be better to do something now so we do not create additional uncertainty among businesses and consumers.

We have to get our fiscal act in order. I mean, and it is either going to be done to us, or we are going to do it ourselves. There is a road map, which I like—not every piece, and I am sure all of you would have your own opinion—and it is called Simpson-Bowles. If we had dome something remotely like Simpson-Bowles, in my opinion, you would have reduced uncertainty about taxes; you would have increased confidence in America; you would have shown a real fix of the long-term fiscal problem. I think you would have had a more efficient tax system and more effective tax system that is conducive to economic growth. And, you know, I would urge everyone to support getting something like that done.

The specifics, unfortunately—I know people are going to argue about every single one—are not as important as getting something like that done.

Senator BENNET. Thank you——

Mr. DIMON. And we missed an opportunity to do it. I do think it helped cause a little downturn last year.

Senator BENNET. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Shelby has a very brief observation to make.

Senator SHELBY. Mr. Dimon, do you know of any bank that has been well capitalized, well-regulated, and well-managed that has failed?

Mr. DIMON. I do not, sir.

Senator SHELBY. Are you aware of—I know you are aware that we have closed about 500 banks in the last 3 or 4 years, and just about every one of those banks failed because they were inadequately capitalized—bad loans, so to speak. So would you agree that there is no substitute for capital?

Mr. DIMON. There is no——

Senator SHELBY. If you are running a financial institution, you have got to have capital and it has got to be liquid.

Mr. DIMON. There is no substitute for capital. That is correct, sir.

Senator SHELBY. Thank you.

Chairman JOHNSON. Thank you, Mr. Dimon, for your testimony and for being here with us today.

Mr. DIMON. Thank you.

Chairman JOHNSON. Today's hearing is a good reminder that we cannot let down our guard and we must remain vigilant so that we continue to have a strong and stable financial system.

Before we adjourn, I also want to provide Committee Members a brief update on housing refinancing. Ranking Member Shelby and I are continuing to discuss a way forward on housing refinance legislation. We have worked together in the past markups to keep amendments to those related to the underlying bill, and I hope that my colleagues will agree to continue this approach.

This hearing is adjourned.

[Whereupon, at 12:14 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN TIM JOHNSON

I call this hearing to order. This hearing is part of the Banking Committee's ongoing oversight of the massive trading loss announced by JPMorgan Chase and the implications for risk management, bank supervision, and the Wall Street Reform Act. Since the announcement of the loss in early May, this Committee has heard from the OCC and the Fed, which are the primary regulators for JPMorgan, as well as the SEC, CFTC and other relevant officials to review and learn from these events. Several Members of the Committee have asked to hear from Mr. Dimon, and after due diligence conducted together by my staff and Ranking Member Shelby's staff, I decided to invite Mr. Dimon.

Last week, the regulators informed the Committee that there was a breakdown in the risk management involved with these trades, despite the fact that the trades were reportedly designed to reduce the bank's risk. As they continue to look into the matter, officials have assured our Committee that the firm's solvency and the stability of our financial system are not in jeopardy this time around. While this is welcome news, questions remain that must be answered if we want our largest banks to better manage their risks to maintain financial stability, as I believe we do.

Today marks the 2-month anniversary of Mr. Dimon's "tempest in a teapot" comments where he downplayed concerns from initial media reports of the company's Chief Investment Office trades. We later learned, however, it was an out-of-control trading strategy with little to no risk controls that cost the company billions of dollars.

I have said before, no financial institution is immune from bad judgment. In Mr. Dimon's own words, he later explained, "We made a terrible egregious mistake. There's almost no excuse for it . . . We know we were sloppy. We know we were stupid. We know there was bad judgment . . . [I]n hindsight, we took far too much risk. The strategy we had was badly vetted. It was badly monitored. It should never have happened."

So what went wrong? For a bank renowned for its risk management, where were the risk controls? How can a bank take on "far too much risk" if the point of the trades was to reduce risk in the first place? Or was the goal really to make money? Should any hedge result in billions of dollars of net gains or losses, or should it be focused solely on reducing a bank's risks? As the saying goes, you can't have your cake and eat it too.

As for the policy implications, some of my colleagues complain that Wall Street Reform micromanages the operation of large banks, and that regulators cannot keep up with bank innovation. I disagree that less supervision and less regulation will magically make the system less risky. While risk cannot be eliminated from our economy, we can, and must, demand that banks take risk management seriously and maintain strong controls. We must also demand that regulators do their job well. After all, banking is an important, but risk-filled business that needs careful scrutiny and oversight so that mismanagement or unsafe and unsound practices do not threaten the stability of our economy.

Some also suggest that capital is the silver bullet in financial regulation. While capital does and must play an important role as a backstop, we should not rely only on capital. Any well-capitalized bank can fail and threaten financial stability if it is not well-managed or well-regulated. Our financial system will be safer and stronger with multiple and well-calibrated lines of defense, which Wall Street Reform requires in addition to higher capital standards. We need our regulators to finalize these Wall Street Reform rules, and Congress should fund them with sufficient resources so they can effectively monitor the financial system.

Again, it has been two months since he first publicly acknowledged the trades, so I expect Mr. Dimon to be able to answer tough, but fair questions today. A full accounting of these events will help this Committee better understand the policy implications for a safer and stronger financial system going forward.

PREPARED STATEMENT OF SENATOR MARK WARNER

I would like to thank the Chairman for holding this important hearing so that the Senate can better understand what happened to cause the loss of at least $2 billion, and possibly several times more than that, at JPMorgan Chase. A family commitment prevents me from attending this hearing in person, but I am submitting this statement and questions for the record.

