S. Hrg. 113–96

JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

VOLUME 1 OF 2

MARCH 15, 2013

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JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES

FRIDAY, MARCH 15, 2013

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:33 a.m., in room SD–G50, Dirksen Senate Office Building, Hon. Carl Levin, Chairman of the Subcommittee, presiding.

Present: Senators Levin, McCain, and Johnson.

Staff present: Elise J. Bean, Staff Director and Chief Counsel; Mary D. Robertson, Chief Clerk; Zachary I. Schram, Senior Counsel; Allison F. Murphy, Counsel; David H. Katz, Counsel; Feras Sleiman, Law Clerk; Todd Phillips, Law Clerk; Elizabeth V. Baltzan, Former Congressional Fellow; Eric S. Walker, Former Detailee; Brian Egger, Detailee (GAO); Christopher Reed, Congressional Fellow; Combiz Abdolrahimi, Law Clerk; Aaron Fanwick, Law Clerk; Adam Goldberg, Law Clerk; Gigi Good, Intern; Alex Harisiadis, Law Clerk; Henry J. Kerner, Staff Director and Chief Counsel to the Minority; Stephanie Hall, Counsel to the Minority; Brad M. Patout, Senior Policy Advisor to the Minority; Scott D. Wittmann, Research Assistant to the Minority; and Rachael Weaver (Sen. Johnson).

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Good morning, everybody. Let me first begin by extending a special welcome to the new Ranking Member of this Subcommittee, a dear and longtime friend, Senator McCain. It is not the first time that we have worked side-by-side. He has been a longtime Member of the Subcommittee and was formerly Ranking Member on the Senate Armed Services Committee, and he has brought great energy and a bipartisan spirit to our work together, and we want to just welcome him as our new Ranking Member here.

We also welcome Senator Johnson, as a new Member on our Subcommittee. Unlike Senator McCain who has been a Member of this Subcommittee for years, Senator Johnson has now joined us. We welcome him.

In April 2012, Americans were confronted with a story of Wall Street excess and the derivatives disaster, now known as the

"JPMorgan Chase whale trades." The largest U.S. banks today are deep into derivatives, which are complex financial instruments that derive their value from other assets. The derivatives behind the JPMorgan whale trades were part of a so-called Synthetic Credit Portfolio (SCP), that made outsized bets on whether particular financial instruments or entities were creditworthy or would default during specified time periods. The bets were made by traders in the London office of the U.S. banking giant JPMorgan Chase. Their trades—meaning their bets—grew so large that they roiled the $27 trillion credit derivatives market, singlehandedly affected global prices, and finally attracted a media storm aimed at finding out who was behind them.

That is when the media unmasked JPMorgan's Chief Investment Office (CIO), which, until then, had been known for making conservative investments with bank deposits. At first, JPMorgan's Chief Executive Officer (CEO) Jamie Dimon claimed the April media reports about the whale trades were a "tempest in a teapot." But a month later, the bank admitted the truth: That their credit derivative bets had gone south, producing not only losses that eventually exceeded $6 billion, but also exposing a litany of risk management problems at what had been considered one of America's safest banks.

JPMorgan Chase is the largest financial holding company in the United States. It is also the largest derivatives dealer in the world and the largest single participant in world credit derivatives markets. It has consistently portrayed itself as a risk management expert with a "fortress balance sheet" that ensures taxpayers have nothing to fear from its extensive dealing in risky derivatives. But that reassuring portrayal of the bank was shattered when whale trade losses shocked the investing public, not only with the magnitude of the losses, but because the financial risk had been largely unknown to bank regulators.

The Subcommittee meets today after 9 months of digging into the facts behind the whale trades. To learn what happened, the Subcommittee collected nearly 90,000 documents, conducted over 50 interviews and briefings, and has issued a 300-page bipartisan report. While the bank and its regulators have cooperated with our investigation, four key former JPMorgan employees directly involved in the derivatives trading declined to cooperate, and because they reside overseas, they remain beyond the Subcommittee's subpoena authority.

Our findings open a window into the hidden world of high-stakes derivatives trading by big banks. It exposes a derivatives trading culture at JPMorgan that piled on risk, that hid losses, that disregarded risk limits, that manipulated risk models, that dodged oversight, and that misinformed the public.

Our investigation brought home one overarching fact: The U.S. financial system may have significant vulnerabilities attributable to major bank involvement with high-risk derivatives trading. The four largest U.S. banks control 90 percent of U.S. derivatives markets, and their profitability is invested, in part, in their derivatives holdings, nowhere more so than at JPMorgan.

The whale trades demonstrate how credit derivatives, when purchased in massive quantities with complex components, can become a runaway train barreling through every risk limit. The whale trades also demonstrate how derivative valuation practices are easily manipulated to hide losses, and how risk controls are easily manipulated to circumvent limits, enabling traders to load up on risk in their quest for profits. Firing a few traders and their bosses will not be enough to staunch Wall Street's insatiable appetite for risky derivative bets or stop the excesses. More control is needed.

Among the most troubling aspects of the whale trades case history is that JPMorgan traders, who were required to book the value of their derivative holdings every business day, used internal profit/loss reports to hide more than half a billion dollars in losses in just 3 months. Eventually, those misreported values forced JPMorgan to restate its earnings for the first quarter of 2012. But to this day, JPMorgan maintains that the mismarked values did not, on their face, violate bank policy or generally accepted accounting principles. But if derivative books can be cooked as blatantly as they were in this case without breaking the rules, then the rules need to be revamped. And given how much major U.S. bank profits remain bound up with the value of their derivatives, derivative valuations that cannot be trusted are a serious threat to our economic stability.

The whale trades also demonstrate how easily a Wall Street bank can manipulate and avoid risk controls. The financial industry assures us that it can prudently manage high-risk activities because they are measured, monitored, and limited. But as the Subcommittee report demonstrates in detail, JPMorgan executives ignored a series of alarms that went off as the bank's Chief Investment Office breached one risk limit after another. Rather than ratchet back the risk, JPMorgan personnel challenged and re-engineered the risk controls to silence the alarms. It is difficult to imagine how the American people can trust major Wall Street banks to prudently manage derivatives risk when bank personnel can readily game or ignore the risk controls that are meant to prevent financial disaster and taxpayer bailouts.

The whale trades also provide another example of a major Wall Street bank's misstatements and concealment. In fact, in January 2012, the bank told the Office of the Comptroller of the Currency (OCC), inaccurately, that the portfolio was decreasing in size, when it was not. Most troubling of all, when the media spotlight hit, senior bank executives mischaracterized to investors and the public the nature of the whale trades and the extent of risk management and regulatory oversight, gambling apparently that the portfolio's bad bets would recover before anyone took a closer look.

Well, we took a closer look, and it is not pretty: a massive derivatives portfolio riddled with risk; a runaway train of derivatives trading blowing through risk limits; hidden losses; bank executives downplaying the bad bets; regulators who failed to act.

Together, these facts are a reminder of what occurred in the recent financial crisis. We just cannot rely on a major bank to resist risky bets, honestly report derivative losses, or disclose bad news without a strong regulator looking over its shoulder, backed by laws that require transparency, risk limits, capital buffers against losses, and consequences for misconduct.

That is the big picture, and here are some of the detailed findings from our investigation.

First, JPMorgan's Chief Investment Office rapidly amassed a huge portfolio of synthetic credit derivatives, in part using federally insured depositor funds, in a series of risky, short-term trades, disclosing the extent of the portfolio only after intense media exposure.

Now, in just a few months during 2011, as shown on Exhibit 1a[1]—and I think we can get Chart 1 up over here—the Chief Investment Office's Synthetic Credit Portfolio grew from a net notional size of $4 billion to $51 billion, and then tripled in the first quarter of 2012 to $157 billion. That exponential growth in holdings and risk occurred with virtually no regulatory oversight.

Second, once the whale trades were exposed, JPMorgan claimed to regulators, investors, and the public that the trades were designed to hedge credit risk. But internal bank documents failed to identify the assets being hedged, how they lowered risk, or why the supposed credit derivative hedges were treated differently from other hedges in the Chief Investment Office. If these trades were, as JPMorgan maintains, hedges gone astray, it remains a mystery how the bank determined the nature, size, or effectiveness of the so-called hedges and how, if at all, they reduced risk.

Third, the Chief Investment Office internally concealed massive losses in the first several months of 2012 by overstating the value of its synthetic credit derivatives. It got away with overstating those values within the bank, even in the face of disputes with counterparties and in the face of two internal bank reviews.

As late as January 2012, the CIO had valued its credit derivatives by using the midpoint in the daily range of bids and asks offered in the marketplace. That is the typical way to value derivatives. But beginning in late January, the traders stopped using midpoint prices and started using prices at the extreme edges of the daily price range to hide escalating losses. In recorded phone conversations, one trader described these marks as "idiotic."

At one point, traders used a spreadsheet to track just how large their deception had grown by recording the valuation differences between using midpoint and more favorable prices. In just 5 days in March, according to the traders' own spreadsheet, the hidden losses exceeded $400 million. The difference eventually exceeded $600 million. Counterparties to the derivative trades began disputing the CIO's booked values involving hundreds of millions of dollars in March and April.

Despite the obvious value manipulation, on May 10—the same day JPMorgan announced that the whale trades had lost $2 billion—the bank's controller concluded a special review and signed off on the CIO's derivative pricing practices as "consistent with industry practices." JPMorgan leadership has continued to argue that the values assigned by its traders to the Synthetic Credit Portfolio were defensible under accounting rules.

Yet in July 2012, the bank reluctantly restated its first quarter earnings. It did so only after an internal investigation listened to

[1] See Exhibit No. 1a, which appears in the Appendix on page 511.

phone conversations, routinely recorded by the bank, in which its traders mocked their own valuation practices.

Now, their mismarked values were not wrong simply because the traders intended to understate losses; they were wrong because they changed their pricing practices after losses began piling up, stopped using the midpoint prices that they had used up until January, and they began using aggressive prices that consistently made the bank's reports look better. Until JPMorgan and others stop their personnel from playing those kinds of games, derivative values will remain an imprecise, malleable, and untrustworthy set of figures that call into question the derivative profits and losses reported by our largest financial institutions.

Fourth, when the CIO's Synthetic Credit Portfolio breached five key risk limits, rather than reduce the risky trading activities, JPMorgan either increased the limits, changed the risk models that calculated risk, or turned a blind eye to the breaches.

As early as January 2012, the rapid growth of the Synthetic Credit Portfolio breached one common measure of risk, called "Value-at-Risk" (VaR), causing a breach not just at the CIO, but for the entire bank. That 4-day breach was reported to top bank officials, including CEO Jamie Dimon, who personally approved a temporary limit increase, and voila, the breach was ended. CIO employees then hurriedly pushed through approval of a new VaR model that overnight dropped the CIO's purported risk by 50 percent. Regulators were told about that remarkable reduction in the CIO's purported risk, but raised no objection to the new model at the time.

The credit derivatives portfolio breached other risk limits as well. In one case, it exceeded established limits on one measure, known as "Credit Spread 01 (CS01)," by 1,000 percent for months running. When regulators asked about the breach, JPMorgan risk managers responded that it was not a "sensible" limit and allowed the breach to continue. When still another risk metric, called "Comprehensive Risk Measure," projected that the Synthetic Credit Portfolio could lose $6.3 billion in a year, a senior CIO risk manager dismissed the result as "garbage." It was not garbage; that projection was 100 percent accurate, but the derivatives traders thought they knew better. Downplaying risk, ignoring one risk warning after another, and pushing to re-engineer risk controls to artificially lower risk results flatly contradict JPMorgan's claim to prudent risk management.

Fifth, at the same time the portfolio was losing money and breaching risk limits, JPMorgan dodged the oversight of the OCC. It omitted CIO data from its reports to the OCC; it failed to disclose size, risk, and losses of the Synthetic Credit Portfolio; and it delayed or tinkered with OCC requests for information by giving the regulator inaccurate or unresponsive information. In fact, when the whale trades first became public, the bank offered such blanket reassurances that the OCC initially considered the matter closed. It was only when the losses exploded that the OCC took another look.

The failure of regulators to act sooner cannot be excused by the bank's behavior. The OCC also fell down on the job. It failed to investigate multiple, sustained risk limit breaches; it tolerated incomplete and missing reports from JPMorgan; it failed to question the bank's new value-at-risk model that dramatically lowered the CIO's risk rating; it accepted JPMorgan's protests that the media reports about the portfolio were overblown. It was not until May 2012, after a new Comptroller of the Currency took the reins at the OCC, that the OCC officials instituted their first intensive inquiry into the Synthetic Credit Portfolio.

Again, with the lessons of the 2008 financial crisis so painfully fresh, it is deeply worrisome that a major bank should seek to cloak its risky trading activities from regulators and doubly worrisome that it was able to succeed so easily for so long.

And, finally, when the whale trades went public, JPMorgan misinformed regulators and the public about the Synthetic Credit Portfolio. JPMorgan's first public response to the April news reports about the whale trades was when its spokesperson, using prepared talking points approved by senior executives, told reporters on April 10 that the whale trades were risk-reducing hedges that were known to regulators. A more detailed description came in a conference call held on April 13 with investment analysts. During that call, Chief Financial Officer (CFO) Douglas Braunstein made a series of inaccurate statements about the whale trades, and that is shown in Exhibit 1f.[1]

He said the trades had been put on by bank risk managers and were fully transparent to regulators; he said the trades were made on a very long-term basis; he said the trades were essentially a hedge; he said the bank believed the trades were consistent with the Volcker Rule which prohibits high-risk proprietary trading by banks. Those public statements on April 13 were not true. As late as May 10, bank CEO Jamie Dimon repeatedly described the synthetic credit trades as hedges made to offset risk, despite information showing the portfolio was not a hedge.

The bank also neglected to tell investors the bad news that the derivatives portfolio had broken through multiple risk limits, losses had piled up, and the head of the portfolio had put management of the portfolio into "crisis mode."

It was recently reported that the eight biggest U.S. banks have hit a 5-year low in the percentage of deposits used to make loans. Their collective average loan-to-deposit ratio has fallen to 84 percent in 2012, down from 87 percent a year earlier and 101 percent in 2007. JPMorgan has the lowest loan-to-deposit ratio of the big banks, lending just 61 percent of its deposits out in loans. Apparently, it was too busy betting on derivatives to issue the loans needed to speed economic recovery.

Based on its investigation into the JPMorgan whale trades, our report makes the following recommendations:

First, when it comes to high-risk derivatives, Federal regulators need to know what major banks are up to. We should require those banks to identify internal investment portfolios that include derivatives over a specified size, require periodic reporting on derivative performance, and conduct regular reviews to detect undisclosed derivatives trading.

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[1] See Exhibit No. 1f, which appears in the Appendix on page 516.

Next, when banks claim they are trading derivatives to hedge risks, we need to require them to identify the assets being hedged, how the derivatives trade reduces the risk associated with those assets, and how the bank tested the effectiveness of its hedging strategy in reducing risk.

Next, we need to strengthen how derivatives are valued to stop inflated values. Regulators should encourage banks to use independent pricing services to stop the games; require disclosure of valuation disputes with counterparties; and require disclosure and justification when, as occurred at JPMorgan, derivative values deviate from midpoint prices.

Next, when risk alarms go off, banks and their regulators should investigate the breaches and take action to reduce risky activities.

Next, Federal regulators should require disclosure of any newly implemented risk model or metric which, when implemented, materially lowers purported risk, and investigate the changes for evidence of model manipulation.

Next, 3 years ago, Congress enacted the Merkley-Levin provisions of the Dodd-Frank Act, also known as the Volcker Rule, to end high-risk proprietary betting using federally insured deposits. Financial regulators ought to finalize the long-delayed implementing regulations.

Next, at major banks that trade derivatives, regulators should ensure the banks can withstand any losses by having adequate capital charges for derivatives trading. It is way past time to finalize the rules implementing stronger capital bank standards.

The derivatives trading that produced the whale trades damaged a single bank. But the whale trades expose problems that reach far beyond one London trading desk or one Wall Street office tower. The American people have already suffered one devastating economic assault rooted largely in Wall Street excess. They cannot afford another. When Wall Street plays with fire, American families get burned. The task of Federal regulators, and of this Congress, is to take away the matches. The whale trades demonstrate that task is far from complete.

Senator McCain.

OPENING STATEMENT OF SENATOR MCCAIN

Senator MCCAIN. Thank you, Mr. Chairman, and let me begin by saying what an honor it is to serve on this Subcommittee, which has a long history of bipartisanship and a celebrated legacy of uncovering waste, fraud, abuse, and outright corruption. And before I move forward, I want to express my gratitude to you and the members of your staff for your unyielding and dedicated efforts in this investigation.

I would also like to recognize the work of my predecessor on the Subcommittee, Senator Coburn, for his contributions prior to my arrival. This investigation into the so-called whale trades at JPMorgan has revealed startling failures at an institution that touts itself as an expert in risk management and prides itself on its fortress balance sheet.

The investigation has also shed light on the complex and volatile world of synthetic credit derivatives. In a matter of months, JPMorgan was able to vastly increase its exposure to risk while dodging oversight by Federal regulators. The trades ultimately cost the bank billions of dollars and its shareholders value. These losses come to light not because of admirable risk management strategies at JPMorgan or because of effective oversight by diligent regulators. Instead, these losses came to light because they were so damaging that they shook the market and so damning that they caught the attention of the press.

Following the revelation that these huge trades were coming from JPMorgan's London office, the bank's losses continued to grow. By the end of the year, the total losses stood at a staggering $6.2 billion.

This case represents another shameful demonstration of a bank engaged in wildly risky behavior. The "London Whale" incident matters to the Federal Government because the traders at JPMorgan were making risky bets using excess deposits, portions of which were federally insured. These excess deposits should have been used to provide loans for Main Street businesses. Instead, JPMorgan used the money to bet on catastrophic risk.

Through an extensive bipartisan investigation, this Subcommittee has uncovered a wealth of new information. Internal emails, memos, and interviews reveal that these trades were not conducted by a group of rogue traders, but that their superiors were well aware of their activities.

Traders at JPMorgan's Chief Investment Office, the CIO, adopted a risky strategy with money they were supposed to use to hedge, or counter, risk. However, even the head of the CIO could only provide a 'guesstimate' as to what exactly the portfolio was supposed to hedge. And JPMorgan's CEO Jamie Dimon admitted that the portfolio had "morphed" into something that created new and potentially larger risks. In the words of JPMorgan's primary Federal regulator, it would require "make-believe voodoo magic" to make the portfolio actually look like a hedge.

Top officials at JPMorgan allowed these excessive losses to occur by permitting the CIO to continually breach all of the bank's own risk limits. When the risk limits threatened to impede their risky behavior, they decided to manipulate the models.

Disturbingly, the bank's primary regulator, the OCC, failed to take action even after red flags warned that JPMorgan was breaching its risk limits. These regulators fell asleep at the switch and failed to use the tools at their disposal to effectively curb JPMorgan's appetite for risk.

However, JPMorgan actively impeded the OCC's oversight. The CIO refused to release key investment data to the OCC and even claimed that the regulator was trying to "destroy" the bank's business.

After these losses were uncovered by the press, JPMorgan chose to conceal its errors and, in doing so, top officials at the bank misinformed investors, regulators, and the public. In an April 2012 earnings call, then Chief Financial Officer Douglas Braunstein falsely told investors and the public that the bank had been "fully transparent to regulators."

The deception did not end there. During the same earnings call, Mr. Dimon tried to downplay the significance of the losses by infamously characterizing them as "a complete tempest in a teapot."

The truth of the matter is that $6 billion, some of which is federally insured, is an inexcusable amount of money to be gambled away on risky bets. This investigation potentially reveals systemic problems in our Nation's financial system. The size of the potential losses and the accompanying deception echo the misguided and dishonest actions that the banks took during the financial crisis 4 years ago.

Let me be clear: JPMorgan completely disregarded risk limits and stonewalled Federal regulators. It is unsettling that a group of traders made reckless decisions with federally insured money and that all of this was done with the full awareness of top officials at JPMorgan. This bank appears to have entertained—indeed, embraced—the idea that it was "too big to fail." In fact, with regard to how it managed the derivatives that are the subject of today's hearing, it seems to have developed a business model based on that notion—the notion that they are too big to fail.

It is our duty to the American public to remind the financial industry that high-stakes gambling with federally insured deposits will not be tolerated. In 2012, the "London Whale" trades resulted in a $6 billion loss. What if it was $60 billion? Or $100 billion? Does JPMorgan operate under the assumption that the taxpayer will bail them out again? What place does taxpayers' underwriting of the big banks' disregard for "moral hazard" have in the proper operation of a truly free market?

I look forward to hearing from our witnesses today as we examine what went wrong at JPMorgan.

Senator LEVIN. Thank you very much, Senator McCain.

Senator Johnson, do you have an opening comment or statement?

OPENING STATEMENT OF SENATOR JOHNSON

Senator JOHNSON. I really do not have anything prepared, but I think what is interesting about this whole process is what Senator McCain just pointed out, that JPMorgan appears to have developed its business model around the fact that they are too big to fail. And I have always said that the fact that we have institutions that simply are too big to fail shows how regulation already failed us. We had regulation in place that probably should have prevented that years ago.

So, again, I am looking forward to hearing the testimony just to really highlight the fact that regulators in general are very incapable of preventing all these things, and I am really looking forward to the recommendations in terms of how we can get regulation up to speed so we can prevent these things in the future.

Senator LEVIN. Thank you very much, Senator Johnson.

Now we will call on our first panel of witnesses, but before we do that, let me make a comment about the procedures here today. We are anticipating a long hearing, and so we are going to call the first panel, witnesses with the most firsthand knowledge of the whale trades that are the central concern of the hearing. And then after taking their testimony and asking questions of them, there will be a very short break. We are going to return then and broaden the panel by adding two senior executives from the bank—one who was responsible for public disclosures about the trades, and the other who led the management postmortem review.

And then when that panel, that extended panel, concludes, there will be another very short break, and we will then hear from the final panel with representatives from the Office of the Comptroller of the Currency.

So now I will call our first panel of witnesses. It is Ms. Ina Drew, the former Chief Investment Officer at JPMorgan; Ashley Bacon, the Acting Chief Risk Officer, JPMorgan; and, finally, Peter Weiland, the former head of market risk for JPMorgan's Chief Investment Office.

We appreciate all of you being with us here this morning. We look forward to your testimony.

Pursuant to Rule VI of this Subcommittee, all witnesses who testify are required to be sworn, so I would ask each of you to please stand and raise your right hand. Do you swear that the testimony that you are about to give to this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. DREW. I do.

Mr. BACON. I do.

Mr. WEILAND. I do.

Senator LEVIN. We will be using a timing system today. About 1 minute before the red light comes on, you will see the light change from green to yellow. It will give you an opportunity to conclude your remarks. And your written testimony, of course, will be printed in the record in its entirety. We would appreciate your limiting your oral testimony to no more than 5 minutes.

Ms. Drew, if you have a prepared statement, we will have you go first, followed by Mr. Bacon, finish up with Mr. Weiland, and then we will turn to questions.

So, Ms. Drew, please proceed. You can keep your microphones on, if you would.

TESTIMONY OF INA R. DREW,[1] FORMER HEAD, CHIEF INVESTMENT OFFICE, JPMORGAN CHASE & CO., NEW YORK, NEW YORK

Ms. DREW. Good morning, Chairman Levin, Ranking Member McCain, and Members of the Subcommittee. My name is Ina Drew. Thank you for the opportunity to provide my perspective on the losses incurred in the Synthetic Credit Portfolio of the Chief Investment Office. As you know, I have submitted a written statement discussing many details which I find important.

I would like to take a moment, though, to talk about my career. I spent over 30 years at JPMorgan and its predecessor institutions in the field of asset and liability management. I joined shortly after receiving a B.A. from the Johns Hopkins University and a Master's degree from Columbia University.

Over the course of my career, I had the privilege of working for truly great CEOs, such as Walter Shipley, William Harrison, and most recently, Jamie Dimon. During this time, I helped build what I believe to be a world-class asset and liability management organization.

I am very proud of the many successes we had in protecting the bank's balance sheet, offsetting risk, and investing prudently. I had

[1] The prepared statement of Ms. Drew appears in the Appendix on page 101.

wonderful mentors who helped me grow and develop my leadership skills, and to them I am very grateful. This was my life's work.

Through at least seven mergers and many financial crises, I always tried to do my best and what was right for the Firm in a thoughtful, diligent manner. I loved the work and the institution and gave it my all while raising a family, balancing my home life, charitable and educational board work, and many other demands.

On Friday night, May 11, 2012, I walked into the office of Mr. Dimon, with whom I had a close and respectful relationship. I told him of my decision to resign from JPMorgan. It was a devastating and very difficult decision for me. It marked the end of three decades of hard work at an institution I loved. We talked about the decision and how important I believed it was to let the company move forward with new leadership. I accepted responsibility for the events that happened on my watch in one of the portfolios in my division. My overwhelming sadness and concern was extended to the 400 people who worked for me, many for more than 20 years. It also went to my colleagues throughout the Firm who are now leading the company going forward.

There were many people from the front office, Risk, Finance, and Quantitative Research (QR) who worked on and analyzed the Synthetic Credit Portfolio. In particular, I relied on the experts, Achilles Macris and Javier Martin-Artajo, to vet and supervise trading in that book and elevate important concerns to me.

Ultimately, my oversight of the synthetic credit book was undermined by two critical facts that I have come to learn only recently based on the company's public statements: First, the company's new VaR model was flawed and significantly understated the real risks in the book that were reported to me; and, second, some members of the London team failed to value positions properly, and in good faith, minimized reported and projected losses, and hid from me important information regarding the true risks of the book.

Throughout these events, I did what I tried to do at all times during my career: Face difficult issues with dignity and integrity. I have had many months to think long and hard about what happened. I do not have all the answers. But what I can tell you is that I always tried to do my best. I tried at all times to approach the issues presented to me thoroughly, thoughtfully, and transparently.

Clearly, mistakes were made. The fact that these mistakes happened on my watch has been the most disappointing and painful part of my professional career.

I thank you for the opportunity to appear today, and I will be happy to answer any questions you may have.

Senator LEVIN. Thank you very much, Ms. Drew.

And now we will call on Mr. Bacon.

TESTIMONY OF ASHLEY BACON,[1] ACTING CHIEF RISK OFFICER, JPMORGAN CHASE & CO., NEW YORK, NEW YORK

Mr. BACON. Good morning, Chairman Levin, Ranking Member McCain, and Members of the Subcommittee. My name is Ashley Bacon, and I am the Acting Chief Risk Officer of JPMorgan. I have been at JPMorgan for 20 years and have spent 6 years in the Firm's Risk Management function.

I appreciate the opportunity to come before you today as part of your inquiry into the CIO Synthetic Credit Portfolio and tell you what I observed after being asked in late April to independently assess the CIO trades. Let me first start by expressing the entire Firm's commitment to the importance of effective risk management.

And turning to the CIO portfolio at issue, at the request of senior Firm management, I was brought in from outside of the Chief Investment Office in late April 2012, along with other individuals from the Investment Bank, to lead a team of professionals conducting a detailed assessment of the Synthetic Credit Portfolio. The purpose of that review was to understand the persistent losses being experienced and to help chart a course forward. The team worked long hours and reported back to senior Firm management at least on a daily basis. After initial reports, we were asked to take over responsibility for the day-to-day management of the Synthetic Credit Portfolio—a responsibility that we held until a new CIO management team took over.

The Firm also requested that my colleague Michael Cavanagh lead a Task Force to investigate these trades. Later today, I believe Mr. Cavanagh will speak in some detail about that effort and to the remedial steps identified by the Task Force in response. I will simply discuss a few key steps we have taken as a Firm to improve our Firm-wide risk management and risk management within CIO.

First, the Firm appointed a new Chief Risk Officer for CIO in May 2012. Additionally, the Firm took steps to ensure Risk's independence and the appropriateness of staffing levels. The new CIO Chief Risk Officer's actual reporting practices now conform to his functional reporting line. He reports to me. His compensation and career advancement are controlled by Risk, with input from the business and others about his performance, as appropriate.

Second, the Firm has overhauled the CIO Risk Committee. The committee now meets on a weekly basis, and attendees include other members of senior management, from within and outside of CIO. It has been reconstituted as the CIO, Treasury, and Corporate Risk Committee to reflect its broader responsibilities and increased participation.

Third, CIO implemented numerous new or restructured risk limits covering a broad set of risk parameters. What remained of the Synthetic Credit Portfolio was transferred to the Firm's Investment Bank, where it is subject to appropriate oversight and detailed analysis.

Last, JPMorgan has conducted a comprehensive self-assessment of the Risk organization, and as a result, we are implementing a series of improvements both Firm-wide and within our lines of

[1] The prepared statement of Mr. Bacon appears in the Appendix on page 108.

business. In addition to working to improve model development, review, approval, and monitoring, the Firm is reaffirming and, where appropriate, revising its market risk limits across all of its lines of business. We have introduced additional granularity and portfolio-level limits, and will continue to do so as appropriate. We have strengthened processes for limit excessions to provide for more rapid escalation and more effective review. We have established a Firm-wide Risk Committee, improved the operation of the Risk Operating Committee and the Risk Governance Committee, and enhanced our reporting to the Board of Directors' Risk Policy Committee.

A risk organization must constantly look for ways to improve. The steps I have described reflect our fundamental belief in how the Firm's risk profile should be overseen with effective challenge and with the right level of information available to address risk issues effectively.

Thank you for the opportunity to appear before you today, and I welcome any questions you have.

Senator LEVIN. Thank you very much. Now, Mr. Weiland.

TESTIMONY OF PETER WEILAND,[1] FORMER HEAD OF MARKET RISK, CHIEF INVESTMENT OFFICE, JPMORGAN CHASE & CO., NEW YORK, NEW YORK

Mr. WEILAND. Good morning, Chairman Levin, Senator McCain, and Members of the Subcommittee. My name is Peter Weiland, and I was head of Market Risk Management for the Office of the CIO from 2008 to 2012. I am here today to help explain some of the facts surrounding the events in question to the best of my knowledge and recollection.

Senator LEVIN. Thank you very much.

Let me start with you, Ms. Drew. If you would take a look at Exhibit No. 81,[2] which is in front of you.

We will have 12-minute rounds, if that is OK. We will have probably more than a round or two with this first panel. We will switch after 12 minutes from me to Senator McCain and then Senator Johnson and any others who may show up.

Do you have Exhibit No. 81?

Ms. DREW. Yes.

Senator LEVIN. This is a presentation which you gave to your Board of Directors' Risk Policy Committee on March 20, 2012, about the CIO. On page 1, you provided a chart listing nine investment portfolios at the CIO, and you indicated whether they had longer or shorter investment horizons.

Now, where is the SCP on that chart?

Ms. DREW. The SCP is on the right side, on the bottom, where it is noted that the portfolio was being reduced, reducing capital-intensive credit securities positions.

Senator LEVIN. All right. So it is at the shorter end of the investment horizon. Is that correct?

Ms. DREW. At that time, that is correct. It was in the process of being reduced.

[1] The prepared statement of Mr. Weiland appears in the Appendix on page 111.
[2] See Exhibit No. 81, which appears in the Appendix on page 877.

Senator LEVIN. I am not asking you whether it was being reduced at that time. I am asking you whether or not it was at the shorter end of the investment horizon. Is that correct?

Ms. DREW. That is correct.

Senator LEVIN. OK. So that in 2012, the Synthetic Credit Portfolio was being actively traded, right? Every week, sometimes every business day, CIO traders were buying and selling credit derivatives on behalf of the portfolio. Is that correct?

Ms. DREW. Yes.

Senator LEVIN. And if the portfolio grew from $51 to $157 billion, is it correct that by the time of your presentation by the Board of Directors on March 20, 2012, most of the positions would have been purchased during the first quarter?

Ms. DREW. That is correct.

Senator LEVIN. So these were not investments that were made on a very long term basis.

Your horizon here is a shorter investment horizon, and they were bought and sold regularly and frequently. Is that correct?

Ms. DREW. That is correct; however, the core position in the book, which was a short, high-yield position, was a long-term position that had been held for many years, and the intention was to be held longer.

Senator LEVIN. All right. But when this portfolio grew in the first quarter from $51 to $157 billion, I take it most of those positions had been purchased during that quarter. Is that correct?

Ms. DREW. They had.

Senator LEVIN. Is that correct?

Ms. DREW. That is correct.

Senator LEVIN. And these trades were made out of London, but when there were losses, for instance, that $6.2 billion in losses that took place over 2012, that affected JPMorgan's balance sheet and its earnings. Is that correct? Those losses, even though the trades were made in London——

Ms. DREW. Yes, certainly it did.

Senator LEVIN. OK. Did the London traders have to get approval of the CIO risk managers like you to put on positions?

Let me ask Mr. Weiland that question. Did the London traders get the approval of CIO risk managers like you to put on these positions?

Mr. WEILAND. Not for individual trades. The traders in London worked within a set of delegated limits.

Senator LEVIN. All right. And so they did not get approval from you for the positions they were putting on?

Mr. WEILAND. Not individual trades. As long as they were working within their limits.

Senator LEVIN. Is that what you call "positions?"

Mr. WEILAND. Is what I call "positions?" Sorry.

Senator LEVIN. The individual trades, the positions they were taking, they did not get your approval. Is that correct?

Mr. WEILAND. Not one by one, no.

Senator LEVIN. On January 30, 2012, the CIO met with the OCC at their standard quarterly meeting to discuss the CIO's upcoming plans. The CIO's chief financial officer, John Wilmot, represented the bank at the meeting with the OCC.

Now, Ms. Drew, take a look, if you would, at Exhibit No. 58.[1] Exhibit No. 58 is the OCC's summary of that January 30 meeting, and in interviews both the OCC examiner, Mr. Berg, who attended the meeting and wrote the summary, and Mr. Wilmot, who attended, confirmed to the Subcommittee that the notes were accurate.

About two-thirds down that page, Exhibit No. 58, the OCC reports what it was told by JPMorgan: "The MTM book"—that is the mark to market book, consisted primarily of the Synthetical Credit Portfolio—"is decreasing in size in 2012. It is expected that the risk-weighted assets (RWA) will decrease from $70 billion to $40 billion."

Do you see that note two-thirds down the page on Exhibit No. 58 where it says, "The MTM book is decreasing in size in 2012?" Do you see that?

Ms. DREW. Yes.

Senator LEVIN. OK. Now, Ms. Drew, in fact, the SCP was rapidly increasing in size in the first quarter of 2012. Is that correct? You can see on the chart over here, Exhibit No. 1a.[2] Is that correct?

Ms. DREW. In the first quarter, that is correct.

Senator LEVIN. So, again, this meeting took place January 31, and the OCC was told that the book was decreasing in size. In fact, it was increasing in size.

Now, also in the first quarter of 2012, the CIO stopped sending standard data to the OCC that might have alerted the agency to the portfolio's growth. For 4 key months, from January to April, the CIO did not send to the OCC its Executive Management Report with its financial data. In February and March, it did not send to the OCC its Valuation Control Group reports with verified profit/loss data for the Synthetic Credit Portfolio.

Is that true, Ms. Drew? Those reports were not sent during those months. Is that true?

Ms. DREW. I do not know, Senator. I had no part of reports being sent to any regulators. Certainly, if I had known they were not being sent, I would have considered that is the wrong thing to do.

Senator LEVIN. All right. So you do not know whether they were sent or not?

Ms. DREW. I do not.

Senator LEVIN. And if they were not sent, you do not know why.

Ms. DREW. I do not.

Senator LEVIN. And who was in charge of getting those reports to the OCC that suddenly were missing during February and March?

Ms. DREW. It is my understanding that both Risk and Finance are——

Senator LEVIN. People. Give us the names of people, if you would. Who would have been in charge of that?

Ms. DREW. I do not have a specific person, but within the Risk and the Finance organizations, any and all contact was made with the OCC.

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[1] See Exhibit No. 58, which appears in the Appendix on page 807.
[2] See Exhibit No. 1a, which appears in the Appendix on page 511.

Senator LEVIN. Mr. Weiland, do you know the answer to that question?

Mr. WEILAND. I do not.

Senator LEVIN. Do you know why those reports suddenly were not sent?

Mr. WEILAND. I do not know why they were not sent, no.

Senator LEVIN. Who was in charge of sending them?

Mr. WEILAND. I do not know the people who were responsible for sending the reports to the regulators, the individual people. My understanding is that normally that is part of the Finance function.

Senator LEVIN. OK. Maybe we can find out later from our next witnesses as to why reports suddenly were not being sent to the OCC during those critical months.

Mr. Weiland, take a look at Exhibit No. 47,[1] would you?

Mr. WEILAND. Sure.

Senator LEVIN. This is an email dated March 2, 2012. It was sent to you by one of the quantitative analysts at the bank, Mr. Krug, talking about CIO "comprehensive risk measure (CRM) results." The OCC now requires all national banks to use this risk measure to calculate how much money could be lost in a year in a worst-case scenario. It was not a requirement in 2012, but it was about to become a requirement. And in anticipation of that, when this email was written, JPMorgan had already begun requiring its offices to start calculating their comprehensive risk measure. So that was in part because the OCC was also going to, and now does, require banks to use their CRM results to calculate their capital requirements—in other words, how much money has to come from shareholders and retained earnings.

Now, Mr. Weiland, on March 2, you received this email—again, Exhibit No. 47—notifying you at the bottom of the first page that "CRM numbers have increased significantly" at the CIO. And you responded: "These results, if I understand them, suggest that there are scenarios where the CIO tranche book"—another name for the Synthetic Credit Portfolio—"could lose $6 billion in 1 year."

You then forwarded the email to Javier Martin-Artajo in London, who is the head of credit trading, and you called the result "garbage." You wrote: "We got some CRM numbers. They look like garbage, as far as I can tell, 2 to 3 times what we saw before."

You and your colleagues in the CIO complained about the CRM analysis to the head of Quantitative Research for the whole bank, a man whose full name is Mr. Venkatakrishnan, known as "Mr. Venkat." If you look at Exhibit No. 49,[2] which includes an email dated March 7 at the bottom of the page from Mr. Venkat to all three of you, and others, explaining that the CIO's portfolio had gotten $33 billion bigger in January and February, which is why the risk of losing so much money also shot up.

Now, here is what he wrote, which is at the bottom of that page on Exhibit No. 49: "Based on our models, though, we believe that the $3 billion increase in RWA"—which was referenced to the CRM—"is entirely explained by a $33 billion notional increase in

[1] See Exhibit No. 47, which appears in the Appendix on page 781.
[2] See Exhibit No. 49, which appears in the Appendix on page 786.

short protection (long risk) in your portfolio between January and February."

"Peter Weiland and your mid-office confirm this $33 billion notional increase in long index risk."

Mr. Weiland, since the SCP portfolio increased in size by about $33 billion in January and February, the SCP was not decreasing, as the CIO told the OCC on January 30. It was increasing. Is that correct? And Ms. Drew has already indicated that. Do you agree with that, it was increasing?

Mr. WEILAND. Yes, they were purchasing long positions.

Senator LEVIN. But the portfolio was also increasing. Is that correct?

Mr. WEILAND. Yes.

Senator LEVIN. Mr. Weiland, the bank's quantitative experts said the portfolio's comprehensive risk measure, numbers shot up to $6 billion in large part because its portfolio shot up in size. I understand that you had questions about that explanation at the time. Do you now believe that the analysts had it right, especially since the portfolio actually did lose $6.2 billion in a year? You now acknowledge that they got it right.

Mr. WEILAND. Yes, I acknowledge it now with all the information we have today that was correct.

Senator LEVIN. All right. And do you think it was a coincidence that the CRM predicted a $6 billion loss in a year in a worst-case scenario and then that is what happened? Do you think that is a coincidence?

Mr. WEILAND. It is hard to believe that it was complete coincidence. I do not know the details of the scenarios that generated the number at the time, but it certainly agrees with the way things unfolded.

Senator LEVIN. Senator McCain.

Senator MCCAIN. Mr. Chairman, if it is OK, Senator Johnson has to go, so could I yield to him?

Senator LEVIN. Of course.

Senator JOHNSON. Thanks, Mr. Chairman and Senator McCain. Mr. Bacon, seeing as you were brought in kind of to assess what happened here and do the postmortem, I would like to ask you a question. Did the management of JPMorgan and people at the trading desk, was there basically a pervasive attitude that JPMorgan was too big to fail and they could drive up their risk portfolio?

Mr. BACON. I do not believe that played a part at all. I think this was a set of egregious mistakes that are much regretted and not at all placing reliance on too big to fail, no.

Senator JOHNSON. Do you believe that the Dodd-Frank Act either ended too big to fail or has any chance of ending too big to fail?

Mr. BACON. Yes, I think the work that is going on should end up in that place, and I think it is to the benefit of JPMorgan and the system generally if we do end up in that place.

Senator JOHNSON. So do you believe it has already ended too big to fail or has the potential of ending it?

Mr. BACON. I think it has potential. I do not know whether it has ended it. I believe the work is ongoing, but I am not the individual working on that process most knowledgeably from JPMorgan.

Senator JOHNSON. Do you have quite a fair amount of contact with bank regulators yourself in your position?

Mr. BACON. A fair amount.

Senator JOHNSON. Do you believe bank regulators are really up to the task of understanding the complexity of these transactions and understanding the limited?

Mr. BACON. I think the answer is generally yes, but when something like this occurs, and we do not understand it ourselves, I think it makes it incredibly difficult for them to understand the details and the context.

Senator JOHNSON. OK. Well, Mr. Chairman, my time is short, but I guess I would just like to sum up by saying that I think the fact that we are even having this hearing would be evidence that we have not ended too big to fail, that we are still concerned about the activities of banks that could pose a systemic risk and danger.

I think the goal of Congress should be to get the American taxpayer off the hook for what happens at the banks. I think the only people that should worry or, care at all whether JPMorgan lost $5 or $6 billion on their London trading desk would be JPMorgan management and JPMorgan shareholders, and not Members of Congress. So I am certainly hoping that, these types of hearings and this type of investigation can get to the bottom of it so that we can actually end too big to fail.

Thank you for your indulgence.

Senator LEVIN. Thank you very much, Senator Johnson. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Mr. Weiland, you said you did not know who was responsible for the reports that were supposed to be made to the OCC?

Mr. WEILAND. That is correct. I do not know who sends the reports.

Senator MCCAIN. Do you know the office that was responsible for sending these reports?

Mr. WEILAND. As I said, my understanding is that the financial function, part of the CFO function, is responsible, the primary responsibility for interaction with the regulators.

Senator MCCAIN. But you do not know who that individual might have been?

Mr. WEILAND. I do not.

Senator MCCAIN. JPMorgan is just so big that you really do not know who would have a very serious responsibility to make required reports to the OCC. Is that correct?

Mr. WEILAND. That is correct.

Senator MCCAIN. Well, do you know the individual who should have been responsible. You do not know who that is.

Mr. WEILAND. I do not know.

Senator MCCAIN. Ms. Drew, your former boss, Jamie Dimon, criticized the performance of the SCP saying, quote, made a terrible egregious mistake, no excuse for it, we knew we were sloppy, we know we were stupid, we know there was bad judgment.

Do you share your former boss' assessment of the SCP?

Ms. DREW. Now that I understand all that transpired during that time, including deception and risk control issues, yes, I do agree.

Senator MCCAIN. You have maintained that the SCP existed to hedge risk, but in a Subcommittee interview, you could only provide a "guesstimate" when asked exactly what the portfolio was designed to hedge. Do you stand by that statement as well?

Ms. DREW. Well, certainly that was not the best word I could have chosen. I would say that in a $2.5 trillion balance sheet, macro hedges, which are fluid as the balance sheet changes, do change. And that is why in the response to Senator Levin I said the positions go up and down. They have to. It is a dynamic process. So it was a poor choice of words, but I would not know the exact amount per se of each individual hedge versus the balance sheet. All I know is that any hedges were limited to the balance sheet and its components.

Senator MCCAIN. Mr. Weiland, you indicated in an interview with the Subcommittee that it was not your job to enforce the risk limits, even though you were the senior risk officer at the SCP. Well, then, whose job was it, then, to enforce the risk limits?

Mr. WEILAND. I saw the way that was written in the report. It is not my recollection that I said those words. Certainly it was my job to enforce the risk limits in cooperation and partnership with the other senior management of the business. We did not—I did not make unilateral decisions about how to respond to risk limit excesses, but certainly it is part of my job.

Senator MCCAIN. Mr. Bacon, as early as March 30, you and your boss, Mr. Hogan, were notified that the international chief investment officer in London had "lost confidence" in his team, that the CIO needed help with the synthetic credit book, and that they were clearly "in a crisis mode." Yet Mr. Hogan said that he was surprised by the April media reports about the losses.

Doesn't this email indicate otherwise and suggest they should have acted sooner?

Mr. BACON. So I recall the email you are referring to. What I took it be referring to at the time—and I still stand by this—is that they had lost faith in their ability to manage their RWA number, that the technicals around the modeling techniques and the additional trades to add to the book and so on were something they were not handling well at all, and they had asked for modeling expertise to be inserted into their group. And I arranged for that to happen.

Senator MCCAIN. Ms. Drew, in January 2012, the CIO's chief financial officer, Mr. Wilmot, assured the OCC that you planned on reducing the portfolio's risk-weighted assets from $70 billion to $40 billion, yet it tripled in size instead. Tell us what happened there. How does that transpire? You assure the OCC that you plan on reducing the portfolio, and yet in actuality it tripled in size. How does that happen? Or was the OCC misled?

Ms. DREW. I do not think so, Senator. If you will allow me to explain, I was not in the meeting when Mr. Wilmot met with the OCC. However, the plan, as signed off by all senior management, including myself, was to reduce the RWA over the course of the total 2012. We had asked for, and received, permission to have a slightly higher capital number for the first quarter before then embarking on a rapid reduction from the second quarter forward. And things went terribly wrong, as we all know, and the very large purchases that were made at the end of March were not brought to my attention on time.

Senator MCCAIN. Was it your responsibility to fully disclose the true nature of the SCP and its increasing size to the OCC? And did you?

Ms. DREW. It is always my responsibility——

Senator MCCAIN. Was it?

Ms. DREW [continuing]. To be fully transparent, but it was not my responsibility to discuss information directly with the OCC, no, sir.

Senator MCCAIN. Mr. Weiland, you were warned in early 2012—I think it is a matter of record—that risk measures predicted massive losses. After the bank lost over $6 billion, do you stand by your statement that the risk measures were "garbage" and not "sensible?"

Mr. WEILAND. So you are referring to two different risk measures. The results of the testing, which I called "garbage"—which is not an appropriate word and not typical of my response to these things, which I take very seriously—that was part of a process that we were working on to develop a model for the new CRM regulatory capital requirements, and that was a very first reaction to a number that, was 2 to 3 times what we had seen previously and after some changes that we had made. So my first reaction was it does not look right. Clearly, as we discussed a little earlier, it turned out to be predictive.

With respect to the CS01, which is the second reference that you made, in fact, when that limit was first breached, it is true that the methodology we were using was not appropriate. It was decided to make a change. But a mistake was made in not making the change immediately. And that was a missed opportunity for us. The CS01 was a sign of something that we did not see at the time.

Senator MCCAIN. Back to a later email, you said, "We are working on a new set of limits for synthetic credit, and the current CS01 will be replaced by something more sensible and granular."

Mr. Bacon, there are Firm-wide risk limits at JPMorgan. Is that true?

Mr. BACON. Yes.

Senator MCCAIN. Well, were those breaches ignored?

Mr. BACON. No, the breaches were not ignored. Specifically the one I expect you are referring to is the VaR breach in January at a Firm-wide level. It was not ignored. It caused action and escalation. It was a situation where we relied upon the explanation that turned out to be wrong about the new VaR model, an implementation that was agreed by the risk management in place at the time, by model review, all of which failed, but reliance was erroneously placed on that.

Senator MCCAIN. Well, let me tell you what is hard to explain to my constituents when their tax dollars are insuring their deposits. They are going to ask, How could we possibly balloon up to a $6 billion loss? And basically there was not only ignoring the facts but sort of endorsing the behavior. And it seemed that the traders seemed to have more responsibility and authority than the higher-up executives.

I have to go to a town hall meeting in Arizona. You tell me what I am supposed to tell my constituents who with their tax dollars some of these deposits were insured, this kind of gambling went on, when, by the way, they are also having extreme difficulty in getting their home loan mortgages consummated and obtained. But tell me, Mr. bacon, what should I say?

Mr. BACON. I think, first of all, we should be clear that this whole thing is regrettable and unacceptable, and, we believe, isolated. But the onus of proof is on us now to demonstrate how this cannot happen in other places, how we weathered the financial crisis well everywhere else, and how we can make the entire Firm a safer place to the satisfaction of you, everybody else, and our regulators.

This failed because the multiple things that should have caught it did not catch it. The two obvious ones, trading oversight and management oversight on the ground in London, failed completely. And second lines of defense, risk primarily and finance after that, also failed with the granularity of limits and the escalation and the pushback through risk committees. It would actually have been easy to catch this in many ways, and very regrettably, it did not happen. I believe we have taken corrective actions on all these counts.

Senator MCCAIN. Do you believe that JPMorgan is too big to fail?

Mr. BACON. I do not think it is too big to fail. I think there is further work that needs to be done to demonstrate and document that, and it is in process. I am not leading that process or deeply involved in it, but I think it is something that needs to be demonstrated to everybody's satisfaction.

Senator MCCAIN. Thank you. I thank the witnesses.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you.

Mr. Weiland, you indicated in response to a question that it was your job to enforce risk limits in cooperation with senior management, I believe. Is that correct?

Mr. WEILAND. Yes.

Senator LEVIN. Now, the bank had five key risk limits for the synthetic portfolio. Those risk limits may be complicated, but the bottom line is that they sound alarms when it looks like an investment portfolio is putting a lot of money at risk or when it looks like projected losses could exceed a dollar limit that was set up ahead of time.

Now, if you take a look at Exhibit No. 1d[1] in your book—and it is up there—this chart is also up in front of you. There are Synthetic Credit Portfolio risk limit breaches.

Now, the VaR limit was breached starting in January, and it then was changed. A new model was put into place, and we have had a little conversation about that, and we are going to have a lot more later on. But the breach which occurred even before the VaR breach was the so-called CS01 breach, and that lasted longer. You can see that long red block there, the CS01 breach, and the CS01 stands for what?

[1] See Exhibit No. 1d, which appears in the Appendix on page 514.

Mr. WEILAND. Credit spread 01. It is the value of a one-basis point move in credit spreads.

Senator LEVIN. All right. So credit spread of one basis point is CS01.

Mr. WEILAND. Correct.

Senator LEVIN. Now, take a look at Exhibit No. 39,[1] if you would, Mr. Weiland. This exhibit lists the breaches from September 20, 2011, through April 30, 2012. It is page after page after page after page after page of breaches—by the way, most of them not VaR breaches because they changed the VaR model.

If you look just at the breaches involving the SCP, in the last quarter of 2011 and the first quarter of 2012, you see a huge jump, 6 breaches in the Synthetic Credit Portfolio to over 170 breaches. So from the last quarter of 2011 to the first quarter of 2012, the number of breaches jumped from 6 to 170.

And then in April 2012, April alone, there were 160 breaches. So almost as many in that 1 month of April as the three previous months combined, and those 3 months had 160—excuse me, 170 breaches compared to the 6 breaches in the previous quarter.

Now, would you agree that when you have that kind of a huge jump in risk limit breaches that is a worrisome pattern? Would you agree to that?

Mr. WEILAND. A large jump in risk limit breaches is a worrisome pattern.

Senator LEVIN. OK.

Mr. WEILAND. But I would say that by April the action of halting trading had already occurred. Breaches and risk metrics can change. Even without making trades or changing positions, the markets move and the team was, at that point, as was written and mentioned somewhere else, in crisis mode trying to figure out what was the best way forward to escape from the position that we were in at that time.

Senator LEVIN. Yes. And on what date had you stopped the trading?

Mr. WEILAND. My recollection is it was after March 28.

Senator LEVIN. After March——

Mr. WEILAND. It is in the report somewhere. I cannot remember the date.

Senator LEVIN. Late March?

Mr. WEILAND. Yes.

Senator LEVIN. You stopped trading. When more than one risk limit is breached at a time, does that send a stronger signal that the portfolio is overly risky?

Mr. WEILAND. It may. It depends. If it is different types of measures, it certainly does. Sometimes an individual position can trigger several limits just because the way the portfolio is organized. So it depends on the situation.

Senator LEVIN. Was the Synthetic Credit Portfolio a low-risk investment portfolio?

Mr. WEILAND. No, it was not.

Senator LEVIN. Now, you have these multiple breaches that are going on in huge numbers in the first quarter. It took until the end

[1] See Exhibit No. 39, which appears in the Appendix on page 748.

of March to act when those breaches were flowing in. Had you seen this many breaches before, by the way, in a portfolio?

Mr. WEILAND. No. What I would say was on the—there are a couple different circumstances. On the CS01, as I have already said, we missed an opportunity there to understand some changes early. And given that the plan was to change the limits, it continued to breach because we were working on the changes. And so it was understood there were active discussions on how to deal with it. So continuing to have the breaches, as long as everybody understands that those are happening, I actually thought it was a good thing which would help keep focus on the portfolio.

Senator LEVIN. Understanding the breaches would be a good thing. The breaches themselves are not a good thing, are they?

Mr. WEILAND. Agreed.

Senator LEVIN. All right. So now let us take a look at the CS01 limit. It sounds alarms when the value of derivatives in the portfolio drops by that specified amount; in technical terms, when the credit spreads widen for specified derivatives by one basis point, that is the reference to the 01 point. The Synthetic Credit Portfolio first breached the CS01 limit on January 6, 2012. It kept on breaching for more than 3 months.

Then on April 19, Mr. Weiland, after the media storm hit, the OCC sent you an email. If you will take a look at Exhibit No. 65.[1] It asked you about that CS01 risk limit which has been "in excession by 1,074 percent" for 71 days.

Now, when the email says "in excession by 1,074 percent," it means the Synthetic Credit Portfolio has breached the risk limit by more than 1,000 percent. Is that correct?

Mr. WEILAND. Correct.

Senator LEVIN. So it was over 10 times the limit, and in that Exhibit No. 39,[2] which we discussed earlier, which was the list of the breaches, it indicates that on April 19 the limit was $5 million, but the projected SCP losses, if the credit spreads widened one basis point, could be $59 million. Is that correct?

Mr. WEILAND. Correct.

Senator LEVIN. Do you see that?

Mr. WEILAND. Yes.

Senator LEVIN. Now, you responded to the OCC inquiry by saying, "We are working on a new set of limits for synthetic credit and the current CS01 will be replaced by something more sensible and granular." So you were ignoring the 1,000-percent breach limit for 71 days because the CS01 limit was not "sensible." So if the risk limit was outdated or not sensible, why did it take that long to update it when bank policy requires and the OCC requires that risk limits be updated every year? Why wasn't the CS01 limit updated?

Mr. WEILAND. Yes, I mean——

Senator LEVIN. As a matter of fact, they had not been updated since 2009, had they?

Mr. WEILAND. The CS01 limit had been the same since 2009.

Senator LEVIN. Even though the policy of the bank was it is supposed to be updated every year, this thing had been in breach now

[1] See Exhibit No. 65, which appears in the Appendix on page 829.
[2] See Exhibit No. 39, which appears in the Appendix on page 748.

for 71 days and by 1,000 percent. So there it sat for 3 years when you got a rule in the bank and an OCC rule saying you update it every year, but 71 days go by looking like that. Now, how do you explain that?

Mr. WEILAND. We were in the midst of a limit re-evaluation at that time, at the same time——

Senator LEVIN. For 3 years?

Mr. WEILAND. No, which was begun in the summer of 2011, but at the time, there were a lot of changes going on both in the regulatory environment and in the market. We were very focused on getting the regulatory capital models up to speed and working properly and adjusting the business to deal with those. Those things took priority. Again, this is another, mistake of ours, but it was all in good faith, and it was with, what we knew at the time to be the case that the change in that limit just did not take first priority at that time.

Senator LEVIN. For 3 years you were supposed to have been looking at that risk limit every year. You did not revise it. Now, this tide hits you for 70 days, by 1,000 percent. That is 10 times the limit breached for 70 straight days. It was outdated anyway. It happened despite the OCC regulation, which you ignore year after year.

Now, Ms. Drew, were you aware of the 4-month-long breach?

Ms. DREW. Yes.

Senator LEVIN. Why didn't you fix it?

Ms. DREW. My understanding was that it was in the process of being reviewed, and I was told by Risk that it was not a useful limit and that it was going to be replaced with a more useful limit which was being worked on in the risk group inside and outside CIO.

Senator LEVIN. Now, if you look at Exhibit No. 54,[1] Ms. Drew, here is what you said when the CIO's chief risk officer Irvin Goldman wrote to you about this breach in an email dated February 13, 2012. He said, "We have a global credit csbpv limit." That is, as I understand it, the 01 limit. That is another name for the CS01 limit. So Mr. Goldman went on as follows: "It was set up at the initiation of the credit book. Unfortunately we have been breaching for most of the year."

This is how you responded, Ms. Drew. You said, "I have no memory of this limit." I think you just told us that you were aware of the breach of that limit, but you told him you did not have memory of the limit.

Ms. DREW. That is correct. I did not know there was a global csbpv limit as well as a csbpv limit, and Mr. Goldman referred in the email to a global csbpv limit, and I probably simply misunderstood. And that is why I followed it by saying the limit needs to be recast with all the other limits, which was a review that I was assured was ongoing, had actually been started, and was making some progress.

Senator LEVIN. Did you know that these limits were supposed to be reviewed every year?

Ms. DREW. Yes.

[1] See Exhibit No. 54, which appears in the Appendix on page 797.

Senator LEVIN. Were you aware of the fact that it had not been reviewed every year?

Ms. DREW. I do not recall.

Senator LEVIN. Were you aware that it was 1,000 percent over the limit?

Ms. DREW. No, I was not.

Senator LEVIN. Senator McCain.

Senator MCCAIN. I have no further questions.

Senator LEVIN. Thank you. Very quickly, and then we are going to take a break and add to our panel.

There is a second risk limit on this chart, Exhibit No. 1d.[1] It is known as the value-at-risk, which sets a dollar limit on how much money is at risk for being lost over the course of a day in ordinary market conditions.

A mathematical model is used to evaluate how much value an investment portfolio is putting at risk. If the value-at-risk exceeds the VaR limit established for the portfolio, notice then goes out to the risk managers.

Now, here the Synthetic Credit Portfolio breached both the CIO and bank-wide VaR limits for several days starting on January 16, and then breached them again for 4 days starting on January 24. CEO Jamie Dimon personally approved a temporary increase in the VaR limit, as a matter of fact, until the CIO then rushed through approval of a new VaR model, which we referred to, which was effectively an end run around the risk limit.

So now when it was activated on January 27, it resulted in an overnight drop. When the new VaR limit was activated, suddenly there was an overnight drop by 50 percent in the CIO's VaR results. The breach ended without the SCP having to get rid of a single risky investment.

Now, under the old model, the CIO's VaR was $132 million. That is how much money was at risk of loss in a 1-day period. When the new model took effect, even though the portfolio had the same risky credit derivatives, its value at risk, its VaR, was suddenly cut in half. Now it is $66 million. And guess what? That new amount was way under the VaR limit.

Now, Ms. Drew, how did you know the new VaR model was going to be more accurate?

Ms. DREW. Well, Senator, the VaR model was a change and a review that had been ongoing for not 1, not 2, but 7 months by the independent risk modeling group, and my understanding was it had gone through quite a few iterations before it arrived in its final form as a correct measure, one that I relied on very heavily to manage the position.

Senator LEVIN. Did you backtest the new model against the old data?

Ms. DREW. That would have been done in Risk, sir.

Senator LEVIN. Do you know whether it was done?

Ms. DREW. I do not.

Senator LEVIN. You saw the Model Review Group approved the new VaR model, but didn't they also say when they approved it that the CIO had to automate the data entry? Isn't that true?

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[1] See Exhibit No. 1d, which appears in the Appendix on page 514.

Ms. DREW. If they did, that would have been an order that would have gone to Risk.

Senator LEVIN. Well, so you are not aware that they said that you had to automate the data entry when they approved this VaR model, right?

Ms. DREW. At the time I was not. I am aware of that now.

Senator LEVIN. OK. Now, you said there was no backtesting that was done. Is that correct?

Ms. DREW. I do not believe I said that. I said I do not know whether——

Senator LEVIN. You do not know. OK. Take a look at Exhibit No. 98,[1] if you would. And it is page 104. This is what the review said about what happened when this new VaR was put in place: "The Model Review Group required only limited backtesting of the new model. . . . That is No. 1. It was critical of that limited backtesting. "And it insufficiently analyzed the results that were submitted."

So now you have a situation where you have a new VaR that is dropped in there. It cuts the VaR in half, suddenly, boom, there is no longer a breach. And the new VaR was approved, but when it was approved, it was approved with the requirement that there be only limited backtesting of the new model, instead of backtesting it to see whether or not it was workable. And it insufficiently analyzed the results that were submitted. So it produced lower VaRs. It was full of operational errors that the bank knew about—ordered corrected, by the way—and did not supply the funds despite multiple requests to deal with the operational errors.

Mr. Bacon, what do you think of a VaR model that drops the CIO's VaR by 50 percent overnight? What do you think about that?

Mr. BACON. I think it is something which would require a lot of inquiry and explanation.

Senator LEVIN. Like backtesting?

Mr. BACON. Yes.

Senator LEVIN. It deserves backtesting?

Mr. BACON. Yes.

Senator LEVIN. But it did not get it here.

Mr. BACON. I think it got insufficient——

Senator LEVIN. Limited.

Mr. BACON. Correct, yes.

Senator LEVIN. And then what it did provide, the insufficient data the limited backtesting did provide, was not even analyzed. Is that correct?

Mr. BACON. It is absolutely not the way to do it.

Senator LEVIN. But it was not even analyzed. Is that correct?

Mr. BACON. I do not know if it was analyzed.

Senator LEVIN. Well, that is what the report said.

Mr. BACON. OK. Then I am sure that was right.

Senator LEVIN. The VaR model, the new one, depended on analyzing a daily stream of new trading data. Instead of constructing an automated database that automatically would feed the daily trading data into a VaR model, Mr. Hagan, the model designer, a Ph.D., was stuck with having to manually enter the trading data

[1] See Exhibit No. 98, which appears in the Appendix on page 963.

every night using spreadsheets which had calculation and formula errors.

In other words, the new key value-at-risk model for the CIO's $350 billion portfolio, including the Synthetic Credit Portfolio, was being run manually using error-prone spreadsheets with operational flaws.

Mr. Weiland, did you know that Mr. Hagan was doing nightly manual data entry and sometimes staying up into the wee hours of the night to get it done? Were you aware of that fact?

Mr. WEILAND. I was not aware of the details of the manual work he was doing. I did know there were spreadsheets involved, and I did know that Mr. Hagan often stayed late at night.

Senator LEVIN. Mr. Bacon, the OCC told us that the operational problems—the spreadsheets, the lack of an automated database, the calculation and formula errors which lower these VaR results—were shocking and absolutely unacceptable. Do you agree?

Mr. BACON. I do.

Senator LEVIN. Ms. Drew, why did the bank model review that approved the VaR knowing that there were problems and then allow it to operate in such a shoddy fashion? Why did the bank allow that to happen?

Ms. DREW. It is very disappointing. I have no idea. The Risk Modeling Group is an independent group staffed by very well trained and educated Ph.D.s who run the models, and I am certainly very disappointed that it was not reviewed properly and that it was delivered to me in poor form.

Senator LEVIN. Did Mr. Hagan work for your group?

Ms. DREW. He did, in London.

Senator LEVIN. What bothers me, if you will take a look at Chart 1d[1], it is not just that the multiple risk limits were breached, and so frequently; they were not even really limits. Nobody was told to stop trading because of a risk limit breach. No one investigated the trading because of the breaches. Mr. Bacon, should someone have investigated risky trading activities that triggered all these breaches? Isn't that the point of breaches, that someone would investigate the breaches?

Mr. BACON. Yes, Senator.

Senator LEVIN. Another thing that bothers me is that the bank's reaction has been to criticize the CIO's old risk limits as inadequate and add a bunch of new ones. So there used to be five big risk limits. OK? Now it has gone to 230 risk limits for the Synthetic Credit Portfolio.

It misses the point. It was not that the Synthetic Credit Portfolio had too few risk limits. It was that risk management personnel did not enforce the ones they had. I do not see how piling on another 225 risk limits solves anything.

Now, do you want to comment on that?

Mr. BACON. Yes. I very much agree with you that the first failure is not to escalate and remediate when the risk limits you have in place are already telling you something. So I do agree with that. And one of the changes is an alteration to our policies and procedures whereby automatically, if there is a Firm-wide or line of

[1] See Exhibit No. 1d, which appears in the Appendix on page 514.

business limit breach for 3 days, it goes all the way to the Firmwide Risk Committee containing Mr. Dimon, our CFO, myself, everybody. So that is now automatic.

I think on the question of whether it is necessary to have more limits, although this particular egregious mistake was caught by a small number of limits, if you had followed up on them, there are other mistakes you could make that may not have been caught by a small set of limits, which is why we want to be safer than that.

Senator LEVIN. Thank you. Senator McCain, do you have anything right now?

Senator MCCAIN. No.

Senator LEVIN. We are going to take a 5-minute break here, and we are going to then widen our panel. It will give us an opportunity to use the restrooms, if anybody needs to do that. It is going to be very brief, though. We will be back in 5 minutes. [Recess.]

OK. We will be back in order.

We will now add to our panel and call two additional witnesses to the hearing: Michael Cavanagh, the head of the JPMorgan Chase Management Task Force reviewing CIO losses and the Co-Chief Executive Officer of the Corporate and Investment Bank at JPMorgan Chase; and Douglas Braunstein, the current Vice Chairman and former Chief Financial Officer from 2010 to 2012 at JPMorgan Chase.

I appreciate very much both of you being with us this morning. We look forward to your testimony. And as you may have heard, pursuant to the rules of this Subcommittee, all witnesses who testify before us are required to be sworn, so I would ask that each of you rise and raise your right hand. Do you swear that the testimony that you are about to give to this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. CAVANAGH. I do.

Mr. BRAUNSTEIN. I do.

Senator LEVIN. Were you here and do you know about the timing system? If you have opening statements now—you do?

Mr. CAVANAGH. There we go. May I?

Senator LEVIN. Yes.

TESTIMONY OF MICHAEL J. CAVANAGH,[1] HEAD OF JPMORGAN CHASE & CO. MANAGEMENT TASK FORCE REVIEWING CIO LOSSES, CO-CHIEF EXECUTIVE OFFICER, CORPORATE AND INVESTMENT BANK, JPMORGAN CHASE & CO., NEW YORK, NEW YORK

Mr. CAVANAGH. Chairman Levin, Ranking Member McCain, and Members of this Committee, my name is Michael Cavanagh, and I am the co-CEO of the Corporate and Investment Bank at JPMorgan. As you know, I recently led a task force that conducted a review of the circumstances surrounding the 2012 losses in JPMorgan's Chief Investment Office. I appreciate the opportunity today to discuss the task force's work, to describe what we found, as well as the steps JPMorgan is taking in response.

[1] The prepared statement of Mr. Cavanagh appears in the Appendix on page 117.

Some of what we found was, frankly, very disappointing and does not reflect our institution at its best. That said, we have addressed the issues head-on and are determined to become a better company because of this experience. We have fully cooperated with the Subcommittee during the course of its inquiry, and as noted in my written statement, we respect the key role the Subcommittee has played in highlighting the importance of effective risk management and oversight of our Nation's financial institutions. We also appreciate the courtesies extended to us by your staff.

As you know, earlier this year our task force issued a report which was the culmination of an extensive review. The work included interviews of many current and former JPMorgan employees and the examination of millions of pages of documents and tens of thousands of audiofiles. The work was overseen by an independent review committee of our board of directors. We have also been cooperating with ongoing inquiries by governmental authorities, both here and in the United Kingdom.

Because our findings are already public and are set forth in my written testimony, I am not going to discuss them in detail now. Instead, I would like to briefly summarize our key conclusions and then describe the steps we have taken to address the problems we found.

In short, the losses were the result of a number of acts and omissions, some involving personnel and some involving governance. Those responsible, in our view, include, to varying degrees: The traders who designed and implemented the flawed trades, the managers who failed to properly vet the strategy and ensure that it was sound, the risk managers who failed to serve as a robust check on the trading activity, and the senior management of the Firm who failed to ensure that CIO was subject to the same type of rigorous oversight as other parts of the Firm.

In light of what we found, the Firm has taken wide-ranging remedial actions, both within CIO and throughout the Firm, to prevent incidents similar to this from occurring in the future. These are described in detail in the task force report, but I would like to briefly highlight for the Subcommittee some of the more significant steps we have taken.

First, the Firm has terminated the employment or accepted the resignations of the responsible CIO personnel and pursued clawbacks of compensation.

Second, JPMorgan has appointed a new CIO leadership team which has refocused CIO on its basic mandate.

Third, the Firm has increased resources for the key risk and finance control functions within CIO.

Fourth, CIO has implemented new or restructured limits covering a broad and granular set of risk parameters.

And, fifth, the Firm has adopted a variety of governance measures to improve its oversight and control of CIO.

The Firm's remedial efforts, though, have not been limited to CIO. The Firm has, among other things, conducted a comprehensive self-assessment of its entire risk organization and, as a result, is implementing a series of improvements across the entire Firm. Where there is room to improve, we can and will do so.

With respect to the trading itself, we have learned many hard lessons, in particular, that any future portfolio hedging will be subject to appropriate monitoring requirements with documentation linking the hedge to the risk it is designed to offset.

So, in conclusion, I want to assure you that this experience has caused substantial and healthy introspection at the senior management level of our Firm and recognition of the need for continued improvement.

Thank you, and I look forward to taking your questions.

Senator LEVIN. Thank you, Mr. Cavanagh. Mr. Braunstein.

TESTIMONY OF DOUGLAS L. BRAUNSTEIN, CURRENT VICE CHAIRMAN, FORMER CHIEF FINANCIAL OFFICER (2010–2012), JPMORGAN CHASE & CO., NEW YORK, NEW YORK

Mr. BRAUNSTEIN. Thank you, Chairman Levin, Ranking Member McCain, and Members of this Committee. My name is Doug Braunstein, and I serve as a Vice Chairman of JPMorgan Chase. From 2010 to 2012, I served as Executive Vice President and Chief Financial Officer of JPMorgan. Thank you for the opportunity to participate in today's hearing. Mr. Cavanagh has already made a statement on behalf of the Firm. I look forward to answering your questions today.

Senator LEVIN. Thank you very much.

During our investigation we came across a number of examples of the bank giving the OCC examiners a hard time. In 2010, according to an OCC email of May 2012, when the OCC concluded an exam of the CIO and told you, Ms. Drew, that the CIO needed to do a better job documenting its risk and investment decisions, you sternly told the OCC that they were being overly intrusive and that there was little need for more documentation since Jamie Dimon was aware of the CIO's investment activities. A record of your reaction is at Exhibit No. 71,[1] and that is a May 2012 email.

When Mr. Waterhouse, the OCC Examiner-In-Charge (EIC), recounted that 2010 incident, the first paragraph, this is what he wrote: "Just for your information (FYI). We did an examination of the CIO at the end of 2010 and have a followup planned soon. Now, this email is May of 2012. "We had some concerns about overall governance and transparency of the activities. We received a lot of pushback from the bank, Ina Drew in particular, regarding our comments. In fact, she called OCC examiner Fred Crumlish in London and sternly' discussed our conclusion with him for 45 minutes. Basically, she said that investment decisions are made with the full understanding of executive management including Jamie Dimon. She said that everyone knows what is going on and there is little need for more limits, controls, or reports."

So, Ms. Drew, according to this email, you said that CIO's investment decisions were made with the full understanding of the executive management. Is that true?

Ms. DREW. Yes, that is true.

Senator LEVIN. Now, according to OCC Examiner-in-Charge Scott Waterhouse, in January or February 2012, the bank stopped sending the Investment Bank's daily profit and loss (P&L) data to

[1] See Exhibit No. 71, which appears in the Appendix on page 843.

the OCC. Just plain stopped sending those documents. No notice, no explanation, no profit or loss data for the investment bank, one of the Nation's largest. This is the investment bank we are talking about.

According to Mr. Waterhouse, the OCC had to escalate the issue to you, Mr. Braunstein, Chief Financial Officer of the bank, to reverse the decision, which you did. During a meeting between you, Mr. Braunstein, Mr. Dimon, and Mr. Waterhouse, it became clear that it was Mr. Dimon who was responsible for directing the data cutoff. Is that correct, Mr. Braunstein?

Mr. BRAUNSTEIN. Yes, sir.

Senator LEVIN. Now, did the bank stop sending the OCC daily profit and loss data for the Investment Bank for a period of time? Was it a week, or how long was it?

Mr. BRAUNSTEIN. I think, Senator, it was approximately 2 weeks.

Senator LEVIN. Two weeks. Then did you restore that data to the OCC?

Mr. BRAUNSTEIN. Yes, sir, I did.

Senator LEVIN. And did Mr. Dimon say why he had ordered the data stopped?

Mr. BRAUNSTEIN. Prior to stopping the data, a number of regulators had breaches in some of the information that we had shared with them. There had been mistaken losses of information, and so we wanted to ensure that prior to restarting the data that we had adequate controls in place to ensure that the data got to the regulators and only to the regulators.

Senator LEVIN. And did you notify them that was your reason?

Mr. BRAUNSTEIN. I did speak to them during the course of that period of time.

Senator LEVIN. And you told them that was the reason that information was not coming to them?

Mr. BRAUNSTEIN. During that——

Senator LEVIN. That January-February time, during that 2-week period when you were not delivering the data and you ordered it restored—apparently there was some heat in the conversation, allegedly. But in any event, you ordered that data restored. Did you during that period tell the OCC why you were stopping that data? That is my question.

Mr. BRAUNSTEIN. Senator, I believe actually the time period was earlier, but I do recall somewhere in that period of time having a conversation to explain why we had turned the data off.

Senator LEVIN. And who did you talk to?

Mr. BRAUNSTEIN. I cannot recall if it was Mr. Waterhouse or Mr. Crumlish.

Senator LEVIN. And what you gave as the explanation for suddenly cutting that data off is the same explanation you gave to them. Is that what you are saying?

Mr. BRAUNSTEIN. I expressed that concern and then told them that I would turn the data back on.

Senator LEVIN. Was Mr. Dimon unhappy when the data was turned back on?

Mr. BRAUNSTEIN. I do not recall the specifics of his reaction, sir.

Senator LEVIN. You do not recall that there was some very deep unhappiness there when it was restored, despite his order?

Mr. BRAUNSTEIN. I do not recall the specifics of that interaction, sir.

Senator LEVIN. How about the generalities of it?

Mr. BRAUNSTEIN. As I said, I do not recollect the specifics of that meeting.

Senator LEVIN. Now, sometimes the bank went further and gave wrong information to the OCC. We showed already today that in the January 30 quarterly meeting, CIO said that it was reducing the size of the Synthetic Credit Portfolio when, in fact, it was not. But here are some more examples of wrong information from JPMorgan, and these come after the media exposed the whale trades and the OCC starting asking the bank for some hard numbers.

The Synthetic Credit Portfolio was a mark-to-market portfolio, which means again that the value of the portfolio was measured and recorded internally every day. On April 16—again, this is after the media storm hit—the bank met with the OCC and provided its first presentation on the Synthetic Credit Portfolio.

Ms. Drew, you were present for the briefing to the OCC, and at that briefing the bank told the OCC that the first quarter losses were $580 million, and that is in Exhibit No. 60.[1] But, actually, the losses at the end of the first quarter, on March 31, had been reported inside the bank as $719 million. And there, if you will take a look at Exhibit No. 1g,[2] this is a list that was provided, I believe in May, of all of the internal profit and loss reports. And if you will look there, you can see that on March 30 it was $719 million, according to the bank's internal reports, but what was reported to the OCC was $580 million.

Now, not only that, but on the Friday before the Monday, April 16 public report that I think you were involved in, Mr. Braunstein, the bank met with the OCC, and losses by then had more than doubled to $1.2 billion.

So before the April 16 conference call, two things had happened here:

One is that the report to the OCC that the first quarter losses were $580 million was wrong; according to the bank's own records, it was $719 million.

And then, the Friday before April 16, the losses had more than doubled to $1.2 billion.

So, first, Ms. Drew, why did you tell the OCC that the first quarter losses were $580 million when the losses were $719 million?

Ms. DREW. Senator, the number I reported was the number that I believed was accurate. Finance added, as it always does after the quarter end, reserves on top of mark-to-market losses. The aggregate of the two is the correct number that was given to the OCC.

Senator LEVIN. I think this is separate from the reserve. I think the losses as reported here on this chart were $719 million——

Ms. DREW. The number I reported was the number that was given to me as calculated by central Risk and Finance, and that is the number I reported——

[1] See Exhibit No. 60, which appears in the Appendix on page 809.
[2] See Exhibit No. 1g, which appears in the Appendix on page 517.

Senator LEVIN. So whatever number was given to you. So you do not know whether that number was accurate or not. You just used the number that was given to you.

Ms. DREW. No. That number agreed with the total consolidated profit and loss statement that was given to me the day I met with the regulators, and it was reviewed by my chief financial officer. I knew that number to be the correct number.

Senator LEVIN. OK. Then when you met with the OCC on April 16, that was the number you gave them. Is that correct?

Ms. DREW. I gave them whatever number was confirmed to me by Finance.

Senator LEVIN. Well, I want you to look at Exhibit 1g.[1]

Ms. DREW. Yes, I am looking at the exhibit.

Senator LEVIN. The first quarter was March 30, right? And do you see that $719 million? Is that correct? And then take a look at April 13. Do you see that number on April 13?

Ms. DREW. Yes.

Senator LEVIN. One point 2 billion dollars, do you see that?

Ms. DREW. Yes.

Senator LEVIN. So the number you gave to OCC on April 16 was $580 million, but your internal report shows $1.2 billion. So the Friday before you met with the OCC, your internal report showed a $1.2 billion loss, according to your records, but you told the OCC that the losses were $580 million. Why not give them the loss as of April 13, the Friday before you met with them?

Ms. DREW. The OCC, to the best of my knowledge—and I asked this question—had profit and loss daily reports. The number I gave to the OCC was——

Senator LEVIN. Say that again?

Ms. DREW. To the best of my knowledge, the OCC was given daily mark-to-market reports of the CIO's activities.

Senator LEVIN. So you are saying that all during this period, January, February, March, and April, the OCC had your daily profit and loss reports?

Ms. DREW. That is my understanding.

Senator LEVIN. For the Synthetic Credit Portfolio?

Ms. DREW. For the total CIO mark-to-market activities of which the Synthetic Credit Portfolio was included.

Senator LEVIN. Was that identified, by the way, separately? The dailies?

Ms. DREW. I am sorry.

Senator LEVIN. Was the SCP identified separately on those reports that——

Ms. DREW. That I do not know.

Senator LEVIN. I think you are inaccurate about this, but we will find out from the OCC. Senator McCain.

Senator MCCAIN. Well, thank you, Mr. Chairman——

Ms. DREW. This is all to the best of my knowledge. Thank you.

Senator MCCAIN. Mr. Braunstein, let me be clear for the record. By regulation, regular reports are required to go to the OCC. Is that correct?

Mr. BRAUNSTEIN. I believe so, sir.

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[1] See Exhibit No. 1g, which appears in the Appendix on page 517.

Senator MCCAIN. And yet Mr. Dimon then made the decision for 2 weeks at a very critical time not to send reports to the OCC. Is that correct?

Mr. BRAUNSTEIN. That is correct, sir, based on a concern about the confidentiality of those reports.

Senator MCCAIN. Well, with normal citizens, normal enterprises, if by regulation you are required to do something, and you do not want to do it, then you seek avenues to avoid it. Do we live in a world, Mr. Braunstein, that government regulations of our business and our lives, we just decide, well, we are not—because we are concerned about something, we are not going to comply with regulations? Is that how JPMorgan works?

Mr. BRAUNSTEIN. No, sir, it does not.

Senator MCCAIN. Did it work that way in this case?

Mr. BRAUNSTEIN. Senator, the report in question, I am not certain, but I am not aware that was a report required to be provided to the regulators. We also were concerned about the loss of some confidential information. We wanted to ensure that we had procedures in place to avoid that going forward.

Senator MCCAIN. Well, I guess we can find out whether those reports are required or not, although I believe they are, but I will have our staff check. But was there any other time where an executive decision was made, we will not send these reports to the OCC?

Mr. BRAUNSTEIN. Not that I am aware of, sir.

Senator MCCAIN. It seems to me it is remarkable that if you are required to make reports or have been, even, making reports regularly to regulators on a routine basis, the timing is very interesting of this, just decides not to give a report. I am not sure that there are many organizations, companies, and corporations in America that could get away with such a thing, and, frankly, it is kind of a testimony to the lack of action on the part of the regulators if they expected those reports.

I would like to go back to this email from Scott Waterhouse to Mike Brosnan. It says, "We did an examination of the CIO at the end of 2010 and have a followup planned soon. We had some concerns about overall governance and transparency of the activities. We received a lot of pushback from the bank, Ina Drew in particular, regarding our comments. In fact, Ina called Crumlish when he was in London and 'sternly' discussed our conclusions with him for 45 minutes. Basically she said that investment decisions are made with the full understanding of executive management including Jamie Dimon."

Did that include you, those decisions that you were fully—had full understanding of the investments that were made?

Mr. BRAUNSTEIN. Senator, I am not familiar with what specifically Ina was referring to in that statement. I was certainly aware——

Senator MCCAIN. Well, let me try and help you out. She was referring to their concerns about overall governance and transparency of the activities.

Mr. BRAUNSTEIN. I would say, Senator, we endeavored to be fully transparent with the regulators, and I would certainly have supported that transparency. As to the specific investment decisions, I was certainly aware of the synthetic credit product.

Senator MCCAIN. You said on the April 13 call that the Firm was "very comfortable" with the positions in the SCP. As Mr. Cavanagh pointed out, that statement was wrong, of course.

When did you learn that your statement was false? And did you take any efforts to correct the record?

Mr. BRAUNSTEIN. Senator, based on the benefit of hindsight, the bank and I were both misinformed and incorrect when I said that we were "very comfortable."

Based on the information that I had available to me at the time, from a whole range of sources—CIO, Risk, independent work done—I believed that to be true. As soon as I discovered that there were behavior patterns inconsistent, subsequent to April 13, in the portfolio's performance, myself, Mr. Dimon, and John Hogan, began a much deeper inquiry.

Senator MCCAIN. Besides the traders who mismarked the book, who should be held accountable or has anyone been held accountable aside from the traders for breaching JPMorgan's own internal risk limits and adjusting the risk models?

Mr. BRAUNSTEIN. Is that a question for me, Senator?

Senator MCCAIN. Yes. Besides the traders who mismarked the book, who should be held accountable for breaching JPMorgan's own internal risk limits and adjusting the risk models?

Mr. BRAUNSTEIN. Senator, in the aggregate, I concur with the task force's report that there were a number of mistakes made—in CIO, in the Risk organization, in the Finance organization, which I ran, and as senior management. And I deeply regret those mistakes.

Senator MCCAIN. Well, when you are "held accountable," what penalty is there that is imposed when you are held accountable at JPMorgan?

Mr. BRAUNSTEIN. The Firm has taken a number of actions. They have terminated the employment of a number of employees. They have clawed back compensation——

Senator MCCAIN. Besides traders?

Mr. BRAUNSTEIN. Yes, sir. They have clawed back compensation, and they have reduced compensation for selected individuals.

Senator MCCAIN. So we have reduced compensation. For example, your compensation was reduced?

Mr. BRAUNSTEIN. Yes, Senator.

Senator MCCAIN. From what to what?

Mr. BRAUNSTEIN. Approximately 50 percent, consistent with the Board's actions for Mr. Dimon.

Senator MCCAIN. And that translated into dollars?

Mr. BRAUNSTEIN. I moved from $9.5 million in compensation in 2011 to $5 million in 2012.

Senator MCCAIN. Mr. Cavanagh, once the SCP was correctly valued, what was the final amount the CIO lost as a result of the whale trades?

Mr. CAVANAGH. $5.8 billion through June 30 of last year and some modest losses that followed.

Senator MCCAIN. Besides this Subcommittee's investigation, what are JPMorgan's ongoing legal and financial exposures, including penalties already paid by the Firm stemming from the whale trades, Mr. Cavanagh?

Mr. CAVANAGH. I do not have a number for you, Senator. We are in the middle of ongoing regulatory work and examination authorities, and there will be litigation. But we do not have any estimates yet for exposure financially on that side.

Senator MCCAIN. Well, I guess I do not have any other questions, but it is hard for me to accept that serious responsibility was assumed by the top management of JPMorgan, especially in light of emails that say that these decisions were, at least according to Ms. Drew, fully discussed and vetted by the top management of JPMorgan.

No more questions, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator McCain.

Let me pursue this issue about the figures that were given to the OCC. I have talked to Ms. Drew about the figure that she gave. What happened then is that the bank on May 4, Mr. Braunstein, you and Mr. Hogan called the OCC Examiner-In-Charge, Scott Waterhouse. And if you will look at Exhibit No. 68,[1] do you see down where it says, about five lines down from the top, "Doug Braunstein and John Hogan called to provide me an update on the CIO position." Then jump down a couple lines. It says, "Current losses are approximately $1.6 billion." Do you see that?

Mr. BRAUNSTEIN. Yes, Senator.

Senator LEVIN. And that is dated May 4, correct?

Mr. BRAUNSTEIN. Yes, Senator.

Senator LEVIN. Now, take a look at Exhibit No. 1g.[2] The day before May 4, the losses had already accumulated to $2.3 billion. Isn't that correct, according to your chart? That is Exhibit No. 1g. Do you see that way over on the right? It goes day by day, May 1, May 2, May 3, and May 4. Excuse me. It is our chart using our data. I stand corrected. But using your data, we put a chart together. These were internal numbers, but you supplied us your data as part of our investigation. We go day by day, starting January 3. Your data shows $2.3 billion. Do you see that?

Mr. BRAUNSTEIN. I do, Senator.

Senator LEVIN. OK. If that data is correct that you gave us, you told Scott Waterhouse, the OCC Examiner-In-Charge, that the Synthetic Credit Portfolio had lost $1.6 billion, but internally your books showed that the losses had already reached $2.3 billion. Is that correct?

Mr. BRAUNSTEIN. Senator, the difference between these two charts is that the first is a year-to-date, so it would have included all the results from the first quarter through that date. The 1.6, I believe, referred to the second quarter losses, and I am certain that when I spoke about the losses, I would have made clear that they were second-quarter-to-date losses. I cannot speak to the note itself, but I am certain I would have drawn that distinction.

Senator LEVIN. Well, in other words, you are saying you did not use the words "current losses." Is that correct?

Mr. BRAUNSTEIN. I do not recall the specifics of a conversation on May 4, but when relating the specific numbers, I am certain I would have been clear that those were quarter-to-date or second-

[1] See Exhibit No. 68, which appears in the Appendix on page 838.
[2] See Exhibit No. 1g, which appears in the Appendix on page 517.

quarter-to-date losses, and those would have had to have been added to the first quarter numbers that the OCC was aware of at that time. I am not sure if I repeated those numbers during the course of that conversation.

Senator LEVIN. The second quarter losses to the date of that were how much?

Mr. BRAUNSTEIN. There were approximately $700 million in the first quarter, so subtracting that $700 million from the 2.3 from your chart, $1.6 billion is the second-quarter-to-date losses.

Senator LEVIN. So when he said in his email that you said that the current losses are 1.6, what you are saying is you told him that the 1.6 was current in the second-quarter-to-date.