In the wake of the financial and economic crisis in 2008, which we recently learned has cost American families two decades worth of accumulated wealth, 40 percent of what they had pre-crisis, this loss at JPMorgan Chase has reminded us of hard learned lessons.

Risk is an everyday feature of our financial system. As a result, we must have a regulatory regime that determines what risks can be undertaken by which financial institutions and markets and how we will manage those risks.

This event has occurred in the middle of writing the rules for the Dodd-Frank Act. I believe that we owe the American people to learn as much as possible from this event, and let it inform how we finish that rule writing process.

This episode demonstrates an extraordinary failure of risk management. It is worth noting that this occurred at one of our soundest banks. No one is happy about this episode, but we should be pleased that JPMorgan Chase has the capital and capacity to deal with this. JPMorgan Chase and markets are addressing this in an orderly way that does not threaten the individual firm, other firms, or our markets. That is a good sign.

From this and also from other hearings, and from the additional work of regulators and experts, we must also understand how we can improve risk management. We must understand how to protect individual firms and the broader system from both the risks that we understand and from unexpected shocks in the future.

I do not expect perfect answers because we cannot know the unknown. But we should learn from large "unexpected" shocks of the past, and we should know how much loss absorption and resilience individual institutions have, including but not limited to capital.

PREPARED STATEMENT OF JAMES DIMON

CHAIRMAN OF THE BOARD, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, JPMORGAN CHASE & CO.

JUNE 13, 2012

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I am appearing today to discuss recent losses in a portfolio held by JPMorgan Chase's Chief Investment Office (CIO). These losses have generated considerable attention, and while we are still reviewing the facts, I will explain everything I can to the extent possible.

JPMorgan Chase's six lines of business provide a broad array of financial products and services to individuals, small and large businesses, Governments, and nonprofits. These include deposit accounts, loans, credit cards, mortgages, capital markets advice, mutual funds, and other investments.

What Does the Chief Investment Office Do?

Like many banks, we have more deposits than loans—at quarter end, we held approximately $1.1 trillion in deposits and $700 billion in loans. CIO, along with our Treasury unit, invests excess cash in a portfolio that includes Treasuries, agencies, mortgage-backed securities, high quality securities, corporate debt and other domestic and overseas assets. This portfolio serves as an important source of liquidity and maintains an average rating of AA+. It also serves as an important vehicle for managing the assets and liabilities of the consolidated company. In short, the bulk of CIO's responsibility is to manage an approximately $350 billion portfolio in a conservative manner.

While CIO's primary purpose is to invest excess liabilities and manage long-term interest rate and currency exposure, it also maintains a smaller synthetic credit portfolio whose original intent was to protect—or "hedge"—the company against a systemic event, like the financial crisis or eurozone situation. Among the largest risks we have as a bank are the potential credit losses we could incur from the loans we make. The recent problems in CIO occurred in this separate area of CIO's responsibility: the synthetic credit portfolio. This portfolio was designed to generate modest returns in a benign credit environment and more substantial returns in a stressed environment. And as the financial crisis unfolded, the portfolio performed as expected, producing income and gains to offset some of the credit losses we were experiencing.

What Happened?

In December 2011, as part of a firmwide effort in anticipation of new Basel capital requirements, we instructed CIO to reduce risk-weighted assets and associated risk. To achieve this in the synthetic credit portfolio, the CIO could have simply reduced its existing positions; instead, starting in mid-January, it embarked on a complex strategy that entailed adding positions that it believed would offset the existing ones. This strategy, however, ended up creating a portfolio that was larger and ultimately resulted in even more complex and hard-to-manage risks.

This portfolio morphed into something that, rather than protect the Firm, created new and potentially larger risks. As a result, we have let a lot of people down, and we are sorry for it.

What Went Wrong?

We believe now that a series of events led to the difficulties in the synthetic credit portfolio. Among them:

- CIO's strategy for reducing the synthetic credit portfolio was poorly conceived and vetted. The strategy was not carefully analyzed or subjected to rigorous stress testing within CIO and was not reviewed outside CIO.
- In hindsight, CIO's traders did not have the requisite understanding of the risks they took. When the positions began to experience losses in March and early April, they incorrectly concluded that those losses were the result of anomalous and temporary market movements, and therefore were likely to reverse themselves.
- The risk limits for the synthetic credit portfolio should have been specific to the portfolio and much more granular, i.e., only allowing lower limits on each specific risk being taken.
- Personnel in key control roles in CIO were in transition and risk control functions were generally ineffective in challenging the judgment of CIO's trading personnel. Risk committee structures and processes in CIO were not as formal or robust as they should have been.
- CIO, particularly the synthetic credit portfolio, should have gotten more scrutiny from both senior management and the firmwide risk control function.

Steps Taken

In response to this incident, we have taken a number of important actions to guard against any recurrence.

- We have appointed new leadership for CIO, including Matt Zames, a world class risk manager, as the Head of CIO. We have also installed a new CIO Chief Risk Officer, Chief Financial Officer, Global Controller and head of Europe. This new team has already revamped CIO risk governance, instituted more granular limits across CIO and ensured that appropriate risk parameters are in place.
- Importantly, our team has made real progress in aggressively analyzing, managing and reducing our risk going forward. While this does not reduce the losses already incurred and does not preclude future losses, it does reduce the probability and magnitude of future losses.
- We also have established a new risk committee structure for CIO and our corporate sector.
- We are also conducting an extensive review of this incident, led by Mike Cavanagh, who served as the company's Chief Financial Officer during the financial crisis and is currently CEO of our Treasury & Securities Services business. The review, which is being assisted by our Legal Department and outside counsel, also includes the heads of our Risk, Finance, Human Resources and Audit groups. Our Board of Directors is independently overseeing and guiding these efforts, including any additional corrective actions.
- When we make mistakes, we take them seriously and often are our own toughest critic. In the normal course of business, we apply lessons learned to the entire Firm. While we can never say we won't make mistakes—in fact, we know we will—we do believe this to be an isolated event.