Mr. BRAUNSTEIN. Yes, sir, because that is what the math would have suggested.

Senator LEVIN. Well, the math may work out for you, but the question is whether or not that is what you said, and we will find out more about that.

Ms. Drew, let me go back just for a minute to ask you again about these daily P&Ls. This was a letter inside the OCC, an email from Fred Crumlish to Scott Waterhouse. And he also says that—and this is in May—this is Exhibit No. 69,[1] by the way. Do you see at the bottom of the last paragraph there, "Given CIO's role, we haven't historically gotten daily P&L from them as we do the [Investment Bank] given the nature of its operations."

Do you disagree with that? That is what you said before, that you did provide the daily P&L.

Ms. DREW. I did not provide them, Senator. My understanding is that they were provided.

Senator LEVIN. From whom?

Ms. DREW. They should have been provided by Finance or Risk. And, in fact, I confirmed with my CFO at the regulatory meeting on April 16 that they were actually being sent daily for the overall mark-to-market position of the CIO, which included the Synthetic Credit Portfolio.

Senator LEVIN. All right. So that this is wrong, this email is wrong. Is that correct?

Ms. DREW. I do not know if it is wrong. My understanding was that profit and loss statements were sent daily.

Senator LEVIN. And that was during January, February, March, right? That is historically.

Ms. DREW. I asked that question in April, and the answer I was given by Finance was yes.

Senator LEVIN. All right. Do you know who at Finance?

Ms. DREW. My CFO at the time confirmed to me that the P&Ls were sent daily.

Senator LEVIN. Who was that at the time, your CEO at the time?

Ms. DREW. CFO.

Senator LEVIN. CFO. Who was that?

Ms. DREW. Mr. Wilmot.

Senator LEVIN. OK. Now let us take a look at the issue of mismarking of the Synthetic Credit Portfolio book. The portfolio traded derivatives every day. It was a mark-to-market portfolio,

[1] See Exhibit No. 69, which appears in the Appendix on page 839.

which meant that under Generally Accepted Accounting Principles (GAAP), its value was measured every day. Every day the CIO had the report internally—that is, within the bank—a profit and loss figure for the Synthetic Credit Portfolio reflecting the actual value of the book on that day. So over the first quarter, the London traders assigned inflated values to the derivatives in the Synthetic Credit Book to minimize its loss. But that wrongdoing was not made public for months. There were red flags signaling a problem in the books. One red flag was on March 30, an audit by the bank's own Internal Audit department, which rated the Chief Investment Office as "needs improvement."

Exhibit No. 82,[1] if you would take a look at that. It criticized the CIO's Valuation Group, which is supposed to validate the values assigned to derivatives for using models that had not been reviewed, not giving adequate attention to taking reserves and lacking "formally documented/consistently applied price testing thresholds." So that is what Exhibit No. 82 says.

Now, another red flag was the sudden rise of the huge disputes between the CIO and its counterparties over the inflated values that were assigned by the CIO to derivatives in the synthetic book. At their peak, these disputes between the CIO and its counterparties, called "collateral disputes," were $690 million.

Now, after the media reports of the whale trades, JPMorgan's head accountant, the bank's Controller, Shannon Warren, reviewed the Synthetic Credit Portfolio from January to April 2012. Her report was released on May 10, and it said the values that were applied to the credit derivatives—and that is the marks—were "consistent with industry practice." That was the conclusion of the Controller, but the facts described in the report actually painted a picture of the derivatives valuation process that was imprecise, was manipulated, and produced inflated values.

Here is the background: A trader in London was tasked with valuing the SCP derivatives each day. Under accounting rules he had to record a fair value for each derivative from the range of prices in the marketplace as indicated by trades or offers for trades that day. Accounting rules say that when picking a fair value, using the midpoint price in the daily price range is a practical expedient for fair value, although they do not require using it.

Recorded telephone and instant messaging conversations show that the junior trader, Julien Grout, and his immediate supervisor, Bruno Iksil, were pressured to use favorable prices and were upset about doing that. On March 16, Mr. Iksil called the marks that they were recording "idiotic" and said the Synthetic Credit book was growing "more and more monstrous." That is Exhibit No. 32a.[2]

At about the same time, Mr. Grout kept a spreadsheet showing that by using inflated prices, in just 5 days the Synthetic Credit book failed to report $432 million in losses that would have been reported using the midpoint prices. So he went through this exercise for 5 days, and this is Exhibit No. 28,[3] where you can see the result of what he did. He went back and he analyzed what the dif-

[1] See Exhibit No. 82, which appears in the Appendix on page 882.
[2] See Exhibit No. 32a, which appears in the Appendix on page 651.
[3] See Exhibit No. 28, which appears in the Appendix on page 647.

ference is between the marks that they were now using and the marks which they would have used had they used the mids.

And if you look at Exhibit No. 28, that is the 5-day report, and you can see where the $432 million figure is arrived at by the folks in London.

Now, the May 10 review evaluated the marks for 18 credit derivatives that were in the portfolio from January through April, and it looked at the values assigned to those derivatives on the last day of each month.

In January—and this is now according to the May 10 review. The May 10 review found that in January, the CIO marks were generally close to the midpoint in the daily price ranges except in two instances. In February, it found that five of the marks deviated from the midpoint. In March, it found that all 18 not only deviated from the midpoint, but 16 were at the extremes of the price ranges, and in every case the bank was benefiting by understating the Synthetic Credit Portfolio losses.

Mr. Braunstein, the May 10 review was prepared by the controller in your shop. It said the pricing practices were "consistent with industry practices." Is it common for JPMorgan to change its pricing practices when losses start to pile up in order to minimize the losses? Is that common practice at JPMorgan?

Mr. BRAUNSTEIN. Senator, the work that led to that May 10 report involved our Controller, our Chief Accounting Offices, our investment bank valuation practices, internal counsel, external counsel, and was done in consultation with PricewaterhouseCoopers (PwC). And the conclusions that we reached on May 10, related to the marks being consistent with U.S. GAAP, were based on all that work.

Senator LEVIN. That is not my question.

Mr. BRAUNSTEIN. The answer is that we believed at the time that the marks were done consistent with U.S. GAAP.

Senator LEVIN. I understand that, but my question is: Here you have a situation where you were using a particular approach. You were taking the mids, basically, and in a few instances there was a deviation from the midpoint. In January, in two instances, there was a deviation from the mids. February, five deviated from the midpoints. In March, now all 18 not only deviated from the midpoints, 16 were at the extreme of the price ranges, bids and asks. And in every case, the bank benefited, looked better, had its losses look better and less than they otherwise would by understating the Synthetic Credit Portfolio's losses.

Now, my question is—we will find out whether doing that, making a shift in how you mark, is consistent with anything, whether that is consistent with good accounting practices to make the losses either disappear or look better, whether that practice is consistent with any accounting principle. That is not my question.

Is it common inside JPMorgan to change your pricing practices when the losses start piling up in order to minimize the losses? That is my question.

Mr. BRAUNSTEIN. No, that is not acceptable practice.

Senator LEVIN. All right. Now, a senior executive, Mr. Webster, working on the May 10 review, telephoned the CIO head of credit trading, Javier Martin-Artajo, and confronted him about using aggressive pricing on the credit derivatives. And this is Exhibit No. 32d,[1] and it is page 2. And Mr. Webster said that in March, the "marks had migrated . . . to the aggressive side . . . from either mid to somewhere close to being at the . . . bounds of the bid or offer."

Mr. Martin-Artajo responded that the extreme prices reflected the prices that the CIO was actually trading at in March. But when the Subcommittee checked the available trades, it found that the actual trades were at different prices than the booked trades, the booked prices, and would have resulted in bigger losses if they had actually been used.

Now, an email from one person working on the May 10 review put it this way. This is Exhibit No. 34a.[2] "At March month end the CIO [Front Office] marked their book at the most advantageous levels based on the positions they held in specific indices and tranches."

Different prices than the booked prices which would have resulted in bigger losses if they had actually been used.

Is it proper, Mr. Braunstein, to change the marks and the way in which the marks are registered in order to reduce on the books the losses? Is that proper?

Mr. BRAUNSTEIN. No, that is not proper, Senator.

Senator LEVIN. Now, Mr. Cavanagh, given the shift in pricing practices that increasingly deviated from the midpoint, but the bias being in favor of the bank, why didn't your Management Task Force report find that the CIO's pricing practices were unacceptable on that basis? Given the deviation from the midpoint, the change in the procedure which was used to make these marks, why didn't your task force find that an unacceptable practice?

Mr. CAVANAGH. I understand the concern. The work that was done, as Mr. Braunstein said, was with full visibility of the issue you describe and, again, our outside-the-CIO line of business, the investment bank valuation team, the top people in accounting at the company, and our outside auditors all went through a very diligent process, looked at that issue. The marks at that time were shaded by the understanding of the influence that the trading in the marketplace was having as an effect.

And so we looked at the work that was done in the period leading up to May 10 and all the folks were involved and felt it was and continue to feel the work done was very sound and reasonable work.

Subsequently is when we learned the information from listening to the tapes during the course of the task force's review.

Senator LEVIN. I am not talking about what is on the tapes. I am talking about the shift in the way these marks are made. You go this way, midpoint, midpoint, midpoint, midpoint. Suddenly, boom, the losses are piling up, and you are now shifting the way those marks are made. You are no longer looking at the midpoint. You are shifting your process to make the losses look better. And you are saying that is an acceptable accounting practice.

Mr. CAVANAGH. We looked at that——

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[1] See Exhibit No. 32d, which appears in the Appendix on page 662.

[2] See Exhibit No. 34a, which appears in the Appendix on page 675.

Senator LEVIN. Were you aware of that?

Mr. CAVANAGH. Yes.

Senator LEVIN. I am not talking about the tapes which show that your traders said that this was terrible. I am saying looking at what happened there, how do you possibly justify changing your process of making marks in order to make your losses go away or be less? How do you justify that?

Mr. CAVANAGH. The process was the process of looking at the marketplace. The marketplace was affected by—the belief that the market was more volatile given all the visibility and the press articles around the—or the knowledge of the positions. So that affected the analysis on May 10 and got people comfortable despite the movement, as you described. The shift was not a change in policy. It was a change in the outcome of that policy. There was definitely a movement inside the bid/ask spread to the outer limits from more toward the mid, just as a result of what was going on in the marketplace. That is what the May 10 review work looked at. The Task Force did not do that work. We looked at the work that was done prior to May 10 and think it is reasonable work.

Senator LEVIN. Did your investment bank stay at the mids?

Mr. CAVANAGH. Typically, yes. And so——

Senator LEVIN. But this did not. This shifted. This had losses, and so it shifts to reduce the amount of those losses. Your investment bank stayed with the same approach. Is that correct, staying at the mids?

Mr. CAVANAGH. The investment bank had a tighter tolerance band around its valuations from the midpoints in their valuation control practice. That is better practice, and we have subsequently—one of the remediations of the task force is to bolster and, I think as your report calls for, taking away that variability. But that is what we have done subsequently.

Senator LEVIN. Was it a coincidence that the way in which these marks were made the losses look better and less as the losses were piling up? Was it a coincidence that you changed the practice from marking at the mids to marking at a broader band? Was that a coincidence? At the time. I am not talking about on May 10. Was it a coincidence when those marks were changed, the way in which those marks were made, is that a coincidence that it just happened to come when losses were piling up?

Mr. CAVANAGH. I would not say it is a coincidence. It is what happened. It was the same factor——

Senator LEVIN. Was it a coincidence that it was done at that time? Did you inquire as to whether it was a coincidence or not?

Mr. CAVANAGH. We inquired as to—we looked at——

Senator LEVIN. I am not saying whether or not it—look, you can argue that this is consistent with accounting practice. It is not consistent with the accounting practice that changed the way you marked these things in order to make your losses go away, and we will talk to accountants about that, by the way, if you want to maintain that position. I am just asking you: Was it a coincidence that the way in which those marks were made changed to reduce the losses on the books at the time those losses were piling up? That is all I am asking.

Mr. CAVANAGH. Yes. I am not going to debate words with you.

Senator LEVIN. There was no relationship between the fact that the losses were piling up and that there was a way in which the marks were made to reduce the impact of those losses on the books. You are saying that is a coincidence.

Mr. CAVANAGH. Yes, absolutely no intent on the part of anyone that we did the work to review what went on. There was no intent on the part of the people that were involved in the May 10 review that were outside CIO——

Senator LEVIN. I am not talking about the May 10 review. I am talking about the marks when they were changed. When the marks were changed, the way in which the marks were made. When was that done? What date?

Mr. CAVANAGH. That was over the course of the first quarter.

Senator LEVIN. Do you remember the date? Wasn't it January?

Mr. CAVANAGH. I am not sure.

Senator LEVIN. When the review was made on May 10, you looked back as to when that change was made, right?

Mr. CAVANAGH. Yes. I am just not recalling as we sit here. Can you repeat the January point?

Senator LEVIN. Well, when did they change the way in which the marks were made?

Mr. CAVANAGH. My understanding, over the course of the quarter the marks——

Senator LEVIN. But it started at some point. It started a shift from the mids to a broader band. When did that shift start taking——

Mr. CAVANAGH. I believe, right, from January as the portfolio was building over the course of the quarter, the marks, became wider relative to the calculated midpoint.

Senator LEVIN. And because those marks became wider, the losses were less than they otherwise would have been if they had stayed at the mid, right?

Mr. CAVANAGH. Yes.

Senator LEVIN. And you are saying you believe, you are telling us that you—and you are under oath, that was——

Mr. CAVANAGH. I understand.

Senator LEVIN. That that was a coincidence?

Mr. CAVANAGH. I was answering the question about the May 10 review——

Senator LEVIN. No, I am not asking——

Mr. CAVANAGH. So now you are asking—I understand the question you are asking. I clearly know now, having done the review, that the people ultimately were mismarking—were not properly marking their books during the course—at least during the course of the middle of March to the end of March, and that is what we came to know during the course of the review, absolutely.

Senator LEVIN. And that those marks, the way in which the marks were made was changed in order to reduce the loss on the books?

Mr. CAVANAGH. Yes.

Senator LEVIN. That was the purpose?

Mr. CAVANAGH. It seems to our review that, absolutely, the——

Senator LEVIN. No, I am just talking—I understand. That became your conclusion. That is the reason it was done.

Mr. CAVANAGH. Yes.

Senator LEVIN. OK. A minute ago you said it was a coincidence. Now you are saying it was not, that was the purpose.

Mr. CAVANAGH. The purpose of the traders.

Senator LEVIN. Yes.

Mr. CAVANAGH. Correct.

Senator LEVIN. OK. Now let me get to——

Mr. CAVANAGH. I was misunderstood. The purpose of the trader——

Senator LEVIN. No, I do not think you were misunderstood. I think I understood it accurately. I think your answer was inaccurate.

Mr. CAVANAGH. I was answering with respect to from the perspective of the people looking at it from the outside during the May 10 review.

Senator LEVIN. Who is your auditor?

Mr. CAVANAGH. Pricewaterhouse.

Senator LEVIN. I am not talking about tapes, after reviewing the tapes. They accept the idea that when losses are piling up, it is OK at that time to shift the way in which you mark these derivatives to reduce the amount of the loss.

Mr. CAVANAGH. They were involved in the review, yes.

Senator LEVIN. And they approved this.

Mr. CAVANAGH. They were consulted and assented to the accounting reviews on May 10.

Senator LEVIN. OK. I think we can agree on one thing, that shifting the pricing practices to minimize losses is not acceptable.

Mr. CAVANAGH. Correct. Absolutely.

Senator LEVIN. Take a look, if you would, Mr. Cavanagh, at Exhibit No. 98,[1] and this is that Task Force Report. This is where you State that you consulted with auditors and that the marks complied with U.S. Generally Accepted Accounting Principles. You have just told us that you agree that shifting pricing practices to minimize losses is not acceptable. Did you say that in your report? Did you say that is what happened?

Mr. CAVANAGH. We said separate from the report——

Senator LEVIN. No. In the report.

Mr. CAVANAGH. I do not believe we called that out in the report. It was aside from the report when we restated the financial results.

Senator LEVIN. That is pretty significant, though, isn't it?

Mr. CAVANAGH. Yes.

Senator LEVIN. But it was left out of your report.

Mr. CAVANAGH. Yes.

Senator LEVIN. Ms. Drew, please look at Exhibit No. 32c,[2] if you would. This is a transcript of a telephone call between you and the head of the CIO's credit trading operation, Javier Martin-Artajo, who sat in the London office and directly influenced the marks. It is undated, but it likely took place in April, and they are talking about what marks to show for the SCP on that day. Exhibit 32c, do you see that?

Ms. DREW. Yes.

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[1] See Exhibit No. 98, which appears in the Appendix on page 963.
[2] See Exhibit No. 32c, which appears in the Appendix on page 659.

Senator LEVIN. OK. On page 1, near the bottom, Ms. Drew, this is what you say: ". . . I just wanted to get a really brief update on, what the P&L might look like."

Mr. Martin-Artajo answers: "Yes. We are going to be showing a slight positive today . . . I think we are going to be up like somewhere around $20 million today, ok? So this is the first, this is a big event for us, because we are starting to get money back."

Then a bit later on page 2 near the bottom, Mr. Martin-Artajo says: "So the instruction to you that we have here is probably around $100 million, ok? So I don't want them to show $100 million today if they are not sure, ok? So just for you to know that, it's about . . . we need to have a real, sort of 3 [basis points] move to . . . recognize that. I hope it happens and, if it happens between now and the end of the day or, or, whenever it happens, I'll show you."

This is your response: "Here's my guidance. It's absolutely fine to stay conservative, but"—and this is the big "but"—"it would be helpful, if appropriate, to get, to start getting a little bit of that mark back."

"If appropriate, so you know, an extra basis point you can tweak at whatever it is I'm trying to show, with demonstrable data . . ."

You are suggesting pretty clearly that he tweak the marks. Is that correct? You used the word "tweak."

Ms. DREW. I used the word "tweak." The suggestion was that he prove—I had been told for a long period of time that the marks were very conservative. He says in his email that there was P&L upside that day of $100 to $150 million, which is possible. Markets move around a lot. And I was challenging him to show with data that if he can possibly and wants to show—and he has been telling me that the position is turning—that it is appropriate to mark it up with data.

Senator LEVIN. And it would help if he did that.

Ms. DREW. It would be correct if he did that with data.

Senator LEVIN. You said "help," didn't you? You used the word "help."

Ms. DREW. Yes. Only with demonstrable data.

Senator LEVIN. I understand. But you told him it would be helpful, right?

Ms. DREW. Because he had been saying that the marks were conservative and the position had been losing money, and he was not marking the position——

Senator LEVIN. Helpful to tweak, start getting a bit of that mark back. Tweaking is not a prediction or a hope, by the way. Tweaking is changing something. And I would hope that the guidance that you and other folks would give would be against tweaking, but being whatever is accurate. And there was a clear suggestion here that it would be helpful if he tweaked something to make things look a little bit better.

Now, the rules allow derivative values to be set anywhere within a daily price range, and that is a range that can be influenced by the banks involved in this conversation. Mr. Martin-Artajo indicates the SCP derivative values could end up anywhere between $20 and $100 million for the day. That is the kind of conversation and analysis going on in our largest banks, apparently, and that is something which you have said now, I believe, Mr. Cavanagh, that is going to end at your bank. Is that correct?

Mr. CAVANAGH. We believe that the marks on all positions should be spot on.

Senator LEVIN. And not tweaked.

Mr. CAVANAGH. Correct.

Senator LEVIN. For some purpose.

Now, mismarks were not just an internal bank issue. The mismarking tainted the bank's public SEC filings. In May 2012, the bank filed a 10–Q report with its first quarter financial results that went out to the public. One of the factors in that report was that the Synthetic Credit Portfolio had lost $719 million, but that understated the SCP losses. It was wrong, which meant that the SEC filing was wrong.

In July 2012, after acknowledging the mismarking of the SCP book, the bank restated its first quarter financial results, hiking the SCP losses by $660 million. In other words, the SEC's first quarter losses were not $719 million but closer to $1.4 billion.

Mr. Cavanagh, I take it you would agree that it matters when a bank gets its public filings wrong.

Mr. CAVANAGH. Yes, we take it very seriously.

Senator LEVIN. And that a $660 million error is material.

Mr. CAVANAGH. Yes, and as soon as we discovered it and understood the causes, we immediately restated our results.

Senator LEVIN. OK. And, by the way, one of our recommendations in our report is that the OCC get banks to use independent pricing services to remove the temptation from a bank's employees to tweak marks. And we also recommend that banks have to disclose when their derivative values deviate from midpoint prices and explain why.

Now, I want to get to the earnings call on April 13 because we have disclosure problems here as well.

Mr. Bacon, before April 13, did you or your boss, John Hogan, the Firm's chief risk officer, approve positions for the Synthetic Credit Portfolio?

Mr. BACON. No.

Senator LEVIN. Two days before the earnings call—in other words, on April 11—the bank's chief risk officer, John Hogan, sent an email, Exhibit No. 87 [1] He sent it to you, Mr. Braunstein, among others, including Mr. Dimon. He said: "This is the governance used in the investment bank to control what is currently going on in the CIO. We obviously need to implement this in CIO as soon as possible." So that is something that you received, Mr. Braunstein, on April 11.

Now, you have a call, an earnings call, on April 13. That is 2 days later. You did not tell investors that the bank's Chief Risk Officer wanted an immediate overhaul of the CIO risk management during that call, did you, Mr. Braunstein?

Mr. BRAUNSTEIN. No, sir.

Senator LEVIN. Now, the SCP had breached all five of its key risk limits by then, and there had been more than 250 risk limit

[1] See Exhibit No. 87, which appears in the Appendix on page 900.

breaches since the beginning of the year. You did not tell investors during that call about those breaches, did you?

Mr. BRAUNSTEIN. No, sir. I was not aware of all of that at the time.

Senator LEVIN. You did volunteer a number of statements about the Synthetic Credit Portfolio—and I want to go through those with you—during that April 13 earnings call.

First, this is Exhibit No. 94,[1] and that is a transcript of the earnings call. Your statements about the Synthetic Credit Portfolio are on page 6 and 7. And so to make it easier to discuss them with you, we have listed the key statements on Exhibit No. 1f,[2] which is in your book.

One of the things that you said there is that all—this is now your public statements on April 13: "All of those positions are put on pursuant to the risk management at the Firm-wide level." I think we have already heard today that Mr. Weiland did not approve individual positions, Mr. Bacon, the risk managers did not approve the positions. So what you said to the public is that all of these positions "are put on pursuant to the risk management at the Firm-wide level." That was not really accurate, was it?

Mr. BRAUNSTEIN. Senator, it was accurate.

Senator LEVIN. That the positions——

Mr. BRAUNSTEIN. That the aggregate positions were put on pursuant to a risk management organization. There was a Chief Risk Officer in CIO. There were limits in CIO. At the time I was not aware of the breaches of a number of those limits, and I certainly was not aware of some of the deficiencies that we uncovered pursuant to the task force report. But, based on what I knew at the time, that was an accurate statement.

Senator LEVIN. But Mr. Bacon says the risk managers did not approve the positions.

Mr. BRAUNSTEIN. What that statement actually refers to is pursuant to a risk management organization, so risk——

Senator LEVIN. Oh, to an organization. All the positions are put on by an organization.

Mr. BRAUNSTEIN. Pursuant to a risk management organization and its control center.

Senator LEVIN. Boy, that is a lot different than saying that "those positions"—"those positions," this was an explosion in the media. You are saying, "All of those positions are put on pursuant to the risk management." That creates an impression which is not true. That is not saying that our organization put all these positions on. Of course they do. As a matter of fact, Mr. Hogan said he learned of the trades from the paper, from the newspaper.

Let us go to the next one, the next statement that you made during that call. You said that, "[A]ll those positions are fully transparent to the regulators. They "get information on those positions"—we are talking about the positions the whale trades—"on a regular and recurring basis as part of our normalized reporting." That is the next statement that you made during that call. In fact, the longstanding practice of the bank is not to give individual posi-

[1] See Exhibit No. 94, which appears in the Appendix on page 927.
[2] See Exhibit No. 1f, which appears in the Appendix on page 516.

tion data to the OCC unless there is a specific request. There was no regular report of the SCP's positions to OCC. Is that correct? There was not a regular report of that position.

Mr. BRAUNSTEIN. I am not aware that there was a regular report. I am aware, prior to making that call, that statement, that on the 9th, Ms. Drew met with regulators and then on May 10 provided them with specific position reports.

Senator LEVIN. That was on May 10 to the regulators?

Mr. BRAUNSTEIN. Yes, Senator.

Senator LEVIN. That is not when these trades were made? That is the issue.

Mr. BRAUNSTEIN. Senator, they also received a number of other reports on a regular basis.

Senator LEVIN. Are you saying that the information on these positions was provided on a regular basis to the OCC?

Mr. BRAUNSTEIN. No, Senator. I am saying there are a number of other reports that they received that had components of these positions in them.

Senator LEVIN. OK. So what you said is not exactly accurate on that day. Is that correct?

Mr. BRAUNSTEIN. On April 13, I believed it to be accurate based on——

Senator LEVIN. I understand that you believed it to be——

Mr. BRAUNSTEIN [continuing]. The information that I had received from Ms. Drew, the risk organization, and from the traders, and from John Wilmot, CIO's CFO.

Senator LEVIN. OK. There are also reports here, by the way, which were never even received by the OCC, and you heard earlier about that this morning. Do you know why those reports were suddenly not sent January through April, these Executive Management Reports? Do you know why?

Mr. BRAUNSTEIN. Yes, Senator, I do.

Senator LEVIN. You do.

Mr. BRAUNSTEIN. Yes. I was not aware of that at the time, but——

Senator LEVIN. You explained earlier today as to why it was.

Mr. BRAUNSTEIN. We changed our reports, and, unfortunately, an error was made. The reports were only forwarded in the new format to the Fed and the FDIC, and we were not aware that the OCC was not getting it. They identified that as an issue, and we corrected that error. On April 13, I was not aware of any of that.

Senator LEVIN. OK. So you thought you were saying something accurate on April 13, but it turned out not to be accurate.

Mr. BRAUNSTEIN. I believe that we, on April 13, were being fully transparent with our regulators.

Senator LEVIN. Did you believe that they got information on these positions on a regular basis as part of your normalized reporting? Did you believe that on April 13?

Mr. BRAUNSTEIN. I believed that they got information related to——

Senator LEVIN. "On a regular, recurring basis" that they got this information—you know it is not true now, right?

Mr. BRAUNSTEIN. Senator, there is information that I know today——

Senator LEVIN. Not information. I am talking about information on these positions. That is the positions. This thing was blowing up in the newspaper. You have these whale trades. You lost billions of dollars. You are representing to the public that the regulators got information on those positions on a regular basis.

Mr. BRAUNSTEIN. Senator, they did——

Senator LEVIN. It turned out that was not true.

Mr. BRAUNSTEIN. Senator, they received information——

Senator LEVIN. On those positions on a regular basis?

Mr. BRAUNSTEIN. On the portfolio, they received daily VaR reports. They received CIO weekly summary information.

Senator LEVIN. I am just asking you, did they get a regular report of the SCP's positions? I am asking you that question.

Mr. BRAUNSTEIN. The specific positions they received, I was aware they had received the positions on the specifics on April 10.

Senator LEVIN. OK. So what you said on April 13 was that the OCC—information on those positions was part of your "normalized reporting," that is what you said, and that the regulators got them "on a regular, recurring basis." Now you are saying they got the information 3 days before your public statements. Is that right?

Mr. BRAUNSTEIN. The statement says that they could—they would have access to them at any time, get the information on these positions——

Senator LEVIN. I understand. They could have accessed, we understand, if they asked for it, they got it.

Mr. BRAUNSTEIN. And I believe based on what I knew at the time, including material sent to me from Ms. Drew and Mr. Wilmot, that they were being fully transparent and the regulators were aware of the positions, I believed that to be a true statement at that time.

Senator LEVIN. Which is a little different from what you said, which is that they "get the information on those positions on a regular and recurring basis." That was not accurate, and I am asking you, did they get—I am just saying whether it is—I am not asking you now what you believed. I am asking you whether or not it is accurate, that the OCC got "the information on those positions on a regular and recurring basis as part of [y]our normalized reporting." I am asking you that. Is that accurate?

Mr. BRAUNSTEIN. They got information——

Senator LEVIN. Not information. I am going to read this to you. I am going to keep reading it to you until you give me the answer. Did they "get the information on those positions on a regular and recurring basis?" You know what "those positions" are. That is the positions in the whale trades. As part of a "normalized reporting," did they?

Mr. BRAUNSTEIN. They did not get the detailed positions regularly.

Senator LEVIN. OK.

Mr. BRAUNSTEIN. They got summary information——

Senator LEVIN. I will settle for that. I am happy to settle for that. They did not get information on those positions regularly. That is fine.

Now, the impression is pretty clear as to what you said on that day, which is they "get the information on those positions on a regular, recurring basis as part of our normalized reporting." So what you say here today I think is, finally, more accurate, and that what you said on that day was a very inaccurate impression.

Now, next, the third statement that you made was that "all of those decisions are made on a very long-term basis." Now, Ms. Drew told us earlier that when she made a presentation in March 2012 to the directors' Risk Policy Committee, which is Exhibit No. 81[1] again, she prepared a chart of all the CIO portfolios, and on that chart she showed whether the investment horizon was long term or short term. We are looking now at Exhibit No. 81.

The Synthetic Credit Portfolio, which was part of the Mark-to-Market Overlay International, she identified that for us. If you will look at Exhibit No. 81, it is at the far right-hand corner, and it is part of the International reference way over to the right, as short as you can get on the investment horizon, as far right as you can get.

Now, would you agree, Mr. Braunstein, that the Synthetic Credit Portfolio was traded on a daily basis and that the decisions to buy and sell credit derivatives were made on a short-term basis?

Mr. BRAUNSTEIN. Senator, I would agree that these positions in the portfolio were traded on a daily basis. However, they were part, as you see at the top of this same chart, of a longer-term perspective. Some of those are shorter in duration than others. And as Ms. Drew said previously, the hedge position on the high yield was a long-term position, but we moderated it over time.

Senator LEVIN. So when you said that "all of those decisions were made on a very long-term basis," what you are saying now is—you are arguing that some were made on a long-term basis and some on a short-term basis?

Mr. BRAUNSTEIN. No, Senator. All I said is trades were made daily. That is a tactical implementation of a longer-term decision.

Senator LEVIN. And the tactical implication or the tactical actions, which were the day-to-day actions and which during the first quarter of 2012 were what we are talking about, because those are the whale trades which cost $6 billion, you think that when you told the public that "all of those decisions are made on a very long-term basis," that you think that the average person listening to that phone call would think that you were talking about some long-term strategy and not what you are actually buying and selling day-to-day during those 3 months? Do you think that is the reasonable way that someone would hear the words "all of those decisions were made on a very long-term basis?"

Mr. BRAUNSTEIN. I think my statement that they were made on a long-term basis reflected my understanding of the position at the time as accurately as I could.

Senator LEVIN. But you knew that these trades were being made day-to-day. You knew that the portfolio had dramatically increased from January to March so that most of them had been bought in the last couple months, those positions. You characterized this, "all the decisions were made on a very long-term basis." And you think the average listener to that statement would think that what you were referring to was some strategy that was adopted, I do not

[1] See Exhibit No. 81, which appears in the Appendix on page 877.

know, months before or a year before? Do you think that is a fair understanding of those words to someone listening to you?

Mr. BRAUNSTEIN. Senator, I believe what I said is accurate.

Senator LEVIN. Technically. You can find a way to make those accurate. That is not my question—to make them sound accurate. That is not my real question. I am trying to figure out what you are really thinking about here. You are talking to people now publicly. You have had this blowup, this huge loss, and now you are telling—you are trying, obviously, to reassure people. You are saying "all these positions are put on pursuant to risk management at the Firm-wide level." Not accurate. "All those positions," you said—the regulators know all about these positions. Not accurate. "All those decisions are made on a very long-term basis." You think that the average listener, that average investor, is going to say that he was technically accurate, they had a long-term strategy here? You think the average person listening to this would not think you were referring to the trades that were at issue that blew up? Is that your statement under oath, that is what you think reasonable people would take from that statement here? That is what you say.

Mr. BRAUNSTEIN. Senator, my obligation on the call and the only thing I was thinking about was reporting based on what I knew at the time, the information as accurately as I could——

Senator LEVIN. Did it turn out to be wrong? Were "all those decisions made on a very long-term basis" relative to those positions?

Mr. BRAUNSTEIN. In hindsight, Senator, the positions and the portfolio did not act as a hedge. It changed dramatically. We misunderstood the risks. We misunderstood the complication in it. We ultimately misunderstood what the estimated performance of it would be. So, in hindsight, we got that wrong. The statements as I made them on April 13 were my very best effort, best good-faith effort, to accurately describe based on the information I knew available to me at the time what the portfolio was.

Senator LEVIN. I have a lot of trouble, I've got to tell you, Mr. Braunstein, believing that those statements were anything other than an effort to calm the seas, because they all were exaggerations or inaccurate. You can say "in hindsight." You can say "as it turned out." But at the time there was all kinds of evidence, which we have shown here today, that those positions were not, as a matter of fact, "put on pursuant to risk management at the Firm-wide level;" the regulator did not receive regular reports, as you indicated they did; that the decisions—and you are referring to decisions relative to the positions—"were made on a long-term basis," when they obviously were—as you put it, tactically, done on a very short-term basis, and that the size of that inventory tripled during those 3 months.

Now let us go to hedging. You say that it turned out not to be a hedge. But what you said on April 13 was that "we have put on positions to manage for a significant stress event in credit." That is what you said on April 13.

When you said that the portfolio put on positions to protect against "a significant stress event," I take it that you meant by that, Mr. Braunstein, that is a new financial crisis. Is that correct?

Mr. BRAUNSTEIN. No, sir.

Senator LEVIN. No? It was aimed at protecting against what? What is the significant stress event if it was not a new financial crisis?

Mr. BRAUNSTEIN. As I understood the position on April 13, again, based on reports from the CIO traders, Ms. Drew, Mr. Wilmot, review by Mr. Hogan and the risk organization, I understood the position to be balanced, and I understood that the position still had jump loss default protection, i.e., bankruptcies. In the event of bankruptcies, the portfolio would perform as gains for the bank.

Senator LEVIN. OK. Now, let us take a look then at Exhibit No. 90,[1] if you would. This is an email that was provided to you and other senior bank executives before that earnings call. It provided you with detailed information about the Synthetic Credit book. And this was prepared by two of the bank's quantitative analysts, Mr. Venkatakrishnan and Mr. Vigneron. I assume you had confidence in those folks. Is that true?

Mr. BRAUNSTEIN. Yes, sir.

Senator LEVIN. So if you will turn to page 3 of Exhibit No. 90, this was a presentation labeled, "Synthetic Credit Summary: Risk and P/L Scenarios." The title indicates that this describes scenarios for the Synthetic Credit Portfolio as to when it would earn money and when it would lose money. And if you look at the table on the left side of the page, it has three columns labeled "Spr01," "Spr+10 percent," and "Up50 percent." So each of those, as I understand it, denotes a situation in which credit gets worse. Is that accurate?

Mr. BRAUNSTEIN. Yes, Senator, that denotes credit spreads widening.

Senator LEVIN. And that would mean that credit is getting worse?

Mr. BRAUNSTEIN. That is correct.

Senator LEVIN. In all three now, the Synthetic Credit Portfolio is projected as losing money. Is that correct?

Mr. BRAUNSTEIN. Yes, Senator.

Senator LEVIN. That is what you call a hedge.

Now, the first scenario, when the credit spreads widen one basis point, the portfolio loses $46 million. In the second, where credit spreads widen by 10 percent, it loses $163 million. In the third scenario, where credit spreads widen 50 percent, which is a severe credit crisis, it loses $918 million. In all three scenarios, the Synthetic Credit Portfolio loses money and loses more and more money as credit quality in the economy progressively gets worse.

Now, those results show that the SCP is not providing any credit loss protection. Would you agree to that? In those three scenarios, that gets worse, but in all three it loses money. Would you agree to that?

Mr. BRAUNSTEIN. I would agree. If that is the only thing that happens in those scenarios, then the portfolio would lose money. Credit scenarios are much more complicated than that, Senator, and so in addition to this, in those types of circumstances, there is default risk, and the portfolio would have gains in the event of defaults.

[1] See Exhibit No. 90, which appears in the Appendix on page 905.

So, again, my understanding at the time was that the portfolio still provided positive gains in a jump to default scenario.

Senator LEVIN. That would have been one 1 of 10 scenarios? Is that it? Take a look at page 7—do you see page 7?

Mr. BRAUNSTEIN. Yes.

Senator LEVIN. Where it has 10 different scenarios?

Mr. BRAUNSTEIN. Yes.

Senator LEVIN. The one you are talking about is the last one, many defaults? Is that correct?

Mr. BRAUNSTEIN. That is a scenario, yes.

Senator LEVIN. OK. But Jamie Dimon testified to the Senate that the SCP was to protect against a financial crisis—that is Scenario No. 4—or bad development in Europe, and that is number 2. That is what he said. And in both of those, the portfolio would lose money, correct? I am not asking you whether you agree with Mr. Dimon or not. I am just simply asking you whether or not in those two scenarios, number 2 and 4, it loses money.

Mr. BRAUNSTEIN. Yes, it loses money.

Senator LEVIN. And when he testified that the SCP was to protect against Scenarios 2 and 4, you go all the way over to number 10 to try to find some scenario in which it might be helpful. But in Scenarios 2 and 4, it loses money. Is that correct?

Mr. BRAUNSTEIN. Yes.

Senator LEVIN. Now, did you disclose in that April 13 statement the portfolio's current status?

Mr. BRAUNSTEIN. Senator, I am not sure exactly what you mean by "current status."

Senator LEVIN. The current status of the portfolio.

Mr. BRAUNSTEIN. I am not, again, sure exactly what you mean by the "current status."

Senator LEVIN. All right. Go to, if you would, Exhibit No. 97.[1] This was a letter that you wrote to the Subcommittee. You said that when you saw this document—and we are talking here about that same document we have been discussing—last April, that you relied on the "central scenarios included on that page describing an 80 [percent] likelihood . . ." Now, the central scenarios with the 80-percent likelihood were a New Financial Crisis, Status Quo, and a Central Scenario, those three. That is what you told the Subcommittee, that you relied on those. You did not talk about Scenario No. 10. That is not one of those. It is not one of the four scenarios that even have a 10-percent likelihood.

No, I am sorry. It is one of the four scenarios, with a 10-percent likelihood, but what you told the Committee in your letter is that you relied on the central scenarios, which are Scenarios 4, 5, and 6, not Scenario No. 10. How come? How come the change?

Mr. BRAUNSTEIN. Senator, there is no change.

Senator LEVIN. OK.

Mr. BRAUNSTEIN. What I was speaking about was the comment I made related to being "very comfortable" with the position. And as I said to your staff, "very comfortable" was derived from those 80-percent likely scenarios, so a loss of $250 million to a gain of $350 million.

[1] See Exhibit No. 97, which appears in the Appendix on page 962.

In addition, I also relied on for the "very comfortable" statement, the independent work that was done through the risk organization. And as I spoke to your staff, that is what I was referring to; those scenarios helped me to communicate the position of the bank as being very comfortable based on our anticipated future losses from the position.

Senator LEVIN. So you were very comfortable with the position you were in under those three central scenarios, showing you losing money under a New Financial Crisis—right?—of $250 million. Is that correct?

Mr. BRAUNSTEIN. Senator, while that is a big number——

Senator LEVIN. That helped make you comfortable.

Mr. BRAUNSTEIN. Senator, while that is a large number for anyone, for JPMorgan, to put that in perspective, it was less than 1 percent of the full-year profits for the company. So, yes, as a P&L matter, we were very comfortable. Again, based on what I know today, that information was inaccurate.

Senator LEVIN. Shouldn't investors have known during that call that the current status of the SCP was not great, it was losing a lot of money, huge positions that it had were hard to exit, it had been violating all five risk limits? Don't you think you should have disclosed that? You said, what do I mean by the shape of the SCP. Well, that is what I mean by the shape. You give this very glowing call: These have all been approved by central, the risk managers have all approved this, all of our regulators know all about it. This is what you are telling investors on April 13 instead of telling them what you also knew, which is that SCP is losing money and had been violating risk limits.

A pretty one-sided presentation, isn't it?

Mr. BRAUNSTEIN. Senator, based on what I knew at the time, I believe it to be the most accurate depiction of the position. All of those——

Senator LEVIN. You thought that was a balanced presentation?

Mr. BRAUNSTEIN. All of those——

Senator LEVIN. You thought that was a balanced presentation of the SCP on April 13?

Mr. BRAUNSTEIN. It was an accurate presentation.

Senator LEVIN. You thought it was a balanced presentation, not disclosing it was losing money, not disclosing that it violated all five risk limits regularly, in some cases for months? You think it is accurate to just tell them you are comfortable, that the regulators know all about this, that your top risk people approved all these positions? You think that is a balanced—honestly, now, you think that is a balanced presentation to investors?

Mr. BRAUNSTEIN. Senator, in hindsight, there is lots more information that we learned.

Senator LEVIN. That you had at the time——

Mr. BRAUNSTEIN. Based on what I——

Senator LEVIN. No. Not that you learned. You had that at the time.

Mr. BRAUNSTEIN. Senator, this financial analysis incorporated all of those factors that we had at the time, so, yes, based on all that information at the time, we were very comfortable based on the predicted outcomes.

Senator LEVIN. Well, we have already covered some of the matters involving hidden financial risks, mismarking, breaches of risk limits, and public disclosure problems. But there is another problem or two which I want to go into now, and that is the issue of and the evidence of model manipulation.

In December 2011, the bank ordered the CIO to reduce its risk-weighted assets, assets that were assigned certain weights by the OCC according to how risky they were. The usual way to reduce risk-weighted assets is to sell off some of the risky assets. But in December 2011, CIO personnel proposed a different solution, one that instead involved manipulating the mathematical models that were used to calculate risk-weighted assets to produce lower results. So this is the solution that was proposed by some CIO personnel in December 2011.

So if you all would turn to Exhibit No. 46.[1] This is an email dated December 22, 2011, which was sent to you, Ms. Drew, by the head of the CIO's equity and credit trading operation, Javier Martin-Artajo.

In this email, Mr. Martin-Artajo suggests reducing the Synthetic Credit Portfolio's risk-weighted assets by $13 billion using several tactics. One was achieving a $2 billion book reduction through a trading reduction—in other words, selling off assets. But he also suggests achieving a much larger reduction, a $7 billion reduction, half of the $13 billion goal, through so-called "model reductions."

Now, here is what the estimates of the reductions would be, and one was CRM, which has already been acknowledged, the model reduction of the VaR, and the model reduction of the stress VaR.

So here is the issue, though. The email identifies three mathematical models used to calculate various components of risk-weighted assets. Now, that is a model, again, used to calculate the CRM that calculates the dollar amount of possible losses over a year; the VaR, which calculates the dollar value at risk of loss in a day under ordinary market conditions; and stress, which calculates stress VaR results, the dollar value at risk of loss in a day under severe economic conditions.

Quantitative Research is the bank outfit that develops the models. And, again, I was reading from the exhibit. The reference to Pat is Pat Hagan, who is the CIO's quantitative analyst who is working to develop the three models listed in the email.

Mr. Hagan told our Subcommittee staff that he, in fact, provided the three estimates attributed to him in the email for the model used to produce the CRM—and, again, that is the comprehensive risk measure that calculates the dollar amount of possible losses over the year. He predicted he could achieve a $5 billion reduction in CRM results, a $500 million reduction in VaR results, and a $1.5 billion reduction in stress VaR results, for a total of $7 billion. The plan was that all those reductions would, in turn, produce a lower RWA result as well as lower capital requirements.

Now, Ms. Drew, what did you think when you got this proposal, in particular the idea of reducing the SCP's RWA by $7 billion through model reductions, which is triple the $2 billion to be achieved through trading reductions? What was your reaction?

[1] See Exhibit No. 46, which appears in the Appendix on page 778.

Ms. DREW. My reaction when I had an estimate from a front office that was dependent on QR was always that QR as an independent review section of the bank was responsible for making the determination, irrespective of Mr. Hagan's or anybody else's estimates.

Going forward, also this was early in the process, the amount of RWA that had to be reduced was increased by Mr. Braunstein, and I delivered the message that it had to come from position reduction over the course of the year to the group directly.

Senator LEVIN. You did deliver that message?

Ms. DREW. Correct.

Senator LEVIN. So, Mr. Cavanagh, in other words, your message was it has to come from reduction of sales and the——

Ms. DREW. Not all of it, no. Some of it.

Senator LEVIN. Some of it.

Ms. DREW. Whatever——

Senator LEVIN. How much of it? Most of it?

Ms. DREW. My directive was that whatever the independent risk group, QR, approved, they could include in their reduction the same—models are updated all the time, and if QR confirmed that the reduction was appropriate, then they could use the reduction proportionally for whatever QR told them would be accurate.

Senator LEVIN. All right. So let me ask you, Mr. Cavanagh: Is it appropriate to set goals to achieve RWA reductions by affecting how the models calculate the results?

Mr. CAVANAGH. If the intention is to take on more risk and be deceptive about it, absolutely not. The models need to be accurate and properly measure under the—we are putting in new capital rules across the Firm, and so some of the targets were in full contemplation of the improvements that were needed to get RWA calculations correct.

Senator LEVIN. So now my question. Is it appropriate to set goals to achieve RWA reductions by affecting how the models calculate the results? Is that appropriate?

Mr. CAVANAGH. I think it is appropriate if there are controls around making sure that there is independent oversight of the model approvals themselves and there is visibility into what the sources are of actual change.

Senator LEVIN. So where the models are changed in order to achieve that reduction, is that appropriate?

Mr. CAVANAGH. Again, if the models are being——

Senator LEVIN. I am saying if the purpose of changing the——

Mr. CAVANAGH. I do not agree that the purpose——

Senator LEVIN. I am not saying you agree with what happened here. I am saying if the purpose of changing the models is to achieve an RWA reduction, is that appropriate?

Mr. CAVANAGH. If we understand—it can be appropriate, yes, sir.

Senator LEVIN. If that is the purpose?

Mr. CAVANAGH. Yes, if there is transparency around the fact that there is an expectation that is going to change and the Firm through its risk governance processes is comfortable with the level of risk-weighted assets that would be used under a new model, that would be fine.

Senator LEVIN. OK. Do you see anything in this memo that I referred to about accuracy, Exhibit 46?[1]

Mr. CAVANAGH. No.

Senator LEVIN. OK. So much for accuracy.

Now, I misspoke before when I said what the CRM was, but we did talk about the CRM or the comprehensive risk measurement that the OCC requires all the national banks to calculate. It measures the amount of expected loss over the course of a year. In a worst-case scenario, it is used to calculate a bank's overall risk-weighted assets and in turn its capital requirements.

Now, the RWA has other components, too, including a risk measure called the "incremental risk charge" (IRC)—which applies only to certain types of assets. And the total RWA will depend upon whether particular positions are categorized as CRM or IRC since the resulting CRM and IRC totals are going to be incorporated into the RWA calculation.

So now, Mr. Weiland, if you would take a look at Exhibit No. 50.[2]

Mr. WEILAND. Yes.

Senator LEVIN. That is an email dated March 21 that you received from Pat Hagan, and he is the CIO's quantitative analyst in London. Here is the subject line of the email: "Optimizing regulatory capital."

In his email Mr. Hagan proposes categorizing synthetic credit positions based on what would create the lowest possible capital charge to the bank. And if you look at the top of page 2, he says the following: ". . . we should treat the regulatory capital calculation as an exercise of automatically finding the best results of an immensely arbitrary and complicated formula."

So a few hours later, Mr. Hagan received a call from Anil Bangia, who worked in the bank's Model Risk and Development Group. Exhibit No. 51a[3] is a transcript of an excerpt of this call now between Mr. Bangia and Mr. Hagan.

"Mr. Bangia: I think . . . the email that you sent out, I think there is a, just FYI, there is a bit of sensitivity around this topic. So—"

"Mr. Hagan: There, there is a lot of sensitivity.

"Mr. Bangia: Exactly, so I think what I would do is not put these things in email."

While Mr. Bangia made it clear in his email that "optimizing regulatory capital" was not safe to put in writing—in other words, they discuss it on the phone.

So later that day, Mr. Hagan and Mr. Bangia spoke again. This is now Exhibit No. 51b.[4]

"Mr. Hagan: Um, that email that I should not have sent?"

"Mr. Bangia: Um hum." "Yes," in other words.

"Mr. Hagan: Have you read it? Is that a feasible thing to do or is that impossible?"

"Mr. Bangia: Well it's, in some ways it's somewhat feasible," and then they go on to discuss Mr. Hagan's proposal.

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[1] See Exhibit No. 46, which appears in the Appendix on page 778.
[2] See Exhibit No. 50, which appears in the Appendix on page 788.
[3] See Exhibit No. 51a, which appears in the Appendix on page 790.
[4] See Exhibit No. 51b, which appears in the Appendix on page 791.

Mr. Weiland, despite the sensitivity, this email indicates that Mr. Hagan continued to pursue his efforts to produce the lowest possible RWA and to "optimize regulatory capital." Right? Do you agree with that, what I read? Did I read that accurately?

Mr. WEILAND. Mr. Hagan was doing calculations to estimate what he thought the regulatory capital should be. He was not responsible for the official calculation of the regulatory capital.

Senator LEVIN. Yes, but the question is whether or not is there some reason you should not put that in an email. Why is this the subject of a phone call, optimizing regulatory capital?

Mr. WEILAND. I was aware——

Senator LEVIN. Why hide it?

Mr. WEILAND. Because it was not the business purpose, it was not what we were trying to achieve. Mr. Hagan had a misunderstanding as to what we were trying to achieve and was treating this regulatory capital exercise as a mathematical problem rather than understanding the actual rules in the process.

Senator LEVIN. That is why you do not put it in writing?

Mr. WEILAND. Well, we did not want anyone to misconstrue or misunderstand what it was we were trying to achieve, and when Pat sent around those emails, people were misunderstanding.

Senator LEVIN. They thought you were doing what it said you were doing, which is——

Mr. WEILAND. What Pat was doing.

Senator LEVIN [continuing]. Optimizing regulatory capital.

Mr. WEILAND. That is what Pat was trying to do.

Senator LEVIN. Yes.

Mr. WEILAND. And what we were doing is telling him that this is not the objective of the exercise.

Senator LEVIN. Therefore, do not say things like that in writing.

Mr. WEILAND. Do not do it, and do not say it.

Senator LEVIN. Yes, but he continued to do it in another phone call.

Take a look at Exhibit No. 51c.[1] That is a transcript of a phone conversation the next day between Mr. Hagan and you. This is what you say to Mr. Hagan: "I keep getting banged up . . . I know you've had some emails back and forth with Venkat and Anil or whoever on the optimization of the IRC and CRM and everything else. I told this to Javier"—in other words, Hagan's boss—"the other day but maybe he didn't mention it to you—everyone is very sensitive about the idea—writing emails about the idea of optimizing."

Why is optimizing such a sensitive issue?

Mr. WEILAND. Because at that point in time, we were making a separation in the portfolios, trying to understand and define which part of the portfolios should be subject, according to the new regulatory rules, to IRC calculation and which part of the portfolios should be subject to CRM calculation. It was not and it is not something that is meant to be recalculated on a daily basis to optimize it. It is meant to be done based on a business purpose of the two portfolios.

[1] See Exhibit No. 51c, which appears in the Appendix on page 793.

Mr. Hagan, in his role as a mathematician and a quantitative specialist, was focused too much on his own mathematical interest in optimizing it and not enough on what the actual rules and objectives of the exercise were.

Senator LEVIN. He was just pursuing a mathematical interest. He was not operating in furtherance of the bank's goals?

Mr. WEILAND. In fact, we were instructing him that it was not the goal, that we had to do a one-time split of the portfolios according to the regulatory rules, and that we were not intending to continue optimizing the portfolio. And it was his, continued—he had an opinion, and he wanted people to hear it, and he continued to send emails about it, and, it was not consistent with what we were trying to achieve that we told him to stop doing it.

Senator LEVIN. He thought he was carrying out a purpose, right?

Mr. WEILAND. He did.

Senator LEVIN. But it was a violation of the bank's policy.

Mr. WEILAND. Right.

Senator LEVIN. Do not put it in emails.

Mr. WEILAND. Well, primarily——

Senator LEVIN. You said, "Do not put it in emails." You did not say, "Hey, you are on the wrong track."

Mr. WEILAND. I told him both things.

Senator LEVIN. You said, "Do not put it in emails."

Mr. WEILAND. I did not want him to put it in an email because it was misconstruing what it was we were trying to achieve.

Senator LEVIN. Where do you see that?

Mr. WEILAND. I am not sure I see it in the transcript, but I had many conversations with Pat about this.

Senator LEVIN. So in this transcript, saying, "Do not write emails about this," because——

Mr. WEILAND. This phone call——

Senator LEVIN [continuing]. This is the wrong policy.

Mr. WEILAND. This phone call was to tell him not to write these emails.

Senator LEVIN. Telling him, "Do not write emails." You did not say, "It is the wrong policy. That is not what we are trying to do at this bank." You say, "This is a sensitive subject. Do not put it in emails." Right?

Mr. WEILAND. Correct.

Senator LEVIN. Mr. Cavanagh, in your prepared statement, you say that, "Future synthetic credit positions in CIO will be subject to appropriate reporting and monitoring requirements and linked with appropriate documentation to a particular risk or set of risks that they are designed to offset."

You also said in your prepared testimony that, "We believe that the changes that we have made appropriately reflect the approach to hedging outlined in the proposed Volcker Rule and that they impose strong internal controls over hedging, including that all hedged transactions be properly documented and monitored."

Are you saying that the bank from now on is going to require contemporaneous hedging documentation for all hedges? Is that what you are saying?

Mr. CAVANAGH. For all portfolio hedging, we will require contemporaneous documentation that links the risk that is to be hedged with what the hedge is constructed to be and require ongoing monitoring from the time a hedge goes on.

Senator LEVIN. Now, you say in your statement that the documentation is going to identify a particular risk or set of risks that they—I presume you mean the hedging positions—are designed to offset. Right?

Mr. CAVANAGH. Yes.

Senator LEVIN. Now, rather than identifying risks to be offset, are you also going to identify the assets to be offset?

Mr. CAVANAGH. Yes. [Pause.]

Senator LEVIN. Let me go back and just clarify one thing. Mr. Weiland, I think that you testified that optimizing RWA was done once. Is that correct? It was allowed on a one-time basis?

Mr. WEILAND. The intention was split the book into a portfolio that included only index positions and no tranches and would receive an IRC charge, and a separate book which would include a mixture of index positions and tranches, which would be, the hedge ratios, and trades would be actively managed; and that going forward after that had been done, trades either needed to be assigned to the IRC book or the CRM book, and that there was not meant to be an ongoing process of optimization that would potentially blur the lines between the two.

Senator LEVIN. All right. So there intention—was not an intention, you said, on an ongoing basis to optimize the book. And my question is this: On that one-time basis, it was going to be allowed. Is that correct, but on a one-time basis?

Mr. WEILAND. Yes. The objective was within the rules to achieve the best RWA, of course.

Senator LEVIN. On that one time.

Mr. WEILAND. Yes. And then move forward assigning trades on a business——

Senator LEVIN. But not on an ongoing basis?

Mr. WEILAND. There was not meant to be any further cross-fertilization between one of the books and the other book for the purpose of optimizing capital.

Senator LEVIN. Now, why should it be allowed on a one-time basis?

Mr. WEILAND. Well, by the rules, if you are using index positions and not tranches—in other words, you are not correlation trading, you are——

Senator LEVIN. Why is it that something not allowed on an ongoing basis is allowed on a one-time basis? That is what I am trying to understand.

Mr. WEILAND. Well, I am not a regulatory policy expert, but my understanding——

Senator LEVIN. You think the regulators allow that optimization for once, but do not allow it on an ongoing basis?

Mr. WEILAND. So I am not clear on what exactly the language in the rule is, but my understanding was that you are allowed to separate the portfolios based on instrumentation and business purpose. But what we understood to be prohibited was ongoing optimization that would include moving trades back and forth between the books not for a business purpose but for optimization purposes.

Senator LEVIN. You think that the regulators say it is OK to do it once but do not keep on doing it?

Mr. WEILAND. That is my understanding.

Senator LEVIN. OK. We will find out later this afternoon.

What we have seen during this investigation is the evidence that JPMorgan piled on risk, broke risk limits, hid losses, manipulated models, dodged oversight, misinformed the public. That is not what a leading bank should be doing. You folks have testified here that you have taken some steps to clean up that act. I hope that is true. The public deserves it. The economy requires it. We have to have confidence in our banks, and particularly the major banks, which have such an impact should there be a major problem with those banks.

And so I want to end with a thank you to you folks for being here without requiring subpoenas and also for your cooperation with the investigation. You have done that, and we are highly critical of these activities, and appropriately so, but at least the bank has been cooperative with our investigation, and for that we are grateful. You are excused.

We are going to take a 5-minute break. [Recess.]

OK. We will come back to order.

I now want to call our final panel of witnesses: Tom Curry, the Comptroller of the Currency; Scott Waterhouse, OCC's Examiner-in-Charge at JPMorgan Chase; and, finally, Michael Sullivan, a Deputy Comptroller for Risk Analysis at the OCC.

Mr. Curry, you testified before the Subcommittee last summer, I believe, at our HSBC hearing, and I know that you made a special effort to get here today, and we very much appreciate that. We welcome you back here and look forward to your testimony. And, Mr. Waterhouse and Mr. Sullivan, I think this is the first time that you have appeared before our Subcommittee. We welcome you both, and I appreciate your being here today.

As you know, under our rules all witnesses who testify before the Subcommittee are sworn in. At this time I would ask each of you then to please stand and raise your right hand. Do you swear that the testimony you are about to give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. CURRY. I do.

Mr. WATERHOUSE. I do.

Mr. SULLIVAN. I do.

Senator LEVIN. We will use again this afternoon the same timing system. One minute before the red light comes on, you will see the light change from green to yellow, and that gives you an opportunity to conclude your remarks. The written testimony will be printed in the record in its entirety, so if you can, please limit your oral testimony to no more than 10 minutes.

I think, Mr. Curry, you will be presenting testimony, I believe, for the OCC. Will that be the only testimony that we will get?

Mr. CURRY. My colleagues will introduce themselves briefly after I conclude, Senator.

Senator LEVIN. That is fine. Thank you very much.

So let me call on you with, again, our thanks, Mr. Curry.

TESTIMONY OF HON. THOMAS J. CURRY,[1] COMPTROLLER OF THE CURRENCY, U.S. DEPARTMENT OF THE TREASURY

Mr. CURRY. Thank you, Chairman Levin, Ranking Member McCain, and Members of the Subcommittee. We appreciate this opportunity to discuss the OCC's oversight of JPMorgan Chase as it relates to the bank's more than $6 billion loss from credit derivatives trades in the Chief Investment Office. The OCC has supported the Subcommittee's investigation into this incident, and we look forward to continuing to cooperate on this matter.

The risk management culture and processes at the bank that allowed these significant trading losses to occur are completely unacceptable to the OCC. A strong culture of corporate governance and oversight was clearly lacking and, thus, internal controls failed to identify and manage the mounting risks in the CIO. Equally troubling was the failure of the bank to provide timely and complete information to the OCC as events unfolded. This is a serious breach in the conduct that we demand from bank management when dealing with our supervisory staff.

The OCC takes these matters very seriously. In January, we issued a comprehensive cease-and-desist order that directed the bank to correct the unsafe and unsound practices and legal violations related to the CIO's derivatives trading.

As more fully described in our cease-and-desist order, we found deficiencies in a number of core functions, mainly oversight and governance; risk management processes and procedures; controls over trade valuation; development and implementation of models; and internal audit processes. We are closely monitoring the bank's compliance with our order and evaluating what additional actions might be necessary.

Had the bank's risk management and audit processed worked as intended, this activity should have been highlighted to us. Nonetheless, there were red flags that we failed to notice and act upon. However, once we became aware of the potential scope of the problem, we quickly took actions.

First, we directed the bank to provide us with granular information about its trading activities in the Synthetic Credit Portfolio of the CIO so that we could fully assess the risks being taken.

We also launched a full-scale, comprehensive review of the activities and oversight of the CIO and Synthetic Credit Portfolio. The review had two components: The first was a comprehensive review to assess the quality of management and the risk management processes in the CIO function. We looked at the effectiveness of board oversight, including whether the Risk Committee members were appropriately informed and engaged, the types and reasonableness of risk metrics and limits; the model governance review process; the valuation control process; and the quality of work by the independent risk management team, as well as internal audit.

We closely monitored the bank's wind-down of the SCP on a daily basis. In addition, we assessed the adequacy of the information reported within the holding company and the bank. We wanted to know, first, whether they had adequate information to monitor their own risk; and, second, whether the information provided to

[1] The prepared statement of Mr. Curry appears in the Appendix on page 129.

the OCC was sufficient for us to evaluate the risks and risk controls associated with the positions undertaken by the CIO.

The second prong was an internal review to assess the quality of our supervision and lessons we could learn to strengthen our supervision at the bank and across the large bank population that we oversee. Our goal here is to ensure that we focus our resources efficiently and effectively to identify risks, assess banks' governance and risk management, and ensure that weaknesses are addressed promptly.

As a result of this review, we are taking a number of steps to strengthen our supervision of large banks. For instance, we are working to ensure that we receive and act upon timely and complete information, that we regularly review models and reports banks use for regulatory capital purposes, and that we treat as red flags any sudden changes in key risk areas. Our lessons learned are more fully described in my written statement.

The Subcommittee's report contains thoughtful recommendations that will further enhance our supervision of derivatives activities. Although we are carefully studying the details in the recommendation, we fully agree with the principles they embody. Indeed, several of the recommendations reinforce requirements in our cease-and-desist order.

We will continue to investigate this matter and the new information provided in the Subcommittee's report. Be assured that I will not hesitate to take additional actions, if warranted, in response to any new information we learn from the report.

I am joined today by Scott Waterhouse and Michael Sullivan. Scott is the OCC's examiner-in-charge of JPMorgan's national bank, and Michael is a Ph.D. economist with a background in quantitative analysis and risk modeling who led the OCC's internal review.

I would like to now turn to Scott and Michael to introduce themselves to the Subcommittee, and then we will be pleased to answer any questions.

Senator LEVIN. Thank you so much, Mr. Curry. Please proceed, Mr. Waterhouse.

TESTIMONY OF SCOTT WATERHOUSE,[1] EXAMINER-IN-CHARGE, OCC NATIONAL BANK EXAMINERS—JPMORGAN CHASE, OFFICE OF COMPTROLLER OF THE CURRENCY

Mr. WATERHOUSE. Chairman Levin and Ranking Member McCain, my name is Scott Waterhouse, and I am the OCC's examiner-in-charge at JPMorgan Chase's national bank subsidiaries. I have been with the OCC for 30 years.

I started as a career bank examiner out in San Francisco, where I spent my first 7 years examining community, mid-sized, and multinational banks on the west coast and internationally. In 1990, I transferred to London where I spent 7 years examining major activities of U.S. banks and then becoming the EIC for the OCC's lending operation.

I have been a team leader of capital markets and an EIC of a large bank. I assumed the role of EIC OF JPMC in 2008. At JPMC,

[1] The prepared statement of Mr. Waterhouse appears in the Appendix on page 129.

I supervised a staff of 65 examiners who provide oversight of the bank's activities. I and several members of my staff have been pleased to assist the Subcommittee in its investigation, and I am happy to answer any questions you have today.

Senator LEVIN. Thank you so much, Mr. Waterhouse. Mr. Sullivan.

TESTIMONY OF MICHAEL SULLIVAN,[1] DEPUTY COMPTROLLER FOR RISK ANALYSIS, RISK ANALYSIS DEPARTMENT, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. SULLIVAN. Chairman Levin, my name is Michael Sullivan. I am the Deputy Comptroller for Risk Analysis at the OCC.

As Deputy Comptroller, I provide executive oversight for the three Risk Analysis Divisions that provide expertise for the agency on modeling of credit risk, market risk, and enterprise-wide risk.

I also serve as a key adviser and technical expert for the OCC Economics Department and the OCC on practical and policy issues related to the use of quantitative models by banks and the oversight of banks' model risk in supervision.

I joined the OCC in 1999 as a financial economist and was appointed Deputy Director for Market Risk Modeling in 2004. In 2008, I was appointed the Director of the Market Risk Analysis Division.

In May 2012, I was asked by the Comptroller and our Executive Committee to do an internal report on JPMC CIO losses. In particular, the report would include a chronology of events associated with the bank's trading loss in order to identify gaps in bank business and risk management.

As important, if not more important, I was asked to provide an objective review of the OCC's supervisory response to the trading loss in order to identify lessons we can learn from this event. I chronicled my findings and report to the Comptroller last October, and the OCC's executive management team agreed with the findings and recommendations and has formulated plans to address them.

I look forward to answering any questions you might have. Thank you.

Senator LEVIN. Thank you all.

Let me start off by kind of summarizing what happened here because one of the mysteries of this investigation is how it is possible that a huge and high-risk derivative trading portfolio could be operated for years at JPMorgan Chase without the OCC's full knowledge and oversight.

The Synthetic Credit Portfolio started out small in 2006, but in 2011 it increased tenfold, and in early 2012 it tripled again to $157 billion, as shown in Exhibit No. 1a,[2] which is in the exhibit book in front of you, and there is a chart there which I think you are probably familiar with as well.

In 2011 and 2012, CIO traders engaged in massive trades, sometimes involving hundreds of millions of dollars, and by March 2012, it compiled a high-risk mix of over 100 credit derivatives that ref-

[1] The prepared statement of Mr. Sullivan appears in the Appendix on page 129.
[2] See Exhibit No. 1a, which appears in the Appendix on page 511.

erenced both investment and non-investment grade companies, had multiple maturity dates, and included both short and long positions that offset each other in very complex ways. The bank did not tell the OCC all about that portfolio, and we will hear more about that from the OCC itself.

Now, let me start off with you, Mr. Waterhouse. As the OCC's head examiner at JPMorgan, what did you think when you saw or heard about the whale trades on April 6, 2012? Tell us what your reaction was. How much did you know about this whole SCP portfolio?

Mr. WATERHOUSE. Well, at that point of time, I knew very little. We had an understanding that the SCP portfolio had been in place for a number of years, and it had operated as management has intended, I think, over a number of years. And having said that, we spent most of our time—given that, and given that it did not surface to our attention, we spent our time focusing on what we considered to be the higher-risk activities. When the London——

Senator LEVIN. The higher-risk activities where?

Mr. WATERHOUSE. All across the bank.

Senator LEVIN. OK. So you did not consider that to be a high-risk activity.

Mr. WATERHOUSE. I did not.

Senator LEVIN. You had no reason to believe it until April 2012?

Mr. WATERHOUSE. And in April 2012, when the London whale article came out, I was surprised by that, and we set about from there a series of meetings with the bank to try to figure out what it all meant. So my initial response was to go to the bank and try to figure out what was going on.

Senator LEVIN. Prior to that time, had you received regular information about the SCP portfolio?

Mr. WATERHOUSE. No, we did not.

Senator LEVIN. Now, when the OCC asked about the whale trades, you apparently got such reassuring answers from the bank that the OCC considered the matter closed on April 30. Is that correct?

Mr. WATERHOUSE. I would not quite characterize it that way. We did get assurances. Management gave us information about what they felt the trade had been doing or the portfolio—how the portfolio was behaving. We were reassured a bit at the time, to be honest, and yet we asked for followup meetings and had a meeting the week after that where we got more information on that.

So as we went through the month of April, we were following it up, but as we look back, we were not following up as aggressively as we ought to at that time. Clearly, we should have been more aggressive in looking at the portfolio.

Senator LEVIN. In Exhibit No. 66,[1] this is an email, from one OCC examiner to another OCC examiner. If you will look at Exhibit No. 66.

Mr. WATERHOUSE. Yes.

Senator LEVIN. At the bottom of the third page, it says, "The Whale Trade issue is considered closed—email went out to Senior Management yesterday." So is that just one examiner telling an-

[1] See Exhibit No. 66, which appears in the Appendix on page 831.

other examiner something that was just not exactly accurate? Or what does that reference?

Mr. WATERHOUSE. I do think—actually, I focused so much on the first half of that sentence; I do not know about the second half. But on the first half, as I discussed with my team leader, who said that, I think it is a poor choice of words right there. We had—and, in fact, just above that, "Follow-Up Items," refers to Fred's email of 4/17 which included a to-do list while he is out. At that point in time, we brought in some trading experts that we have that work primarily on the investment bank, and they were beginning to delve into the SCP portfolio. Those individuals are very aggressive, and I think Fred's comment here was, "Hey, wait, we just had a meeting with the bank. The bank is going to gather some information and come back to us. Let us wait and see what their response is."

Again, it was not as aggressive as it should have been.

Senator LEVIN. All right. The "Meeting Minutes (4/18)" are the place where those words are located. Do you see that right at the top of that? About one-third up the page it says, "Meeting Minutes (4/18)."

Mr. WATERHOUSE. Yes.

Senator LEVIN. So it is right in the minutes that it made that reference, but you are saying it is just an inaccurate description.

Mr. WATERHOUSE. Down at the bottom, the London whale issue being closed, we did not consider it closed.

Senator LEVIN. OK. Now, what should the bank have told the OCC about the SCP? For instance, when it grew tenfold in 2011 to $51 billion, should the OCC have been informed of that?

Mr. WATERHOUSE. I think we should have been informed, yes, sir.

Senator LEVIN. And what about in the first quarter of 2012 when the portfolio tripled in 3 months to $157 billion? Should the OCC have been informed about that?

Mr. WATERHOUSE. Absolutely.

Senator LEVIN. Is it not true that when a derivatives portfolio gets to be that big that there is a special danger because even a small drop in price can result in massive losses?

Mr. WATERHOUSE. Yes, particularly when it is as complex as this one was.

Senator LEVIN. This was described, this portfolio, as being a "perilous size," I think by Mr. Cavanagh, actually, in one of his emails or at one point. Is that an accurate description, when it gets to be this size it has got some real dangers?

Mr. WATERHOUSE. I think that is one of many adjectives that would fit.

Senator LEVIN. And if a portfolio consists of synthetic derivatives—maybe I will ask this of you, Mr. Curry—does it pose special risk because there is no tangible asset or revenue stream to stop losses and derivative prices are often subject to split second trading and price changes?

Mr. CURRY. Yes, Senator.

Senator LEVIN. Now, the bank has represented to the SEC that the portfolio served as a key tool for offsetting credit risks in their $350 billion portfolio and maybe for the rest of the bank as well.

Should the bank have told you about the hedging strategy along the way? Maybe I will ask you again, Mr. Waterhouse.

Mr. WATERHOUSE. I think there were all aspects of the portfolio that we should have been informed about.

Senator LEVIN. All right. What is the regulatory standard—maybe I will ask you again, either you, Mr. Curry, or anyone who you wish to designate. What is the regulatory standard for when a bank is required to alert the OCC to new derivatives information?

Mr. CURRY. Senator, generally speaking, we do not view the disclosure requirements of institutions to be very narrow. We view them as being broad. A bank should flag or highlight to us any significant change in their business activities, particularly those that could pose additional risk. We do not base it on specific regulatory or other requirements. We need to have full knowledge of the bank's activities.

Mr. WATERHOUSE. Senator, if I may just jump in there?

Senator LEVIN. Sure, please.

Mr. WATERHOUSE. My expectation of the bank is if they are going to enter any new business, any new activity, we ought to be informed, and they ought to have some type of risk management control system designed ahead of time before they implement it and have thought through the management reporting and the limit structure and the whole governance process. And whether that is codified or not, it is certainly my expectation for safe and sound operation.

Senator LEVIN. We had a $157 billion high-risk derivatives portfolio here that OCC hardly knew existed, and that strikes me as being a hidden financial risk. Is that the way the OCC views it?

Mr. WATERHOUSE. I would view it that way, yes, sir.

Senator LEVIN. Now, is this something that OCC has to or is expected to have to ferret out? Or is this something that the banks are supposed to disclose? You sort of answered that before, but where does the responsibility lie here?

Mr. WATERHOUSE. The responsibility would lie first and foremost with management, to have the proper risk systems and controls, proper reporting. And then for us as the primary regulator of the national bank, we ought to be informed, receive the regular reports, and understand the risks as they transpire.

Senator LEVIN. During our investigation we came across a number of incidents where it appeared that JPMorgan Chase was not being straight with the OCC, and here are a couple:

On January 30, 2012, the CIO met with the OCC at a standard quarterly meeting that the OCC requires to discuss upcoming plans. The CIO's chief financial officer, John Wilmot, attended that meeting with the OCC. So take a look, if you would, at Exhibit No. 58.[1]

Exhibit No. 58 is an OCC summary of this meeting of January 30, 2012. In interviews, both the OCC examiner, Jaymin Berg, who attended the meeting and who wrote this summary, and Mr. Wilmot, who is, again, the CIO's Chief Financial Officer, confirmed to this Subcommittee that the notes were an accurate summary.

[1] See Exhibit No. 58, which appears in the Appendix on page 807.

About two-thirds down the page, the OCC States that they were told the following by Mr. Wilmot—and you can see this. It is near the bottom. "The MTM Book"—mark-to-market book—"is decreasing in size in 2012."

Now, this is a January 31 summary of a meeting, again, between OCC and the bank. Did the SCP decrease in size in 2012? That is question one.

Mr. WATERHOUSE. Absolutely not. It mushroomed or ballooned.

Senator LEVIN. Now, on April 16, 2012, the bank met with the OCC and provided its first written presentation on the Synthetic Credit Portfolio since the media turned the spotlight on the whale trades. At that April 16, 2012, meeting, the bank gave the OCC a presentation which stated that the SCP's first quarter losses were $580 million. Internally, the CIO had reported that at the end of the first quarter SCP losses were $719 million. And that is laid out in a chart which is Exhibit No. 1g,[1] but I think you can just assume that I am stating that accurately—for the moment, at least.

By April 16, the day of the meeting, the losses had already climbed to $1.25 billion, and, again, that is on Exhibit No. 1g, and this data came to us from the bank. We put together the chart.

So the bank gave the OCC a number on April 16, $580 million, that was 20 percent less than it had reported internally for the quarter end, which was $719 million, and it was half of what was on the bank's books for the day of the meeting, or the day before the meeting, $1.2 billion.

So was that an understatement of SCP losses to the OCC?

Mr. WATERHOUSE. Absolutely.

Senator LEVIN. Is that acceptable? And what do you do when you find out about that?

Mr. WATERHOUSE. Well, in the first instance, it is not acceptable, and in the second instance, as we find out about this and, honestly, as we go through your report, there is a lot of interesting information that we have to digest still. So I think we are still in the process of determining.

Mr. CURRY. Senator, it is wholly unacceptable for an institution, its officers, or employees to provide false or misleading information to the OCC and its examiners.

Senator LEVIN. A couple weeks later, on May 4, the bank was working to finalize its first quarter financials, which it had to report publicly on its SEC filings. On that day, Mr. Waterhouse, you received a call from two senior bank executives, the Chief Financial Officer, Mr. Braunstein, and the Chief Risk Officer, Mr. Hogan. You summarized that call in Exhibit No. 68.[2] If you turn to Exhibit No. 68, you summarized that call you had with Mr. Braunstein and Mr. Hogan.

Halfway down the page, this is what you wrote. You wrote that the bank said that the Synthetic Credit Portfolio had lost approximately $1.6 billion. But internally, the bank reported as of the end of the previous day, the SCP loss was about $91 million for the day and had cumulative losses of $2.2 billion.

So did the bank give the OCC inaccurate information on May 4?

[1] See Exhibit No. 1g, which appears in the Appendix on page 517.
[2] See Exhibit No. 68, which appears in the Appendix on page 838.

Mr. WATERHOUSE. In respect to the $1.6 billion, I thought that was a cumulative number at the time. But, I heard the testimony earlier today that——

Senator LEVIN. That is OK. No, that is good. If you heard that testimony—I was going to ask you about that.

Mr. WATERHOUSE. Because whether——

Senator LEVIN. They said it was intended to be the second quarter loss up to that point and did not include the first quarter losses. Did you hear that?

Mr. WATERHOUSE. I did hear that, yes, sir.

Senator LEVIN. And does that resonate?

Mr. WATERHOUSE. I do not know. I thought that this was the all-in number, but it could have been that way.

Senator LEVIN. All right. Now, you also wrote in the email that the bank said, quote, that if you—referring to the OCC—"have been watching the position reports and the P&Ls," do you know what position reports and P&Ls you could have been watching?

Mr. WATERHOUSE. We were not getting daily P&L reports on the SCP portfolio at that point in time. We started getting them mid-May through today.

Senator LEVIN. After the whole thing blew up.

Mr. WATERHOUSE. After it all blew up. But we were not getting SCP daily reports at that time.

Senator LEVIN. All right. So when Ms. Drew said you were, or she thought you were, she was wrong. You were not.

Mr. WATERHOUSE. We were not getting specific detailed SCP reports.

Senator LEVIN. All right. And you were not getting the position reports or the P&L data for the synthetic credit book. Is that right?

Mr. WATERHOUSE. That would be correct. To the best of my knowledge.

Senator LEVIN. All right. Now, on January 31, they said that the SCP is decreasing when it is increasing. They then kind of take a little jab at you by saying you guys would have—if you would have been following our position reports and our P&Ls, then you would have been able to know what was going on, when you were not even getting the position reports and the P&Ls. So far are you with me?

Mr. WATERHOUSE. Yes. To the best of my knowledge, yes.

Senator LEVIN. OK. Now, that kind of tone I am afraid went to the top. There were a number of occasions when that kind of a tone about the OCC coming too much into the bank's business and so forth is, I am afraid, carried on with another conversation. Here is what happened, as far as we can tell, in late 2011 or maybe early 2012. The bank stopped sending the investment bank's daily profit and loss data to the OCC. Does anyone remember that, when that happened?

Mr. WATERHOUSE. Yes, that would be me, and, in fact, it was in 2011 that actually occurred.

Senator LEVIN. Do you know the month?

Mr. WATERHOUSE. August.

Senator LEVIN. OK. So in August 2011, the bank just stopped sending its investment bank's daily profit and loss data to the OCC. Was there an explanation given to you?

Mr. WATERHOUSE. There was—after we inquired, day two—we found it day one, thought it was a systems error. Day two, when it did not come again, we inquired with the regulatory liaison, and then ultimately it went up to Mr. Braunstein, and later on I had a conversation with Mr. Braunstein and Mr. Dimon. I am sorry. The second part of your question, yes, I was given an explanation at the time that said that there had been some leaks of information and lost data, and I would say none of which were attributed to the OCC, but that the bank was concerned about who was getting what and that it was rethinking its distribution of certain reports.

Senator LEVIN. They were not accusing you then of leaking.

Mr. WATERHOUSE. They did not accuse me.

Senator LEVIN. No, I do not mean you. They did not accuse the OCC of leaking?

Mr. WATERHOUSE. I do not think so. But I think at that point in time, they were unsure where they were coming from. It could have been internal bank, could have been a regulator, could have been anywhere.

Senator LEVIN. All right. And then, as you just pointed out, you escalated the issue to the senior bank executives urging a reversal of the decision. Is that correct?

Mr. WATERHOUSE. I did.

Senator LEVIN. And did Mr. Braunstein agree to restore that report?

Mr. WATERHOUSE. Yes he did.

Senator LEVIN. Did he mention he was going to do that in front of Mr. Dimon? Is it true—or how did Mr. Dimon react?

Mr. WATERHOUSE. Well, we had the discussion of why the information was turned off, which parallels what I just mentioned here. And when Mr. Dimon was saying why we were not going to get it, Mr. Braunstein basically said, "Well, I actually already started giving it to them again." To which Mr. Dimon expressed his dismay and, said that it was his decision to be able to make that.

Senator LEVIN. As to whether to return to——

Mr. WATERHOUSE. Whether to turn the reports back on to the OCC.

Senator LEVIN. So apparently he had decided to stop the reports and——

Mr. WATERHOUSE. It sounded—I took it that way, yes, sir.

Senator LEVIN. And so he would be the one to restore the flow.

Mr. WATERHOUSE. Yes, sir.

Senator LEVIN. And did he raise his voice?

Mr. WATERHOUSE. He did.

Senator LEVIN. Did he say the OCC did not need the information? Or what did he say?

Mr. WATERHOUSE. Not in that part of the conversation. Earlier in the conversation, he was pressing me as to, "Why would you need this information? What good is it? What do you use it for?" And he said, "I do not think you need this amount of detail. You can still do your supervision without it."

Senator LEVIN. OK. So that was earlier in the conversation.

Mr. WATERHOUSE. That was earlier in the conversation.

Senator LEVIN. And then later in the conversation, when Mr. Braunstein said that he had agreed to restore this report, that is when Mr. Dimon reacted angrily and said that it is his decision, not Mr. Braunstein's decision, to do that.

Mr. WATERHOUSE. That is correct. To the best of my recollection, that is——

Senator LEVIN. All right. That is correct to the best of your——

Mr. WATERHOUSE. That is correct.

Senator LEVIN. OK. Now, there is another incident, which was referred to, in May 2012 in an email, Exhibit No. 71,[1] where, Mr. Waterhouse, you recounted something that had happened 2 years before, so it obviously had an impression on you. It was in 2010, the OCC was doing a direct examination of the CIO's investment portfolios and said that the CIO should do a better job documenting the investment decisions. In this Exhibit No. 71, you were saying the following: ". . . we did an examination of the CIO at the end of 2010 and have a followup planned soon. We had some concerns about overall governance and transparency of the activities." Now, that was back in 2010. Is that correct? Is that right?

Mr. WATERHOUSE. That is correct.

Senator LEVIN. And you were referring to the CIO investment portfolios, which I gather unbeknownst to you included the SCP. Is that correct?

Mr. WATERHOUSE. Correct.

Senator LEVIN. So you went on to write, "We received a lot of pushback from the bank, Ina Drew in particular, regarding our comments. In fact, Ina called [OCC Examiner Fred] Crumlish . . . in London and 'sternly' discussed our conclusions with him for 45 minutes. Basically she said that investment decisions are made with the full understanding of executive management including Jamie Dimon. She said that everyone knows what is going on and there is little need for more limits, controls, or reports."

So, now, you wrote that 2 years after the event. Is that right?

Mr. WATERHOUSE. That is correct.

Senator LEVIN. How did it happen that the incident stayed with you?

Mr. WATERHOUSE. Actually, to be clear on this, that is written—that is actually Mr. Crumlish's comments that I have paraphrased. He and I recounted that as this thing was unfolding. So I guess it was ingrained on Mr. Crumlish's mind, and he brought it back up to me.

Senator LEVIN. He shared it with you and you remembered it?

Mr. WATERHOUSE. Yes.

Senator LEVIN. Now, the OCC issued what is called "a Matter Requiring Attention" after the 2010 exam, about documenting the investment decisions and positions. But it did not followup for 2 years.

So, Mr. Waterhouse, if the OCC had required the CIO to document its investment decisions, is it possible that OCC would have learned of SCP earlier?

Mr. WATERHOUSE. Yes, it is possible.

Senator LEVIN. Now, Mr. Curry, let me ask you, is it up to the bank and should it be up to the bank to decide what is appropriate to give a regulator and what information can be withheld?

[1] See Exhibit No. 71, which appears in the Appendix on page 843.

Mr. CURRY. Absolutely not. It is not the role of the bank to determine what information or records we have access to. As Commissioner of Banks in Massachusetts, I had on the wall the charter for the Bank of Massachusetts, 1784, signed by John Hancock, and the very last provision of it says that, "Examiners appointed by the Commonwealth shall have full and free access to all the books and records of an institution." That is the fundamental cornerstone of our system of bank supervision in this country for over 200 years, and that is an unacceptable premise that the bank decides what information is provided to the OCC and to our examiners.

Senator LEVIN. So when Mr. Dimon is giving a hard time to his own staff and to you, Mr. Waterhouse, saying you, "Do not need this, why do you need this?" that is not up to him to decide. If you ask for that—even if you do not ask for that, if it has an effect on the bank's books and the bank's solidity, then you have a right to it and should get it even without asking. Is that correct?

Mr. WATERHOUSE. That is correct.

Senator LEVIN. Now, Mr. Curry, when a senior executive at a bank is engaging in kind of stopping the transmission of key data, is that a message to the rest of the bank which is not very helpful, to put it mildly?

Mr. CURRY. I think the institution's attitude or relationship with our examiners starts from the top. We want and expect, particularly from large institutions, an openness of communication between the supervisors and the institution.

Senator LEVIN. Now, the bank stopped including key CIO data in the bank's Executive Management Report. It failed to tell the OCC that the CIO had started issuing its own Executive Management Report in January 2012. It did not send copies of the new reports for months. That is Exhibit No. 64.[1] And the bank also failed to send regular reports providing verified price data for the CIO's synthetic credit derivatives for February and March. That just suddenly stopped. That is Exhibit No. 61.[2]

And, by the way, these are the same months that the SCP tripled in size and the value manipulation intensified.

I will ask you, Mr. Waterhouse. Why didn't the OCC examiners that oversaw the CIO—why didn't you ask the bank for missing reports until mid-April, after the media storm hit on the whale trades?

Mr. WATERHOUSE. Senator, this is something we should have been all over from day one, and we did not followup promptly, and I am not exactly sure what happened in these instances. I would say, though, that given our understanding of the nature of the risk in the SCP and in the CIO in general, we were looking in different areas, examining different parts of the bank that we perceived to have higher risk. So this was an area, this was one of those red flags that you point out in your report and that we point out in our report that we should have seen and we should have done better at.

[1] See Exhibit No. 64, which appears in the Appendix on page 828.
[2] See Exhibit No. 61, which appears in the Appendix on page 822.

Senator LEVIN. OK. Now, Mr. Sullivan, I think you have looked into the question of how the OCC missed these flags. I believe that was part of your investigation?

Mr. SULLIVAN. That is correct.

Senator LEVIN. Can you tell us what you found?

Mr. SULLIVAN. I guess what I found was that SCP was obscure but not hidden—obscure to the extent that, as I went through looking, at the historical reports the OCC had received, then there were little pieces that might be of it, but no definitive reporting.

I did note gaps, because I was looking through the history of OCC reports received, so I ran into gaps several times in terms of what was in the OCC's collected files. So that was one of them. I was looking through the EMR through—month by month, but then suddenly it, just dropped off in January. So I noted that among several other——

Senator LEVIN. And those should have been picked up by the OCC?

Mr. SULLIVAN. Yes, it was the standard practice, and in contrast, like in the investment bank, all the reports were there. So, yes, it was the expectation that these reports would be followed, and if they are not, I mean, people are supposed to followup on that.

Senator LEVIN. So that was just a failure at the OCC.

Mr. SULLIVAN. That was a mistake by the OCC.

Senator LEVIN. Now, the bank is also obligated to send to the OCC regular reports about risk limit breaches, keep the agency informed about risk problems. The bank apparently did send those reports, and they reported hundreds of SCP risk limit breaches in the first 4 months of 2012.

This Exhibit No. 39[1] is the list that was prepared by the bank in May 2012 after the media storm of all the CIO risk limit breaches from September 2011 through April 30, 2012. Those risk limit breaches jumped from 6 in the last quarter of 2011 to 170 in the first quarter of 2012, and then in April, 160 breaches in that 1 month alone.

So I take it, Mr. Waterhouse, you would agree that this is a pretty big jump, a huge jump in risk limit breaches and a worrisome pattern.

Mr. WATERHOUSE. Absolutely.

Senator LEVIN. But were they caught at the OCC?

Mr. WATERHOUSE. We were actually more focused on the investment bank at that time where we thought there was more risk to the bank and to the system. So we did not pursue those as we should have.

Senator LEVIN. OK. Now, Mr. Sullivan, what did you find in your investigation?

Mr. SULLIVAN. Certainly in terms of those 2012 exceptions, but one thing as part of our report, the first thing we tried to do is provide a detailed chronology of SCP, so we went back farther in history, back to 2006 in some cases, and I think another oversight, a mistake by the OCC, was in the early part of 2011. That was a time when the SCP portfolio was creating large and sustained limit excesses. So that was a year before the 2012 events.

[1] See Exhibit No. 39, which appears in the Appendix on page 748.

And so it was—indications are that it was brought up in a meeting that the OCC and other regulators had with the bank. The bank said it is hard to keep track of excesses, we are working on automating the system. But certainly I think even at the time then, people would agree we should have followed up on those because that was a chance to get a view into the portfolio, and I think it could have made a difference.

Senator LEVIN. On the EMRs, there were no reports for 4 months, no complaint from the OCC. Risk breach reports, no one acted. I am just wondering. Is this because there is not enough people at the OCC to read these reports? How does it happen?

Mr. WATERHOUSE. I think our capital markets team, which is the team that is responsible for this—we have 10 folks on the team, and I think that is a comfortable level for us. We are actually going to go up by one. There are a number of examinations that we were doing during the first quarter of 2001. There were a number of other activities that we were doing. But there is no excuse for not having somebody look at those, and I think we were focused on what we considered to be higher-risk activities, and that took our attention away from that. I think we have reinforced back-ups and line-ups of responsibility, and I think that would have helped even something as simple as that.

Senator LEVIN. OK. Now the media blitz hits, on April 19, 2012, after, again, the media broke the story of the whale trades, an OCC examiner finally contacts the bank about the SCP's many risk breaches, including CS01, if we take a look at Exhibit No. 1d.[1] In an email dated April 19, which is Exhibit No. 65[2]—this is an email from OCC Examiner James Hohl—an OCC examiner asked the CIO why it has been in excession by 1,074 percent and had been in excession for 71 days. That is the email, Exhibit No. 65.

In response, Pete Weiland, senior CIO risk officer who testified earlier today, wrote the following: "We are working on a new set of limits for synthetic credit and the current CS01 will be replaced by something more sensible and granular."

Now, this is a 1,000-percent breach for 71 days. Is that an adequate answer, to say that "we are working on a new set of limits?"

Mr. WATERHOUSE. No, sir.

Senator LEVIN. If the risk limit—and particularly here, by the way, the limit had been in place for 3 years, and they did not replace it for 3 years. Shouldn't that have been caught by the OCC? Shouldn't you have noticed that they did not review these limits for 3 years?

Mr. WATERHOUSE. Yes, our expectation is that they ought to be reviewing limits on an ongoing basis. It does not necessarily have to be annually.

Senator LEVIN. But it is supposed to be at least once a year, isn't it?

Mr. WATERHOUSE. According to the bank policy. But our expectation is they are reviewed and updated as and when needed.

Senator LEVIN. So that you do not have a requirement of 1 year?

[1] See Exhibit No. 1d, which appears in the Appendix on page 514.
[2] See Exhibit No. 65, which appears in the Appendix on page 829.

Mr. WATERHOUSE. No, not that I know of, but our requirement would be they have to be appropriate throughout, any time.

Senator LEVIN. I know that, but they do not have to be automatically reviewed every year under your policy, but it was under the bank policy that they would do so.

Mr. WATERHOUSE. Not to my knowledge.

Senator LEVIN. Not to your knowledge about OCC.

Mr. WATERHOUSE. About OCC, correct.

Senator LEVIN. OK. So you then were assuming that it was going to be updated as needed. Is that correct?

Mr. WATERHOUSE. Yes, our expectation was that the limit process and approvals and escalation activities were happening as they were designed to do.

Senator LEVIN. OK. Now, Mr. Sullivan, is this something you looked into as well?

Mr. SULLIVAN. Sorry. Could you refresh my——

Senator LEVIN. Yes, the question of the risk limits not being reviewed, is that something that you looked at? Do you agree with Mr. Waterhouse that this is something where the OCC properly could just rely on the bank to keep updated and that did not have to check the box that it would be reviewed every year or so, the limits?

Mr. SULLIVAN. Yes, I would agree with Scott that our expectation is that risk limits are adjusted as necessary. I think it is helpful that many banks do have an annual cycle, just to make sure that happens. But they should be adequate at all times.

Senator LEVIN. Now, the second risk limit on this chart is known as the value at risk which estimates how much money can be lost over the course of a day in ordinary market conditions. A mathematical model is used to evaluate how much value an investment portfolio is putting at risk, and if that amount exceeds the VaR, or the VaR limit established for the portfolio, a notice goes out to risk managers who are supposed to act.

In this case, the Synthetic Credit Portfolio breached both the CIO and bank-wide VaR limits for several days starting on January 16, breached them again for 4 days starting January 24, and the breach ended when the CIO rushed through approval of a new VaR model.

When the new CIO 10–Q VaR model was activated on January 27, it resulted in an overnight 50-percent drop in the CIO's VaR results, and we have a chart up here Exhibit 1e[1] showing that drop.

Under the old model, the VaR was $132 million. Again, that is how much money was at risk of loss in a 1-day period. Under the new model, even though the portfolio had the same risky synthetic credit derivatives, its VaR dropped to $66 million, not coincidentally way under the VaR limit.

So, in fact, it was so far under that the traders in London were immediately able to increase their risky activities without breaching the limit.

[1] See Exhibit No. 1e, which appears in the Appendix on page 515.

In January, the bank notified the OCC that it was planning to change the CIO's VaR model, and the new model would immediately lower the CIO's VaR by 44 percent.

Mr. Waterhouse, did any OCC examiner take note in January of the planned change in the VaR model?

Mr. WATERHOUSE. We understood that the bank was implementing a new VaR model with the intention to bring the VaR into compliance with the percentage Basel 2.5 regulations. So we know that it was coming in.

Senator LEVIN. OK. Now, shouldn't the model—and I will ask maybe Mr. Sullivan this question—that produces a 44-percent drop in VaR overnight raise a red flag, cause the OCC to investigate how that is possible?

Mr. SULLIVAN. Yes, and so it is certainly, a gap on the part of the OCC and, I agree that it is not just the drop, but it is also the fact that it comes at a time when you are breaching limits.

I would say that we have and sometimes do evaluate VaR model changes even within CIO. For example, the mortgage servicing rights VaR model, it was changed, had a big change, and the OCC put people on it, both an examiner and then a financial economist from the OCC. So it is frustrating to see the gap here. That was a good chance for the OCC to get some view of the portfolio.

Senator LEVIN. OK. Now, when you mentioned Basel, that was supposed to require tougher risk controls, was it not?

Mr. SULLIVAN. Basel 2.5, which was not yet finalized, has additional components for risk-weighted assets for market risk and also heightened expectations for model validation or, more generally, model risk management. It also has specific direction in terms of what positions are trading positions and so should properly go through that model.

Senator LEVIN. But its general direction, its general theme is to lead to tougher risk controls, is it not?

Mr. SULLIVAN. Yes. Higher capital and more stringent and direct direction to the banks in terms of their risk management, including model risk management.

Senator LEVIN. All right. But here we have a case where the VaR was dropped by half. I mean, that is not only a red flag; that is a pretty bright red flag, is it not?

Mr. SULLIVAN. I would say so, so it is something you would want to followup on.

Senator LEVIN. Well, it would seem to me, given Basel, or Basel 2.5, it would be even stranger to see a 44-percent VaR drop, and if it were not for the coming of Basel II.

Mr. SULLIVAN. Basel 2.5 was not yet in effect.

Senator LEVIN. Right.

Mr. SULLIVAN. The bank was kind of getting ready for it. We had planned—and actually later executed—a review of all models associated with Basel 2.5. We did that in the summertime. That had been planned already. I think you would need to investigate the source. And so sometimes when you see these large changes, that can be changes in input data, changes in the model calculations, etc. So, definitely we need to take a look, and I think that practices have changed at JPMC, and I think we hope that this will go across the system. So that now all significant, material VaR model changes are reported by the bank to the OCC in regular meetings, and that gives us the opportunity to pay attention to them.

Senator LEVIN. Well, that is looking forward, but, again, analyzing what happened here, I will go back to you, Mr. Waterhouse. The 44-percent drop in the VaR cannot be explained by the fact that they were getting ready for Basel 2.5. That does not explain a drop in the VaR. If anything, you would expect no drop in the VaR at all as a general matter. Why would that take you off the hunt?

Mr. WATERHOUSE. Well, in this instance, the drop in VaR, we saw it, but as Michael said, the intent was we were going to be looking at all the VaR models at a regularly scheduled review that we had planned for later on in the summer. So we did not act immediately.

And the other thing, as to your earlier point, the bank did not calibrate its VaR limit alongside the drop in that, so that clearly does not go along with our expectation.

Senator LEVIN. OK. Now, we also learned that the VaR model was developed by CIO's Pat Hagan to lower the VaR.

Mr. SULLIVAN. If I may, Chairman Levin, one reason they had to change the model is because it was missing a key source of risk: correlation risk. And the VaR model that was in operation in the IB captured that risk because the OCC directed the bank to do that. We did not realize that the bank would not also apply it to CIO.

So the change was for Basel 2.5 purposes, but it would not explain, the big drop.

Senator LEVIN. And did you know that this was developed by Mr. Hagan at the CIO in order to lower the VaR? Were you aware of that?

Mr. SULLIVAN. I knew it was developed by him——

Senator LEVIN. No, with the purpose of lowering the VaR.

Mr. SULLIVAN. For the purpose of lowering it, no, I have not seen that as the stated purpose of it.

Senator LEVIN. If you had known that, or if you had known that, Mr. Waterhouse, would that have affected you?

Mr. WATERHOUSE. Well, I think, at this point we agree that we should have looked at the VaR model and what—we are implementing changes to make sure that we look at any models that do result in a change in the VaR or the risk-weighted assets by a certain degree. We will be more forthright on that. But this is definitely something that we ought to have looked at.

Senator LEVIN. Now, when the bank reviewed the new model for approval, at that time it said that implementation issues, certain issues, had to be worked out before the model was activated, and that included a couple things: Developing a database which would automatically input trading data into the model. The bank did not fix those problems before the model was activated, and the consequences we have seen or talked about, was that they had manual data entry into spreadsheets every trading day, input errors, formula and calculation errors, and erroneous VaR results.

So we have a situation where they used a flawed VaR model for a $350 billion portfolio, forced the CIO's quantitative expert to do manual data entry into the wee hours of the night, used spreadsheets because the bank could not be bothered to fund development of an automated database.

Did the OCC know any about that, what I have just described? Mr. Waterhouse, were you aware of any of that, what I just described, that they were told by the risk folks, OK, you can change your VaR, but you got to have automated data, and that, in fact, they did go to automated data? Were you aware of that?

Mr. WATERHOUSE. No, that there were conditions for the approval of the VaR model, no, I did not, which is all the more disappointing there because we have been working with the bank for a number of years on upgrading its model governance processes, and we had been working on it. But this was clearly a failure on that, which is why we wound up putting this in our Consent Order.

Senator LEVIN. Now, the new VaR model was activated on January 27, 2012. It produced VaR totals for the CIO that were substantially lower than would have been produced by the prior model, and I think you may have heard earlier today, as Exhibit No. 1e[1] shows, there is a chart that shows the difference in the VaR totals produced by the two models.

Mr. Waterhouse, did any OCC examiner know about that difference in the model results at that time?

Mr. WATERHOUSE. No, not at that time. I do not think.

Senator LEVIN. As far as you know.

Mr. WATERHOUSE. As far as I know, yes.

Senator LEVIN. Did the OCC test the accuracy of the new model?

Mr. WATERHOUSE. No, we did not test the accuracy at that time.

Senator LEVIN. Now, in May 2012, after the media disclosure of the whale trades, the bank determined the new VaR model was not portraying the SCP's risk accurately. They discarded it, and they reinstated the old model, which immediately produced higher VaR results for the CIO.

The story does not end there, though. Four months later, in September 2012, the bank switched VaR models a third time. The new model, once it was put in place, again substantially lowered the CIO's VaR results, this time not by 40 or 50 percent, but by about 20 percent.

So, Mr. Sullivan, maybe you can explain this to us. How is the same trading activity suddenly determined to be 20 percent less risky than the day before?

Mr. SULLIVAN. In that particular circumstance, there was a change in the way in which they represented risk, and so what they had moved to in that summer period was to represent the risk at the index level as opposed to breaking it down into single-name exposures. They felt that the data at the index level was a better quality than they had at the single-name level.

We took a look at that model and noted that it would lead to a difference in the treatment of the same instruments within the IB where SCP was located at that time. So we decided not to allow them to use that for the purposes of regulatory capital.

Senator LEVIN. If you would, turn please to Exhibit No. 46,[2] and, Mr. Sullivan, this is an email dated 12/22/11. It was sent to Ina

[1] See Exhibit No. 1e, which appears in the Appendix on page 515.
[2] See Exhibit No. 46, which appears in the Appendix on page 778.

Drew by the head of the CIO's equity and credit trading operation, Mr. Martin-Artajo.

In this email, Mr. Martin-Artajo suggests reducing the Synthetic Credit Portfolio's risk-weighted assets, by $13 billion using different tactics. One was achieving a $2 billion book reduction through a trading reduction, which is selling off assets. But he also suggests something else: A $7 billion reduction, half of the $13 billion goal, through so-called model reductions. And my question is whether or not under bank capital rules, bank models such as what we have talked about before, CRM and VaR and stress VaR, are used to calculate the RWA. And the OCC has a role in making sure that RWA calculations are accurate because they in turn determine how much of a capital buffer banks have to maintain.

Now, without getting into the OCC's evaluation of JPMorgan's models, without doing that, what is your reaction when you see a bank trying to reduce its RWA, not by selling off risky assets but by designing models to produce lower numbers?

Mr. SULLIVAN. Anytime we see—well, banks would propose changes in models for us, and so we would evaluate the quality of the model, try to get a sense of how it relates to the risks and the business, etc. So we would have to look at the specifics of the situation.

Senator LEVIN. Well, in general, let me ask you, Mr. Curry, what is your reaction to that activity, reducing the RWA not by selling risky assets but by designing models in order to produce lower numbers?

Mr. CURRY. I think we would have some—or I would have some hesitation if it was—the purpose was to subvert the risk-weighting process.

Senator LEVIN. Well, if its purpose is to do exactly what I said, would that trouble you?

Mr. CURRY. Initially, yes.

Senator LEVIN. And then you mean that you would see where the review led to, but your first reaction would be this is a troublesome idea and we better look into it? Is that fair?

Mr. CURRY. Yes.

Senator LEVIN. OK. Now, the portfolio traded derivatives every day. It was a mark-to-market portfolio so that its value had to be measured every day. The CIO had to report internally within the bank a profit or loss figure for the Synthetic Credit Portfolio reflecting the actual value of the book on that day compared to the day before.

The bank now acknowledges that the books basically were cooked, that inflated values were assigned to the derivatives in the synthetic credit book to minimize its losses. But the bank did not catch or admit that wrongdoing for months despite many flags.

Now, one of the flags was an increase in the so-called collateral disputes, counterparties saying the values were too high. At one point these collateral disputes hit $5690 million.

The collateral disputes began in March 2012, and picked up steam in April. Mr. Waterhouse, did the CIO ever have such large disputes before?

Mr. WATERHOUSE. Not that I am aware of.

Senator LEVIN. And OCC examiners had, in fact, noticed the collateral disputes in May, Exhibit No. 73,[1] went to the bank executives and asked about them. Exhibit No. 78[2] is an email dated June 29, 2012, from an OCC examiner, Michael Kirk, describing an earlier call. Here is what he said, and this is Exhibit No. 78:

"On that first daily call, Mr. Hogan"—that is the bank chief risk officer—"discussed that earlier there had been a large collateral dispute with their counterparties. I questioned him on how it was resolved and he said JPM eventually agreed to the counterparties' marks and then paid out the near $400 million amount. I then followed with a question relating to what I described as mismarked books to which Hogan forcefully stated JPM books were not mismarked; leaving both Elwyn and me left puzzled over how a collateral dispute could be resolved by agreeing to the counterparties' marks, without admitting your own marks were incorrect."

So as Mr. Kirk's email explains, either the bank's marks were right or the counterparties' marks were right, and when the bank decided to accept the counterparties' marks, it was clear the CIO marks were wrong. But the bank did not acknowledge that its marks were wrong until July.

So, Mr. Sullivan, is it appropriate or a bank to hide its head in the sand after it pays its counterparties such a huge amount of money on these collateral disputes and insist against contrary evidence that it did not have a mismarking problem?

Mr. SULLIVAN. Senator, I did not really follow the collateral dispute, but, having looked at some of the evidence here, then I would share the examiner's skepticism.

Senator LEVIN. OK. The bank was concerned enough about the marks that its head accountant, the bank's Controller, conducted a special review of the SCP book from January through April 2012. The Controller released a report on May 10, finding that the SCP marks were "consistent with industry practice," and that is Exhibit No. 36,[3] and we had quite a conversation about that earlier today. So this is a report—we call it the May 10 report—where the bank says that what it did was consistent with industry practice.

Now, the facts that were described in that report to me paint a very disturbing picture of a derivatives valuation process that was highly open to manipulation, resulted in some mighty hard to justify numbers that, in fact, were discredited the very next month when the bank acknowledged the mismarking.

For instance, that May 10 report documented that SCP pricing practices changed dramatically over the course of the first quarter. In January 2012, prices were marked near the midpoint of the daily price range, which is how derivatives are usually valued.

In January, only 2 of the 18 prices noticeably deviated from the midpoint. In February, 5 out of 18 prices noticeably deviated from the midpoint prices. And in March, 16 out of the 18 prices were not even near the midpoint. They were at the extreme edge of the daily price range.

The Controller collected and presented that data in the appendices of the report, but she made no mention of what had hap-

[1] See Exhibit No. 73, which appears in the Appendix on page 845.
[2] See Exhibit No. 78, which appears in the Appendix on page 853.
[3] See Exhibit No. 36, which appears in the Appendix on page 687.

pened. She simply concluded that, "The CIO valuation process is documented and consistently followed period to period."

Now, is it not relevant that in a period where there are growing problems and growing losses that suddenly there is a huge change in the way the prices are marked from being generally at the midpoint, as was true with the investment bank, and moved all the way over to the extremes in order to reduce the apparent loss on the books? Is that not a troubling set of facts? Mr. Curry.

Mr. CURRY. Yes, it is, Senator.

Senator LEVIN. Now, there an industry practice on this question? I mean, shouldn't you stick to your process and, if you are going to change it, have some rationalization for changing it? Mr. Waterhouse?

Mr. WATERHOUSE. I would say our expectation is that your revaluation process has to be consistently applied day after day after day, and it should not be adjusted without going through a rigorous process to justify any changes.

Senator LEVIN. Is it not obvious what was happening here, that these prices were being changed in order to reduce the loss on the books?

Mr. WATERHOUSE. It appears so, yes, sir.

Senator LEVIN. Their report noted that the SCP book had reported internally within the bank losses which, at the end of the first quarter, were $719 million. But if the midpoint prices had been used, the report noted that an additional $512 million in losses would have been recorded. That is Exhibit No. 36.

If the $512 million were added to the $719 million, the reported losses would have totaled $1.2 billion, or 70 percent more than the actual—or the losses that were reported. Is it not that kind of a variance that leads to potential abuse, Mr. Waterhouse?

Mr. WATERHOUSE. Yes, absolutely. And it is important for us as the regulator to know what the actual market is and be informed on a timely basis.

Senator LEVIN. Do our largest banks generally go back and forth like that, do you know, Mr. Curry?

Mr. CURRY. I would have to defer to Mr. Waterhouse on that, but, that type of activity is cited an unsafe and unsound activity in our cease-and-desist order, and it is a focus of the affirmative provisions of the order that require corrective action.

Senator LEVIN. Do you have any comment on that, Mr. Waterhouse?

Mr. WATERHOUSE. Without speaking to the other banks, because I am not close to them anymore, but, again, the expectation is that they have a rigorous valuation process that is independent and provides credible prices to it. And, again, as the Comptroller just mentioned, as this collateral dispute became known, that is about when we started our evaluation work and our supervisory activities that culminated in a supervisory letter with a number of MRAs and the consent order that requires the bank to straighten this out.

Senator LEVIN. Here is one of the differences that I had, one of the many differences that I had with the bank earlier today.

An OCC capital markets examiner told us that it was clear from the numbers that the CIO was marking prices at the edge of "what they could get away with," and they were booking "fictitious profits."

Now, it seems to me that the numbers tell the story, just as the OCC examiner told us, and that you do not have to have subjective statements by the person making the marks he viewed them as bizarre. I mean, that is a subjective comment, and the bank was saying, well, until they heard the record of that person and their employee saying that, they could not tell anything from the marks themselves.

And so I just want it real clear. Is it not true that the marks themselves, when you see that kind of a shift in the way they are made at the time they are made, when the losses are piling up, that those numbers themselves tell a story about possible mismarking? Mr. Waterhouse.

Mr. WATERHOUSE. I would say that is something that is very troubling. On the face of it, I would have to perform our own investigation into that to make sure of that. But as you have prices that are being delivered that vary and are not consistently applied, that is very troubling.

Senator LEVIN. And do you think that this kind of practice is allowed by the GAAP? Do you have any knowledge of that? Can you comment on that? Is it possible that the accounting principles allow this kind of a deviation to happen?

Mr. WATERHOUSE. I actually cannot speak to GAAP, but I would expect that their standards would be that you have to have a consistent and rigorous and independent process.

Senator LEVIN. Would you do this for the Subcommittee, Mr. Curry? Would you take this set of facts up with GAAP and what the bank said today about this is consistent with accounting practices, what happened here?

Mr. CURRY. Yes.

Senator LEVIN. And what happened here is factually clear, and they acknowledge what happened here. But they just say it is consistent with accounting practices. I cannot believe that what happened here on the objective marks before they got to any of these subjective comments on record by their own people who did the marking, who raised questions but did not pass those problems along at the time, but the marks were there.

Could you do something for this Subcommittee and raise with GAAP what happened here, objectively, before we had the records of the traders' comments from London? Objectively on these marks at this time, there were major losses occurring to reduce those losses on the books, differences on the books as to what happened in terms of the losses shown according to GAAP, are these consistent, is what they did is consistent with accounting practices? Would you do that?

Mr. CURRY. I would be happy to have our chief accountant look into it and report back to you, Mr. Chairman.

Senator LEVIN. Thank you.

Again, the CIO traders that were directly involved in marking this book called their marks "idiotic," and that is surely true. But, you cannot wait for the person doing the marking to say that his marks are idiotic when the marks on their face show a real deviation from a normal practice—and, by the way, a total deviation from their own investment bank's practices—and at a time when the losses are piling up and just simply say this is consistent with accounting principles. And so we appreciate that very much, Mr. Curry.

Mr. CURRY. I would just add, we would view the GAAP accounting standards as a baseline. We are looking for a much higher standard with our institutions, particularly larger institutions. So merely meeting a regulatory or accounting standard is not always sufficient.

Senator LEVIN. I welcome that and I am glad to hear that, but I say even if you take a low baseline, I cannot believe general accounting practices allow this to happen. I just have a lot of trouble—I am not an accountant. I just have a lot of trouble believing that you have to get a smoking gun of the guy doing the markings saying, hey, I cooked the books—when you have a situation that is this clear, with this kind of a record of marks suddenly deviating from a median, from the mid, at a time when losses are piling up, and where the purpose is clearly to reduce the amount of those losses, that can be accepted as a general accounting principle. So I am glad that you have a higher standard, but I cannot believe this meets even a lower standard.

Mr. CURRY. We will be happy to look into that.

Senator LEVIN. Thank you.

If you take a look at Exhibit No. 32c,[1] this is a transcript of a telephone call between Ina Drew and the head of the CIO's credit trading operation, Javier Martin-Artajo. And he was in the London office. He directly influenced the marks. It is not dated, but it probably took place in April.

I do not know if you heard this part of our conversation with Ms. Drew about this transcript, and they are talking about what marks to show for the SCP that day, and she says at one point—did you hear this earlier this morning? Did you three happen to hear this conversation about tweaking?

Mr. CURRY. I did not hear it personally.

Senator LEVIN. Did you hear this, Mr. Waterhouse?

Mr. WATERHOUSE. No.

Senator LEVIN. Then let me ask you: Ms. Drew is giving guidance to Mr. Martin-Artajo, and he is basically saying it would be helpful—telling Mr. Martin-Artajo, it "would be helpful . . . to start getting a little bit of that mark back."

"If appropriate, so you know, an extra basis point you can tweak at whatever it is I'm trying to show, with demonstrable data . . ."

She said before that it is all fine to be conservative, but it would be "helpful . . . to start getting a little bit of that mark back," to "tweak" the mark.

What do you think of that, Mr. Waterhouse?

Mr. WATERHOUSE. I think the bank needs to provide true, accurate, independent marks every day.

Senator LEVIN. And the person doing the marks gets the hint from the head of the department, it would sure be "helpful" if you could "tweak" that mark, that is inconsistent with what the bank is required to do?

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[1] See Exhibit No. 32c, which appears in the Appendix on page 659.

Mr. WATERHOUSE. Yes, I think that is something that we would definitely not condone.

Senator LEVIN. Now, the rules—I think you have already commented on this, Mr. Curry, but let me make sure. We have shown a derivative valuation process which is to open to manipulation. It tempts bankers to manipulate derivative values to increase their profits or at least minimize the losses. And so that is something which is intolerable, and I think we have shown that is what happened here. But this is our recommendation:

We recommend that the OCC tell banks to use independent pricing services to remove the temptation from their own employees to tweak marks. We also recommend that banks have to disclose when their derivative values deviate from midpoint prices and explain why.

What is your reaction to that recommendation?

Mr. CURRY. As I stated in my opening remarks, we support this recommendation, and we are looking at how to best implement it at the OCC and with our other Federal banking agencies as well.

Senator LEVIN. Thank you. Now, after these whale trades became known to regulators and the public, and the media started to report on April 6, JPMorgan had an earnings call. It was Mr. Braunstein who made a number of statements about the Synthetic Credit Portfolio, and I would like to ask you about two of those statements. This is Exhibit No. 94,[1] and this is a transcript of the April 13 earnings call, and his statements about the Synthetic Credit Portfolio are on page 7, and we have made it easier to discuss them, so we have listed the key statements in Exhibit No. 1f[2] in your exhibit book, and that is what is up here, and that is what is up here to my right.

Mr. Braunstein said—now, he is talking about the whale trades, and he is saying, "I would add that all of those positions are fully transparent to the regulators. They review them, have access to them at any point in time, get the information on those positions, and on a regular and recurring basis as part of our normalized reporting."

Mr. Waterhouse, is that true?

Mr. WATERHOUSE. That is not true.

Senator LEVIN. Regulators did not "get the information" on those positions on a regular basis, did they?

Mr. WATERHOUSE. No, we did not; not until May after they started reporting daily did we get the information.

Senator LEVIN. All right. In fact, wasn't it a longstanding practice for the bank not to give individual position data to the OCC unless there was a special request?

Mr. WATERHOUSE. We would ask for position data only in certain instances. What we wanted to do is get more aggregated risk information that would be by desk and by portfolio.

Senator LEVIN. All right. So it had to be a special request.

Mr. WATERHOUSE. For position data, yes.

Senator LEVIN. Right. It would not come on a routine basis.

Mr. WATERHOUSE. No. Way too detailed.

[1] See Exhibit No. 94, which appears in the Appendix on page 927.
[2] See Exhibit No. 1f, which appears in the Appendix on page 516.

Senator LEVIN. Well, too detailed but you did not get it. He was telling the public you did get it, and you are saying you did not get it, it would be too detailed for you.

Mr. WATERHOUSE. We did not get it on a——

Senator LEVIN. A regular, routine basis——

Mr. WATERHOUSE [continuing]. Regular basis.

Senator LEVIN. Is that right? I did not mean to interrupt you. Is that right?

Mr. WATERHOUSE. Yes, sir.

Senator LEVIN. The second statement by Mr. Braunstein involves the issue of whether the SCP was a risk-reducing hedge. I think today they acknowledged it was not a hedge. Would you agree, Mr. Waterhouse, it was not a risk-reducing hedge?

Mr. WATERHOUSE. I think particularly when you look at 2012, it was not a hedge at all.

Senator LEVIN. And so on April 13, Mr. Braunstein said, "We also need to manage the stress loss associated with the portfolio, so we have put on positions to manage for a significant stress event in Credit. We have had that position for many years." And would you agree that they sure as heck did not have it in 2012?

Mr. WATERHOUSE. They did not have it in 2012.

Senator LEVIN. And the bank here was making decisions about how to invest depositors' funds, right?

Mr. WATERHOUSE. Yes, sir.

Senator LEVIN. The excess depositors' funds.

Mr. WATERHOUSE. Yes.

Senator LEVIN. The words "to manage a significant stress event in Credit," does that in effect mean that they put on positions to hedge? Is that what that means?

Mr. WATERHOUSE. I would interpret that to mean to put that position on with the expectation that there may be an economic recession and the bank would take credit losses over the course of time. It would be supposedly designed to offset those credit losses.

Senator LEVIN. And, therefore, would be a hedge against those credit losses.

Mr. WATERHOUSE. In that construct, yes, sir.

Senator LEVIN. And so when he said that on that day, when you read that, is that the way you interpret it, that he was saying that this was a hedge against a significant stress event? "We have put on positions to manage for a significant stress event in Credit." Is that what you would understand him to be saying in common parlance?

Mr. WATERHOUSE. In just reading the words on the board up there, that is the way I would interpret it.

Senator LEVIN. That was in a public call that was made, that Mr. Braunstein made on April 13. That was a misstatement, misrepresentation, and flat out falsity, as far as I am concerned. But we are going to let others judge that.

If you look at Exhibit No. 1c,[1] this chart tracks the SCP's cumulative profits and losses from January through April 2012 as the bank reported them at the time. Those profits and losses were reported internally. They were not disclosed publicly, so this is infor-

[1] See Exhibit No. 1c, which appears in the Appendix on page 513.

mation known only to the bank. And I think you have already said that the OCC did not receive daily CIO profit and loss data. Right, Mr. Waterhouse, you said that?

Mr. WATERHOUSE. Yes, specifically we did not receive daily SCP, detailed daily SCP information from the bank.

Senator LEVIN. And how about CIO? Did you get the daily profit/loss on CIO?

Mr. WATERHOUSE. We did not get from the CIO daily P&L, detailed daily P&Ls. There was some risk limit reports that we got elsewhere in the bank that had some information on the CIO in aggregate.

Senator LEVIN. Was that daily?

Mr. WATERHOUSE. Yes, we did get the daily risk limit reports, yes, sir.

Senator LEVIN. Did you get the profit/loss data on the CIO daily?

Mr. WATERHOUSE. In aggregate, there was a stop-loss utilization limit that contained a line item that showed, I believe, the current utilization against that limit.

Senator LEVIN. OK. Is that the same as profit and loss data, do you know?

Mr. WATERHOUSE. That was coming off——

Senator LEVIN. Was that the same, what you just described, the same as profit/loss data?

Mr. WATERHOUSE. It would not be the standard P&L data that we would be looking for such as what we got out of the IB. But from my understanding, it was an aggregate mark-to-market of the CIO, so that would be everything that was in the CIO that was marked to market going against the limit.

Senator LEVIN. All right. So it was not what would be generally described as profit/loss data.

Mr. WATERHOUSE. No.

Senator LEVIN. And the OCC in any event did not get daily profit and loss data for the SCP.

Mr. WATERHOUSE. That is correct.

Senator LEVIN. Now, I kind of interrupted my own flow here. Exhibit No. 1c,[1] it tracks the SCP's cumulative profits and losses from January to April 2012. Those profits and losses were reported internally. They were not disclosed publicly. So this was information known only to the bank, and it was not disclosed to the OCC either. The downward-sloping line represents increasing losses, and would you agree that this shows as a matter of fact that the Synthetic Credit Portfolio was not reducing the bank's risks but was increasing them?

Mr. WATERHOUSE. It was a very rapid increase in losses.

Senator LEVIN. OK. And Exhibit No. 1a[2] shows how the SCP tripled in size in the first quarter in 2012 from $51 billion to $157 billion. In March, the CIO traders went on a buying spree engaging in several huge transactions that added $40 billion in long positions to the portfolio, which the OCC has characterized as "doubling down" in Exhibit 78.[3] Is that correct?

[1] See Exhibit No. 1c, which appears in the Appendix on page 513.
[2] See Exhibit No. 1a, which appears in the Appendix on page 511.
[3] See Exhibit No. 78, which appears in the Appendix on page 853.

Mr. WATERHOUSE. That is correct.

Senator LEVIN. Do you know why your examiner would have said it was doubling down? That is a gambling term, isn't it?

Mr. WATERHOUSE. That is a gambling term, and as our examiner looked at in here, it was position data. We made a request. We got some position data. And as we saw what happened over that period of time, we did see this rapid increase in positions. And I think the examiner who made that comment, his thinking there was that based on the information that he had, that rather than try to just get out of the positions, the trader was trying to take advantage of price anomalies so that he could profit from it.

Senator LEVIN. Would you call that a high-risk approach?

Mr. WATERHOUSE. This is definitely a high-risk approach.

Senator LEVIN. OK. So, Mr. Waterhouse, take a look, if you would, at Exhibit No. 50.[1] Now, that is an email from Pat Hagan, the top quantitative analyst at the CIO, and it is a March 21, 2012, email. The subject line is "Optimizing regulatory capital," and on the top of page 2, Mr. Hagan writes, ". . . we should treat the regulatory capital calculation as an exercise of automatically finding the best results of an immensely arbitrary and complicated formula." "Optimizing" here means to produce the lowest possible RWA.

Now, does the OCC intend that its regulatory capital rules be implemented by the banks that it regulates in that way?

Mr. WATERHOUSE. No. I think the objective here is to have clear and consistent calculations on the RWA without optimizing, but having pure clear numbers that are consistent with the rule.

Senator LEVIN. To arrange things, in other words, to produce the most accurate RWA.

Mr. WATERHOUSE. Yes, absolutely. Consistent with the rule. The Basel rule provides the framework for calculations, and this work has to be consistent with that.

Senator LEVIN. OK. Now, Mr. Hagan proposed distributing the CIO synthetic credit derivatives into a couple books to "optimize regulatory capital." You have indicated that this is not appropriate. The bank testified that ultimately they did not agree to Hagan's proposal to divide the portfolio in that way. The bank only agreed to let him do it once. Is that OK? Is that like a one-bite rule for a dog?

Mr. WATERHOUSE. It has to be a consistent process applied consistently.

Senator LEVIN. But if you allow them to use the optimizing approach once, that is OK with you?

Mr. WATERHOUSE. I did not allow that.

Senator LEVIN. No, I am not saying—well, let me ask Mr. Curry. Does the OCC allow optimization one time and then from there on, hey, quit it?

Mr. SULLIVAN. What I would say is that Basel 2.5 rules are fairly clear about the distinction between the Incremental Risk Charge and the Comprehensive Risk Measure. And so it has strict requirements for banks to identify what are called correlation trading portfolios, and then the CRM should be applied consistently to

[1] See Exhibit No. 50, which appears in the Appendix on page 788.

that. So in the rule, both in its actual wording and I think within the spirit of the rule, you look at the business purpose of that portfolio. So if it qualifies as a correlation trading portfolio, then it would go into CRM. It is not that you would pick what goes into CRM based on other purposes. The regulation is very clear about the requirements that need to be met, and they do not include optimization.

Senator LEVIN. And optimization is not authorized by the OCC even once.

Mr. SULLIVAN. That is not a legitimate purpose for designing a risk-weighted assets calculator.

Senator LEVIN. All right. So you are not allowed to do it once and then quit it. You are told, "Do not do that at all."

Mr. SULLIVAN. The rule tells you——

Senator LEVIN. Follow the rule——

Mr. SULLIVAN [continuing]. Follow the rules——

Senator LEVIN [continuing]. The first time.

Mr. SULLIVAN. Yes. You follow the rules.

Senator LEVIN. You are not allowed to not follow the rule once and then follow the rule from the second time on.

Mr. SULLIVAN. No.

Senator LEVIN. You are supposed to follow the rule right at the beginning.

Mr. SULLIVAN. Definitely, yes.

Senator LEVIN. OK. Now, these regulatory capital requirements are one of the most important tools that we have to ensure the safety and soundness of our financial system. Is that not true? Mr Curry, would you say that regulatory capital requirements are one of the most important tools that we have to ensure the safety of our institutions?

Mr. CURRY. Absolutely, and I think that has been more than borne out by our experience during the global financial crisis.

Senator LEVIN. Now, Mr. Curry, let me go over the recommendations that we have made in our report, our so-called Levin-McCain recommendations, and get your reaction to the ones that you have not reacted to already.

The first recommendation is to make it clear that when it comes to high-risk derivatives, Federal regulators need to know what the major banks are up to. We recommend requiring banks to identify all internal investment portfolios that include derivatives over a specified notional size, required periodic reporting on derivative performance, and conduct regular reviews to detect undisclosed derivatives trading.

What is your reaction to that?

Mr. CURRY. We would agree generally with the recommendation that better data is necessary to monitor compliance and potential risk exposure.

Senator LEVIN. OK. The next recommendation is: In order to try to stop any games that might be played by banks trying to recast proprietary bets as hedges, we recommend that banks be required to create contemporaneous documentation that identifies the assets being hedged, how the derivatives trade reduces the risk associate with those assets, and how the bank tested the effectiveness of its hedging strategy in reducing risk.

What is your reaction to that one?

Mr. CURRY. Again, we agree in general principle with the recommendation, and actually this is an area of focus in our interagency rulemaking with the Volcker Rule.

Senator LEVIN. OK. Now, we have already asked you about independent pricing services and requiring banks to disclose valuation disputes with counterparties. I think we have already covered that recommendation.

Next, when risk alarms go off, we recommend that banks and your agency investigate the breaches and take action to reduce risky activities. Would you agree with that?

Mr. CURRY. Yes, Senator.

Senator LEVIN. On the issue of model manipulation, we recommend that regulators require banks to disclose to you when their models produce substantially lower numbers than the prior model, investigate the new model for evidence of model manipulation, and impose heavy penalties for any misconduct.

What is your reaction to that?

Mr. CURRY. We believe that would be a sound supervisory response, and it would be something that we would look to incorporate in our examination procedures as well as our training for personnel.

Senator LEVIN. Thank you.

Now, 3 years ago, Congress enacted a law to shut down high-risk proprietary betting that uses federally insured deposits or by systemically important financial institutions. We recommend that regulators finally issue the long-delayed final rule implementing Merkley-levin provisions of Dodd-Frank, which are known as the Volcker Rule.

Would you agree? And I am not going to ask you about what the final words would be, but do you agree with what I said, that it is time to get that done? And can you give us a prediction as to when the rule is going to be finalized?

Mr. CURRY. I think it is imperative that we adopt an interagency rule on the Levin-Merkley provision, or the Volcker Rule. It is something that the OCC and I are committed to doing as quickly as possible, and I believe that our experience with JPMorgan's CIO office has proven to be an invaluable resource to that effort.

Senator LEVIN. Thank you.

And, finally we recommend that regulators finalize the pending rules to impose stronger capital requirements for banks, especially in the area of derivatives trading. And when do you think that rule is going to be finalized on the capital requirement?

Mr. CURRY. To the extent that it is not addressed by the higher capital requirements to the market risk rules, we would look to see that as part of the Basel III rulemaking that is pending.

Senator LEVIN. Mr. Curry, you took office at Comptroller not even a year ago, just as these whale trade stories broke, and since then the OCC has conducted an intensive review of the whale trades. Were you surprised at the level of the problems uncovered?

Mr. CURRY. I was certainly taken aback by the press stories and, as we delved into it, how complex and serious the situation was.

Senator LEVIN. Have you given thought as to how to tackle the problem of detecting undisclosed derivative portfolios above a certain size since the derivative issue is so huge, in the trillions, around the world? And I think in the trillions here, for that matter. Have you given thought as to how we are going to provide some control limits so that these do not create a major problem down the line?

Mr. CURRY. I think this is an area where we need to do considerably more work. I think we have already learned through some of the work of Mr. Sullivan and the reviews conducted by Mr. Waterhouse that, at least from a supervisory standpoint, we need to be much more alert and make sure we have both the resources in terms of the capital market skills and a healthy skepticism that is exercised on a regular basis.

Senator LEVIN. We have gone into the concerns which we have had about the whale trades all day long, and the OCC has a list of its own concerns, and you have indicated those concerns in six supervisory letters and a cease-and-desist order which you have issued with respect to JPMorgan, and I would like to ask whether you found safety and soundness problems in the following areas during your inquiries?

First, have you found safety and soundness problem in the CIO's derivative valuation controls?

Mr. CURRY. Yes, and that is a provision of our order as well.

Senator LEVIN. Have you found safety and soundness problems in the CIO risk management?

Mr. CURRY. Yes.

Senator LEVIN. Have you found safety and soundness concerns in the VaR model risk management?

Mr. CURRY. Yes.

Senator LEVIN. Have you found safety and soundness problems in the model approvals and the RWA?

Mr. CURRY. Yes.

Senator LEVIN. And have you found them in JPMorgan's management?

Mr. CURRY. Yes, we have.

Senator LEVIN. Would you agree that the whale trades were not just a problem caused by rogue traders but were a problem of management weaknesses at the bank?

Mr. CURRY. We identified serious risk management weaknesses throughout the entire Firm, and they became particularly evident in the CIO office.

Senator LEVIN. Am I correct that the next step relative to the cease-and-desist order is to evaluate compliance when the time comes and to then make decisions as to any penalties?

Mr. CURRY. That is an accurate statement, Senator.

Senator LEVIN. Well, we thank our witnesses here, and we have seen today a very disturbing picture which raises questions not just about JPMorgan but about derivatives in general, how they are valued, disclosed, how they are disclosed or not disclosed, how they are managed to limit risk or not managed to limit risk.

The OCC has already lowered JPMorgan's management rating. They have issued a supervisory letter—more than one. The OCC has issued a cease-and-desist order, but I believe, Mr. Curry, that you and your colleagues have a challenge to get America's biggest bank back on the straight and narrow and to keep our banks on the straight and narrow, and that is exacerbated when we have the world of derivatives, particularly those derivatives which are synthetic.

And so we thank you for your work. We again want to express our appreciation to you, Mr. Curry, for making the effort you did to get back here for this hearing. And we stand adjourned.

[Whereupon, at 3:41 p.m., the Subcommittee was adjourned.]

APPENDIX

PRESS RELEASE

U. S. Senate Permanent Subcommittee on Investigations
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE

Carl Levin, Chairman
John McCain, Ranking Member

March 15, 2013
Contacts: Tara Andringa 202-228-3685

Opening Statement of Senator Carl Levin (D-Mich.)
U.S. Senate Permanent Subcommittee on Investigations Hearing on JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses

March 15, 2013

Good morning. Let me begin by extending a special welcome to a longtime friend, the new Ranking Member of the Subcommittee, Senator McCain. This is not the first time we have worked side-by-side. I deeply appreciate the energy and bipartisan spirit Senator McCain brings to our work together on the Armed Services Committee when he was Ranking Republican there and now here on this Subcommittee. Like the Armed Services Committee, this Subcommittee has a tradition of bipartisanship, and I very much look forward to continuing our partnership here.

In April 2012, Americans were confronted with a story of Wall Street excess and the derivatives disaster now known as the JPMorgan Chase whale trades. The largest U.S. banks today are deep into derivatives, complex financial instruments that derive their value from other assets. The derivatives behind the JPMorgan whale trades were part of a so-called "Synthetic Credit Portfolio" that essentially made outsized bets on whether particular financial instruments or entities were creditworthy or would default during specified time periods. The bets were made by traders in the London office of U.S. banking giant, JPMorgan Chase. Their trades – meaning their bets -- grew so large that they roiled the $27 trillion credit derivatives market, singlehandedly affected global prices, and finally attracted a media storm aimed at finding out who was behind them.

That's when the media unmasked JPMorgan's Chief Investment Office (CIO) which, until then, had been known for making conservative investments with bank deposits. At first, JPMorgan's CEO Jamie Dimon claimed the April media reports about the whale trades were "a tempest in a teapot." But a month later, the bank admitted the truth: that their credit derivative bets had gone south, producing not only losses that eventually exceeded $6 billion, but also exposing a litany of risk management problems at what had been considered one of America's safest banks.

JPMorgan Chase & Company is the largest financial holding company in the United States. It is also the largest derivatives dealer in the world and the largest single participant in world credit derivatives markets. It has consistently portrayed itself as a risk management expert with a "fortress balance sheet" that ensures taxpayers have nothing to fear from its extensive dealing in risky derivatives. But that reassuring portrayal of the bank was shattered when whale trade losses shocked the investing public, not only with the magnitude of the losses, but because the financial risk had been largely unknown to bank regulators.

The Subcommittee meets today after nine months of digging into the facts behind the whale trades. To learn what happened, the Subcommittee collected nearly 90,000 documents, conducted over 50 interviews and briefings, and has issued a 300-page bipartisan report. While the bank and its regulators have cooperated with our investigation, four key former JPMorgan employees directly involved in the derivatives trading declined to cooperate and, because they reside overseas, they remain beyond the Subcommittee's subpoena authority.

Our findings open a window into the hidden world of high stakes derivatives trading by big banks. It exposes a derivatives trading culture at JPMorgan that piled on risk, hid losses, disregarded risk limits, manipulated risk models, dodged oversight, and misinformed the public.

Our investigation brought home one overarching fact: the U.S. financial system may have significant vulnerabilities attributable to major bank involvement with high risk derivatives trading. The four largest U.S. banks control 90 percent of U.S. derivatives markets, and their profitability is invested, in part, in their derivatives holdings, nowhere more so than at JPMorgan.

The whale trades demonstrate how credit derivatives, when purchased in massive quantities with complex components, can become a runaway train barreling through every risk limit. The whale trades also demonstrate how derivative valuation practices are easily manipulated to hide losses, and how risk controls are easily manipulated to circumvent limits, enabling traders to load up on risk in their quest for profits. Firing a few traders and their bosses won't be enough to staunch Wall Street's insatiable appetite for risky derivative bets or stop the excesses. More control is needed.

Among the most troubling aspects of the whale trades case history is that JPMorgan traders, who were required to book the value of their derivative holdings every business day, used internal profit-loss reports to hide more than half a billion dollars in losses in just three months. Eventually, those misreported values forced JPMorgan to restate its earnings for the first quarter of 2012. But to this day, JPMorgan maintains that the mismarked values did not, on their face, violate bank policy or generally accepted accounting principles. But if derivative books can be cooked as blatantly as they were in this case without breaking the rules, then the rules need to be revamped. And given how much major U.S. bank profits remain bound up with the value of their derivatives, derivative valuations that can't be trusted are a serious threat to our economic stability.

The whale trades also demonstrate how easily a Wall Street bank can manipulate and avoid risk controls. The financial industry assures us that it can prudently manage high risk activities, because they are measured, monitored, and limited. But as the Subcommittee report demonstrates in detail, JPMorgan executives ignored a series of alarms that went off as the bank's Chief Investment Office breached one risk limit after another. Rather than ratchet back the risk, JPMorgan personnel challenged and re-engineered the risk controls to silence the alarms. It is difficult to imagine how the American people can trust major Wall Street banks to prudently manage derivatives risk when bank personnel can readily game or ignore the risk controls meant to prevent financial disaster and taxpayer bailouts.

The whale trades also provide another example of a major Wall Street bank's misstatements and concealment. Our investigation found that the bank failed to fully disclose the Synthetic Credit Portfolio to regulators for years, even when it tripled in size in the first three months of 2012, and even when traders went on a buying spree, acquiring $40 billion of new credit derivatives in March, "doubling down," in the words of the OCC, on an already losing trading strategy. In fact, in January 2012, the bank told the OCC, inaccurately, that the portfolio was decreasing in size, when it wasn't. Most troubling of all, when the media spotlight hit, senior bank executives mischaracterized to investors and the public the nature of the whale trades and the extent of risk management and regulatory oversight, gambling apparently that the portfolio's bad bets would recover before anyone took a closer look.

Well, we took that closer look, and it isn't pretty. A massive derivatives portfolio riddled with risk. A runaway train of derivatives trading blowing through risk limits. Hidden losses. Bank executives downplaying the bad bets. Regulators who failed to act.

Together, the facts are a reminder of what occurred in the recent financial crisis: we can't rely on a major bank to resist risky bets, honestly report derivative losses, or disclose bad news, without a strong regulator looking over its shoulder, backed by laws that require transparency, risk limits, capital buffers against losses, and consequences for misconduct.

That's the big picture. Here are some of the detailed findings from the Subcommittee's investigation.

1) JPMorgan's Chief Investment Office rapidly amassed a huge portfolio of synthetic credit derivatives, in part using federally insured depositor funds, in a series of risky, short-term trades, disclosing the extent of the portfolio only after intense media exposure.

In just a few months during 2011, as shown in Chart 1, the Chief Investment Office's Synthetic Credit Portfolio grew from a net notional size of $4 billion to $51 billion, and then tripled in the first quarter of 2012 to $157 billion. That exponential growth in holdings and risk occurred with virtually no regulatory oversight.

2) Once the whale trades were exposed, JPMorgan claimed to regulators, investors and the public, that the trades were designed to hedge credit risk. But internal bank documents failed to identify the assets being hedged, how they lowered risk, or why the supposed credit derivative hedges were treated differently from other hedges in the Chief Investment Office. If these trades were, as JPMorgan maintains, hedges gone astray, it remains a mystery how the bank determined the nature, size, or effectiveness of the so-called hedges, and how, if at all, they reduced risk.

3) The Chief Investment Office internally concealed massive losses in the first several months of 2012 by overstating the value of its synthetic credit derivatives. It got away with

overstating those values within the bank, even in the face of disputes with counterparties and two internal bank reviews.

As late as January 2012, the CIO had valued its credit derivatives by using the midpoint in the daily range of "bids" and "asks" offered in the marketplace. That's the typical way to value derivatives. But beginning in late January, the traders stopped using midpoint prices and started using prices at the extreme edges of the daily price range to hide escalating losses. In recorded phone conversations, one trader described these marks as "idiotic."

At one point, traders used a spreadsheet to track just how large their deception had grown by recording the valuation differences between using midpoint and more favorable prices. In just five days in March, according to the traders' own spreadsheet, the hidden losses exceeded $400 million. The difference eventually exceeded $600 million. Counterparties to the derivative trades began disputing the CIO's booked values involving hundreds of millions of dollars in March and April.

Despite the obvious value manipulation, on May 10 – the same day JPMorgan announced that the whale trades had lost $2 billion – the bank's controller concluded a special review and signed off on the CIO's derivative pricing practices as "consistent with industry practices." JPMorgan leadership has continued to argue that the values assigned by its traders to the Synthetic Credit Portfolio were defensible under accounting rules.

Yet in July 2012, the bank reluctantly restated its first-quarter earnings. It did so only after an internal investigation listened to phone conversations, routinely recorded by the bank, in which its traders mocked their own valuation practices.

Their mismarked values weren't wrong simply because the traders intended to understate losses; they were wrong because they changed their pricing practices after losses began piling up, stopped using the midpoint prices they had used up until January, and began using aggressive prices that consistently made the bank's reports look better. Until JPMorgan and others stop their personnel from playing those kinds of games, derivative values will remain an imprecise, malleable, and untrustworthy set of figures that call into question the derivative profits and losses reported by our largest financial institutions.

4) When the CIO's Synthetic Credit Portfolio breached five key risk limits, rather than reduce the risky trading activities, JPMorgan either increased the limits, changed the risk models that calculated risk, or turned a blind eye to the breaches.

As early as January 2012, the rapid growth of the Synthetic Credit Portfolio breached one common measure of risk, called "Value-at-Risk" or VaR, causing a breach, not just at the CIO, but for the entire bank. That four-day breach was reported to top bank officials, including CEO Jamie Dimon, who personally approved a temporary limit increase, and voila, the breach was ended. CIO employees then hurriedly pushed through approval of a new VaR model that, overnight, dropped the CIO's purported risk by 50 percent. Regulators were told about that remarkable reduction in the CIO's purported risk, but raised no objection to the new model at the time.

The credit derivatives portfolio breached other risk limits as well. In one case, it exceeded established limits on one measure, known as Credit Spread 01, by 1,000 percent for months running. When regulators asked about the breach, JPMorgan risk managers responded that it wasn't a "sensible" limit and allowed the breach to continue. When still another risk metric, called Comprehensive Risk Measure, projected that the Synthetic Credit Portfolio could lose $6.3 billion in a year, a senior CIO risk manager dismissed the result as "garbage." It wasn't garbage; that projection was 100 percent accurate, but the derivatives traders thought they knew better. Downplaying risk, ignoring one risk warning after another, and pushing to reengineer risk controls to artificially lower risk results, flatly contradict JPMorgan's claim to prudent risk management.

5) At the same time the portfolio was losing money and breaching risk limits, JPMorgan dodged OCC oversight. It omitted CIO data from its reports to the OCC; failed to disclose the growing size, risk, and losses of the Synthetic Credit Portfolio; and delayed or tinkered with OCC requests for information by giving the regulator inaccurate or unresponsive information. In fact, when the whale trades first became public, the bank offered such blanket reassurances that the OCC initially considered the matter closed. It was only when the losses exploded that the OCC took another look.

6) The failure of regulators to act sooner can't be excused by the bank's behavior. The OCC also fell down on the job. It failed to investigate multiple, sustained risk limit breaches; tolerated incomplete and missing reports from JPMorgan; failed to question the bank's new "value at risk" model that dramatically lowered the CIO's risk rating; and accepted JPMorgan's protests that the media reports about the portfolio were overblown. It was not until May 2012, after a new Comptroller of the Currency took the reins at the agency, that OCC officials instituted their first intensive inquiry into the Synthetic Credit Portfolio.

Again, with the lessons of the 2008 financial crisis so painfully fresh, it is deeply worrisome that a major bank should seek to cloak its risky trading activities from regulators, and doubly worrisome that it was able to succeed so easily for so long.

And finally:

7) When the whale trades went public, JPMorgan misinformed regulators and the public about the Synthetic Credit Portfolio. JPMorgan's first public response to the April news reports about the whale trades was when its spokesperson, using prepared talking points approved by senior executives, told reporters on April 10, that the whale trades were risk-reducing hedges known to regulators. A more detailed description came in a conference call held on April 13 with investment analysts. During that call, Chief Financial Officer Douglas Braunstein made a series of inaccurate statements about the whale trades as shown in Chart 2: He said the trades had been put on by bank risk managers and were fully transparent to regulators; he said the trades were made on a very long-term basis; he said the trades were essentially a hedge; and he said the bank believed the trades were consistent with the Volcker Rule which prohibits high risk proprietary trading by banks. Those public statements on April 13 were not true. As late as May 10, bank CEO Jamie Dimon repeatedly described the synthetic credit trades as hedges made to offset risk, despite information showing the portfolio was not functioning as a hedge. The bank also neglected to tell investors the bad news that the derivatives portfolio had broken through

multiple risk limits, losses had piled up, and the head of the portfolio had put management of the portfolio into "crisis mode."

It was recently reported that the eight biggest U.S. banks have hit a five-year low in the percentage of deposits used to make loans. Their collective average loan-to-deposit ratio has fallen to 84 percent in 2012, down from 87 percent a year earlier, and 101 percent in 2007. JPMorgan has the lowest loan-to-deposit ratio of the big banks, lending just 61 percent of its deposits out in loans. Apparently, it was too busy betting on derivatives to issue the loans needed to speed economic recovery.

Based on its investigation into the JPMorgan whale trades, our report makes the following recommendations.

1) When it comes to high-risk derivatives, federal regulators need to know what major banks are up to. We should require those banks to identify all internal investment portfolios that include derivatives over a specified size, require periodic reporting on derivative performance, and conduct regular reviews to detect undisclosed derivatives trading.

2) When banks claim they are trading derivatives to hedge risks, we should require them to identify the assets being hedged, how the derivatives trade reduces the risk associated with those assets, and how the bank tested the effectiveness of its hedging strategy in reducing risk.

3) We need to strengthen how derivatives are valued to stop inflated values. Regulators should encourage banks to use independent pricing services to stop the games; require disclosure of valuation disputes with counterparties; and require disclosure and justification when, as occurred at JPMorgan, derivative values deviate from midpoint prices.

4) When risk alarms go off, banks and their regulators should investigate the breaches and take action to reduce risky activities.

5) Federal regulators should require disclosure of any newly implemented risk model or metric which, when implemented, materially lowers purported risk, and investigate the changes for evidence of model manipulation.

6) Three years ago, Congress enacted the Merkley-Levin provisions of the Dodd-Frank Act, also known as the Volcker Rule, to end high risk proprietary betting using federally insured deposits. Financial regulators ought to finalize the long-delayed implementing regulations.

7) At major banks that trade derivatives, regulators should ensure the banks can withstand any losses by imposing adequate capital charges for derivatives trading. It is way past time to finalize the rules implementing stronger capital standards.

The derivatives trading that produced the whale trades damaged a single bank. But the whale trades expose problems that reach far beyond one London trading desk or one Wall Street office tower. The American people have already suffered one devastating economic assault rooted largely in Wall Street excess, and they cannot afford another. When Wall Street plays with fire, American families get burned. The task of federal regulators, and of this Congress, is to take away the matches. The whale trades demonstrate that task is far from complete.

OPENING STATEMENT BY SENATOR MCCAIN
Ranking Minority Member
Permanent Subcommittee on Investigations
March 15, 2013

Thank you, Mr. Chairman. Let me begin by saying what an honor it is to serve on this Subcommittee, which has a long history of bipartisanship and a celebrated legacy of uncovering waste, fraud, abuse, and outright corruption.

Before I move forward, Mr. Chairman, I want to express my gratitude to you and the members of your staff for your unyielding and dedicated efforts to this investigation. I would also like to recognize the work of my predecessor on the Subcommittee, Senator Coburn, for his contributions prior to my arrival.

This investigation into the so-called "Whale Trades" at JPMorgan has revealed startling failures at an institution that touts itself as an expert in risk management and prides itself on its "fortress balance sheet." The investigation has also shed light on the complex and volatile world of synthetic credit derivatives. In a matter of months, JPMorgan was able to vastly increase its exposure to risk while dodging oversight by federal regulators. The trades ultimately cost the bank billions of dollars and its shareholders value.

These losses came to light not because of admirable risk management strategies at JPMorgan or because of effective oversight by diligent regulators. Instead, these losses came to light because they were so damaging that they shook the market, and so damning that they caught the attention of the press. Following the revelation that these huge trades were coming from JPMorgan's London Office, the bank's losses continued to grow. By the end of the year, the total losses stood at a staggering $6.2 billion dollars.

This case represents another shameful demonstration of a bank engaged in wildly risky behavior. The "London Whale" incident matters to the federal government because the traders at JPMorgan were making risky bets using excess deposits, portions of which were federally insured. These excess deposits should have been used to provide loans for main-street businesses. Instead, JPMorgan used the money to bet on catastrophic risk.

Through an extensive bipartisan investigation, this Subcommittee has uncovered a wealth of new information. Internal e-mails, memos, and interviews reveal that these trades were not conducted by a group of rogue traders, but that their superiors were well aware of their activities.

Traders at JPMorgan's Chief Investment Office, the CIO, adopted a risky strategy with money they were supposed to use to hedge, or counter, risk. However, even the head of the CIO could only provide a quote "guesstimate" as to what exactly the portfolio was supposed to hedge. And JPMorgan's CEO Jamie Dimon admitted that the portfolio had quote "morphed" into something that created new and potentially larger risks. In the words of JPMorgan's primary federal regulator, it would require quote "make-believe voodoo magic" to make the portfolio actually look like a hedge.

Top officials at JPMorgan allowed these excessive losses to occur by permitting the CIO to continually breach all of the bank's own risk limits. When the risk limits threatened to impede their risky behavior, they decided to manipulate the models.

Disturbingly, the bank's primary regulator, the OCC, failed to take action even after red flags warned that JPMorgan was breaching its risk limits. These regulators fell asleep at the switch and failed to use the tools at their disposal to effectively curb JPMorgan's appetite for risk.

However, JPMorgan actively impeded the OCC's oversight. The CIO refused to release key investment data to the OCC and even claimed that the regulator was trying to quote "destroy" the bank's business.

After these losses were uncovered by the press, JPMorgan chose to conceal its errors and, in doing so, top officials at the bank misinformed investors, regulators, and the public. In an April 2012 earnings call, then Chief Financial Officer Douglas Braunstein, falsely told investors and the public that the bank had been quote "fully transparent to regulators."

The deception did not end there. During the same earnings call, Mr. Dimon tried to downplay the significance of the losses by infamously characterizing them as a quote "a complete tempest in a teapot." The truth of the matter is that $6 billion dollars, some of which is federally insured, is an inexcusable amount of money to be gambled away on risky bets. This investigation potentially reveals systemic problems in our nation's financial system. The size of the potential losses and the accompanying deception echo the misguided and dishonest actions that the banks took during the financial crisis four years ago.

Let me be clear. JPMorgan completely disregarded risk limits and stonewalled federal regulators. It is unsettling that a group of traders made reckless decisions with federally insured money, and that all of this was done with the full awareness of top officials at JPMorgan. This bank appears to have entertained—indeed, embraced—the idea that it was quote "too big to fail". In fact, with regard to how it managed the derivatives that are the subject of today's hearing, it seems to have developed a business model based on that notion.

It is our duty to the American public to remind the financial industry that high-stakes gambling with federally insured deposits will not be tolerated. In 2012, the "London Whale" trades resulted in a $6 billion loss. What if it was $60 billion? Or, $100 billion? Does JP Morgan operate under the assumption that the taxpayer will bail them out again? What place does taxpayers' underwriting of the big banks' disregard for "moral hazard" have in the proper operation of a truly free market?

I look forward to hearing from our witnesses today as we examine what went wrong at JPMorgan.

Testimony of Ina R. Drew

Former Head of the Chief Investment Office, JPMorgan Chase & Co.

Before the U.S. Senate Permanent Subcommittee on Investigations

Washington, D.C.

March 15, 2013

Good morning, Chairman Levin, Ranking Member McCain, and members of the Subcommittee. Thank you for the opportunity to meet and discuss with you my perspective on the losses incurred last year in JPMorgan Chase's synthetic credit portfolio, one of many portfolios managed by the Company's Chief Investment Office (CIO) when I was the head of that office. I am greatly saddened by the entire episode, which has caused financial and reputational harm to JPMorgan Chase and a large number of people with whom I was honored to work, and I deeply regret that the losses occurred on my watch. I am also saddened that the losses led to my departure from the Company, to which I had devoted 30 years of my life.

Before I address the synthetic credit portfolio, I believe it would be useful for the Subcommittee to know about my background and career and about the range of asset-liability management activities of the CIO at JPMorgan Chase.

My background and career at JPMorgan Chase

After attending public schools, I graduated from The Johns Hopkins University, as part of only the fourth class that admitted women, with a degree in international studies. I went on to earn a master's in international affairs from Columbia University. I have been a member of the Board of Trustees of The Johns Hopkins University for the past twelve years.

In March 1982, I joined Chemical Bank in New York and thus began my 30-year career at what would ultimately become JPMorgan Chase. Over the course of my career at the Company I worked primarily in the area of asset-liability management, and I received a succession of promotions and increasing management responsibilities. By asset-liability management, I am broadly referring to transactions and portfolio positions designed for the purpose of managing assets and liabilities on the Company's balance sheet, earning a favorable rate of return on capital, and prudently hedging exposures and risks in the Company's lines of business.

I helped the Company manage assets and liabilities through a series of significant mergers and acquisitions, including those involving Texas Commerce Bank, Manufacturers Hanover, Chase Manhattan, J.P. Morgan, Bank One, Bear Stearns and Washington Mutual, and I worked closely with a series of CEOs, including Walter Shipley, William Harrison and Jamie Dimon.

In 1999, I became the head of Global Treasury, the unit responsible for asset-liability management for the Company. In that role I oversaw the management of the Company's core investment securities portfolio, the foreign-exchange hedging portfolio, the mortgage servicing rights (MSR) hedging book, and a series of other investment and hedging portfolios based in London, Hong Kong and other foreign cities. As of mid-2004 – the time of the merger with Bank One and the beginning of Mr. Dimon's tenure as Chief Executive Officer of JPMorgan Chase – I reported directly to Mr. Dimon. During 2005, the Global Treasury function was renamed the Chief Investment Office (CIO) and was moved out of the Company's investment banking division to become a Corporate function.

During Mr. Dimon's tenure as CEO my responsibilities increased significantly, for two principal reasons. First, the CIO's purview was expanded to include several additional books, including the JPMorgan Chase employee retirement plan, the company-owned-life insurance portfolio, and the capacity for both investment and hedging activities in the credit markets. Second, the Company's balance sheet grew significantly as a result of the acquisitions of Bear Stearns and Washington Mutual and the large inflow of retail deposits during the financial crisis.

In 2006, I became a member of the JPMorgan Chase Operating Committee, the highest-level management and strategy committee of the Company. During 2007 and 2008, I served on the industry-wide Treasury Borrowing Advisory Committee. I am proud to be one of a small number of women who rose to senior positions in the financial industry.

Asset-liability management activities of the CIO

The CIO engaged in a wide range of asset-liability management activities. As of the first quarter of 2012, the CIO managed the Company's $350 billion investment securities portfolio (this portfolio exceeded $500 billion during 2008 and 2009), the $17 billion foreign exchange hedging book, the $13 billion employee retirement plan, the $9 billion company-owned-life insurance portfolio, the strategically-important MSR hedging book, and a series of other books including the cash and synthetic credit portfolios.

Our department engaged in all of these activities as part of what we viewed as prudent and normal-course asset-liability management for a large financial institution such as JPMorgan Chase. In varying combinations, each activity was designed to preserve and enhance Company assets and to protect, or hedge, against losses and liabilities in the Company's various business lines resulting from various types of risks. Those risks included interest rate risk, foreign exchange risk, liquidity risk, duration risk, and credit risk.

I recognize that we are focused today on the 2012 losses in the synthetic credit book, but it is worth noting that the CIO's asset-liability management activities in total – including the strategic hedges in the synthetic credit book – contributed about $23 billion to the Company's earnings from 2007 through 2011, helping to offset business losses incurred during that difficult period of time. My colleagues and I in CIO worked extremely hard to protect the Company, through the financial crisis and beyond, by investing conservatively and prudently hedging business risks. I am extremely proud that our investing and hedging strategies – which were developed over many years and were more successful than those of many other major financial institutions – played a critical role in the Company's efforts to weather the financial storms during this period of time.

My management of the CIO

As head of the CIO, I had a team of six experienced and accomplished financial professionals who reported directly to me. With respect to most of the various books I oversaw, including the cash and synthetic credit books, I delegated responsibility to, and relied on, my CIO management team. Several of my direct reports – including Achilles Macris, who had supervisory responsibility for the cash and synthetic credit books, among other responsibilities – were members of the JPMorgan Chase Executive Committee, which consisted of the top 50 or so executives of the Company. Mr. Macris, who was based in London, served as head of the CIO for Europe and Asia. My management team also included a Chief Financial Officer of the CIO who also reported to the Chief Financial Officer of the Company. Separately, there was a team of independent Risk Management personnel assigned to the CIO, all of whom reported up to the Chief Risk Officer of the Company. This included several CIO Risk personnel based in London and several who were focused on the synthetic credit book.

I managed the CIO in a variety of ways. I had daily meetings or communications with all of my direct reports and with CIO Risk Management personnel. I reviewed key written reports, including regular Risk Management reports and regular portfolio summaries from members of my management team or their teams. I held weekly portfolio review meetings, which covered most of the major books managed by the CIO, including the cash and synthetic credit portfolios managed by the London office. These meetings always included London personnel via videoconference, and always included a review of risk management issues. I visited the London office several times each year, and Messrs. Macris and Martin-Artajo came to New York several times each year; through these visits and otherwise, I met with them in person at least several times each year.

The synthetic credit book

The synthetic credit book, which was started in late 2006, was designed principally as a protective macro-level hedge against stressed credit environments, and it served this purpose well. From 2007 through 2011 – a period which included the financial crisis of 2008-2009 and the ensuing difficult and uncertain credit environment during 2010-2011 – the book had positive returns every year and contributed in total approximately $2 billion to the Company's earnings. These gains helped offset losses in various credit-sensitive business activities, including the Company's very large loan portfolio, which totaled approximately $700 billion during 2011 and 2012.

The synthetic credit book consisted of a portfolio of synthetic credit derivatives based in various segments of the credit markets. Generally speaking, the book was positioned to generate significant returns during stressed or difficult credit environments and modest returns during more benign credit environments.

Mr. Macris had supervisory responsibility for the synthetic credit book, which was executed and managed out of London. The book was managed on a day-to-day basis by Mr.

Martin-Artajo, who reported to Mr. Macris and who supervised the activities of the book's traders, including the principal trader, Bruno Iksil. Messrs. Macris and Martin-Artajo enjoyed reputations as experienced and highly-skilled managers who had extraordinary expertise in credit derivatives. They also had a five-year track record of successful management of both the cash and synthetic credit books. I naturally relied heavily (and I thought appropriately) on their views and judgments concerning the synthetic credit book. I also relied on the analysis and judgment of the CIO Risk Management and Finance personnel assigned to review the positions in the synthetic credit book. I believed that such reliance was reasonable.

2012 developments in the synthetic credit book

In December 2011, in accordance with a Company-wide plan to reduce risk-weighted assets (RWA) in anticipation of the new Basel III capital requirements, and consistent with the widely-held view within the Company that the macro credit environment was broadly improving, I told Messrs. Macris and Martin-Artajo that the overall size and RWA of the synthetic credit book would need to be reduced over the course of 2012. I also emphasized to them that they needed to keep the book within all applicable risk limits, including value-at-risk (VaR), and that the book's VaR would need to be reduced over the course of 2012.

In January 2012, they informed me that because most of the book's short positions were in the relatively illiquid high-yield market, the most cost-effective near-term way to manage the book was to put on offsetting long positions in the more liquid investment grade market, thus moving the book towards a neutral or balanced position, rather than a large net short. They also explained that this situation would necessitate a one-quarter delay in RWA reduction as compared with what had been originally contemplated. This delay was approved by the Company's senior management.

Also in January the Company's independent Model Review Group, part of the corporate Risk Management organization, approved a new, and purportedly better and more accurate, value-at-risk (VaR) model for the synthetic credit book. The process of developing and seeking approval of the new VaR model had been pending since the middle of 2011. Although I, as well as the Company's senior management, was well aware that a new VaR model was pending, I had no involvement in the process of developing, requesting or approving the new model and no basis to personally assess the merits of either the new or old model.

In February Messrs. Macris and Martin-Artajo informed me on several occasions that they were in the process of moving the book to a more neutral position, that the book remained appropriately positioned and net short on a risk-adjusted basis, that the book remained within VaR and other relevant risk limits, and that they were continuing to work to try to reduce RWA. These same conclusions were reported to the Company's senior management in late February, as part of the annual CIO business review, during which Mr. Macris discussed the overall credit risk protection afforded by the book.

In late March, pointed concerns regarding the investment grade long positions were raised to my attention. I learned from Mr. Martin-Artajo that he believed that other market participants had learned of the CIO's investment grade long positions and were skewing market valuations by taking positions against the CIO. Soon thereafter, CIO Risk Management expressed concerns to me that the book's traders had recently purchased very large amounts of investment grade long positions. Shortly thereafter, in a group videoconference that included CIO Risk Management personnel, Mr. Martin-Artajo reiterated his concern about other market participants skewing market valuations and recommended that the traders purchase even more investment grade long positions in order to counteract the skewed valuations. I immediately instructed Messrs. Martin-Artajo and Iksil to cease all trading of investment grade long positions. I also instructed them, along with Mr. Macris, to do a full review of the book, and to prepare a written analysis and plan for reducing the book going forward.

Over the course of the next few weeks, during which time the book experienced a few days of large mark-to-market losses, I and CIO Risk Management personnel received a series of reassuring analyses and conclusions from Messrs. Macris and Martin-Artajo. Indeed, throughout this period, I made successive requests of Messrs. Macris and Martin-Artajo for greater analysis and explanation of the book's positions. Their responses were seemingly thorough and consistently reassuring. On multiple occasions, both orally and in detailed writings, Messrs. Macris and Martin-Artajo expressed their confident belief that, notwithstanding the issues that had been raised and the recent mark-to-market losses, the synthetic credit book remained properly balanced; the investment grade long positions were strategically appropriate; the recent mark-to-market losses reflected temporary market dislocations due to unsustainable actions by other market participants; and the losses would dissipate over the near term. In addition, Messrs. Macris and Martin-Artajo provided several detailed written scenario analyses estimating, with high confidence, that the book's second quarter performance would range between a $350 million profit and a $250 million loss.

I have since come to learn – based on the Company's public statements in July 2012 and Task Force Report in January of this year – that valuations for many of the book's positions were inflated and not calculated or reported in good faith; that the original version of the second quarter scenario analyses reflected much higher projected losses and was specifically re-done before it was sent to me so as to reflect lower projected losses; and that some members of the London team participated in or condoned such conduct and hid from me important information regarding the true risks in the book. I have also since come to learn – based on the same public statements of the Company – that the new VaR model was flawed and significantly understated the true risks in the book. Needless to say, I had no knowledge of these things at the time.

CIO Risk Management received all of Messrs. Macris and Martin-Artajo's written analyses and conclusions, including the second quarter scenario analyses. In addition, during this critical period I kept the Company's senior management apprised of the issues and the conclusions being presented by Messrs. Macris and Martin-Artajo. Over the week leading up to the Company's April 13 earnings call, I made sure that Messrs. Macris and Martin-Artajo's written analyses and conclusions, including the second quarter scenario analyses, were distributed to senior management and that senior management had an opportunity to raise questions and issues directly with them.

<u>My oversight of the synthetic credit portfolio</u>

I believe that my oversight of the synthetic credit portfolio, including during 2012, was reasonable and diligent, and it was accomplished through multiple means. I relied on Messrs. Macris and Martin-Artajo, each a recognized expert on credit derivatives, to vet and supervise trading strategy and to keep me apprised generally on the trading and the performance of the book. They did so through regular written reports from their team and numerous video, telephone and in-person conferences. I relied on the Company's formal risk metrics – in particular VaR, stress performance, and CSW 10% – to alert me to excessive risks, and I relied on CIO Risk Management to alert me to particular problems or concerns.[1] I relied on the independent Model Review Group to vet the VaR and other risk models. Further, I relied on CIO Finance – in particular the Valuation Control Group – to ensure that the book's positions were valued properly.

When issues or concerns were brought to my attention during the first quarter of 2012, I responded forcefully and thoughtfully and ensured that the key people, including Risk Management personnel, were analyzing the issues and critically assessing the risks. I insisted that Mr. Macris and Mr. Martin-Artajo, the executive and manager with the greatest expertise and experience in credit derivatives, focus on and analyze the issues, assess future risks, and report back to me. I ensured that CIO Risk Management personnel were fully engaged and provided their independent analysis and judgment. When pointed concerns were brought to my attention in late March, I made sure that key members of the company's senior management were fully informed of the issues, received the written analyses and conclusions coming from Mr. Macris and Mr. Martin-Artajo, and had a full opportunity to raise questions with the London team.

Ultimately, it appears that my oversight of the synthetic credit book during 2012 was undermined by two critical facts of which I was not aware at the time but have come to learn based on the Company's Task Force Report and other public statements: (i) the new VaR model was flawed and significantly understated the real risks in the book; and (ii) some members of the London team failed to value positions properly and in good faith, minimized reported and projected losses, and hid from me important information regarding the true risks of the book. I believe it goes without saying that it is extremely difficult, if not impossible, to oversee a portfolio under such circumstances.

Also, it appears that my oversight of the book was undermined by control failures by CIO Risk Management and CIO Finance. In particular, it appears that CIO Risk Management failed to properly understand and assess the risks in the book, and that CIO Finance failed to properly review the position valuations recorded by the traders.

I recognize that the Task Force Report makes certain management-related criticisms of me, but I respectfully disagree with many of those criticisms. For the reasons cited, I believe that

[1] During the first quarter of 2012, CIO Risk Management included a manager, Keith Stephan, who sat with the traders in London, a more senior manager, Peter Weiland, who received daily reports with details of the positions and the trades, and a chief risk officer, Irv Goldman, who although new to that position had spent over a month in London in mid-2011 getting to know the London team and developing a better understanding of the synthetic credit portfolio.

my management of the CIO and oversight of the synthetic credit book was reasonable and diligent. It is also important to note that the Task Force Report itself lays out the critical factors – the flaws in the new VaR model and the deceptive conduct by members of the London team – that undermined my management and my oversight of the book.

My departure from JPMorgan Chase

In late April of 2012, following a series of additional large mark-to-market losses in the synthetic credit book, it became clear to me and other members of senior management that the reassuring analyses and conclusions provided by Messrs. Macris and Martin-Artajo, including the second quarter scenario analyses, had been erroneous. This realization led to detailed reviews by Corporate Risk Management and other members of senior management, which in turn led to the Company's May 10 filings and its conference call with investors and analysts regarding the CIO losses.

I was, and I remain, deeply disappointed and saddened that such significant losses occurred in the business unit I oversaw, a unit I managed diligently and successfully for many years. Although asset-liability management, by its nature, involves regular ups and downs in both investment and hedging books, I had never before experienced a situation like this one. Though I did not (and do not) believe I bore personal responsibility for the losses in the synthetic credit book, in late April I began to consider whether, for the good of JPMorgan Chase, I should step down and make it easier for the Company to move beyond these issues. In the wake of the May 10 disclosures I approached Mr. Dimon and told him that I thought it would be best for the Company if I stepped down. He reluctantly agreed, and shortly thereafter I submitted my retirement letter. Similarly, although I did not (and do not) believe that I engaged in any misconduct, I offered to give up a significant amount of my recent JPMorgan Chase compensation, which I have done, in recognition of the size of the losses and my position as head of the business.

Since my departure I have learned of the deceptive conduct by members of the London team, and I was, and remain, deeply disappointed and saddened to learn of such conduct and the extent to which the London team let me, and the Company, down.

Looking back over my long career at JPMorgan Chase, I know that I – like the vast majority of the people with whom I worked – always did my job with integrity and care and always tried to act in the best interests of the Company. In the end, I left a job and a company I loved dearly, after 30 years of dedicated service, because of significant losses that occurred on my watch.

I thank you for the opportunity to submit this statement, and I will be happy to answer any questions you may have.

Ashley Bacon
Acting Chief Risk Officer, JPMorgan Chase & Co.
Written Testimony for the Senate Permanent Subcommittee on Investigations
March 15, 2013

Good morning Chairman Levin, Ranking Member McCain, and Members of the Committee. My name is Ashley Bacon, and I am the Acting Chief Risk Officer of JPMorgan. I have been at JPMorgan for 20 years and have spent six years in the Firm's Risk Management function. I appreciate the opportunity to come before you today as a part of your inquiry into the CIO synthetic credit portfolio to tell you about what I observed after being asked in late April to independently assess the CIO trades. Let me first start by expressing the entire Firm's commitment to the importance of effective risk management.

Turning to the CIO portfolio at issue: at the request of senior Firm management, I was brought in from outside the Chief Investment Office in late April 2012, along with other individuals from the Investment Bank, to lead a team of professionals conducting a detailed assessment of the synthetic credit portfolio. The purpose of that review was to understand the persistent losses being experienced and to help chart a course forward. Our team worked long hours on this review and reported back to senior Firm management on at least a daily basis. After initial reports, we were asked to take over responsibility for the day-to-day management of the synthetic credit portfolio—a responsibility that we held until a new CIO management team took over.

The Firm also requested that my colleague Michael Cavanagh lead a Task Force to investigate these trades. Later today, I believe that Mr. Cavanagh will speak in some detail to that effort and to the remedial steps identified by the Task Force in response. I will simply discuss a few of the key steps we have taken as a Firm to improve our risk management—both within the CIO and elsewhere in the Firm.

First, the Firm appointed a new Chief Risk Officer for CIO in May 2012. Additionally, the Firm took steps to ensure Risk's independence and the appropriateness of staffing levels. The new CIO Chief Risk Officer's actual reporting practices now conform to his functional reporting line. He reports to me, and his compensation and career advancement are controlled by Risk, with input from the business and others about his performance, as appropriate.

Second, the Firm has overhauled the CIO Risk Committee. The Committee now meets on a weekly basis and attendees include other members of senior management, from within and outside of CIO. It has been reconstituted as the CIO, Treasury and Corporate Risk Committee, to reflect its broader responsibilities and increased participation.

Third, CIO has implemented numerous new or restructured risk limits covering a broad set of risk parameters. What remained of the synthetic credit portfolio was transferred to the Firm's Investment Bank, where it is subject to appropriate oversight and detailed analysis.

Finally, JPMorgan has conducted a comprehensive self-assessment of the Risk organization and, as a result, we are implementing a series of improvements both Firm-wide and within our lines of business. In addition to working to improve model development, review, approval, and monitoring, the Firm is reaffirming and, where appropriate, is revising its market risk limits across all of its lines of business. We have introduced additional granular, portfolio-level limits and will continue to do so as appropriate. We have strengthened our processes for limit excessions to provide for more rapid escalation and more effective review. We have established a Firm-wide Risk Committee, improved the operation of our Risk Operating and Risk

Governance Committees, and enhanced our reporting to the Board of Directors' Risk Policy Committee.

A risk organization must constantly look for ways to improve. The steps I have described reflect our fundamental belief in how the Firm's risk profile should be overseen with effective challenge and with the right level of information available to address risk issues effectively.

Thank you for the opportunity to appear before you today, and I welcome any questions you have.

STATEMENT OF PETER WEILAND

Written Testimony for the Senate Permanent Subcommittee on Investigations
March 15, 2013

Chairman Levin, Ranking Member McCain, and Members of the Subcommittee:

My name is Peter Weiland. I was employed at J.P. Morgan as its Head of Market Risk in J.P. Morgan's Chief Investment Office ("CIO") from October 2008 until October 2012. I am here in response to the invitation I received from the Subcommittee, and I will attempt to provide information and answer questions to the best of my recollection and knowledge.

I am proud of the CIO and its accomplishments. It was a hard working team that took its job seriously. The events of 2012 were a substantial disappointment but I am here today to help explain the facts surrounding those events.

In your invitation to me, you asked for information on several different topics. I will try to respond to those questions as directly and as succinctly as I can.

You asked me about the risk management structure in the CIO and my role in managing risks, including within the London office. The risk management structure changed over the four years I was there. I was hired in October, 2008, by Ina Drew to be the Head of Market Risk. There was no Chief Risk Officer for the CIO at that time. When I was hired, I had a direct reporting line to Ms. Drew with an indirect line to J.P. Morgan's Chief Risk Officer ("CRO") Barry Zubrow. In mid-2009, my official reporting line changed to a direct line to Mr. Zubrow with an indirect line to Ms. Drew.

In September, 2011, a search was announced to bring in a Chief Risk Officer for the CIO to whom I would report. In January, 2012, Irv Goldman was selected to be the CRO for the CIO. Upon his hiring, I reported directly to Mr. Goldman.

The second question posed to me by the Subcommittee was to describe the risk management practices at the CIO, including the risk metrics and the limits that were used, who set the limits, and how the breaches were handled. During most of the period in question, the CIO's activity was divided into SAA (strategic, longer term investment activity mostly in AFS accounting) and TAA (tactical, shorter term activity, mostly mark-to-market accounting). The SAA risk framework was generally not based on delegated trading limits; the SAA Committee specifically approved portfolio activity.

The TAA was treated with a traditional delegated limit framework, including limits on Value-at-Risk ("VaR"), stress, and non-statisticals. Synthetic credit, although intended to offset strategic credit exposures, was included in the TAA because accounting rules require derivatives to be mark-to-market. Therefore, CIO market risk limits largely applied only to TAA activity with some exceptions, including individual issuer limits in SAA ("single name limits"). In late 2011 and early 2012, it was agreed to include the SAA in firm-wide stress limit in the firm-wide stress limit framework. This was implemented during the first quarter of 2012.

Limit approvals were to be made at various levels; limits were agreed by the nature of the business and the Risk. Top (Level 1) CIO limits were approved by the CEO, the CRO, and the CIO. Within the CIO, Level 2, limits were approved by Ms. Drew, regional CIOs, and myself. Some regional limits were approved by regional CIOs and myself. Breaches of the limits were handled according to firm-wide Market Risk policy; the designated approvers were notified when the breaches occurred.

The third question that the Subcommittee posed was the CIO's efforts to develop alterative risk and capital models during 2011 and 2012, in particular to recalculate the Value-at-

Risk, the Comprehensive Risk Measure ("CRM"), and the Risk Weighted Assets ("RWA") results, and my role in those efforts.

In early 2011, I discussed expected Basel 2.5 risk requirements with central Risk QR staff. Risk QR was developing a CRM model to encompass all J.P. Morgan synthetic credit activity. In addition, it became clear that the VaR for CIO synthetic credit would need to be upgraded. The target date for this upgrade was to be the end of 2011. In this regard, several historical factors are relevant:

- In 2009, the CIO synthetic credit VaR was initially modeled after the Investment Bank ("IB") for consistency;
- the IB upgraded its VaR with a heavy dependence on individual credit curves in 2010. Because CIO activity is purely index based, it was clear that the IB's individual name approach would be inappropriate for the CIO;
- in 2011, the Market Risk Technology group developed a VaR tool that was expected to take data feeds from both the IB and the CIO. In August, 2011, the initial feeds from CIO failed and it was determined that the VaR tool did not work without IB transformation tools;
- in September, 2011, the CIO office began work on a new VaR model that was intended to meet all the requirements of Basel 2.5. The development of this new VaR model was led by Pat Hagan of the CIO, with close monitoring by the Risk QR to ensure fulfillments of all regulatory requirements;
- concurrently, the Risk QR was developing a CRM model, another contributor to RWA for synthetic credit (RWA = VaR + stress VaR + CRM). The CIO business quantitative team had questions about the details about the central CRM model

development. The European CIO team requested approval to develop a CRM model specifically for CIO, but their request was denied;

- the CIO business quant team developed a parallel model CRM to try to better understand the central CRM model;
- ultimately, the CIO synthetic credit VaR was approved by the Risk QR and then implemented at the end of January, 2012. Subsequently, it was determined that coding errors resulted in an incorrect VaR calculation and the VaR was rolled back to its previous model;
- my role throughout the process was to maintain focus to ensure that the new VaR was implemented so that the firm would meet regulatory deadlines as well as maintain communication with the Risk QR regarding CRM model development and testing.

The fourth question that you submitted asked for information about my role in analyzing the risks associated with the Synthetic Credit Portfolio (SCP) and the SCP's record of risk limit breaches and actions taken in response to those breaches in 2011 and 2012. As always, the answers to SCP questions are complicated. But I was responsible for all Market Risk within the CIO, including synthetic credit, during my tenure as the Head of Market Risk. This included a wide range of activities, including:

- the AFS securities portfolio consisting of a wide variety of asset classes including MBS, CMBS, CLOs, student loan ABS, credit card ABS, uni-bonds and so forth. This was a portfolio of approximately $400 billion;
- Mortgage Servicing Rights hedging activity, including very large interest rates, volatility, and prepayment risks;
- structural Foreign Exchange (FX) hedging activity;

- tactical positioning in New York, London, and Hong Kong, primarily in rates and FX and also including synthetic credit;
- CIO private equity activity.