Perspective

We will not make light of these losses, but they should be put into perspective. We will lose some of our shareholders' money—and for that, we feel terrible—but no client, customer, or taxpayer money was impacted by this incident.

Our fortress balance sheet remains intact: as of quarter end, we held $190 billion in equity and well over $30 billion in loan loss reserves. We maintain extremely strong capital ratios which remain far in excess of regulatory capital standards. As of March 31, 2012, our Basel I Tier 1 common ratio was 10.4 percent; our estimated Basel III Tier 1 common ratio is at 8.2 percent—both among the highest levels in the banking sector.[1] We expect both of these numbers to be higher by the end of the year.

All of our lines of business remain profitable and continue to serve consumers and businesses. While there are still two weeks left in our second quarter, we expect our quarter to be solidly profitable.

In short, our strong capital position and diversified business model did what they were supposed to do: cushion us against an unexpected loss in one area of our business.

While this incident is embarrassing, it should not and will not detract our employees from our main mission: to serve clients—consumers and companies—and communities around the globe.

- In just the first quarter of this year, we provided $62 billion of credit to consumers.
- Over the same period we provided $116 billion of credit to mid-sized companies that are the engine of growth for our economy, up 16 percent year on year.
- For America's largest companies, we raised or lent $368 billion of capital in the first quarter to help them build and expand around the world.
- We are one of the largest small business lenders and the leading Small Business Administration lender in America, providing $17 billion in credit to small businesses in 2011, up 70 percent year on year. In the first quarter, we provided over $4 billion of credit to small businesses, up 35 percent year on year.
- Even in this difficult economy, we have hired thousands of new employees across the country—over 61,000 since January 2008. We also have hired nearly 4,000 veterans over the past 2 years, in addition to the thousands of veterans who already worked at our Firm. We founded the "100,000 Jobs Mission"—a partnership with 45 other companies to hire 100,000 veterans by the year 2020.
- Recently, we launched a groundbreaking and consumer-friendly reloadable card—Chase Liquid—that offers customers financial control and flexibility.
- And over the past 3 years, in the face of significant economic headwinds, we made the decision not to retrench—but to step up—as we did with markets in turmoil when 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.

All of these activities come with risk. And just as we have remained focused on serving our clients, we have also remained focused on managing the risks of our business, particularly given today's considerable global economic and financial volatility.

Last, I would like to say that in the face of these recent losses, we have come together as a Firm, acknowledged our mistakes, and committed ourselves to fixing them. We will learn from this incident and my conviction is that we will emerge from this moment a stronger, smarter, better company.

Thank you, and I'd welcome any questions you might have.

[1] On June 7th, the Federal Reserve Board issued proposed Basel III rules, and we will be reviewing these ratios under the proposal.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM JAMES DIMON

Q.1. You stated, in response to my question on risk controls at the CJO, "It did have its own risk committee. That risk committee was supposed to properly overview and vet all the risks. I think that risk committee itself, while independent, was not independent-minded enough and should have challenged more frequently and more rigorously this particular synthetic credit portfolio." Please provide detail on the role of the CIO risk committee and its reporting lines between CIO management and senior JP Morgan management, as well as on the role of the Board-level risk committee and its oversight over division-level risk committees. What are you doing to ensure that all risk committees play a more active role in oversight of risk management, including that they are independently verifying that the risk controls are working as intended?

A.1. The CIO Risk Committee operated to oversee CIO's risk management practices. The Committee typically met on a quarterly basis (monthly meetings were instituted in the first quarter of 2012) and participants typically included CIO's CEO, CRO, COO, Global CFO, regional CFOs and regional CIOs. The Committee discussions included, among other things, market risk limits, limits usage, new product initiatives and risk policies.

As part of our remediation efforts, we have implemented a stronger risk structure, including: (i) establishing more robust committees to improve governance and controls (weekly Investment Committee, weekly CIO Risk Committee, monthly Business Control Committee and monthly CIO Valuation Governance Forum); (ii) restructuring governance to ensure tighter linkages between CIO, Corporate Treasury and other activities in Corporate; and (iii) conducting Corporate Business Reviews with the same structure and frequency as for client-facing businesses. We believe these steps will ensure that risk committees play a more active role in oversight of risk management.

The Board-level Risk Policy Committee is responsible for oversight of the CEO's and senior management's responsibilities to assess and manage the corporation's credit risk, market risk, interest rate risk, investment risk, liquidity risk and reputational risk, and is also responsible for review of the company's fiduciary and asset management activities. As part of its oversight role, the Risk Policy Committee, among other things, receives periodic presentations from CIO and the lines of business addressing risk management issues, approves the company's overall risk tolerance policy, and approves certain firmwide risk policies.