Supporting me in London was one senior risk manager for whom the synthetic credit portfolio was part of his responsibilities. There were also two junior resources dedicated to the synthetic credit portfolio.

The main limits on CIO synthetic credit in 2012 were VaR, stress, csbpv, and csw10%. The initial breaches were csbpv breaches. The csbpv values for all synthetic credit positions were added to arrive at the usage. During early 2012, as investment grade ("IG") positions began to be used in size to offset high yield (HY) positions, the total csbpv grew because risk equivalent IG and HY positions had a very different csbpv value. Given this change in the business mix, it was determined that the csbpv was no longer a useful limit.

VaR limit breaches also occurred during January, 2012, sometimes resulting in a firmwide VaR limit breach. Given that the CIO VaR was known to consistently overstate P/L volatility and because it was believed that an improved model was near implementation, the new VaR model output was an important consideration in the approval of one-off increases and gave management comfort that the VaR breaches would not have occurred if a new model were already in place. However, because of further breaches of the csw10% limits and stress limits that were occurring at the end of March and April, 2012, there was increased attention to the portfolio from senior management due to the RWA, the losses, and the press.

The fifth question you asked was an inquiry as to what actions were taken to inform senior bank managers about the SCP risk issues. Let me first note that the size of the synthetic credit portfolio was well understood among the senior management at J.P. Morgan. The portfolio dominated CIO VaR for most of the period from 2008 to 2012, and it had a significant impact on stress test results as well. Because the track record for managing such a significant risk had been good, namely there were significant gains in 2009 and relatively stable results during the rest of the period, matters proceeded in the normal course. There were active discussions on regulatory capital usage.

The final question you asked me related to what actions were taken to inform regulators about SCP issues. During the period in question, I had occasional meetings with regulators with regard with to the CCAR regulatory stress exercises. In addition, the CIO management team met with regulators in April 2012 to discuss the SCP events. I also recall that there were some additional meetings about synthetic credit following up on the meeting with regulators in April, 2012.

I hope the above answers are helpful to your inquiry. Because this subject area is so complicated, it is hard to give succinct answers. I am happy to answer any questions about the above topics.

Thank you.

Michael Cavanagh
Co-Chief Executive Officer, Corporate and Investment Bank,
on Behalf of JPMorgan Chase & Co.
Written Testimony for the Senate Permanent Subcommittee on Investigations
March 15, 2013

I. Introduction

Good morning Chairman Levin, Ranking Member McCain, and Members of the Subcommittee. My name is Michael Cavanagh, and I serve as the Co-Chief Executive Officer of the Corporate and Investment Bank at JPMorgan Chase & Co. ("JPMorgan" or the "Firm"). I also led the JPMorgan Management Task Force's review of losses incurred in 2012 by the Firm's Chief Investment Office ("CIO"). I appreciate the opportunity to participate in today's hearing on matters relating to those losses, and will answer as best I can any questions you might have.[1]

We have worked closely with the Subcommittee's staff during the course of its inquiry regarding the 2012 CIO losses, and have cooperated as completely as possible to help provide a full picture of what happened and how it happened, as well as JPMorgan's response. We appreciate the courtesies the staff has extended throughout the course of this inquiry and thank them for their professionalism.

You have requested that we address in this testimony a range of topics, including the findings of the Task Force, oversight of CIO and the Synthetic Credit Portfolio (including trading strategies, risk management, hedging, valuation, and modeling), and communications with third parties, including investors and regulators, regarding the Synthetic Credit Portfolio. I address each of these topics below. Before turning to them, however, and on behalf of our entire

[1] My testimony today is intended to reflect the Task Force's view of the facts. Others, including regulators conducting their own investigations, may have a different view of the facts, or may focus on facts not described in the Task Force Report, and may also draw different conclusions regarding the facts and issues. The Task Force's mandate did not include drawing any legal conclusion, and accordingly, by my testimony today, neither I nor the Task Force purport to do so.

management team, I want to repeat what we have said before: that we let down our shareholders and failed to meet the high standard we set for ourselves. We have learned valuable lessons from our experience, and have taken and are continuing to take a number of significant remedial actions that we believe will make us an even stronger company going forward.

II. The Task Force

Over the past nine months, the Task Force and its advisors conducted a thorough review of the CIO losses. The Task Force's work – which included interviews of many current and former JPMorgan employees, an examination of millions of documents, and review of tens of thousands of audio files – was overseen by an independent Review Committee of the Board of Directors, which conducted its own investigation and with whom the Task Force also shared and discussed its findings. The Task Force also shared and discussed its findings with the entire Board, and as you know, made its findings public on January 16, 2013.

The Task Force made five key observations, which are described briefly below. These observations reflect the Task Force's view that direct and principal responsibility for the losses lies with the traders who designed and implemented the flawed trading strategy. However, they also reflect the Task Force's view that responsibility for the flaws that *allowed* the losses to occur lies primarily with CIO management but also with senior Firm management.

The Firm's views on responsibility for these losses have had direct and concrete results. The Firm has terminated the employment of those most responsible and clawed back their compensation; it has accepted the resignations of other relevant employees; and it has reduced the compensation of other personnel both within CIO and elsewhere, including the Chief Executive Officer. Beyond these employment actions, the Firm has undertaken a significant effort, across the entire Firm, to re-examine its risk management practices, and has worked to take all necessary steps to ensure that the Firm is employing best practices and is well-positioned to prevent similar incidents in the future.

A. The Findings of the Task Force

1. Key Observations

The Task Force made five key observations regarding CIO and the losses, and these observations correlate to several of the topics you have requested this testimony address. First, CIO's judgment, execution and escalation of issues in the first quarter of 2012 were poor, in at least six critical areas: (1) CIO management established competing and inconsistent priorities for the Synthetic Credit Portfolio without adequately exploring or understanding how the priorities would be simultaneously addressed; (2) the trading strategies that were designed in an effort to achieve the various priorities were poorly conceived and not fully understood by CIO management and other CIO personnel who might have been in a position to manage the risks of the Synthetic Credit Portfolio effectively; (3) CIO management (including CIO's Finance function) failed to obtain robust, detailed reporting on the activity in the Synthetic Credit Portfolio, and/or to otherwise appropriately monitor the traders' activity as closely as they should have; (4) CIO personnel at all levels failed to adequately respond to and escalate (including to senior Firm management and the Board) concerns that were raised at various points during the trading; (5) certain of the traders did not show the full extent of the Synthetic Credit Portfolio's losses; and (6) CIO provided to senior Firm management excessively optimistic and inadequately analyzed estimates of the Synthetic Credit Portfolio's future performance in the days leading up to the April 13 earnings call.

Second, the Firm did not ensure that the controls and oversight of CIO evolved commensurately with the increased complexity and risks of CIO's activities. As a result, significant risk management weaknesses developed within CIO that allowed the traders to pursue their flawed and risky trading strategies. On this point, the Task Force concluded that senior Firm management's view of CIO had not evolved to reflect the increasingly complex and risky strategies CIO was pursuing in the Synthetic Credit Portfolio; instead, they continued to view CIO as the manager of a stable, high-quality, fixed-income portfolio. As a result, they were less focused on CIO relative to client-facing businesses, and did not do enough to verify that CIO was well managed or that the Firm was fully applying its various risk and other controls to the Synthetic Credit Portfolio's activities. Compounding the matter, the CIO Finance function failed to ensure that its price-testing procedures for the Synthetic Credit Portfolio were being properly and rigorously implemented, and that it produced robust reporting and analytics regarding the portfolio's performance and characteristics.

Third, CIO Risk Management lacked the personnel and structure necessary to manage the risks of the Synthetic Credit Portfolio. With respect to personnel, a new CIO Chief Risk Officer was appointed in early 2012, and he was learning the role at the same time the traders were building the ultimately problematic positions. More broadly, the CIO Risk function had been historically understaffed, and some of the CIO risk personnel lacked the requisite skills. With respect to structural issues, the CIO Risk Committee met only infrequently, and its regular attendees did not include personnel from outside CIO. As a result, the CIO Risk Committee did not effectively perform its intended role as a forum for constructive challenge of practices, strategies and controls. Furthermore, at least some CIO risk managers did not consider themselves sufficiently independent from CIO's business operations and did not feel empowered to ask hard questions, criticize trading strategies or escalate their concerns in an effective manner to Firm-wide Risk Management.

CIO Risk Management made a number of key missteps, including failures to (1) review the appropriateness of the CIO risk limits used from 2009 to 2012; (2) ensure that the change to the CIO Value-at-Risk ("VaR") model for the Synthetic Credit Portfolio in January 2012 was appropriate and being properly implemented; and (3) appreciate the significance of the changes in the Synthetic Credit Portfolio during early 2012.

Fourth, the risk limits applicable to CIO were not sufficiently granular. There were no limits by size, asset type or risk factor specific to the Synthetic Credit Portfolio; rather, limits in CIO were applied only to CIO as a whole. The absence of granular limits played a role in allowing the flawed trading strategies to proceed in the first quarter, especially as the positions grew in size.

Fifth, approval and implementation of the new CIO VaR model for the Synthetic Credit Portfolio in late January 2012 were flawed, and the model as implemented understated the risks presented by the trades in the first quarter of 2012. The model suffered from significant operational shortcomings that received inadequate scrutiny by CIO Market Risk, the Model Review Group, and the model's developer in the model approval process. Moreover, although the model produced significantly different results from its predecessor, the personnel involved in reviewing and approving the new model required only limited back-testing.

2. Remediation

The Firm has taken comprehensive remedial steps to address deficiencies identified since the losses. These include the following:

First, the Firm has replaced the individuals within CIO responsible for the losses. The Firm has terminated the employment or accepted the resignations of the traders and managers who were responsible for the trades that generated the losses, and pursued the maximum clawback of their compensation. The Firm also accepted the Chief Investment Officer's retirement, as well as her voluntary agreement to return or waive amounts that the Firm otherwise deemed subject to a clawback. The Firm has also substantially reduced (in some cases, to zero) the 2012 incentive compensation for a number of employees and, in addition to reductions for specific CIO employees, has also reduced the 2012 incentive compensation pool for all of CIO.

Second, the Firm has appointed a new, experienced CIO leadership team. The new leadership team began promptly to reposition CIO to focus on its basic mandate, and the Firm also has increased resources for key support functions within CIO, including Finance and Risk Management.

Third, the Firm has adopted a variety of governance measures to improve its oversight of CIO, and ensure that CIO is better integrated into the rest of the Firm. For example, the Firm has instituted new and robust committee structures within CIO, and has taken steps to enhance the Firm's internal audit coverage of CIO activities and ensure tight linkages among CIO, Corporate Treasury and other operations within the Firm's Corporate sector.[2] The Firm has also integrated the existing CIO Valuation Control Group ("VCG") staff into the Investment Bank's Valuation Control Group. In addition, the Firm has established a CIO Valuation Governance Forum ("VGF") as part of a Firm-wide initiative to strengthen the governance of valuation activities. The Firm has also mandated that the CIO Corporate Business Review be conducted with increasing frequency, and with the same rigor as similar reviews for the Firm's client-facing lines of business.

[2] The Corporate sector (also referred to as the "Corporate/Private Equity" sector) comprises Private Equity, Treasury, Chief Investment Office, and Other Corporate, which includes corporate staff units (such as Audit, Finance, Human Resources, and others) and other centrally managed expense.

Fourth, the Firm has overhauled the Risk Committee for CIO and enhanced the independence of the CIO Risk function. For example, the new CIO Chief Risk Officer's functional reporting practices now conform to his official reporting line; there is no confusion about his accountability to the Firm-wide Risk function. His compensation and career advancement will be controlled by the Firm Chief Risk Officer, with input about his performance from others, as appropriate. CIO's Risk Committee has been renamed the CIO, Treasury and Corporate Risk Committee, and now has broader responsibilities, covering Treasury and Corporate functions as well as CIO, and significant representation beyond CIO. The committee now meets on a weekly basis, and attendees also now include other members of senior management, from within and outside of CIO.

Fifth, CIO has implemented new or restructured risk limits covering a broad set of risk parameters. Furthermore, the Synthetic Credit Portfolio – after significant de-risking – was transferred at the end of the second quarter of 2012 from CIO to the JPMorgan Investment Bank, which has an experienced team of traders and risk managers who were better positioned to close out the remaining positions.

Finally, under the guidance of its Chief Risk Officer, the Firm conducted a comprehensive self-assessment of its entire Risk organization and, as a result, has implemented a series of improvements both Firm-wide and within the lines of business. In addition to working to improve model development, review, approval, and monitoring, the Firm is reaffirming and, where appropriate, revising its market risk limits across all of its lines of business, and has already introduced additional granular and portfolio-level limits. It has strengthened the Firm-wide limit excession policy to provide for more rapid escalation and a more thorough review. It is working to further improve market-risk reporting, and has made substantial enhancements to risk reports presented to the Board of Directors' Risk Policy Committee ("DRPC"). The Firm also has restructured its Firm-wide Risk Operating Committee in order to increase focus on identifying and implementing best practices across the Firm. Finally, the Firm has enhanced the structure of its Risk Governance Committee and established a Firm-wide Risk Committee.

B. Oversight of CIO and the Synthetic Credit Portfolio

You have asked that I address five specific oversight-related topics: (1) oversight of CIO and the Synthetic Credit Portfolio generally; (2) oversight of the Synthetic Credit Portfolio's trading strategies and risk management; (3) oversight of hedging activities by the Synthetic Credit Portfolio; (4) oversight of valuation practices; and (5) oversight of risk and capital models. Several of these topics are addressed above in the context of specific Task Force observations and remedial actions; I separately discuss below oversight of hedging activities and valuation practices.

With respect to oversight of the hedging activities, let me note at the outset that CIO no longer engages in the type of trading that generated the losses in the Synthetic Credit Portfolio and has refocused on its core mandate of traditional Asset and Liability Management. Future synthetic credit positions will be within applicable risk limits, linked to a particular risk or set of risks that they are designed to offset, and subject to specified documentation, reporting and monitoring requirements.

As to valuation practices, the Firm determined in July 2012 that CIO's internal controls over valuation of the Synthetic Credit Portfolio suffered from a material control weakness as of March 31, 2012. Since this discovery, the Firm has restructured and enhanced its independent valuation control group in order to remedy this shortcoming.

C. Communications with Third Parties

1. Investors

You also asked that I address actions taken to inform investors about the Synthetic Credit Portfolio. The Firm made two relevant disclosures to the market relating to the Synthetic Credit Portfolio during the first half of 2012: on an April 13, 2012 earnings call, and in a May 10, 2012 Form 10-Q and accompanying analyst call. With respect to both, the Firm subsequently learned information that caused it to make a further disclosure to the market.

As to the April 13, 2012 earnings call, as you are aware, Mr. Braunstein stated that the Firm was "very comfortable" with the positions in the Synthetic Credit Portfolio, and Mr. Dimon agreed with an analyst's characterization of the publicity surrounding the Synthetic Credit Portfolio as a "tempest in a teapot." Those statements turned out to be wrong, of course, though they were the product of good-faith efforts to assess the Synthetic Credit Portfolio. As described in the Task Force Report, in the period leading up to April 13, Mr. Dimon and Mr. Braunstein, among others, requested that CIO provide information and analyses about the Synthetic Credit Portfolio in light of recent press coverage relating to the Synthetic Credit Portfolio. These analyses concluded, in broad terms, that the Synthetic Credit Portfolio was generally "balanced," that the market was currently dislocated, and that mark-to-market losses were temporary and manageable. One of the traders in particular expressed confidence that mark-to-market prices in the Synthetic Credit Portfolio would "mean revert."

The losses in the Synthetic Credit Portfolio, however, increased in the weeks after the April 13 earnings call. These losses prompted senior Firm management in late April to direct non-CIO personnel to review and, ultimately, assume control of the Synthetic Credit Portfolio. A team led by a senior member of Firm-wide Market Risk examined the portfolio, and after analyzing, among other things, correlations of the positions and sensitivities under a range of market scenarios, the team concluded – and informed senior Firm management – that the Synthetic Credit Portfolio faced much greater exposure than previously reported by CIO. The team also found that the market's knowledge of CIO's positions would make it even more challenging to reduce the risks presented by those positions.

In addition to this risk-related review, in preparation for the filing of its Form 10-Q for the first quarter of 2012, the Firm undertook a review relating to the valuations of positions in the Synthetic Credit Portfolio. Based on this review, the Firm concluded that its marks at March 31 for the Synthetic Credit Portfolio complied with U.S. Generally Accepted Accounting Principles. This conclusion was reached in consultation with the Firm's outside auditors, PricewaterhouseCoopers LLP ("PwC").

On May 10, the Firm disclosed that there were significant problems with the strategy for the Synthetic Credit Portfolio. In Mr. Dimon's words, the strategy was "flawed, complex, poorly reviewed, poorly executed, and poorly monitored." The Firm disclosed that the Synthetic Credit Portfolio had incurred more than $2 billion in mark-to-market losses up to that point in the second quarter, with the possibility of additional future losses and volatility.

Shortly after May 10, the Task Force was formed to investigate the causes of the losses. In the course of our ensuing work, we became aware of evidence – primarily in the form of electronic communications and taped conversations – that raised questions about the integrity of the marks in the Synthetic Credit Portfolio in March 2012. After consulting with PwC, the Firm concluded that it was no longer confident that the March 31 marks reflected good-faith estimates of the fair value of all the instruments in the Synthetic Credit Portfolio. Accordingly, on July 13, the Firm announced that it would be restating its first-quarter net income, to lower it by $459 million. At the same time, the Firm also announced that it had been expeditiously reducing risk in the Synthetic Credit Portfolio and that the cumulative year-to-date losses through June 30, 2012 had grown to approximately $5.8 billion.

2. Regulators

Finally, you asked about actions taken to inform regulators about the Synthetic Credit Portfolio. The Task Force's focus was the causes of the losses, and as a result, a detailed timeline of the Firm's communications with its regulators relating to the portfolio was beyond our scope. As a general matter, we try to be very open and communicative with our regulators, and they generally have access to whatever information they seek about matters like trading positions. Unfortunately, as we have said before, to the extent that we were wrong about the riskiness of the Synthetic Credit Portfolio in mid-April, we were also wrong when we discussed the portfolio's losses with our regulators at that time. And thereafter, when the losses in the Synthetic Credit Portfolio accelerated at the end of April, we should have been proactive in keeping our regulators so informed. That said, as noted in the Task Force report, senior Firm management and the new CIO leadership team recognize the importance of an open and transparent culture, including in its communications with the Firm's regulators. The Firm has been working and will continue to work to ensure regulators consistently have full and timely visibility into CIO's activities, and to enhance a culture of prompt and complete disclosure in accordance with regulators' expectations.

III. Policy Considerations

JPMorgan and its regulators have a common interest in ensuring that the Firm has the right risk controls in place; CIO no longer engages in the types of trades that generated the losses in the Synthetic Credit Portfolio. Future synthetic credit positions in CIO will be subject to appropriate reporting and monitoring requirements, and linked with appropriate documentation to a particular risk or set of risks that they are designed to offset. We believe that the changes we have made appropriately reflect the approach to hedging outlined in the proposed Volcker rule, in that they impose strong internal controls over hedging, including requirements that all hedge transactions be properly documented and monitored. We also understand that Congress and our regulators will determine the appropriate regulatory and policy response to ensure that the issues we faced are not repeated by us or other institutions.

IV. Conclusion

As described above, the Task Force does not believe that the CIO losses stemmed from any one specific act or omission. Rather, the Task Force concluded that the losses were the result of a number of acts and omissions, some large and some seemingly small, some involving personnel and some involving structure, and a change in any one of which might have led to a different result. This experience has caused substantial and healthy introspection at the Firm and recognition of the need for continued improvement in multiple areas. Ultimately, the Task Force concluded that this incident teaches a number of important lessons that the Firm is taking very seriously. Thank you for the opportunity to participate in this hearing and I am happy to answer your questions.

For Release Upon Delivery
9:30 a.m. March 15, 2013

TESTIMONY OF

**THE OFFICE OF THE
COMPTROLLER OF THE CURRENCY**

before the

**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS**

UNITED STATES SENATE

March 15, 2013

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Levin, Ranking Member McCain, and members of the Subcommittee, we appreciate this opportunity to discuss the OCC's oversight of JPMorgan Chase, National Association (the bank), as it relates to the bank's more than $6 billion in trading losses last year. The Subcommittee's important work in this area will enhance our understanding of lessons learned from the specific events at the bank and how we may apply them to improve both the risk management of other large institutions and our own supervisory processes. The OCC has supported the Subcommittee's efforts to review the bank's credit derivatives trades, and we will continue to cooperate on this matter.

The risk management culture and processes that led to the significant trading losses at the bank are unacceptable. The bank's risk management and internal controls failed to identify and appropriately manage credit derivatives trading practices conducted by the Chief Investment Office (CIO) on behalf of the bank. Corporate governance and oversight were lacking with respect to the CIO risk taking. As a result, the activity and the risk associated with the CIO were not transparent. Equally troubling was the failure of the bank to provide timely and complete information to the OCC as events unfolded. This represents a fundamental breakdown in the open communication that we expect bank management to maintain with our supervisory staffs. Had the risk management and audit processes worked as intended, this activity should have been highlighted to bank management and supervisors, thereby resulting in greater scrutiny by both the bank and the OCC.

Clearly, there were red flags that we should have noticed and acted upon, and as our testimony will describe, we have taken actions to strengthen our supervision in this area. However, once we became aware of the potential scope of the problems in the trades conducted by the CIO on behalf of the bank, we quickly took actions to obtain more information from the bank, and we initiated a series of targeted examinations. Based on our findings, we issued a Cease and Desist (C&D) order against the bank to remedy the unsafe and unsound practices and legal violations related to the derivatives trading activities conducted by the CIO on behalf of the bank.[1] As more fully described in our C&D, we found deficiencies in the following core functions: oversight and governance; risk management processes and procedures; control over trade valuation; development and implementation of models; and internal audit processes. Throughout this time, we were working closely with supervisors from the Federal Reserve System, and, concurrent with the OCC's enforcement action, the Board of Governors of the Federal Reserve System (FRB) issued a C&D order against the bank's parent company, JPMorgan Chase & Co (the holding company).

We also launched an internal review to assess the quality of our supervision and lessons learned in order to strengthen our supervision at the bank and across the large bank population that we supervise. Our goal is to ensure that we focus resources efficiently and effectively to identify risks, assess the adequacy of banks' governance and risk management, and ensure that weaknesses are promptly addressed.

Our testimony addresses the key issues highlighted in the Subcommittee's invitation letter, including our oversight of the CIO activities affecting the bank and the Synthetic Credit Portfolio (SCP); the extent to which the bank provided evidence of the SCP risk mitigation activities; our oversight of the SCP's valuation practices and the bank's use of its Value at Risk (VaR) models; and the extent to which the CIO and the bank impeded effective oversight by the OCC. Our testimony then describes the lessons

[1] See OCC NR 2013-7, http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-7.html.

we have learned from our internal review and examinations, and how we are using those lessons to improve our supervision of large banks.

I. An Overview of the Bank, the CIO, and SCP

JPMC is a $2.4 trillion bank holding company with approximately $140 billion in Tier 1 common capital as of December 31, 2012. The lead national bank has approximately $1.9 trillion in total consolidated assets and $112 billion in Tier 1 common capital.

The activities that generated the reported $6 billion loss were conducted in the national bank by the CIO. CIO performs a number of tasks, principally taking positions to manage the holding company's (and the bank's) exposure to various risks and investing cash. The CIO's primary mandate is to manage structural interest rate risk and hedge foreign currency capital and mortgage servicing rights. It also manages company-owned and bank-owned life insurance and oversees the holding company's pension funds. The CIO also had small securities and derivatives positions for both trading and investment purposes. The CIO functions separately from the holding company's investment banking business, where most trading and market making take place.

In 2006, the holding company formally approved a modest initiative of the CIO to trade credit indexes in North America and London to manage the holding company's large cyclical exposure to credit. The VaR limit for this program was initially $5 million. The program grew rapidly in 2007 and 2008 as the financial crisis developed, taking substantial short positions in High Yield (HY) credit in SCP intended to hedge potential credit losses in loan and other portfolios. Because they were short positions, their value would generally increase if credit conditions in this market segment deteriorated.

Premiums paid for that protection were offset by long credit positions in other HY maturities and indexes as well as short and long Investment Grade (IG) credit positions across a variety of indexes, maturities, series, regions, and tranches. As HY positions are generally not bank-eligible, the bank transferred the market risk of these positions into a subsidiary of an Edge Act corporation, which took most of the losses. SCP was actively managed to achieve a dual mandate: make modest returns in a benign environment and more substantial returns in a credit stress event.

Throughout the financial crisis, the position appeared to perform well. By September 2010 the bank had reduced its SCP risk, and CIO management planned to further reduce the position. 2011 was a pivotal year, as markets stabilized and the risk/reward of the book was not as compelling as it had been. Consequently, the book size was reduced until June 2011. However, this cutback in stress loss protection led to large and sustained excesses of the CIO stress loss limits from February through June 2011. The limit excesses stopped in June 2011 when the HY short positions were increased once again as credit markets deteriorated.

In late 2011, CIO management had a stated goal of reducing the internal risk-based capital allocated to the CIO unit through reductions in the CIO's risk-weighted assets (RWA). This was to be accomplished in part by changes in the credit derivatives positions. Despite that goal, CIO added to its HY short positions in late 2011 and early 2012. The CIO also added to the other positions to offset premiums paid on the short position. Losses, both actual and potential, accumulated in January 2012 so that by the end of the month, traders and CIO management were struggling to come up with a viable strategy to either stop building positions or, conversely, to continue aggressively trading with the hope that markets would turn more favorable. Ultimately, they chose the latter strategy and in February and March, there was a large and rapid increase in positions across a wide range of indexes, maturities, series, and tranches.

The positions became so large as to be noticed by external market traders and reported in the press. Losses continued to mount through April leading to the holding company's public announcement of $2 billion dollars in losses with the potential for more to come. To-date, reported losses on the position have totaled some $6 billion.

II. The OCC's Oversight of the CIO and the SCP

The OCC oversees the holding company's national banks and various subsidiaries, including a branch in London. The FRB oversees the holding company and its affiliates, as well as the Edge Act subsidiary of the national bank. The OCC's supervisory team includes approximately 65 onsite examiners who are responsible for reviewing nearly all facets of the bank's activities and operations, including commercial and retail credit; mortgage banking; trading and other capital markets activities; asset liability management; bank technology and other aspects of operational risk; audit, and internal controls; and compliance with the Bank Secrecy Act, anti-money laundering laws, and the Community Reinvestment Act. These onsite examiners are supported by additional subject matter experts from across the OCC, and a small team of examiners in London.

OCC supervises the CIO activities affecting the bank as part of its broader supervision of capital markets activities in the bank. The CIO activities are conducted globally but managed and controlled out of the holding company's New York offices. As a result, these activities are supervised by OCC and FRB staff assigned to the firm's headquarters in New York.

Examination targets for the bank's capital markets activities were determined based on our risk assessment system. As part of this process, our capital markets team made supervisory judgments in order to focus attention where we perceived the largest risk to be. We examined high risk and complex trading books in the bank's investment bank. The examination team also reviewed the bank's compliance with Basel rules, liquidity, and interest rate risk management. Within the CIO, our supervisory focus was on its investment portfolio. This $350 billion portfolio had grown quickly through 2008 and 2009 due to mergers and growth in deposits. The objectives of the portfolio are twofold: 1) to serve as a warehouse of liquid assets should the bank experience deposit losses due to idiosyncratic or systemic stress; and 2) to provide an earnings buffer for deployment of excess deposits. Given its growth, we were focusing much of our attention there.

We were aware of the various short term strategies being conducted in the CIO, and their performance and risk were mentioned briefly in Treasury, CIO, and holding company reports. While we knew that the CIO held a position protecting against an economic downturn, we now realize that the bank's reporting on SCP did not convey the full nature of the activities or risks. Throughout much of the financial crisis and into 2011, the SCP book was consolidated into CIO performance metrics and not reported separately. Because of this lack of granular information, in 2011 and until the disclosure of the losses, reporting about the SCP was not transparent, and information of interest to examiners on emerging issues was not provided. This lack of transparency inhibited our ability to fully understand the nature of the risk taking and evolution of the SCP strategy.

Following the April 2012 *Wall Street Journal* article about the "London Whale," we directed the bank to provide us with granular information about the SCP so that we could fully assess the risks being taken, and we began internal discussions on the scope of corrective actions warranted. We quickly determined that a full-scale, comprehensive review of the activities and oversight of the CIO and SCP was required due to increasing levels of losses the bank was then reporting and the bank's lack of fulsome responses to our requests for information. Our review was launched during the first week of May and had two components. The first component focused on evaluating the adequacy of the bank's risk controls and risk governance, informed by their application to the positions at issue. The second component evaluated the lessons that could be learned from this episode to enhance risk control and risk management processes at this and other banks, and to improve OCC supervisory approaches.

The first prong of our review involved our onsite examination team focusing on three broad areas. First, we actively assessed the quality of management and risk management in the CIO function. This review looked at decision making and board oversight, including whether the risk committee members were appropriately informed and engaged; the types and reasonableness of risk measurement metrics and limits; the model governance review process; the valuation control process; and the quality of work by the independent risk management team, as well as internal audit. Second, we assessed the adequacy of the information provided within the holding company and the bank and made available to the OCC to evaluate the risks and risk controls associated with the positions undertaken by the CIO. Third, we are now reviewing the compensation process of the CIO and assessing the bank's determination on "claw backs" as part of that analysis.

Working on a parallel track, as part of the second prong of our supervisory review, we compiled a detailed chronology of events to identify gaps in the bank's risk management and to provide lessons to be learned for the OCC. To ensure that we had a full and complete picture of the SCP portfolio and how it changed over time, our internal review initially covered activities from the start of 2011, over a year before the losses were realized, and in some cases, extended back several years. We focused particular attention on the rationale for the transactions and how they fit within the framework of the bank's risk management processes; the quality and extent of information provided to the OCC; and consistency of the bank's actions with OCC supervisory guidance. In addition, we assessed relevant audit and examination findings and whether deficiencies were addressed; the extent to which the risks associated with the strategy were recognized and evaluated; and whether there was an effective exchange of views among the business unit and control groups.

As a result of the work of the onsite examination teams, and as previously noted, we issued a C&D order against the bank for unsafe and unsound practices, and legal violations related to derivatives trading activities conducted on behalf of the bank by the CIO. Those practices and violations are detailed in the C&D order, which is available on the OCC website.[2] The bank has committed to taking all necessary and appropriate steps to remedy the deficiencies, unsafe or unsound practices, and violations identified by the

[2] See http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-7a.pdf.

OCC, and our examiners are closely monitoring the bank's corrective actions and compliance with our order.

III. The Extent to Which the Bank Provided Evidence of SCP Hedging Activities in 2012

The SCP portfolio was never specifically linked to a dedicated pool of assets. In addition, it was characterized by the bank as a hedge of overall credit risk of the holding company and as a hedge of credit risk of the CIO. Not until the OCC demanded a meeting on April 16, 2012, did the CIO management provide a more fulsome explanation of SCP positions. Even then, significant information was lacking; for example, that trading had been stopped and that losses had increased significantly.

IV. OCC Oversight of the Valuation Practices Applied to the SCP

Our ongoing supervision of valuation practices is also based on our assessment of risk. Valuations are often tested during targeted examinations. Between examinations, we review internal reports, including reports of internal auditors. The OCC's supervision of the valuation practices at the bank focused on the investment bank, where the bulk of trading in complex and difficult to value instruments took place. Within the CIO, we had reviewed the valuation of the investment portfolio and found the processes to be satisfactory. As mentioned, we did not, however, perform detailed testing of the SCP. We became aware of problems in SCP valuation practices as a result of both the bank management's internal review in late April, and an internal audit report provided to us at about the same time.

We have since conducted an examination of bank-wide valuation processes, including the CIO, and focused on the consistency of practices and controls bank-wide, and as reflected in our C&D, we have directed the bank to make improvements to its valuation practices. We will be conducting onsite verification to determine the bank's compliance.

V. OCC Oversight of the CIO's Implementation of a New Value-at-Risk Model in January 2012 and Revocation of that Model in May 2012

VaR is one risk measure used by banks to monitor and control risk taking. VaR methodology is also used in the federal banking agencies' and Basel risk-based capital rules for market risk. In general, VaR models are not designed to capture extreme tail or stress events.

The OCC was aware that changes were being made to the CIO VaR model intended to make the model comply with the new Basel 2.5 market risk capital rules, and that VaR could fall by as much as one-half under this new model. We had an existing requirement that the bank improve its model risk management in general and the surrounding control processes, and we expected the bank to follow the processes developed to address that deficiency.

In a meeting on May 9, 2012, to brief the OCC on the large losses in the SCP, bank management revealed that they had found major problems with regard to implementation of the new VaR model and had decided to revert to the prior VaR model. Bank management acknowledged that the new model had not been implemented properly and was poorly controlled. As a result, we immediately commenced a comprehensive review of both the VaR model change in the CIO and the use of VaR across the bank. Our review identified numerous deficiencies and found violations of qualitative regulatory requirements. As a result, we directed corrective action, and we are closely monitoring the bank's progress.

We should have asked for more information about the change in the VaR model in January, given the large drop in VaR and the recent VaR limit excesses, even though the model was not changed for Basel 1 RWA. As previously noted, at the time, our examiners were focused on evaluating stress testing methods, and had been focused on ensuring the firm improved its internal review process. As we learned later, the bank's internal processes for model risk management were not being effectively applied to the CIO. As a result, we have changed our supervisory practices, and we now discuss VaR model changes during monthly meetings with the bank. We expect the bank to address the reporting and other control weaknesses specified in our supervisory letters and C&D order.

VI. The Extent to Which the CIO and the Bank Impeded Effective OCC Oversight of the SCP and Engaged in Unsafe or Unsound Banking Practices

Despite regular meetings with JMPC Treasury and CIO, review of corporate and business unit reports, and targeted examinations of the CIO, it was the *Wall Street Journal* article naming the London Whale that led the OCC to contact the CIO and ask detailed questions about the credit derivatives trading. At that time, we were focusing resources on areas perceived to be of higher risk, and managers and control groups in the bank were believed to be competent. We now know, however, that they were not forthcoming about the business and did not raise issues appropriately with the OCC. Holding company-wide reporting provided limited and sometimes incomplete information about these trading activities and performance. We were aware in general terms of CIO stress loss protection, but not about the details of the SCP. However, the fact that the CIO was not transparent about the SCP and that its reports were not informative does not excuse us from asking additional questions of the bank. We have learned a number of lessons from this event, and as a result, are making improvements to our supervision.

VII. Lessons Learned for OCC Supervision

The OCC's Large Bank supervision program is structured to promote consistent risk-based supervision of large banks, including internationally-active, complex financial institutions. While we believe our supervision-by-risk program is fundamentally sound, our internal review of the events at the bank and our own processes have highlighted a number of areas where we could improve. These lessons and the actions we are taking to strengthen our supervision are summarized below.

1) The Need to Obtain and Verify Timely, Accurate, and Complete Information

First, we failed to recognize the extent of SCP risk and potential for losses in a timely manner. Regardless of the contributing factors, we must test the quality of information and reports provided by firms we regulate to ensure we have a complete view of their operations. That is our standard practice, but SCP showed us that we can improve. We continue to emphasize that it is the responsibility of bank risk management, finance, and audit to ensure information is complete, accurate, and meaningful.

While we have been emphasizing the need for banks to have firm-wide risk measures and reporting, this event also underscores the need to evaluate desk and business unit level risk and performance reporting to ensure that firm-wide reporting is adequate and highlights trends and outliers in the data for further review and discussion. Since examiners receive substantial amounts of data, it is particularly important to ensure that the data we obtain is presented in a clear format and reviewed in a timely fashion. In this particular case, we realize that while the reports themselves did not have necessary details, a more thorough follow up with the bank could have given us a better view on SCP strategies before the rapid buildup of positions occurred. As a result, we have changed our daily operating processes at the bank to ensure that an examiner reviews excesses in a timely fashion and that there is a back-up process in place.

2) The Need to Identify and Apply Resources with Prerequisite Skills

The OCC has resources and expertise for supervising trading units but we did not adequately deploy them to the SCP. Instead, examiners with specific trading expertise, including those with a combination of industry and bank supervision experience, as well as experts in OCC headquarters in various areas including trading, derivatives accounting, and economics, were dedicated to reviewing investment bank trading. Others were focused on how the bank protected its corporate and counterparty credit exposure. Our work in the CIO focused on the $350 billion investment portfolio, rather than the SCP. We paid particular attention to the investment portfolio since it had grown dramatically since the crisis and had a composition that differed from other national banks in important ways that affected both credit and liquidity risk.

Effectively developing, applying, and coordinating the varied sources of expertise across the agency, in this case for trading, but more generally across the many units and strategy of the bank, is a challenge we are addressing. We continue to aggressively train examiners and will continue to seek and hire staff with the required technical and trading expertise. We are also evaluating our staffing and our use of technical experts to oversee this bank and other large banks. Improved analysis of trade and market data is a goal of the OCC's data analytics groups.

3) *Need to Apply Matters Requiring Attention Appropriately*

The OCC has standards for tracking Matters Requiring Attention (MRA) that were not effectively followed in the case of the CIO. An MRA associated with the CIO investment portfolio should have come with clear deadlines, and progress should have been more closely tracked. As a result of identifying this weakness, we have reinforced these standards, and we are conducting ongoing monitoring to ensure they are being followed consistently across the agency.

4) The Need for Regular Review of Internal Risk-Weighted Asset Models and Reporting

We noted a number of deficiencies in the regulatory reporting in regards to market risk RWA for the CIO. Along with evaluating the bank's policies, procedures, practices, and controls to ensure the integrity of regulatory reporting, we need to consistently track the use of internal models; review RWA reporting to ensure it is informative, accessible, and accurate; and review material changes in internal models used for RWA. While examiners from the OCC and FRB met regularly with JPM to discuss internal models, our C&D order requires improved controls and reporting which should enable us to better ensure material changes are identified. Specifically, VaR model changes are being highlighted and reviewed in monthly meetings with the bank.

The implementation of Basel 2.5 will provide us with the opportunity to validate or, in some cases, revalidate VaR models and require improved processes as conditions of approval. Basel 2.5 approvals are done in partnership with the FRB, but we will impose conditions we feel are appropriate for the national bank. Our large bank quality assurance unit will be undertaking a targeted review of efforts to improve our review of

RWA reporting to ensure that these practices are undertaken across our large bank portfolio where relevant.

5) The Need to Look Across Business Lines and Locations and Coordinate with Other Supervisors

The events at the bank highlighted our need to be more cognizant of market risks outside the conventional trading lines of business and operational breakdowns in the oversight and control of these risks. SCP also exposed the dangers of trading in offices or "hubs" removed from close proximity to senior management, despite advances in information technology and communication. It also highlights that at large complex institutions, risks and risk management functions can span across legal entities, resulting in overlapping responsibilities among banking supervisors. As a result we will focus more attention on overseas hubs, and conduct onsite examinations as appropriate. We also are looking for ways to enhance our collaboration with the FRB and other appropriate supervisors in our supervision of large complex firms.

6) The Need to Identify Risks Associated with Risky Siloed Business Activities

The CIO's structure illustrates characteristics that we need to look for in other business units in this bank and other banks. In this case, we observed a business unit operating in a silo, with poorly integrated reporting and application of controls. Processes for calculating risk and RWA calculation at the CIO were outside technology control processes; risk management portfolios lacked a clear mandate and reporting was limited; and, large and sustained limit excesses and limits raised to accommodate new risk taking lacked adequate review and evaluation by the firm. Identifying these characteristics in other business units may give us additional direction on where to look for potential issues before they become major problems.

7) *The Need to Identify Changes in Strategic Direction*

Our supervision needs to place more emphasis on identifying key changes with a bank's risk management or risk culture. For example, areas that are considered to be low risk but have experienced significant changes in management or key staff talent, strategy, unusual movements in gains/losses, and position growth or changes in types of activities or risk/reward profiles should be a red flag for more in-depth investigation. Our efforts to drive banks to strengthen their independent risk management, valuation, and audit functions will be the most important factor in reducing surprises. We are committed to involving our technical experts in reviews of all capital markets examination scoping, and in ongoing reviews of management information systems (MIS) to ensure that their technical skills are utilized to identify red flags and assess risk management processes.

8) The Need to Improve Internal OCC Information Management Systems

An ongoing challenge for the OCC is to improve our internal information management systems, to reduce manual processes to verify that the correct reports are being collected, and to ensure we take advantage of improvements in technology. Detailed data on trades and markets could have provided additional value, for example, in the identification of concentrations. Improving the information management systems and taking advantage of additional market data will require additional resources, and we are strengthening our data analytics team.

VIII. Holding Large Banks to Higher Standards

Finally, the events at the bank underscore the need to hold the largest banks to the highest standards. These banks must be managed and governed more rigorously than less systemically important institutions. We are doing this by demanding strong capital, reserves, and liquidity, and raising the bar for the corporate governance under which we expect large banks to operate.

Stronger Capital, Reserves, and Liquidity Standards

Since the onset of the financial crisis, we have directed the largest institutions to strengthen their capital, reserves, and liquidity positions. As a result, the quality and level of capital at national banks and bank holding companies with total assets greater than $50 billion have improved significantly. The median percentage of Tier 1 common capital relative to total assets for bank holding companies increased from 5.1 percent in 2008 to more than 7.4 percent today, while the comparable ratio for national banks and federal savings institutions rose from 6.2 percent to 8.7 percent over that same period.

Under scrutiny of our examiners, the largest banks have increased their loan loss reserves as a percentage of gross loans since the end of 2007, from 1.4 percent to 2.1 percent. Similarly, the largest banks have materially strengthened their liquidity buffers through increases in short-term liquid assets that can be used to meet unanticipated liquidity demands and through a decreased reliance on short-term, volatile funding. System-wide, liquid assets are up $3.4 trillion over the past four years. The implementation of proposed rules related to Basel III will further enhance the quality and quantity of capital and liquidity held for regulatory purposes, ensuring that today's historically high levels remain sustainable through the next cycle.

Heightened Expectations for Strong Corporate Governance and Oversight

While stronger capital and liquidity buffers are essential components for improving the resiliency of large banks, strong corporate governance is equally important. We have set higher expectations for corporate governance at large banks in five specific areas.

1. **Board willingness to provide credible challenge.** A key element in corporate governance is a strong, knowledgeable board with independent directors who provide a credible challenge to bank management. Effective directors prudently question the propriety of strategic initiatives, talent decisions, and the balance between risk taking and reward. Effective information flow and risk identification within the organization is essential to the ability of directors to perform this role.
2. **Talent Management and Compensation.** We expect large banks to have a well-defined personnel management process that ensures appropriate, quality staffing levels, provides for orderly succession, and maintains appropriate compensation tools to motivate and retain talent. Of particular importance is the need to ensure that incentive compensation structures balance risk and financial rewards and are compatible with effective controls and risk management.
3. **Defining and Communicating Risk Tolerance Expectations Across the Company.** Consistent with prudent governance practices, banks must define and communicate acceptable risk tolerance, and results need to be visible and periodically compared to pre-defined limits. Examiners are directing banks to strengthen their existing risk tolerance structures by better articulating the bank's risk appetite, its measures and limits of risk to capital or earnings on a firm-wide basis, the amount of

risk that may be taken in each line of business, and the amount of risk that may be taken in each of the key risk categories monitored by the banks.

4. **Development and Maintenance of Strong Audit and Risk Management Functions.** The recent crisis reinforced the importance of quality audit and risk management functions. We have directed bank audit and risk management committees to perform gap analyses relative to OCC's standards and industry practices and to take appropriate action to improve their audit and risk management functions. We expect members of the bank's board and its executive management team to ensure audit and risk management teams are visibly and substantively supported.

5. **Sanctity of the Charter.** While holding companies of large banks are typically managed on a line of business basis, directors at the bank level are responsible for oversight of the bank's charter—the legal entity. Such responsibility requires separate and focused governance. We have reminded the boards of banks that their primary fiduciary duty is to ensure the safety and soundness of the national bank or federal savings association. This responsibility involves focus on the risk and control infrastructure. Directors must be certain that appropriate personnel, strategic planning, risk tolerance, operating processes, delegations of authority, controls, and reports are in place to effectively oversee the performance of the bank. The bank should not simply function as a booking entity for the holding company. It is incumbent upon bank directors to be mindful of this primary fiduciary duty as they execute their responsibilities.

IX. Conclusion: Commitment of OCC Leadership

The leadership of the OCC is committed to strong and effective supervision. As demonstrated by our C&D, we will not hesitate to take strong action whenever we discover significant problems at an institution we supervise. Our work at the bank is ongoing, and we will continue to assess whether additional enforcement actions or referrals are warranted.

We are equally committed to continuously enhancing our supervisory programs. The results of our internal investigation have been carefully reviewed by the OCC's executive management team, who agreed with the findings and recommendations, and formulated plans to address them. Within the OCC, we have disseminated the lessons we have learned to our large bank EICs, as well as our capital markets team leads. We have held meetings with them and provided them with guidance for incorporating these lessons learned in supervisory plans and practices. Our large bank management teams are providing semiannual status reports to ensure effective implementation of the lessons learned. These reviews will be supplemented by an independent evaluation of some of these areas by the OCC's Quality Assurance unit.

We appreciate the Subcommittee's investigation into this incident, and we will carefully review its report and recommendations to consider further enhancements to our supervisory program.

United States Senate
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
Committee on Homeland Security and Governmental Affairs

Carl Levin, Chairman
John McCain, Ranking Minority Member

JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES

MAJORITY AND MINORITY STAFF REPORT

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

UNITED STATES SENATE

RELEASED IN CONJUNCTION WITH THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS MARCH 15, 2013 HEARING

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Chairman

SENATOR JOHN McCAIN
Ranking Minority Member

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JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES

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JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES

March 15, 2013

JPMorgan Chase & Company is the largest financial holding company in the United States, with $2.4 trillion in assets. It is also the largest derivatives dealer in the world and the largest single participant in world credit derivatives markets. Its principal bank subsidiary, JPMorgan Chase Bank, is the largest U.S. bank. JPMorgan Chase has consistently portrayed itself as an expert in risk management with a "fortress balance sheet" that ensures taxpayers have nothing to fear from its banking activities, including its extensive dealing in derivatives. But in early 2012, the bank's Chief Investment Office (CIO), which is charged with managing $350 billion in excess deposits, placed a massive bet on a complex set of synthetic credit derivatives that, in 2012, lost at least $6.2 billion.

The CIO's losses were the result of the so-called "London Whale" trades executed by traders in its London office – trades so large in size that they roiled world credit markets. Initially dismissed by the bank's chief executive as a "tempest in a teapot," the trading losses quickly doubled and then tripled despite a relatively benign credit environment. The magnitude of the losses shocked the investing public and drew attention to the CIO which was found, in addition to its conservative investments, to be bankrolling high stakes, high risk credit derivative trades that were unknown to its regulators.

The JPMorgan Chase whale trades provide a startling and instructive case history of how synthetic credit derivatives have become a multi-billion dollar source of risk within the U.S. banking system. They also demonstrate how inadequate derivative valuation practices enabled traders to hide substantial losses for months at a time; lax hedging practices obscured whether derivatives were being used to offset risk or take risk; risk limit breaches were routinely disregarded; risk evaluation models were manipulated to downplay risk; inadequate regulatory oversight was too easily dodged or stonewalled; and derivative trading and financial results were misrepresented to investors, regulators, policymakers, and the taxpaying public who, when banks lose big, may be required to finance multi-billion-dollar bailouts.

The JPMorgan Chase whale trades provide another warning signal about the ongoing need to tighten oversight of banks' derivative trading activities, including through better valuation techniques, more effective hedging documentation, stronger enforcement of risk limits, more accurate risk models, and improved regulatory oversight. The derivatives overhaul required by the Dodd-Frank Wall Street Reform and Consumer Protection Act is intended to provide the regulatory tools needed to tackle those problems and reduce derivatives-related risk, including through the Merkley-Levin provisions that seek to implement the Volcker Rule's prohibition on high risk proprietary trading by federally insured banks, even if portrayed by banks as hedging activity designed to lower risk.

I. EXECUTIVE SUMMARY

A. Subcommittee Investigation

The JPMorgan Chase whale trades first drew public attention in April 2012. Beginning that same month, Senator Carl Levin's office made preliminary inquiries into what happened and subsequently received a series of briefings from JPMorgan Chase. On June 13, 2012, the U.S. Senate Committee on Banking, Housing, and Urban Affairs held a hearing in which JPMorgan Chase's Chief Executive Officer Jamie Dimon testified and answered questions about the whale trades.[1] On June 19, 2012, Mr. Dimon appeared at a second hearing before the U.S. House Committee on Financial Services.[2]

In July 2012, the U.S. Senate Permanent Subcommittee on Investigations initiated a bipartisan investigation into the trades. Over the course of the next nine months, the Subcommittee collected nearly 90,000 documents, reviewed and, in some cases transcribed, over 200 recorded telephone conversations and instant messaging exchanges,[3] and conducted over 25 interviews of bank and regulatory agency personnel. The Subcommittee also received over 25 briefings from the bank and its regulators, including the Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation (FDIC), and consulted with government and private sector experts in financial regulation, accounting practices, derivatives trading, and derivatives valuation.

The materials reviewed by the Subcommittee included JPMorgan Chase filings with the Securities and Exchange Commission (SEC), documents provided to and by the OCC, JPMorgan Chase board and committee minutes, internal memoranda, correspondence, and emails, chronologies of trading positions, records of risk limit utilizations and breaches, audio recordings and instant messaging exchanges, legal pleadings, and media reports. In addition, JPMorgan Chase briefed the Subcommittee about the findings of an internal investigation conducted by a task force headed by Michael Cavanagh, a senior bank official who is a member of the firm's Executive and Operating Committees. That investigation released its results to the public in a report on January 16,

[1] See "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012).
[2] See "Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss," U.S. House of Representatives Committee on Financial Services, Serial No. 112-136 (June 19, 2012).
[3] The British regulator, the Financial Services Authority, requires telephone calls regarding trading to be taped, including with respect to all financial transactions likely to result in a trade. See Conduct of Business Sourcebook (Recording of Telephone Conversations and Electronic Communications) Instrument 2008, FSA 2008/6 (U.K.).

2013.[4] Bank representatives also read to the Subcommittee portions of notes taken during interviews conducted by the JPMorgan Chase Task Force of CIO personnel, including traders, who were based in London. In addition to bank materials, the Subcommittee reviewed documents prepared by or sent to or from banking and securities regulators, including bank examination reports, analyses, memoranda, correspondence, emails, OCC Supervisory Letters, and Cease and Desist Orders. Those materials included nonpublic OCC examination materials and reports on the whale trades and on the OCC's own oversight efforts.[5] The Subcommittee also spoke with and received materials from firms that engaged in credit derivative trades with the CIO.

JPMorgan Chase has cooperated fully with the Subcommittee's inquiry, as have the regulatory agencies. However, several former JPMorgan Chase employees located in London declined Subcommittee requests for interviews and, because they resided outside of the United States, were beyond the Subcommittee's subpoena authority. Those former employees, Achilles Macris, Javier Martin-Artajo, Bruno Iksil, and Julien Grout, played key parts in the events at the center of this inquiry; their refusal to provide information to the Subcommittee meant that this Report had to be prepared without their direct input. The Subcommittee relied instead on their internal emails, recorded telephone conversations and instant messages, internal memoranda and presentations, and interview summaries prepared by the bank's internal investigation, to reconstruct what happened.

B. Overview

The Subcommittee's investigation has determined that, over the course of the first quarter of 2012, JPMorgan Chase's Chief Investment Office used its Synthetic Credit Portfolio (SCP) to engage in high risk derivatives trading; mismarked the SCP book to hide hundreds of millions of dollars of losses; disregarded multiple internal indicators of increasing risk; manipulated models; dodged OCC oversight; and misinformed investors, regulators, and the public about the nature of its risky derivatives trading. The Subcommittee's investigation has exposed not only high risk activities and troubling misconduct at JPMorgan Chase, but also broader, systemic problems related to the valuation, risk analysis, disclosure, and oversight of synthetic credit derivatives held by U.S. financial institutions.

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[4] See 1/16/2013 "Report of JPMorgan Chase & Co. Management Task Force Regarding 2012 CIO Losses," prepared by JPMorgan Chase, http://files.shareholder.com/downloads/ONE/2288197031x0x628656/4cb574a0-0bf5-4728-9582-625e4519b5ab/Task_Force_Report.pdf.

[5] See 10/26/2012 Confidential Supervisory Report, OCC, PSI-OCC-13-000014-126 [Sealed Exhibit].

(1) Increasing Risk

In 2005, JPMorgan Chase spun off as a separate unit within the bank its Chief Investment Office (CIO), which was charged with investing the bank's excess deposits, and named as its head, Ina Drew, who served as the bank's Chief Investment Officer. In 2006, the CIO approved a proposal to trade in synthetic credit derivatives, a new trading activity. In 2008, the CIO began calling its credit trading activity the Synthetic Credit Portfolio.

Three years later, in 2011, the SCP's net notional size jumped from \$4 billion to \$51 billion, a more than tenfold increase. In late 2011, the SCP bankrolled a \$1 billion credit derivatives trading bet that produced a gain of approximately \$400 million. In December 2011, JPMorgan Chase instructed the CIO to reduce its Risk Weighted Assets (RWA) to enable the bank, as a whole, to reduce its regulatory capital requirements. In response, in January 2012, rather than dispose of the high risk assets in the SCP – the most typical way to reduce RWA – the CIO launched a trading strategy that called for purchasing additional long credit derivatives to offset its short derivative positions and lower the CIO's RWA that way. That trading strategy not only ended up increasing the portfolio's size, risk, and RWA, but also, by taking the portfolio into a net long position, eliminated the hedging protections the SCP was originally supposed to provide.

In the first quarter of 2012, the CIO traders went on a sustained trading spree, eventually increasing the net notional size of the SCP threefold from \$51 billion to \$157 billion. By March, the SCP included at least \$62 billion in holdings in a U.S. credit index for investment grade companies; \$71 billion in holdings in a credit index for European investment grade companies; and \$22 billion in holdings in a U.S. credit index for high yield (non-investment grade) companies. Those holdings were created, in part, by an enormous series of trades in March, in which the CIO bought \$40 billion in notional long positions which the OCC later characterized as "doubling down" on a failed trading strategy. By the end of March 2012, the SCP held over 100 different credit derivative instruments, with a high risk mix of short and long positions, referencing both investment grade and non-investment grade corporations, and including both shorter and longer term maturities. JPMorgan Chase personnel described the resulting SCP as "huge" and of "a perilous size" since a small drop in price could quickly translate into massive losses.

At the same time the CIO traders were increasing the SCP's holdings, the portfolio was losing value. The SCP reported losses of \$100 million in January, another \$69 million in February, and another \$550 million in March, totaling at quarter-end nearly \$719 million. A week before the quarter ended, on March 23, 2012, CIO head Ina Drew ordered the SCP traders to "put phones down" and stop trading.

In early April, the press began speculating about the identity of the "London Whale" behind the huge trades roiling the credit markets, eventually unmasking JPMorgan Chase's Chief Investment Office. Over the next three months, the CIO's credit derivatives continued to lose money. By May, the Synthetic Credit Portfolio reported losing $2 billion; by the end of June, the losses jumped to $4.4 billion; and by the end of the year, the total reached at least $6.2 billion.

JPMorgan Chase told the Subcommittee that the SCP was not intended to function as a proprietary trading desk, but as insurance or a "hedge" against credit risks confronting the bank. While its original approval document indicated that the SCP was created with a hedging function in mind, the bank was unable to provide documentation over the next five years detailing the SCP's hedging objectives and strategies; the assets, portfolio, risks, or tail events it was supposed to hedge; or how the size, nature, and effectiveness of its hedges were determined. The bank was also unable to explain why the SCP's hedges were treated differently from other types of hedges within the CIO.

While conducting its review of the SCP, some OCC examiners expressed skepticism that the SCP functioned as a hedge at all. In a May 2012 internal email, for example, one OCC examiner referred to the SCP as a "make believe voodoo magic 'composite hedge.'" When he was asked about the Synthetic Credit Portfolio, JPMorgan Chase CEO Jamie Dimon told the Senate Banking Committee that, over time, the "portfolio morphed into something that rather than protect the firm, created new and potentially larger risks." Mr. Dimon has not acknowledged that what the SCP morphed into was a high risk proprietary trading operation.

(2) Hiding Losses

In its first four years of operation, the Synthetic Credit Portfolio produced positive revenues, but in 2012, it opened the year with sustained losses. In January, February, and March, the days reporting losses far exceeded the days reporting profits, and there wasn't a single day when the SCP was in the black. To minimize its reported losses, the CIO began to deviate from the valuation practices it had used in the past to price credit derivatives. In early January, the CIO had typically established the daily value of a credit derivative by marking it at or near the midpoint price in the daily range of prices (bid-ask spread) offered in the marketplace. Using midpoint prices had enabled the CIO to comply with the requirement that it value its derivatives using prices that were the "most representative of fair value." But later in the first quarter of 2012, instead of marking near the midpoint, the CIO began to assign more favorable prices within the daily price range (bid-ask spread) to its credit derivatives. The more favorable prices enabled the CIO to report smaller losses in the daily profit/loss (P&L) reports that the SCP filed internally within the bank.

The data indicates that the CIO began using more favorable valuations in late January and accelerated that practice over the next two months. By March 15, 2012, two key participants, Julien Grout, a junior trader charged with marking the SCP's positions on a daily basis, and his supervisor, Bruno Iksil, head trader in charge of the SCP, were explicit about what they were doing. As Mr. Grout told Mr. Iksil in a recorded telephone conversation: "I am not marking at mids as per a previous conversation." The next day, Mr. Iksil expressed to Mr. Grout his concerns about the growing discrepancy between the marks they were reporting versus those called for by marking at the midpoint prices: "I can't keep this going .... I think what he's [their supervisor, Javier Martin-Artajo] expecting is a re-marking at the end of the month .... I don't know where he wants to stop, but it's getting idiotic."

For five days, from March 12 to 16, 2012, Mr. Grout prepared a spreadsheet tracking the differences between the daily SCP values he was reporting and the values that would have been reported using midpoint prices. According to the spreadsheet, by March 16, 2012, the Synthetic Credit Portfolio had reported year-to-date losses of $161 million, but if midpoint prices had been used, those losses would have swelled by another $432 million to a total of $593 million. CIO head Ina Drew told the Subcommittee that it was not until July 2012, after she had left the bank, that she became aware of this spreadsheet and said she had never before seen that type of "shadow P&L document."

On March 23, Mr. Iksil estimated in an email that the SCP had lost about $600 million using midpoint prices and $300 million using the "best" prices, but the SCP ended up reporting within the bank a daily loss of only $12 million. On March 30, the last business day of the quarter, the CIO internally reported a sudden $319 million daily loss. But even with that outsized reported loss, a later analysis by the CIO's Valuation Control Group (VCG) noted that, by March 31, 2012, the difference in the CIO's P&L figures between using midpoint prices versus more favorable prices totaled $512 million.

On April 10, 2012, the CIO initially reported an estimated daily loss of $6 million, but 90 minutes later, after a confrontation between two CIO traders, issued a new P&L report estimating a loss of $400 million. That change took place on the first trading day after the whale trades gained public attention; one CIO trader later said CIO personnel were "scared" at the time to hide such a large loss. As a result, the SCP internally reported year-to-date losses of about $1.2 billion, crossing the $1 billion mark for the first time.

One result of the CIO's using more favorable valuations was that two different business lines within JPMorgan Chase, the Chief Investment Office and the Investment Bank, assigned different values to identical credit derivative holdings. Beginning in March 2012, as CIO counterparties learned of the price differences, several objected to the CIO's values, resulting in collateral disputes peaking at $690 million. In May, the bank's Deputy Chief Risk Officer Ashley Bacon directed the CIO to mark its books in the same manner as the Investment Bank, which used an independent pricing service to identify the midpoints in the relevant price ranges. That change in valuation methodology resolved the collateral valuation disputes in favor of the CIO's counterparties and, at the same time, put an end to the mismarking.

On May 10, 2012, the bank's Controller issued an internal memorandum summarizing a special assessment of the SCP's valuations from January through April. Although the memorandum documented the CIO's use of more favorable values through the course of the first quarter, and a senior bank official even privately confronted a CIO manager about using "aggressive" prices in March, the memorandum generally upheld the CIO valuations. The bank memorandum observed that the CIO had reported about $500 million less in losses than if it had used midpoint prices for its credit derivatives, and even disallowed and modified a few prices that had fallen outside of the permissible price range (bid-ask spread), yet found the CIO had acted "consistent with industry practices."

The sole purpose of the Controller's special assessment was to ensure that the CIO had accurately reported the value of its derivative holdings, since those holdings helped determine the bank's overall financial results. The Controller determined that the CIO properly reported a total of $719 million in losses, instead of the $1.2 billion that would have been reported if midpoint prices had been used. That the Controller essentially concluded the SCP's losses could legitimately fall anywhere between $719 million and $1.2 billion exposes the subjective, imprecise, and malleable nature of the derivative valuation process.

The bank told the Subcommittee that, despite the favorable pricing practices noted in the May memorandum, it did not view the CIO as having engaged in mismarking until June 2012, when its internal investigation began reviewing CIO recorded telephone calls and heard CIO personnel disparaging the marks they were reporting. On July 13, 2012, the bank restated its first quarter earnings, reporting additional SCP losses of $660 million. JPMorgan Chase told the Subcommittee that the decision to restate its financial results was a difficult one, since $660 million was not clearly a "material" amount for the bank, and the valuations used by the CIO did not clearly violate bank policy or generally accepted accounting principles. The bank told the Subcommittee that the key consideration leading to the restatement of the bank's losses was its determination that the London CIO personnel had not acted in "good faith" when marking the SCP book, which meant the SCP valuations had to be revised.

The ability of CIO personnel to hide hundreds of millions of dollars of additional losses over the span of three months, and yet survive internal valuation reviews, shows how imprecise, undisciplined, and open to manipulation the current process is for valuing credit derivatives. This weak valuation process is all the more troubling given the high risk nature of synthetic credit derivatives, the lack of any underlying tangible assets to stem losses, and the speed with which substantial losses can accumulate and threaten a bank's profitability. The whale trades' bad faith valuations exposed not only misconduct by the CIO and the bank's violation of the derivative valuation process mandated in generally accepted accounting principles, but also a systemic weakness in the valuation process for all credit derivatives.

(3) Disregarding Risk

In contrast to JPMorgan Chase's reputation for best-in-class risk management, the whale trades exposed a bank culture in which risk limit breaches were routinely disregarded, risk metrics were frequently criticized or downplayed, and risk evaluation models were targeted by bank personnel seeking to produce artificially lower capital requirements.

The CIO used five key metrics and limits to gauge and control the risks associated with its trading activities, including the Value-at-Risk (VaR) limit, Credit Spread Widening 01 (CS01) limit, Credit Spread Widening 10% (CSW10%) limit, stress loss limits, and stop loss advisories. During the first three months of 2012, as the CIO traders added billions of dollars in complex credit derivatives to the Synthetic Credit Portfolio, the SCP trades breached the limits on all five risk metrics. In fact, from January 1 through April 30, 2012, CIO risk limits and advisories were breached more than 330 times.

In January 2012, the SCP breached the VaR limit for both the CIO and the bank as a whole. That four-day breach was reported to the bank's most senior management, including CEO Jamie Dimon. In the same month, the SCP repeatedly breached the CS01 limit, exceeding the limit by 100% in January, by 270% in early February, and by more than 1,000% in mid-April. In February 2012, a key risk metric known as the Comprehensive Risk Measure (CRM) warned that the SCP risked incurring a yearly loss of $6.3 billion, but that projection was dismissed at the time by CIO personnel as "garbage." In March 2012, the SCP repeatedly breached the CSW10% limit, as well as stress loss limits signaling possible losses in adverse market conditions, and stop loss advisories that were supposed to set a ceiling on how much money a portfolio was allowed to lose over a specified period of time. Concentration limits that could have prevented the SCP from acquiring outsized positions were absent at the CIO despite being commonplace for the same instruments at JPMorgan Chase's Investment Bank.

The SCP's many breaches were routinely reported to JPMorgan Chase and CIO management, risk personnel, and traders. The breaches did not, however, spark an in-depth review of the SCP or require immediate remedial actions to lower risk. Instead, the breaches were largely ignored or ended by raising the relevant risk limit.

In addition, CIO traders, risk personnel, and quantitative analysts frequently attacked the accuracy of the risk metrics, downplaying the riskiness of credit derivatives and proposing risk measurement and model changes to lower risk results for the Synthetic Credit Portfolio. In the case of the CIO VaR, after analysts concluded the existing model was too conservative and overstated risk, an alternative CIO model was hurriedly adopted in late January 2012, while the CIO was in breach of its own and the bankwide VaR limit. The bank did not obtain OCC approval as it should have to use the model for the SCP. The CIO's new model immediately lowered the SCP's VaR by 50%, enabling the CIO not only to end its breach, but to engage in substantially more risky derivatives trading. Months later, the bank determined that the model was improperly implemented, requiring error-prone manual data entry and incorporating formula and calculation errors. On May 10, the bank backtracked, revoking the new VaR model due to its inaccuracy in portraying risk, and reinstating the prior model.

In the case of the bank's CRM risk metric and model, CIO quantitative analysts, traders, and risk managers attacked it for overstating risk compared to their own far more optimistic analysis. The CIO's lead quantitative analyst also pressed the bank's quantitative analysts to help the CIO set up a system to categorize the SCP's trades for risk measurement purposes in a way designed to produce the "optimal" – meaning lowest – Risk Weighted Asset total. The CIO analyst who pressed for that system was cautioned against writing about it in emails, but received sustained analytical support from the bank in his attempt to construct the system and artificially lower the SCP's risk profile.

The head of the CIO's London office, Achilles Macris, once compared managing the Synthetic Credit Portfolio, with its massive, complex, moving parts, to flying an airplane. The OCC Examiner-in-Charge at JPMorgan Chase told the Subcommittee that if the Synthetic Credit Portfolio were an airplane, then the risk metrics were the flight instruments. In the first quarter of 2012, those flight instruments began flashing red and sounding alarms, but rather than change course, JPMorgan Chase personnel disregarded, discounted, or questioned the accuracy of the instruments instead. The bank's actions not only exposed the many risk management deficiencies at JPMorgan Chase, but also raise systemic concerns about how many other financial institutions may be disregarding risk indicators and manipulating models to artificially lower risk results and capital requirements.

(4) Avoiding and Conducting OCC Oversight

Prior to media reports of the whale trades in April 2012, JPMorgan Chase provided minimal information about the CIO's Synthetic Credit Portfolio to its primary regulator, the Office of the Comptroller of the Currency (OCC), despite the SCP's supposedly important role in offsetting the bank's credit risks, its rapid growth in 2011 and 2012, and its increasingly risky credit derivatives. While the OCC, in hindsight, has identified occasional references to a "core credit portfolio" in bank materials, and the bank has produced copies of some emails sent to the OCC with routine risk information and occasional similar references, the OCC told the Subcommittee that the earliest explicit mention of the SCP did not appear until January 27, 2012, in a routine VaR report.

Because the OCC was unaware of the risks associated with the SCP, it conducted no reviews of the portfolio prior to 2012. Both the OCC and JPMorgan Chase bear fault for the OCC's lack of knowledge – at different points, the bank was not forthcoming and even provided incorrect information, and at other points the OCC failed to notice and follow up on red flags signaling increasing CIO risk in the reports it did receive from the bank. During 2011, for example, the notional size of the SCP grew tenfold from about $4 billion to $51 billion, but the bank never informed the OCC of the increase. At the same time, the bank did file risk reports with the OCC disclosing that the CIO repeatedly breached its stress limits in the first half of 2011, triggering them eight times, on occasion for weeks at a stretch, but the OCC failed to follow up with the bank. Later in 2011, the CIO engaged in a $1 billion high risk, high stakes credit derivatives bet that triggered a payout of roughly $400 million to the CIO. The OCC learned of the $400 million gain, but did not inquire into the reason for it or the trading activity behind it, and so did not learn of the extent of credit derivatives trading going on at the CIO.

In January 2012, in its first quarterly meeting with the OCC, the CIO downplayed the portfolio's importance by misinforming the OCC that it planned to reduce the SCP. Instead, over the course of the quarter, the CIO tripled the notional size of the SCP from $51 billion to $157 billion, buying a high risk mix of short and long credit derivatives with varying reference entities and maturities. The increase in the SCP's size and risk triggered a breach of the CIO's and bankwide VaR limits, which the bank disclosed to the OCC in routine risk reports at the time, but which did not trigger an agency inquiry. Also in January, the bank sent routine risk management notices which informed the OCC of the bank's implementation of a new VaR model for the CIO that would dramatically lower the SCP's risk profile, but the OCC did not inquire into the reasons for the model change, its impact on risk, or how the CIO was able to reduce its risk results overnight by 50%.

In February and March, the bank began to omit key CIO performance data from its standard reports to the OCC, while simultaneously failing to provide timely copies of a new CIO management report. The OCC failed to notice the missing reports or request the new CIO management report until after the April 6 press articles exposed the CIO's risky trades. By minimizing the CIO data it provided to the OCC about the CIO and SCP, the bank left the OCC misinformed about the SCP's risky holdings and growing losses.

Beginning in January and continuing through April 2012, the SCP's high risk acquisitions triggered multiple breaches of CIO risk limits, including its VaR, credit spread, stress loss, and stop loss limits. Those breaches were disclosed on an ongoing, timely basis in standard risk reports provided by the bank to the OCC, yet produced no reaction at the time from the agency. The Subcommittee found no evidence that the OCC reviewed the risk reports when received, analyzed the breach data, or asked any questions about the trading activity causing the breaches to occur.

On April 6, 2012, when media reports unmasked the role of JPMorgan Chase in the whale trades, the OCC told the Subcommittee that it was surprised to read about the trades and immediately directed inquiries to the bank for more information. The OCC indicated that it initially received such limited data about the trades and such blanket reassurances from the bank about them that, by the end of April, the OCC considered the matter closed.

It was not until May 2012, a few days before the bank was forced to disclose $2 billion in SCP losses in its public SEC filings, that the OCC learned of the problems besetting the portfolio. On May 12, OCC staff told staff for a Senate Banking Committee member that the whale trades would have been allowed under the draft Volcker Rule, an assessment that, a few days later, the OCC disavowed as "premature." At the instruction of the OCC's new Comptroller, Thomas Curry, the OCC initiated an intensive inquiry into the CIO's credit derivatives trading activity. Even then, the OCC told the Subcommittee that obtaining information from JPMorgan Chase was difficult, as the bank resisted and delayed responding to OCC information requests and sometimes even provided incorrect information. For example, when the OCC inquired into whether the CIO had mismarked the SCP book, the bank's Chief Risk Officer initially denied it, and the bank delayed informing the OCC of later evidence indicating that CIO personnel had deliberately understated the SCP losses.

On January 14, 2013, the OCC issued a Cease and Desist order against the bank, on top of six Supervisory Letters it issued in 2012, detailing 20 "Matters Requiring Attention" that required corrective action by the bank. In addition, the OCC conducted a review of its own missteps and regulatory "lessons learned," described in an internal report completed in October 2012. Among multiple failures, the OCC internal report concluded that the OCC had failed to monitor and investigate multiple risk limit breaches by the CIO and improperly allowed JPMorgan Chase to submit aggregated portfolio performance data that obscured the CIO's involvement with derivatives trading.

The JPMorgan Chase whale trades demonstrate how much more difficult effective regulatory oversight is when a bank fails to provide routine, transparent performance data about the operation of a large derivatives portfolio, its related trades, and its daily booked values. They also demonstrate the OCC's failure to establish an effective regulatory relationship with JPMorgan Chase founded on the bank's prompt cooperation with OCC oversight efforts. JPMorgan Chase's ability to dodge effective OCC oversight of the multi-billion-dollar Synthetic Credit Portfolio until massive trades, mounting losses, and media reports exposed its activities, demonstrates that bank regulators need to conduct more aggressive oversight with their existing tools and develop more effective tools to detect and stop unsafe and unsound derivatives trading.

(5) Misinforming Investors, Regulators, and the Public

To ensure fair, open and efficient markets for investors, federal securities laws impose specific disclosure obligations on market participants. Public statements and SEC filings made by JPMorgan Chase in April and May 2012 raise questions about the timeliness, completeness, and accuracy of information presented about the CIO whale trades.

The CIO whale trades were not disclosed to the public in any way until April 2012, despite more than $1 billion in losses and widespread problems affecting the CIO and the bank, as described in this Report. On April 6, 2012, media reports focused public attention on the whale trades for the first time; on April 10, which was the next trading day, the SCP reported internally a $415 million loss. The bank's communications officer and chief investor liaison circulated talking points and, that same day, April 10, met with reporters and analysts to deliver reassuring messages about the SCP. Their primary objectives were to communicate, among other matters, that the CIO's activities were "for hedging purposes" and that the regulators were "fully aware" of its activities, neither of which was true. The following day, April 11, one of the traders told Ms. Drew, "The bank's communications yesterday are starting to work," suggesting they were quieting the markets and resulting in reduced portfolio losses.

At the end of the week, on April 13, 2012, JPMorgan Chase filed an 8-K report with the SEC with information about the bank's first quarter financial results and hosted an earnings call. On that call, JPMorgan Chase Chief Financial Officer Douglas Braunstein reassured investors, analysts, and the public that the SCP's trading activities were made on a long-term basis, were transparent to regulators, had been approved by the bank's risk managers, and served a hedging function that lowered risk and would ultimately be permitted under the Volcker Rule whose regulations were still being developed. CEO Jamie Dimon dismissed the media reports about the SCP as a "complete tempest in a teapot."

A month later, in connection with its May 10, 2012 10-Q filing finalizing its first quarter financial results, the bank announced that the SCP had lost $2 billion, would likely lose more, and was much riskier than earlier portrayed. The 10-Q filing stated: "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." Though the markets had not reacted against JPMorgan Chase's stock after the reassuring April 13 8-K filing and earnings call, the bank's stock did drop after the May 10 10-Q filing and call, as well as its announcement on May 15, that Ina Drew was departing the bank, declining from $40.74/share on May 10 to $33.93/share one week later on May 17, representing a drop of 17%. The stock continued to decline to $31/share on June 4, representing an overall decline of 24%.

Given the information that bank executives possessed in advance of the bank's public communications on April 10, April 13, and May 10, the written and verbal representations made by the bank were incomplete, contained numerous inaccuracies, and misinformed investors, regulators, and the public about the CIO's Synthetic Credit Portfolio.

More than a Tempest in a Teapot. In the April 13 earnings call, in response to a question, Mr. Dimon dismissed media reports about the SCP as a "complete tempest in a teapot." While he later apologized for that comment, his judgment likely was of importance to investors in the immediate aftermath of those media reports. The evidence also indicates that, when he made that statement, Mr. Dimon was already in possession of information about the SCP's complex and sizeable portfolio, its sustained losses for three straight months, the exponential increase in those losses during March, and the difficulty of exiting the SCP's positions.

Mischaracterizing Involvement of Firmwide Risk Managers. Mr. Braunstein stated on the April 13 earnings call that "all of those positions are put on pursuant to the risk management at the firm-wide level." The evidence indicates, however, that in 2012, JPMorgan Chase's firmwide risk managers knew little about the SCP and had no role in putting on its positions. JPMorgan Chase's Chief Risk Officer John Hogan told the Subcommittee, for example, that, prior to the April press reports, he had been unaware of the size and nature of the SCP, much less its mounting losses. Virtually no evidence indicates that he, his predecessor, or any other firmwide risk manager played any role in designing or approving the SCP positions acquired in 2012, until well after the April 13 earnings call when the bank's risk managers effectively took over management of the SCP. In addition, Mr. Braunstein's statement omitted any mention of the across-the-board risk limit breaches triggered by the SCP during the first quarter of 2012, even though those breaches would likely have been of interest to investors.

Mischaracterizing SCP as "Fully Transparent to the Regulators." In the bank's April 13 earnings call, Mr. Braunstein said that the SCP positions were "fully transparent to the regulators," who "get information on those positions on a regular and recurring basis as part of our normalized reporting." In fact, the SCP positions had never been disclosed to the OCC in any regular bank report. The bank had described the SCP's positions to the OCC for the first time, in a general way, only a few days earlier and failed to provide more detailed information for more than a month. Mr. Braunstein's statement also omitted the fact that JPMorgan Chase had dodged OCC oversight of the SCP for years by failing to alert the agency to the establishment of the portfolio, and failing to provide any portfolio-specific information in CIO reports. During the April 13 call, the bank led investors to believe that the SCP operated under close OCC supervision and oversight, when the truth was that the bank had provided barely any SCP data for the OCC to review.

Mischaracterizing SCP Decisions as "Made on a Very Long-Term Basis." On the bank's April 13 earnings call, Mr. Braunstein also stated that with regard to "managing" the stress loss positions of the Synthetic Credit Portfolio, "[a]ll of the decisions are made on a very long-term basis." In fact, the CIO credit traders engaged in daily derivatives trading, and the bank conceded the SCP was "actively traded." An internal CIO presentation in March 2012, provided to the bank's executive committee a month before the earnings call, indicated that the SCP operated on a "short" time horizon. In addition, many of the positions producing SCP losses had been acquired just weeks or months earlier. Mr. Braunstein's characterization of the SCP as making long-term investment decisions was contrary to both the short-term posture of the SCP, as well as how it actually operated in 2011 and 2012. His description was inaccurate at best and deceptive at worst.

Mischaracterizing SCP Whale Trades As Providing "Stress Loss Protection." During the April 13 call, Mr. Braunstein indicated that the SCP was intended to provide "stress loss protection" to the bank in the event of a credit crisis, essentially presenting the SCP as a portfolio designed to lower rather than increase bank risk. But in early April, days before the earnings call, Ms. Drew told the bank's executive committee that, overall, the SCP was "long" credit, a posture that multiple senior executives told the Subcommittee was inconsistent with providing protection against a credit crisis. Moreover, a detailed analysis reviewed by senior management two days before the April 13 earnings call showed that in multiple scenarios involving a deterioration of credit, the SCP would lose money. While the bank may have sought to reassure investors that the SCP lowered the bank's credit risk, in fact, as then configured, the SCP would have amplified rather than reduced the bank's losses in the event of a credit crisis. The bank's description of the SCP was simply erroneous.

Asserting SCP Trades Were Consistent With the Volcker Rule. The final point made in the April 13 earnings call by Mr. Braunstein was: "[W]e believe all of this is consistent with what we believe the ultimate outcome will be related to Volcker." The Volcker Rule is intended to reduce bank risk by prohibiting high risk proprietary trading activities by federally insured banks, their affiliates, and subsidiaries. However, the Volcker Rule also allows certain trading activities to continue, including "risk-mitigating hedging activities." Mr. Braunstein's statement gave the misimpression that the SCP was "hedging" risk. When the Subcommittee asked the bank for any legal analyses regarding the Volcker Rule and the SCP, the bank responded that none existed. On the day prior to the earnings call, Ina Drew wrote to Mr. Braunstein that "the language in Volcker is unclear," a statement that presumably refers to the fact that the implementing regulation was then and still is under development. In addition, the bank had earlier written to regulators expressing concern that the SCP's derivatives trading would be "prohibited" by the Volcker Rule. The bank omitted any mention of that analysis to investors, when essentially asserting that the CIO would be permitted under the law to continue operating the SCP as before.

Omitting VaR Model Change. Near the end of January, the bank approved use of a new CIO Value-at-Risk (VaR) model that cut in half the SCP's purported risk profile, but failed to disclose that VaR model change in its April 8-K filing, and omitted the reason for returning to the old model in its May 10-Q filing. JPMorgan Chase was aware of the importance of VaR risk analysis to investors, because when the media first raised questions about the whale trades, the bank explicitly referred analysts to the CIO's VaR totals in its 2011 annual 10-K filing, filed on February 29, 2012. Yet, days later, on April 13, the bank's 8-K filing contained a misleading chart that listed the CIO's first quarter VaR total as $67 million, only $3 million more than the prior quarter, without also disclosing that the new figure was the product of a new VaR model that calculated a much lower VaR profile for the CIO than the prior model. An analyst or investor relying on the disclosed VaRs for the end of 2011 and the first quarter of 2012 would likely have believed that the positions underlying those VaRs were similar, since the VaR totals were very similar. The change in the VaR methodology effectively masked the significant changes in the portfolio.

When asked in a May 10 call with investors and analysts why the VaR model was changed, Mr. Dimon said the bank made "constant changes and updates to models, always trying to get them better," but did not disclose that the bank had reinstated the old CIO VaR model because the "update[d]" CIO VaR had understated risk by a factor of two, was error prone, and suffered from operational problems. The May 10-Q filing included a chart showing a revised CIO VaR for the first quarter of $129 million, which was twice the VaR amount initially reported for the first quarter, and also twice the average amounts in 2011 and 2010. The only explanation the May 10-Q filing provided was that the revised VaR "was calculated using a methodology consistent with the methodology used to calculate CIO's VaR in 2011."

Together, these misstatements and omissions about the involvement of the bank's risk managers in putting on SCP positions, the SCP's transparency to regulators, the long-term nature of its decisionmaking, its VaR totals, its role as a risk-mitigating hedge, and its supposed consistency with the Volcker Rule, misinformed investors, regulators, and the public about the nature, activities, and riskiness of the CIO's credit derivatives during the first quarter of 2012.

C. Whale Trade Case History

By digging into the details of the whale trades, the Subcommittee investigation has uncovered systemic problems in how synthetic derivatives are traded, recorded, and managed for risk, as well as evidence that the whale trades were not the acts of rogue traders, but involved some of the bank's most senior managers.

Previously undisclosed emails and memoranda showed that the CIO traders kept their superiors informed of their trading strategies. Detailing the Synthetic Credit Portfolio showed how credit derivatives, when purchased in massive quantities, with multiple maturities and reference entities, produced a high risk portfolio that even experts couldn't manage. Internal bank documents revealed that the SCP was not managed as a hedge and, by March 2012, was not providing credit loss protection to the bank. Systemic weaknesses in how some hedges are documented and managed also came to light. In addition, the investigation exposed systemic problems in the derivative valuation process, showing how easily the SCP books were manipulated to hide massive losses. Recorded telephone calls, instant messages, and the Grout spreadsheet disclosed how the traders booking the derivative values felt pressured and were upset about mismarking the book to minimize losses. Yet an internal assessment conducted by the bank upheld the obviously mismarked prices, declaring them to be "consistent with industry practices."

While the bank claimed that the whale trade losses were due, in part, to a failure to have the right risk limits in place, the Subcommittee investigation showed that the five risk limits already in effect were all breached for sustained periods of time during the first quarter of 2012. Bank managers knew about the breaches, but allowed them to continue, lifted the limits, or altered the risk measures after being told that the risk results were "too conservative," not "sensible," or "garbage." Previously undisclosed evidence also showed that CIO personnel deliberately tried to lower the CIO's risk results and, as a result, lower its capital requirements, not by reducing its risky assets, but by manipulating the mathematical models used to calculate its VaR, CRM, and RWA results. Equally disturbing is evidence that the OCC was regularly informed of the risk limit breaches and was notified in advance of the CIO VaR model change projected to drop the CIO's VaR results by 44%, yet raised no concerns at the time.

Still another set of previously undisclosed facts showed how JPMorgan Chase outmaneuvered its regulator, keeping the high risk Synthetic Credit Portfolio off the OCC's radar despite its massive size and three months of escalating losses, until media reports pulled back the curtain on the whale trades. In a quarterly meeting in late January 2012, the bank told the OCC that it planned to reduce the size of the SCP, but then increased the portfolio and its attendant risks. Routine bank reports that might have drawn attention to the SCP were delayed, detailed data was omitted, blanket assurances were offered when they should not have been, and requested information was late or not provided at all. Dodging OCC oversight went to the head of the CIO, Ina Drew, a member of the bank's Operating Committee, who criticized the OCC for being overly intrusive.

Senior bank management was also involved in the inaccurate information conveyed to investors and the public after the whale trades came under the media spotlight. Previously undisclosed documents showed that senior managers were told the SCP was massive, losing money, and had stopped providing credit loss protection to the bank, yet downplayed those problems and kept describing the portfolio as a risk-reducing hedge, until forced by billions of dollars in losses to admit disaster.

The whale trades case history offers another example of a financial institution engaged in high risk trading activity with federally insured deposits attempting to divert attention from the risks and abuses associated with synthetic derivatives. The evidence uncovered by the Subcommittee investigation demonstrates that derivatives continue to present the U.S. financial system with multiple, systemic problems that require resolution.

D. Findings of Fact

Based upon the Subcommittee's investigation, the Report makes the following findings of fact.

(1) **Increased Risk Without Notice to Regulators.** In the first quarter of 2012, without alerting its regulators, JPMorgan Chase's Chief Investment Office used bank deposits, including some that were federally insured, to construct a $157 billion portfolio of synthetic credit derivatives, engaged in high risk, complex, short term trading strategies, and disclosed the extent and high risk nature of the portfolio to its regulators only after it attracted media attention.

(2) **Mischaracterized High Risk Trading as Hedging.** JPMorgan Chase claimed at times that its Synthetic Credit Portfolio functioned as a hedge against bank credit risks, but failed to identify the assets or portfolios being hedged, test the

size and effectiveness of the alleged hedging activity, or show how the SCP lowered rather than increased bank risk.

(3) **Hid Massive Losses.** JPMorgan Chase, through its Chief Investment Office, hid over $660 million in losses in the Synthetic Credit Portfolio for several months in 2012, by allowing the CIO to overstate the value of its credit derivatives; ignoring red flags that the values were inaccurate, including conflicting Investment Bank values and counterparty collateral disputes; and supporting reviews which exposed the SCP's questionable pricing practices but upheld the suspect values.

(4) **Disregarded Risk.** In the first three months of 2012, when the CIO breached all five of the major risk limits on the Synthetic Credit Portfolio, rather than divest itself of risky positions, JPMorgan Chase disregarded the warning signals and downplayed the SCP's risk by allowing the CIO to raise the limits, change its risk evaluation models, and continue trading despite the red flags.

(5) **Dodged OCC Oversight.** JPMorgan Chase dodged OCC oversight of its Synthetic Credit Portfolio by not alerting the OCC to the nature and extent of the portfolio; failing to inform the OCC when the SCP grew tenfold in 2011 and tripled in 2012; omitting SCP specific data from routine reports sent to the OCC; omitting mention of the SCP's growing size, complexity, risk profile, and losses; responding to OCC information requests with blanket assurances and unhelpful aggregate portfolio data; and initially denying portfolio valuation problems.

(6) **Failed Regulatory Oversight.** The OCC failed to investigate CIO trading activity that triggered multiple, sustained risk limit breaches; tolerated bank reports that omitted portfolio-specific performance data from the CIO; failed to notice when some monthly CIO reports stopped arriving; failed to question a new VaR model that dramatically lowered the SCP's risk profile; and initially accepted blanket assurances by the bank that concerns about the SCP were unfounded.

(7) **Mischaracterized the Portfolio.** After the whale trades became public, JPMorgan Chase misinformed investors, regulators, policymakers and the public about its Synthetic Credit Portfolio by downplaying the portfolio's size, risk profile, and losses; describing it as the product of long-term

investment decisionmaking to reduce risk and produce stress loss protection, and claiming it was vetted by the bank's risk managers and was transparent to regulators, none of which was true.

E. Recommendations

Based upon the Subcommittee's investigation and findings of fact, the Report makes the following recommendations.

(1) **Require Derivatives Performance Data.** Federal regulators should require banks to identify all internal investment portfolios containing derivatives over a specified notional size, and require periodic reports with detailed performance data for those portfolios. Regulators should also conduct an annual review to detect undisclosed derivatives trading with notional values, net exposures, or profit-loss reports over specified amounts.

(2) **Require Contemporaneous Hedge Documentation.** Federal regulators should require banks to establish hedging policies and procedures that mandate detailed documentation when establishing a hedge, including identifying the assets being hedged, how the hedge lowers the risk associated with those assets, how and when the hedge will be tested for effectiveness, and how the hedge will be unwound and by whom. Regulators should also require banks to provide periodic testing results on the effectiveness of any hedge over a specified size, and periodic profit and loss reports so that hedging activities producing continuing profits over a specified level can be investigated.

(3) **Strengthen Credit Derivative Valuations.** Federal regulators should strengthen credit derivative valuation procedures, including by encouraging banks to use independent pricing services or, in the alternative, prices reflecting actual, executed trades; requiring disclosure to the regulator of counterparty valuation disputes over a specified level; and requiring deviations from midpoint prices over the course of a month to be quantified, explained, and, if appropriate, investigated.

(4) **Investigate Risk Limit Breaches.** Federal regulators should track and investigate trading activities that cause large or sustained breaches of VaR, CS01, CSW10%, stop loss limits, or other specified risk or stress limits or risk metrics.

(5) Investigate Models That Substantially Lower Risk. To prevent model manipulation, Federal regulators should require disclosure of, and investigate, any risk or capital evaluation model which, when activated, materially lowers the purported risk or regulatory capital requirements for a trading activity or portfolio.

(6) Implement Merkley-Levin Provisions. Federal financial regulators should immediately issue a final rule implementing the Merkley-Levin provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, also known as the Volcker Rule, to stop high risk proprietary trading activities and the build-up of high risk assets at federally insured banks and their affiliates.

(7) Enhance Derivative Capital Charges. Federal financial regulators should impose additional capital charges for derivatives trading characterized as "permitted activities" under the Merkley-Levin provisions, as authorized by Section 13(d)(3) of the Bank Holding Company Act.[6] In addition, when implementing the Basel III Accords, Federal financial regulators should prioritize enhancing capital charges for trading book assets.

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[6] Section 13(d)(3), which was added by Section 619 of the Dodd Frank Act, states: "CAPITAL AND QUANTITATIVE LIMITATIONS.--The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall, as provided in subsection (b)(2), adopt rules imposing additional capital requirements and quantitative limitations, including diversification requirements, regarding the activities permitted under this section if the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission determine that additional capital and quantitative limitations are appropriate to protect the safety and soundness of banking entities engaged in such activities."

II. BACKGROUND

This section provides background information on JPMorgan Chase, its Chief Investment Office, the Office of the Comptroller of the Currency, capital requirements for banks, and credit derivatives.

A. JPMorgan Chase & Company

JPMorgan Chase & Co. (JPMorgan Chase) is a leading global financial services firm incorporated under Delaware law and headquartered in New York City.[7] On the New York Stock Exchange (NYSE), it is listed under the ticker symbol "JPM" and is a component of the Dow Jones Industrial Average.[8] In addition to being the largest financial holding company in the United States, the firm conducts operations in more than 60 countries, employs more than 240,000 people, maintains 5,500 bank branches, and as of December 31, 2012, has more than $2 trillion in assets.[9]

The JPMorgan Chase & Co. of today began as JPMorgan, a commercial bank, in the 19th century.[10] Subsequently, it grew into a complex, diversified firm through a series of acquisitions and mergers that have included Chase Manhattan, a commercial bank; Bear Stearns, an investment bank; and the banking operations of Washington Mutual, a thrift institution.[11] In January 2013, JPMorgan Chase & Co. reported a 2012 record net income of $21.3 billion, on revenue of $99.9 billion.[12]

JPMorgan Chase & Co. engages in a wide variety of financial services, including banking, mortgage lending, securities, credit card

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[7] 1/9/2013 Form 8-K, JPMorgan Chase & Co., at 1, (hereinafter "1/9/2013 JPMorgan Form 8-K"), http://xml.10kwizard.com/filing_raw.php?repo=tenk&ipage=8650849; see also "Financial Highlights," JPMorgan Chase & Co., http://files.shareholder.com/downloads/ONE/2156230184x0x556141/09bf5025-eea2-413d-a0af-96820dd964f6/JPMC_2011_annual_report_finhighlights.pdf.

[8] "JPMorgan Chase & Co.," New York Stock Exchange, http://www.nyse.com/about/listed/jpm.html.

[9] JPMorgan is the largest bank holding company by asset size. See "Top 50 Holding Companies (HCs) as of 9/30/2012," Federal Reserve System, National Information Center, http://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx; 2/28/2013 Form 10-K (Annual Report), JPMorgan Chase & Co., at 1, http://files.shareholder.com/downloads/ONE/2275559219x0xS19617-13-221/19617/filing.pdf; see "About Us," JPMorgan Chase & Co., http://www.jpmorganchase.com/corporate/About-JPMC/about-us.htm; see also "Financial Highlights," JPMorgan Chase & Co., http://files.shareholder.com/downloads/ONE/2156230184x0x556141/09bf5025-eea2-413d-a0af-96820dd964f6/JPMC_2011_annual_report_finhighlights.pdf.

[10] See "The History of JPMorgan Chase & Co.," JPMorgan Chase & Co., http://www.jpmorganchase.com/corporate/About-JPMC/document/shorthistory.pdf.

[11] See "History of Our Firm," JPMorgan Chase & Co., http://www.jpmorganchase.com/corporate/About-JPMC/jpmorgan-history.htm.

[12] 1/16/2013 JPMorgan Chase & Co. press release, "JPMorgan Chase Reports Fourth-Quarter 2012 Net Income of $5.7 Billion, or $1.39 Per Share, on Revenue of $24.4 Billion," at 1, http://files.shareholder.com/downloads/ONE/2275559219x0x628669/0de76d99-815a-4a63-b14d-c9f41ed930a3/JPM_News_2013_1_16_Current.pdf.

issuance, commodities trading, and asset management.[13] It also serves as a primary dealer in U.S. Government securities.[14] The firm's principal bank subsidiaries are JPMorgan Chase Bank, N.A., a national bank with U.S. branches in 23 states, and Chase Bank USA, N.A., a national bank specializing in credit cards.[15] The firm's principal non-bank subsidiary is JPMorgan Securities LLC.[16] The bank and non-bank subsidiaries of the firm operate nationally as well as through overseas branches and subsidiaries, representative offices, and subsidiary foreign banks.[17]

The holding company's activities are organized into six major lines of business or business segments: (1) Retail Financial Services, (2) Card Services and Automobile Loans, (3) Commercial Banking, (4) Investment Banking, (5) Treasury and Securities Services, and (6) Asset Management.[18] In addition, JPMorgan Chase & Co. maintains an internal group called "Corporate/Private Equity," which houses its internal treasury function, a private equity group, and the Chief Investment Office (CIO).[19] JPMorgan Chase has highlighted its focus on risk management and often refers to its "fortress balance sheet."[20]

JPMorgan Chase is also the largest derivatives dealer in the United States, active in derivatives markets involving commodities, credit instruments, equities, foreign currencies, and interest rates.[21] Four U.S. banks dominate the U.S. derivatives markets, of which the credit derivatives market is the third largest, representing about 6% of all derivatives activities.[22] JPMorgan Chase is the largest U.S. derivatives dealer in the credit markets.[23]

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[13] 5/10/2012 JPMorgan Form 10-Q, at 4-5.
[14] "Primary Dealer List," Federal Reserve Bank of New York, http://www.newyorkfed.org/markets/pridealers_current.html.
[15] 5/10/2012 JPMorgan Form 10-Q, at 4.
[16] Id.
[17] Id.
[18] Id., at 4-5.
[19] Id., at 4; JPMorgan Chase & Co. 2011 annual report at 107 (hereinafter "2011 JPMorgan annual report"), http://files.shareholder.com/downloads/ONE/2265496134x0x556139/75b4bd59-02e7-4495-a84c-06e0b19d6990/JPMC_2011_annual_report_complete.pdf.
[20] See, e.g., testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., before the U.S. Senate Committee on Banking, Housing and Urban Affairs, S. Hrg. 112-715 (June 13, 2012), at 2, http://files.shareholder.com/downloads/ONE/2156234165x0x577097/c0734566-d05f-4b7a-9fa4-ec12a29fb2da/JPM_News_2012_6_13_Current.pdf; see also 1/13/2012 "2011 Business Results," JPMorgan Chase & Co. press release, at 2, http://files.shareholder.com/downloads/ONE/2156234165x0x533390/4026b17b-89d6-4ada-be00-9548c93ff325/4Q11_JPM_EPR_FINAL.pdf.
[21] See "OCC's Quarterly Report on Bank Trading and Derivatives Activity Second Quarter 2012," Office of Comptroller of Currency, at Tables 1-5 and Graph 3, http://www2.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq212.pdf.
[22] Id., at 9, Graphs 3 and 4.
[23] Id., at Tables 11 and 12.

James (Jamie) Dimon is Chairman of the Board of Directors and Chief Executive Officer (CEO) of JPMorgan Chase & Co.[24] In his capacity as CEO of the holding company, Mr. Dimon certifies the accuracy of required regulatory filings with the Securities and Exchange Commission (SEC), such as the Company's Forms 10-K and 10-Q.[25]

Douglas Braunstein served as JPMorgan Chase & Co.'s Chief Financial Officer (CFO) from July 2010 to December 2012. He was also a member of the firm's Executive and Operating Committees.[26] In November 2012, JPMorgan Chase announced that Mr. Braunstein would step down from that post at the end of the year, and he has since become a Vice Chairman of the holding company.[27] In his capacity as CFO, Mr. Braunstein was charged with overseeing and certifying the accuracy of the firm's financial reporting, and ensuring adequate capital and liquidity, among other duties.[28]

John Hogan currently serves as JPMorgan Chase's Chief Risk Officer, having taken that position in January 2012. Before that, he served as the Chief Risk Officer in the Investment Bank.[29] His predecessor was Barry Zubrow, who served as the firm's Chief Risk Officer from November 2007 to January 2012, after which he was appointed head of Corporate and Regulatory Affairs.[30] In October 2012, Mr. Zubrow announced he would retire.[31]

Stephen Cutler serves as JPMorgan Chase's general counsel.[32] Greg Baer is a managing director and deputy general counsel in charge

[24] Mr. Dimon became Chairman of the Board on December 31, 2006, and has been Chief Executive Officer since December 31, 2005. See "Members of the Board," JPMorgan Chase & Co., http://www.jpmorganchase.com/corporate/About-JPMC/board-of-directors.htm#dimon.
[25] 2/29/2012 "Form 10-K," JPMorgan Chase & Co., at 342, http://files.shareholder.com/downloads/ONE/2204603745x0xS19617-12-163/19617/filing.pdf; 11/8/2012, "Form 10-Q," JPMorgan Chase & Co., at 230, http://files.shareholder.com/downloads/ONE/2204603745x0xS19617-12-308/19617/filing.pdf.
[26] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[27] The current Chief Financial Officer of the holding company is Marianne Lake. 1/16/2013 "Report of JPMorgan Chase & Co. Management Task Force Regarding 2012 CIO Losses," http://files.shareholder.com/downloads/ONE/2288197031x0x628656/4cb574a0-0bf5-4728-9582-625e4519b5ab/Task_Force_Report.pdf" (hereinafter "2013 JPMorgan Chase Task Force Report"), at 18.
[28] Subcommittee interview of Douglas Braunstein, JPMorgan Chase & Co. (9/12/2012); see also 12/4/2012 "Form 8-K," JPMorgan Chase & Co., at 3, http://files.shareholder.com/downloads/ONE/2204603745x0xS1193125-12-489964/19617/filing.pdf.
[29] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
[30] 2013 JPMorgan Chase Task Force Report, at 19.
[31] Id.
[32] "About Us: Leadership Team – Operating Committee," JPMorgan Chase & Co., http://www.jpmorganchase.com/corporate/About-JPMC/operating-committee.htm.

of corporate and global regulatory affairs since September 2010.[33] Prior to that, Mr. Baer worked in a similar position at Bank of America.[34]

James E. (Jes) Staley served as Chairman and CEO of the Corporate and Investment Bank, capping a career of more than 30 years at JPMorgan Chase.[35] He was also a member of the firm's Executive and Operating Committees. In January 2013, Mr. Staley left JPMorgan to become a managing partner at BlueMountain Capital Management, a hedge fund.[36]

C.S. Venkatakrishnan is the head of the holding company's Model Risk and Development office which oversees development of risk and capital models and metrics. Prior to assuming that post in February 2012, he was head of the Investment Bank Structuring and Pricing Direct office.[37]

Michael Cavanagh has served as Co-CEO of the Corporate and Investment Bank since July 2012, and is a member of the firm's Executive and Operating Committees.[38] Prior to that position, he served as CEO of the firm's Treasury and Securities Services from June 2010 to July 2012.[39] Before that, Mr. Cavanagh served as the firm's Chief Financial Officer from September 2004 to June 2010.[40] In May 2012, Mr. Cavanagh became head of the JPMorgan Chase & Co. Management Task Force established to conduct an internal investigation of the CIO losses.[41] Daniel Pinto is currently the other Co-CEO of the Corporate and Investment Bank.[42]

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[33] "JPM Chase Hires B of A's Gregory Baer," American Banker, Rob Blackwell (9/9/2010), http://www.americanbanker.com/issues/175_173/jpm-chase-hires-bofa-greg-baer-1025302-1.html.
[34] Id.
[35] "JP Morgan's Staley Quits to Join BlueMountain Hedge Fund," Bloomberg, Mary Childs and Dawn Kopecki (1/8/2013), http://www.bloomberg.com/news/2013-01-08/jpmorgan-s-staley-quits-to-join-bluemountain-hedge-fund.html.
[36] Id.
[37] 2013 JPMorgan Chase Task Force Report, at 21.
[38] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012); see also "Michael J. Cavanagh," Bloomberg Businessweek Executive Profile, http://investing.businessweek.com/research/stocks/people/person.asp?personId=170434&ticker=JPM.
[39] "Michael J. Cavanagh," Bloomberg Businessweek Executive Profile, http://investing.businessweek.com/research/stocks/people/person.asp?personId=170434&ticker=JPM.
[40] Id.; Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012).
[41] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012); 2013 JPMorgan Chase Task Force Report, at 1, footnote 1.
[42] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012).

B. Chief Investment Office

The Chief Investment Office (CIO) is located within JPMorgan Chase's Corporate/Private Equity division.[43] It has a staff of about 425, including 140 traders, and maintains offices in several locations, including New York and London.[44]

According to JPMorgan Chase, the CIO's predominant purpose is to maintain an investment portfolio to manage the bank's excess deposits.[45] JPMorgan Chase explained to the Subcommittee that the CIO's excess deposits portfolio results from an "enduring mismatch" that the bank experiences between customer deposits, which it treats as a liability since the bank must repay them upon demand, and bank loans, which the bank treats as an asset since they must be repaid to the bank with interest.[46] According to JPMorgan Chase, the deposits managed by the CIO are "mostly uninsured corporate deposits," but also include some insured deposits.[47]

Ina Drew, who headed the CIO from 2005 to May 2012, told the Subcommittee that, during the 2008 financial crisis, about $100 billion in new deposits were added to the bank by depositors seeking a safe haven for their assets,[48] effectively doubling the CIO's pool of excess deposits.[49] By 2012, the CIO was managing a portfolio of approximately $350 billion, a historic high.[50] According to the OCC, the enormous size of this $350 billion portfolio would make the CIO alone the seventh largest bank in the country.[51]

The CIO was formerly part of the bank's internal treasury function, but was split off into a stand-alone office in 2005.[52] According to JPMorgan Chase, its Treasury office and the CIO perform similar tasks in terms of managing the bank's assets, but the Treasury office focuses more on shorter-term asset liability management.[53] In 2012, JPMorgan Chase's proxy statement described the CIO and its Treasury office as

[43] 2011 JPMorgan annual report at 107; Subcommittee briefing by JPMorgan Chase (5/22/2012) (Greg Baer).
[44] 2013 JPMorgan Chase Task Force Report, at 21; Levin Office briefing by JPMorgan Chase, (5/25/2012) (Greg Baer).
[45] 2013 JPMorgan Chase Task Force Report, at 21; Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
[46] Levin Office briefing by JPMorgan Chase (5/22/2012) (Greg Baer).
[47] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
[48] Subcommittee interview of Ina Drew, CIO (9/7/2012); see also 2/13/2012 letter from JPMorgan Chase to U.S. Department of the Treasury and others, "Comment Letter on the Notice of Proposed Rulemaking Implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," JPM-CIO-PSI-0013270, at 57 ("As the crisis unfolded, JPMorgan experienced an unprecedented inflow of deposits (more than $100 billion) reflecting a flight to quality.").
[49] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[50] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[51] Id.
[52] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss).
[53] Id.

follows: "The Chief Investment Office and Corporate Treasury are responsible for managing the Firm's liquidity, interest rate and foreign exchange risk, and other structural risks."[54] A March 2012 internal JPMorgan Chase presentation on "CIO 2012 Opportunities and Challenges," prepared by the CIO, stated that the CIO's "key mandate" was to: "[o]ptimize and protect the firm's balance sheet from potential losses, and create and preserve economic value over the longer-term."[55]

CIO Investment Portfolios. In its March 2012 presentation, the CIO described managing nine investment portfolios spanning an investment horizon that extended from the shorter term to the longer term.[56] At the short end of the horizon, the CIO indicated that it maintained "North America" and "International" portfolios, whose assets were "mainly in mark to market accounts."[57] In the medium-term, the CIO presentation indicated that the CIO had a "Strategic Asset Allocation" portfolio, which was a portfolio used to "manage the Firm's structural risk exposures" using assets that were "[m]ainly available-for-sale."[58] Also included in the medium-term horizon were portfolios of assets used to hedge the bank's activities relating to foreign exchange and mortgage servicing rights.[59] On the longer-term investment horizon, the CIO presentation indicated that the CIO maintained a portfolio to fund the bank's retirement plans; a portfolio to maximize "tax advantaged investments of life insurance premiums"; and a private equity portfolio that, by 2012, was characterized as "in run-off mode."[60] A final component of the CIO's longer term horizon was a portfolio of "Special Investments," which consisted of stressed or distressed investment opportunities "related to undervalued or underperforming loans" on the bank's balance sheet.[61]

Altogether, the CIO's March 2012 internal presentation identified nine separate investment portfolios, yet made no explicit mention of the Synthetic Credit Portfolio, despite its then massive size and alleged importance in hedging the bank's overall credit risk. Ms. Drew told the Subcommittee that the SCP was part of the Tactical Asset Portfolio

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[54] 5/15/2012 JPMorgan Chase 2012 Proxy Statement, "Board's Role in Risk Oversight," at 11, http://files.shareholder.com/downloads/ONE/2265496134x0x556146/e8b56256-365c-45aa-bbdb-3aa82f0d07ea/JPMC_2012_proxy_statement.pdf.

[55] Mar. 2012 "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," prepared by Ina Drew and Irvin Goldman, CIO, JPM-CIO-PSI 0015015.

[56] Id.

[57] Id.

[58] Id.

[59] Id.

[60] Id. Subcommittee interview of Fred Crumlish, OCC (8/28/2012). According to Ina Drew, the private equity portfolio was added to the CIO in 2010, at the request of Mr. Dimon. Subcommittee interview of Ina Drew, CIO (9/7/2012).

[61] Mar. 2012 "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," prepared by Ina Drew and Irvin Goldman, CIO, JPM-CIO-PSI 0015015. Ms. Drew told the Subcommittee that this portfolio was also added to the CIO at the request of Mr. Dimon. Subcommittee interview of Ina Drew, CIO (9/7/2012).

which, in turn, was part of the International portfolio identified as having a shorter term investment horizon.[62]

The OCC capital markets examiner responsible for JPMorgan Chase told the Subcommittee that, while Ms. Drew viewed the CIO as providing "special" asset management functions, he viewed the CIO as providing typical asset-liability management services for the bank, combined with private equity and pension management arms.[63]

Ina Drew served as the bank's Chief Investment Officer and head of the CIO from February 2005, when it was first spun off as a stand-alone office, until May 2012.[64] Ms. Drew reported directly to Mr. Dimon and was a member of JPMorgan Chase's Executive and Operating Committees.[65] Prior to taking the helm at the CIO, Ms. Drew had headed the holding company's Global Treasury office.[66] On May 14, 2012, about a month after media reports on the trading losses in the CIO's Synthetic Credit Portfolio, the firm announced that Ms. Drew had decided to retire.[67] She was replaced initially by Matthew Zames, from May to September 2012, and then by Craig Delaney.[68]

Other senior CIO management included the CIO's Chief Financial Officer, a position held by Joseph Bonocore from late 2000 until November 2010; and by John Wilmot from January 2011 until May 2012.[69] He was then replaced by Marie Nourie.[70] The CIO's most senior risk officer was Peter Weiland from 2008 until 2012; then Irvin Goldman from January 2012 until he resigned in July 2012.[71] He was replaced by Chetan Bhargiri who now serves as Chief Risk Officer for the CIO as well as the bank's Treasury and Corporate offices.[72] Since 2007, Patrick Hagan served as the CIO's chief quantitative analyst.[73]

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[62] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[63] Subcommittee interview of Fred Crumlish, OCC (8/28/2012). See also FDIC presentation, "JPMC & COMPANY CIO Synthetic Credit Portfolio," FDICPROD-0001783, at 2 ("As far back as 2006, CIO's mandate was to act as a traditional ALM function with multiple priorities, including investing the firm's excess cash, managing the firm's pension fund and capital hedging (mitigating stress events).").
[64] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[65] Id. See also 4/2012 JPMorgan Chase & Co. internal presentation to Subcommittee entitled, "Chief Investment Office – Organization," JPM-CIO-PSI 0001875.
[66] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[67] 5/14/2012 "JPMorgan Chase Announces Management Changes; Ina Drew to Retire; Matt Zames Named New CIO," JPMorgan Chase & Co. press release, http://investor.shareholder.com/jpmorganchase/releasedetail.cfm?ReleaseID=673037.
[68] Mr. Zames is now co-Chief Operating Officer of JPMorgan Chase & Co., and Mr. Delaney reports to him. 2013 JPMorgan Chase Task Force Report, at 15, 107.
[69] Subcommittee interviews of Joseph Bonocore, JPMorgan Chase (9/11/2012) and John Wilmot, CIO (9/11/2012); 2013 JPMorgan Chase Task Force Report, at 20.
[70] 2013 JPMorgan Chase Task Force Report, at 15.
[71] Subcommittee interviews of Peter Weiland (8/29/2012) and Irvin Goldman (9/15/2012); 2013 JPMorgan Chase Task Force Report, at 19-20. Mr. Weiland resigned in October 2012. Id., at 20.
[72] 2013 JPMorgan Chase Task Force Report, at 15.
[73] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

The International Chief Investment Officer was Achilles Macris, who joined the CIO in 2006, rose quickly to management, and served as Ms. Drew's top deputy in the CIO's London office.[74] He oversaw management of the Synthetic Credit Portfolio. Prior to working at the CIO, Mr. Macris worked for Dresdner Kleinwort Wasserstein, a British investment bank, as a proprietary trader.[75] Mr. Macris is a Greek national and U.S. citizen.

Javier Martin-Artajo joined the CIO in 2007, as the head of Credit and Equity Trading.[76] He worked in the CIO's London office, reported to Mr. Macris, and directly oversaw the Synthetic Credit Portfolio.[77] He had earlier worked for Mr. Macris at Dresdner Kleinwort Wasserstein.[78] Mr. Martin-Artajo is a Spanish national living in London.[79]

Bruno Iksil was a trader in the CIO's London office and reported to Mr. Martin-Artajo.[80] Mr. Iksil joined the CIO in 2005, and served as the head trader managing the Synthetic Credit Portfolio from January 2007 until April 2012.[81] Prior to joining JPMorgan Chase, Mr. Iksil worked as a proprietary trader at Banque Populaire and later as head of Credit Derivatives at Natixis, a French investment bank.[82] Mr. Iksil is a

[74] Subcommittee interview of Ina Drew, CIO (9/7/2012); 4/2012 JPMorgan Chase & Co. internal presentation to Subcommittee entitled, "Chief Investment Office – Organization," JPM-CIO-PSI 0001875, at 876, 879.

[75] See "JPMorgan Said to Transform Treasury to Prop Trading," Bloomberg, Erik Schatzker, Christine Harper, and Mary Childs (4/13/2012), http://www.bloomberg.com/news/2012-04-13/jpmorgan-said-to-transform-treasury-to-prop-trading.html.

[76] Apr. 2012 JPMorgan Chase & Co. internal presentation to Subcommittee entitled, "Chief Investment Office – Organization," JPM-CIO-PSI 0001875, at 880. See also "JPMorgan Said to Transform Treasury to Prop Trading," Bloomberg, Erik Schatzker, Christine Harper, and Mary Childs (4/13/2012), http://www.bloomberg.com/news/2012-04-13/jpmorgan-said-to-transform-treasury-to-prop-trading.html.

[77] Subcommittee interview of Ina Drew, CIO (9/7/2012); see also "At J.P. Morgan, Whale & Co. Go," Wall Street Journal, Dan Fitzpatrick and Gregory Zuckerman (7/13/2012); "JPMorgan Said to Transform Treasury to Prop Trading," Bloomberg, Erik Schatzker, Christine Harper, and Mary Childs (4/13/2012), http://www.bloomberg.com/news/2012-04-13/jpmorgan-said-to-transform-treasury-to-prop-trading.html.

[78] Subcommittee interview of Ina Drew, CIO (9/7/2012); see also "JPMorgan Said to Transform Treasury to Prop Trading," Bloomberg, Erik Schatzker, Christine Harper, and Mary Childs (4/13/2012), http://www.bloomberg.com/news/2012-04-13/jpmorgan-said-to-transform-treasury-to-prop-trading.html.

[79] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).

[80] Apr. 2012 JPMorgan Chase & Co. internal presentation to Subcommittee entitled, "Chief Investment Office – Organization," JPM-CIO-PSI 0001875, at 880.

[81] Subcommittee interview of Ina Drew, CIO (9/7/2012); see also "'London Whale' Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne (4/6/2012), http://online.wsj.com/article/SB10001424052702303299604577326031119412436.html; "JPMorgan Trader Iksil Fuels Prop-Trading Debate with Bets," Bloomberg, Sharron D. Harrington, Bradley Keoun, and Christine Harper (4/9/2012), http://www.bloomberg.com/news/2012-04-09/jpmorgan-trader-iksil-fuels-prop-trading-debate-with-bets.html.

[82] See "Ten Questions to be Answered on 'London Whalegate,'" Financial News (5/11/2012), http://www.efinancialnews.com/story/2012-05-11/10-questions-jp-morgan-scandal-iksil;

French national who lived outside of Paris and commuted to his job in London.[83] In April 2012, the media reported that Mr. Iksil, trading on behalf of JPMorgan Chase, had been dubbed the "London Whale" by industry insiders because of the CIO's large trades in the credit markets.[84] He oversaw several other CIO traders including Julien Grout.[85]

In July 2012, JPMorgan Chase fired Messrs. Macris, Martin-Artajo, and Iksil, and suspended Mr. Grout.[86] On July 13, 2012, the bank announced that "all CIO managers based in London with responsibility for [the] Synthetic Credit Portfolio have been separated from the Firm," that JPMorgan Chase would withhold all severance payments and 2012 incentive compensation from them, and that it would "claw back compensation from each individual."[87] The bank told the Subcommittee that it had obtained the maximum recovery permitted under its employment policies from Ms. Drew and Messrs. Marcis, Martin-Artajo, Iksil, and Grout, through a combination of canceling outstanding incentive awards and obtaining repayment of awards previously paid.[88] The bank indicated the recovered amounts were roughly equal to two years' worth of the person's total compensation.[89] At the time of her departure, Ms. Drew forfeited approximately $21.5 million.[90]

"JPMorgan Trader Iksil Fuels Prop-Trading Debate With Bets," Bloomberg, Shannon D. Harrington and Christine Harper (4/9/2012), http://www.bloomberg.com/news/2012-04-09/jpmorgan-trader-iksil-fuels-prop-trading-debate-with-bets.html.

[83] See "Who Is the London Whale? Meet JPMorgan's 'Humble' Trader Bruno Iksil – Daily Intel," New York Magazine, Joe Coscarelli (5/11/2012), http://nymag.com/daily/intelligencer/2012/05/jpmorgan-london-whale-bruno-iskil-2-billion-loss.html.

[84] See, e.g., "'London Whale' Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne (4/6/2012), http://online.wsj.com/article/SB10001424052702303299604577326031119412436.html.

[85] Apr. 2012 JPMorgan Chase & Co. internal presentation to Subcommittee entitled, "Chief Investment Office – Organization," JPM-CIO-PSI 0001875, at 880.

[86] Subcommittee interview of Michael Cavanagh (12/12/2012). See also 7/12/2012 letter from JPMorgan Chase to Achilles Macris, JPM-CIO-PSI-H 0002742-743, at 742; 7/12/2012 letter from JPMorgan Chase to Javier Martin-Artajo, JPM-CIO-PSI-H 0002744-745, at 744; 7/12/2012 letter from JPMorgan Chase to Bruno Iksil, JPM-CIO-PSI-H 0002740-741, at 740. Mr. Grout subsequently resigned from the bank on December 20, 2012.

[87] 7/13/2012 "CIO Task Force Update," JPMorgan Chase & Co., at 22, Exhibit 99.3 to JPMorgan Chase 7/13/2012 Form 8-K, http://files.shareholder.com/downloads/ONE/2204603745x0x582869/df1f2a5a-927e-4c10-a6a5-a8ebd8dafd69/CIO_Taskforce_FINAL.pdf.

[88] 1/16/2013 email from JPMorgan Chase counsel to Subcommittee, "CIO clawbacks," PSI-JPMC-33-000001.

[89] 2013 JPMorgan Chase Task Force Report, at 106.

[90] Id. See also "JPMorgan Chase Executive Resigns in Trading Debacle," New York Times, Nelson D. Schwartz and Jessica Silver-Greenberg (5/13/2012), http://www.nytimes.com/2012/05/14/business/jpmorgan-chase-executive-to-resign-in-trading-debacle.html?pagewanted=all; "JPMorgan's Drew Forfeits 2 Years' Pay as Managers Ousted," Bloomberg, Dawn Kopecki (7/13/2012), http://www.businessweek.com/news/2012-07-13/dimon-says-ina-drew-offered-to-return-2-years-of-compensation.

C. Office of the Comptroller of the Currency

The OCC is an independent bureau of the U.S. Department of Treasury charged with supervising federally chartered banks (also called "national" banks), U.S. Federal branches of foreign banks, and Federal savings associations.[91] Under the Dodd-Frank Act, the OCC has also become the primary regulator of federally chartered thrift institutions.[92] The OCC maintains four district offices plus an office in London.[93] The head of the OCC, the Comptroller of the Currency, is also a member of the Financial Stability Oversight Council and of the board of the Federal Deposit Insurance Corporation (FDIC).[94] The current OCC head is Thomas J. Curry, who took office in April 2012, just days after the whale trade stories broke.[95]

The OCC is charged with ensuring the safety and soundness of the financial institutions it oversees, and is authorized to conduct examinations, identify problems, and require corrective action.[96] Safety and soundness examinations are organized around a rating system called CAMELS, an acronym for the six components that are evaluated. The CAMELS rating system evaluates a financial institution's: (C) capital adequacy, (A) asset quality, (M) management effectiveness, (E) earnings, (L) liquidity, and (S) sensitivity to market risk. One consequence of a poor CAMELS rating is a higher fee assessment the bank must pay to the Deposit Insurance Fund of the FDIC. The OCC can impose a range of enforcement measures and penalties, including issuing cease and desist orders, banning personnel from the banking industry, imposing fines, and, in an extreme case, revoking a bank's charter.[97] The OCC can also lower a bank's CAMELS rating and order it to take specific actions to correct unsafe or unsound practices or eliminate high risk or inappropriate assets.

The OCC has structured its supervision activities into three categories: a Large Bank program, covering banks with assets of $50

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[91] "Agency Profile and History," Office of the Comptroller of the Currency, Annual Report, FY 2011, at i, http://occ.gov/publications/publications-by-type/annual-reports/2011AnnualReport.pdf; "About the OCC," Office of the Comptroller of the Currency, http://occ.gov/about/what-we-do/mission/index-about.html.

[92] Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), P.L. 111-203, codified at 12 U.S.C. § 5412 (b)(2)(B) (2010).

[93] "About the OCC," Office of the Comptroller of the Currency, http://occ.gov/about/what-we-do/mission/index-about.html.

[94] Id. See also "Financial Stability Oversight Council: About the FSOC," U.S. Department of the Treasury, http://www.treasury.gov/initiatives/fsoc/about/Pages/default.aspx.

[95] "Biography: Thomas J. Curry, Comptroller of Currency," U.S. Department of Treasury, http://www.occ.gov/about/who-we-are/comptroller-of-the-currency/bio-thomas-curry-print.pdf.

[96] "About the OCC," Office of the Comptroller of the Currency, http://occ.gov/about/what-we-do/mission/index-about.html.

[97] Id. See also "Section Five – Licensing and Enforcement Measures," Office of the Comptroller of the Currency, Annual Report, FY 2011, http://occ.gov/publications/publications-by-type/annual-reports/2011AnnualReport.pdf.

billion or more; a Midsize Bank program, covering banks with assets generally ranging from $10 billion to $50 billion; and a Community Bank program, focusing on banks with under $10 billion in assets.[98] The OCC maintains a continuous on-site presence at each of the 19 largest banks under its supervision.[99] An Examiner-in-Charge (EIC) leads each bank's on-site team of examiners.[100] National banks and Federal savings associations must submit regular reports to the OCC covering a wide range of safety and soundness factors.[101]

Although the Federal Reserve oversees U.S. financial holding companies, because JPMorgan Chase's banks hold federal charters and the Chief Investment Office invests the banks' deposits, the OCC is the primary prudential regulator of JPMorgan Chase Bank and its subsidiaries, including the CIO.[102] The OCC's supervisory team includes approximately 65 on-site examiners who are responsible for reviewing nearly every facet of JPMorgan Chase's activities and operations.[103] Several OCC examiners were responsible for overseeing the CIO.[104]

D. Capital Requirements

One key regulatory tool for limiting risk at federally insured banks and ensuring banks meet their financial obligations involves requiring banks to meet minimum capital standards. Banks that are well capitalized can withstand losses without endangering deposits, collapsing, or seeking a taxpayer bailout. Banks that fail to maintain minimum capital levels can be deemed to be operating in an unsafe and unsound manner and required to take corrective action.[105]

Federal bank regulators have long required U.S. banks to maintain a minimum amount of capital, meaning money raised primarily from shareholders and retained earnings, adjusting the required level according to the amount and type of activities engaged in by the

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[98] Testimony of Thomas J. Curry, Comptroller of the Currency, before the House Committee on Financial Services, (June 19, 2012), at 2, http://www.occ.gov/news-issuances/congressional-testimony/2012/pub-test-2012-91-written.pdf.
[99] Id., at 3; "OCC at-a-glance," Office of the Comptroller of the Currency, Annual Report, FY 2011, http://occ.gov/publications/publications-by-type/annual-reports/2011AnnualReport.pdf.
[100] Testimony of Thomas J. Curry, Comptroller of the Currency, before the House Committee on Financial Services, (6/19/2012), at 3, http://www.occ.gov/news-issuances/congressional-testimony/2012/pub-test-2012-91-written.pdf.
[101] "About the OCC," Office of the Comptroller of the Currency, http://occ.gov/about/what-we-do/mission/index-about.html.
[102] See Testimony of Thomas J. Curry, Comptroller of the Currency, before the U.S. House of Representatives Committee on Financial Services, (June 19, 2012), at 11-12, http://www.occ.gov/news-issuances/congressional-testimony/2012/pub-test-2012-91-written.pdf.
[103] Id., at 11.
[104] For more information about OCC oversight of the CIO, see Chapter VI.
[105] See, e.g., OCC enforcement authority codified at 12 C.F.R. § 3.14, and the Federal Deposit Insurance Corporation (FDIC) enforcement authority codified at 12 C.F.R. Part 325.

individual bank.[106] In general, the regulations require banks to maintain less of a capital cushion for safer activities, such as investing in Treasury bonds, and more of a capital cushion for riskier activities, such as trading synthetic credit derivatives. To carry out that approach, the regulations generally assign greater "risk weights" or "capital charges," to riskier assets.[107]

United States capital requirements reflect the Basel Accords, a set of international standards on bank capital requirements issued by the Basel Committee on Banking Supervision.[108] Over time, the Basel Committee has issued four sets of capital standards. Basel I, issued in 1988, provided the first international capital standards; Basel II, issued in 1999, revised the first Accord, and was finalized in 2004; Basel 2.5, issued in 2009, strengthened capital standards related to securitizations and trading book exposures in response to the financial crisis; and Basel III, issued in 2010, provided a broader set of reforms.[109] Basel III increased minimum capital requirements and introduced a new set of bank liquidity standards to "improve the banking sector's ability to absorb shocks arising from financial and economic stress, ... improve risk management and governance, [and] strengthen banks' transparency and disclosures."[110] Among other provisions, Basel III increased the minimum amount of capital that had to be raised from common equity.[111]

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[106] See, e.g., OCC minimum capital requirements, 12 C.F.R. Part 3, including Appendices A-C.
[107] See, e.g., OCC minimum capital requirements, 12 C.F.R. Part 3, Appendix A, and FDIC minimum capital requirements, 12 C.F.R. Part 325, Appendix C.
[108] The Basel Committee on Banking Supervision (BCBS), first established in 1974, is an international body composed of representatives from countries with major banking centers, including the United States and the G-20 countries. See "Basel Committee on Banking Supervision," Basel Committee on Banking Supervision, Bank for International Settlements, http://www.bis.org/bcbs/index.htm. The Basel Committee's recommendations do not have the force of law, but must be implemented by individual member countries using national laws and regulations. See "History of the Basel Committee and its Membership," Basel Committee on Banking Supervision, Bank for International Settlements, http://www.bis.org/bcbs/history.htm. The BCBS is part of the Bank for International Settlements, an international organization, located in Basel, Switzerland, which supports and facilitates collaboration among central banks around the world. See "About BIS," Bank for International Settlements, http://www.bis.org/about/index.htm.
[109] See "Basel Committee on Banking Supervision," Basel Committee on Banking Supervision, Bank for International Settlements, http://www.bis.org/bcbs/index.htm (summarizing history of Basel Accords); October 2011 "Progress report on Basel III implementation," Basel Committee on Banking Supervision, Bank for International Settlements, http://www.bis.org/publ/bcbs203.pdf.
[110] "International regulatory framework for banks (Basel III)," Basel Committee on Banking Supervision, Bank for International Settlements, http://www.bis.org/bcbs/basel3.htm (providing general information about Basel III). See also October 2011 "Progress report on Basel III implementation," Basel Committee on Banking Supervision, Bank for International Settlements, http://www.bis.org/publ/bcbs203.pdf. In January 2013, the BCBS weakened the liquidity standards issued in 2010, and delayed their implementation date. See January 2013 "Basel III: Liquidity Coverage Ratio and liquidity risk management tools," prepared by BCBS, http://www.bis.org/publ/bcbs238.htm.
[111] "Basel III overview table," Basel Committee on Banking Supervision, Bank for International Settlements, http://www.bis.org/bcbs/basel3/b3summarytable.pdf (table summarizing Basel III

To determine the amount of capital required at a particular bank, the Basel Accords recommend, and U.S. bank regulators require, calculation of the bank's "Risk Weighted Assets."[112] Risk Weighted Assets (RWA) are a dollar measure of a bank's total assets, adjusted according to the assets' risk.[113] U.S. bank regulators provide detailed guidance on the required components of the mathematical model used to calculate RWA, but do not mandate the use of a specific model.[114] Instead, individual banks are allowed, within regulatory parameters and subject to regulatory approval and oversight, to develop their own model to calculate RWA.[115] The bank's aggregate RWA is then used to calculate its required minimum capital, with a greater ratio of equity-based capital required for banks with higher RWA.[116]

Risk-based capital requirements offer a powerful tool to discourage overly risky bank activities and safeguard against losses from such activities. Some commentators worry, however, that when combined with Federal Reserve policies that lower capital costs for banks by holding down interest rates, they may also create a perverse temptation for banks to engage in riskier activities than if capital were more expensive.[117] During the several years before the whale trades, the Federal Reserve initiated a series of actions that lowered capital costs for banks, and also lowered the returns on such safe investments as Treasury bonds, making them less attractive investments for banks. Those Federal Reserve policies may have inadvertently encouraged banks to engage in riskier, higher return activities like the derivatives trading that led to the whale trades.

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reforms). For information about what qualifies as capital and common equity, see December 2011 "Basel III definition of capital – Basel III Frequently Asked Questions," Basel Committee on Banking Supervision, Bank for International Settlements, http://www.bis.org/publ/bcbs211.htm?ql=1. U.S. regulators have yet to fully implement Basel III; regulations have been proposed to implement its new capital requirements and additional, proposed regulations are being developed to implement its new liquidity requirements.

[112] See, e.g., OCC minimum capital requirements, 12 C.F.R. Part 3, Appendices A-B; "Revisiting Risk-Weighted Assets," IMF Working Paper No. WP/12/90, Vanessa Le Leslé and Sofiya Avramova (March 2012); June 2011 "Basel III: A global regulatory framework for more resilient banks and banking system," prepared by BCBS, http://www.bis.org/publ/bcbs189.pdf (revised version 2011).

[113] See, e.g., "Revisiting Risk-Weighted Assets," IMF Working Paper No. WP/12/90, Vanessa Le Leslé and Sofiya Avramova (March 2012); 2013 JPMorgan Chase Task Force Report, at 26; 12 C.F.R. Part 3, Appendix A *("Risk-weighted assets* means the sum of total risk-weighted balance sheet assets and the total of risk-weighted off-balance sheet credit equivalent amounts. Risk-weighted balance sheet and off-balance sheet assets are calculated in accordance with section 3 of this appendix A.").

[114] See, e.g., OCC minimum capital requirements, 12 C.F.R. Part 3, Appendices A-B.

[115] Subcommittee briefing by OCC (3/4/2013); 12 C.F.R. Part 3, Appendices A-B.

[116] See, e.g,, OCC's minimum capital requirements, 12 C.F.R. Part 3, Appendix A ("A bank's risk-based capital ratio is obtained by dividing its capital base (as defined in section 2 of this appendix A) by its risk-weighted assets (as calculated pursuant to section 3 of this appendix A).").

[117] See. e.g., "The Soviet Banking System – And Ours," Wall Street Journal (7/24/2012), Judy Shelton, http://online.wsj.com/article/SB10000872396390444025204577545522816187642.html.

E. Credit Derivatives

The trading activity that is the focus of this Report revolves around complex credit derivatives, including credit default swaps, credit indices, and credit index tranches.

Derivatives are financial instruments that derive their value from another asset.[118] Credit derivatives derive their value from the creditworthiness of a specified financial instrument such as a corporate bond, or from the creditworthiness of a referenced entity such as a corporation or sovereign nation.[119] In essence, credit derivatives place bets on whether, during a specified period of time, the referenced financial instruments or entities will experience a negative "credit event," such as a bankruptcy, default, or failure to pay.[120] Parties taking the "long" side of the bet wager that no credit event will occur;[121] parties taking the "short" side of the bet wager that the negative credit event will occur.[122] These credit instruments are often described as "synthetic," because they do not contain any tangible assets such as a loan or bond; they simply reference the financial instrument or entity whose credit quality is at issue.[123]

Credit Default Swaps. The simplest type of credit derivative, which also dominates the credit derivative markets,[124] is a credit default swap (CDS).[125] A credit default swap is a contract between two parties placing opposite bets on the creditworthiness of a specified financial instrument or entity. A "single name" credit default swap references a single financial instrument or a single entity. Other credit default swaps can reference a specified pool of instruments or entities.

Traders often analogize credit default swaps to insurance contracts.[126] The long party is essentially selling insurance, or "credit protection," against the occurrence of a negative credit event, while the

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[118] Markit Credit Indices: A Primer (October 2012), Appendix 4 at 32, (hereinafter "Markit Credit Indices: A Primer"), http://www.markit.com/assets/en/docs/products/data/indices/credit-index-annexes/Credit_Indices_Primer_Oct_2012.pdf.
[119] See, e.g., H.P. Kravitt & Edmund Parker, Securitization of Financial Assets § 20.02 (2012).
[120] See Markit Credit Indices: A Primer, at 4-5 ("Investors take a view on deterioration or improvement of credit quality of a reference credit.").
[121] Markit Credit Indices: A Primer, Appendix 4, at 34.
[122] Id., at 37.
[123] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 9, PSI-JPM-30-000001.
[124] See "OCC's Quarterly Report on Bank Trading and Derivatives Activity Second Quarter 2012," at 8, http://www2.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq212.pdf.
[125] See, e.g., 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 15-19, PSI-JPM-30-000001.
[126] See, e.g., 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 18, PSI-JPM-30-000001 ("The Basic Contract: A Credit Default Swap"); see also Markit Credit Indices: A Primer, at 4.

short party is essentially buying that insurance or credit protection.[127] To buy the credit protection, the short party typically makes a payment upfront and then additional periodic payments to the long party, analogous to insurance premiums.[128] Those periodic payments are sometimes referred to as "premiums," "coupon" payments, or the "credit spread."[129] In exchange for receiving those payments, the seller, that is, the long party, is obligated, if a credit event like a default takes place during the covered period, to make the buyer, that is, the short party, whole.[130]

The value of a CDS is typically related to the premium amount or "credit spread" that the short party has to pay.[131] The premium amount or credit spread typically increases when a default is perceived to be more likely, because the insurance or credit protection becomes more valuable.[132] When the premium amount increases, traders often describe the increase as the credit spread "widening." When the premium amount falls, traders often refer to the decrease as the credit spread "narrowing." To ensure payment of the amounts owed, the parties often require each other to post cash collateral, with the amount of collateral changing over time in line with the changing value of the credit default swap.

In most cases, credit default swaps are entered into between a swap dealer and an institutional investor like a hedge fund, insurance company, or other financial institution.[133] The parties typically use standardized documentation developed by the International Swaps and Derivatives Association to make it easier to trade the swap after the initial transaction.[134] Parties may enter into a credit default swap either to offset or "hedge" a particular credit risk or to engage in a proprietary bet on the credit quality of a financial instrument or entity.[135]

Credit Indices. A more complicated form of credit derivative involves a credit index. Credit indices were first invented by JPMorgan Chase and Morgan Stanley in 2001.[136] Each credit index references a basket of selected credit instruments, typically credit default swaps or

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[127] Markit Credit Indices: A Primer, at 4.
[128] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 16, PSI-JPM-30-000001; see also Markit Credit Indices: A Primer, at 4.
[129] Markit Credit Indices: A Primer, Appendix 4, at 30.
[130] Markit Credit Indices: A Primer, at 4.
[131] Id., at 6.
[132] Id.
[133] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 17, PSI-JPM-30-000001; see also Markit Credit Indices: A Primer, at 4.
[134] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 19, PSI-JPM-30-000001; see also Markit Credit Indices: A Primer, at 7.
[135] Markit Credit Indices: A Primer, at 5.
[136] Id., at 7.

other types of credit instruments.[137] The value of the index is typically determined by calculating the value of each constituent credit instrument and using a mathematical formula to combine them into a single dollar value for the entire basket.[138] Parties then enter into swaps that reference the index.[139] The long party bets the index value will increase;[140] the short party bets it will fall.[141]

Investing in a credit index, whose value reflects multiple credit instruments, can be analogized to investing in a portfolio of bonds or loans.[142] The short buyer of a credit index, as with a credit default swap, typically makes an upfront payment reflecting the value of the index and then makes fixed periodic payments to the long party over a specified timeframe.[143] Those periodic payments are, again, typically referred to as premiums, coupon payments, or credit spreads.[144] When the instrument matures or expires, or a trade otherwise closes, the short party may be required to make a final payment reflecting the change in the value of the instrument.[145] On the other hand, if a credit event takes place during the covered time period, it triggers a typically substantial payout by the long party to the short party.[146] After the credit event, the defaulting credit instrument is effectively eliminated from the index.[147]

Credit index transactions are typically entered into "over the counter" (meaning outside of a regulated exchange) between a licensed swap dealer and an investor, using standardized documents.[148] Once the initial index swap is executed, as the value changes, either party can trade or unwind its side of the bet. The index's changing value typically reflects the initial index price or premium amount, which is also called the credit spread.[149] If a party trades or unwinds a swap prior to its expiration, that party typically makes a final payment reflecting the value of the index at that time.[150]

IG9, HY, and iTraxx Indices. The CIO traded a variety of credit indices. CIO profit-loss reports indicate that, by March 2012, the CIO

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[137] Markit Credit Indices: Fact Sheet, at 1, http://www.markit.eom/assets/en/docs/fact-sheets/MKT_Credit_
Indices_factsheet.pdf
[138] Markit Credit Indices: A Primer, at 12-13.
[139] Id., at 11.
[140] Id., Appendix 4, at 34.
[141] Id., Appendix 4, at 36.
[142] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 16, PSI-JPM-30-000001; see also Markit Credit Indices: A Primer, at 11.
[143] Markit Credit Indices: A Primer, at 11.
[144] Markit Credit Indices: A Primer, Appendix 4, at 30.
[145] Id., at 11.
[146] Id., at 13.
[147] Id., at 14.
[148] Id., at 11.
[149] Id.
[150] Id.

held more than 100 different types of credit derivative instruments.[151] Its largest holdings involved indices administered by the Markit Group, Ltd., a global financial information services company that administers multiple index products.[152] Markit owns and operates the indices, and performs a variety of services related to them, including calculating the index values and publishing the daily index prices on its website.[153]

Markit's two primary credit index groups are the CDX, which is a group of indices referencing corporations in North America and Emerging Markets; and the iTraxx, which is a group of indices referencing corporations in Europe and Asia.[154] One key index traded by the CIO is the CDX.NA.IG.9.[155] "CDX" refers to credit index. "NA" refers to North America.[156] "IG" refers to "investment grade," because the index tracks credit default swaps (CDS) for 125 investment grade companies in North America.[157] Each year, Markit issues two series of this index, updating it every six months with a revised reference list of 125 constituent CDS.[158] The number "9" in "IG9" denotes the relevant series of the index. The IG9 series was issued in 2007.[159]

Parties can bet on the index by entering into standardized swap agreements that reference the IG9 series, providing varying maturities. For example, "IG9 5year" indicates that the swap referencing the IG9 index will expire in 2012, five years after the IG9 index was issued. "IG9 10year" indicates that the swap will expire in 2017, 10 years after the IG9 index was issued. Parties can trade the IG9 swaps until the relevant expiration date. Long parties essentially bet that the value of the IG9 will increase; short parties bet that the value will fall. If an investor is "long" the index, and a "credit event," such as a bankruptcy or failure to pay, occurs at one of the referenced companies during the

[151] See, e.g., 4/10/2012 email from Julien Grout, CIO, to "CIO Credit Positions" email group, "CIO CORE Credit Positions: 10-Apr-12," JPM-CIO-PSI 0023061 (estimating the fair value of numerous credit derivative positions).
[152] See Markit Credit Indices: A Primer, Appendix 1, at 19-21; see also 4/10/2012 email from Julien Grout to "CIO Credit Positions" email group, "CIO CORE Credit Positions: 10-Apr-12," JPM-CIO-PSI 0023061.
[153] Markit Credit Indices: A Primer, at 7. The prices are freely accessible to the public at www.markit.com. Id., at 12.
[154] See 2013 JPMorgan Chase Task Force Report, at 24.
[155] See, e.g., 4/10/2012 email from Julien Grout, CIO, to "CIO Credit Positions" email group, "CIO CORE Credit Positions: 10-Apr-12," JPM-CIO-PSI 0023061.
[156] See, e.g., 3/16/2007 "CDS IndexCo and Markit Announce Official Name Change for New Series of CDX Indices," Markit, http://www.markit.com/en/media-centre/press-releases/detail.page?dcr=/markit/PressRelease/data/2007/03/2007-03-16.
[157] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 24, PSI-JPM-30-000001; Markit Credit Indices: A Primer, at 20; see also David Mengle, Credit Derivatives: An Overview, Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter 2007, at 3.
[158] Markit Credit Indices: A Primer, at 21. Although each index starts with 125 companies, if a company experiences a "credit event," such as a bankruptcy, the company's weight in the index will be changed to zero, effectively deleting it from the index. Id., at 14.
[159] See 2013 JPMorgan Chase Task Force Report, at 24.

covered period, the long party will have to make a payment to the short party holding the credit protection.[160]

The CIO also traded the CDX.NA.HY.[161] "HY" refers to High Yield, because the index tracks credit default swaps naming 100 North American companies that pose higher credit risks and so produce higher returns to investors.[162] These companies are often rated as HY companies because they carry non-investment grade or "junk bond" ratings.[163] A third index that was traded by the CIO is the iTraxx Europe which tracks credit default swaps for 125 investment grade companies in Europe.[164] The iTraxx group of indices also had a high yield index known as the "XO" index.[165] As with the CDX indices, Markit issues a new series of the iTraxx indices every six months, with revised reference lists and varying maturities.[166]

When a new credit index series is issued, it is referred to as the "on-the-run" series.[167] Earlier series of the index are then referred to as "off-the-run."[168] They continue to trade until their maturity dates, but are typically less actively traded.[169]

The CDX and iTraxx indices typically required an initial payment upfront that reflected the value of the index at the time of acquisition; four quarterly fixed "coupon" payments on March 20, June 20, September 20, and December 20; and a final payment reflecting the value of the index at the close of the trade.[170]

Credit Index Tranches. A third, still more complicated type of credit derivative involves credit tranches. The credit tranches that were

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[160] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 17-18, PSI-JPM-30-000001; see also Markit Credit Indices: A Primer, at 5. The amount of the payment will depend upon a market auction that sets the recovery rate on the company's debt. Id.

[161] See, e.g., 4/10/2012 email from Julien Grout to "CIO Credit Positions" email group, "CIO CORE Credit Positions: 10-Apr-12," JPM-CIO-PSI 0023061.

[162] Markit Credit Indices: A Primer, at 20.

[163] See "Junk Bond," OCC February 2008 Comptroller's Handbook: Leveraged Lending – Appendix B, at 63, http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/ pdf/leveragedlending.pdf.

[164] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 25, PSI-JPM-30-000001; see also Markit Credit Indices: A Primer, at 19.

[165] See 2013 JPMorgan Chase Task Force Report, at 24.

[166] See 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 23-25, PSI-JPM-30-000001; Markit Credit Indices: A Primer, at 19.

[167] Markit Credit Indices: A Primer, at 9.

[168] Id., Appendix 4, at 35. One JPMorgan Chase document used a more restrictive definition, defining "off-the-run" indices as "any index older than 4 series – for example, the current on the run CDX series are 13, therefore, all indices series 9 and older are considered off the run"). 5/21/2010 "CIO-VCG Procedure: Valuation Process," OCC-SPI-00052685, at 15.

[169] Id., at 9; see also 2013 JPMorgan Chase Task Force Report, at 24-25.

[170] Markit Credit Indices: A Primer, at 9, 11.

traded by the CIO typically related to Markit credit indices.[171] Each of the Markit credit indices tracked the value of a specified basket of credit instruments.[172] Instead of requiring bets on the creditworthiness of the entire basket, for some credit indices, Markit offered instruments that enabled parties to place bets on just a portion of the basket, offering, for example, four tranches with different degrees of vulnerability to default.[173] The riskiest tranche, called the "equity tranche," was immediately affected by any default at any company in the basket.[174] The next tranche, called the "mezzanine," was affected only by losses that exceeded 15% of the loss distribution.[175] Those losses usually required one or more defaults to take place. The next tranche, called the "senior" tranche, was affected only by losses that exceeded 25% of the loss distribution.[176] The last and most secure tranche, the "super senior tranche," was affected only by losses that exceeded 35% of the loss distribution.[177] Those losses typically required multiple defaults to take place.

Credit tranche instruments, like other credit derivatives, typically required the short party to make an upfront payment and periodic payments during the covered time period, although the riskiest tranches sometimes did not require any premiums.[178] These instruments also typically required the parties to make a final payment when the swap expired or the trade otherwise closed.[179] CIO documents show that the CIO traded credit tranches as well as credit indices and credit default swaps.[180]

Thinly Traded Market. Due to the complexity and riskiness of credit derivative transactions, the credit derivative market has relatively few participants and, as a result, is thinly traded. Markit identifies only 14 banks in the world that buy and sell its credit indices.[181] Markets with a limited number of participants pose special risks, due to the relative paucity of buyers and sellers. While buyers are often able to buy credit derivatives easily, selling them can be difficult. A seller may

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[171] See 4/10/2012 email from Julien Grout to "CIO Credit Positions" email group, "CIO CORE Credit Positions: 10-Apr-12," JPM-CIO-PSI 0023061.
[172] Markit Credit Indices: A Primer, Appendix 1, at 18-21.
[173] Id., at 15.
[174] Id., at 15, Appendix 4, at 37.
[175] Id.
[176] Id.
[177] Id.
[178] Id., at 28.
[179] Id., at 15.
[180] See 4/10/2012 email from Julien Grout, CIO, to "CIO Credit Positions" email group, "CIO CORE Credit Positions: 10-Apr-12," JPM-CIO-PSI 0023061.
[181] See "Markit CDX Contributing Banks," Markit website, http://www.markit.com/en/products/data/indices/credit-and-loan-indices/cdx/contributing-banks.page; "Markit iTraxx Contributing Banks," Markit website, http://www.markit.com/en/products/data/indices/credit-and-loan-indices/itraxx/contributing-banks.page?.

have to dramatically reduce the price of a credit derivative to attract a buyer. If the seller wants to dispose of a large number of credit derivatives, even a slightly lower price can translate into large losses.

OCC data shows that, of the commercial banks it tracks, just four U.S. banks account for more than 90% of credit derivative trading and holdings, with JPMorgan Chase as the largest participant by far.[182] The resulting market is so small that, when the CIO reported a $3.7 billion loss to the OCC in June 2012, those losses caused overall credit derivative trading revenues for all U.S. commercial banks to decline by 372% from the prior year; it also caused their derivative trading revenues as a whole to drop by 73%.[183]

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[182] See OCC Quarterly Report on Bank Trading and Derivatives Activity Second Quarter 2012, at 1, Graph 1 and 4, Tables 11 and 12, http://www2.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq212.pdf.

[183] OCC Quarterly Report on Bank Trading and Derivatives Activity Second Quarter 2012, at 1-2, http://www2.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq212.pdf. Holding companies tracked by the OCC saw a decline of 126% in their credit derivatives trading revenues and a drop of 46% in their overall derivatives trading revenues, compared to the year before. Id., at 3.

III. INCREASING RISK

In 2005, JPMorgan Chase spun off as a separate unit within the bank its Chief Investment Office (CIO), which was charged with investing the bank's excess deposits, and named as its head Ina Drew who served as the bank's Chief Investment Officer. In 2006, the CIO approved a proposal to trade in synthetic credit derivatives, a new trading activity. In 2008, the CIO began calling its credit trading activity the Synthetic Credit Portfolio (SCP).

Three years later, in 2011, the SCP's net notional size jumped from \$4 billion to \$51 billion, a more than tenfold increase. In late 2011, the SCP bankrolled a \$1 billion credit derivatives trading bet that, after American Airlines declared bankruptcy, produced revenues of approximately \$400 million. In December 2011, JPMorgan Chase instructed the CIO to reduce its Risk Weighted Assets (RWA) to enable the bank, as a whole, to reduce its regulatory capital requirements. In response, in January 2012, rather than dispose of the high risk assets in the SCP – the most typical way to reduce RWA – the CIO launched a trading strategy that called for purchasing additional long credit derivatives to offset its short derivative positions and lower the CIO's RWA that way. That trading strategy not only ended up increasing the portfolio's size, risk, and RWA, but also, by taking the portfolio into a net long position, eliminated the hedging protections the SCP was originally supposed to provide.

In the first quarter of 2012, the CIO traders went on a sustained trading spree, eventually increasing the net notional size of the SCP threefold from \$51 billion to \$157 billion. By March, the SCP included at least \$62 billion in holdings in a U.S. credit index for investment grade companies; \$71 billion in holdings in a credit index for European investment grade companies; and \$22 billion in holdings in a U.S. credit index for high yield (non-investment grade) companies. Those holdings were created, in part, by an enormous series of trades in March, in which the CIO bought \$40 billion in notional long positions, which the OCC later characterized as "doubling down" on a failed trading strategy. By the end of March, the SCP held over 100 different credit derivative instruments, with a high risk mix of short and long positions, referencing both investment grade and non-investment grade corporations, and including both shorter and longer term maturities. JPMorgan Chase personnel described the resulting SCP as "huge" and of "a perilous size" since a small drop in price could quickly translate into massive losses.

At the same time the CIO traders were increasing the SCP's holdings, the portfolio was losing value. The SCP reported internally losses of \$100 million in January, another \$69 million in February, and another \$550 million in March, totaling at quarter-end nearly \$719 million. A week before the quarter ended, on March 23, 2012, CIO head Ina Drew ordered the SCP traders to "put phones down" and stop trading.

In early April, the press began speculating about the identity of the "London Whale" behind the huge trades roiling the credit markets, eventually unmasking JPMorgan Chase's Chief Investment Office. Over the next three months, the CIO's credit derivatives continued to lose money. By May, the Synthetic Credit Portfolio reported losing $2 billion; by the end of June, losses jumped to $4.4 billion; and by the end of the year, the total reached at least $6.2 billion.

JPMorgan Chase told the Subcommittee that the SCP was not intended to function as a proprietary trading desk, but as insurance or a "hedge" against credit risks confronting the bank. While its original approval document indicated that the SCP was created with a hedging function in mind, the bank was unable to provide documentation over the next five years detailing the SCP's hedging objectives and strategies; the assets, portfolio, risks, or tail events it was supposed to hedge; or how the size, nature, and effectiveness of its hedges were determined. The bank was also unable to explain why the SCP's hedges were treated differently from other types of hedges within the CIO.

While conducting its review of the SCP, some OCC examiners expressed skepticism that the SCP functioned as a hedge at all. In a May 2012 internal email, for example, one OCC examiner referred to the SCP as a "make believe voodoo magic 'composite hedge.'" When he was asked about the Synthetic Credit Portfolio, JPMorgan Chase CEO Jamie Dimon told the Senate Banking Committee that, over time, the "portfolio morphed into something that rather than protect the firm, created new and potentially larger risks." Mr. Dimon has not acknowledged that what the SCP morphed into was a high risk proprietary trading operation.

A. Origins of the Synthetic Credit Portfolio

Traditionally, the CIO had invested the bank's excess deposits in very safe instruments, an approach typical among large banks.[184] Those instruments included, for example, U.S. treasury bonds, municipal bonds, corporate securities, high grade corporate bonds, and high grade mortgage-backed securities.[185] At a Senate hearing, Mr. Dimon stated:

[184] Subcommittee interview of Mike Sullivan, OCC (8/30/2012).
[185] 2013 JPMorgan Chase Task Force Report, at 22; Levin Office Briefing by JPMorgan Chase, (5/22/2012) (Greg Baer); 2/8/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, OCC-SPI-00022351 (describing the portfolio as "36 percent US government and agency securities," with the remainder primarily in mortgage backed securities).

"the bulk of CIO's responsibility is to manage [its] portfolio in a conservative manner," noting that the average credit rating for its investment holdings was AA+.[186]

The OCC told the Subcommittee that, over time, the CIO also began to invest in higher risk corporate bonds to balance out its portfolio and achieve a higher investment return with a "decent" risk profile.[187] The CIO also diversified its portfolio with a mix of instruments to avoid concentrating its investments in one type of instrument.[188]

In 2006, CIO hired a new trader, David Olson, to diversify the excess deposits investment portfolio by purchasing credit products.[189] According to the OCC, purchasing synthetic credit derivatives was unusual for a CIO-type asset-liability management function.[190] While banks often trade in credit derivatives, the OCC has testified that no other large bank uses them to hedge credit risk.[191] However, JPMorgan Chase told the Subcommittee that it viewed the CIO's use of synthetic credit derivatives to be similar to buying insurance: the CIO was paying a premium for protection against credit risk.[192]

In May 2006, the CIO formally approved a request by Achilles Macris, soon to become head of its International Office, to establish a "credit trading" program under a "New Business Initiative" (NBI) at the CIO.[193] According to the internal CIO approval document for the NBI, JPMorgan Chase had "cyclical exposure to credit, which is the single largest risk concentration from the operating businesses," and the new credit trading program could help counter that risk.[194] The NBI generally authorized the CIO to trade in credit derivative indices and

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[186] Testimony of Jamie Dimon, "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012); http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=32db0782-9ccf-42fd-980e-00ab870fd0d9.
[187] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[188] Id.
[189] Subcommittee interview of David Olson, CIO (9/14/2012).
[190] Subcommittee interview of Elwyn Wong, OCC (8/20/2012).
[191] Testimony of Thomas J. Curry, Comptroller of the Currency, "Implementing Wall Street Reform: Enhancing Bank Supervision and Reducing Systemic Risk," before the Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg 112-714, (June 6, 2012), at 27; see also Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
[192] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
[193] 5/10/2006 "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability," OCC-SPI-00081631, at 1; Subcommittee interview of Mike Sullivan, OCC (8/30/2012).
[194] 5/10/2006 "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability," OCC-SPI-00081631, at 1.

broad credit default swaps that were not limited to a single corporation.[195]

The new credit trading program was presented as a risk reduction effort, and, perhaps for that reason, the NBI contained no discussion of how synthetic credit instruments themselves could pose market, credit, and counterparty risk. The NBI approval document did, however, state: "Credit trading is essentially a new business and therefore requires a new limits infrastructure comprising both VaR and non-statistical measures."[196] In 2006, the portfolio was assigned an initial "Value-at-Risk" (VaR) limit of $5 million,[197] which meant that if the portfolio's potential loss calculation was more than that amount on a given day, the traders would have to either reduce their holdings to end the breach or ask management to increase the limit.[198]

In 2007, to carry out the credit trading portion of the New Business Initiative, CIO began a program to purchase "ABX and TABX protection."[199] At that time, the ABX and TABX were new credit derivative indices that "serve[d] as liquid instruments for trading subprime credit risk."[200] Neither had a track record, making their risk profiles unknown.

In November 2007, JPMorgan Chase's internal audit group conducted an audit of "CIO Global Credit Trading," characterizing it as a "First Time Review of New Business, Product or Service."[201] The audit report stated: "Chief Investment Office (CIO) credit trading activities commenced in 2006 and are proprietary position strategies executed on credit and asset backed indices." The audit made no mention of hedging or credit stress loss protection, and contained no analysis of the credit trading activity in terms of lowering bank risk. It also did not identify any assets or portfolios that were being hedged by the credit derivatives. The audit rated the CIO's "control environment" as "Satisfactory," but noted, among other matters, that the CIO's Valuation Control Group committed multiple "calculation errors" when testing the prices of the credit derivatives.[202]

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[195] Subcommittee interview of Michael Sullivan, OCC (8/30/2012); 5/22/2008 "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability," OCC-SPI-00081631, at 8.
[196] 5/10/2006 "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability," OCC-SPI-00081631, at 10.
[197] Id.; Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
[198] See, e.g., 2011 JPMorgan Chase Annual Report, at 162.
[199] 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "Synthetic Credit Materials," JPM-CIO-PSI 0001101.
[200] 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, "CDO Briefing," at 21, PSI-JPM-30-000001.
[201] 11/29/2007 "CIO Global Credit Trading," JPMorgan Chase & Co. Audit Department Report, JPM-CIO-PSI-H 0006022-023.
[202] Id.

In July 2008, the CIO started a credit derivative trading program intended to "benefit from large defaults on High Yield names."[203] "High Yield names" referred to individual corporations perceived to be at higher risk of default, often signaled by carrying a junk bond rather than investment grade bond rating.[204] Credit default swaps or "High Yield" credit indices naming these non-investment grade corporations generally required the payment of higher premiums by the short parties, but also promised large payoffs if the named corporations defaulted.[205] Each of these derivatives, under generally accepted accounting principles, was subject to mark-to-market accounting, which meant their value had to be calculated and booked on a daily basis.[206]

Despite credit trades and a formal approval document dating from 2006, it is difficult to establish when the credit trading program actually coalesced into the Synthetic Credit Portfolio (SCP). The 2007 internal bank audit stated that the credit trading commenced in 2006, although Ms. Drew told the Subcommittee that the SCP was established in June 2007.[207] The OCC determined that the SCP acquired its current name in 2008.[208]

The timing is somewhat unclear due to a lack of documentation regarding the SCP during its first five years of operation. Even though the Synthetic Credit Portfolio involved higher risk instruments that were unusual for an asset-liability management function, the Subcommittee has uncovered no evidence that the CIO alerted the OCC to the establishment of the SCP or briefed the OCC about SCP trading activities. The OCC told the Subcommittee that it expects banks to provide information to the agency in a forthcoming, transparent way so the regulator can focus its resources on areas of higher risk. But according to the OCC, while the CIO created a formal NBI approval document to initiate credit trading in 2006, the CIO did not update or amend that NBI when its traders began purchasing more complex credit

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[203] 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "Synthetic Credit Materials," JPM-CIO-PSI 0001101.
[204] See "Junk Bond," OCC February 2008 Comptroller's Handbook: Leveraged Lending – Appendix B, at 63, http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_pdf/leveragedlending.pdf.
[205] For more information on the HY credit index, see Chapter 2.
[206] See 5/22/2008 "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability," OCC-SPI-00081631, at 11.
[207] Subcommittee interview of Ina Drew, CIO (9/7/2012); see also 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "Synthetic Credit Materials," JPM-CIO-PSI 0001100-106, at 104 ("The Chief Investment Office has utilized the 'synthetic credit portfolio,' which is a portfolio of credit derivatives, to construct a hedge against other risks on JPMC's balance sheet. This activity has been part of the CIO portfolio construction and risk management since 2007.").
[208] See Subcommittee interview of Doug McLaughlin and Mike Sullivan, OCC (8/30/2012).

derivative products, such as credit index tranches,[209] and engaging in larger volumes of trades.[210]

The OCC has since determined that, in 2008, the bank violated OCC notification requirements by adding credit index tranche positions to the SCP without notifying the agency of that "new product" which represented "a substantial change in business strategy."[211] The OCC also determined that those credit derivatives had been moved from what was then called the "Proprietary Positions Book" in the Investment Bank when that Proprietary Positions Book closed down, but the bank failed to notify the OCC, in contravention of its notice obligations.[212] According to the OCC, the first time the SCP was even mentioned in a written communication to the OCC was on January 27, 2012, in a routine VaR report,[213] and the first time the OCC became aware of the portfolio's size and high risk nature was after it attracted media attention in April 2012.[214]

JPMorgan Chase has acknowledged to the Subcommittee that, despite more than five years of operation, the CIO never detailed the purpose or workings of the SCP in any formal document nor issued any specific policy or mandate setting out its parameters or hedging strategies.[215] The bank did not undertake that effort even though OCC regulations state that, in connection with calculating its risk-based capital requirements, a bank "must have clearly defined trading and hedging strategies for its trading positions" and each hedging strategy "must articulate for each portfolio of trading positions the level of market risk the bank is willing to accept and must detail the instruments, techniques, and strategies the bank will use to hedge the risk of the portfolio."[216]

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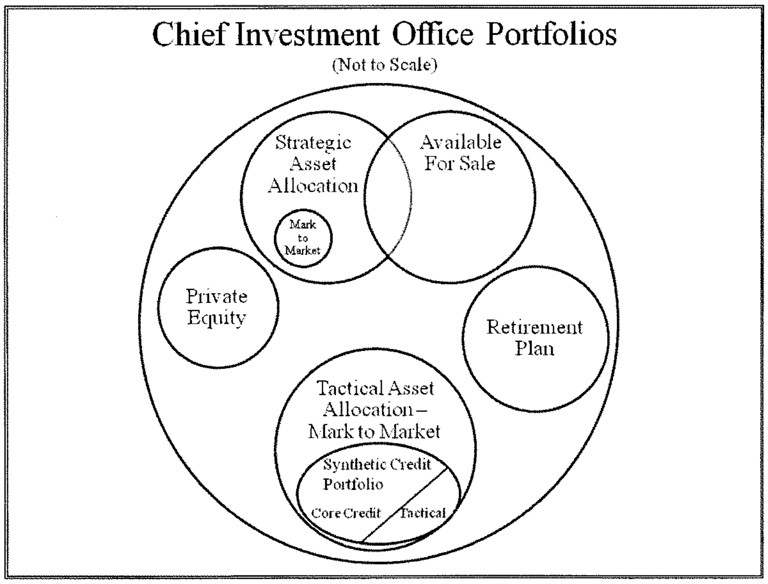
[209] For more information on credit tranches, see Chapter II.
[210] Subcommittee interview of Mike Sullivan, OCC (8/30/2012); 5/22/2008 "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability," OCC-SPI-00081631, at 6. A part of the NBI form called "Post-Implementation Review" which was "to be completed at the time of approval" was left blank. Id., at 19.
[211] 10/26/2012 Confidential Supervisory Report, OCC, at PSI-OCC-13-000104 [Sealed Exhibit].
[212] Id. When asked by the Subcommittee about the OCC's determination, however, the bank disputed that any derivatives in the Proprietary Positions Book were ever moved to the CIO.
[213] Subcommittee interview of Doug McLaughlin, OCC (8/30/2012). The SCP was mentioned in a routine CIO Value-at-Risk report. See also 10/26/2012 Confidential Supervisory Report, OCC, at 12, PSI-OCC-13-000025 [Sealed Exhibit].
[214] Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
[215] Levin Office briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
[216] 12 C.F.R. Part 3, Appendix B, Section 3(a)(2) ("(2) Trading and hedging strategies. A bank must have clearly defined trading and hedging strategies for its trading positions that are approved by senior management of the bank.

> (i) The trading strategy must articulate the expected holding period of, and the market risk associated with, each portfolio of trading positions.
> (ii) The hedging strategy must articulate for each portfolio of trading positions the level of market risk the bank is willing to accept and must detail the instruments, techniques, and strategies the bank will use to hedge the risk of the portfolio.").

There is also a lack of documentation regarding where the Synthetic Credit Portfolio was housed within the CIO, since it was generally not named in internal bank presentations or reports discussing the CIO's investment portfolios. Ina Drew, David Olson, and OCC examiners told the Subcommittee that the SCP was part of the CIO's "Tactical Asset Allocation" (TAA) portfolio, earlier known as the "Discretionary Trading Book."[217] Ms. Drew told the Subcommittee that the TAA portfolio was a book of assets managed on a short term basis.[218] Chetan Bhargiri, the CIO's Chief Risk Officer since May 2012, told the Subcommittee that the TAA was an "idea" book that could be used to test new strategies.[219] A number of internal CIO documents referred to the SCP as the "Core Credit Book,"[220] but Ms. Drew clarified that the Core Credit Book was only one part of the SCP, which also had a "tactical piece."[221] In 2012, the TAA book was subsumed under a new name, "MTM Overlay."[222] Ms. Drew said that multiple terms evolved over time to refer to various portfolios within the CIO, but that the changing terminology was for business reasons and not to be evasive.[223]

Whether established in 2006, June 2007, or somewhat later, the SCP joined a complex set of investment portfolios already in existence at the CIO. When asked about how the SCP fit into the broader CIO investment structure, Ms. Drew indicated that the following chart approximated the placement of key portfolios in the CIO at the beginning of 2012:

[217] Subcommittee interviews of Mike Sullivan, OCC (8/30/2012), Jaymin Berg, OCC (8/31/2012); and David Olson, CIO (9/14/2012). Ms. Drew told the Subcommittee that the terms TAA and Discretionary Trading Book were used interchangeably and that the SCP was part of the TAA. Subcommittee interview of Ina Drew, CIO (9/7/2012).
[218] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[219] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Chetan Bhargiri, CIO).
[220] For example, Bruno Iksil's presentations on the synthetic credit portfolio were sometimes entitled "Core Credit Book Highlights." See, e.g., JPM-CIO-PSI 0000099; JPM-CIO-PSI 00000160. Another presentation entitled "CIO Synthetic Credit Update" (JPM-CIO-PSI 0001247-258) is a discussion of the "Core Credit Book." (JPM-CIO-PSI 0001249).
[221] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[222] Id.; 3/2012 "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," prepared by Ina Drew and Irvin Goldman, Chief Investment Office, JPM-CIO-PSI 0015016.
[223] Subcommittee interview of Ina Drew, CIO (9/7/2012).



Source: Replication of Subcommittee hand-drawing approved by Ina Drew during her Subcommittee interview (9/7/2012).

The seven investment portfolios identified in this chart differ from a list of nine portfolios described in a CIO internal presentation in March 2012; it remains unclear how the two lists relate to each other.[224]

Another issue is whether the SCP evolved over time to function as a proprietary trading effort. The 2007 internal bank audit described the CIO's "Global Credit Trading" portfolio as involving "proprietary position strategies."[225] In 2013, the JPMorgan Chase Task Force wrote: "The Synthetic Credit Portfolio's trading strategies sought, among other things, to take advantage of changes in the relative prices (the 'basis') among different [credit] indices and tranche instruments," a description more in keeping with profitmaking investments than risk management.[226] The SCP was also housed in the CIO's Tactical Asset Allocation portfolio, formerly known as the Discretionary Trading

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[224] Compare chart with 3/2012 presentation entitled, "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," prepared by Ina Drew and Irvin Goldman, CIO, JPM-CIO-PSI 0015016 (listing the following nine investment portfolios: Private Equity, Retirement Plan, Special Investments, COLI-BOLI, Strategic Asset Allocation, FX Hedging, MSR Hedging, North America, and International). In 2010, after reviewing the CIO's investment portfolios, the OCC had directed CIO management to do a better job "document[ing] investment policies and portfolio decisions" and managing the related risks. See 12/8/2010 OCC Supervisory Letter, JPM-2010-80, OCC-SPI-00011201(Matter Requiring Attention) [Sealed Exhibit]. For more information about the OCC review, see Chapter VI.
[225] 11/29/2007 "CIO Global Credit Trading," JPMorgan Chase & Co. Audit Department Report, JPM-CIO-PSI-H 0006022-023.
[226] 2013 JPMorgan Chase Task Force Report, at 24, footnote 23.

Book. According to the former co-head of the JPMorgan Chase Investment Bank, Bill Winters, "discretionary" risk is risk the bank does not have to undertake to operate prudently, and discretionary trading is proprietary trading.[227] In addition, one OCC official who reviewed the SCP told the Subcommittee that the SCP reflected "classic prop trading,"[228] a view buttressed by the fact that the CIO had no client-facing customers[229] or client-facing activity.[230] Instead, all of the SCP trades were made by the bank's own traders for the bank's own purposes, and the resulting profits and losses affected the bank's own bottom line, rather than the bottom line of any client.

B. Purpose of the Synthetic Credit Portfolio: Undocumented, Unclear, and Subject to Change

JPMorgan Chase told the Subcommittee that the SCP was originally established to function as insurance or a "hedge" against certain credit risks confronting the bank. In its 2013 report, the JPMorgan Chase Task Force charged with investigating the whale trades wrote: "The Synthetic Credit Portfolio managed by CIO was intended generally to offset some of the credit risk that JPMorgan faces, including in its CIO investment portfolio and in its capacity as a lender."[231] While some evidence supports that view of the SCP, there is a dearth of contemporaneous SCP documentation establishing what exact credit risks, potential losses, or tail risks were supposedly being hedged by the SCP; how its hedges were sized, targeted, and tested for effectiveness; and why SCP "hedges" were treated so differently from other types of hedges within the CIO.

As noted above, the 2006 New Business Initiative (NBI) that formally authorized the CIO to engage in credit trading said the purpose was to address the bank's "cyclical exposure to credit."[232] In particular, according to JPMorgan Chase senior officials, the SCP was intended to provide the bank with protection during the financial crisis: it was a "macro" "anticipatory" hedge against "tail events."[233] Tail events are

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[227] Subcommittee interview of Bill Winters, JPMorgan Chase (9/11/2012).
[228] Subcommittee interview of Mike Sullivan, OCC (8/30/2012); see also Subcommittee interview of James Hohl, OCC (9/6/2012) (describing the Tactical Asset Allocation as a discretionary portfolio that took on positions to enhance income).
[229] Subcommittee interview of Mike Sullivan, OCC (8/30/2012).
[230] Subcommittee interviews of Jaymin Berg, OCC (8/31/2012) and Michael Cavanagh, JPMorgan Chase (12/11/2012).
[231] 2013 JPMorgan Chase Task Force Report, at 2. See also id., at 22 (SCP "was generally intended to protect the Firm against adverse credit scenarios").
[232] 5/22/2008 "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability," OCC-SPI-00081631, at 1; Subcommittee interview of Mike Sullivan, OCC (8/30/2012).
[233] Subcommittee interviews of Jamie Dimon, JPMorgan Chase (9/19/2012) and Michael Cavanagh, JPMorgan Chase (12/12/2012); Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).

developments viewed as highly unlikely, but very costly if they do occur.[234] JPMorgan Chase told the Subcommittee that during the financial crisis the key tail event that the SCP was insuring against was an unexpectedly large number of corporate defaults.[235]

JPMorgan Chase CEO Jamie Dimon testified before the U.S. Senate that the purpose of the SCP was to make "a little money" in a benign environment and more substantial returns for the bank if there was a credit crisis, so that those returns would offset other losses.[236] In a March 2012 internal presentation, Ms. Drew described the CIO's key mandate as follows: "Optimize and protect the Firm's balance sheet from potential losses, and create and preserve economic value over the long term."[237]

Despite these and other descriptions of the SCP as a "hedge" or "protection" against potential bank losses, in over five years, no CIO document spelled out exactly what the SCP was meant to hedge. The initial 2006 NBI approval document stated that the credit trading activities would be used to "manage corporate credit exposures,"[238] but the Subcommittee found no CIO document that went beyond that generalization to identify the precise credit exposures intended to be offset. The former CIO Chief Financial Officer, John Wilmot, told the Subcommittee that the assets hedged against by the SCP were not specifically defined in writing.[239] One JPMorgan Chase legal counsel stated that the SCP's hedging function was described differently in different places, but was unable to point the Subcommittee to helpful documents.[240]

When asked – despite the lack of contemporaneous documentation – to identify the assets or portfolio that the SCP was intended to hedge, CIO and other bank officials gave inconsistent answers. Some said they understood that the SCP was meant to hedge the firm's balance sheet as

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[234] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss); Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012). See also 2013 JPMorgan Chase Task Force Report, at 38, footnote 49 (defining a "tail event" as "generally understood to be one that arises when the market environment moves more than three standard deviations from the mean based on predictions from a normal distribution of historical prices").

[235] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).

[236] Testimony of Jamie Dimon, "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012) ("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 make a little money, but if there was a crisis, like Lehman, like Eurozone, it would actually reduce this dramatically by making money.")

[237] Subcommittee interview of Ina Drew, CIO (9/7/2012), relying on 3/2012 "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," prepared by Ina Drew and Irv Goldman, Chief Investment Office, JPM-CIO-PSI 0015016.

[238] 5/22/2008 "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability," OCC-SPI-00081631 at 1.

[239] Subcommittee interview of John Wilmot, CIO (9/11/2012).

[240] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss).

a whole.[241] Others explained that it was meant to mitigate losses on the firm's balance sheet as opposed to hedging the whole balance sheet.[242] Still others stated that the SCP was meant to hedge the CIO's own $350 billion Available-For-Sale (AFS) book of assets.[243] The head of CIO's International unit – Achilles Macris, who oversaw the Synthetic Credit Portfolio – claimed it was meant to hedge the international component of the AFS book.[244] Former CIO head Ina Drew even told the Subcommittee at one point that every CIO trader had a book that it was hedging, including the SCP traders, yet the Subcommittee has found no evidence to support that assertion.[245]

It is possible the SCP may have been meant to hedge all of the above at some point.[246] Ms. Drew explained that the SCP originally hedged the bank's entire balance sheet.[247] However, after the financial crisis intensified in 2008, the CIO's AFS portfolio expanded, acquired greater credit risk, and became a more obvious candidate for hedging.[248] The OCC Examiner-in-Charge at JPMorgan Chase agreed with that analysis, noting that the CIO's AFS portfolio grew from $70 billion to $350 billion after 2008, acquiring substantial credit risk along the way.[249] Mr. Wilmot, former CIO CFO, told the Subcommittee that the SCP was meant to hedge the CIO's own AFS book, but could have also been used for other risks on the bank's balance sheet, albeit not all of the structural risk in the firm.[250] While it is possible that the portfolio the SCP was meant to hedge changed over time, the absence of SCP documentation is inadequate to establish whether that was, in fact, the case.

At the same time, the CIO's most senior quantitative analyst, Patrick Hagan, who joined the CIO in 2007 and spent about 75% of his time on SCP projects, told the Subcommittee that he was never asked at any time to analyze another portfolio of assets within the bank, as would be necessary to use the SCP as a hedge for those assets.[251] In fact, he

[241] Subcommittee interviews of Ina Drew, CIO (9/7/2012); John Hogan, JPMorgan Chase (9/4/2012); Irvin Goldman, CIO (9/15/2012).
[242] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Chetan Barghiri; Jay Balacek).
[243] Subcommittee interviews of Douglas Braunstein, JPMorgan Chase (9/12/2012); John Wilmot, CIO (9/11/2012); Irvin Goldman, CIO (9/15/2012) (Goldman explained that the SCP had different hedge targets over time); David Olson, CIO (9/14/2012). Several OCC officials also expressed this view. Subcommittee interviews of Elwyn Wong, OCC (8/20/2012); Michael Kirk, OCC (8/22/2012); Mike Sullivan, OCC (8/30/2012).
[244] 2/2012 "CIO February 2012 Business Review," JPM-CIO-PSI 0001940-984, at 950 ("The credit derivatives portfolio seeks to efficiently provide mark-to-market stress offset to the CIO Int'l credit investments activity.").
[245] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[246] Subcommittee interview of Michael Kirk, OCC (8/22/2012). Mr. Kirk told the Subcommittee that the SCP was initially a hedge against the AFS book but underwent a metamorphosis.
[247] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[248] Id.
[249] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[250] Subcommittee interview of John Wilmot, CIO (9/11/2012).
[251] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

told the Subcommittee that he was never permitted to know any of the assets or positions held in other parts of the bank.[252]

Given the lack of precision on the assets to be hedged, JPMorgan Chase representatives have admitted to the Subcommittee, that calculating the size and nature of the hedge was "not that scientific"[253] and "not linear."[254] According to Ms. Drew, it was a "guesstimate."[255] She told the Subcommittee that there was "broad judgment" about how big the hedge should be, and that she used her "partners" as "sounding boards" if she later wanted to deviate from what had been agreed to.[256] According to the OCC, on April 16, 2012, JPMorgan Chase told the OCC that the SCP was expected to gain $1 billion to $1.5 billion in value to offset $5 to $8 billion in firm wide losses.[257]

The OCC capital markets examiner with responsibility for JPMorgan Chase told the Subcommittee that a distinction should be made among hedges, protection, and stress loss protection.[258] He explained that a dedicated hedge meant that "x" hedges "y" and is reported accordingly. An example is buying the short side of a credit default swap that names a specific company and using that short position to hedge a bank loan to that same company.[259] If the company later declared bankruptcy and defaulted on its loans, the credit default swap would provide a countervailing payment to offset the loan loss incurred by the bank. Another example is identifying an interest rate exposure and buying an interest swap with the opposite exposure to offset any change in the interest rate. Such hedges have a direct correlation with the credit risk they are meant to offset.