Q.2. In response to my question on risk control review or lack thereof, you speculated that there may have been "a little bit of complacency . . . and maybe overconfidence" at the CIO. But that perspective neglects the fact that good risk controls and reviews should provide a check on complacency or overconfidence. You also indicated that "if we'd been paying a little more attention to why there weren't more granular limits here we could have actually caught this and stopped that." You later stated before the House that " the CIO, as a total, had limits. But this unit didn't have its own, they used the CIO's limits which they eventually hit." Please describe what you mean by "more granular limits"? Do you mean limits on individual trading desks? What changes have you made, or will you make, so that risk limits are well-calibrated for a wide variety of activities and risks throughout your bank?

A.2. CIO had a number of risk limits *(e.g.,* VaR, stress testing, credit spreads, *etc.)* in place. There were not at the time, however, metrics in place that were specific to the CIO's Synthetic Credit Portfolio, which is where the investments that resulted in losses were located. Furthermore, there were no limits by size, asset type or type of risk for the Synthetic Credit Portfolio during the relevant timeframe, there were ongoing discussions about revising the limits structure in CIO to include limits more specifically tailored to the Synthetic Credit Portfolio and make other changes. The new structure, however, was not implemented prior to the losses.

More specific limits for the Synthetic Credit Portfolio, rather than limits for that portfolio being subsumed within the aggregate CIO limits, are what Jamie Dimon was referring to when he talked about "more granular limits," and more granular limits were in place for the credit derivatives desk in the Investment Bank. In May, a number of new limits specific to the CIO's Synthetic Credit Portfolio were put in place. We have conducted a thorough review and reaffirmed market risk limits throughout the firm. We have also conducted risk assessment reviews across all lines of business to address Risk Management findings from the review. Furthermore, we have revised our Markets Risk Limits policy to require more rapid escalation of limits excessions and have put in place additional procedures to ensure that periodic limits reviews are thorough and occurring on a regular basis. The various committees addressed in the previous answer will also play an active role in ensuring that risk management is appropriately robust within CIO and throughout the firm.

Q.3. In response to my question on compensation, you stated that the individuals in the CIO were paid based on "their performance, the unit's performance, the company's performance . . ." You also stated that "it's likely there'll be claw backs." You also said your company hasn't used claw backs. Why hasn't your company utilized your claw back authority and do you plan to use it more frequently going forward?

A.3. All CIO managers in London with responsibility for the Synthetic Credit Portfolio have been separated from the firm. None are receiving severance or 2012 incentive compensation. We have made the decision to claw back compensation from each of these individuals in the maximum permitted amount. The claw backs represent approximately 2 years of total annual compensation for each individual, including restricted stock claw backs and stock option grant values.

Ina Drew has voluntarily given-up a significant amount of her past compensation, which is equivalent to the maximum claw back amount.

The Board of Directors has stated that for all other individuals, 2012 performance-year compensation and claw backs, if appropriate, will be determined in the ordinary course considering, among other things, the following factors:

- Company, unit and individual performance both on absolute and relative basis.
- Achievement of nonfinancial objectives.
- Involvement in and responsibility for CIO matter.

More generally, we have had claw back provisions for some time and have used them in the past in cases of misconduct. More recently we strengthened our claw back provisions to include conduct that causes material financial or reputational harm and risk-related provisions for certain employees. We will apply these provisions in the future as the situation warrants.

Q.4. You stated that the hedge became problematic because of the "way it was contrived between January, February, and March" and "changed into something I cannot publicly defend." When your company executes a trading strategy, what do you know about how the strategy will play out in different stressed scenarios? How can you prevent future hedges from "changing" into something problematic in the future?

A.4. For decades, JPMorgan Chase has emphasized the importance of stress testing to identify risks in our portfolios. While we attempt to construct varied scenarios in order to identify potential risk, markets can be unpredictable and we may not anticipate a given stress event. The best way to ensure that hedges do not present unexpected risks is to construct them in ways that are readily understood by both traders and risk personnel, with sufficiently numerous and granular risk limits.

Q.5. In response to my question on the CIO's risk model, you referred to an independent model review group, which was responsible for the change in the model. Can you describe the role of this group with respect to the company's risk management and to whom the group reports? You further stated that "sometime in 2011, the CIO had asked to update their models, partially to get them updated to be compliant with the new Basel rules." Please describe why compliance with the new Basel rules required changes in the firm's modeling. You also stated that "models are changed all the time, always being adjusted." Please describe how frequently the models a re changed and the process for notifying the regulators of these changes. Has your company instituted any changes regarding the independent model review group or the risk models the company uses?

A.5. Our Model Review Group was and is imbedded in our Risk function, with responsibility for reviewing models across the enterprise. Under a capital rule proposed by the Federal Reserve relating to market risk—the so-called Basel II.5 standard—the VaR model being utilized by CIO would not have been compliant, as it failed to capture some risks that the proposed rule required. As a result, in 2011, the CIO undertook to upgrade its model, partially to get it updated to be compliant with the new Basel rules. The proposed upgrade was reviewed and approved by the Model Review Group.

Our company, like other banks, uses numerous models across its various businesses for various risk management and regulatory reporting purposes. These models are upgraded to reflect better ways of measuring and managing risk, and those changes are reviewed by our Model Review Group. These changes are reported to and reviewed with the regulators.

In the course of our management review of the CIO losses, we identified weaknesses in our model review policies and practices and have instituted changes company-wide.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM JAMES DIMON

Q.1. In January, JPMorgan replaced the value-at-risk (VaR) model for the Chief Investment Office's (CIO) synthetic credit portfolio. It appears that the new model significantly understated the risk exposure and the bank reverted to the methodology used to calculate the CIO's VaR in 2011. One benefit of a reduced risk exposure is a reduction in capital held against the portfolio.