The OCC examiner explained that, in contrast, "protection" and "stress loss protection" were more general concepts that often cannot be linked to a specific credit risk. He explained that credit protection should be viewed as more like providing insurance against a variety of possible losses, while stress loss protection should be viewed as providing protection against severe losses which are unlikely, but can happen, a so-called tail event.[260] In his view, JPMorgan Chase did not need a "top of the house" credit hedge – meaning a credit hedge for JPMorgan Chase as a whole. Instead, he said that credit risk should be managed by the individual lines of business.[261] For example, the

[252] Id.
[253] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss).
[254] Id.
[255] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[256] Id.
[257] See 4/17/2012 email from Fred Crumlish, OCC, to Mike Brosnan, OCC, and others, "JPM CIO/IG9 'whale' trade," OCC-SPI-00010490.
[258] Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
[259] Id.
[260] Id.
[261] Id.

Subcommittee was told that JPMorgan Chase's Investment Bank already managed its own credit risk and did not look to the CIO for that purpose.[262]

JPMorgan Chase's counsel told the Subcommittee that, while the descriptions of the purpose of the SCP have not always been consistent, the common element was that the SCP was intended to provide credit loss protection against tail risk,[263] risks that were unlikely but could be costly if they occurred. The OCC capital markets examiner told the Subcommittee, however, that the bank was unable to explain exactly how this stress loss protection worked.[264] In other words, just as the bank has had difficulty identifying the portfolio the SCP was meant to hedge, it has had difficulty identifying the nature of the tail risk the SCP was supposed to offset. At some points, bank officials described it as hedging against a Eurozone crisis.[265] They also described it as hedging against a U.S. financial crisis.[266] In his Senate testimony, Mr. Dimon pointed to both risks, saying the Synthetic Credit Portfolio's "original intent was to protect or hedge the company against a systemic event like the financial crisis or the euro zone situation."[267] In his interview with the Subcommittee, Mr. Dimon indicated that, given a range of scenarios where credit spreads widened, his focus was on a severe situation in which credit spreads widened by 50%.[268]

To clarify the risk that the SCP was intended to address, at one point on April 2012, according to an internal bank email, Mr. Dimon asked the CIO for the correlation between the SCP and the portfolio the SCP was meant to hedge.[269] Mr. Dimon told the Subcommittee that he did not recall if he received a response.[270] Ms. Drew explained that, even though the request had been made by the CEO, so many events were unfolding at the time, that she did not recall if the correlation analysis was sent to him.[271] The bank has been unable to produce that analysis, and the Subcommittee found no evidence this analysis was completed. In an email around the same time, the bank's firmwide Chief Risk Officer told CIO personnel that on a call with regulators the next day "we should have a discussion of what we believe the

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262 Subcommittee interview of John Wilmot, CIO (9/11/2012).
263 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss).
264 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
265 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Chetan Barghiri; Harry Weiss; Gregg Gunselman).
266 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Gregg Gunselman).
267 Testimony of Jamie Dimon, "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012).
268 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
269 See 4/11/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "updated," JPM-CIO-PSI 0001077 ("[w]e are working on Jamie's request for [c]orrelation of the credit book against the portfolio").
270 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
271 Subcommittee interview of Ina Drew, CIO (12/11/2012).

correlation is."[272] There is no documentation, however, of such a discussion. The OCC told the Subcommittee that it asked for documentation of what was being hedged by the SCP and repeated this request a number of times, but JPMorgan Chase never produced the information.[273]

Also of interest is an internal CIO presentation created to help prepare senior JPMorgan Chase executives for a public earnings call in April 2012, which included multiple charts indicating the SCP was no longer performing a hedging function.[274] The charts depicted several scenarios in which the bank suffered credit losses, including one involving a new "financial crisis," and projected that, rather than offset those losses, the SCP would also lose money for the bank in those scenarios.[275] That April 11, 2012 analysis flatly contradicted the SCP's status as a hedge.

Other CIO Hedges. The ambiguity surrounding the objectives, size, and effectiveness of the purported hedge to be provided by the SCP stands in stark contrast to the discipline with which other hedges were handled within the CIO. Specifically, one of the primary tasks undertaken by the CIO was to hedge risks associated with the bank's mortgage servicing rights and interest rates.[276] To hedge risks associated with its mortgage servicing rights (MSR), the mortgage servicing line of business calculated the amount of credit risk that needed to be hedged, provided the total or a range to the CIO, and the CIO constructed an MSR hedge accordingly.[277] The MSR hedges appear to have been

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[272] 4/10/2012 email from John Hogan, JPMorgan Chase, to John Wilmot, CIO, and others, "Materials for FED/OCC Questions," JPM-CIO-PSI 0001021.
[273] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). See also Subcommittee interview of Michael Kirk, OCC (8/22/1012); 4/10/2012 email from Michael Kirk, OCC, to Fred Crumlish, OCC, and others, "CIO info on elephant trade," OCC-00004730 (Mr. Kirk: "What would be helpful would be to see the stress scenarios without these assets, and with these assets so one can understand the impact. ... It would also be helpful if the CIO could provide some indication of a present target level they are trying to achieve, and hence the change of activity that resulted in the same (in other words results prior to and after recent trades.)" Mr. Crumlish: "In my response on JPM email .... I also said it would be useful if they provided analytics or a summary that recapped the hedge strategy, such as the expected impact of the hedge on the projected stress loss identified. I asked for this on the call as well."); 4/10/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, and others, "JPM CIO trades," OCC-00004087 ("We asked the bank for a number of items yesterday that reflect details on the trades and support the stress loss hedge rationale associated with this particular strategy."). For more information on the OCC's oversight of the SCP, see Chapter VI.
[274] 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701-709 ("attached please find a presentation on the synthetic credit book that was reviewed this afternoon with Doug, Jes, Ina, Barry, and John. It covers the relevant data requests from the past several days.").
[275] See id., at JPM-CIO 0001158. For a more detailed discussion of this presentation, see Chapter VII.
[276] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss).
[277] Subcommittee interview of Michael Sullivan, OCC (8/30/2012); Levin Office briefing by JPMorgan Chase (8/15/2012) (Greg Baer).

routinely documented.[278] With respect to interest rate hedging, JPMorgan Chase's Corporate Treasury gathered interest rate data from the relevant lines of business, aggregated the data using a standard industry model that quantified risk, and then provided the information to the CIO to establish the hedge.[279] Information about the MSR and interest rate hedges was also provided to CIO managers and the bank's Chief Financial Officer Douglas Braunstein on a weekly basis.[280] In contrast, no line of business calculated the size of the credit risk to be offset by the CIO or provided a specific number or range to CIO to construct the SCP hedge, and the CIO did not provide routine information about the SCP "hedge" to either CIO managers or the Chief Financial Officer. According to JPMorgan Chase, the SCP's "credit" hedge "did not have that level of discipline."[281]

In addition, a number of CIO hedges were recorded, tracked, and tested for hedge effectiveness, in part to qualify for favorable accounting treatment, but SCP hedges were not. For example, in the case of a hedge involving the conversion of a fixed rate asset into a floating rate asset, hedge effectiveness was tested every reporting period.[282] At the time the instrument was issued, it was identified as a hedge, and recorded a notional amount and maturity date.[283] In contrast, for the SCP, the CIO had no standardized method or documentation in place for identifying what was being hedged, recording a notional amount or maturity date, or testing the hedge effectiveness.[284] Ms. Drew told the Subcommittee that SCP performance was evaluated in relation to the underlying asset that it was trying to hedge,[285] however, neither she nor the bank identified or produced any documentation supporting that assertion.

If the SCP had used credit derivatives as dedicated hedges, it should have triggered the bank's standard hedging documentation procedures, at least in later years. JPMorgan Chase's 2011 annual report stated, for example, that the bank had a detailed set of internal procedures for tracking derivatives used as hedges:

> "For a derivative to be designated as a hedge, the risk management objective and strategy must be documented. Hedge documentation must identify the derivative hedging

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[278] See 4/20/2012 "CIO MSR POSITION SUMMARY – OAS MODEL," JPM-CIO-PSI 0005996. The MSR hedge is also now documented in monthly Executive Management Reports. See, e.g., Chief Investment Office – Executive Management Report (April 2012), OCC-SPI-00033169. See also, e.g., 1/20/2012 "CIO Weekly Performance Summary," JPM-CIO-PSI-H 0001577.
[279] Levin Office briefing by JPMorgan Chase (6/4/2012) (Greg Baer).
[280] See 1/20/2012 "CIO Weekly Performance Summary," JPM-CIO-PSI-H 0001577.
[281] Levin Office briefing by JPMorgan Chase (6/15/2012) (Greg Baer).
[282] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Chetan Bhargiri).
[283] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Gregg Gunselman).
[284] Subcommittee interview of Michael Kirk, OCC (8/22/2012).
[285] Subcommittee interview of Ina Drew, CIO (9/7/2012).

> instrument, the asset or liability or forecasted transaction and type of risk to be hedged, and how the effectiveness of the derivative is assessed prospectively and retrospectively. To assess effectiveness, the Firm uses statistical methods such as regression analysis, as well as nonstatistical methods including dollar-value comparisons of the change in the fair value of the derivative to the change in the fair value or cash flows of the hedged item. The extent to which a derivative has been, and is expected to continue to be, effective at offsetting changes in the fair value or cash flows of the hedged item must be assessed and documented at least quarterly. Any hedge ineffectiveness (i.e., the amount by which the gain or loss on the designated derivative instrument does not exactly offset the change in the hedged item attributable to the hedged risk) must be reported in current-period earnings."[286]

Those procedures were used by the bank to qualify its hedges for favorable accounting treatment, but the annual report does not indicate that those procedures applied only to those types of hedges that received favorable accounting treatment. At the same time, despite this detailed description, JPMorgan Chase has not identified any CIO documentation indicating that credit derivatives in the SCP were subjected to any of the analysis or documentation described above.

Macro Hedge. A number of bank representatives told the Subcommittee that the SCP was intended to provide, not a dedicated hedge, but a macro-level hedge to offset the CIO's $350 billion investment portfolio against credit risks during a stress event.[287] In a letter to the OCC and other agencies, JPMorgan Chase even contended that taking away the bank's ability to establish that type of hedge would undermine the bank's ability to ride out a financial crisis as it did in 2009.[288] The bank also contended that regulators should not require a macro or portfolio hedge to have even a "reasonable correlation" with

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[286] JPMorgan Chase 2011 Annual Report, at 202-203.

[287] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer, Chetan Bhargiri); Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012) (stating that the synthetic credit portfolio was a "fat tail hedge" against the CIO's investment portfolio, which would also benefit the bank generally); Subcommittee interview of Ina Drew, CIO (9/7/2012) (explaining that the SCP's purpose when it was established was to hedge firmwide risk, but then changed to hedge the CIO's investment portfolio against credit risks during a stress event); Subcommittee interview of John Wilmot, CIO (9/11/2012); Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012); Subcommittee interview of John Hogan, JPMorgan Chase (9/5/2012) (characterizing the SCP as a hedge against macro credit risk).

[288] See 2/13/2012 letter from JPMorgan Chase, to Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and Office of the Comptroller of the Currency, "Comment Letter on the Notice of Proposed Rulemaking Implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," at 56-57.

the risks associated with the portfolio of assets being hedged.[289] The counter to this argument is that the investment being described would not function as a hedge at all, since all hedges, by their nature, must offset a specified risk associated with a specified position.[290] Without that type of specificity and a reasonable correlation between the hedge and the position being offset, the hedge could not be sized or tested for effectiveness. Rather than act as a hedge, it would simply function as an investment designed to take advantage of a negative credit environment. That the OCC was unable to identify any other bank engaging in this type of general, unanchored "hedge" suggests that this approach is neither commonplace nor useful.

Given the size and constantly changing nature of the SCP, the absence of basic documentation over time about its hedging objectives and strategies; the assets, portfolio, risks, or tail events it was supposed to hedge; and how the size, nature, and effectiveness of its hedges were to be determined, suggests that the SCP did not, in fact, function as a hedge. After briefings by the bank, some OCC examiners expressed skepticism that the SCP functioned as a hedge at all, given the lack of specificity over what was being offset,[291] and the fact that, by March, the SCP held a net long position rather than the short position typical of a hedge. In a May 2012 internal email following a discussion with JPMorgan Chase in which the bank defended the SCP trading strategy as a loss-reducing hedge, one OCC examiner referred to the SCP as a "make believe voodoo magic 'composite hedge.'"[292]

C. SCP Trading

Whether or not it functioned as a hedge at any point in time, the facts are clear that the Synthetic Credit Portfolio underwent profound change from its inception in 2006, to its demise in 2012. The change was most dramatic in the first three months of 2012, when the portfolio exploded in size, complexity, and risk, with little or no notice to the bank's senior risk managers or its regulators.

(1) The Early Years: 2006 to 2010

When first approved by JPMorgan Chase in 2006, the CIO was authorized to trade in credit default swaps and indices and had an initial VaR limit of $5 million, signifying a relatively small portfolio.

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[289] Id., at 25.
[290] See, e.g., OCC definition of a hedge, 12 C.F.R. Part 3, Appendix B, Section 2 ("Hedge means a position or positions that offset all, or substantially all, of one or more material risk factors of another position.").
[291] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). The OCC Examiner-in-Charge told the Subcommittee that the SCP hedge was at best "conceptual," and that a "conceptual hedge that is undocumented is not good."
[292] 5/18/2012 email from Elwyn Wong, OCC, to Michael Kirk, OCC, "CIO Call with Mike Brosnan," OCC-SPI 00021602.

According to Ms. Drew, the SCP expanded as CIO traders gained experience and credibility within the bank, and credit derivative instruments became more liquid and more viable as investment vehicles.[293] In addition, during the financial crisis, after the bank purchased Bear Stearns and Washington Mutual Bank, took in more funds, and the CIO's portfolio expanded as a whole, Ms. Drew said the SCP also grew.[294]

According to an internal CIO chart, in 2008, the SCP produced revenues totaling about $170 million.[295] By March 2009, according to CIO trader Bruno Iksil, the SCP had grown again, and the book's "value at risk" (VaR) was "high."[296] In June 2009, according to Mr. Iksil, General Motors filed for bankruptcy, the SCP book gained value, and the CIO cashed in certain SCP positions for "profit taking."[297] By the end of 2009, SCP revenues had increased fivefold over the prior year, producing $1 billion in revenues for the bank.[298]

In 2010, as the financial crisis began to ease, the credit landscape changed and the SCP began to contract.[299] One reason was that the profit-taking after the General Motors bankruptcy reduced the size of the SCP book of assets. In addition, the CIO's Chief Market Risk Officer told the Subcommittee that the overall strategy was to increase protection when people were worried but decrease it when people are not worried, like insurance;[300] as people became less worried after the financial crisis, less credit protection was needed by the bank. According to Mr. Iksil, in January 2010, a decision was made to shrink the SCP's positions.[301] The head of the CIO's equity and credit trading, Mr. Martin-Artajo stated that, in June 2010, the traders began to unwind the SCP book.[302] As further evidence of the shrinking portfolio, the OCC told the Subcommittee that the VaR limit on the SCP was reduced

[293] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[294] Id. See also JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[295] 6/21/2012 "CIO Compensation – Revenue to Compensation Historical Lookback," JPM-CIO-PSI-H 0002749.
[296] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[297] Id. A class action lawsuit filed by JPMorgan Chase shareholders claims that during this period, the SCP engaged in high risk proprietary trades involving mortgage backed securities, collateral debt obligations, Fannie and Freddie preferred stock, and foreign currency swaps, among other trades. See In re JPMorgan Chase & Co., Case No. 1:12-CV-03852-GBD (USDC SDNY), Consolidated Amended Class Action Complaint (11/20/2012), at ¶¶ 67-72.
[298] 6/21/2012 "CIO Compensation – Revenue to Compensation Historical Lookback," JPM-CIO-PSI-H 0002749.
[299] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[300] Subcommittee interview of Peter Weiland, CIO (8/29/2012).
[301] JPMorgan Chase Task Foree interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[302] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).

to $50 million in 2010, as the portfolio was derisked.[303] Notwithstanding that reduction, according to Mr. Iksil, CIO management wanted to keep a "tail" hedge, so the SCP was not eliminated entirely.[304] The SCP produced 2010 revenues totaling nearly $150 million, which was only about 15% of the revenues produced in 2009.[305]

(2) 2011 SCP Expansion

According to one of the head SCP traders, Mr. Martin-Artajo, by April and May of 2011, the VaR limit and average utilization on the Synthetic Credit Portfolio had dropped, reflecting a dramatic reduction in its size.[306] In June 2011, however, the CIO determined that the credit markets might deteriorate due to uncertainty in Europe,[307] and the financial markets were bearish.[308] According to Mr. Macris, Ms. Drew thought there would be more defaults.[309] Together, these signs suggested that more rather than less credit protection was needed.

The CIO credit traders began to re-evaluate the SCP's trading strategy. According to Mr. Martin-Artajo, the CIO wanted to have a "smart short,"[310] meaning one that did not cost much, but provided effective protection against corporate defaults. Mr. Martin-Artajo later told the JPMorgan Chase Task Force investigation that he proposed doing a combination of long and short trades, similar to a strategy he had proposed, and the CIO had used, earlier that year to benefit the CIO if there were defaults.[311]

More specifically, beginning in mid-2011, the CIO traders began to buy credit protection against defaults by purchasing short credit derivatives referencing "high yield" or higher risk companies; at the same time, they sold credit protection against defaults by purchasing long credit derivatives referencing "investment grade" or lower risk companies.[312] Greg Baer, a deputy general counsel at the bank, explained that the traders were essentially selling insurance on the lower

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[303] Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
[304] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[305] 6/21/2012 "CIO Compensation – Revenue to Compensation Historical Lookback," JPM-CIO-PSI-H 0002749.
[306] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[307] Subcommittee briefing by JPMorgan Chase (9/4/2012) (Jeanette Boot).
[308] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[309] JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012).
[310] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[311] Id. Mr. Martin-Artajo proposed doing "forward trades," a type of trade that includes short and long positions. Forward trades are discussed in more detail below.
[312] Levin Office briefing by JPMorgan Chase (5/22/2012) (Greg Baer), Levin briefing by JPMorgan Chase (6/27/2012) (Greg Baer and Harry Weiss).

risk investment grade indices and using the insurance premiums they received to buy insurance on the higher risk, high yield indices.[313] In a later email sent by Ina Drew to senior JPMorgan Chase management describing the SCP book's trading strategy, she wrote that selling protection or insurance on investment grade companies generated "carry" or cash income from the premiums received from counterparties, which reduced the CIO's cost of buying high yield credit protection.[314] Some current and former JPMorgan Chase personnel referred to that strategy as the long positions "financing" the short positions.[315]

Due to the new trading strategy requiring the purchase of both long and short credit instruments, and the addition of some distressed securities, the SCP expanded rapidly in size. At the beginning of 2011, the SCP's notional size was $4 billion; by the end of 2011, it was $51 billion, a more than tenfold increase.[316] Most of this growth occurred in the first half of 2011. Notionals more than tripled in the first quarter, then tripled again in the second quarter to reach $42 billion.[317]

Towards the end of 2011, JPMorgan Chase became concerned about the level of the CIO's Risk Weighted Assets (RWA) and ordered a reduction in its RWA.[318] RWA is a dollar measure of a bank's assets, adjusted according to the assets' risk.[319] It is used to calculate the bank's minimum capital requirements, with a greater ratio of equity-based capital required for banks with higher RWA.[320] Mr. Iksil strategized that the SCP could go long on credit risk, use the longs to offset the portfolio's shorts, and thereby reduce the CIO's overall RWA.[321] He wrote: "We can reduce [RWA] by simply selling

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[313] Levin Office briefing by JPMorgan Chase (5/22/2012) (Greg Baer). See also 2013 JPMorgan Chase Task Force Report, at 30.
[314] 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "Synthetic Credit Materials," JPM-CIO-PSI 0001101 ("to balance the negative carry cost of the High yield Book overtime [we have] been using Investment Grade strategies that gave us some carry or buying optionality ... to offset the directionality of the High Yield Book").
[315] Subcommittee interviews of Douglas Braunstein, JPMorgan Chase (9/12/2012) and Irvin Goldman, CIO (9/15/2012); JPMorgan Chase Task Force interview of Bruno Iksil, CIO (8/27/2012); JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[316] See "Summary of Positions by Type," prepared by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037609. See also 2013 JPMorgan Chase Task Force Report, at 25.
[317] See "Summary of Positions by Type," prepared by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037609.
[318] Testimony of Jamie Dimon, "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012) ("In December 2011, as part of a firm wide effort and in anticipation of new Basel Cap[ital] requirements, we instructed CIO to reduce risk weighted assets and associated risk."); 2013 JPMorgan Chase Task Force Report, at 2.
[319] For more information about RWA, see Chapter II.
[320] Id. See also 2013 JPMorgan Chase Task Force Report, at 26-27.
[321] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012); 12/22/2011 email from Bruno Iksil to Achilles Macris and Javier Martin-Artajo, CIO, "urgent -----: Rwa," JPM-CIO-PSI 0001227. See also FDIC presentation,

protection but then the pnl [profit and loss] volatility will increase potentially."[322]

His supervisor, Mr. Martin-Artajo, responded that the CIO should not go outright long on its credit assets because it would breach the CIO's stress loss limit.[323] Instead, Mr. Martin-Artajo instructed Mr. Iksil to do "forward trades."[324] The type of forward trade he was suggesting occurs when a trader buys a long credit position with a long-term maturity date, and a short credit position with a short-term maturity date, in order to be hedged in the shorter term but gain exposure to credit risk in the longer term.[325] The CIO traders adopted that trading strategy.

Whether that trading strategy helped reduce the CIO's RWA in 2011 is unclear. The records that have been produced to the Subcommittee tracing the SCP's RWA in 2011 and 2012 are incomplete and contradictory. For example, one January 2012 OCC document reported that the SCP's RWA at the end of 2011 was $70 billion,[326] while other materials reported that, by the beginning of 2012, the CIO's RWA was around $40 billion.[327] When asked by the Subcommittee for more complete RWA records, the bank responded that such records were not prepared and were not available, although a former CIO employee who worked on RWA models recalled that monthly RWA reports for CIO and SCP did exist.[328]

In any event, when Mr. Macris was asked about the 2011 effort to reduce the SCP's RWA, he told the JPMorgan Chase Task Force

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"JPMC & COMPANY CIO Synthetic Credit Portfolio," at 2, FDICPROD-0001783 ("The firm believed that due to the historical correlation (beta) of the tranches of the IG-9 index, they were getting into a neutral position by going long 4-5 times the high yield short positions.").

[322] 12/22/2011 email from Bruno Iksil to Achilles Macris and Javier Martin-Artajo, CIO, "urgent -----: Rwa," JPM-CIO-PSI 0001227. The profit and loss volatility would potentially increase, because, as the portfolio grew larger, even small changes in the price of individual holdings could translate into large variations in the portfolio's overall value.

[323] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).

[324] Id.

[325] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeannette Boot).

[326] See 1/31/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, "CIO Quarterly Meeting," OCC-SPI-00004695 (summarizing quarterly meeting with CIO in which CIO Chief Financial Officer John Wilmot indicated that, in 2012, the CIO expected to reduce the RWA of its "MTM" book, which included the SCP, from "$70B [billion] to $40B").

[327] See 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," conveying presentation entitled, "Core Credit Book Highlights," prepared by Mr. Iksil, at JPM-CIO-PSI 0000100 (indicating CIO's RWA was then $40.3 billion); JPMorgan Chase Task Force Report, at 28, footnote 30 (indicating CIO RWA at start of 2012 was about $43 billion); 1/19/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario clarification," JPM-CIO-PSI 0000152 (indicating CIO RWA at start of 2012 was $43 billion).

[328] Subcommittee interview of Patrick Hagan, CIO (2/7/2013). The Subcommittee also located some RWA data in the monthly Executive Management Reports prepared by the bank. See, e.g., December 2011 "Chief Investment Office – Executive Management Report," OCC-SPI-00033116, at 8, 10; April 2012 "Chief Investment Office – Executive Management Report," OCC-SPI-00033162, at 4.

investigation that, as a result of the trading strategy to reduce the RWA, by August 30, 2011, the SCP had "a long front leg and a short back leg," adding further complexity to the Synthetic Credit Portfolio.[329] Mr. Macris also told the investigation that the traders – and he – knew they were using "dangerous" instruments.[330]

(3) 2011 SCP Profit From Bankruptcies

In late 2011, the CIO engaged in a series of short term credit index tranche trades that ended up producing a large payoff for the bank. The trading strategy behind this gain was intended from its inception to last no more than four months, in sharp contrast to the type of long-term, conservative investments often attributed to the CIO.

According to the OCC and an internal CIO audit report, during the fall of 2011, the CIO placed a massive bet on a high yield credit index that tracked credit default swaps for 100 higher risk companies.[331] Beginning in September 2011, the CIO, through its trader Bruno Iksil, began to purchase the short side of several tranches of the index, building a short position that would pay off only if at least two companies declared bankruptcy or otherwise defaulted before the position expired on December 20, 2011.[332]

As the short party, the CIO was required to pay premiums to its counterparties, but the amounts required were not viewed by the CIO traders as significant since the position was expiring in less than four months. In addition, to offset the initial cost of buying the position as well as the cost of the ongoing premiums, the CIO purchased the long side of another credit index, the CDX.NA.IG9 which tracked investment grade companies. By taking the long side on that index, the CIO became the recipient of the premiums paid by its short counterparties and could use those incoming cash premium payments to offset other SCP costs.

Over the next few months, the value of the HY11 changed repeatedly, showing both gains and losses. Mr. Iksil continued to build the CIO's large short position, eventually spending as much as $1 billion.[333]

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[329] JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012).
[330] Id.
[331] Subcommittee interview of Doug McLaughlin, OCC (8/30/2012); 2011 CA Quarterly Summary: Global Chief Investment Office 4th Quarter CA summary," OCC-SPI-00002483. See also JPMorgan Corporate Sector Executive Management Report (Full Year 2011 Actuals), JPM-CIO-PSI 0018046, at 071.
[332] For more information on credit index tranches, see Chapter II.
[333] See OCC data analysis derived from DTCC data for JPMorgan Chase, described in "JPMC-CIO timeline of Significant Events and OCC Discovery," prepared by the OCC, OCC-SPI-00038895, at 6 [Sealed Exhibit]; 10/26/2012 OCC Confidential Supervisory Report, Appendix 11 at PSI-OCC-13-0000113 [Sealed Exhibit]; "From 'Caveman' to 'Whale,'" Wall Street Journal, Gregory Zuckerman (5/17/2012),

The accumulated index position became so large and the counterparty stakes so high, they caught the attention of the press, which later reported on the standoff and reported that some traders had referred to Mr. Iksil as a "caveman, for stubbornly pursuing the trade."[334] With just six weeks left before the index expired, one hedge fund investor later said: "It seemed like the trade of the century to be long the index,"[335] since the expectation was that the CIO's bet would fail and the long side would end up benefiting from both the premiums and final settlement payments. But then, on November 29, 2011, American Airlines declared bankruptcy,[336] triggering a massive payout to the CIO and others holding the short side of the position.

Ina Drew told Jamie Dimon that the gains were about $400 million.[337] The CIO traders later claimed internally that they made $550 million,[338] but did not record the profits all on the same day.[339] The key CIO trader, Bruno Iksil, later described the gains as "massive,"[340] while a JPMorgan Chase internal report characterized them as a "windfall."[341] JPMorgan Chase's internal auditors also referred to them as "windfall gains."[342]

Despite the drama and $400 million gain associated with the 2011 "caveman trade," the CIO's revenues contributed only about 8% of JPMorgan Chase's net income for 2011.[343] JPMorgan Chase senior risk managers told the Subcommittee that they had been unaware of the 2011 trades involving the SCP at the time.[344]

The OCC told the Subcommittee that, while its examiners noticed the CIO's $400 million gain at the end of 2011, they did not look into its

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http://online.wsj.com/article/SB10001424052702303879604577408621039204432.html. When asked to confirm the $1 billion figure, JPMorgan Chase told the Subcommittee that it was unable to confirm or deny it. Subcommittee briefing by JPMorgan Chase (2/4/2013).

[334] "From 'Caveman' to 'Whale,'" Wall Street Journal, Gregory Zuckerman (5/17/2012); Subcommittee interview of Doug McLaughlin, OCC (8/30/2012).

[335] "From 'Caveman' to 'Whale,'" Wall Street Journal, Gregory Zuckerman (5/17/2012).

[336] See In re AMR Corporation, Case No. 11-15463 (SHL) (Bankr. SDNY), Voluntary petition for relief under Chapter 11 (11/29/2011), http://www.amrcaseinfo.com/maincase.php?start_dt=11/29/2011&end_dt=&start_no=&end_no=&desc=&prev_desc=&sort=F&event_SEARCH=Y&range_start=&range_stop=.

[337] See 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "CIO," JPM-CIO-PSI 0000539 ("The fourth quarter 400 million gain was the result of the unexpected American airlines default.").

[338] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).

[339] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).

[340] Id.

[341] JPMorgan Corporate Sector Executive Management Report (Full Year 2011 Actuals), JPM-CIO-PSI 0018046 at 071.

[342] 2011 CA Quarterly Summary: Global Chief Investment Office 4th Quarter CA summary," OCC-SPI-00002483.

[343] See FDIC presentation, "JPMC & COMPANY CIO Synthetic Credit Portfolio," at 11, FDICPROD-0001783.

[344] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

cause and were unaware of the 2011 SCP trades until after the OCC began examining the Synthetic Credit Portfolio in depth several months later in 2012.[345] According to the OCC, the SCP's 2011 gain came from a concentrated position in illiquid credit derivatives,[346] that had been "pretty risky" and was completely dependent upon timing.[347] That is, if American Airlines had defaulted three weeks later, the SCP's short position would have already expired, and the SCP would not have reaped its "massive" profit.[348] The OCC explained that the CIO had essentially engaged in a high stakes, high risk wager that ended up paying off, but could have easily gone the other way. The OCC also told the Subcommittee that the SCP's increased size and risk breached a number of risk limits, which it should have noticed at the time but did not, leaving the OCC unaware of the SCP's high risk trading activity in 2011.

Within the bank, little or no concern appears to have been expressed about the CIO's having engaged in a risky trading strategy; instead the SCP's trades and resulting $400 million gain appear to have been viewed favorably by CIO management. Ms. Drew told the Subcommittee that it was not merely coincidence that the traders profited from the American Airlines default, but that they deserved "some credit" for having taken the position.[349] In fact, she told the CIO traders to try to repeat their performance in 2012.[350] Mr. Macris told the JPMorgan Chase Task Force investigation that he viewed the 2011 gain as a great event for the CIO.[351] Mr. Iksil told that investigation that kind of gain was "unprecedented" within the CIO,[352] and that he had just "reset" the position the month before because it was "cheap."[353] According to JPMorgan Chase but for that $400 million gain, the SCP would have lost money in 2011.[354]

The American Airlines gain also appears to have colored how the CIO viewed the SCP thereafter, as a portfolio that could produce significant profits from relatively low cost default protection. In addition, it produced a favorable view within the CIO of the SCP's complex trading strategy that involved combining investment grade and

345 Subcommittee interviews of Doug McLaughlin, Michael Sullivan, and Fred Crumlish, OCC (8/30/2012).
346 Subcommittee interview of Doug McLaughlin, OCC (8/30/2012).
347 Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
348 Subcommittee interview of Fred Crumlish, OCC (8/30/2012).
349 Subcommittee interview of Ina Drew, CIO (9/7/2012).
350 Subcommittee interview of Ina Drew, CIO (12/7/2012).
351 JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012).
352 JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
353 Id.
354 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot); Subcommittee interview of Ina Drew, CIO (9/7/2012).

non-investment grade credit index trades, accumulating massive tranche positions, and sustaining a period of losses in anticipation of a large payoff.

It is also notable that JPMorgan Chase has been unable to explain how the 2011 trading strategy that produced the $400 million gain functioned as a hedge or credit loss protection for the bank. JPMorgan Chase has been unable, for example, to link the 2011 SCP gain from American Airlines' bankruptcy to any loan or credit loss suffered elsewhere in the bank,[355] as would be appropriate if the SCP were a hedge. Ina Drew told the Subcommittee that the SCP's credit protection did not serve as an offset for any bank loan losses involving American Airlines.[356] The CIO's Chief Risk Officer, Irvin Goldman, also told the Subcommittee that the CIO's own $350 billion Available-for-Sale portfolio did not have single-name credit exposure,[357] would not have sustained losses from any individual corporate bankruptcy, and so was not using the SCP's 2011 trading strategy as a hedge.

In the view of the OCC capital markets examiner responsible for JPMorgan Chase, the 2011 gain was "outsized," based on an "idiosyncratic trade," and the CIO "shouldn't have been doing this."[358] In light of the disconnect between the credit derivative trading that took place and any credit risk or loss to the bank, the 2011 profit-taking appears to have been an example of proprietary trading intended to make money for the bank, rather than protect it from loss.

(4) SCP Size and Revenues

From its inception in 2006, until 2011, the Synthetic Credit Portfolio generated uneven, but sometimes substantial revenues for the bank.[359] The year with the highest revenues was 2009, when the SCP generated over $1 billion for the bank; the next highest year was 2011 when the American Airlines bankruptcy resulted in year-end revenues of about $450 million. In 2012, the CIO produced an internal chart tracking both SCP revenues and SCP trader compensation, indicating that the SCP produced the following revenues from 2008 to 2011.

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355 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
356 Subcommittee interview of Ina Drew, CIO (12/11/2012).
357 Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
358 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
359 See "CIO Compensation – Revenue to Compensation Historical Lookback," JPM-CIO-PSI-H 0002749. Ms. Drew told the Subcommittee that JPMorgan Chase did not establish any specific goals on the amount of return expected from the SCP book. Subcommittee interview of Ina Drew, CIO (9/7/2012).

CIO Synthetic Credit Portfolio Revenues 2008-2011

Year	SCP Revenue
2008	$ 170 million
2009	$ 1.05 billion
2010	$ 149 million
2011	$ 453 million
Total	$ 1.772 billion

Source: 6/21/2012 presentation entitled, "CIO Compensation," chart entitled, "Synthetic Credit Book Comparison: Revenue and SCB Trader Incentive (2008-2011)," JPM-CIO-PSI-H 0002746-2792, at 749.

When 2007 is added to those years, other internal CIO documents indicate that the total revenues produced by the SCP, prior to 2012, was around $2.5 billion.[360]

(5) SCP Trader Compensation

SCP compensation records from its early years also provide evidence about whether the SCP functioned as a hedge or a proprietary trading operation. As the JPMorgan Chase Task Force Report noted: "Incentive-based compensation systems are premised on the basic assumption that one of the factors that influence individuals' performance and conduct is financial reward."[361] Compensation that rewarded effective risk management would suggest that the SCP functioned as a hedge, while compensation that rewarded profitmaking would suggest that the SCP functioned more as a proprietary trading operation. The compensation history for key employees with responsibility for SCP trading suggests that the bank rewarded them for financial gain and risk-taking more than for effective risk management.

In June 2012, as part of its analysis of the SCP, the bank reviewed the compensation awarded, from 2009 to 2011, to three key CIO employees involved with SCP trading, Achilles Macris, Javier Martin-Artajo, and Bruno Iksil. The bank prepared a summary chart which is reprinted below:

[360] See 4/5/2012 email from Ina Drew to Jamie Dimon and other members of the Operating Committee, "CIO," JPM-CIO-PSI 0000539 (The SCP has been "extremely profitable for the company (circa $2.5 billion) over the last several years"); "CIO February 2012 Business Review, CIO International Core Credit: Tail Risk Book," JPM-CIO-PSI 0001940-963 ("This is a tail risk book that ... from 2007-2011 has generated US$2.4bln total return."); Subcommittee interview of Michael Sullivan, OCC (11/7/2012). But see 2013 JPMorgan Chase Task Force Report, at 25 (indicating the SCP "generated roughly $2 billion in gross revenues" from its inception until late 2011).

[361] 2012 JPMorgan Chase Task Force Report, at 91.

"Seat value" comparisons

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
				[illegible]	[illegible]		[illegible]
				[illegible]	[illegible]	[illegible]	[illegible]
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[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
				Top Paid Fixed Income	10-12.75	10.6 – 15	Internal - IB Fixed Income (Top 3 below IBOC)
				AM Fixed Income Inv.	8.0	8.0	Internal - AM Fixed Income Investment Head
EMEA CIO Mgt	Martin-Artajo Iksil	10.98 6.78	12.75 7.32	EMEA IB MDs	Avg. – High 5.9 – 10.5	Avg. – High 6.0 – 13.3	Internal - EMEA Sales & Trading (n=25)
				IB Fixed Income	Avg. – 75P 4.4 – 9.8 2.7 – 5.0		MGMC Market Survey: [a] • Global FI – Trading Products MDs • Global FI – All Products MDs
SCB Traders	Buraya Grout de Sangues	1.3 1.0 1.25	1.48 .78 .77	Wholesale Front Office	Avg. – 75P 1.0 - 1.85	Avg. – 75P 1.2 – 2.2	Market: [a] 1.1 – 1.9 (MGMC/McLagan)
				IM Fixed Income PMs	.9 – 1.5		McLagan Survey [a]
				CPG	Avg. = 2.16 Avg. = .6	Avg. = 2.23 Avg. = .83	Internal – IB MDs IB ED/VPs

[a] Independent third party pay survey data used in direct job benchmarking
[b] Independent third party pay survey data used for comparable jobs in other LOBs that are referenced as part of internal comparisons

JPMorgan Chase & Co.

Source: 6/21/2012 CIO Compensation Presentation, JPM-CIO-PSI-H 0002746, at 754.

The compensation data for both Mr. Macris and Mr. Martin-Artajo, which shows them receiving incentive pay worth millions of dollars each year, indicates that their compensation moved in tandem with and reflected SCP profits, which peaked in 2009 with $1 billion in revenues, and then diminished in 2010 and 2011.[362] Mr. Iksil's pay did not follow the same pattern, however, peaking instead in 2010. All three employees also received positive performance reviews in those years.[363]

The JPMorgan Chase Task Force Report noted that two of the CIO traders "maintained a strong focus on daily, monthly, and quarterly profit-and-loss numbers, and were acutely concerned about mounting losses in the Synthetic Credit Portfolio."[364] It also stated that "[t]he Task Force [] found little in the form of direct evidence to reveal what [employees] were thinking about their own specific compensation as they made decisions with respect to the Synthetic Credit Portfolio,"[365] But at least one of the traders contemplated what would occur after the SCP suffered large losses. In a March 23, 2012 email, after a day of large losses, Bruno Iksil wrote: "I am going to be hauled over the coals. ... [Y]ou don't lose 500 M[illion] without consequences."[366]

The JPMorgan Chase Task Force explained in its report that the CIO did not have its own incentive compensation system, but participated in a bankwide annual incentive compensation plan overseen by the Compensation and Management Development Committee of JPMorgan's Board of Directors.[367] It stated: "Awards under the plan are discretionary and non-formulaic, and compensation is dependent on multiple factors that can be adjusted and modified depending on the particular circumstances."[368]

According to internal bank documents, the three SCP employees were among the most highly-paid employees in the bank, and their compensation was reviewed by the bank's Operating Committee and approved by CEO Jamie Dimon.[369] In developing the total compensation amounts to be paid to each employee, the bank established a "reference group" for each individual based upon internal and external benchmark positions. The reference group used for the SCP employees consisted primarily of Investment Bank employees in positions that were profit-oriented, rather than risk management-based. For Mr. Macris, his compensation exceeded the salary range for his reference group in both 2010 and 2011 (the only years available); Mr. Martin-Artajo's compensation exceeded his reference group in 2011 and was at the top

[362] See 6/21/2012 CIO Compensation Presentation, JPM-CIO-PSI-H 0002746, at 754. See also "CIO Compensation – Revenue to Compensation Historical Lookback," JPM-CIO-PSI-H 0002749.
[363] 6/21/2012 CIO Compensation Presentation, JPM-CIO-PSI-H 0002746, at 757-760; 766-770; 772-781.
[364] 2013 JPMorgan Chase Task Force Report, at 92.
[365] Id., at 92.
[366] 3/23/2012 instant messaging session between Bruno Iksil and Julien Grout, CIO, JPM-CIO 0003515-541.
[367] 2013 JPMorgan Chase Task Force Report, at 92.
[368] Id.
[369] 6/21/2012 CIO Compensation Presentation, JPM-CIO-PSI-H 0002746, at 750.

end of the range in 2010; and Mr. Iksil was at the top end of the range for 2011 (the only year available).[370] This data indicates that, not only were the SCP employees compensated like Investment Bank employees, but they were compensated at levels that were at the top range of, or better than, the best Investment Bank employees.

After the SCP whale trades became public, some investors and analysts asked JPMorgan Chase how the CIO traders were compensated and whether their compensation was linked to SCP profits,[371] but the bank chose not to disclose publicly their compensation levels. The Task Force did report, however, that it recovered "approximately two years' worth of each individual's total compensation" from Mr. Macris, Mr. Martin-Artajo, and Mr. Iksil, as well as from their supervisor, Ina Drew.[372]

The JPMorgan Chase Task Force also recommended that the bank make it clear to employees in the future that losses are sometimes expected and, if the losses are a consequence of achieving bank priorities, will not necessarily reduce compensation:

> "CIO management, including Ms. Drew, should have emphasized to the employees in questions that, consistent with the Firm's compensation framework, they would be properly compensated for achieving the RWA and neutralization priorities – even if, as expected, the Firm were to lose money doing so. There is no evidence that such a discussion took place. In the future, when the Firm is engaged in an exercise that will predictably have a negative impact ... on a front office employee's or business unit's contribution to the Firm's profits and losses, the Firm should ensure those personnel are reminded that the Firm's compensation framework recognizes that losses (as well as profits) are not necessarily the measure of success."[373]

(6) 2012 Opens with Order to Reduce RWA

In 2012, the year began with a decision by bank management to reduce the SCP, but instead, over the next three months, the SCP exploded in size, complexity, and risk.

According to JPMorgan Chase's Chief Financial Officer Douglas Braunstein, by the end of 2011, senior JPMorgan Chase management,

[370] Id., at 754.
[371] 7/13/2012 "JPMorgan Chase's CEO Discusses Q2 2012 Results – Earnings Call Transcript," transcribed by Seeking Alpha (A question from an unidentified analyst asks "I'm just wondering if in the CIO review there was any
conclusions based on – if incentives were aligned with long-term shareholder interest.")
[372] 2013 JPMorgan Chase Task Force Report, at 106. See also id., at 109 (reporting that the bank had strengthened its ability "to claw back certain equity awards in the event of poor performance by CIO").
[373] Id., at 93.

including Jamie Dimon, and Ina Drew, had determined that the macroeconomic environment was improving[374] and credit markets were expected to improve as well, with fewer defaults.[375] The SCP traders also expressed the view that they were getting "bullish signals" at the end of December, in part because the European Union had agreed to provide long-term financing to prop up "bank lending and liquidity" in Europe.[376] As Mr. Braunstein explained to the Subcommittee, there was also less of a need for the CIO to protect its $350 billion Available-for-Sale portfolio.[377] Together, this analysis suggested that the SCP should be reduced in size.[378]

Another factor in favor of reducing the SCP was its high RWA.[379] Although the CIO traders had succeeded in reducing the CIO's overall RWA in 2011, the CIO's RWA was still many billions of dollars. In December 2011, Mr. Dimon and Mr. Braunstein directed the CIO to reduce its RWA even further.[380]

Mr. Braunstein told the Subcommittee that, because the CIO had previously asked for an increase in its RWA for its $350 billion Available-for-Sale portfolio, CIO management decided to use the SCP to achieve its new RWA reduction.[381] Mr. Braunstein told the Subcommittee that he approved of this approach, since the value of the economic protection the SCP was providing at that time to the rest of the bank was less valuable than the capital it required the bank to provide.[382] Similarly, Mr. Dimon told the Subcommittee that the SCP's loss protection was becoming less relevant, since the bank was bigger and

[374] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[375] Id.
[376] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012). See also 12/8/2012 European Central Bank Press Release, http://www.ecb.int/press/pr/date/2011/html/pr111208_1.en.html.
[377] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[378] CIO management even told regulators, at a January 2012 meeting, that they intended to reduce the size of the SCP. See 1/31/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, "CIO Quarterly Meeting," OCC-SPI-00004695 (summarizing quarterly meeting with CIO in which CIO Chief Financial Officer John Wilmot indicated that the CIO's "MTM" book was "decreasing in size in 2012" and it was "expected that RWA will decrease from $70B [billion] to $40B"). For more information about this meeting, see Chapter VI.
[379] See 2013 JPMorgan Chase Task Force Report, at 2, 26-27.
[380] Subcommittee interviews of Jamie Dimon, JPMorgan Chase (9/19/2012), Ina Drew, CIO (9/7/2012) and Douglas Braunstein, JPMorgan Chase (9/12/2012). At the time, JPMorgan Chase had recently engaged in stock buybacks totaling $9 billion, and had received permission from its regulators to buy back another $15 billion in 2012 and 2013. See letter from Jamie Dimon to JPMorgan Chase shareholders, 2011 JPMorgan Chase Annual Report, at 3. To carry out this buyback program, the bank may have wanted to further reduce the bank's RWA to minimize its mandatory capital requirements.
[381] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[382] Id.

earning more money, and the SCP's synthetic assets would require the use of a lot of capital under the upcoming Basel III standards.[383]

Irvin Goldman, who had become the CIO's Chief Risk Officer in January, told the Subcommittee that he did not recall the order to reduce the RWA being linked to an improving macroeconomic environment. He said that Mr. Dimon and Mr. Braunstein had simply ordered the CIO to reduce its RWA quickly, and it was easy to look to the SCP to accomplish that objective, because derivatives were "inefficient from a regulatory capital standpoint."[384] The CIO's CFO at the time, John Wilmot, agreed; he said the SCP – as a derivatives book – drew a lot of capital, and running a balanced book was very costly from a capital perspective.[385] Mr. Goldman also told the Subcommittee that, in December 2011, a decision was made to stop using the SCP as a hedge,[386] which made its credit loss protection characteristics irrelevant to the decision to reduce its RWA.

Mr. Iksil later told the JPMorgan Chase Task Force investigation that then-CFO John Wilmot told the traders in December 2011, that notwithstanding the $37 billion reduction in RWA during the earlier part of 2011, he wanted an additional reduction in RWA of $25 billion.[387] Mr. Martin-Artajo told the internal investigation that Ms. Drew had told the traders that they might need to reduce the SCP even "more" and "faster" to reach the desired RWA outcome.[388] According to the traders, reducing the portfolio still more, and faster, would be more expensive[389] because of execution costs.[390] In other words, if they had to sell assets quickly, they would have to accept whatever prices were offered and would likely lose money. Alternatively, allowing the traders more time to execute asset sales would allow them to trade at better prices.

According to one trader, Bruno Iksil, when his supervisor, Javier Martin-Artajo, asked him how much it would cost to reduce the SCP book to achieve the $25 billion RWA reduction, Mr. Iksil estimated a cost of $400 million.[391] Mr. Martin Artajo later told the JPMorgan Chase Task Force investigation that the CIO had not been given any

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[383] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012). See also 2013 JPMorgan Chase Task Force Report, at 26-27.
[384] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
[385] Subcommittee interview of John Wilmot, CIO (9/11/2012).
[386] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
[387] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[388] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[389] Id.
[390] Subcommittee interviews of Ina Drew, CIO (9/7/2012) and Michael Cavanagh, JPMorgan Chase (12/12/2012).
[391] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).

budget to cover that cost to reduce the SCP.[392] When Ms. Drew requested an estimate of the costs to unwind the entire SCP, the traders gave her a presentation estimating that the "cost to execute the unwinding" of about 35% of the SCP would be $516 million.[393] Ms. Drew told the Subcommittee that she then asked the traders to see if it was possible to reduce RWA without holding a "fire sale."[394]

In response, the traders undertook an analysis of how they could reduce the SCP and the CIO's RWA at a lower cost. When asked whether bank management had provided any instruction to the CIO about how to proceed, Mr. Dimon told the Subcommittee that he did not provide specific instructions or had a specific expectation as to how the RWA would be reduced – that is, by unwinding the book or adopting another course of action – his only expectation had been that the reduction be done "wisely."[395] Mr. Braunstein told the Subcommittee that Ms. Drew was not told how to achieve the RWA reduction, but also explained it was "fair to say" that it was his assumption that unwinding the SCP positions was the most direct way to reduce the RWA.[396] Mr. Goldman told the Subcommittee that there was no discussion of reducing "notionals," meaning the size of the SCP, but rather the discussion centered on the expectation that CIO would exit the synthetic business as a hedging mechanism over the course of the next year.[397]

An additional consideration, however, militated against simply unwinding the SCP book. According to Mr. Iksil, Ms. Drew was mindful of the $400 million gain the SCP had achieved by having default protection on its books to profit from the American Airlines bankruptcy. Mr. Iksil told the JPMorgan Chase Task Force investigation that, in early December 2011, Ms. Drew instructed him to "recreate" the American Airlines situation, because those were the kinds of trades they wanted at the CIO: the CIO "likes cheap options."[398] Thus, as he described it, he was told to maintain the SCP's default protection in order to position the CIO to profit from future American Airlines-type defaults.[399] Ms. Drew confirmed to the Subcommittee that she gave guidance to the traders to position the book for another gain like in late

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392 JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
393 12/28/2011 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, "10B RWA Target Reduction.ppt," JPM-CIO-PSI 0000039; JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012). See also 2013 JPMorgan Chase Task Force Report, at 28 ("a 35% proportional unwind of the [SCP] would result in a $10 billion RWA reduction, but could cost slightly more than $500 million").
394 Subcommittee interview of Ina Drew, CIO (9/7/2012).
395 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
396 Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
397 Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
398 JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
399 Id.

2011.[400] In short, Ms. Drew indicated her preference to avoid reducing the SCP book in a way that would reduce its default protection and the opportunity to profit from future corporate defaults.

On January 4, 2012, the CIO traders prepared a presentation for Ms. Drew, John Wilmot, and Irvin Goldman that set out the execution costs for unwinding the SCP. The cover email stated: "[P]lease find attached a grid for the Core credit Book RWA reduction scenarios .... Currently any major reduction will lead to a very high cost through proportional reducing."[401] That presentation estimated the execution cost for achieving a $10 billion reduction in RWA to be $516 million.[402] The presentation also identified the possible lost profits from eliminating default protection if one or two corporations were to declare bankruptcy.[403]

On January 10, 2012, Javier Martin-Artajo, head of CIO equity and credit trading, sent an email to Ms. Drew informing her that initial efforts to unwind the SCP were proving costly:

> "Bruno has been unwi[n]ding some of these pos[i]tions opportunistic[al]ly. The other side of the P/L [profit and loss] is that it has been somewhat costly to unwind too so net net we have actually lost a little bit of money to unwind."

Ms. Drew responded: "Let's review the unwind plan to maximize p l [profit/loss]. We may have a tad more room on rwa." Her comments followed information the day before, that the SCP's RWA total might be better – that is, lower – than anticipated.[404] Her comments also underscored her reluctance to incur the costs associated with unwinding the SCP.

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[400] Subcommittee interview of Ina Drew, CIO (12/11/2012). See also 2013 JPMorgan Chase Task Force Report, at 3 (indicating CIO traders were "directed to ensure that the Synthetic Credit Portfolio was well-positioned for future corporate defaults"); 1/9/2012 email from Ina Drew, CIO, to John Wilmot, CIO, "CRM results for Q4," JPM-CIO-PSI 0000073 (Ms. Drew wrote that she wished to avoid "deleveraging" the SCP book to maintain "option[al]ity"). Mr. Wilmot told the Subcommittee that "deleveraging" meant exiting positions. Subcommittee interview of John Wilmot, CIO (9/11/2012). JPMorgan Chase counsel explained that "optionality" referred to default protection. Id. (Jay Balacek).

[401] 1/4/2012 email from Julien Grout, CIO, to Ina Drew, John Wilmot, and Javier Martin-Artajo, CIO, "RWA reduction for Core Credit- scenario analysis summary," JPM-CIO-PSI 0001259.

[402] Id., at 260.

[403] Id.

[404] 1/10/2012 email from Ina Drew, CIO, to Javier Matin-Artajo, CIO, "International Credit Consolidated P&L 09-Jan-2012," JPM-CIO-PSI 0000075. Ms. Drew told the Subcommittee that, in January 2012, Mr. Dimon and Mr. Braunstein had not yet decided how much capital reduction would be sought from the CIO. Subcommittee interview of Ina Drew, CIO (9/7/2012).

According to the bank, it ultimately decided to require the CIO to meet its original RWA reduction target by the end of 2012, and no more.[405]

(7) Eastman Kodak Default

Another key development early in 2012, was a declaration of bankruptcy by still another U.S. corporation, Eastman Kodak. This time, however, instead of producing profits, the bankruptcy resulted in the SCP's losing money – an outcome contrary to the SCP's purported function of providing loss protection against precisely that type of default. The loss also ended up reinforcing the CIO's decision to increase rather than decrease the size of the SCP.

The Eastman Kodak loss had its roots in a December 2011 decision to reduce the CIO's net short position. JPMorgan Chase told the Subcommittee that in December 2011,[406] some short credit protection instruments held in the SCP book expired, which "opened up default exposure," meaning it exposed the SCP to possible losses if certain corporations were to default, since the SCP held the long side of several credit index tranches that tracked individual companies.[407] Notwithstanding the instruction to reduce RWA and to maintain less protection due to the improving economic environment, the CIO traders decided to buy short credit protection to replace most, but not all, of the instruments expiring in December. As an internal JPMorgan Chase presentation later explained in part: "In preparation for large expiry of HY [high yield] short risk positions in Dec'11 ... the HY short risk position [was] increased."[408]

While the CIO traders acquired the new short credit instruments in December and early January,[409] they did not replace all of the expiring shorts due to the instruction to lower the SCP's RWA and reduce its size

[405] 2013 JPMorgan Chase Task Force Report, at 28. It is unclear, however, what the ultimate RWA target was for the CIO in 2012, since different documents specified different targets, varying from $30 billion to $20 billion. See, e.g., id. (specifying $30 billion RWA reduction); JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012) (specifying $25 billion); 1/19/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario clarification," JPM-CIO-PSI 0000152 (specifying $20 billion). According to Mr. Martin-Artajo, the purpose of the RWA reduction had been to free up capital to enable the firm to buy back its stock from the marketplace. He indicated that the firm ultimately could not buy back as much stock as had been anticipated, which created less pressure to lower the CIO's RWA by unwinding the SCP book. See also JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).

[406] Subcommittee briefing by JPMorgan Chase (9/4/2012) (Jeanette Boot).

[407] JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012). For more information on credit indices, see Chapter II.

[408] See 5/2012 "JPM CIO Synthetic Credit Presentation," at 2, JPM-CIO-PSI-H 0000546.

[409] See, e.g., 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Breach of firm var," JPM-CIO-PSI 0000142 (indicating purchases of short risk positions from December 21 through January 19).

due to the improving macroeconomic climate. By January 10, 2012, Mr. Iksil reported internally that the SCP was less "short" than it had been at the end of December 2011,[410] which meant that it was providing less credit protection.

On January 19, 2012, Eastman Kodak filed for bankruptcy,[411] and the SCP book "suffered significant losses as a result."[412] Mr. Goldman told the Subcommittee that because the SCP held long positions that were exposed to Eastman Kodak, but protection against the company's default had rolled off in December, the SCP was caught having to make a substantial payout to its short counterparties when Eastman Kodak filed for bankruptcy.[413] One internal CIO document estimated the CIO's loss at $50 million.[414]

According to one CIO trader, they were told not to let an Eastman Kodak-type loss happen again.[415] In response, the CIO traders bought additional short credit protection on a variety of derivative indices.[416]

(8) Credit Market Rally Devalues SCP

January proved problematic for the traders beyond the $50 million loss related to the Eastman Kodak default on January 19. Throughout the month, the CIO purchased greater amounts of long credit protection as part of its new trading strategy. It also purchased more short credit protection to maintain its "upside on defaults" and prevent another Eastman Kodak-style loss. At the same time, as economies strengthened in the United States and elsewhere, worldwide credit markets rallied,

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[410] 1/10/2012 email from Bruno Iksil, CIO, to Keith Stephan, CIO, "CRM results for Q4," JPM-CIO-PSI 0000083.

[411] See In re Eastman Kodak Company, Case No. 12-10202 (ALG) (Bankr. SDNY), Voluntary petition for relief under Chapter 11 (1/19/2012), http://www.kccllc.net/kodak. See also "Eastman Kodak Files for Bankruptcy," New York Times (1/19/2012), http://dealbook.nytimes.com/2012/01/19/eastman-kodak-files-for-bankruptcy/; Subcommittee briefing by JPMorgan Chase (9/4/2012) (Jeanette Boot); Subcommittee interview of Irvin Goldman, CIO (9/15/2012).

[412] 2013 JPMorgan Chase Task Force Report, at 30.

[413] Subcommittee interview of Irvin Goldman, CIO (9/15/2012). In connection with the Eastman Kodak loss, Mr. Goldman explained that if "a tranche rolls off that protects you, then if somebody defaults you lose money." Id. For more information about credit index tranches, see Chapter II.

[414] See 3/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "First draft of the presentation," conveying "CIO Synthetic Credit Update" (3/2012) at JPM-CIO-PSI 0001247-258, at 258.

[415] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012); see also 2013 JPMorgan Chase Task Force Report, at 30.

[416] 2013 JPMorgan Chase Task Force Report, at 30, footnote 33 ("Trading data shows that the traders had been adding some high-yield short positions throughout much of January, prior to this instruction. However, the additions increased substantially in the period after this instruction."). See also, e.g., 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman and Peter Weiland, CIO, "Breach of firm var," JPM-CIO-PSI 0000141-42 (indicating SCP bought enough protection to trigger a firmwide VaR breach); 1/20/2012 email from MRM Reporting, JPMorgan Chase, to Jamie Dimon and others, JPMorgan Chase, "JPMC 95% 10Q VaR – Limit Excession Notification (COB 1/19/2012).

meaning that the value of long credit positions increased and the value of short credit positions fell.[417] Since the value of short credit protection generally declined, the SCP book also lost value.[418] As the OCC explained it to the Subcommittee, general market movements went against the CIO in January 2012.[419]

The result was that the SCP experienced nine straight days of losses in the second half of January.[420] The OCC told the Subcommittee that the ratio of days with losses versus days with profits was already "ugly" at that point – long before credit positions added in February and March accelerated the SCP losses.[421] Under U.S. generally accepted accounting principles (GAAP), the value of derivatives, including credit derivatives, has to be recorded at their fair market value – "marked to market" – at the close of each business day.[422] That meant the decreased value of the SCP's short position had to be recorded on the CIO's books, even if no derivative instruments were actually traded during the day. In a January 26, 2012 email, the head trader in charge of the SCP book prepared a report for CIO managers indicating that the SCP book has already lost $100 million and predicting further losses of $300 million.[423]

It was while these losses were piling up that critical decisions were made that ultimately resulted in the much more massive SCP losses JPMorgan experienced. According to Javier Martin-Artajo, head of the CIO's equity and credit trading operation, it was then that the head of the CIO's International Office, Achilles Macris, told him that the SCP book was no longer needed to hedge tail risk at the bank and should be reshaped, primarily to put a stop to the losses it was experiencing.[424] Mr. Martin-Artajo later told the JPMorgan Chase Task Force investigation that, despite Mr. Macris's comment, he still viewed the

[417] Subcommittee interview of Peter Weiland, CIO (8/29/2012).
[418] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot); Subcommittee interview of Michael Sullivan, OCC (8/30/2012). See also 2013 JPMorgan Chase Task Force Report, at 26 (stating that in the fourth quarter of 2011, the SCP held an overall net short position).
[419] Subcommittee interview of Michael Sullivan, OCC (11/7/2012).
[420] See Synthetic Credit Profit and Loss, OCC-SPI-00000298, and chart tracking the SCP's daily profit and loss reports in Chapter IV.
[421] Subcommittee interview of Michael Kirk, OCC (8/22/2012).
[422] See Section 3.3: Securities and Derivatives of the FDIC Risk Management Manual of Examination Policies, at 6 and 16. http://www.fdic.gov/regulations/safety/manual/section3-3.pdf.
[423] 1/26/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "credit book last version,"conveying "Core Credit Book Highlights," JPM-CIO-PSI 0000159-173, at 161.
[424] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012). Irvin Goldman, the CIO's Chief Risk Officer, told the Subcommittee that the decision to stop using the SCP as a hedge was actually made in December 2011. Subcommittee interview of Irvin Goldman, CIO (9/15/2012). See also JPMorgan Chase Task Force Report, at 29 (indicating CIO trader was told that the"focus in managing the [SCP] at that point should be on profits and losses").

SCP book as a hedge.[425] In any event, the issue in late January was whether to sell off the short positions; take no action when positions naturally expired; purchase long positions; or take some other action to reshape the SCP.

The evidence indicates that CIO management gave only cursory attention to the option of leaving the SCP book as-is, since the book would have continued to lose value during the credit market rally, as was the case for hedges and short positions generally.[426] According to Mr. Martin-Artajo, Mr. Macris did not want to lose money and, in fact, would be "angry" to lose money.[427] At one point at the end of January, Mr. Iksil sent Mr. Martin-Artajo an email advising that they should just "take the pain fast" and "let it go."[428] But according to Mr. Iksil, his supervisor Mr. Martin-Artajo disagreed and explicitly instructed him to stop losing money.[429]

The second option, unwinding the book, had already been calculated to cost a minimum of $516 million.[430] Mr. Martin-Artajo later told the JPMorgan Chase Task Force investigation that Mr. Macris did not want to lose money at all, but particularly did not want to lose money from unwinding the book.[431] In addition, Ms. Drew had already expressed concern about the high cost of unwinding the book.[432]

(9) Four Options to Reshape the SCP

On January 18, 2012, the day before the Kodak default and the start of the nine straight days of losses in the SCP, Ms. Drew convened a meeting to discuss the SCP and, in particular, how to reduce its RWA.[433]

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[425] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[426] Hedges, like insurance, cost money to keep in place. The CIO traders, however, appeared unwilling to absorb the cost of this "insurance," trying instead to position the SCP book to produce gains rather than reflect the costs of maintaining credit loss protection.
[427] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to Subcommittee on 9/6/2012). (According to Mr. Martin-Artajo, "Achilles told me every day every minute that he would be angry with P&L loss.").
[428] 1/30/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, JPM-CIO-PSI 0001225 (Mr. Iksil also warned: "there is more loss coming in core credit book").
[429] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[430] 1/4/2012 email from Julien Grout, CIO, to Ina Drew, John Wilmot, and Javier Martin-Artajo, CIO, "RWA reduction for Core Credit- scenario analysis summary," JPM-CIO-PSI 0001259-260, at 260. The $516 million was the projected cost for unwinding just 35% of the SCP.
[431] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[432] See 1/10/2012 email from Ina Drew, CIO, to Javier Martin-Artajo, CIO, "International Credit Consolidated P&L 09-Jan-2012," JPM-CIO-PSI 0000075.
[433] See 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," JPM-CIO-PSI 0000098-104, conveying presentation entitled, "Core Credit Book Highlights," (earlier email in chain from Andrew Perryman, CIO, to Gina Serpico, who was Ms. Drew's assistant: "Hi Gina, Please find attached a copy of the meeting materials for Ina's 3 pm meeting with Javier, Achilles and Bruno."). See also 2013 JPMorgan Chase Task Force Report,

In preparation for the meeting, Mr. Iksil provided Ms. Drew a written presentation with key information about the SCP.[434] The first page of the presentation focused on the SCP's RWA. Specifically, it compared the SCP's RWA results using the bank's standard RWA model, which had been developed by the bank's Model Risk and Development group (also referred to as Quantitative Research or "QR," a function located within JPMorgan Chase's bankwide risk group), versus the SCP's RWA results using a model newly developed by the CIO. The presentation noted that the CIO's "Core Credit Book RWA" under the bank's QR model was $40.3 billion, while under the CIO model it was $20.9 billion.[435] The CIO's Chief Market Risk Officer told the Subcommittee that the new CIO model was a "shadow model"[436] that had been developed by the CIO's quantitative expert, Patrick Hagan. Mr. Hagan told the Subcommittee that he had not developed a fully functioning, alternative RWA model for the CIO at that time, but acknowledged that he had worked on the major contributors to the RWA model and had provided the $20.9 billion estimate used in the presentation.[437] Mr. Iksil's presentation indicated that as of mid-January, implementing the CIO's shadow RWA model would have had the effect of reducing the SCP's apparent RWA by almost 50%.

At the time the presentation was prepared, the Synthetic Credit Portfolio had already grown to enormous size. The presentation described just three of its credit derivative holdings as follows:

Credit Index IG9 – $278 billion in gross notional value;

Credit Index HY10 and 11 – $115 billion in gross notional value; and

Main iTraxx S9 – $90 billion in gross notional value.[438]

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at 29 (describing January 18 meeting involving Ms. Drew, Mr. Wilmot, Mr. Weiland, and "two senior members" of the SCP team to discuss the SCP and RWA reduction).

[434] 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," JPM-CIO-PSI 0000098-104, conveying presentation entitled, "Core Credit Book Highlights," (see earlier email in chain from Andrew Perryman, CIO, to Gina Serpico, who was Ms. Drew's assistant: "Hi Gina, Please find attached a copy of the meeting materials for Ina's 3 pm meeting with Javier, Achilles and Bruno."). See also JPMorgan Chase Task Force interview of Javier Martin-Artajo, JPMorgan Chase (partial readout to the Subcommittee on 9/6/2012).

[435] 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," JPM-CIO-PSI 0000098-104, conveying presentation entitled, "Core Credit Book Highlights."

[436] Subcommittee interview of Peter Weiland, CIO (8/29/2012).

[437] Subcommittee interview of Patrick Hagan, CIO (2/7/2013). For more information about RWA, see Chapter II; for more information about the CIO's efforts to produce an alternative RWA model, see Chapter V.

[438] 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," conveying presentation entitled, "Core Credit Book Highlights" (January 2012), at JPM-CIO-PSI 0000101. The IG9 tracked 125 investment grade companies in the United States; the HY10 and 11 each tracked 100 companies at higher risk of default; the Main ITraxx S9

Those credit positions were inherently higher risk, due to their synthetic nature which meant that no real economic asset lay behind the positions to stem any losses. The GAAP requirement that the positions' fair value be recorded on the SCP's books each day also contributed to SCP price volatility. In addition, the huge size of the holdings meant that even a small drop in price resulted in substantial losses. The complexity of the holdings also meant that they interacted in unpredictable ways. The higher risk nature of these positions on top of their huge size all boosted the SCP's RWA.

The next day, January 19, 2012, to follow up on the prior day's meeting, Mr. Martin-Artajo sent Ms. Drew an email describing four scenarios for reducing the SCP's RWA that had been discussed during the meeting:

> "Ina,
>
> [A]s a follow up from yesterday[']s conversation regarding the tranche book I would like to further clarify the different scenarios and assumptions for each of them.
>
> The first scenario is the one discussed when you were in London an[d] is a scenario that we reduce our book to the agreed [RWA] target at year end 2012 of 20.5 Bln but the current model used by QR remains. This ... strategy ... would have high trading costs and a higher risk profile so that we could also have a large drawdown [loss].
>
> The second scenario ... is a scenario that we meet the year end target by opportunistically reducing the necessary legs and optimization is used[439] following the current QR model guidelines ....
>
> The third scenario is possible if we get the new [CIO] model ....
>
> The fourth scenario is our Target scenario and the one we are hoping to implement ... by midyear."[440]

Each of the four scenarios turned on whether the CIO would be required to use the bank's official "QR" model or its own shadow model to calculate RWA; and whether the CIO traders would be permitted to

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tracked 125 investment companies in Europe. For more information on credit indices, see Chapter II.

439 The reference to "legs" is to the SCP's trading strategy in which it made coordinated acquisitions of credit derivatives with both shorter and longer term maturities, and recommended that both sets of derivatives be reduced. The reference to "optimization" is to a strategy designed by Mr. Martin-Artajo to offset long and short credit instruments to lower their overall risk. Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

440 1/19/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario Clarification," at JPM-CIO-PSI 0000105-106.

engage in "opportunistic risk reduction" with respect to the SCP.[441] According to Mr. Martin-Artajo, "opportunistic risk reduction" meant that risk could be reduced in a way that minimized execution costs, and that the risk reduction did not have to be completed quickly, but could occur over time.[442]

Mr. Martin-Artajo attached to his email a "Decision Table" describing the four scenarios, a copy of which is reprinted below.[443]

[441] Id., at 106.
[442] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[443] 1/19/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario Clarification," at JPM-CIO-PSI 0000106. Mr. Hagan told the Subcommittee that, despite the fact that the Decision Table featured his RWA model and contrasted it with the bank's standard RWA model, he was not consulted about it, was unaware of the Decision Table at the time it was created, and had not seen it prior to his interview. Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

Credit book Decision Table in "no diversification" assumption

Model	QR model prevails	QR model prevails	CIO model prevails	CIO model prevails
Scenarios and perceived feasibility as of today	REDUCTION (as discussed at 7th December 2011 meeting London and follow up on Xmas)	[illegible]	Possible if approved by QR	[illegible]
Model applied and diversification	QR Model no diversification	[illegible]	CIO Model no diversification	[illegible]
Data?	No detailed data	[illegible]	Data available	[illegible]
Reduction in RWA	RWA reduced from USD 43 Bln to USD 20 Bln	[illegible]	RWA reduced from USD 21 Bln to USD 15 Bln	[illegible]
RWA target EOY (undiversified)	USD 20 Bln	[illegible]	USD 15 Bln	[illegible]
Estimated Diversified RWA	USD 20 Bln	[illegible]	USD 15 Bln	[illegible]
Risk management	Systematic reduction of the largest legs across the book Unwind of existing trades across the board	[illegible]	Active risk reduction of the critical legs with regards to RWA marginals Buying protection on IG9 10yr, MAIN S9, HY10 7yr	[illegible]
Trading cost	USD 590mm	[illegible]	USD 100mm	[illegible]
Carry	USD 400-500mm	[illegible]	USD 200mm	[illegible]
Optionality	USD 0-50mm	[illegible]	USD 0-50mm	[illegible]
P&L range	USD -150mm to USD -50mm	[illegible]	USD 50mm to USD 150mm	[illegible]
Drawdown needed	USD 300mm	[illegible]	USD 150mm	[illegible]

Source: 1/19/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario Clarification," at JPM-CIO-PSI 0000106.

Of the four scenarios laid out in the Decision Table, the fourth, or "Target Scenario," had the lowest "drawdown" or expected loss.[444] Under the first two scenarios, if the QR model prevailed, produced a higher RWA, and required the CIO to reduce SCP assets, the Decision Table estimated the SCP losses at $200 to $300 million, depending upon whether the traders reduced the risk actively – meaning immediately – or opportunistically – meaning over time.[445] Under the third scenario, if the CIO model prevailed and the traders reduced risk actively, the Decision Table estimated losses at $150 million. Under the final scenario, if the CIO model prevailed and the traders reduced risk over time, the Decision Table estimated the losses at $100 million.[446]

A week after Mr. Martin-Artajo sent Ms. Drew the email describing the four scenarios and providing the Decision Table, Mr. Iksil included the Decision Table again in a January 26 presentation proposing a trading strategy for the CIO on "the trades that make sense."[447] Mr. Iksil later told the JPMorgan Chase Task Force investigation that the last scenario in the table was the one that the CIO traders began to pursue.[448]

The Subcommittee asked Ms. Drew about the Decision Table. In her first interview, Ina Drew told the Subcommittee that she had never seen it before. In her second interview, the Subcommittee staff drew her attention to Mr. Martin-Artajo's email, which indicated that he had discussed the scenarios with her, described them again in his email, and also sent her the table. Ms. Drew conceded that she did receive the Decision Table as an attachment to another email later on, but said she did not focus on it.[449] The Subcommittee has been unable to identify any documentation establishing Ms. Drew's approval of the RWA reduction strategy described in the fourth scenario, although it's difficult to understand why Mr. Martin-Artajo would have discussed the options with her, followed up with an email, and had one of his traders include the Decision Table in a subsequent presentation, if he had not intended to inform her of the strategy and obtain her approval before proceeding.

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[444] 1/19/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario Clarification," JPM-CIO-PSI 0000106. The OCC explained to the Subcommittee that a drawdown in this context is a loss that is expected to occur. Subcommittee interview of Michael Sullivan, OCC (11/7/2012).

[445] 1/19/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario Clarification," JPM-CIO-PSI 0000106.

[446] Id.

[447] See 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," conveying "Core Credit Book Highlights," (January 2012), prepared by Mr. Iksil, at JPM-CIO-PSI 0000161.

[448] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).

[449] Subcommittee interview of Ina Drew, CIO (12/11/2012). The Decision Table she received was attached to the Iksil email sent a week later. See 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," conveying "Core Credit Book Highlights" prepared by Mr. Iksil, at JPM-CIO-PSI 0000161.

The analysis undertaken in the January 18 presentation was designed to reduce the SCP's RWA so that the RWA for the CIO as a whole, and in turn, for the bank as a whole, would also drop and reduce the bank's capital requirements. Immediately after the presentation, however, the SCP began to experience a series of dramatic losses stemming from the Eastman Kodak default on January 19, and the credit market rally that reduced the value of the SCP's credit holdings, leading to SCP losses totaling $100 million by the end of January. JPMorgan Chase has acknowledged that the traders' goals of reducing RWA and avoiding losses were in "constant tension."[450] By the end of January, these problems converged, and the traders came up with a solution that they believed would address both problems.

(10) Decision to Go Long

In the second half of January 2012, the CIO traders were confronted with a series of complex objectives: to stem the losses in its credit portfolio, reduce the SCP's RWA, and maintain default protection to take advantage of any large corporate defaults.[451] The traders had also received permission to reduce the SCP's RWA opportunistically, rather than immediately.

The traders decided against simply unwinding the SCP book by disposing of its assets, in part because the trading costs associated that type of broad "unwind" of the portfolio was expected to be $590 million.[452] In addition, removing short positions would have made it impossible to prevent Eastman Kodak-style losses or obtain American Airlines-style gains. The CIO traders decided instead to advocate buying more credit positions that were "long" on risk, that is, where the CIO was essentially selling insurance against future credit defaults.

The SCP already had some long credit positions on its book, but its longstanding overall position was to be net short. In other words, most of the SCP's credit assets would produce gains only when a referenced entity declared bankruptcy or defaulted on its debts. Since the original function of the SCP was to provide the bank with insurance against credit risks such as loan losses, bankruptcies, or tail risks, it seems contradictory for a hedge book that was meant to protect a bank against credit risk to decide to *sell* protection against credit risk.

The CIO traders apparently reasoned, however, that, just as buying protection required CIO to pay a premium, selling protection would

[450] Levin Office briefing of JPMorgan Chase (6/26/2012) (Harry Weiss).
[451] The JPMorgan Chase Task Force later criticized CIO management for establishing "competing and inconsistent priorities" for the SCP "without adequately exploring or understanding how the priorities would be simultaneously addressed." 2013 JPMorgan Chase Task Force Report, at 10.
[452] See 1/19/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario Clarification," at JPM-CIO-PSI 0000106.

allow the CIO to *collect* premiums, which they often referred to as "carry."[453] It could then use this carry both to finance other credit trades and offset losses.[454] In addition, the CIO traders expressed the view that the CIO could use the new credit assets to reduce the SCP's RWA, by balancing the long positions against its short positions.[455] Still another benefit was that the value of the long credit protection would increase during a market rally so, according to CIO's market risk officer at the time, adding longs would help balance the portfolio's losses if the credit market continued to rally.[456] Finally, buying long credit products financed the CIO's purchase of more short positions, enabling the CIO to retain its ability to profit from another American Airlines-type default.[457]

In short, the CIO traders began accumulating long credit derivatives – selling credit protection – in a mistaken effort to address all of the CIO's problems at once: to offset losses by producing carry, reduce RWA, add appreciating positions to the portfolio during the market rally, and allow the CIO to maintain default protection.

(11) Adoption of 2012 Trading Strategy

Accordingly, on January 26, 2012, Mr. Iksil prepared a presentation for the CIO's International Senior Management Group (ISMG) advocating a new trading strategy in which the CIO would buy

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[453] Subcommittee briefing by JPMorgan Chase (10/4/2012) (Olivier Vigneron).

[454] According to JPMorgan Chase's then CFO, Douglas Braunstein, the "long positions helped pay for the carry" for the short positions. Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012). CIO's former CFO, John Wilmot, agreed: the traders "earned" carry on the credit products where they "took risk" – that is, where they were exposed to risk by selling credit protection that would have to pay up if a specified credit event occurred. Subcommittee interview of John Wilmot, CIO (9/11/2012). The SCP even included $30 million in the SCP budget for 2012, as the estimated amount of carry the traders expected to produce from selling credit protection. Id. See also 2013 JPMorgan Chase Task Force Report, at 30-31.

[455] See 12/22/2011 email from Bruno Iksil to Achilles Macris and Javier Martin-Artajo, CIO, "urgent -----: Rwa," JPM-CIO-PSI 0001227 (stating Mr. Iksil had reduced RWA in the past by selling protection). The CIO's former CFO, Joseph Bonocore, told the Subcommittee that he agreed it was possible to reduce RWA by taking offsetting positions, although the positions would have to be in the same instruments. Subcommittee interview of Joseph Bonocore, CIO (9/11/2012). C.S. Venkatakrishnan, a risk expert at the bank, concurred, telling the Subcommittee that RWA could "typically" be reduced by offsetting instruments but only with the exact same characteristics, including the same "tenor" or maturity date and counterparty. Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012). See also 4/9/2012 email from John Wilmot, CIO, to Ina Drew, CIO, and others, "Deliverables for meeting tomorrow," JPM-CIO-PSI 0001645 (referring to conversation with CFO Douglas Braunstein, who explained that selling protection might not have been as economic, from an RWA perspective, as reducing the existing protection); JPMorgan briefing (7/5/2012) (Greg Baer).

[456] Subcommittee interview of Peter Weiland, CIO (8/29/2012).

[457] See, e.g., 5/3/2012 email from Irvin Goldman, CIO, to Douglas Braunstein, JPMorgan Chase, and others, "CSW 10%," conveying "CIO Synthetic Credit" presentation (5/2012), JPM-CIO-PSI-H 0000549 (presentation indicating that the SCP sought to retain the upside on potential defaults and thus sold protection on investment grade indices).

more long credit derivatives.[458] The ISMG was, as its name indicates, a group of senior managers within the CIO's International Office, including Mr. Macris, Mr. Martin-Artajo, and CIO risk personnel, including Keith Stephan.[459] The ISMG participants were resident in the CIO's London office, and Ms. Drew attended their meetings when she was in London.[460] Ms. Drew told the Subcommittee that she considered the ISMG to be the appropriate level for an SCP strategy review.[461]

The Iksil presentation began by noting that "the credit book ha[d] a YTD [year-to-date]" loss of $100 million and was expected to lose another $300 million.[462] The presentation identified several sources of the loss, including the "rally in US HY [High Yield credit index] and defaults at the same time (as Eastman Kodak this year)."[463] It also stated that the SCP already included some long credit instruments which were providing "offsetting gains to the loss," both because the long assets had gained value and, due to the premiums being paid by the short parties, were producing carry.[464]

Mr. Iksil's presentation then proposed executing "the trades that make sense."[465] Specifically, it proposed:

"The trades that make sense:

- sell the forward spread and buy protection on the tightening move
    - Use indices and add to existing position
    - Go long risk on some belly tranches especially where defaults may realize
    - Buy protection on HY and Xover in rallies and turn the position over to monetize volatility"[466]

This proposal encompassed multiple, complex credit trading strategies, using jargon that even the relevant actors and regulators could

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458 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," JPM-CIO-PSI 0000159-173, conveying "Core Credit Book Highlights," (1/2012), prepared by Mr. Iksil; Subcommittee interview of Peter Weiland, CIO (8/29/2012).
459 JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
460 Subcommittee interview of Ina Drew, CIO (9/7/2012).
461 Id. See also JPMorgan Chase Task Force Report, at 32, footnote 39 (stating "there is no evidence that Ms. Drew received" the Iksil presentation and that she only "generally" understood "around this time that the traders were planning to add long positions," thereby implying that the ISMG rather than Ms. Drew actually approved the trading strategy in January 2012).
462 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," conveying "Core Credit Book Highlights," (1/2012), prepared by Mr. Iksil, JPM-CIO-PSI 0000161.
463 Id.
464 Id.
465 Id.
466 Id.

not understand. Because the traders themselves declined the Subcommittee's request for interviews and were outside of the Subcommittee's subpoena authority, the Subcommittee asked other current and former CIO personnel to explain the proposal. Ina Drew, CIO head, told the Subcommittee that the presentation was unclear, and she could not explain exactly what it meant.[467] Irvin Goldman, then the CIO's Chief Risk Officer, told the Subcommittee that the presentation did not provide enough information to clarify its meaning.[468] Peter Weiland, the CIO Market Risk Officer, offered the explanation that Mr. Iksil was basically describing a strategy of buying low and selling high.[469] No CIO official offered a more detailed explanation of the specific trading strategies set forth in the January proposal.

The OCC told the Subcommittee that while it agreed the presentation was confusing, senior CIO management should have understood exactly what was being proposed before allowing billions of dollars in trades, and should have been able to explain the presentation.[470] The OCC provided the Subcommittee with its understanding of the proposed trading strategies as follows.

> *Selling the forward spread:* The presentation proposed buying credit protection in the short term and selling credit protection in the long term.[471]
>
> *Buy protection on the tightening move:* The presentation proposed essentially buying credit protection when it was less expensive.[472] As noted above, when credit markets are improving, credit insurance becomes less costly.
>
> *Turn the position over to monetize volatility:* The presentation proposed selling SCP positions to take advantage of changing prices and locking in any profits.[473] Coupled with the purchase of protection "on the tightening move," the presentation was essentially proposing to buy low and sell high.[474]
>
> *Go long risk on some belly tranches:* The reference to "belly tranches" is unclear. Most likely, belly tranches are credit index tranches which contain less risk than the equity tranches but more than the super senior tranches.[475] The presentation appears to propose buying the long side of those credit instruments.

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[467] See, e.g., Subcommittee interview of Ina Drew, CIO (9/7/2012).
[468] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
[469] Subcommittee interview of Peter Weiland, CIO (8/29/2012).
[470] Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
[471] Id.
[472] Id.
[473] Id.
[474] Id.
[475] For more information on these credit index tranches, see Chapter II.

Use indices and add to existing position: The presentation noted that the SCP already had some long credit index positions on the books,[476] and proposed expanding those holdings.

In addition to advocating those particular trading strategies, the presentation contained a warning about possible losses. In a section entitled, "Adverse scenarios and possible drawdowns," the proposal stated that if unanticipated defaults occurred, they could impose costs of $200 million "upfront," and if prices failed to behave as expected, additional losses of $300 million were possible.[477] In other words, the proposal warned from the beginning that its trading strategies could result in losses totaling $500 million.

The Subcommittee has not identified any formal approval document, but the ISMG apparently approved the proposed trading strategies, since the CIO traders immediately began implementing them in late January, in particular by buying substantial amounts of the IG9 credit derivative index on the long side.[478] This trading strategy would prove, however, in the words of Mr. Dimon, to have been "poorly conceived and vetted."[479]

D. SCP's Increasing Risk and Losses

As the CIO traders implemented the new trading strategy and began acquiring more long positions in late January, the SCP exploded in size, complexity, and, consequently, risk. In contrast to its earlier years when the Synthetic Credit Portfolio produced positive revenues for the bank, beginning in January 2012, the SCP began incurring sustained losses. The CIO traders expressed increasing concern about the losses, which they were unable to stem, in part because of dropping market values, the large size of the portfolio which meant that even small price drops cascaded into large losses, and the small number of credit market participants willing to purchase the positions held by the SCP at an acceptable price. Even after the CIO traders stopped all SCP trading, the SCP book incurred escalating losses for the rest of the year.

(1) January 2012

As noted above, in June 2011, the CIO began to increase the size of the Synthetic Credit Portfolio in anticipation of deteriorating credit

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[476] Subcommittee interview of Michael Sullivan, OCC (8/30/2012).

[477] 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," conveying "Core Credit Book Highlights," (January 2012), prepared by Mr. Iksil, at JPM-CIO-PSI 0000165.

[478] See 2013 JPMorgan Chase Task Force Report, at 31 (stating that by the end of January, the CIO traders had purchased about a $20 billion long position in the 10-year IG9 credit index and another $12 billion long position in the 5-year IG9 credit index).

[479] Testimony of Jamie Dimon, "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012).

markets associated with Europe. By August 30, 2011, the SCP included forward trades in the form of a "long front leg" and a "short back leg" in the IG9 credit index.[480] JPMorgan Chase told the Subcommittee that the CIO chose the IG9 index, because it referenced credit default swaps for only investment grade companies, which were less likely to default and provided a solid foundation for a trading strategy that involved selling credit protection (going "long risk").[481]

The Iksil presentation on January 26, 2012, proposed, not to unwind, but to increase the size of the SCP book of assets.[482] After the ISMG meeting, the CIO traders did just that, buying and selling credit protection across a wide variety of high yield and investment grade purchases, but in general, buying more credit protection against high yield defaults and selling more protection for investment grade companies.[483] The traders thus increased the size of *both* legs of their existing trades – the high yield and investment grade – incurring more risk along the way.[484]

The CIO appears to have adopted the Iksil trading strategy even though he had warned that the book had already lost $100 million and the new strategy could, if it didn't go well, result in losses of another $500 million.[485] One trader explained the losses as the result of a combination of factors: the high-yield short positions losing more value than expected and the investment-grade long positions gaining less value than expected.[486] When the Subcommittee asked the OCC about those losses, the OCC explained that the bank had not informed it of either the losses or the new trading strategy at the time, but since the CIO was already losing money with its trading strategy, the traders should have

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[480] JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 9/6/2012).

[481] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot). JPMorgan Chase told the Subcommittee that the SCP used the IG9 index on both sides of its forward trades, with the "short leg" (buying credit protection) maturing in December 2012, and the "long leg" (selling credit protection) maturing in 2017. Id. The trade meant the CIO was both liable for and protected against defaults in investment grade companies through December 2012, but thereafter was liable for only defaults in investment grade companies through December 2017. See, e.g., 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, "synthetic credit information," conveying presentation, at 5, JPM-CIO-PSI-0001706 (describing the "roll-off" of protection in December 2012). This characterization pertains to the IG9 forward trade and does not necessarily reflect the sum total of the CIO's positions.

[482] 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," conveying "Core Credit Book Highlights," (1/2012), prepared by Mr. Iksil, at JPM-CIO-PSI 0000161.

[483] Subcommittee interview of John Wilmot, CIO (9/11/12).

[484] JPMorgan Chase Task Force interview of Javier Martin-Artajo, JPMorgan Chase (partial readout to the Subcommittee on 9/6/2012).

[485] 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," conveying "Core Credit Book Highlights," (1/2012), prepared by Mr. Iksil, at JPM-CIO-PSI 0000162 (explaining "credit book has a YTD P&L of -100M," unanticipated defaults could impose costs of $200 million "upfront," and if prices failed to behave as expected, additional losses of $300 million were possible).