When was the decision made to adopt the new VaR model? What were you told about the rationale for changing the VaR model? How involved were you in the decision?

A.1. In 2011, the CIO undertook to upgrade its model, partially to get it updated to be compliant with the new Basel rules. Model reviews are done by an independent Model Review Group. They started the process 6 months earlier and in January, they did in fact put in a new model. We should note that models are changed all the time, and are always being improved and updated. Typically, Mr. Dimon is not involved in the decision to implement or approve a new VaR model nor was he in this case, until May 10, 2012, when we decided to switch back to the old VaR model because we thought it was more accurate.

Q.2. When in January was the new VaR model adopted? When was the 2011 model reinstated?

A.2. The new VaR model was adopted on January 30, 2012, for purposes of the January 27, 2012, VaR calculation. Formal approval came on February 2, 2012.

Q.3. What validation work was performed with respect to the new VaR model?

A.3. Our Model Review Group reviewed the methodology of the model and conducted limited back testing. As part of our management review, we concluded that the approval and implementation of the Synthetic Credit VaR model were inadequate.

Between August and November 2011, CIO developed a new Synthetic Credit VaR model to prepare for implementation of Basel II.5. A review by the independent Model Review Group between November 2011 and January 2012 focused primarily on methodology and CIO-submitted test results. Our model review policy and process presumed a robust operational and risk infrastructure that exists in our client-facing businesses. In addition, the Model Review Group relied on CIO to conduct parallel testing and ensure operational stability.

CIO Risk Management played a passive role in model development, approval, implementation and monitoring. They relied on testing by the CIO front office prior to implementation. CIO Risk Management insufficiently challenged the VaR results generated by the front office prior to approval. They had insufficient ownership, oversight, and post-implementation monitoring of VaR operational environment.

Finally, the implementation of the model by CIO front office suffered from operational challenges. Although a correctly implemented model was expected to result in lower VaR, errors in model implementation contributed to a further lowering of VaR.

Q.4. Was the VaR model used to determine JPMorgan's regulatory capital requirements?

A.4. The new VaR model was never used to calculate our regulatory capital requirements. It was used as part of a pro forma estimate of what our capital ratios would be under Basel III, once adopted.

Q.5. Under the new VaR model, how much capital would JPMorgan have been required to hold for the risk exposure in the CIO portfolio? Under the 2011 model, how much capital would JPMorgan have been required to hold on the CIO portfolio?

A.5. While CIO used the new VaR model for internal risk purposes, it continued to use the original model for the purpose of calculating capital and never calculated capital using the new model.

Q.6. Who were the personnel in JPMorgan responsible for developing the new CIO VaR model, including management and business line staff? What were their roles relative to model development and validation responsibilities?

A.6. Model development was conducted by front office quantitative experts in CIO, whose primary duties consisted of front office support through risk analytics. Their work was reviewed by the independent Model Review Group.

Q.7. Were the traders in the CIO's London unit aware of the model change? If so, when did they become aware of the change?

A.7. The traders were aware that a model change was in process and that it was adopted at the end of January 2012.

Q.8. What was your understanding of the OCC's supervisory activities at the CIO's London unit? Did you know that the OCC did not have an examiner on site at the CIO's London unit?

A.8. Prior to April 2012, Mr. Dimon did not have any knowledge of whether or not the OCC had an examiner on site at the CIOs' London unit. Mr. Dimon generally understood that the OCC periodically examines the various business units and parts of the company.

It is our understanding that the OCC did not have any staff members tasked specifically with overseeing the activities of CIO on a full-time basis. Rather, the OCC assigned a number of examiners to specific exams conducted on the activities of CIO.

Q.9. When did bank management first communicate with any member of the board about the positions? Were potential losses discussed? Were management oversight failures discussed? If so, provide details.

A.9. In response to this question, please see the response to Question 7 below from Senator Menendez, in answer to the question

"When did you first brief JPMorgan's Board of Directors about these trades? What did you tell them?"

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM JAMES DIMON

Q.1. What level of capital do you consider adequate for JPMorgan to hold considering the need to protect against systemic risk and also fund loans? Do you still oppose 9.5 percent capital for the world's largest systemically significant banks under Basel?

A.1. U.S. regulators have agreed with other supervisors, through the Basel Committee on Banking Supervision's Basel III process, to a dramatic increase in regulatory capital requirements. JPMorgan Chase strongly supports the Basel III capital requirements, and we believe that they will bring additional stability to the financial system without causing adverse consequences that outweigh these benefits. As discussed below, it is a potential surcharge on Globally Systemically Important Financial Institutions (G–SIFis) that may be a bridge too far, and creates costs that risk exceeding the diminishing benefits of higher capital requirements above Basel III minimums.

As a frame of reference for how stringent capital standards are at this point, our analysis shows that at the Basel III 7 percent minimum, the nine likely U.S. G–SIFI banks, in aggregate, could absorb an instantaneous loss equal to 2 years of their average losses during the financial crisis—$203 billion—and still maintain a 5 percent Tier 1 Common capital ratio. (The 2-year time frame and 5 percent ratio were the standards required by the Federal Reserve under CCAR. The average 2 years of losses include losses both for the nine banks and the institutions they acquired during the crisis.)

As another frame of reference for current capital levels, consider that JPMorgan Chase entered the financial crisis with a ratio of tier 1 common equity to risk-weighted assets of 7 percent under the applicable capital rules (Basel I). (In other words, we held $7 in common stock or instruments of similar quality for every $100 of loans or other assets we had at risk.) Starting at that level, we were able to weather the financial crisis, and to acquire both Bear Stearns and Washington Mutual, and the chairman of Congress's Financial Crisis Inquiry Commission has stated that JPMorgan Chase would have survived the crisis without assistance.

With this in mind, note that the Basel III rules effectively would require JPMorgan Chase to hold approximately 45 percent more capital than it did during the crisis. This is because the new 7 percent tier 1 common equity minimum standard under Basel III corresponds to more than 10 percent under its Basel I predecessor requirement in effect in 2007, particularly for banks having meaningful counterparty exposures and that are engaged in trading activity. This includes, through an interim measure called Basel II.5 that focuses on market risk—a 100 percent capital charge against high-risk securitization structures, including certain high risk CDOs, which contributed to losses in the recent crisis. It also includes a narrowing of the definition of what instruments count as capital, which we strongly support.

It is also worth noting that the results of the stress tests included in the Federal Reserve's CCAR process demonstrated that leading U.S. banks are appropriately capitalized under highly adverse stress scenarios. The results of the CCAR are particularly significant given their methodology, which included a replay of the financial crisis and recession over a 2-year stress period.

Nonetheless, we have generally been supportive of Basel III and its higher requirements. We have been critical, however, of a proposed 250 basis point capital surcharge on us and other large banks, as we believe that the surcharge is not necessary and will impose more costs than benefits on the financial system and the economy as a whole.

Q.2. Did any of the top executives in the Chief Investment Office have significant risk management experience?

A.2. Achilles Macris and Javier Martin-Artajo, both of whom had supervisory responsibilities over the Synthetic Credit Portfolio, were experienced traders whose roles included managing market and credit risks.

Q.3. Did Ina Drew have any significant risk management experience? What did that consist of?

A.3. Ina Drew was an experienced participant in the global markets for approximately 30 years and as such had substantial familiarity with management of market risk and credit risk.

Q.4. Do you agree that trading for purposes of making money shouldn't be allowed in banks with deposits that are insured by the Government?

A.4. Banks perform an essential role in the global markets as market makers in providing liquidity to clients.

Q.5. It's been reported that you did not learn of the sizes of these trades until around April 30th. Is that accurate?

A.5. Mr. Dimon learned some information about the trades before April 13, 2012, but not all of the particulars. As time went on, though, and in particular following losses in the portfolio in late April, he dug deeper and learned more, including some of the specific attributes and correlation characteristics of the portfolio.

Q.6. On an April 13th call with analysts, you called concerns about these trades "a complete tempest in a teapot." If you didn't completely review the positions until April 30th, then what basis did you have for saying they were a "tempest in a teapot" on April 13th? Did someone mislead you about them? Who was that and what did they say?

A.6. Management had been looking into the issue prior to April 13, 2012. Based on information we received, including stress testing that was conducted, we thought it was under control. A lot of folks thought the losses experienced up to that point were aberrational and would come back, which happens sometimes. And so on April 13, 2012, Mr. Dimon genuinely did believe it was a tempest in a teapot. But with that said, and as Mr. Dimon has repeated many times, he was wrong.

Q.7. When did you first brief JPMorgan's Board of Directors about these trades? What did you tell them?

A.7. On April 12, 2012, management discussed with the Audit Committee, which consists of three members of the Board of Directors, the recent news articles on CIO and first quarter performance for the trading book that was subject of the press reports.

On April 17, 2012, the Risk Policy Committee of the Board, which consists of three other Board members, received a presentation on CIO's activity and recent news reports. The Risk Committee was briefed on an ongoing post mortem on the trades.

On May 2, 2012, Ina Drew, the Chief Investment Officer, gave a presentation to the Audit Committee on the hedging losses being realized in CIO. She went through an analysis, including the causes of the losses, control issues, lessons learned and remediation efforts.

Prior to the May 10, 2012, special meeting of the Board of Directors described in the next paragraphs, Mr. Dimon had telephone conversations with several members of the Board, during which he updated them on the CIO issue.

Mr. Dimon briefed our Board of Directors at a special meeting on May 10, 2012, that we would be filing our quarterly report on Form 10-Q with the SEC that day and that the Form 10-Q would contain disclosure that in Corporate, net income (excluding Private Equity results and litigation expense) for the second quarter was currently estimated to be a loss of approximately $800 million after tax. Prior guidance for Corporate quarterly net income was approximately $200 million. Mr. Dimon advised the Board that actual results for the second quarter could be substantially different from the current estimate and would depend on market levels and portfolio actions related to investments held by the CIO, as well as other activities in Corporate during the remainder of the quarter.

Mr. Dimon told the Board at its May 10 meeting that since March 31, 2012, CIO has had significant mark-to-market losses in its Synthetic Credit Portfolio, and this portfolio has proven to be riskier, more volatile and less effective as an economic hedge than the Firm previously believed. On a before tax basis, the losses were in the range of approximately $2 billion, and these had been partially offset by realized gains in CIO's available for sale securities portfolio. Mr. Dimon further advised the Board that reviews of what occurred in CIO were underway, including by Audit, Legal, Compliance and Risk Management. The Finn was in the process of repositioning CIO's Synthetic Credit Portfolio and we had brought in talent from the Investment Bank to help manage the positions. In managing these positions, we would do so in a manner designed to maximize economic value, and as a result net income in Corporate was likely to be more volatile in future periods than it has been in the past, and it could cost a further $1 billion or more in the quarter and potentially additional losses in future quarters.

Q.8. Why did JPMorgan change its accounting methods regarding these trades?