[486] See 2013 JPMorgan Chase Task Force Report, at 33.

stopped, rather than expanded its use.[487] The OCC further told the Subcommittee that the CIO apparently did not stop, because it did not want to take the additional, short-term losses that would have resulted from simply reducing the size of the SCP.[488]

The losses continued for the rest of January, including after Mr. Iksil began to execute the January 26 strategy and increase the size of the SCP book. On January 30, 2012, Mr. Iksil sent his supervisor, Mr. Martin-Artajo, an email warning of additional losses and poor liquidity in the credit markets, and seeking guidance on what to do. He noted that the trading strategy called for purchasing more credit instruments – adding "notionals" – which "increase[d] the issues with the risks and the size" of the portfolio.

> "[W]e have to report a loss in the widening today, much less because the book has a long risk bias. Comes month end and we cannot really prevent the forward spreads from moving up .... To trade ... is costly and leads to increase in notionals. We need to discuss at this stage I guess: All I see is that liquidity is so poor that we just add notionals with the stress. So that improves the outright final P&L [profit and loss] number but this increases the issues with the risks and the size, as well as our sensitivity to price moves and trading costs .... [T]he only one I see is to stay as we are and let the book simply die ...."[489]

In his email, Mr. Iksil singled out the "poor" liquidity then in the market, which meant that he had difficulty locating buyers for the SCP's assets. He also alluded to how purchasing long credit instruments meant the book received premium payments from the short parties which "improve[d] the outright final P&L number," but at the same time increased the size of the portfolio and its "sensitivity to price moves and trading costs." In other words, buying new long positions brought in more valuable positions as well as cash carry that could be used to offset the book's daily losses, but it also increased the portfolio size which meant that even small price drops rolled into large daily losses. After noting the tradeoffs between the portfolio's increasing size and risk of loss, Mr. Iksil wrote that in his view the "only" course of action was "to stay as we are and let the book simply die." In other words, he advocated against buying additional credit positions and allowing the existing positions to expire with the attendant losses.

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[487] Subcommittee interview of Mike Sullivan, OCC (8/30/2012).
[488] Subcommittee interview of Doug McLaughlin, OCC (8/30/2012).
[489] 1/30/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "update on core credit book," JPM-CIO-PSI 0001223.

In the same January 30 email, Mr. Iksil expressed concern about the danger of taking on ever-increasing positions under the new trading strategy:

> "[T]he control of the drawdown [loss] now is generating issues that make the book only bigger in notionals .... [T]he notionals become scary and [the] upside is limited unless we have really unexpected scenarios. In the meantime, we face larger and larger drawdown pressure versus the risk due to notional increase. Please let me know the course of action I should take here."[490]

The Subcommittee was unable to locate any written record of any guidance provided by Mr. Martin-Artajo in response.

That same day, January 30, 2012, Mr. Macris sent an email to Mr. Martin-Artajo also expressing concern about the ongoing losses:

> "We need to discuss the synthetic book. The current strategy doesn't seem to work-out. The intention was to be more bullish, but the book doesn't behave as intended .... The financial [p]erformance is worrisome."[491]

In hindsight, it appears that the CIO essentially took the trading strategy that had worked during the bear market of the second half of 2011, and applied it to the bull market in the early part of 2012, with disastrous results.[492] Not only did the SCP's short positions lose value as the economy improved, but the long credit protection the CIO purchased for investment grade companies did not increase in value as much as was needed to offset the losses. As Mr. Macris put it, the investment grade rally "lagged" the high yield rally.[493] That meant that the mark-to-market profits the CIO was able to post on the investment grade credit protection it sold was insufficient to offset the mark-to-market losses it had to post on the high yield protection they purchased.

Mr. Iksil later told the JPMorgan Chase Task Force investigation that he had not been able to sell as much credit protection as he would have liked (which would have generated more carry and profits to keep pace with the high yield rally). He said that two risk limits – the "VaR" and "CS01" – prevented him from doing so. He later wrote in an email: "[T]he need to reduce VAR – RWA and stay within the CS01 limit

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[490] Id.

[491] 1/31/2012 email from Achilles Macris, CIO, to Javier Martin-Artajo, CIO, "Core book P&L drawdown and main exposures," JPM-CIO-PSI 0000221.

[492] See, e.g., 1/31/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "Core book p&l drawdown and main exposures," JPM-CIO-PSI 0000222 (forwarded to Achilles Macris and subsequently Ina Drew).

[493] JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 9/6/2012).

prevented the book from being long risk enough."[494] However, had Mr. Iksil actually acquired even more long positions, it is unclear that he would have been able to offset the losses then being reported on the books; it is possible he would have dug the SCP hole even deeper.

(2) February 2012

Despite the concerns expressed by Mr. Iksil and Mr. Macris about the SCP trading strategy, the CIO traders continued to pursue it throughout February, acquiring even more credit derivatives and incurring even more losses. According to the key trader, Bruno Iksil, at the beginning of February, Ms. Drew asked him how much the book would lose if the positions were reduced, and he responded "a lot," because the IG9 long positions were not liquid enough to sell easily.[495] Apparently neither Ms. Drew nor any other CIO manager told the traders to stop the book's acquisitions or reduce any of the growing SCP positions. Instead, over the course of February, the CIO traders increased the size of the IG9 forward position from $75 billion at the beginning of the month to $94 billion at the beginning of March.[496] Those purchases dramatically increased the SCP's long holdings, leading one trader to describe the book as set to "trade on the bullish side."[497]

At the same time, during the month of February, the credit market continued to rally, and the overall value of the SCP book continued to fall.[498] Mr. Iksil continued to trade.[499] On February 9, 2012, the SCP book breached a risk limit called "CS01."[500] The book at that point had reported losses exceeding $128 million since the beginning of the

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[494] 3/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "First draft of the presentation," conveying "CIO Synthetic Credit Update" (3/2012) at JPM-CIO-PSI 0001256. As discussed below, Mr. Iksil was not able to start selling protection in earnest until a new VaR model entered into force on January 30, retroactive to January 27. He similarly was constrained by the CS01 limit which the SCP ultimately breached in February. For more information on these limits, see Chapter V.

[495] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).

[496] See 4/9/2012 email from Achilles Macris, CIO, to Douglas Braunstein, JPMorgan Chase, and Ina Drew, CIO, "Synthetic Credit Presentation," conveying presentation entitled "Core Credit P/L estimates for Q2," at 22, JPM-CIO-PSI-H 0002204-213, at 212; Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot).

[497] 2/22/2012 email by Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, and others, "core credit latest version," conveying "Core Credit Book P&L Review," (2/2012), at JPM-CIO-PSI 0001787.

[498] Subcommittee briefing by JPMorgan Chase (10/4/2012) (Olivier Vigneron).

[499] See, e.g., 2013 JPMorgan Chase Task Force Report, at 34-37; undated internal document authored by Bruno Iksil, CIO, with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021890.

[500] 2/13/2012 email from Syed Hassan, JPMorgan Chase, to Keith Stephan, CIO, Janet Lee, JPMorgan Chase, and others, "CIO Global Credit spread BPV limit breach- COB 02/09/2012," JPM-CIO-PSI 0001825. For more information on how the CIO responded to the SCP's breaching that risk limit, see Chapter V.

year.[501] Despite the breach – and the losses – CIO managers allowed the traders to continue to implement their trading strategy.

On February 13, 2012, an additional complication arose. According to notations in an internal document authored by Mr. Iksil, Ally Financial, Inc., a bank holding company, announced that it was preparing a pre-packaged bankruptcy petition for its mortgage subsidiary, Residential Capital LLC (ResCap).[502] Mr. Iksil explained that this news affected the prices of the indices in which the SCP was trading to such an extent that the SCP had to post mark-to-market losses on both the protection it had bought and the protection it had sold.[503] The reasons for this double loss were unclear, yet the traders continued to acquire still more credit derivatives.

Mr. Iksil later indicated in an internal document that, by mid-February, he had sent Ms. Drew his explanation of the ongoing losses, but JPMorgan Chase has been unable to provide a copy of that explanation. Mr. Iksil also wrote around the same time that he was trying to reduce RWA and VaR "as much as I can in a bleeding book."[504]

According to Mr. Iksil, he and Mr. Martin-Artajo discussed the trading strategy in February. Mr. Iksil later told the JPMorgan Chase Task Force investigation that he had explained to Mr. Martin-Artajo that he did not want to add volume to the book,[505] that is, increase the overall size of the positions. In Mr. Iksil's view, the losses would only be multiplied by volume.[506] He indicated that Mr. Martin-Artajo responded that the book had to be "hedged on high yield defaults."[507] In that light, Mr. Iksil contended the only solution was to continue to finance the acquisition of high yield default protection through the sale of investment grade protection.[508] So he continued to purchase long credit instruments and collect the carry.

[501] See chart, prepared by the Subcommittee and printed in Chapter IV, tracking SCP's daily reported profit and losses (P&L) from January to May 15, 2012, derived from an OCC spreadsheet, OCC-SPI-00000298. Numbers do not reflect corrected P&L figures after JPMorgan Chase's restatement in July 2012.
[502] Undated internal document authored by Bruno Iksil, CIO, with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021890. See also In re Residential Capital, LLC, Case No. 12-12020 (MG) (Bankr. SDNY), Voluntary petition for relief under Chapter 11 (5/14/2012), http://www.kccllc.net/documents/8822900/8822900120514000000000001.pdf.
[503] See undated internal document authored by Bruno Iksil, CIO, with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021890.
[504] Undated internal document authored by Bruno Iksil, CIO, with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021891.
[505] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[506] Id.
[507] Id.
[508] Id.

On February 28, Mr. Iksil wrote that there was "more bleeding," and he had added approximately "[$]6-7 bln [billion] ig9 10yr" to the SCP book.[509] On February 29, he indicated that he had "sold important amounts of protection in ig9 10yr (close to 7bln all day ...)," and was concerned it might breach a risk limit.[510] Altogether, according to Mr. Macris who oversaw the SCP, the CIO traders added some $34 billion in notional value to the SCP book in January and February 2012.[511]

On February 29, 2012, senior CIO managers, including Ms. Drew, Mr. Wilmot, and Mr. Goldman, participated in a regularly scheduled "business review" meeting with senior bank officials, including Mr. Dimon, Mr. Braunstein, and Mr. Hogan, to review CIO activities.[512] According to the JPMorgan Chase Task Force, CIO management discussed reducing the SCP's RWA, but did not disclose that the CIO was doing so by increasing the size and complexity of the portfolio.[513] They also did not disclose that the SCP had incurred two straight months of losses.

As the losses mounted in February, the CIO traders blamed each other and the market for the inability of the trading strategy to staunch the losses. According to Mr. Iksil, he had told Ms. Drew he wanted to wait until the indices were more liquid to add to the portfolio, but by month end he had to "cover the short."[514] Mr. Iksil later explained that, in February, he "added to IG9 and S9 forwards in order to contain the P&L loss" and to "cover" the high yield short position.[515] Mr. Iksil said that he had not expected to sell as much protection as he did, but that one hedge fund was "buying protection outright."[516] Mr. Macris later said that all of the trades and losses were "well-communicated" to CIO management, meaning that his supervisors were fully informed about the status of the SCP book.

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[509] Undated internal document authored by Bruno Iksil, CIO, with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021894.
[510] 2/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "Core credit book update", JPM-CIO 0003443.
[511] JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012). See also 4/9/2012 email from Achilles Macris, CIO, to Douglas Braunstein, JPMorgan Chase, and Ina Drew, CIO, "Synthetic Credit Presentation," conveying presentation entitled "Core Credit P/L estimates for Q2," at 22, JPM-CIO-PSI-H 0002204-213; 3/7/2012 email from C.S. Venkatakrishnan, JPMorgan Chase, to Ina Drew, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0001815 (stating SCP increased in January and February by $33 billion); Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot).
[512] 2/28/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, "CIO Business Review Materials," JPM-CIO-PSI 0001940, at 942.
[513] See 2013 JPMorgan Chase Task Force Report, at 37-38.
[514] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[515] 3/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, and others, "First draft of the presentation," conveying "CIO Synthetic Credit Update," (3/2012), JPM-CIO-PSI 0001257.
[516] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012) (referring to Boaz Weinstein of Saba Capital Management).

When asked about the February trading activity, the OCC told the Subcommittee that the CIO traders apparently believed that the prices in the markets were wrong, and that the traders had a strategy to defend their positions and keep the prices from falling by taking on more of them.[517]

(3) March 2012

In March, the CIO traders purchased still more long positions, enlarged the SCP further, and by the end of the month had moved the SCP firmly into a net long posture. Their actions not only increased the portfolio's risk, breaching multiple risk limits along the way, but also escalated the SCP's losses which, by the end of the month, exceeded half a billion dollars.

On March 1, Mr. Macris expressed concern about having to reduce the SCP book to comply with management's direction to reduce the portfolio's RWA, writing:

> "I am worried that the $20b RWA committed b[y] year-end, is too aggressive, if we need to [a]ctually reduce the book, we will not be able to defend our positions."[518]

Mr. Macris later told the JPMorgan Chase Task Force investigation that, in the first part of March, the credit market was "unusually bullish," and as it continued to rally, the SCP book continued to "underperform."[519] In fact, the portfolio was not just underperforming; it was losing substantial value. In response, throughout the month, the traders continued to increase the size of the long positions in an apparent attempt to staunch the losses.

By mid-March, according to Mr. Macris, there were meetings every other day to discuss the book.[520] According to Mr. Martin-Artajo, the protection the traders bought continued to lose money relative to the protection the traders sold.[521] Mr. Iksil expressed concern about the size of the positions and the traders' limited options: "We look at what we can do ... while not growing the positions especially in IG9. The solutions are very limited."[522] Yet, on March 19, 2012, Mr. Iksil wrote that perhaps they should increase the book's long positions even more:

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[517] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). See also 2013 JPMorgan Chase Task Force Report, at 39.
[518] 3/1/2012 email from Achilles Macris, CIO, to Javier Martin-Artajo, CIO, "priorities," JPM-CIO-PSI 0001219.
[519] JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012).
[520] Id.
[521] See undated internal document authored by Bruno Iksil, CIO, with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021898.
[522] 3/15/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "Update on Core," JPM-CIO-PSI 0000386.

"One solution would be to let the book be really long risk, yet this would not be in a liquid market and may increase the P&L noise especially in corrections .... The solution proposed amounts to be longer risk."[523]

The CIO did just that, executing a series of trades over a couple of weeks in March that were so large that the OCC described them internally and to the Subcommittee as "doubling down" on the SCP's already losing trading strategy.[524] The first involved the acquisition of an $8 billion notional long position in the most recent North American Investment Grade index series – not the IG9, but the IG17.[525] The second involved an even newer IG index series, the IG18, which was first issued on March 20, 2012, and in which the CIO acquired a $14 billion notional long position.[526] On top of that, the CIO acquired a massive $18 billion long position in the corresponding iTraxx series of credit indices.[527] Altogether, in a few weeks, these trades increased the notional size of the SCP by $40 billion.

Mr. Iksil later explained to the JPMorgan Chase Task Force investigation that he had switched from the IG9 index to the more recent series to be "less noticeable" to the rest of the market.[528] He explained that he had sold so much protection in the IG9 index that he believed the

[523] 3/19/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "Core Book analysis and proposed strategy," JPM-CIO-PSI 0001234-235.

[524] 6/29/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, CIO, and others, "2nd Wilmer Hale Call," OCC-SPI-00071386 ("Macris told Braunstein the majority of the positions were taken in Jan and Feb but we now know the doubling down in March."); Subcommittee interviews of Scott Waterhouse, OCC (9/17/2012), Michael Sullivan and Douglas McLaughlin, OCC (8/30/2012); OCC Presentation to the Subcommittee, page entitled, "1Q2012," (noting that "CS01 Exposure nearly doubled . . . between March 14 and March 28"), PSI-OCC-06-000028. See also 2013 JPMorgan Chase Task Force Report, at 41 (indicating the CIO traders had reasoned they could "put on a large position very quickly near the roll date (March 20)" in order to stem the SCP's losses and reduce the SCP's VaR and RWA totals prior to the bank's quarter-end public filings).

[525] See 2013 JPMorgan Chase Task Force Report, at 42; Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot). See also 3/22/2012 email from Peter Weiland, CIO, to Irvin Goldman, CIO, "I would like to understand the increase in positions in credit," JPM-CIO-PSI 0000410-411 (reporting that the SCP's notional CDX IG position – which includes a variety of IG on and off-the-run holdings – had increased from $22.4 billion on March 7, 2012, to $52.1 billion on March 21, 2012, a $30 billion increase in two weeks).

[526] See 2013 JPMorgan Chase Task Force Report, at 42; Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot). See also 3/22/2012 email from Peter Weiland, CIO, to Irvin Goldman, CIO, "I would like to understand the increase in positions in credit," JPM-CIO-PSI 0000410-411.

[527] See 2013 JPMorgan Chase Task Force Report, at 42. See also 3/22/2012 email from Peter Weiland, CIO, to Irvin Goldman, CIO, "I would like to understand the increase in positions in credit," JPM-CIO-PSI 0000410-411 (reporting that the SCP's notional iTraxx MN position had increased from $38.9 billion on March 7, 2012, to $45.7 billion on March 21, 2012, a $7 billion increase in two weeks); 3/22/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, "CIO Core Credit P&L Predict [22 Mar]: +$82k (dly) -$276,990k (ytd)," JPM-CIO-E 00014689-691, at 691(reporting an additional purchase of iTraxx long positions totaling $5.65 billion).

[528] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).

other credit traders "knew" his position, and were taking advantage.[529] In fact, on March 19, 2012, Mr. Iksil warned his supervisor that the SCP was a very visible player in a small market: "[T]here is a trap that is building: if we limit the Mark-to-Market we risk increasing the notionals further and weaken our position versus the rest of the market."[530] Later, Mr. Iksil wrote to a colleague:

> "[I]t had to happen. [I]t started back in 2008 you see. [I] survived pretty well until [I] was alone to be the target. [Y]es [I] mean the guys know my position because [I] am too big for the market. ... [B]ut here is the loss and it becomes too large and this is it. [W]e realize that [I] am too visible."[531]

On March 20, 2012, CIO head Ina Drew and CIO Chief Risk Officer Irvin Goldman participated in a meeting with the bankwide Directors Risk Policy Committee regarding the CIO, and gave a presentation on the CIO's investment portfolios and risk profile, but according to the bank, did not disclose the SCP's ongoing losses, risk limit breaches, increased portfolio size, or increased RWA.[532] On that same day, two CIO traders, Mr. Iksil and Mr. Grout, circulated the daily profit-loss email for the SCP, estimating a daily loss of $40 million which was the largest daily loss yet for the SCP, and also describing a $600 million to $800 million "lag" in the SCP book.[533] Ms. Drew told the Subcommittee that she never read that email,[534] and even though it was sent to multiple CIO recipients, no action was taken by any CIO manager to investigate the enormous "lag" it described.

On March 21, Ms. Drew held a lengthy meeting with Mr. Macris and Mr. Martin-Artajo on the SCP, in which they discussed the SCP's "underperformance" and strategies to reduce its RWA.[535] According to Ms. Drew, she was not informed at that meeting about the SCP's recent

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[529] JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012).
[530] 3/19/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo and Julien Grout, CIO, "Core Book analysis and proposed strategy," JPM-CIO 0003476-477, at 477.
[531] 3/23/2012 instant messaging session between Bruno Iksil and Ade Adetayo, CIO, JPM-CIO-PSI 0001240-246.
[532] See 2013 JPMorgan Chase Task Force Report, at 42-43, 88; 3/2012 "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," prepared by Ina Drew and Irvin Goldman, CIO, JPM-CIO-PSI 0015016.
[533] See 3/20/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, "CIO Core Credit P&L Predict [20 Mar]: -$39,686k (dly) -$275,424k (ytd)," JPM-CIO-PSI 0016487-489, at 489 (explaining that the IG9 was "underperform[ing]" by $450 to $500 million; the iTraxx Main credit index was "lagging" by another $60 to $80 million; and the High Yield index had a $100 million "loss" plus another "lag" of $100 to $200 million, concluding that the total "lag in P&L" was "material" and in the range of $600 to $800 million). For more information about this email, see Chapter IV.
[534] Subcommittee interview of Ina Drew, CIO (12/11/2012).
[535] See 3/22/2012 email from Ina Drew, CIO, to Achilles Macris and Javier Martin-Artajo, CIO, "I was confused by the inc[re]ased position noted today after yesterday's exhaustive meeting," JPM-CIO 0003492. For more about this meeting, see Chapter IV.

acquisition of additional long positions, the $600 million to $800 million lag described in the prior day's email, or the traders' use of more favorable derivative prices to minimize reported SCP losses.[536]

The next day, March 22, 2012, the CIO traders acquired still more long positions. As recounted in the daily email explaining the SCP's profit-loss status:

> "Again, the book is getting hurt with losses in index forward spreads in S9 and IG9, and in tranches (Weaker CDX.HY equity and mezzanine tranches, steeper IG9 equity tranches). Today we sold protection in the following index: iTraxx.Main (5.65B), iTraxx.Xover (300M), CDX.IT (3.95B) and FINSUB (100M). Besides providing carry, these trades should reduce the VaR, but increase the IRC. We are pausing in our sale of protection, to see what the overall impact on capital numbers is going to be."[537]

Ms. Drew, who had met with Mr. Macris and Mr. Martin-Artajo the prior day, expressed "confusion" over the SCP's increased positions.[538] According to both Ms. Drew and the bank, at the March 21 meeting, she had been given SCP trading data as of March 7, and was told nothing about the intense trading activity which had taken place over the following two weeks and further enlarged the SCP book.[539] On March 22, 2012, her reaction to the increased positions prompted one CIO risk manager to email another: "Ina is freaking – really! Call me."[540]

The CIO's massive purchases in March magnified the SCP's risks and later its losses. Overall, according to JPMorgan Chase, by the end of March, the Synthetic Credit Portfolio had swollen in notional value to $157 billion, three times greater than the $51 billion it held at the end of 2011, just three months earlier.[541] When asked for more detail, JPMorgan Chase told the Subcommittee that, at the end of March, the SCP included $62 billion in IG index holdings, $71 billion in iTraxx index holdings, $22 billion in High Yield index holdings, and a variety

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536 Subcommittee interview of Ina Drew, CIO (12/11/2012). For more information on the traders' pricing practices, see Chapter IV.
537 See 3/22/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, "CIO Core Credit P&L Predict [22 Mar]: +$82k (dly) -$276,990k (ytd)," JPM-CIO-E 00014689-691, at 691.
538 See 3/22/2012 email from Ina Drew, CIO, to Achilles Macris and Javier Martin-Artajo, CIO, "I was confused by the inc[re]ased position noted today after yesterday's exhaustive meeting," JPM-CIO 0003492; see also Subcommittee interview of Ina Drew, CIO (12/11/2012).
539 Subcommittee interview of Ina Drew, CIO (12/11/2012); 2013 JPMorgan Chase Task Force Report, at 44. See also 6/29/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, OCC, and others, "2nd Wilmer Hale Call," OCC-SPI-00071386.
540 3/22/2012 email from Irvin Goldman, CIO to Peter Weiland, CIO, "I would really like to understand the increase in positions in credit," JPM-CIO-PSI 0000410.
541 "Summary of Positions by Type and Series," prepared by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037609.

of other synthetic credit derivatives.[542] Other contemporaneous internal bank documents provide even larger figures. For example, an April 2012 analysis stated that, at the end of March, the SCP held an $82 billion long position in the IG9 index alone,[543] which comprised over half the market in that index.[544] The differing figures over the SCP's holdings are an indicator of not only how poor the SCP recordkeeping was, but also how quickly the portfolio was changing and how imprecise existing systems are for valuing derivative positions. Ms. Drew told the Subcommittee that she had become increasingly frustrated at the shifting numbers and capital calculations of the SCP as the quarter drew to a close, which she felt made her look "incompetent" for being unable to calculate the SCP's RWA.[545]

The end result was that what had begun as a small, experimental portfolio in 2006, had ballooned into a massive, high risk portfolio in 2012. In addition, by the end of March 2012, Mr. Iksil had acquired so many long index instruments that the SCP – which had traditionally held a net short position to provide protection against credit risks for the bank – had flipped and held a net long position.[546] In other words, overall, the SCP book held a long credit position at the same time as the bank, instead of holding the opposite position as a hedge.

Ms. Drew told the Subcommittee that being long was "not terrible" given that the credit market was rallying and short positions had lost so much value, but she conceded that the index positions were longer than necessary to "balance the book."[547] According to the CIO's longtime CFO, Joseph Bonocore, the SCP book had always held a net short

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[542] Id.

[543] 4/10/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, "Net positions vs. average trading volumes," JPM-CIO-PSI 0001026. See also 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," conveying presentation entitled, "Core Credit Book Highlights," prepared by Mr. Iksil, at JPM-CIO-PSI 0000101 (reciting even larger SCP positions in January, including a $278 billion notional position in the IG9 index, $115 billion notional position in the HY10 and 11 indices, and $90 billion notional position in the Main ITraxx S9). See also FDIC presentation, "JPMC & COMPANY CIO Synthetic Credit Portfolio," FDICPROD-0001783, at 22 (indicating JPMorgan Chase had estimated that its IG9 position was $82 billion notional in March); FDICPROD 0039218-219, at 218 (estimating the notional value of the SCP's long position in the IG9 alone was $75 billion).

[544] See DTCC presentation to Subcommittee (9/27/2012), at 2, PSI-DTCC-01-000001 (showing total CDX IG9 untranched trading to total approximately $150 billion).

[545] Subcommittee interview of Ina Drew, CIO (12/11/2012).

[546] See 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "CIO," JPM-CIO-PSI 0000546; 4/16/2012 email from Joseph Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, "materials for Fed/OCC/FDIC call at noon today," OCC-SPI-00009712; Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot and Harry Weiss); Subcommittee interviews of Ina Drew, CIO (9/7/2012), John Hogan, JPMorgan Chase (9/4/2012), and Michael Kirk, OCC (8/22/2012); 2013 JPMorgan Chase Task Force Report, at 43 (quoting an unnamed CIO trader, likely Bruno Iksil, saying on March 23: "[I] switched the book to long risk[.] [I] am done."), at 45 (indicating SCP had "assumed an overall net-long credit risk orientation").

[547] Subcommittee interview of Ina Drew, CIO (9/7/2012).

position when he was there, and he observed that a net long position could not serve as an effective hedge.[548] Mr. Martin-Artajo told the JPMorgan Chase Task Force investigation that, while he believed that the long position was necessary to stabilize the book, being long did not serve the mission of the SCP.[549]

(4) Phones Down

On March 23, 2012, Ms. Drew ordered the CIO traders to "put phones down" and stop trading.[550] According to Ms. Drew, she took that action during a video conference meeting with CIO personnel in London attended by Mr. Macris, Mr. Martin-Artajo, Mr. Iksil, and other CIO staff.[551] She explained that Mr. Martin-Artajo had told her that they were trading in the market to "defend" their positions.[552] Ms. Drew said that he had told her that counterparties were increasingly pushing the valuation of the positions, and by "defending," CIO could push back.[553] Ms. Drew told the Subcommittee that, in her view, "you buy or sell something based on value, not to defend your position,"[554] an approach that Mr. Iksil confirmed as reflective of her philosophy.[555] The CIO's Chief Risk Officer, Irvin Goldman, communicated her order in an email to the credit traders, writing: Ms. Drew "**does not want any trades executed until we discuss it**."[556]

Another development occurring at the same time also signaled the increasing risk in the SCP book.[557] On March 22, 2012, the SCP breached a key risk limit known as "CSW10."[558] Two other risk limits, VaR and CS01, had been breached earlier in the year, but Ms. Drew told

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548 Subcommittee interview of Joseph Bonocore, CIO (9/11/2012).
549 JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
550 Subcommittee interviews of Ina Drew, CIO (9/7/2012) and Irvin Goldman, CIO (9/15/2012); JPMorgan Chase Counsel interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012); 2013 JPMorgan Chase Task Force Report, at 45.
551 Subcommittee interviews of Ina Drew, CIO (9/7/2012) and (12/11/2012).
552 Id.
553 Subcommittee interview of Ina Drew, CIO (12/11/2012). See also 6/29/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, OCC, and others, "2nd Wilmer Hale Call," OCC-SPI-00071386 (describing the traders' actions in March to acquire still more positions: "Traders were intentionally doing larger notionals to drive the market their way. They talked about 'taking the P/L pain' versus the risk of building larger positions.").
554 Subcommittee interview of Ina Drew, CIO (9/7/2012).
555 JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
556 3/26/2012 email from Irvin Goldman, CIO, to Achilles Macris, Javier Martin-Artajo, and John Wilmot, CIO, "Tranche Plan," JPM-CIO-PSI 0001267. [Emphasis in original.]
557 5/9/2012 email from Michael Kirk, OCC, to James Hohl, OCC, "Document 1," OCC-SPI-00021996, at 997.
558 Id.

the Subcommittee that she considered the CSW10 to be the "overriding" limit.[559]

About a week later, on March 30, 2012, Achilles Macris sent an email to the bank's Chief Risk Officer, John Hogan, stating that he had "lost confidence" in his team and requesting "help with the synthetic credit book."[560] Mr. Macris reported:

> "Just spoke to Ashley [Bacon] regarding the issue and he has agreed to dedicate Olivier to help us with RWA targeting for Q2. ... [T]he objective is to determine what is the best course of action to insure that the book is and remains balanced in risk and P+L terms. ... [C]learly, we are in crisis mode on this."[561]

The OCC told the Subcommittee that, after reviewing the SCP's swollen portfolio and trading activities, it was clear that the CIO traders had made trades that violated the CIO's risk limits with "aggressive positions" in a way that was "unsafe and unsound."[562] The OCC also said that the credit trades taken on were "risk additive" rather than "risk reducing."[563] One OCC regulator said that the trades had so many dimensions of risk that "no matter what happened, they would lose money."[564]

The order to stop trading prevented the CIO traders from expanding the SCP still further, but came too late to prevent the losses caused by the positions already acquired. In fact, when the CIO traders stopped trading, the losses increased.[565] The year-to-date losses reported by the CIO climbed from $719 million in March, to $2.1 billion in April, to $4 billion in May, to $4.4 billion in June, and then to $6.2 billion in September.[566] Since JPMorgan Chase transferred many SCP index

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559 Subcommittee interview of Ina Drew, CIO (9/7/2012). For more information on risk limits breached by the SCP, see Chapter V.

560 3/30/2012 email from Achilles Macris, CIO, to John Hogan, JPMorgan Chase, "synthetic credit- crisis action plan," JPM-CIO-PSI 0001220.

561 3/30/2012 email from Achilles Macris, CIO, to Irvin Goldman, CIO, copies to Ina Drew, CIO, and others, "synthetic credit – crisis action plan," JPM-CIO-PSI 0001220-222, at 221. See also 2013 JPMorgan Chase Task Force Report, at 45-46.

562 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). See also 11/6/2012 OCC Supervisory Letter JPM-2012-52, "Chief Investment Office Risk Management Review," PSI-OCC-17-000015 [Sealed Exhibit] ("Board and senior management did not ensure effective oversight of CIO activities. ... Our examinations of Model Approvals and Risk Weighted Assets, Audit Coverage, CIO Risk Management, VAR Model Risk Management, and CIO Valuation Governance disclosed specific weakness that created an unsafe and unsound environment.").

563 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

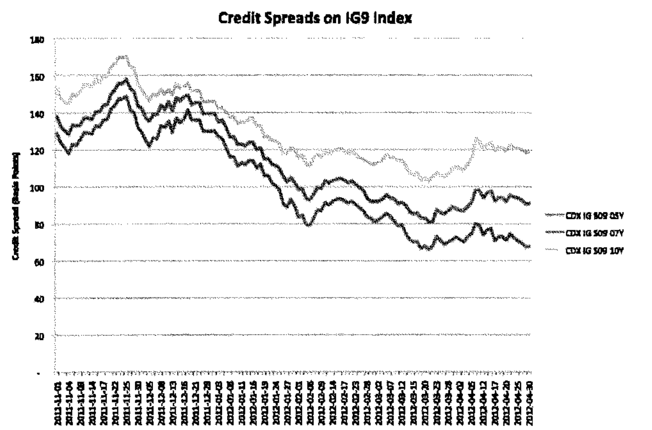
564 Subcommittee interview of Michael Sullivan, OCC (8/30/2012).

565 JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).

566 See chart, prepared by the Subcommittee and printed in Chapter IV, tracking SCP's daily reported profit and losses (P&L) from January to May 15, 2012, derived from an OCC spreadsheet, OCC-SPI-00000298. Numbers do not reflect restated P&L figures after JPMorgan

positions to its Investment Bank on July 2, 2012, the total amount of losses associated with the Synthetic Credit Portfolio will likely never be known.[567]

One key area of inquiry with respect to the SCP losses has focused on the CIO's massive long position in the IG9 index. To help explain what happened, JPMorgan Chase provided the Subcommittee with a chart showing how the credit spreads – the premium amounts charged to obtain long IG9 credit protection – generally declined from November 2011 through April 2012. In particular, the chart shows a general decline in spreads from January 2012 until March 23, 2012, the day Ina Drew told the traders to stop trading, after which the prices began to rebound.[568]



Confidential Treatment Requested by J.P. Morgan Chase & Co. JPM-CIO-PSI-0002062

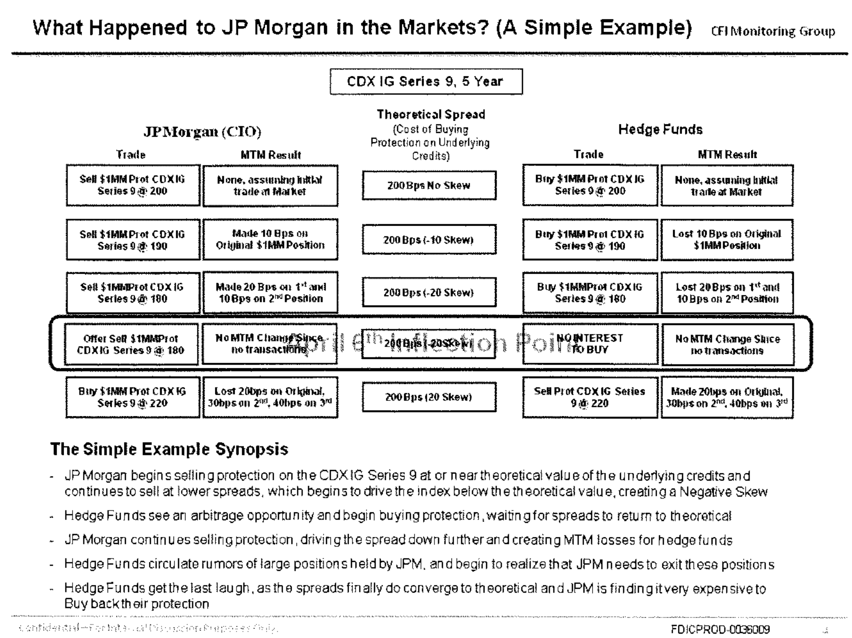
At first, the general downward trajectory of the IG9 prices over the first quarter of 2012 allowed the CIO to post mark-to-market gains on its IG9 holdings. The FDIC chart below explains how based on a series of theoretical spreads. If the CIO entered into a contract to sell a certain

Chase's restatement in July 2012. See also JPMorgan Chase & Co. Form 10-Q (for period ending 9/30/2012), filed with the SEC (11/08/2012), at 10, 220.

567 Subcommittee interview of Elwyn Wong, OCC (8/20/2012); 2013 JPMorgan Chase Task Force Report, at 110; JPMorgan Chase & Co. Form 10-Q (for period ending 9/30/2012), filed with the SEC (11/08/2012), at 8 ("Principal transactions in CIO included $449 million of losses on the index credit derivative positions that had been retained by it following the transfer of the synthetic credit portfolio to IB on July 2, 2012, reflecting credit spread tightening during the quarter.").

568 Undated chart entitled, "Credit Spreads on IG9 Index," prepared by JPMorgan Chase, JPM-CIO-PSI-0002062.

amount of IG9 protection at 200 basis points (meaning the counterparty would pay 200 basis points in periodic premiums to the CIO), and the market price for that protection subsequently dropped to 190 basis points, the CIO would receive 200 basis points for protection subsequently valued at 190 basis points – a mark-to-market gain of 10 basis points. If the CIO then entered into another contract to sell protection at 190 basis points, and the market price dropped to 180 basis points, the CIO would be able to post mark-to-market gains of 20 basis points on the first contract, and 10 basis points on the second contract. In addition, the CIO sold such massive amounts of credit protection that, according to some market participants, it drove down the overall IG9 market price, which caused the CIO's earlier acquisitions to continue to gain in value and post even more mark-to-market gains.



Source: 07/16/2012 FDIC presentation, "What Happened in JP Morgan's CIO? A Primer," at 4, FDICPROD-0036009.

But posting gains in its IG holdings by driving down the premium prices (credit spreads), was not enough, because the CIO's other holdings, such as its short positions in the high yield indices, were posting losses even more quickly. In addition, the IG9 gains themselves were under pressure. One journalist described the CIO's IG9 trading strategy as playing a game of "chicken" with its counterparties, most of whom were hedge funds. As Mr. Iksil amassed an increasingly enormous IG9 position:

> "Other people in the markets - like hedge funds and other traders - thought Iksil was being ridiculously overconfident. Waiting for the giant Iksil's [bet] to fail, the anti-Iksil team took the other side of the bet. The rival traders bought credit-default swaps on the Index. They also bought protection on the underlying corporate bonds to influence the value of those as well. Their hope was that Iksil's bet would go down in value; then he would have to run to them to *buy* credit-default swaps to cover his rear and keep his bet even. They outsmarted Iksil. As he kept digging himself deeper into his position, he got backed into a corner and couldn't cover his losses."[569]

When Ms. Drew ordered the trades to stop, the SCP book had to begin absorbing the losses that came when the IG9 price began to rise and the CIO traders were no longer taking actions to reduce the losses that had to be booked.

Although Mr. Dimon told the Subcommittee that, in March, the CIO traders were simply defending their positions without manipulating any market prices,[570] once they stopped selling large amounts of IG9 protection, the bank's own chart shows that the prices – the premiums or credit spreads paid for that protection – began to rise.[571] JPMorgan Chase acknowledged as much, when a representative explained that when the CIO stopped trading, it stopped "supporting the price."[572] An OCC examiner also told the Subcommittee that the traders, by increasing volume at the end of the month, were artificially driving the prices lower.[573] Once the IG9 premiums began to rise, the value of the CIO's IG9 holdings fell, adding to the SCP's problems. Those problems only worsened when Mr. Iksil's massive positions were reported in the press two weeks later.

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[569] "JPMorgan's Loss: The Explainer," Marketplace, Heidi N. Moore, (5/11/2012), http://www.marketplace.org/topics/business/easy-street/jp-morgans-loss-explainer.

[570] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

[571] Undated chart entitled, "Credit Spreads on IG9 Index," prepared by JPMorgan Chase, JPM-CIO-PSI-0002062.

[572] Levin Office briefing by JPMorgan Chase (6/26/2012) (Greg Baer).

[573] Subcommittee interview of James Hohl, OCC (9/6/2012).

E. Unmasking JPMorgan Chase

By the time Ms. Drew ordered the traders to stop trading, the book was, by the traders' own account, "huge"[574] and "more and more monstrous."[575] The JPMorgan Chase official charged with conducting the internal investigation of the SCP described the book as having grown to a "perilous size."[576] As Mr. Iksil had warned in January, the "scary" notionals produced price "volatility" which, in turn, produced hundreds of millions of dollars in losses.

An additional consequence of the size of the positions was that the CIO's positions became visible to the rest of the market. Mr. Iksil had expressed for some time a concern that the traders on the opposite side were moving against him.[577] In January, he had predicted a fight in March.[578] By mid-March, in an effort to be less visible, Mr. Iksil had begun to purchase long positions in newly issued credit indices instead of in the IG9, where the SCP already held massive positions.[579] Yet even there, the SCP's massive buys attracted market attention.

By early April, press speculation about the large trades in the credit markets was building. On April 4, 2012, Peter Weiland, the head of market risk for the CIO, received a call from a reporter at the Wall Street Journal indicating that the paper was working on a story about Bruno Iksil and the CIO.[580] The next day, JPMorgan Chase's head of Corporate Communications, Joe Evangelisti, sent an email to management describing the upcoming article. He wrote: "[T]hey are saying that Iksil currently has more than $200 billion in positions in credit trading products and has made JPM more than $600 million in profits over the past two years."[581]

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[574] 3/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "First draft of the presentation," conveying "CIO Synthetic Credit Update," JPM-CIO-PSI 0001249.
[575] Recorded telephone conversation between Bruno Iksil, CIO, and Julien Grout, CIO (3/16/2012), JPM-CIO-PSI-H 0003820-822.
[576] Michael Cavanagh, quoted in "JPMorgan's 'Whale' Loss Swells to $5.8 billion," Financial Times, Tom Braithwaite, (7/13/2012).
[577] See, e.g.,1/30/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "there is more loss coming in the core credit book," JPM-CIO-PSI 0001225 ("The guys have a huge skew trade on and they will defend it as much as we do .... It is pointless to go for a fight."); 1/30/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "core credit," JPM-CIO-PSI 0001226 ("they really push against our positions here everywhere. there is more pain to come in HY too.").
[578] 1/31/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "hello, quick update in core credit...," JPM-CIO-PSI 0001229 ("I went to ISMG and advised that we set the book for long risk carry the time for us to see whether we really need to fight in mars.").
[579] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot); JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[580] 4/4/2012 email from Peter Weiland, CIO, to Irvin Goldman, CIO, "Call," JPM-CIO-PSI-H 0002093.
[581] 4/5/2012 email from Joseph Evangelisti, JPMorgan Chase, to Ina Drew, CIO, Douglas Braunstein, JPMorgan Chase, and others, "WSJ/Bloomberg CIO stories," JPM-CIO-PSI 0000543-545, at 544.

On April 6, 2012, both Bloomberg and the Wall Street Journal ran articles on Mr. Iksil's trading. The Bloomberg story, entitled "JPMorgan Trader's Positions Said to Distort Credit Indexes," began:

> "A JPMorgan Chase & Co. (JPM) trader of derivatives linked to the financial health of corporations has amassed positions so large that he's driving price moves in the $10 trillion market, traders outside the firm said."[582]

Identifying Mr. Iksil, the article cited investors as complaining that his trades "may be distorting prices, affecting bondholders who use the instruments to hedge hundreds of billions of dollars of fixed-income holdings."[583] More specifically, according to the article, two hedge-fund traders said they had seen "unusually large price swings when they were told by dealers that Mr. Iksil was in the market. At least some traders refer to Mr. Iksil as 'the London Whale.'"[584] The article also said the size of the position could have been as large as $100 billion.[585]

The Wall Street Journal article, entitled "London Whale Rattles Debt Market," told a similar tale.[586] The article stated:

> "[In] recent weeks, hedge funds and other investors have been puzzled by unusual movements in some credit markets, and have been buzzing about the identity of a deep-pocketed trader dubbed 'the London Whale.' That trader, according to people familiar with the matter, is a low-profile, French-born J.P. Morgan Chase & Co. employee named Bruno Michel Iksil. Mr. Iksil has taken large positions for the bank in insurance-like products called credit-default swaps. Lately, partly in reaction to market movements possibly resulting from Mr. Iksil's trades, some hedge funds and others have made heavy opposing bets, according to people close to the matter. Those investors have been buying default protection on a basket of companies' bonds using an index of ... CDS. Mr. Iksil has been selling the protection, placing his own bet that the companies won't default."

The article also asserted that the hedge funds were betting against Mr. Iksil, hoping to force him to reduce some of his holdings, which would result in gains for them and losses for JPMorgan Chase.[587] The article

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582 "JPMorgan Trader's Positions Said to Distort Credit Indexes," Bloomberg , Stephanie Ruhle, Bradley Keoun, and Mary Childs, (4/6/2012), http://www.bloomberg.com/news/2012-04-05/jpmorgan-trader-iksil-s-heft-is-said-to-distort-credit-indexes.html.
583 Id.
584 Id.
585 Id.
586 "London Whale Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne, (4/6/2012), http://online.wsj.com/article/SB10001424052702303299604577326031119412436.html.
587 Id.

identified the IG9 credit index as the credit instrument whose price some traders believed may have been "moved" by the size of Mr. Iksil's trades.[588] The article closed by noting that the notional volume in IG9 trades had "ballooned to $144.6 billion on March 30 from $92.6 billion at the start of the year."[589]

Because of the Easter holiday in Europe, the first day of trading after the articles appeared was April 10, 2012. The CIO reported a $412 million SCP loss that day, more than senior management had expected.[590]

F. Dismantling the SCP

After the whale trades became public knowledge, JPMorgan Chase ordered a team of derivatives experts from the bank's Investment Bank to analyze the CIO's Synthetic Credit Portfolio.[591] At a later Senate hearing, Mr. Dimon explained what they found as follows:

> "In December 2011, as part of a firm wide effort and in anticipation of new Basel Cap[ital] 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 [m]any positions that it did believe 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. ... CIO's strategy for reducing the Synthetic Credit Portfolio was poorly conceived and vetted."[592]

In another context, Mr. Dimon was even more blunt:

> "We made a terrible, egregious mistake. There is almost no excuse for it. We knew we were sloppy. We know we were stupid. We know there was bad judgment. In hindsight, we

[588] Id.
[589] Id.
[590] 4/10/2012 email from Douglas Braunstein, JPMorgan Chase, to John Hogan, JPMorgan Chase, "Credit," JPM-CIO-PSI-H 0002276 (upon receiving notice of the $412 million loss, Mr. Braunstein responded: "A bit more than we thought," to which Mr. Hogan replied: "Lovely").
[591] On April 27, 2012, Chief Risk Officer John Hogan sent his Deputy Risk Officer Ashley Bacon to London, along with Rob O'Rahilly from the Investment Bank, and Olivier Vigneron, London Head of Model Risk and Development, to analyze every position in the SCP. Subcommittee interviews of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) and Ashley Bacon, JPMorgan Chase (9/5/2012) (he told the Subcommittee that, beginning on April 27, his work on the SCP became "all consuming"); Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss); 2013 JPMorgan Chase Task Force Report, at 71.
[592] Testimony of Jamie Dimon, "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012).

> took far too much risk. That strategy we had was badly vetted. It was badly monitored. It should never have happened."[593]

Mr. Dimon directed his team of derivative experts to dismantle the CIO's Synthetic Credit Portfolio.[594] At its height in March 2012, the portfolio included holdings of more than 100 types of credit derivatives, almost all index or tranche holdings, most of which had lost value since their acquisition. The bulk of the SCP credit derivatives were transferred to the Investment Bank, which closed out most of the positions; about $12 billion in notional amount was left with the CIO which closed out those positions by the end of September.[595] Unwinding those positions led the CIO to report another $449 million loss.[596]

The escalating losses during 2012, which outpaced all predictions, provide concrete proof of the high risk nature of the Synthetic Credit Portfolio. In January 2012, the SCP book lost $100 million, with the largest daily loss during that month reaching $23 million on January 30. In February, the book lost another $69 million, with the largest daily loss of $24 million on February 8. In March, the SCP's reported losses increased nearly eightfold, to $550 million, with the month's largest loss taking place on the last business day, March 30, 2012, of $319 million. The losses continued for the next six months. At the end of April, the CIO reported year-to-date losses totaling $2.1 billion. On May 11, the SCP reported its largest single daily loss of $570 million. In July 2012, the bank restated the first quarter's financial results, disclosing additional unreported losses of $660 million, and a year-to-date total of $4.2 billion. As of September 2012, the bank reported additional SCP losses of $449 million. By December, year-to-date losses from the whale trades exceeded $6.2 billion, or approximately 45% of the bank's pre-tax earnings through September,[597] with another $1 billion possible.[598] To date, the SCP book has lost more than three times the revenues it produced in its first five years combined.

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[593] Statement by Jamie Dimon, quoted by Chairman Tim Johnson at "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012).
[594] See JPMorgan Chase & Co. Form 10-Q (for period ending 9/30/2012), filed with the SEC (11/08/2012), at 10.
[595] Id., at 220.
[596] Id.
[597] See 12/12/2012 OCC Supervisory Letter, JPM-2012-66, PSI-OCC-18-000001 [Sealed Exhibit].
[598] See, e.g., "Mortgage Lending Helps JPMorgan Profit Rise 34%," New York Times (10/12/2012), http://dealbook.nytimes.com/2012/10/12/jpmorgan-quarterly-profit-rises-34/?ref=global.

CIO Synthetic Credit Portfolio Reported Mark-To-Market Losses January - December 2012

Month or Quarter End	Monthly or Quarterly Losses	Cumulative Losses YTD
January	$ 100 million	$ 100 million[599]
February	$ 69 million	$ 169 million
March	$ 550 million	$ 719 million
April	$ 1.413 billion	$ 2.132 billion
As of May 15	$ 1.563 billion	$ 3.695 billion
June	Not available	$ 4.4 billion[600]
July restatement of first quarter losses	$ 660 million[601]	$ 5.8 billion[602]
September	$ 449 million[603]	$ 6.2 billion
December	Not available	$ 6.2 billion[604]

Source: JPMorgan Chase & Co. 2012 SEC filings; OCC spreadsheet, OCC-SPI-00000298.

G. Analysis

JPMorgan Chase is the largest derivatives dealer in the United States, with years of experience in trading credit derivatives. At times, bank representatives told the Subcommittee that the synthetic credit derivatives traded by the CIO should be viewed as an effective risk management tool designed to lower the bank's overall credit risk. The facts associated with the whale trades, however, prove otherwise. They show how credit derivatives, when purchased in massive quantities, with multiple maturities and reference entities, produce a high risk portfolio that even experts can't manage. Step by step, the bank's high paid credit derivative experts built a derivatives portfolio that encompassed hundreds of billions of dollars in notional holdings and generated billions of dollars in losses that no one predicted or could stop. Far from reducing or hedging the bank's risk, the CIO's Synthetic Credit Portfolio functioned instead as a high risk proprietary trading operation that had no place at a federally insured bank.

The whale trades also demonstrate how risk can be misunderstood, manipulated, and mishandled when a bank claims to have been using derivative trades to lower its overall risk, but has no contemporaneous

599 For losses from January through May 15, 2012, see OCC spreadsheet, OCC-SPI-00000298.
600 JPMorgan Chase & Co. Form 10-Q for quarterly period ending 6/30/2012, at 6, 11.
601 JPMorgan Chase & Co. Form 8-K, (7/13/2012), at 2.
602 Testimony of Michael J. Cavanagh, Co-Chief Executive Officer, Corporate and Investment Bank, JPMorgan Chase, "JPMorgan Chase Whale Trades: A Case History of Derivatives Risks & Abuses," before the U.S. Senate Permanent Subcommittee on Investigations (March 15, 2013).
603 JPMorgan Chase & Co. Form 10-Q for quarterly period ending 9/30/2012, at 10, 12.
604 12/12/2012 OCC Supervisory Letter, JPM-2012-66, PSI-OCC-18-000001 [Sealed Exhibit]. The $6.2 billion did not change from September, apparently because, by then, the SCP had been largely dismantled and most of its positions transferred to the Investment Bank.

records detailing the risk reduction strategy or the assets being hedged, no analysis showing how the size and nature of the hedge were determined, and no tests gauging the hedge's effectiveness. Hedging claims require those types of contemporaneous records in order to be substantiated. In addition, the fact that the OCC was not fully aware of the Synthetic Credit Portfolio for years, because its performance data was subsumed within a larger investment portfolio, highlights the need for improved derivatives data to ensure the OCC can detect and oversee all substantial derivatives portfolios being traded by a bank through a U.S. or foreign office.

IV. HIDING LOSSES

In its first four years of operation, the Synthetic Credit Portfolio produced positive revenues, but in 2012, it opened the year with sustained losses. In January, February, and March, the days reporting losses far exceeded the days reporting profits, and there wasn't a single day when the SCP was in the black. To minimize its reported losses, the CIO began to deviate from the valuation practices it had used in the past to price credit derivatives. In early January, the CIO had typically established the daily value of a credit derivative by marking it at or near the midpoint price in the daily range of prices (bid-ask spread) offered in the marketplace. Using midpoint prices had enabled the CIO to comply with the requirement that it value its derivatives using prices that were the "most representative of fair value." But later in the first quarter of 2012, instead of marking near the midpoint, the CIO began to assign more favorable prices within the daily price range (bid-ask spread) to its credit derivatives. The more favorable prices enabled the CIO to report smaller losses in the daily profit/loss (P&L) reports that the SCP filed internally within the bank.

The data indicates that the CIO began using more favorable valuations in late January and accelerated that practice over the next two months. By March 15, 2012, two key participants, Julien Grout, a junior trader charged with marking the SCP's positions on a daily basis, and his supervisor, Bruno Iksil, head trader in charge of the SCP book, were explicit about what they were doing. As Mr. Grout told Mr. Iksil in an instant message conversation: "[I] am not marking at mids as per a previous conversation."[605] The next day, Mr. Iksil expressed to Mr. Grout his concerns about the growing discrepancy between the marks they were reporting versus those called for by marking at the midpoint prices: "I can't keep this going .... I think what he's [their supervisor, Javier Martin-Artajo] expecting is a re-marking at the end of the month .... I don't know where he wants to stop, but it's getting idiotic."[606]

For five days, from March 12 to 16, 2012, Mr. Grout prepared a spreadsheet tracking the differences between the daily SCP values he was reporting and the values that would have been reported using midpoint prices. According to the spreadsheet, by March 16, 2012, the Synthetic Credit Portfolio had reported year-to-date losses of $161 million, but if midpoint prices had been used, those losses would have swelled by at least another $432 million to a total of $593 million. CIO head Ina Drew told the Subcommittee that it was not until July 2012, after she had left the bank, that she became aware of this spreadsheet

[605] 3/15/2012 instant messaging session among Bruno Iksil, CIO, Julien Grout, CIO, and Luis Buraya, CIO, JPM-CIO-PSI-H 0003798-819, at 805.

[606] 3/16/2012 transcript of recorded telephone conversation between Bruno Iksil, CIO, and Julien Grout, CIO, JPM-CIO-PSI-H 0003820-822, at 821.

and said she had never before seen that type of "shadow P&L document."

On March 20, 2012, in a lengthy telephone conversation, Mr. Iksil told his supervisor, Mr. Martin-Artajo, that in an effort to begin to show the SCP's losses he had issued a profit/loss (P&L) report disclosing not only a $40 million SCP loss for the day, but also projecting a "material" P&L "lag" of $600 to $800 million. Mr. Martin-Artajo expressed dismay at disclosing large losses prior to a meeting scheduled the next day to discuss the SCP with Ms. Drew. Ms. Drew told the Subcommittee that, despite the P&L report, the traders' growing agitation over underreporting SCP losses, and an "exhaustive" meeting on the SCP, she did not learn at that time that the CIO London team was mismarking the SCP book.

On March 23, Mr. Iksil estimated in an email that the SCP had lost about $600 million using midpoint prices and $300 million using the "best" prices, but the SCP reported a daily loss of only $12 million. On March 30, the last business day of the quarter, the CIO suddenly reported a daily loss of $319 million, a loss six times larger than any prior day. But even with that outsized reported loss, a later analysis by the CIO's Valuation Control Group (VCG) noted that, by March 31, 2012, the cumulative difference in the SCP's P&L figures between using midpoint prices versus more favorable prices totaled $512 million.

On April 10, 2012, the CIO initially reported an estimated daily loss of $6 million, but 90 minutes later, after a confrontation between two CIO traders, issued a new P&L report estimating a loss of $400 million. That change took place on the first trading day after the whale trades gained media attention; one CIO trader later said CIO personnel were "scared" at the time to hide such a large loss. As a result, the SCP internally reported year-to-date losses of about $1.2 billion, crossing the $1 billion mark for the first time.

One result of the CIO's using more favorable valuations was that two different business lines within JPMorgan Chase, the Chief Investment Office and the Investment Bank, assigned different values to identical credit derivative holdings. At one point, the CIO accused the Investment Bank, which was a counterparty to some of its trades, of damaging the CIO by using different marks and leaking the CIO's positions to the marketplace, accusations it later dropped. Other CIO counterparties also noticed the price differences between the two business lines and objected to the CIO's values, resulting in collateral disputes peaking at $690 million. In May, the bank's Deputy Chief Risk Officer, Ashley Bacon, directed the CIO to mark its books in the same manner as the Investment Bank, which used an independent pricing service to identify the midpoints in the relevant price ranges. That change in valuation methodology resolved the collateral disputes in favor of the CIO's counterparties and, at the same time, put an end to the CIO's mismarking.

On May 10, 2012, the bank's Controller issued an internal memorandum summarizing a special assessment of the SCP's valuations from January through April. Although the memorandum documented the CIO's use of more favorable values through the course of the first quarter, and a senior bank official even privately confronted a CIO manager about using "aggressive" prices in March, the memorandum generally upheld the CIO valuations because, on their face, the prices generally fell within the daily price range (bid-ask spread) for the relevant derivatives. The bank memorandum observed that the CIO had reported about $500 million less in losses than if it had used midpoint prices for its credit derivatives, and even disallowed and modified a few prices that had fallen outside of the permissible price range (bid-ask spread), yet found the CIO had acted "consistent with industry practices."

The sole purpose of the Controller's special assessment was to ensure that the CIO had accurately reported the value of its derivative holdings, since those holdings helped determine the bank's overall financial results. The Controller determined that the CIO could properly report a total of $719 million in losses, instead of the $1.2 billion that would have been reported if midpoint prices had been used. That the Controller essentially concluded the SCP's losses could legitimately fall anywhere between $719 million and $1.2 billion exposes the subjective, imprecise, and malleable nature of the derivative valuation process.

The bank told the Subcommittee that, despite the overly favorable pricing practices noted in the May memorandum and the collateral disputes resolved in favor of the CIO's counterparties, it did not view the CIO as having engaged in any mismarking until June 2012, when its internal investigation began reviewing CIO recorded telephone calls and heard CIO personnel disparaging the very marks they were reporting. On July 13, 2012, the bank restated its first quarter earnings, reporting additional SCP losses of $660 million. JPMorgan Chase told the Subcommittee that the decision to restate its financial results was a difficult one, because $660 million was not clearly a "material" amount for the bank, and the valuations used by the CIO did not clearly violate bank policy or generally accepted accounting principles since they used prices that were generally within the daily price range (bid-ask spread) for the relevant credit derivatives. The bank told the Subcommittee that the key consideration leading to the restatement of the bank's losses was its determination that the London CIO personnel had not acted in "good faith" when marking the SCP book, which meant the SCP valuations had to be revised. Essentially, the CIO traders had failed to use the price "that is most representative of fair value in the circumstances" as required by bank policy and generally accepted accounting principles.

The ability of CIO personnel to hide hundreds of millions of dollars of additional losses over the span of three months, and yet survive valuation reviews by both internal and external accounting experts, shows how imprecise, undisciplined, and open to manipulation the current process is for valuing derivatives. This weak valuation process is all the more troubling given the high risk nature of synthetic credit derivatives, the lack of any underlying tangible assets to stem losses, and the speed with which substantial losses can accumulate and threaten a bank's profitability. The whale trades' bad faith valuations exposed not only misconduct by the CIO and the bank's violation of the derivative valuation process mandated in generally accepted accounting principles, but also a systemic weakness in the valuation process itself for derivatives.

In compiling the information for this section of the Report, as explained earlier, the Subcommittee was unable to interview the key CIO personnel involved in marking the SCP book and preparing the CIO's daily P&L statements, Achilles Macris, Javier Martin-Artajo, Bruno Iksil, and Julien Grout, each of whom declined to speak with the Subcommittee and remained outside the reach of the Subcommittee's subpoena authority. Mr. Macris was the head of the CIO's International Office. Mr. Martin-Artajo was the head of the CIO's equity and credit trading operation. Mr. Iksil was a senior CIO trader who oversaw the Synthetic Credit Portfolio. Mr. Grout was a more junior CIO trader specializing in credit derivatives and charged with preparing the SCP's daily marks.

A. Background

(1) Valuing Derivatives In General

Under U.S. Generally Accepted Accounting Principles (GAAP), at the close of every business day, companies that own derivatives, including credit derivatives, must establish their "fair value."[607] Under GAAP, fair value is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."[608] GAAP explains that deriving fair value "assumes a hypothetical transaction but is nonetheless a market-driven exercise using the best available information at hand."

[607] Accounting Standards Codification Topic 820-10-30, *Fair Value Measurements and Disclosures* (ASC 820).
[608] Id.

GAAP specifies a hierarchy of three categories of information that should be used when calculating the fair value of a derivative, placing a priority on observed market prices.[609] Level 1 consists of "quoted prices in active markets for identical assets or liabilities."[610] Level 2 consists of "inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly."[611] They include, for example, quoted prices for similar assets in either active or inactive markets. Level 3 consists of "unobservable inputs," such as pricing models used when no actual market prices are available.[612]

To establish the fair value of a derivative that is traded in a dealer's market, such as credit derivatives, GAAP focuses on the prices actually used by the dealers. Since those prices fluctuate over the course of the day, a key issue is what price to use within the daily range of prices being offered in the marketplace. The daily price range is often referred to as the "bid-ask spread," meaning the prices that dealers offer to buy or sell a derivative during the course of a trading day. GAAP states: "[T]he price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value."[613]

Determining what price within a given price range is "most representative of fair value in the circumstances" permits market participants to exercise a degree of subjective judgment. GAAP also supports using "mid-market pricing ... as a practical expedient for fair value measurements within a bid-ask spread."[614] By "mid-market pricing," it means the price in the middle of the day's price range. For that reason, many market participants routinely use the midpoint price of a derivative's bid-ask spread in their daily financial reporting. To supply that information, some firms that administer credit indices publish or provide clients with the daily bid-ask spread and midpoint price for derivatives of interest.[615] Some financial firms employ independent price reporting services to identify, for a fee, the bid-ask

[609] Accounting Standards Codification Topic 820-10-35-37, *Fair Value Measurements and Disclosures* (ASC 820).
[610] Accounting Standards Codification Topic 820-10-35-40, *Fair Value Measurements and Disclosures* (ASC 820).
[611] Accounting Standards Codification Topic 820-10-35-47, *Fair Value Measurements and Disclosures* (ASC 820).
[612] Accounting Standards Codification Topic 820-10-35-52, *Fair Value Measurements and Disclosures* (ASC 820).
[613] Accounting Standards Codification Topic 820-10-35-36C, *Fair Value Measurements and Disclosures* (ASC 820).
[614] Accounting Standards Codification Topic 820-10-35-36D, *Fair Value Measurements and Disclosures* (ASC 820).
[615] See, e.g., Markit Group, Ltd., a global financial information services company that administers multiple credit index products, and publishes the daily bid-ask spread and midpoint price for them on its website at www.markit.com. Markit Credit Indices: A Primer (October 2012), at 7, 12; see also http://www.markit.com/en/products/data/indices/credit-and-loan-indices/cdx/cdx-prices-iframe.page.

spread and midpoint prices of specified derivatives for use in their financial reporting.[616] Still other firms use their own personnel to identify the daily bid-ask spread and midpoint prices for their derivatives.

Although GAAP essentially provides a safe harbor for midpoint prices, it does not compel firms to use them. For example, if a trade were to occur late in the day at a price near the extreme end of the daily price range (bid-ask spread), GAAP would allow a market participant to use that price (versus the mid-price) if it were to determine that the end-of-day price was "most representative of fair value in the circumstances."[617]

Because GAAP requires derivative values to be recorded each business day in accordance with market values, derivatives are often characterized as "mark-to-market." The values or prices assigned to the derivatives each day are often referred to as the daily "marks." Under GAAP, the value of every derivative must be recorded or marked-to-market each day in a company's books, even if the derivative was not actually purchased, sold, or otherwise actively traded. The daily gain or loss is typically reported internally by each business line within a firm and rolled up into a firmwide daily profit and loss statement.

Because derivative values often fluctuate, parties to a derivative agreement often agree to post cash collateral on an ongoing basis to cover the cost of settling the derivatives contract. The amount of cash collateral that has to be posted typically changes periodically to reflect the fair value of the derivative. If a dispute arises over the value of the derivative and the amount of collateral to be posted, the parties typically negotiate a resolution of the "collateral dispute."

As part of establishing the fair value of derivatives, pricing adjustments are also sometimes made when the derivatives are, for example, traded in less liquid markets,[618] or are part of a large holding whose size might affect the price.[619] Parties with derivative portfolios

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[616] JPMorgan Chase's Investment Bank, for example, took this approach.

[617] Accounting Standards Codification Topic 820-10-35-24B, *Fair Value Measurements and Disclosures* (ASC 820).

[618] See Accounting Standards Codification Topic 820-10-35-54D, *Fair Value Measurements and Disclosures* (ASC 820) ("If a reporting entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed.").

[619] See, e.g., 2013 JPMorgan Chase Task Force Report, at 49, footnote 60 ("By convention, the exit price is estimated for normal trading size, and CIO was not required to estimate the prices it would have received if it attempted to sell its entire (large) position at once."). See also 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at 5, JPM-CIO 0003637-654, at 641 ("GAAP continues to permit size-based adjustments for derivatives portfolios if an election is made to do so.").

may also establish a reserve, known as a fair value adjustment, based on such considerations as the illiquidity of the market, the creditworthiness of its derivative counterparties, the extent to which it holds a concentrated block of assets, and the uncertainties associated with its pricing methodology.[620]

(2) Valuing Derivatives at JPMorgan Chase

Because JPMorgan Chase is one of the largest derivative dealers and traders in the world and the value of its derivatives holdings affect its financial results, it has longstanding policies and procedures on how to price its derivative holdings and report their fair value on the company's books. Its policies and procedures generally adhere closely to GAAP principles.

To determine fair value, for example, as summarized in a 2012 internal report examining SCP pricing, JPMorgan Chase policies reflect GAAP's accounting principles:

> "General
> Fair value is the price to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability (an exit price). The sale or transfer assumes an orderly transaction between market participants.
>
> Data Sources and Adjustments
> Valuation techniques used to measure the fair value of an asset or liability maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources. Valuations consider current market conditions and available market information and will, therefore, represent a market-based, not firm-specific, measurement.
>
> Where available, quoted market prices are the principal reference point for establishing fair value. Market quotation may come from a variety of sources, but emphasis is given to executable quotes and actual market transactions (over indicative or similar non-binding price quotes). In certain circumstances valuation adjustments (such as liquidity adjustments) may be necessary to ensure that financial instruments are recorded at fair value.
>
> Bid-offer spread and position size

[620] Subcommittee briefing by Public Company Accounting Oversight Board (9/14/2012).

> As further described in US GAAP Accounting Standards Codification Topic 820 Fair Value Measurement ('ASC 820'), the objective of a fair value measurement is to arrive at an appropriate exit price within the bid-offer spread, and ASC 820 notes that mid-market pricing may (but is not required to) be used a practical expedient."[621]

In its January 2013 report on the CIO whale trades, the JPMorgan Chase Task Force summarized the bank's derivatives valuation approach as follows: "[B]oth U.S. GAAP and Firm policy required that CIO make a good-faith estimate of the exit price for a reasonably sized lot of each position, and assign values reflecting those estimates."[622]

Since at least 2007, JPMorgan Chase policy has been to use midpoint prices as the "starting point" for valuing its derivatives:

> "The Firm makes markets in derivative contracts, transacting with retail and institutional clients as well as other dealers. ... In general, the dealer market is the Firm's principal market for derivative transactions as the greatest volume of the Firm's derivatives activities occur in the dealer market. In addition the dealer market is the most advantageous exit market for the Firm. ... The starting point for the valuation of a derivatives portfolio is mid market. As a dealer, the Firm can execute at or close to mid market thereby profiting from the difference between the retail and dealer markets. If the Firm cannot exit a position at mid market certain adjustments are taken to arrive at exit price."[623]

Investment Bank. Within JPMorgan Chase, the Investment Bank is one of the largest holders of derivatives. JPMorgan Chase told the Subcommittee that the Investment Bank's standard practice was to value its derivatives using the midpoint price in the relevant price range.[624] To identify the mid-price, the Investment Bank employed an independent pricing valuation service which provided pricing

[621] 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January through April 2012, at 4, JPM-CIO 0003637-654, at 640. See also 11/8/2007 Controllers Corporate Accounting Policies, "Fair Value Measurements," prepared by JPMorgan Chase, OCC-SPI-00056794, at 4 ("The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price).").

[622] 2013 JPMorgan Chase Task Force Report, at 48-49.

[623] 11/8/2007 Controllers Corporate Accounting Policies, "Fair Value Measurements," prepared by JPMorgan Chase, OCC-SPI-00056794, at 11. See also 5/10/2012 Controllers Corporate Accounting Policies, "Fair Value Measurements," prepared by JPMorgan Chase, JPM-CIO 0003424-442.

[624] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Olivier Vigneron).

information on a number of derivatives for trading book valuations.[625] This service typically provided the bank with the midpoints of the bid-ask spreads for specified derivatives.

Chief Investment Office. The CIO began actively investing in credit derivatives and assembling a Synthetic Credit Portfolio beginning in 2006. The internal document authorizing the CIO to conduct credit derivatives trading contained this paragraph on valuing credit derivatives:

> "Valuation Control
> CIO is not a market maker and uses the Investment Bank's risk and valuation systems to transact its products. As such CIO is a price taker using prices and valuation inputs controlled and determined by the market making businesses of the bank. CIO's Valuation Control Group coordinator will ensure that where pricing adjustments are identified from the month end price test process for market making groups in the Investment Bank, that where CIO hold the same positions the adjustments are also discussed with/applied to CIO."[626]

In 2010, a CIO internal procedure for testing the accuracy of CIO asset valuations stated that "[i]ndependent and reliable direct price feeds are the preferred method for assessing valuation. In general, third party prices/broker quotes are considered the next best pricing source."[627] It also indicated that the CIO's price testing group obtained independent and reliable direct price feeds from the "Finance Valuation & Policy Group ('FVP') within the Investment Bank" for "select CIO products," and that in other cases, the "IB FVP team conducts price testing of select positions" for the CIO. It also noted that "[i]ndependent prices are obtained from various external sources (Markit, Totem, etc.) and applied to CIO positions for price testing purposes."[628]

These documents indicate that, to value its credit derivatives, the CIO was to use the same "prices and valuation inputs" as the Investment Bank and to work closely with the Investment Bank's valuation team, drawing in part on independent pricing information from valuation services like Markit and Totem. The evidence indicates, however, that was not how the CIO actually operated in the case of the Synthetic Credit Portfolio in 2012.

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[625] Subcommittee briefing by JPMorgan Chase legal counsel (2/4/2013). For example, Markit provides price data for credit derivative indices, while Totem, a related company, provides price data for credit index tranches. See 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January through April 2012, at 6, JPM-CIO 0003637-654, at 642.
[626] CIO Executive Summary, "Chief Investment Office New Business Initiative Approval" on "Credit and Equity Capability," (undated, but in 2006), at 11, OCC-SPI-00081631.
[627] 5/21/2010 CIO-VCG Procedure: Valuation Process, OCC-SPI-00052685, at 1.
[628] Id., at 3.

In 2012, there was little or no evidence that CIO personnel valuing SCP credit derivatives coordinated their review with the Investment Bank, used Investment Bank prices, or relied on daily prices supplied by independent pricing valuation services. Instead, CIO personnel unilaterally reviewed the market data each business day for each of its credit derivatives, estimated their fair value, and then, on a daily basis, entered the fair value of each derivative position in the CIO's Synthetic Credit Portfolio trading book.[629] As explained in a later bank report on the CIO's derivatives pricing practices:

> "CIO's valuation process reflects how and to whom CIO would exit positions by typically seeking price quotes from the dealers with whom CIO would most frequently transact and with whom CIO would seek to exit positions, rather than looking for more broad based consensus pricing from a wide variety of dealers not active in these credit markets. ... CIO necessarily uses judgment to identify the point within the bid-offer spread that best represents the level at which CIO reasonably believes it could exit its positions, considering available broker quotes, market liquidity, recent price volatility and other factors."[630]

By March 2012, when the SCP routinely encompassed over 100 different types of credit derivatives, this daily pricing effort required sustained effort.[631] The resulting CIO prices often differed from those of the Investment Bank, as explained below.

During the period examined by the Subcommittee, the daily task of marking the SCP book with the fair value of its credit derivatives fell to a junior CIO trader, Julien Grout, who performed the task with assistance from the head Synthetic Credit Portfolio manager Bruno Iksil.[632] Late in the afternoon each business day, Mr. Grout determined the daily marks for each of the SCP's holdings and then used a series of computer programs to generate an estimate of the SCP's overall daily profit or loss, known as the "P&L Predict."[633] He also often drafted a short explanation for the day's gains or losses and included that

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[629] See 2013 JPMorgan Chase Task Force Report, at 46.

[630] 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at 5, JPM-CIO 0003637-654, at 641. See also 2013 JPMorgan Chase Task Force Report, at 46-47.

[631] See, e.g., 4/10/2012 email from Julien Grout, CIO, to "CIO Credit Positions" email group, "CIO CORE Credit Positions: 10-Apr12," JPM-CIO-PSI 0023061 (listing numerous credit derivative positions and their fair values).

[632] See 2013 JPMorgan Chase Task Force Report, at 46. According to the JPMorgan Chase Task Force, to determine the fair value of particular derivatives, the trader considered "recently executed trades," "price quotes received from dealers and counterparties," and his "observations of and judgment regarding market conditions, including the relationships between and among different instruments." Id.

[633] 2013 JPMorgan Chase Task Force Report, at 47.

explanation in the P&L Predict as well.[634] At the end of the business day in London, Mr. Grout sent an email with the P&L Predict to a designated list of CIO personnel in both London and New York.[635]

In New York, a CIO colleague, Isi Oaikhiena, consolidated a variety of daily CIO P&L reports, including the SCP P&L Predict from London, into a single document each day known as the CIO "EOD" (End of Day) P&L report, and emailed it to the "EOD Credit Estimate" group.[636] That group consisted of about 20 CIO employees, including CIO head Ina Drew, Chief Financial Officer John Wilmot, the key CIO traders, and various CIO risk managers and VCG analysts.[637] The EOD Credit Estimate Group reviewed and produced a final CIO EOD P&L report for the day, using a computer database to generate a composite, cumulative daily P&L figure for the CIO.[638] The final EOD P&L report included an SCP P&L figure that often differed from the original estimate and sometimes, but not always, included the explanation provided by Mr. Grout. The final CIO P&L results were also rolled it up into a bankwide, internal, cumulative, daily P&L statement.[639]

Although it seems that the CIO's practice prior to 2012 had been to value the SCP credit derivatives at or near the midpoint price in the relevant daily price range, at some point in early 2012, that practice changed. According to notes of an interview of Bruno Iksil by the JPMorgan Chase Task Force review, Mr. Martin-Artajo told Mr. Iksil that he was not there to provide "mids." Mr. Martin-Artajo thought that the market was irrational, and Mr. Iksil should provide his judgment and estimate the value of the positions, not rely on the exit price. Mr. Iksil told the Task Force that there was a difference between what Mr. Martin-Artajo and the bank expected him to do.[640]

Valuation Control Group. Due to the importance of derivative valuations, which can encompass a large set of assets that affect bankwide profit and loss calculations on a daily basis, all banks are required to set up an internal process to crosscheck the accuracy of the

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[634] Id.
[635] See, e.g., 3/20/2012 email from Julien Grout, CIO, to "CIO ESTIMATED P&L" mail list, "CIO Core Credit P&L Predict [20 Mar]: -$39,686k (dly) -$275,424k (ytd)," JPM-CIO-PSI 0016487-89.
[636] See, e.g., 3/20/2012 email from Isi Oaikhiena, CIO, to "EOD Credit estimate" mail list, copy to "CIO P&L Team" mail list, "International Credit Consolidated P&L 20-Mar-2012," JPM-CIO-PSI 0019484.
[637] 12/12/2012 distribution list document, "Distribution List Membership Around March 2012," provided to Subcommittee by JPMorgan Chase legal counsel, JPM-CIO-PSI-H 0002815.
[638] Subcommittee briefing by JPMorgan Chase legal counsel (2/4/2013).
[639] Id. (explaining that the bank's internal database, "Monster Truck," generated P&L data for both the CIO and firmwide P&L reports).
[640] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).

values reported internally.[641] At JPMorgan Chase, this process was administered by the Valuation Control Group (VCG). VCGs at the level of the bank's lines of business reported to the Chief Financial Officer at the line of business, who in turn reported to the bank's Chief Financial Officer, Douglas Braunstein.[642] At the end of each month, each VCG was required to validate the asset valuations in the relevant books, including the CIO's VCG which reviewed the credit derivative marks in the SCP book.[643]

According to the bank, the CIO VCG "independently price test[ed] the front office marks at each month end and determine[d] necessary adjustments to arrive at fair value for the purposes of US GAAP books and records."[644] The bank has also explained that, to test the accuracy of the booked values, the VCG examined, for each position, transaction data, dealer quotes, and independent pricing service data on the last day of the month, and then selected a value that fell within that day's price range (bid-ask spread).[645] That value was called the "VCG mid price." The VCG then compared the booked price on the last day of the month to the VCG mid price.

Because both GAAP and bank policy permitted lines of business to exercise subjective judgments when calculating the fair value of their derivatives, the CIO VCG explicitly allowed the CIO to deviate from the VCG mid prices.[646] The extent of the permitted deviation varied depending upon the type of credit index or tranche position at issue.[647] Some of the permitted deviations were so extensive that they allowed the CIO to select from a wide range of prices which, when applied to the SCP's large positions, then translated into valuations which, collectively, could vary by tens or even hundreds of millions of dollars from the VCG mid prices. In addition to reviewing the SCP book, the VCG was responsible for calculating and monitoring the amount and categorization of any liquidity and concentration reserves established for the SCP derivatives.[648]

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[641] See 1/29/2013 email from OCC legal counsel to the Subcommittee, PSI-OCC-23-000001.
[642] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012). See also 2013 JPMorgan Chase Task Force Report, at 53.
[643] See 5/21/2010 CIO-VCG Procedure: Valuation Process, OCC-SPI-00052685.
[644] See 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at 5, JPM-CIO 0003637-654, at 642.
[645] See 2013 JPMorgan Chase Task Force Report, at 53.
[646] See, e.g., 5/21/2010 CIO-VCG Procedure: Valuation Process, OCC-SPI-00052685, at 6.
[647] See, e.g., 4/20/2012 email from Jason Hughes, CIO, to Edward Kastl, JPMorgan Chase, "Credit Index and Tranche Book," JPM-CIO-PSI-H 0006636-639, at 636 (listing price deviations allowed from VCG mid prices for 18 credit derivative positions). See also 2013 JPMorgan Chase Task Force Report, at 54.
[648] See 5/21/2010 CIO-VCG Procedure: Valuation Process, OCC-SPI-00052685, at 6 ("In assessing the reasonableness of fair value measurements that are subject to testing, VCG will consider whether such measurements appropriately reflect liquidity risk, particularly in the case of instruments for which CIO maintains either a significant/concentrated position and/or if the market for given instrument can be observed to be less liquid. In this regard, VCG is responsible

B. Mismarking the CIO Credit Derivatives

The mismarking of the SCP credit derivatives appears to have begun in late January, accelerated in February, and peaked in March 2012. Recorded telephone conversations, instant messaging exchanges, and a five-day spreadsheet indicate that key CIO London traders involved with the marking process were fully aware and often upset or agitated that they were using inaccurate marks to hide the portfolio's growing losses.

(1) Mismarking Begins

On January 31, 2012, CIO trader Bruno Iksil, manager of the Synthetic Credit Portfolio, made a remark in an email to his supervisor, Javier Martin-Artajo, which constitutes the earliest evidence uncovered by the Subcommittee that the CIO was no longer consistently using the midpoint of the bid-ask spread to value its credit derivatives. Mr. Iksil wrote that, with respect to the IG9 credit index derivatives: "we can show that we are not at mids but on realistic level."[649] A later data analysis conducted by the bank's Controller reviewing a sample of SCP valuations suggests that, by the end of January, the CIO had stopped valuing two sets of credit index instruments on the SCP's books, the CDX IG9 7-year and the CDX IG9 10-year, near the midpoint price and had substituted instead noticeably more favorable prices.[650]

This change in the CIO's pricing practice coincided with a change in the SCP's profit-loss pattern in which the Synthetic Credit Portfolio began experiencing a sustained series of daily losses. The SCP book lost money on 17 of 21 business days in January, reporting just four profitable days.[651] By month-end, not only had the book reported losses totaling $100 million, but there was not a single day in January when the book was cumulatively in the black.[652] In addition, the book lost money on nine business days in a row at the end of January, producing

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for calculating / monitoring these reserves and consulting with the business on such estimates ...."); Subcommittee interview of Elwyn Wong, OCC (8/20/2012).

649 1/31/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "hello, quick update in core credit...," JPM-CIO-PSI 0001229 (Mr. Iksil: "as to IG9, things look much better. Not that we are immune but we can show that we are not at mids but on realistic level.").

650 See 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at 17, JPM-CIO-0003637-654, at 653, excerpted in charts below. The report showed that the two prices used by the CIO deviated from the midpoint prices by more than one basis point and produced prices more favorable to the CIO. The IG9 7-year credit index was priced at 102.000, when the midpoint price was 103.500; the IG9 10-year index was priced at 119.500 when the midpoint price was 120.750. Id., at 653. For more information about credit indices, see Chapter II.

651 See OCC spreadsheet, OCC-SPI-00000298, reprinted below. Numbers do not reflect restated P&L figures.

652 Id.

collective losses of $81 million.[653] February was equally bleak, losing money on 15 of 21 business days, including on seven consecutive business days at the end of the month.[654] March continued the pattern, losing money on 16 of 22 business days, including a string of losses – 15 of the last 16 business days – at the end of the month.[655] April and May were more of the same.[656]

The following chart, which was prepared by the Subcommittee using daily SCP P&L data supplied by the OCC, sets out the daily profit-loss figures reported internally by the CIO to bank management from January through mid-May 2012.[657]

[653] Id.
[654] Id.
[655] Id.
[656] Id.
[657] Id. While most P&L numbers in January likely used midpoint prices to calculate the value of the book's derivatives, the remaining P&L figures likely incorporated the more favorable prices used by the CIO from late January to mid-May 2012.

Synthetic Credit Portfolio - Internal Reports of Daily and Year-To-Date Profit and Loss
January 1, 2012 through May 15, 2012

Date	Daily P&L	YTD P&L
3-Jan	($2,331,403)	($2,331,403)
4-Jan	($9,405,151)	($11,736,554)
5-Jan	$11,489,045	($247,509)
6-Jan	($6,118,207)	($6,365,716)
9-Jan	($8,161,497)	($14,527,213)
10-Jan	($1,147,064)	($15,674,277)
11-Jan	$223,462	($15,450,815)
12-Jan	($3,552,588)	($19,003,403)
13-Jan	($1,328,679)	($20,332,082)
16-Jan	($1,474,654)	($21,806,736)
17-Jan	$538,245	($21,268,491)
18-Jan	$1,531,279	($19,737,212)
19-Jan	($2,497,903)	($22,235,115)
20-Jan	($5,824,024)	($28,059,139)
23-Jan	($14,937,654)	($42,996,793)
24-Jan	($18,663,381)	($61,660,174)
25-Jan	($5,349,602)	($67,009,776)
26-Jan	($1,609,067)	($68,618,843)
27-Jan	($3,637,880)	($72,256,723)
30-Jan	($22,790,129)	($95,046,852)
31-Jan	($5,320,915)	($100,367,767)

Date	Daily P&L	YTD P&L
1-Feb	$11,899,066	($88,468,701)
2-Feb	($2,476,245)	($90,944,946)
3-Feb	$800,677	($90,144,269)
6-Feb	($3,633,327)	($93,777,596)
7-Feb	($749,985)	($94,527,581)
8-Feb	($23,773,934)	($118,301,515)
9-Feb	($4,114,971)	($122,416,486)
10-Feb	$1,044,270	($121,372,216)
13-Feb	($5,029,818)	($126,402,034)
14-Feb	($1,756,535)	($128,158,569)
15-Feb	($3,310,361)	($131,468,930)
16-Feb	$2,787,722	($128,681,208)
17-Feb	$151,612	($128,529,596)
20-Feb	$1,402	($128,528,194)
21-Feb	($3,647,248)	($132,175,442)
22-Feb	($5,258,735)	($137,434,177)
23-Feb	($1,144,086)	($138,578,263)
24-Feb	($5,248,999)	($143,827,262)
27-Feb	($7,575,866)	($151,403,128)
28-Feb	($2,894,309)	($154,297,437)
29-Feb	($14,744,318)	($169,041,755)

Date	Daily P&L	YTD P&L
1-Mar	$15,808,609	($153,233,146)
2-Mar	($878,902)	($154,112,048)
5-Mar	$1,171,999	($152,940,049)
6-Mar	$3,161,395	($149,778,654)
7-Mar	$1,264,716	($148,513,938)
8-Mar	$1,154,204	($147,359,734)
9-Mar	($4,565,697)	($151,925,431)
12-Mar	($838,406)	($152,763,837)
13-Mar	($55,325)	($152,819,162)
14-Mar	($3,654,838)	($156,474,000)
15-Mar	($730,181)	($157,204,181)
16-Mar	($3,864,759)	($161,068,940)
19-Mar	($3,368,891)	($164,437,831)
20-Mar	($43,553,294)	($207,991,125)
21-Mar	$701,825	($207,289,300)
22-Mar	($1,786,282)	($209,075,582)
23-Mar	($12,555,383)	($221,630,965)
26-Mar	($32,426,419)	($254,057,384)
27-Mar	($44,740,604)	($298,797,988)
28-Mar	($50,685,464)	($349,483,452)
29-Mar	($49,996,238)	($399,479,690)
30-Mar	($319,192,503)	($718,672,193)

Date	Daily P&L	YTD P&L
2-Apr	$11,615,112	($707,057,081)
3-Apr	($10,407,844)	($717,464,925)
4-Apr	($11,100,155)	($728,565,080)
5-Apr	($9,517,665)	($738,082,745)
10-Apr	($415,342,049)	($1,153,424,794)
11-Apr	($6,301,198)	($1,159,725,992)
12-Apr	($4,809,755)	($1,164,535,747)
13-Apr	($50,629,714)	($1,215,165,461)
16-Apr	($37,415,502)	($1,252,580,963)
17-Apr	$9,948,665	($1,242,632,298)
18-Apr	($28,338,553)	($1,270,970,851)
19-Apr	($29,239,630)	($1,300,210,481)
20-Apr	($32,236,022)	($1,332,446,503)
23-Apr	($161,148,061)	($1,493,594,564)
24-Apr	($81,602,918)	($1,575,197,482)
25-Apr	($187,629,766)	($1,762,827,248)
26-Apr	($162,235,258)	($1,925,062,506)
27-Apr	$15,364,325	($1,909,698,181)
30-Apr	($222,070,242)	($2,131,768,423)

Date	Daily P&L	YTD P&L
1-May	($794,944)	($2,132,563,367)
2-May	($52,404,248)	($2,184,967,615)
3-May	($91,590,554)	($2,276,558,169)
4-May	($103,250,854)	($2,379,809,023)
7-May	($58,065,892)	($2,437,874,915)
8-May	($195,248,051)	($2,633,122,966)
9-May	($108,126,095)	($2,741,249,061)
10-May	($36,461,805)	($2,777,710,866)
11-May	($570,159,849)	($3,347,870,715)
14-May	($227,592,775)	($3,575,463,490)
15-May	($119,236,467)	($3,694,699,957)

Source: OCC spreadsheet, OCC-SPI-00000298. Losses are indicated by figures in parentheses. Numbers do not reflect restated P&L figures.
Prepared by U.S. Senate Permanent Subcommittee on Investigations, March 2013.