A.8. We did not change our accounting methods with regard to these trades. They were booked as mark-to-market assets throughout this period. As we have disclosed, we did conclude as a result of our management review that we should restate the valuation of the Synthetic Credit Portfolio for purposes of first quarter of 2012.

Q.9. Did this change in the metric lead to the understatement of the risk to the bank?

A.9. As described above, we adopted a new VaR model for CIO effective at the end of January 2012. We now believe that weaknesses in this model caused it to understate the VaR of the Synthetic Credit Portfolio. We abandoned use of this model for purposes of first quarter 2012 reporting, and used the same model we had employed throughout 2011. For purposes of the second quarter of 2012, we have adopted a new model.

Q.10. Was that change disclosed to your agencies and investors before May 1?

A.10. We assume you are referring to the change in the VaR model. Yes, the change in the model was disclosed to our regulators. Regular daily reports sent to the regulators in the days leading up to the model change in January included information that CIO was implementing a new model.

The change in the VaR model was not disclosed to investors before May 1, 2012.

Q.11. Steven Rattner, formerly the head of the Auto Task Force, said that these trading losses are "small beer." Do you agree with him?

A.11. We have taken this matter very seriously. We appointed a Task Force to review the circumstances that gave rise to the losses, and our Board named a Review Committee to oversee our work. We have identified a number of key lessons and have implemented a number of changes as a result. It is true, however, that these trades did not impose losses on clients or the deposit insurance funds, and that our other lines of businesses, and the financial system, were not affected. We also earned $4.9 billion and $5.0 billion in the first and second quarters of this year, respectively, even after accounting for the CIO trading losses. Our fortress balance sheet and diversified business model ensured that we were able to weather the losses while continuing to lend and otherwise serve the needs of our clients.

Q.12. Did JPMorgan have adequate internal controls over these trades?

A.12. We have determined that there were certain deficiencies in CIO's internal controls over financial reporting at March 31, 2012. These deficiencies, which related to CIO's internal controls over valuation of the Synthetic Credit Portfolio, were substantially remediated by June 30, 2012.

Q.13. Did bank executives respond appropriately to the "red flags" you pointed to regarding these trades?

A.13. As we have detailed in our management review, we were slow to react to the losses in the portfolio. CIO risk management did not deal with the issues in a timely manner as they arose and did not escalate to firmwide risk early enough. CIO management generally did not sufficiently question the answers being given by traders in early April such that firmwide management was not given the complete picture at an early enough stage.

Q.14. What specific positions were you trying to hedge?

A.14. The Synthetic Credit Portfolio was intended to establish positions that would generate revenue in a down credit market, and offset anticipated losses in CIO's AFS portfolio and other businesses.

Q.15. What process did your bank undertake to ensure that the positions taken to hedge them were sufficiently correlated to act as a real hedge and not just a bet?

A.15. Positions held by CIO were incorporated into our regular stress testing, as well as the Federal Reserve's CCAR stress test. These tests showed how these positions were expected to behave, and thus the extent to which they were hedges, under various economic and market shocks. In early 2012, however, the Synthetic Credit Portfolio was increased in size and complexity, and our risk measures were not sufficiently granular to identify the heightened risk embedded in this portfolio.

Q.16. Is it true that JPMorgan was considering taking a reserve against these trades in 2010?

A.16. We are not aware of any discussion about taking reserves against the Synthetic Credit Portfolio positions in 2010.

Q.17. Is your bank too big to manage? Are any banks too big to manage?

A.17. We are not too big to manage. In this case, our fortress balance sheet and diversified business model ensured that we were able to weather the losses from CIO while continuing to Lend and otherwise serve the needs of our clients.

Q.18. Is it possible that these types of trading losses could put the bank at risk in the future despite your best efforts to institute better risk management?

A.18. As noted above, we believe that while trading losses are always possible, the significant capital and revenue strength of our company makes us better able to withstand any such losses than a less diversified or less well capitalized firm.

Q.19. How many OCC regulators were tasked with overseeing the activities of the Chief Investment Office?

A.19. It is our understanding that the OCC did not have any staff members specifically tasked with overseeing the activities of CIO on a full-time basis. Rather, the OCC assigned a number of examiners to specific exams conducted on the activities of CIO.

Q.20. When did regulators first raise questions about the London trades? Were they provided with all of the information requested? Were they ever misled?

A.20. The regulators first raised questions about the London trades in early April 2012 after news articles regarding the London trader. On April 9, 2012, we met with members of the staff of the Federal Reserve and the OCC to discuss the trades. We believe we shared with our regulators the information they requested.

Q.21. Your chief financial officer said on an investor call that the bank's regulators were aware of the trades and comfortable with them in mid-April 2012. What regulators were aware of the trades? What did your bank do to specifically make your regulators aware of these positions? What information did you provide to those regulators? How did the regulators communicate to the bank that they were "comfortable"?

A.21. Our chief financial officer said that we were comfortable with our positions and that the regulators were aware of the positions. The Federal Reserve and the OCC received regular risk reports on the CIO positions, some on a daily, weekly or monthly basis. In addition, we met with representatives from our Federal Reserve and OCC exam teams on April 9, 2012, to discuss the trades.

Q.22. Why did you publicly go after Bloomberg for reporting that these were risky trades?

A.22. Management had been looking into the issue prior to April 13, 2012. Based on information we received, including stress testing that was conducted, we thought it was under control. And so on April 13, 2012, Mr. Dimon genuinely did believe it was a tempest in a teapot. But with that said, and as Mr. Dimon has repeated many times, he was wrong.

Q.23. Your chief investment office has put money in corporate bonds as opposed to less risky Treasury bonds, then used derivatives to bet on directions of the market. That indicates that the purpose of the unit, unlike at some of your competitors, is to generate profit rather than protect the bank from losses. Should the investment office be a profit center?

A.23. We do not agree with this characterization of the purpose of the Chief Investment Office. CIO invests excess cash in a variety of instruments. We believe it is appropriate for corporate bonds to be among those investments.

Q.24. You have said you would consider claw backs for people involved in the losses. Your proxy statement says that an employee's pay will be clawed back if he or she "engages in conduct that causes material financial or reputational harm." Have you clawed back any of Ina Drew's previous income or that of others in the group? If yes, how much? If not, why not? Also, did you strike any financial arrangement with Ms. Drew as part of her agreement to retire? Have you struck financial deals with any of the other executives who are expected to leave the firm by the end of the year? If so, please provide the details and rationales for taking those actions.

A.24. As announced, CIO managers based in London with responsibility for Synthetic Credit Portfolio have been separated from the Firm without severance or 2012 incentives, and the maximum permitted claw backs were invoked. Ina Drew came forward voluntarily agreed to give up compensation equivalent to the maximum claw back amount. We did not strike any financial arrangement with Ina Drew as part of her agreement to retire.

For others, 2012 performance-year compensation and claw backs, if appropriate, will be determined in the ordinary course.

Q.25. Do you think it's appropriate for bank executives to sit on the regional Federal Reserve Boards that regulate those same banks?

A.25. The regional Federal Reserve Boards basically meet and talk about the economy. There are 12 Federal Reserve Boards, and that information is put together and sent to Washington. The Boards are more of an informational advisory group. Mr. Dimon does not vote for the president of the Federal Reserve Bank of New York, he does not get involved in supervisory matters, and he cannot serve on the Audit Committee.

We think it makes sense for the Federal Reserve to hear the views of bank representatives.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNER FROM JAMES DIMON

Q.1. Did CIO, in its investments or through its hedging, take on more risk than it was authorized to, and if so, did the people taking that risk know that they were exceeding their authority?

A.1. CIO had controls in place to manage and monitor its portfolios, including numerous risk metrics and limits (*e.g.,* VaR, stress testing, credit spreads, *etc.*). In certain instances, these limits were exceeded by the investment positions taken by CIO and the appropriate individuals were informed accordingly, depending on the type of limit exceeded. The policy governing market risk limits contemplated such situations and provided for appropriate responses, including managing the position to bring it within the limit or allowing for a temporary increase in the limit under some circumstances. In certain cases, however, the response to these notifications may not have been as timely as it should have been. The new policy we have implemented addresses this issue by requiring m ore rapid escalation of limits excessions.

Q.2. If CIO took on more risk than it was supposed to, did the person or people overseeing its operations know, or should they have known, that it was taking on too much risk?

A.2. The answer to this question is very similar to the one immediately above. CIO had controls in place to manage and monitor its portfolios, including numerous risk metrics and limits. In certain instances, these limits were exceeded by the investment positions taken by CIO and the appropriate individuals were informed accordingly, including the head of CIO and risk management personnel where necessary. As noted above, the risk policy contemplated such situations and provided for appropriate responses, including managing the position to bring it within the limit or allowing for a temporary increase in the limit under some circumstances. In certain cases, however, the response to these notifications may not have been as timely as it should have been. Our new policy addresses this issue by requiring more rapid escalation of limits excessions.

Q.3. You have criticized the Volcker rule for requiring a backward look at the intent of traders. In your own internal review of what happened, do you feel comfortable that you are able to look back and understand to your satisfaction what people were thinking and why specific decisions were made? Have your opinions on the value of better recording and tracking intent, as required by the Volcker rule, been changed by this event?

A.3. We have found it very difficult and labor-intensive to reconstruct the intent of traders.

Q.4. Do you now believe it is possible for an individual or firm to abuse the portfolio hedging exemption to evade the Volcker rule, and if so, how do you think we can best prevent that while still allowing firms to hedge the risks they undertake in the normal course of business?

A.4. We continue to believe that portfolio hedging is an important function that should not be prohibited by the Volcker Rule. We also note that portfolio hedging through derivatives will be subject, independent of the Volcker Rule, to extraordinarily high capital requirements through Basel II.5 and Basel III.

Q.5. Mr. Dimon, Prince William County in Virginia is a location that was especially hard hit by the subprime lending abuses that took place and subsequent housing market declines. I have been working with a group from that area called VOICE, and it is my understanding that people from JPMorgan Chase have been as well. Will JPMorgan Chase continue to work with VOICE and the community in Price William to mitigate the damage that has taken place in that community, and help to restore it?

A.5. JPMC has been actively engaged with VOICE since July 2011. Since that time, we had several face-to-face meetings with the organization and provided updates on our foreclosure prevention efforts in Virginia and Prince William County. To further assist borrowers, we conducted a cobranded 2-day outreach event in Prince William County at which our Chase Homeownership Center staff met face-to-face with borrowers and walked them through the options available to them.

We have offered to provide training for VOICE counselors and conduct ongoing pipeline reviews. Chase provided funding to the VA Housing Finance Agency's Hispanic Committee for a HUD counselor in the community.

We believe we share a common goal with VOICE—help homeowners stay in their homes. We are committed to partnering with and strengthening our relationship with community organizations to work with homeowners and stabilize communities in Virginia and Prince William County.