The SCP had never before experienced those types of sustained losses. According to CIO personnel, at the beginning of 2012, $5 million was considered a sufficiently large loss that the head of CIO, Ina Drew, would ask about it.[658] On February 29, 2012, the SCP book reported internally a daily loss of $15 million. CIO trader Bruno Iksil informed his supervisor, Javier Martin-Artajo, on that date that he had made some large trades, all of which experienced "adverse" price changes, and seemed to obliquely reference manipulating the marks as a method to limit the amount of losses reported, when he wrote that the trades had experienced "month end price moves that were all adverse although we could limit the damage."[659] He also advocated analyzing "the lags we have in the core book."[660] The "core book" was a reference to the SCP, which the traders often described as the "Core Credit Book." According to the bank, the term "lag" referred to "the aggregate differential between the prices being assigned and the unadjusted mid-market price."[661]

On March 9, 2012, in a recorded telephone conversation with Mr. Iksil, Mr. Grout expressed concern about how "we're lagging," predicting that the final outcome of the SCP trading strategy would be "a big fiasco" and "big drama when, in fact, everybody should have … seen it coming a long time ago."[662] His use of the term "lagging" in the telephone conversation appears to have been a reference to the SCP's ongoing, unreported losses. He cautioned: "We have until December to

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[658] Javier Martin-Artajo, head of CIO equity and credit trading, reported: "If we ever had a loss over $5 million, Ina calls me at night." JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012). See also 2013 JPMorgan Chase Task Force Report, at 50, footnote 64.

[659] 2/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "Core credit book update", JPM-CIO 0003443. A later analysis by JPMorgan Chase's Controller showed that, of 18 positions on February 29 examined to verify their values, five or nearly one third had used more favorable prices than the midpoint prices. See chart on February valuations, 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, JPM-CIO 0003637-654, at 653.

[660] 2/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "Core credit book update", JPM-CIO 0003443.

[661] 2013 JPMorgan Chase Task Force Report, at 47. The JPMorgan Chase Task Force defined the "unadjusted mid-market price" as "the mathematical mid-point between the best bid and best offer in the market." Id. It also noted that "at times" some traders used the term "lag" to refer to "the amount by which the Synthetic Credit Portfolio was underperforming a theoretical or fundamental valuation of the positions – i.e., how far behind their expectations it was." Id., at 48, footnote 57. For a longer discussion of the meaning of the term "lag," see below.

[662] See 3/9/2012 transcript of a recorded telephone conversation between Julien Grout, CIO, and Bruno Iksil, CIO, JPM-CIO 0003445-356, at 449. ("**Mr. Grout:** Here we're lagging – we're lagging. Well, you'll tell me this on Monday and, and anyway, I see the impact very well. I have a vague idea you know how this is going to end up. You know that [indecipherable] Trevor is going to try to get some capital, Ina will say no, so it will be a big fiasco and it will be a [b]ig drama when, in fact, everybody should have, should have seen it coming a long time ago. … Anyway, you see, we cannot win here. … I believe that it is better to say that it's dead, that we are going to crash. The firm will service the debt. … It's going to be very uncomfortable but we must not screw up. … It's going to be very political in the end. … We have until December to cover this thing. … we must be careful.").

cover this thing. ... [W]e must be careful."[663] His supervisor, Mr. Martin-Artajo, later told the JPMorgan Chase Task Force investigation that their strategy was as follows: "We can lose money on a daily basis, but correct with carry of the book.[664] Month-end is not as important as quarter-end."[665] Mr. Martin-Artajo likely viewed the quarter-end as more important because, as part of their mandatory SEC filings, corporations registered with the SEC have to file a financial statement that is made public and whose accuracy must be attested to by the Chief Executive Officer and Chief Financial Officer. In addition, at quarter-end, federally insured banks have to file with the FDIC call reports with financial information whose accuracy also has to be attested to by bank management.

(2) Mismarking Peaks

The end of the first quarter was March 31, 2012. The last business day was Friday, March 30. As the quarter-end approached, the SCP losses deepened rather than abated. CIO personnel responded by booking even more favorable prices more often than before to minimize the reported losses.

Data later compiled by the JPMorgan Controller's office as part of a special assessment of the SCP marks during the first four months of the year indicates that the mismarking likely peaked in March. The data showed that, for 18 selected SCP marks as of March 31, 2012, with respect to 16 of those marks, the CIO had booked a value equal to the price at the extreme boundary of the bid-ask spread, had booked one mark almost at the extreme, and had even booked one mark outside of the bid-ask spread. All of this led to more favorable values for the SCP book than would have been provided by marking at the midpoint, which helped minimize the SCP losses.[666] While similar analyses by the Controller's office of selected CIO marks at the end of January and February also showed marks using more favorable prices than those at the midpoint, none of those marks had gone so far as to use a price at the extreme edge of the bid-ask spread.[667]

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[663] Id.
[664] "Carry" refers to the cash premiums that short counterparties were paying to the CIO as the long party on certain credit derivatives. Mr. Martin-Artajo seemed to be saying that the daily losses in the SCP book could be "correct[ed]" or lessened through the receipt of the cash premiums or "carry" from the short counterparties.
[665] JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
[666] See chart examining 18 SCP marks as of March 31, 2012, 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at 17, JPM-CIO 0003637-654, at 653, reprinted in part below.
[667] Id., the charts examining 18 SCP marks as of January 31 and as of February 29, 2012, reprinted in part below.

The OCC noticed the same trend when it examined the March marks. As one OCC examiner put it: "New marks increase loss [$]472m[illion] for March. ... Instead of marking to mid, in most cases longs were marked at offer and shorts a[t] bid."[668] In its January 2013 management report, JPMorgan Chase also acknowledged the mismarking:

> "[F]rom at least mid-March through early April, the Synthetic Credit Portfolio's losses appear to have been understated. ... [O]n a number of days beginning in at least mid-March, at the direction of his manager, [a CIO trader] assigned values to certain of the positions in the Synthetic Credit Portfolio that were more beneficial to CIO than the values being indicated by the market. The result was that CIO underreported the losses, both on a daily basis and on a year-to-date basis."[669]

Evidence indicates that the CIO personnel in London responsible for reporting the SCP marks were fully aware that they were misusing the valuation process to understate the SCP losses. As the discrepancy in the marks grew, the two key CIO traders recording the marks became increasingly agitated.

In mid-March, the junior CIO trader charged with reporting the daily value of the SCP book, Julien Grout, began keeping a spreadsheet tracking the difference between what he was reporting to the bank using the more favorable values versus what he would have reported using the midpoint prices.[670] For five days, he tracked the divergence for three of the largest credit derivative holdings in the SCP book, the "CDX.IG" credit index referencing credit default swaps for U.S. investment grade companies, the "iTraxx Main" index which is the European equivalent of the IG index, and the "CDX.HY," or High Yield credit index, which referenced credit default swaps for below investment grade companies.

On the spreadsheet, the first column, entitled "Distance," showed the total difference between the midpoint prices and the CIO's booked values for all three indices on each of the five days. The next six

[668] 7/10/2012 email from Fred Crumlish, OCC, to Mike Brosnan and Scott Waterhouse, OCC, "Company lost confidence in March marks," OCC-SPI-00055687.
[669] 2013 JPMorgan Chase Task Force Report, at 46. See also id., at 53 ("Unlike the January and February month-end prices, the marks for March 30 were not generally at or near the mid.") and 89 ("From at least mid-March through at least March 30, the traders did not provide good-faith estimates of the exit prices for all the positions in the Synthetic Credit Portfolio.").
[670] See spreadsheet maintained by Julien Grout, CIO, depicting the divergence from the midpoint of the bid-ask spread for various credit derivative indexes in dollars and basis points, JPM-CIO-PSI-H 0002812.

columns broke out the difference for each of the three credit indices, using both dollars and basis points.[671]

Grout Spreadsheet

	U.S. Dollars				Basis Points		
Date	Distance	iTraxx	CDX.IG	CDX.HY	iTraxx.Main S9 10y	CDX.IG9 10y	CDX.HY
12-Mar-12	(202,543,647)	(59,050,049)	(90,077,977)	(53,415,621)	3.0	2.0	0.17
13-Mar-12	(206,639,426)	(61,372,979)	(89,698,506)	(54,687,653)	3.5	2.0	0.18
14-Mar-12	(268,984,074)	(82,396,799)	(136,202,780)	(58,279,879)	4.0	3.0	0.18
15-Mar-12	(292,470,549)	(83,045,952)	(181,254,945)	(37,635,855)	4.0	4.0	0.12
16-Mar-12	(498,717,231)	(100,525,860)	(158,706,386)	(107,356,237)	5.0	3.0	0.34
16-Mar-12	(432,348,435)	(130,119,511)	(143,345,094)	(107,356,237)	5.0	3.0	0.34

Source: Spreadsheet prepared by Julien Grout, CIO, JPM-CIO-PSI-H 0002812. Losses are indicated by figures in parentheses.

[671] A basis point is a unit of measure describing a change in value. One basis point is equivalent to one hundredth of a percent (0.01%).

On March 15, 2012, in a recorded session of instant messaging, Mr. Grout discussed the spreadsheet results up to that date with Mr. Iksil who asked him to send a copy of the spreadsheet to their supervisor, Javier Martin-Artajo.

> **Mr. Iksil:** "Can [yo]u drop me here the breakdown of the lag[672] please? ... And send it to javier email ... Put me in copy ... I refer to the spreadsheet"[673]
>
> **Mr. Grout:** "itraxx 83 (4bp) ig180 (4bp) hy 37) 0.12"[674]
>
> **Mr. Iksil:** "... So julien, basically [yo]u say the worsening is 1bp in ig9 ..."[675]
>
> **Mr. Grout:** "correct bruno"
>
> [Later that same day]
>
> **Mr. Iksil:** "We have 6 bps in ig9 after all[676] ... I question here how we position ourselves Aren't we making ig9 10 responsible for all here?"
>
> **Mr. Grout:** "ah yes it's definitely pb [problem] number one[677] also: main s9 10y"
>
> **Mr. Iksil:** "I am confused. I mean, [I']m trying to keep a relatively realistic picture here - ig9 10y put aside Because 7 bps in ig9 10yr makes up for 7x50 gives 350 ..."[678]

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[672] In this context, "lag" refers to the difference between what the CIO was reporting as losses and what those losses would have been had the CIO used midpoint prices.

[673] As requested, Mr. Grout, CIO, sent an email and the spreadsheet to Mr. Martin-Artajo, CIO. See 3/15/2012 email and spreadsheet from Julien Grout, CIO, to Javier Martin-Artajo, CIO, with copy to Mr. Iksil, CIO, JPM-CIO 0003457-459. That version of the spreadsheet contained data for only four days, March 12 through March 15. A later version of the spreadsheet added data for March 16, which is the version reprinted above.

[674] Mr. Grout was directing Mr. Iksil's attention to the divergent figures he had calculated for that day for the three individual credit indices. See spreadsheet showing the iTraxx "distance" (unreported losses) totaled $83 million, which was 4 basis points away from the total that would have been reported using the midpoint price in the marketplace; the CDX.IG's unreported losses totaled $180 million, which created a 4 basis point difference; and the CDX HY's unreported losses totaled $37 million, which created a 0.12 basis point difference.

[675] See spreadsheet showing that the "difference" for the CDX.IG had dropped 1 basis point from the prior day, from 3.0 on March 14 to 4.0 on March 15. The figures show that a one basis point change in this index was equivalent to nearly $50 million.

[676] The reference to "6 bps" is to a policy of the CIO's Valuation Control Group which allowed the CIO to report derivative values for the IG credit index that could vary from the midpoint market prices by up to 6 basis points. See 4/20/2012 email from Jason Hughes, CIO, to Edward Kastl, JPMorgan Chase, "Credit Index and Tranche Book," JPM-CIO-PSI-H 0006636-639, at 636 (listing tolerance levels for 18 credit derivative positions).

[677] This reference is to the spreadsheet entries showing that the amount of divergence from midpoint prices was the largest for the CDX.IG of the three indices; it exceeded $136 million on March 14 and $181 million on March 15, the day of the conversation.

> **Mr. Grout:** "that's what [I] am saying. [I] am not marking at mids as per a previous conversation …"
>
> **Mr. Iksil:** "… Send to me and javier the spread[s]heet where [yo]u store the breakdown of the difference between our estimate and crude mids I will comment to javier"[679]

The Grout spreadsheet and the March 15 instant messaging exchange show that the CIO traders knew that the changes they had made in how the credit index derivatives were valued had produced enormous reductions in the amount of losses reported internally, compared to the losses that would have been reported using midpoint prices. By March 16, 2012, the spreadsheet showed that the unreported losses – the "Difference" – had reached at least $432 million. If that amount had been added to the amount of cumulative losses actually reported to the bank on that same day by the CIO, $161 million, the loss total would have nearly tripled to $593 million.[680]

Later on March 15, 2012, Mr. Iksil sent an email to his supervisor, Mr. Martin-Artajo, about the Grout spreadsheet:

> "The divergence increases between crude mid prices and our estimate. Julien [Grout] will send a small sprea[d]sheet recording the brea[k]down of the divergence per blocks. The ig9 10yrs lags another bp [basis point] today."[681]

Mr. Iksil's observation, that the IG9 10 year credit index "lag[ged]" by another basis point "today" was reflected in the spreadsheet column showing that, between March 14 and March 15, the "distance" between the midpoint price and the CIO's booked price for the "CDX.IG9 10y" had increased from "3.0" basis points to "4.0" basis points. In his email, Mr. Iksil used the word "lag" to refer to the unreported losses in the SCP book.

The next day, March 16, 2012, Mr. Iksil informed Mr. Martin-Artajo that the problem was growing and already, in less than a day, involved $300 million in hidden losses: "[T]he divergence has increased

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678 Mr. Iksil is essentially asking whether the figures show that a 7 basis point divergence in the values assigned to the IG9 10-year credit index would, given the large notional size of the SCP book's holdings, translate into $350 million in additional, unreported losses.

679 See 3/15/2012 instant messaging session between Bruno Iksil, CIO, Julien Grout, CIO, and Luis Buraya, JPMorgan Chase, JPM-CIO-PSI-H 0003798-819, at 801-806.

680 See 3/15/2012 email and spreadsheet from Julien Grout, CIO, to Javier Martin-Artajo, CIO, with copy to Mr. Iksil, CIO, JPM-CIO 0003457-459, at 458; see also spreadsheet maintained by Julien Grout, CIO, depicting the divergence from the midpoint of the bid-ask spread for various credit derivative indexes in dollars and basis points, JPM-CIO-PSI-H 0002812.

681 3/15/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "Update on core," JPM-CIO-PSI 0000386.

to 300 now."[682] Mr. Iksil warned that the book would continue to lose money: "[I]t has been like this since the start of the year and the drift keeps going. I reckon we get to 400 difference very soon."[683] He speculated later in the day that, by the end of March, the total divergence might reach $1 billion.[684]

In another email on March 16, 2012, Mr. Iksil told Mr. Martin-Artajo, Mr. Grout, and Patrick Hagan, a CIO quantitative analyst, that additional trades in the IG9 10 year and iTraxx Main S9 10 year indices might enable the CIO to "lock a PNL [profit and loss] in form of carry forward that offsets the current unrealized loss."[685] He was suggesting that taking additional long positions in those credit indices might be used to offset "the current unrealized loss."

The sudden jump on March 16, between the losses being reported by the CIO and the losses that would have been reported by using midpoint prices, led to several agitated exchanges between the CIO traders later that day. For example, Mr. Iksil and Mr. Grout had the following telephone conversation over an apparent instruction from Mr. Martin-Artajo to wait until the end of the month before making a large "one-off" or one-time adjustment to reduce the divergence between the marks that had been booked and the marks that would have been booked using midpoint market prices. Mr. Iksil expressed dismay with the marks and described the SCP book as growing "more and more monstrous": [686]

> **Mr. Grout:** "Did you speak to [...]"
>
> **Mr. Iksil:** "Yes, yes. He says nothing I find that ridiculous. I'll send you the thing that I sent."
>
> **Mr. Grout:** "You sent something to propose doing that?"
>
> **Mr. Iksil:** "Yes, that's what I sent when you said it was at 300. I can't keep this going, we do a one-off at the end of the month to remain calm. I think what he's [Mr. Martin-Artajo's] expecting is a remarking at the end of the month, you can't do it unless it's

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[682] 3/16/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "update on Core PNL," JPM-CIO 0003475.
[683] Id.
[684] 3/16/2012 transcript of an instant messaging session between Bruno Iksil, CIO, Julien Grout, CIO, and Eric de Sangues, JPMorgan Chase, JPM-CIO-PSI-H 0003815, at 818 (**Mr. Iksil:** "sent an Email to Javier an[n]ouncing this is more 300 now. that was 100 Monday. it is 300 now. 1000 for month end? **Mr. de Sangues:** "Ouch." **Mr. Iksil:** "well that is the pace.").
[685] See 3/16/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, Julien Grout, CIO, and Patrick Hagan, JPMorgan Chase, "trade ideas on core," JPM-CIO-PSI 0000387.
[686] 3/16/2012 transcript of a recorded telephone conversation between Julien Grout, CIO, and Bruno Iksil, CIO, JPM-CIO-PSI-H 003820-822.

> month[-]end. … I don't know where he wants to stop, but it's getting idiotic. … [N]ow it's worse than before … there's nothing that can be done, absolutely nothing that can be done, there's no hope. … [T]he book continues to grow, more and more monstrous."[687]

Mr. Iksil's comments indicate that the CIO traders themselves were uncomfortable with the SCP marks they were booking.

The Grout spreadsheet contained two entries for March 16, the first showing that the unreported losses had grown to $498 million and the second showing a smaller amount of $432 million. Both exceeded the prior day's losses by about $200 million. JPMorgan Chase told the Subcommittee that it could not explain why there were two entries for March 16, or which correctly depicted the difference between the losses that the CIO traders reported internally and the additional losses they would have reported had they been using midpoint prices. According to the bank's counsel, Mr. Grout's five day spreadsheet is the only written document of its kind that the bank's internal investigation uncovered.[688] And despite the spreadsheet's indicating a $200 million increase in losses for the day using midpoint prices, the CIO reported internally on March 16, that the SCP incurred a daily loss of just $3.9 million.[689]

When asked about the Grout spreadsheet, CIO head Ina Drew told the Subcommittee that she first became aware of the spreadsheet in late April or early May when Douglas Braunstein and John Hogan were reviewing the marks with the CIO team over one of the weekends.[690] When asked about the spreadsheet again in a later interview, Ms. Drew retracted her earlier statement and told the Subcommittee that she did not remember when she learned of the spreadsheet; she may have learned about it in July when the firm publicly announced the problems with the CIO's marks.[691] This spreadsheet, however, was not disclosed to the public in July and, by then, Ms. Drew had already left the bank.

Ms. Drew also told the Subcommittee that she had never before seen that type of "shadow P&L document."[692]

Three days after the spreadsheet was apparently discontinued, on March 19, 2012, the CIO traders appear to have calculated that, by mid-

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[687] Id.
[688] JPMorgan Chase's legal counsel to the Subcommittee (11/16/2012) (Reginald Brown).
[689] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above. Numbers do not reflect restated P&L figures. The Subcommittee is unaware of any analysis of the derivative marks underlying the $3.9 million loss to determine the extent to which those marks reflected prices within the daily bid-ask spread.
[690] Subcommittee interview of Ina Drew, CIO (12/11/2012).
[691] Subcommittee interview of Ina Drew, CIO (12/21/2012).
[692] Id.

day, the cumulative unreported losses were in the range of $500 million. Mr. Iksil provided Mr. Martin-Artajo with the following analysis of the market:

> "When markets are caught in a squeeze like this one, the P&L [profit and loss] volatility can become very large : this is what is happening since the beginning of this year in CDX IG9 and Main ITRAXX S9 series. The hit amounts to 5-10 Bps [basis point] lag in those forwards .... [T]he loss is likely to range between [$]100m[illion] to [$]300m[illion] – main reason is the CDX IG9 lag (2-3 bps or 100-150m) – second next is CDX HY : the hit is another 100m spread within the tranche and index bid-ask. Typical here, you cannot really trade but the mid does not change. – third is Main itraxx : the curve in S9 steepened by 5bps pushing the forward back up while the other curves steepened 1 bp in the rally. The hit here is 80-100m. – **the estimated bid-ask on the book grossly amounts to 500m all-in** (200m for IG, 100m for Itraxx main, 200m for CDX HY).[693]

In calculating the $500 million "all-in" figure, Mr. Iksil repeatedly used the words "hit," "lag," and "loss" in connection with the three credit indices he was analyzing. Despite his analysis discussing hundreds of millions of dollars in cumulative losses, at the end of the day on March 19, the CIO reported internally an SCP daily loss of only $3 million.[694]

(3) Increasing the Reported Losses

His telephone calls, instant messages, and emails show that Mr. Iksil, who was charged with managing the SCP book, was becoming increasingly concerned about the growing difference between the SCP losses that the CIO was reporting to the bank versus the losses that would have been reported by marking at the midpoint. When on March 19, 2012, the unreported losses reached half a billion dollars, Mr. Iksil decided not to wait until the end of the month, as his supervisor had requested, but to begin reporting larger losses immediately to better

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[693] 3/19/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, with copy to Julien Grout, CIO, "Core Book analysis and proposed strategy," JPM-CIO 0003476-477. [Emphasis added.]

[694] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above. Numbers do not reflect restated P&L figures. The Subcommittee is unaware of any analysis of the derivative marks underlying the $3 million loss to determine the extent to which those marks reflected prices within the daily bid-ask spread. In its 2013 report, the JPMorgan Chase Task Force stated that, by March 19, the CIO had reported only a small SCP daily loss for each of the prior seven consecutive days. 2013 JPMorgan Chase Task Force Report, at 50. It also wrote that the CIO trader recording the SCP marks "told another trader that a more senior trader had pressured him throughout this period not to show large losses in the Synthetic Credit Portfolio." Id.

reflect the actual market prices. On March 20, 2012, Mr. Iksil directed Mr. Grout to report a much larger SCP loss than had been reported previously during the year.[695]

While Mr. Grout was preparing the SCP P&L Predict email that would report the larger daily loss, Mr. Martin-Artajo met briefly with Ms. Drew about the SCP. In a March 20, 2012 email sent by Ms. Drew to Mr. Martin-Artajo's supervisor, Achilles Macris, Ms. Drew wrote:

> "Javier briefed me this morning on the credit book. He sounded quite nervous. Let's discuss on our weekly call. The full briefing is later in the morning but I want to understand the course of action from you."[696]

Mr. Macris, Ms. Drew, Mr. Martin-Artajo, and Chief Risk Officer Irvin Goldman arranged a meeting for the next day, Wednesday, March 21, to discuss the SCP.

In the meantime, Mr. Grout worked with Mr. Iksil to complete the daily SCP P&L Predict email to report a sizeable SCP loss, together with a brief explanation. Prior to it being sent, Mr. Iksil left a telephone message and an electronic message with Mr. Martin-Artajo to obtain his approval, but received no response. In his telephone message, Mr. Iksil said that the CIO needed to start showing losses: "[W]e would show a loss of 40 million core and 3 million in, in tactical .... I think we should, we should start, start showing it."[697]

The largest daily loss reported for the SCP book, up to that point in 2012, was a $24 million loss on February 8. On March 20, Mr. Iksil instructed Mr. Grout to report an estimated daily loss of $43 million and a year-to-date cumulative loss of $207 million, which he believed would get the immediate attention of CIO management, including Ina Drew.[698]

[695] See 3/20/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, "CIO Core Credit P&L Predict [20 Mar]: -$39,686k (dly) -$275,424k (ytd)," JPM-CIO-PSI 0016487-489.
[696] 3/20/2012 email from Ina Drew, CIO, to Achilles Macris, CIO, "Wed call," JPM-CIO-PSI 0001236.
[697] 3/20/2012 audio file of recorded telephone message left by Bruno Iksil, CIO, for Javier Martin-Artajo, CIO, JPM-CIO-PSI-A 0000054 ("Hello Javier, it's Bruno. Again, you know, we can't try to be close to the market prices and we, we would show a loss of 40 million core and 3 million in, in tactical and I wanted to know if that was okay with you. I'm going to send you an SMS, to get your, your approval. We're still in the range but it's a 3 everywhere so, as I try to get closer to, to the target and I don't want to make it last, you know? I think we should, we should start, start showing it. Please call me back if you can or just reply to my SMS please."); see also written transcript of the recorded telephone message, at JPM-CIO 0003481. The reference to "SMS" is to an instant messaging service.
[698] See JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012) ("A $5 million loss? Ok. But this $43 million would cause issues with Ina.").

In addition, in the P&L email's commentary explaining the CIO's loss, Mr. Iksil[699] told senior CIO management that the IG9 was "underperform[ing]" by $450 to $500 million; the iTraxx Main credit index was "lagging" by another $60 to $80 million; and the High Yield index had a $100 million "loss" plus another "lag" of $100 to $200 million, concluding that the total "lag in P&L" is "material" and in the range of $600 to $800 million:

> "As of today, reconstructing the CDX.IG9 10yr performance from the on the run indices and the 4 widest names in CDX.IG9 (Radian, MBIA, Istar, Sprint), the underperformance of the CDX.IG9 curves is between 6bps [basis points] to 13bps, which amount approximately to $450-500M[illion] for the sole CDX.IG9 series. iTraxx.Main S9 is also lagging by 3-4 bps or another $60-80M. Added to this the CDX.HY loss of $100M for Kodak and Rescap, plus the lag of CDX.HY10-CDX.HY11 series versus on-the-runs that is also $100-200M, **the lag in P&L is material ($600-800M).**"[700]

By way of context, a loss of $600 million, on top of the marked loss of $208 million,[701] would more than extinguish all of the revenues produced by the Synthetic Credit Book in 2010 and 2011, combined.[702]

Mr. Grout emailed the SCP P&L Predict, projecting a $40 million loss and the commentary discussing a "material" P&L "lag" of $600 to $800 million, to the designated list of CIO personnel who routinely received the SCP P&L Predict. The same information was also included in the CIO's End of Day (EOD) P&L report, which was sent at the close of the business day in New York to about 20 designated CIO personnel, including Ina Drew, John Wilmot, Achilles Macris, Javier Martin-Artajo, Irvin Goldman, Peter Weiland, Keith Stephan, Patrick Hagan, and Jason Hughes.[703]

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[699] See 3/20/2012 transcript of recorded telephone conversation between Bruno Iksil, CIO, and Javier Martin-Artajo, CIO, JPM-CIO-PSI-A 0000055, JPM-CIO-PSI-H 0006392, at 394 (**Mr. Iksil**: "[B]ut that's why I tried sending this P&L, I sent also the comments it came from Julien but I wrote it, where I said okay you know we take this loss, we are maintaining long risk where we have to be, the rally is on IG but guess what you know it's lagging so much that actually we have to show loss.").

[700] 3/20/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, "CIO Core Credit P&L Predict [20 Mar]: -$39,686k (dly) -$275,424k (ytd)," JPM-CIO-PSI 0016487-489, at 489. [Emphasis added.] For more information about the referenced credit indices and such terms as "on the run" and "basis points," see Chapter II.

[701] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above (showing a cumulative loss of $207,991,125 as of March 20, 2012). Numbers do not reflect restated P&L figures.

[702] See 5/3/2012 email from Irvin Goldman, CIO, to Douglas Braunstein, John Hogan, and Ashley Bacon, JPMorgan Chase, "CSW 10%," JPM-CIO-PSI-H 0000546-556, at 552.

[703] See 3/20/2012 email from Isi Oaikhiena, JPMorgan Chase, to "EOD Credit estimate" mail list, copy to "CIO P&L Team" mail list, "International Credit Consolidated P&L 20-Mar-2012,"

Soon after the SCP P&L Predict email went out at the end of the business day in London, Mr. Martin-Artajo telephoned Mr. Iksil.[704] In a lengthy conversation, Mr. Martin-Artajo repeatedly expressed dismay at the action taken by Mr. Iksil and indicated that neither he nor his supervisor, Achilles Macris, had wanted to report increased SCP losses until they received guidance from Ina Drew at the meeting that was scheduled for the next day.[705] Mr. Martin-Artajo also acknowledged that Mr. Iksil had been placed in a difficult position.

> **Mr. Iksil:** "Yea[h] so, yea[h] we sent an estimate down [$]40 million today. …"
>
> **Mr. Martin-Artajo:** "Okay, okay. I just don't want you to do this. I don't know why you've done it anyway you've done it ... [Y]ou should have told me this because it doesn't help us for the conversation for tomorrow."
>
> **Mr. Iksil:** "… [Y]ou know, I thought we should actually you know, not do like minus, minus 5 every day but say okay boom you know there is, there is something happening…"
>
> **Mr. Martin-Artajo:** "… You think that this is right. This is not what I would have done but you've done it so I'm okay with this. I've already said what the problem is, so okay they know they're not going to be surprised we have a meeting tomorrow…"
>
> **Mr. Iksil:** "I know it's embarrassing but --"
>
> **Mr. Martin-Artajo:** "Yea[h] I don't understand your logic mate, I just don't understand. I've told Achilles, he told me that he didn't want to show the loss until we know what we're going to do tomorrow. But it doesn't matter I know that you have a problem you want to be at peace with yourself, okay, it[']s okay Bruno. I've, it's alright I know that you're in a hard position here…"
>
> **Mr. Iksil:** "[W]hat we've tried to do is to say okay you know for month's end, we want to fight … [R]eally, really, if we want to just be realistic as to what we can expect to do, I wanted to show like upfront, precisely before we discuss, you know, what it's going to look like[.] [T]hat you know if we expect potentially to

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JPM-CIO-PSI 0019484-487, at 486; 12/12/2012 distribution list document, "Distribution List Membership Around March 2012," provided to Subcommittee by JPMorgan Chase legal counsel, JPM-CIO-PSI-H 0002815.

[704] See 3/20/2012 transcript of recorded telephone conversation between Bruno Iksil, CIO, and Javier Martin-Artajo, CIO, JPM-CIO-PSI-H 0006392-400.

[705] Id., at 398 (**Mr. Martin-Artajo**: "I wish I could discuss it with you, because, um, I didn't, I didn't want to show the P&L and Achilles told me yesterday not to do it.").

lose [$]100, 200 million it's because from where we are today, right, we will fail to bring back one basis point here, a crossover point in high yield there. …"

Mr. Martin-Artajo: "No, no, no, it's okay, it's everywhere. I know."

On the same call, Mr. Martin-Artajo expressed displeasure at Mr. Iksil's disclosing in the daily SCP P&L Predict that the "lag" in the SCP book could approach $800 million ("800 bucks"). In addition, Mr. Martin-Artajo expressed concern over what would happen if Ms. Drew were to instruct them to stop "going long," which would likely intensify the book's losses.

Mr. Iksil: "[W]e take this loss, we are maintaining long risk where we have to be, the rally is on IG but guess what you know it's lagging so much that actually we have to show loss, and I explained that this is a lag that keeps going, that amounts to a potential of 800 bucks, right …"

Mr. Martin-Artajo: "What are you saying, Bruno? What are you talking about? What is, you're losing your mind here, man, why did, you're sending an email that you would get, what is the 800 bucks?"

Mr. Iksil: "It's just the lag that we have in IG, in high yield, in main, that is all over the book that makes that this book is just bleeding the money but it's just the lag, that's just the lag."

Mr. Martin-Artajo: "Okay but this is what we need to explain tomorrow you don't need to explain in the email man."

Mr. Iksil: "Yea[h] but I had to put the comment on this big move, I thought, I thought that was, that was a way to, to, to show what's happening on a day like --"

Mr. Martin-Artajo: "Yea[h] but why do you do it today when we are going to explain it tomorrow …"

Mr. Iksil: "Because, because, because that's, that's what we saw today, you know we've tried everything …"

Mr. Martin-Artajo: "Why don't you explain it tomorrow when Ina is there and we have, because this only, this only creates, it just creates more tension, you understand? ... What happens if she tells me that we cannot keep going long?"[706]

Continuing the conversation, Mr. Iksil indicated that the divergence between the reported and unreported losses, which then approached four basis points, or as much as $200 million, in two credit indices, were too large for him to ignore. He expressed the hope that Ms. Drew would read the SCP P&L commentary which would give her additional time before the meeting the next day to think about what the CIO should do, especially as the quarter-end approached. Mr. Iksil also commented that he had been forced to choose between "one bad thing and one thing that I think was worse" – perhaps referring to admitting increased SCP losses versus hiding losses that were rapidly escalating.

> **Mr. Iksil:** "[I]t's like there were 4 basis points missing on IG9 or 4 basis points missing on S9 …"
>
> **Mr. Martin-Artajo:** [interrupting] "Okay, okay, okay …."
>
> **Mr. Iksil:** "… [Y]ou know it's just that, I have to, I don't know I thought, I thought that was, that was not realistic know what we were doing, and … I said probably I was wrong you know, I thought that it was this estimate before tomorrow, you know, was the way to, because I know Ina is going to read the comments, so maybe it will leave some time, and she will have different questions, or I don't know. ... [I]t's one mistake for another here, because if I don't --"
>
> **Mr. Martin-Artajo:** "No, no, no, man, no man."
>
> **Mr. Iksil:** "I think I do a worst one, you know so. It's sort of my logic is strange but in fact I have to choose between one bad thing and one thing that I think was worse."[707]

Mr. Martin-Artajo responded that he had already informed Ms. Drew that the SCP was experiencing problems, which was why he and Mr. Macris had a meeting scheduled to seek her guidance on how to proceed.

> **Mr. Martin-Artajo:** "I'm trying to get all the facts in front of Achilles and Ina, the fact that we show a loss here it's okay it's not, it is a problem, you know. I've already told her that there's a problem, so, you know, I've already told her, so, you know we're

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[706] Id., at 394-395.
[707] Id., at 396-397.

going to sit down tomorrow and talk about the CRM[708] and we're going to talk about the problems. You know I've sent you an email on what she wants to discuss tomorrow she wants to see the changes in the book okay so you need to make sure that Julien does that."

Mr. Iksil: "It, I was working on it."[709]

Finally, Mr. Iksil apologized to Mr. Martin-Artajo for creating more work for him with Ms. Drew, but also reaffirmed his belief that the CIO needed to get its marks closer to market value, stating: "we had to get closer to where the market is even if the market is wrong."

Mr. Martin-Artajo: "I didn't want to show the P&L and Achilles told me yesterday not to do it. So, okay, so we're just going to have to explain that this is getting worse, that's it. ..."

Mr. Iksil: "... Sorry for that .... in any case, I feel bad. If I do that I know I'm not making your life easier, and if --"

Mr. Martin-Artajo: "No, no, no, you know I think that you're an honest guy. ... I did not want you to do this way, but you know you feel that the bid offer spreads are giving you a headache, and you want to release it this way, which is your own way of doing it. ... "

Mr. Iksil: "The thing is you know today, I said I told Julien you know okay let's try to frame this you know, this P&L estimate whatever it's going to be, right, so that with tomorrow, whatever the decision made, right, whether we settle or we decide to fight, you know like we go long and then we are going to defend the position on IG, on 9, on high yield you know, try to do the minimum size everywhere you know so that the book grows a little bit but not too much, so that we are, you know, we maintain knowledge the level where we are, and [inaudible] we aren't too far off. I thought that tomorrow, at one stage, after, before at one stage later, I would show you, you know what the plan can be, where, how many basis points here and there we are chasing and what size we can expect to do, right? And I realized we were, we were, we had to get closer to where the market is even if the market is wrong, you see? ..."

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708 "CRM" refers to "Comprehensive Risk Measure," which measures portfolio risk in the context of calculating a bank's capital requirements; generally, Federal regulators require banks to acquire more capital when engaging in higher risk activities. For more information on CRM, see Chapter V.

709 3/20/2012 transcript of recorded telephone conversation between Bruno Iksil, CIO, and Javier Martin-Artajo, CIO , JPM-CIO-PSI-H 006392, at 397.

> **Mr. Martin-Artajo:** "Ok, Bruno, no, no, no, it's fine, okay, I see what you're going through. ... [W]e'll sit down tomorrow and we'll look at the spreadsheet. I'm sure you've done some numbers that make sense and you think this is part of something you can't recover therefore you've released, and you know, I know what you're doing and you're signaling here that there is a problem. I've already said it, Achilles knows it, and Ina knows it, and you're saying it now so, okay. I truly don't have a lot to say now because we have so much to speak tomorrow, I mean, we have a long day tomorrow."[710]

The next day, on March 21, 2012, Mr. Martin-Artajo sent an email to Ms. Drew, Mr. Macris, and Irvin Goldman, then the CIO's Chief Risk Officer, confirming that the purpose of the meeting to take place later that day was to discuss issues related to the Synthetic Credit Portfolio's "underperformance" and Risk Weighted Assets (RWA).[711] The meeting on March 21 took place, as confirmed in an email the next day from Ms. Drew to Mr. Martin-Artajo and Mr. Macris in which she described the meeting as "exhaustive."[712]

When asked about the March 20 SCP P&L report, Ms. Drew told the Subcommittee that, while she routinely received the CIO's daily EOD P&L emails and was meeting the next day to discuss the SCP, she did not open or read that particular email. When shown the text, Ms. Drew told the Subcommittee that she interpreted it as disclosing potential SCP losses and said, had she seen the $800 million figure at the time, it would have been a "game changer" in how she viewed the SCP book.[713] A week after her interview, Ms. Drew's legal counsel contacted the Subcommittee to indicate that Ms. Drew had changed her interpretation of the email.[714] He told the Subcommittee that Ms. Drew had become "emotional" when listening to the recording of the conversation between Mr. Iksil and Mr. Martin-Artajo in preparation for her second Subcommittee interview and had become "emotional" again when seeing the transcript of the call during the interview. The legal counsel said that, upon reflection, Ms. Drew decided she had been too

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[710] Id., at 398-399.
[711] See 3/21/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, with copies to Achilles Macris, CIO, and Irvin Goldman, CIO, "Synthetic Book," JPM-CIO 0003489-490 ("The fact that the increase that we have seen in the book has not materialized in our performance has raised the following issues: 1. Our current underperformance in the Synthetic Book is large compared to our estimates given the changes in the profile of the book.").
[712] See 3/22/2012 email from Ina Drew, CIO, to Achilles Macris and Javier Martin-Artajo, CIO, "I was confused by the inc[re]ased position noted today after yesterday's exhaustive meeting," JPM-CIO 0003492.
[713] Subcommittee interview of Ina Drew, CIO (12/11/2012). See also March 2012 presentation, CIO Synthetic Credit Update, JPM-CIO-PSI 0021953-974, at 970 ("the realistic P&L miss is rather 800M USD").
[714] Ina Drew's legal counsel to the Subcommittee (12/18/2012) (Lee Richards).

quick to interpret the $600 to $800 million figure in the email as referring to unreported losses, and that upon reading the email again, it appeared the traders were trying to reassure her by writing about a lag in market performance and predicting the SCP would regain $600 to $800 million in value. This telephone call took place after the Subcommittee's interview of Michael Cavanagh, head of the bank's internal investigation of the SCP losses, in which he and the bank's general counsel, Stephen Cutler, told the Subcommittee that they viewed the March 20 email, not as disclosing unreported losses, but as predicting that the market would rebound and add $600 to $800 million to the value of the SCP holdings.[715]

This interpretation of the March 20 email as conveying a positive message about future market performance is difficult to reconcile with the email's generally negative tone regarding the SCP. The purpose of the email's commentary was to explain a $40 million loss, which was the largest of the year and followed two straight months of losses. The email described problems with three key credit index positions held by the SCP;[716] used the words "underperformance," "lagging" and "loss" to describe those problems; attached a monetary figure to each described problem; then added up the figures and concluded that the "lag in P&L" was "material" and in the range of $600 to $800 million. The email also referred to the Eastman Kodak and Rescap bankruptcies, which cannot be interpreted as any type of prediction of better market performance. In addition, predictions about future market performance are rarely described as "material," and the email contains no positive descriptors of the $600 to $800 million figure.[717] Moreover, those figures did, in fact, reflect the ballpark amount of unreported losses then at stake, given the CIO's valuation practices; the bank's subsequent restatement put the first quarter's unreported losses at $660 million.[718]

In any event, whether or not the March 20 email was intended to or did disclose the extent of the unreported CIO losses to CIO management, Ms. Drew told the Subcommittee that she did not see the email at the time it was sent to her. In addition, despite her "exhaustive" meeting on March 21 regarding the SCP and evidence that Mr. Iksil and Mr. Grout viewed the mismarking as having reached "idiotic" and

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[715] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012). Counsel for Ms. Drew told the Subcommittee that she was not aware of the explanation of Mr. Cutler and Mr. Cavanagh.

[716] The same three credit index positions were the subject of the Grout spreadsheet from the prior week. See undated spreadsheet referencing 3/16/2012, JPM-CIO-PSI-H 0002812.

[717] The email also described $100 million in losses caused by Eastman Kodak and Rescap bankruptcies that had already taken place.

[718] See also prior communications involving Mr. Grout, CIO, or Mr. Iksil, CIO, cited earlier in this section, using the word "lag" to refer to unreported losses. See also March 29, 2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "first draft of the presentation," JPM-CIO 0003543-554, at 545 ("the book is huge: 96Bln IG9 and 38Bln S9 fwds. ... Series 9 lag is overwhelming: total loss YTD is 1.5bln."). See also 2013 JPMorgan Chase Task Force Report, at 47.

"monstrous" proportions and wanted to start showing the losses, Ms. Drew told the Subcommittee that no one informed her at the time about the mismarking.[719]

On the same day, March 21, 2012, that Mr. Martin-Artajo and Mr. Macris met with Ms. Drew to discuss the synthetic credit book, the CIO reported its only profitable day during the second half of March. Its internal daily P&L statement reported a gain of over $700,000.[720] The next day, March 22, 2012, the CIO reported a daily loss of $1.8 million.[721]

(4) Trading Stopped

On Friday, March 23, 2012, Ina Drew ordered Mr. Martin and Mr. Iksil to "put phones down" and stop trading credit derivatives related to the SCP book.[722] The halt in trading did not, however, produce a halt in the mismarking.

The SCP book, which was essentially frozen in place on March 23, continued to incur losses throughout the trading day. Mr. Iksil informed Mr. Martin-Artajo that the SCP losses that day were huge, between $300 and $600 million, depending upon whether the CIO used the midpoint or "best" prices available in the daily price range (bid-ask spread): "I reckon we have today a loss of 300M USING THE BEST BID ASKS and approximately 600m from the mids."[723]

Using instant messaging, Mr. Iksil asked Mr. Grout to find out from Mr. Martin-Artajo what level of losses to report for the day. Mr. Iksil characterized the huge losses as "hopeless," predicted "they are going to trash/destroy us," and "you don't lose 500 M[illion] without consequences," concluding that he no longer knew what marks to use:

> **Mr. Iksil:** "[I]t is over/it is hopeless now ... I tell you they are going to trash/destroy us ... [T]onight you'll have at least [$]600m[illion], BID ASK MID BID ASK YOU HAVE

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[719] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[720] See OCC spreadsheet, OCC-SPI-00000298. Numbers do not reflect restated P&L figures. The Subcommittee is unaware of any analysis of the derivative marks underlying the $700,000 to determine the extent to which those marks reflected prices within the daily bid-ask spread.
[721] Id. The Subcommittee is unaware of any analysis of the derivative marks underlying the $1.8 million loss to determine the extent to which those marks reflected prices within the daily bid-ask spread.
[722] Subcommittee interview of Ina Drew, CIO (9/7/2012). See also 5/5/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, "per the last call, here are the facts," JPM-CIO-E 00013052 ("Jamie asked if the position was increased after you ordered to stop trading. I think that your instruction came on March 23 following the SAA meeting in the previous day in which Bruno presented the book.").
[723] See 3/23/2012 instant messaging session between Bruno Iksil, CIO, and Javier Martin-Artajo, CIO, JPM-CIO 0003507-508, at 508. See also 2013 JPMorgan Chase Task Force Report, at 51.

[$]300M[illion] AT LEAST… [I]t is everywhere/all over the place we are dead I tell you --"

[Later that day]

Mr. Grout: "[W]ill you give me the color please? [I]f there is some."

Mr. Iksil: "[N]othing for now … [I]t will be negotiated with the IB [Investment Bank] at the top and I am going to be hauled over the coals … [Y]ou don't lose [$]500M[illion] without consequences --"

[Later that day]

Mr. Iksil: "[A]sk javier what pnl [profit and loss] we print today. … please, go see javier. I don't know which pnl I should send …"

Mr. Grout: "Did you talk to Javier?"

[5 minutes later]

Mr. Iksil: "yes. we show -3 [basis points] until month end on this one … [A]ll that I am asking you is to tell Javier what you see. [T]hat's it and he decides what we show because me, I don't know anymore."[724]

Less than an hour later, Mr. Iksil repeated many of the same complaints to a CIO colleague, stating that the crux of the problem was that the CIO had become "too big for the market."

Mr. Iksil: "[I]t had to happe[n] [I]t started back in 2008 you see [I] survived pretty well until [I] was alone to be the target … [Y]es [I] mean the guys know my position because [I] am too big for the market. … [B]ut here is the loss and it becomes too large and this is it … [W]e realize that [I] am too visible"[725]

Despite the emails predicting losses of between $300 million and $600 million, at the end of the day on March 23, 2012, the CIO reported internally a daily loss of only $12.5 million.[726]

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[724] 3/23/2012 instant messaging session between Bruno Iksil, CIO, and Julien Grout, CIO, JPM-CIO 0003515-541, at 528-541.

[725] 3/23/2012 instant messaging session between Bruno Iksil, CIO, and Ade Adetayo, CIO, JPM-CIO 0001240-246, at 244-245.

[726] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above. Numbers do not reflect restated P&L figures. The Subcommittee is unaware of any

(5) Accusing the Investment Bank

In the second half of March as the SCP losses continued to pile up, CIO management began to suspect and then blame the JPMorgan Chase Investment Bank for some of its trading problems. The Investment Bank, like the CIO, managed a large portfolio of derivatives and was active in the credit derivative markets. In fact, the original authorization for the CIO to trade in credit derivatives indicated that the CIO should use the Investment Bank's marks, because the Investment Banker was a market maker in the product.[727] However, by 2012, the CIO was not using the Investment Bank's marks (if it ever did), leading to a growing valuation discrepancy between the two entities within JPMorgan Chase. This discrepancy not only drew the SCP valuations into question overall, they also caused problems because the CIO and Investment Bank were sometimes on opposite sides of the same credit derivative trade, and settling those trades using the Investment Bank marks would result in much larger losses for the SCP than it would otherwise record using its own, more favorable marks.[728]

Mr. Macris and Mr. Martin-Artajo communicated a variety of concerns in emails and telephone conversations, including that the Investment Bank was competing with the CIO, assigning unfavorable marks to positions where the SCP held the opposite side of the trade, and disclosing information about the CIO's positions to the marketplace at large.[729] In response, a senior Investment Bank executive, Daniel Pinto,[730] investigated the allegations and determined they were untrue.

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analysis of the derivative marks underlying the $12.5 million loss to determine the extent to which those marks reflected prices within the daily bid-ask spread.

727 See "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability" (undated, but in 2006), at 11, OCC-SPI-00081631.

728 See, e.g., 3/23/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, copy to Achilles Macris, CIO, "Synthetic Book – URGENT," JPM-CIO-PSI 0000416 (discussing whether to "settle" SCP trades with the Investment Bank and noting that settling them could lead to a "permanent loss" for the SCP book as large as $350 million).

729 See, e.g., 3/23/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, "This is not 'normal'….," JPM-CIO-PSI 0000415 (**Mr. Macris:** "Javier and team here feel 'surrounded' and blindsided in terms of methodology etc. I think that we will need to intervene and somehow mediate this issue with the IB and insure the unbiased role of Ashley and Risk management. Let's please decide and coordinate on our exact course of action, as this issue is really taking a worrisome direction that could be embarrassing to the firm. Clearly, the IB knows our positions as well as the 'checkmate' in terms of Capital treatment. They will certainly like to settle with CIO and close their short position in IG. … The problem with 'settling' with the IB and help closing their shorts, is that CIO will be substantially short the market, post settlement. This is not where we [sic] I would like us to be in the middle of this strong market."); 3/23/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, copy to Achilles Macris, CIO, "Synthetic Book – URGENT," JPM-CIO-PSI 0000416 (**Mr. Martin-Artajo:** "[D]uring the last week we have been trying to work on our best path for the Synthetic Book trying to both to reduce our overall RWAs and get the book in a balanced way. The problem with this has been that we have engaged in a dialogue with Risk Management (Ashley Bacon), QR (Venkat) and the IB (Guy America and Daniel Pinto) and this has resulted in a heightened alert about our positions in the IB and is really hurting us in various ways. … and also we have worse marks against our current book. … In any case it is very important that we need to let the IB know that we need to talk to

On March 23, 2012, the same day that Ms. Drew ordered a halt in the SCP derivatives trading, the allegations were discussed in a telephone conversation between Mr. Martin-Artajo and Keith Stephan, the market risk officer in the CIO's London office.[731]

Mr. Martin-Artajo: "Hey Keith, man. Having a lot of headaches here."

Mr. Stephan: "... I mean, I've been through the book before with Pete [Weiland] as you're aware. I talk to him every day about it. So I have some patience to take Irv through it. But then it seems like there is a breakdown in the link of communication here because I was under the impression that everybody was very clear that ... what we were doing was adding sort of another 20 to 25 [b]illion dollars of risk in one sense, right, you know, on the run? And now it seems like everybody says no we don't, we didn't know what we were doing ...."

Mr. Martin-Artajo: "No, no, no. I spoke with Ina. The reason I told her, the reason I'm doing that is to defend the position, okay? We can reduce that [RWA]. I just didn't want the investment bank to roll over us, okay? This[732] has increased the book by 25 or 26 billion of RWA which is freaking them out. ... So this is going all the way up, man, just, just for you to know. Achilles and I, we've raised this issue to Ashley Bacon and he's going to talk to [Chief Risk Officer John] Hogan and he's going to talk to Daniel Pinto and he's going to talk to Guy America, okay? So we're escalating the problem here, all the way up, okay?"

Mr. Stephan: "Okay."

Mr. Martin-Artajo: "The issue here is that the investment bank is manipulating the prices. They want us out of – you know how valuable the IG9 position is, right?"

Mr. Stephan: "I know."

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them to stop this negative [s]piral that we are seeing in the market because we have disclosed too much information to them and we are sever[e]y affected by this. Specifically on the long IG9 position that is getting the attention of the market." **Ms. Drew**: "You guys need to get irv [Goldman] and call [CRO John] hogan and explain. I can give him a heads up.").

[730] At the time, Mr. Pinto was co-head of fixed income and CEO of the bank's Europe, Middle East and Africa (EMEA) region. Mr. Pinto is now the co-head of Corporate and Investment Banking, a position shared with Michael Cavanagh, JPMorgan Chase.

[731] 3/23/2012 recorded telephone conversation between Keith Stephan, CIO, and Javier Martin-Artajo, CIO, JPM-CIO-PSI-A 0000060. See also, partial transcript of this conversation at JPM-CIO 0003493.

[732] Mr. Martin-Artajo was referring to several recent large trades by the CIO, including a $9 billion purchase of one credit index and a $14 billion purchase of another, for a total of $23 billion.

Mr. Martin-Artajo: "And we have a lot of it, okay? So it's almost they are trying to squeeze us out. ... We have a good position, it's not performing and we are getting paranoid here, okay? ... But this is out of my control or Achilles' control now. This is Ina. Ina has to decide this with, with, with whoever it is."

Mr. Stephan: "Jes Staley."

Mr. Martin-Artajo: "With Jes, basically. ... They [the Investment Bank] are not trading volume. They are just avoiding us, okay? They are just giving us bad marks. So they are manipulating the market and we have to stop it because now it's coming to me from the market. The market is asking us what ... are we doing? Okay? They think that we have a large position. Okay? And, you know, that's the last thing you want."

That same day, March 23, Mr. Pinto spoke with Achilles Macris about the accusations against the Investment Bank.[733] During the conversation, Mr. Macris began to retreat.

Mr. Macris: "So we are acting after Ina's instruction, you know, who, you know, wants to talk to [John] Hogan about it ...."

Mr. Pinto: "Ok, well then, I need to talk to Hogan too. ... [W]e don't have any collateral, significant collateral disputes with anyone. I will, I'm trying to ... really check on all of the valuations of the positions. ..."

Mr. Macris: "... Javier has, like, you know, sort of, you know, some, you know, feedback, and you know, issues, you know, with the dealers. ..."

Mr. Pinto: "I should say that it's a situation where I need to do a formal investigation. And, really, if Javier is fantasizing about this, he's going to really, he will, he will have a ba-, a hard time here. I mean, if he's right, I need to fire a lot of people. ..."

Mr. Macris: "Yeah, exactly, you know, I mean, I'm not on that page so much. Like, I don't disagree with you. You know, this elevation is not my style, right?"

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[733] 3/23/2012 Subcommittee transcription of recorded telephone conversation among Achilles Macris, CIO, and Javier Martin-Artajo, CIO, and Daniel Pinto, Investment Bank, JPM-CIO-PSI-A 0000140.

Mr. Pinto: "From what I understand, how we got here, honestly, I don't care. What I see, is that it is an accusation that the investment bank, with someone leaking the position of CIO, is acting against CIO on mismarking the books to damage CIO. ...."

Mr. Macris: "No, it's not, that is not to my understanding. My understanding is, listen, I, yeah, I don't know. These are very aggressive comments. ... I don't know how ... this has become ... an issue of disciplinary action ...."

Mr. Pinto: "Yeah, that's fine. But that, at the moment what it is, is a real accusation. It's not that a concern that you may have for the future. And the way that the people think, over this side, is someone in my group, did something wrong. Either mismarked the books or used information that they should have not used to trade against your position and acted against the benefit of the, to harm the bank. So that is what is floating around."[734]

Mr. Pinto then questioned Mr. Martin-Artajo about the accusations against the Investment Bank.

Mr. Pinto: "So my question is, there is something that DID happen, that in any shape or form, you think that our investment bank is trading against your position, because the position was leaked in some weird form to them?"

Mr. Martin-Artajo: "Ok, I don't think that there is anything here that has happened that is of, of a serious nature. What I think is happening here, that is of a serious nature, is that what can happen with the marks that we get from the investment bank. Ok?"

Mr. Pinto: (laughs) "... So now we go to the marks. Have you got any, we don't have any collateral disputes, so, or very little ones. Have you, have you, can you see, any of the marks, that they are deliberately un-, mismarked to hurt your position? ..."

Mr. Martin-Artajo: "Ok, what happens is that, every time we put a trade on, I get, you know, I get, sort of like an immediate ask from, from the dealer into the position that we just traded, right? So, I get evidence that they have access either to ICE or to some other way to look at what we do and you know, I am concerned about that ...?"

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[734] Id.

Mr. Pinto: "Honestly, I don't, I, I don't know. Is that the case? That someone is accessing your, your position? Because Olivier gave it to them or someone? So I need to fire that person."

Mr. Martin-Artajo: "Ok."

Mr. Pinto: "So we need to be extremely careful."[735]

Ultimately, Mr. Pinto pointed out that the market had likely become aware of the CIO's positions, because the CIO's positions at the time were enormous and the market had a limited number of participants. He also promised to examine the issue of how the positions were being marked, since the CIO and Investment Bank had different values on their books for the same credit derivatives.

Mr. Martin-Artajo: "[R]isk management knows that we have large, large, concentrations, ok? Now, I, I, I am hearing in the market that, you know, some of the guys in the company are talking to them and wondering what we are going to do with the positions. Now, I, I just want to stop that ...yeah?"

Mr. Pinto: "But Javier, Javier, Javier, Javier, my friend. You know that over these days, because of the difference in performance, everyone is stating that. So that it's very likely --."

Mr. Martin-Artajo: "But I want it to be inside the company. I don't want it to be, known out there. ..."

Mr. Pinto: "But ... obviously, you bought those positions in the market so it is very likely that some of the market people can put two and two together. ... That someone is trading against you, knowing your position, is something that I will be extremely surprised that is going on but we'll take a look and see if that is coming up and that's it."

Mr. Martin-Artajo: "Ok, thank you. Thank you for that Daniel. Thank you for that."

Mr. Pinto: "And if you could, so how much do you think is [the] damage?"

Mr. Martin-Artajo: "It's a few basis points but it's in a large position so that's the issue."

Mr. Pinto: "So it's not many millions of dollars?"

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[735] Id.

Mr. Martin-Artajo: "I don't know like, maybe 250?"

Mr. Pinto: "Two hundred and fifty million dollars?"

Mr. Martin-Artajo: "Yeah."

Mr. Pinto: "Ok. And you think that the fact that we marked the book that way, so we are benefitting with that amount and you are having a loss of that amount?"

Mr. Martin-Artajo: "Well, I, I just, I'm just concerned that the bid/offer spread is wide, and I don't know where the, the, the prices are when we trade. That's basically what it is, really."

Mr. Pinto: "Ok, so then, then, I think that we need to get Jean Francois[736] to take a look of the marks and see if there is anything that is being done inappropriate. What I was telling Achilles is that we haven't ... had recently, any substantial ... discrepancies in the valuations with clients, or any market disputes."

Mr. Martin-Artajo: "Ok."

Mr. Pinto: "So, if we would have something of that nature, we would have substantial market disputes. But in any case, so I'll take a look and then we'll take it from there. ..."

Mr. Pinto: "But, but, yeah but to think, to think, that someone from us ... went and openly in the market, talked about your positions? Really? I would be extremely surprised."

Mr. Macris: "Ok."

Mr. Pinto: "That the market knows that, what your positions are? That may be, because you bought tons of it."

Mr. Macris: "Yeah."[737]

According to JPMorgan Chase, the Investment Bank reviewed its books, determined it had not traded in size against the CIO, had correctly marked its positions, and had no material collateral disputes indicating a problem with its marks.[738] Mr. Pinto's logic in identifying collateral disputes as a red flag of mismarking shows that the bank itself

[736] Jean Francois Bessin was the director and global head of valuation for the Investment Bank.
[737] 3/23/2012 Subcommittee transcription of recorded telephone conversation between Achilles Macris, CIO, Javier Martin-Artajo, CIO, and Daniel Pinto, Investment Bank, JPM-CIO-PSI-A 0000140.
[738] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

should have focused on the CIO's growing collateral disputes in March and April as evidence of a mismarking problem. JPMorgan Chase also told the Subcommittee "there was no evidence that the Investment Bank was leaking" information about the CIO's positions to the market at large.[739] Instead, as Mr. Pinto pointed out and as Mr. Macris admitted, the market's awareness of the CIO's positions was attributable to the CIO's voluminous trading.

(6) Mismarking Continued

When Ina Drew halted trading in the SCP book on March 23, 2012, the CIO personnel in London continued to use more favorable prices than those at the midpoint to value the SCP's credit derivatives, although they also began reporting substantially more losses than previously. On Monday, March 26, the CIO reported a daily loss for the SCP of $32 million and year-to-date losses of $254 million. The next day, March 27, the CIO reported a $45 million loss, its highest daily loss during the year to date. On March 28, the CIO reported a $51 million loss, and on the day after that, a $50 million loss. Altogether, the SCP book lost $179 million in the first four days of the week, and the year-to-date loss by then totaled $399 million.[740] JPMorgan Chase told the Subcommittee that the CIO traders were apparently attempting to get the reported losses closer to the actual losses in light of the upcoming end to the quarter.[741]

The last day of the week was March 30, 2012, which was also the last business day of the first quarter of the year. The marks at quarter-end are more important than on other days or month-ends, because quarter-end information is included in various publicly filed financial reports, and publicly traded corporations are required to attest to their accuracy. Within JPMorgan Chase, month-end and quarter-end marks were also validated within each line of business by an independent internal review team, the Valuation Control Group (VCG).[742]

Ina Drew expressed concern about how the SCP would perform on the last day of the month and how the day's losses would affect the quarter as a whole.[743] Earlier in the month, before she halted SCP

[739] Id. (noting that the bank's compliance group had come to that conclusion, which Mr. Martin-Artajo accepted).
[740] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above. Numbers do not reflect restated P&L figures.
[741] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012).
[742] 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, JPM-CIO 0003637-654, at 642.
[743] See 3/30/2012 email exchange between Irvin Goldman, CIO, and Javier Martin-Artajo, CIO, "Any better numbers so far?," JPM-CIO 0003564-565 ("No further progress on estimate yet. Will update you again in one hour." "As I mentioned to Keith, Ina wants a summary of breakdown when u have it bid offer attribution etc."). See also transcript of recorded telephone conversation between Irvin Goldman, CIO, and Javier Martin-Artajo, CIO, JPM-CIO 0003555

trading, the CIO traders had engaged in a series of enormous trades, involving $40 billion in credit derivatives, which dramatically increased the size of the portfolio and which the OCC later characterized as "doubling down" on the book's trading strategy. Due to the portfolio's enormous size by the end of March,[744] even small price variances in the positions could produce large losses.[745]

On March 30, 2012, the CIO ended up reporting losses totaling $319 million, more than six times larger than any other daily loss up to that point in the year.[746] When added to the previous day's cumulative year-to-date loss of $399 million, the losses on the last day of March produced a grand total for the quarter of almost $719 million.

Even that large number, however, hid the true extent of the losses in the SCP book at quarter end. A recorded telephone conversation on March 30, 2012, between Mr. Grout and Mr. Martin-Artajo, indicates that they were continuing to use overly favorable prices.

> **Mr. Grout:** "Go ahead and tell me where I should put…"
>
> **Mr. Iksil:** Yes."
>
> **Mr. Grout:** "Tell me where I should take a reserve?"
>
> **Mr. Iksil:** "If you can avoid doing that screwed-up thing you can really stay within bid-ask. It's better you see since you don't have a reserve, you see?"

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and JPM-CIO-PSI-A 0000069 ("**Mr. Goldman:** "Ina just called me…she was curious if you had any range of estimate about what the day is going to look like." **Mr. Martin-Artajo:** "I don't have that yet, unfortunately. I don't have it Irv. I don't have it. It is not looking good." **Mr. Goldman:** "You still don't know if it's minus 50 or minus 150?" **Mr. Martin-Artajo:** "I don't know man. I have a bad feeling about bid-offer spread here." **Mr. Goldman:** "If we get what you are nervous about, where do you think it could be?" **Mr. Martin-Artajo:** "It could be we have a very bad number, could have 150."). See also 3/30/2012 email from Achilles Macris, CIO, to Irvin Goldman, CIO, copies to Ina Drew, CIO, and others, "synthetic credit – crisis action plan," JPM-CIO-PSI 0001220-222, at 221 (**Mr. Macris:** "Just spoke to Ashley [Bacon] regarding the issue and he has agreed to dedicate Olivier to help us with RWA targeting for Q2. …the objective is to determine what is the best course of action to insure that the book is and remains balanced in risk and P+L terms. …**clearly, we are in crisis mode on this.**" [Emphasis added.]). See also 2013 JPMorgan Chase Task Force Report, at 51-53.

[744] See 3/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "first draft of the presentation," JPM-CIO 0003543-554, at 545 ("the book is hug : 96Bln IG9 and 38Bln S9 fwds. … Series 9 lag is overwhelming: total loss YTD is 1.5bln.").

[745] See 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at 2, JPM-CIO 0003637-654, at 638. See also 2013 JPMorgan Chase Task Force Report, at 52.

[746] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above. Numbers do not reflect restated P&L figures. See also 6/29/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, CIO, and others, "2nd Wilmer Hale Call," OCC-SPI-00071386 ("Real market marks were trued by end of Mar and the large loss on 3/31/2012 was due to that one reason.").

Mr. Grout: "For the United States, we're back to the bid-ask on the on-the-run … and for Europe, if you want, I can scratch out two bps [basis points] on the crossover."

Mr. Iksil: "But you see what I mean? This is a little bit at the limit. We should probably do something cleaner with a, you see, a lesser result. You see what I mean?"

Mr. Grout: "Okay. But if I take off … I can take off four bps on the crossover."

Mr. Iksil: "…okay, then do that. Do that and we'll see. Okay? … I'm sorry to ask you to do this. But I prefer to do it this way. It's cleaner, you see."

Mr. Grout: "I must look into this because …"

Mr. Iksil: "You see, now it's okay. I have the connection. I will validate it for you right away, okay?"

Mr. Grout: "Okay, that's good."[747]

At the end of the business day in London, the CIO traders sent an SCP P&L Predict estimating that the daily losses on March 30, 2012, would total $138 million.[748] The final P&L for the day reported considerably larger losses of $319 million, a revised total apparently due to changes made by CIO personnel in New York.

Despite that massive daily loss, which followed three straight months of losses that seemed to be escalating rather than easing, JPMorgan Chase did not alert the OCC, its primary Federal regulator, to the problems being experienced by the CIO's Synthetic Credit Portfolio. In fact, bank management did not even begin a dialogue with the OCC about the SCP until April 9, 2012, after media reports unmasked the bank's role behind the whale trades roiling credit markets, and even then downplayed the SCP's losses and the risks to the bank. The OCC told the Subcommittee that the bank should have reported the SCP losses much earlier.[749]

The evidence indicates that the mismarking continued into April, although the CIO continued to report much higher losses than in the

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[747] 3/30/2012 transcript of recorded telephone conversation between Bruno Iksil, CIO, and Julien Grout, CIO, JPM-CIO 0003562-563.

[748] See 3/30/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, "CIO Core Credit P&L Predict [30 Mar]: -$138,135k (dly) -$583,296k (ytd)," JPM-CIO 003567-569, at 569.

[749] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). For more information on the poor quality of bank disclosures to the OCC about the SCP, see Chapter VI.

beginning of the year.[750] On Friday, April 6, 2012, Bloomberg and the Wall Street Journal published the articles that first directed public attention to the SCP book.[751] On that same day, Jamie Dimon and Douglas Braunstein asked Ina Drew for a "full diagnostic" of the SCP by Monday.[752] Ms. Drew then asked Achilles Macris for more detailed information on the P&L status of the SCP book.

Mr. Macris responded that he was unsure how big the losses or "drawdown" in the SCP book would be at the end of the second quarter, since it would be "highly depend[e]nt on the marks."[753] Later that day, Mr. Martin-Artajo sent an email to Ms. Drew estimating that the second quarter losses would not exceed $200 million, provided they "exclude[d] very adverse marks" from the SCP books:

> "In terms of the worse case scenario for us for Q2 [second quarter] I am redoing the work once again to make sure that if we exclude very adverse marks to our book the potential loss due to market moves or any economic scenario including defaults would not exceed a number higher than -200 MM USD [$200 million] at the end of Q2 with the current book as it is."[754]

The email did not explain to Ms. Drew how the CIO could "exclude very adverse marks" from the SCP book, and in that email exchange, she did not ask.

The first trading day after the whale trade media reports was April 10, 2012.[755] At the close of business in London, the CIO traders sent out

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[750] See 2013 JPMorgan Chase Task Force Report, at 46 ("[F]rom at least mid-March through early April, the Synthetic Credit Portfolio's losses appear to have been understated.").

[751] "London Whale Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne (4/6/2012); "JPMorgan Trader Iksil's Heft Is Said to Distort Credit Market," Bloomberg News, Stephanie Ruhle, Bradley Keoun and Mary Childs (4/6/2012), http://www.bloomberg.com/news/2012-04-05/jpmorgan-trader-iksil-s-heft-is-said-to-distort-credit-indexes.html.

[752] See 4/6/2012 email from Ina Drew, CIO, to Achilles Macris, CIO, "Credit," JPM-CIO-PSI 0000571, at 573 (**Ms. Drew:** "Jamie and Doug want a full diagnostic monday. I will need it sunday night.").

[753] See 4/6/2012 email from Ina Drew, CIO, to Achilles Macris, CIO, "Credit," JPM-CIO-PSI 0000571 at 572; 4/6/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, and Javier Martin-Artajo, CIO, JPM-CIO-PSI 0001582-583, at 583 (**Mr. Macris:** "Any further draw-down, will be the result of further distortions and marks between the series where we are holding large exposures. ... I am however unsure on the potential magnitude of an 'one touch' draw-down for Q2 which is highly depend[e]nt on marks."). See also 4/9/2012 email from Douglas Braunstein, JPMorgan Chase to Jamie Dimon, JPMorgan Chase, "Follow up", JPM-CIO-PSI 0000944 ("Have asked Ina and Wilmot for clear analysis of the positions – maturities, balances, spreads (current) and normalized.").

[754] 4/6/2012 email exchange among Javier Martin-Artajo, CIO, Ina Drew, CIO, and Achilles Macris, CIO, "Update," JPM-CIO-PSI 0001429.

[755] The markets were closed on Monday, April 9, due to Easter. See 2013 JPMorgan Chase Task Force Report, at 64, footnote 78.

an SCP P&L Predict projecting a daily loss of only about $6 million,[756] which suggests that a decision had been made to continue the mismarking. Less than ninety minutes later, however, a second P&L Predict email was sent showing an estimated loss of $395 million.[757] That loss was 60 times greater than the loss reported in the first SCP P&L Predict.

The difference between the two estimates was $389 million. Of that difference, a comparison of the two estimates shows that $142 million or nearly half of the difference was directly attributable to the CIO's changing the marks on two of its largest positions, the "CDX.IG S09 10Y" and the "iTraxx.Main S09 10Y." The mark for the SCP's IG9 10 year credit index position was changed from 123.75 to 126,[758] a significant change on a position with a notional value of $79 billion; it increased the daily loss on this position from $330 million to $418 million, a $88 million increase. Almost as dramatic, the mark for the iTraxx Main S9 10 year position was changed from 164 to 167.25,[759] which, for a position with the notional value of $23 billion, increased its daily loss from $227 million to $282 million, a $55 million increase. These increased losses were combined with over 100 other gains and losses in the SCP book.

When asked about the huge increase in the reported daily loss after the 90-minute interval, Bruno Iksil later told the JPMorgan Chase Task Force investigation that the first number was simply an "accident."[760] When the two emails are compared, however, they contain multiple differences at various points, including the new marks just described; there is no single typographical or arithmetic mistake. In its 2013 report, the JPMorgan Chase Task Force wrote that the CIO trader responsible for the SCP daily marks – who was Mr. Grout – had been directed by an unnamed trader to use the lower number in the first P&L Predict.[761] According to the JPMorgan Chase Task Force report, after the first P&L Predict was emailed, there was a "confrontation between the other two traders" – again unnamed – and a decision was made to send out the second P&L Predict. Mr. Venkatakrishnan told the JPMorgan Chase Task Force that, on April 10, 2012, after Mr. Martin-Artajo indicated that the CIO planned to value the SCP positions at what they were really

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[756] See 4/10/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, dated April 10, time 19:02:01 GMT, subject "CIO Core Credit P&L Predict [10 Apr]: -$5,711k (dly) - $626,834k (ytd). See JPM-CIO 0003570-572.

[757] See 4/10/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, time "10 Apr 2010 20:30:42 GMT," "CIO Core Credit P&L Predict [10 Apr]: -$394,735k (dly) - $1,015,858k (ytd)," JPM-CIO 0003573.

[758] Compare email from Julien Grout, CIO, to the CIO Credit Positions mailing list, dated April 10, time 19:02:23 GMT, JPM-CIO-PSI 0032406, with email from Julien Grout, CIO, to the CIO Credit Positions mailing list, dated April 10, time 20:31:08 GMT, JPM-CIO-PSI 0023061.

[759] Id.

[760] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012) (Harry Weiss).

[761] See 2013 JPMorgan Chase Task Force Report, at 64-65.

worth rather than what the market showed, Mr. Venkatakrishnan told him instead to "let the losses flow," after which Mr. Martin-Artajo walked away without saying anything.[762] Trader interviews with the JPMorgan Chase Task Force suggest that Mr. Martin-Artajo then directed the second SCP P&L Predict to be emailed.[763]

With respect to the second P&L report, Mr. Grout told the Task Force investigation: "Bruno was scared about a big number. Bruno thought it was real. Bruno spoke with Javier and Achilles. They decided to show the losses."[764] His statement suggests Mr. Iksil and his colleagues may have been "scared" about hiding a $400 million loss on that day, given the media spotlight on the whale trades.

In an April 10, 2012 email sent by Ina Drew at the end of the day to Jamie Dimon, Douglas Braunstein, John Wilmot, and others, she attributed the $400 million loss to the market moving against the CIO's positions in anticipation of its liquidating the SCP book:

> "[T]he mtm [marked-to-market] loss is [$]412 mil today, an 8 standard deviation event mostly from the steep[en]ing of the [IG]9 curve. SPECIFIC to our position. No other high grade or high yield index moved much clearly anticipating our liquidation."[765]

Her email notified the most senior officials in the bank about an "8 standard deviation event," meaning a wholly unexpected and unpredictable loss; however, bank officials told the Subcommittee that, at the time, they were expecting large losses as a result of the media attention.[766]

The final daily loss recorded internally for the SCP by the bank on April 10, 2012, was $415 million.[767] That $415 million loss was the single largest daily loss for the book up to that point in the year. The

[762] JPMorgan Chase Task Force interview of C.S. Venkatakrishnan, JPMorgan Chase (partial readout to the Subcommittee on 1/18/2013).
[763] JPMorgan Chase Task Force interviews of Julien Grout, CIO, and Bruno Iksil, CIO (partial readout to the Subcommittee on 1/18/2013).
[764] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[765] 4/10/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "Credit," JPM-CIO-PSI-H 0002276.
[766] Subcommittee interview of Ina Drew, CIO (12/7/2012) (noting that the news article itself was "a cause of a large piece of the loss," and that Messrs. Iksil, Martin-Artajo, and Macris believed it was the "provocateur" for losing money); see also JPMorgan Chase Task Force interview of Julien Grout, CIO (partial readout to the Subcommittee on 1/18/2013) (stating he expected a "bloodbath" of losses based on public disclosure of market positions in the media reports).
[767] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above. Numbers do not reflect restated P&L figures.

cumulative year-to-date losses then jumped to $1.2 billion, the first time the cumulative SCP losses had crossed the $1 billion threshold.[768]

Three days later, on April 13, 2012, JPMorgan Chase held an earnings call and discussed the whale trades for the first time. Mr. Dimon dismissed concerns about the trades as a "complete tempest in a teapot."

Around the same time, in a recorded telephone conversation, Ms. Drew told Mr. Martin-Artajo: "[S]tart getting a little bit of that mark back ... so, you know, an extra basis point you can tweak at whatever it is I'm trying to show."[769] When asked about this telephone conversation, Ms. Drew told the Subcommittee that the traders had told her they were being "conservative in the bid offer," and she wanted them to be more aggressive. "If the position is starting to mean revert," Ms. Drew said, she wanted them to "show it."[770] Her recommendation that the CIO traders "tweak" the marks, as well as her explanation that she wanted them to be less conservative in their analysis, provide additional evidence of the imprecise and subjective nature of the marks assigned by the bank to its credit derivative holdings. On April 17, 2012, the SCP showed a gain of $10 million, after eight consecutive days of losses.[771]

On April 19, 2012, in a recorded telephone conversation, Mr. Iksil, Mr. Grout, and another CIO colleague, Luis Buraya, discussed an ongoing collateral valuation dispute caused by a disagreement over the accuracy of the CIO marks. Mr. Iksil commented:

> "[W]e have to be careful, not to be too stretched. ... The point is we need to have a strong position. ... I think our method is good. But we need to be careful that we don't look like we are too stretched, you know, on the one we use. ... [W]e are less stretched on the, on the mark we use and that's it, you know, from the bid-ask."[772]

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[768] Due to the media attention and escalating losses in the synthetic credit book, Ina Drew, CIO, set up daily conference calls for the next two days (leading up to the quarterly earnings call) with Jamie Dimon, Douglas Braunstein, Barry Zubrow, John Hogan, Jes Staley, and Achilles Macris. See 4/10/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "8:30am Calls Set up for Wednesday and Thursday," JPM-CIO-PSI 0001719.

[769] Subcommittee transcription of undated (likely mid to late April 2012) recorded telephone conversation between Ina Drew, CIO, and Javier Martin-Artajo, CIO, JPM-CIO-PSI-A 0000076.

[770] Subcommittee interview of Ina Drew, CIO (9/7/2012).

[771] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above. Numbers do not reflect restated P&L figures. The Subcommittee is unaware of any analysis of the derivative marks underlying the $10 million to determine the extent to which they reflected appropriate prices within the daily bid-ask spread.

[772] 4/19/2012 Subcommittee transcription of recorded telephone conversation among Bruno Iksil, Julien Grout, and Luis Buraya, CIO, JPM-CIO-A 00000018 (**Mr. Iksil:** "...we have to be careful not to be too stretched. ..." **Mr. Buraya:** "I can imagine the next headline 'JP Morgan is hoarding cash. They are not marking the stuff in the right place.' I can see it happening. ..." **Mr. Iksil:** "...The point is we need to have a strong position. So, we need to work. We need to

Mr. Iksil's comment may have meant that he did not want to use a mark that was too far from the midpoint of the bid-ask spread, since another party would be contesting the validity of the mark. Mr. Buraya commented in part: "I can imagine the next headline 'JP Morgan is hoarding cash. They are not marking the stuff in the right place.' I can see it happening." Mr. Iksil replied in part: "... and if they want us to line 500 [million] lower, so be it. So be it. Right? There's nothing wrong with it."[773] Mr. Iksil's response demonstrates, again, the malleable nature of the bank's credit derivative valuation process in which he viewed a half a billion dollar downward adjustment of the SCP book's value as a possible outcome if management wanted it.

C. Ending the Mismarking

The CIO's mismarking of the SCP appears to have finally ended in May 2012, as part of a concerted effort by JPMorgan Chase to resolve a series of collateral disputes with CIO counterparties that began in March and intensified throughout April.[774] The disputes apparently arose, in

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be less stretched. ..." **Mr. Grout:** "...now, I think Javier should be aware of this. Because as you suggest, that could be another article in the press. ..." **Mr. Iksil:** "...all we have to do is stick to our method. I agree, not change anything. I think our method is good. But we need to be careful that we don't look like we are too stretched, you know, on the one we use. So on the one hand, we acknowledge these quotes. On the other hand, from the prices we use, you know, we need to be less stretched. ... So just with that, you know, I think, we keep talking to Jason [Hughes]. We keep adjusting from what show us, and we are less stretched on the, on the mark we use and that's it, you know, from the bid/ask." **Mr. Buraya:** "...we do the exercise on Monday [April 23], or we are marking where we see it. We give it to Jason. So we prove that 10 days before month end, we were where we were saying we were. Yeah? ... It would be nice ... otherwise I can tell you, they might actually, without us saying anything, they might actually come and ask on Monday 'ok, we want to see where the market is and what you guys have.'" **Mr. Iksil:** "Yeah, that's why, that's why we need to be not too stretched on the marks, you know, so that whatever adjustments there are, we can do it, you see? But they have to provide, you know, marks with a proper data, you see?" **Mr. Buraya:** "No I mean, exactly. I totally agree. That's, that's why it is important to agree with Jason. ... Better to be prepared and not diplomatically correct." **Mr. Iksil:** "...and if they want us to line 500 [million] lower, so be it. So be it. Right? There's nothing wrong with it. But we have to address the problem, right?"). See also "JPMorgan restates first-quarter results, citing trader marks," Reuters (7/13/2012) http://www.reuters.com/article/2012/07/13/us-jpmorgan-loss-restatement-idUSBRE86C0FR20120713.

[773] Id.

[774] See 4/20/2012 email from Mark Demo, JPMorgan Chase, "Largest OTC Collateral Call Dispute Report plus Update on Collateral Disputes Reported to Supervisors," JPM-CIO 0003590-596, at 592. See also 4/20/2012 email from Mark Demo, JPMorgan Chase, to John Wilmot, CIO, and others, "Largest OTC Collateral Call Dispute Report plus Update on Collateral Disputes Reported to Supervisors," JPM-CIO-PSI-H 0000141-146, at 142 ("This is a weekly report that we in IB Collateral produce that reflects the 10 largest collateral disputes for the week. You should know that in our top 10 this week, we have quite a few disputes that are largely driven by mtm [mark to market] differences on CIO London trades. If I look at the total mtm differences across the CIO book facing the G-15 – the mtm difference totals over $500MM. ... The collateral team also provided a time series which shows the overall difference growing through March to approx[imately] $500mm at March month end. March month end was tested as satisfactory by VCG."). This email was forwarded to Ina Drew, CIO, and Irvin Goldman, CIO, on 4/23/2012. See also 4/23/2012 email from Ina Drew, CIO, to Irvin Goldman, CIO, "Largest OTC Collateral Call Dispute Report plus Update on Collateral Disputes Reported to Supervisors," JPM-CIO-PSI-H 0000141-146, at 141.

part, as the CIO's counterparties became aware that the CIO was marking the value of its derivative holdings using much more favorable numbers than JPMorgan Chase's Investment Bank did for the same derivatives. In May, JPMorgan Chase ordered the CIO to begin using the same valuation methodology as the Investment Bank for its credit derivatives. That change in valuation methodology erased the difference between the CIO and Investment Bank marks, validated the complaints of the counterparties, and led to the CIO's resolving the collateral disputes with dollar adjustments in the favor of those counterparties.

Collateral disputes arise when there is disagreement between parties over the value of a derivative position, especially when the parties have agreed to post cash collateral based upon the fluctuating value of a position in which each holds the opposite side. Ina Drew told the Subcommittee that the CIO did not typically have collateral disputes, and that "large disputes over $200 million had not happened before" 2012.[775] At their peak in mid-April 2012, the CIO collateral disputes involved $690 million.[776]

The collateral disputes were escalated to the attention of Ms. Drew.[777] By April 20, 2012, the CIO had collateral disputes with 10 different counterparties, involving primarily differences over the prices assigned to credit tranche positions.[778] On April 20, 2012, Daniel Vaz sent an email to the CIO with a subject line "URGENT ::: Huge Difference for iTraxx & CDX trades," asking the CIO to check its marks.[779] The CIO collateral disputes were so large that even JPMorgan Chase senior personnel took note. On April 20, 2012, Chief Risk Officer John Hogan sent an email to Chief Financial Officer Douglas Braunstein stating: "This isn't a good sign on our valuation process on the Tranche book in CIO. I'm going to dig further."[780]

The largest single dispute involved Morgan Stanley which contested credit derivative valuations that it contended were overstated by more than $90 million.[781] Morgan Stanley told the Subcommittee

[775] Subcommittee interview of Ina Drew, CIO (12/11/2012).
[776] 5/14/2012 email from James Hohl, OCC, to Fred Crumlish, OCC, and others, "May 14 minutes," OCC-SPI-00025835 ("At one time widest collateral disputes were $690MM. Morgan Stanley difference was once in excess of $120MM. The largest difference was around mid April.").
[777] Subcommittee interview of Ina Drew, CIO (12/11/2012).
[778] See 4/20/2012 email from Mark Demo, JPMorgan Chase, to John Wilmot, CIO, and others, "Largest OTC Collateral Call Dispute Report plus Update on Collateral Disputes Reported to Supervisors," JPM-CIO-PSI-H 0000141-146, at 142.
[779] See 4/20/2012 email from Daniel Vaz, JPMorgan Chase, "URGENT ::: Huge Difference for iTraxx and CDX trades," JPM-CIO 0003586-587.
[780] 4/20/2012 email from John Hogan, JPMorgan Chase, to Douglas Braunstein, JPMorgan Chase, "Collateral Disputes," JPM-CIO-PSI-H 0000108.
[781] See 5/14/2012 email from James Hohl, OCC, to Fred Crumlish, OCC, and others, "May 14 minutes," OCC-SPI-00025835; Morgan Stanley response to Subcommittee questions

that the marks it had assigned to the derivative positions in question were in line with JPMorgan's Investment Bank, but diverged significantly from the marks used by the CIO.[782] It explained the problem in an email sent to JPMorgan Chase as follows:

> "We completed our initial analysis and it shows two different prices used depending if the tranche is done through the CIO desk vs the JPM dealer desk. We [Morgan Stanley] have significant MTM [mark to market] breaks on positions facing the CIO trades whereas trades facing you[r] dealer desk are very much in-line."[783]

According to Ina Drew, the large collateral disputes generated a series of questions internally about the CIO's valuation process. She told the Subcommittee that Jamie Dimon "felt that one way to find out [about the validity of the disputes] was to ask Mr. Macris, Mr. Martin, and Mr. Iksil to narrow the bid-offer spreads. Over a period of a few days, you should see a narrowing of the disputes. Then we would find out if the disputes were real or not."[784] As the disputes narrowed, it meant that the bank's marks were getting closer to their counterparties' marks (and closer to the midpoints of the bid-offer spreads where the values had historically been marked). As shown in the chart below, the collateral disputes did narrow in early May, apparently due to a re-emphasis on the CIO marks at the request of the bank's CEO.

(representing that the largest collateral dispute with the CIO was in mid-April at approximately $90 million); Subcommittee interview of Morgan Stanley (9/25/2012).

782 Subcommittee interview of Morgan Stanley (9/25/2012).

783 4/20/2012 email from Morgan Stanley to JPMorgan Chase, JPM-CIO 0003603-605.

784 Subcommittee interview of Ina Drew, CIO (12/10/2012).

Chief Investment Office Collateral Disputes - April 20-May 23, 2012

Date	Total of CIO Collateral Disputes	Largest Counterparty Difference	Counterparty of Largest Dispute
4/20/2012[785]	$ 520 million	$ 115 million	Morgan Stanley
05/02/2012[786]	$ 182 million	$ 55 million	Morgan Stanley
05/03/2012[787]	$ 194 million	$ 57 million	Morgan Stanley
05/04/2012[788]	$ 203 million	$ 61 million	Morgan Stanley
05/07/2012[789]	$ 212 million	$ 61 million	Morgan Stanley
05/08/2012[790]	$ 144 million	$ 54 million	Morgan Stanley
05/09/2012[791]	$ 120 million	$ 58 million	Morgan Stanley
05/10/2012[792]	$ 66 million	$ 46 million	Morgan Stanley
05/11/2012[793]	$ 69 million	$ 27 million	Morgan Stanley
05/14/2012[794]	$ 156 million	$ 46 million	Morgan Stanley
05/15/2012[795]	$ 152 million	$ 110 million	DBKAG
05/17/2012[796]	$ 42 million	$ 27 million	Morgan Stanley
05/21/2012[797]	$ 25 million	$ 32 million	Morgan Stanley
05/23/2012[798]	($ 29) million	$ 17 million	Morgan Stanley
05/24/2012[799]	($ 29) million	$ 17 million	Morgan Stanley
05/25/2012[800]	$ 25 million	$ 39 million	Morgan Stanley

Source: JPMorgan Chase and OCC documents cited in the above footnotes.

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785 See 4/20/2012 email from John Hogan to Douglas Braunstein, JPMorgan Chase, "Collateral Disputes," JPM-CIO 0003597, at 598. The largest disputed position was the iTraxx Main S09 10 year 22-100 tranche.

786 See 5/6/2012 email from Paul Bates, JPMorgan Chase, to Jamie Dimon, Douglas Braunstein, John Hogan, JPMorgan Chase, Ina Drew, CIO, and others, "CIO Credit Collateral differences as of COB Thursday 3rd," JPM-CIO-PSI 0014195.

787 Id.

788 See 5/7/2012 email from Paul Bates, JPMorgan Chase, to Phil Lewis, CIO, and others, "CIO Credit Collateral differences as of COB Friday 4th," JPM-CIO-PSI 0008878.

789 See 5/8/2012 email from Paul Bates, JPMorgan Chase, to Jamie Dimon, Douglas Braunstein, John Hogan, JPMorgan Chase, Ina Drew, CIO, and others, "CIO Credit Collateral differences as of COB Monday 7th," JPM-CIO-PSI 0014779.

790 See 5/9/2012 email from Hema Coombes, JPMorgan Chase, to Jamie Dimon, Douglas Braunstein, John Hogan, JPMorgan Chase, Ina Drew, CIO, and others, "CIO Credit Collateral differences as of COB [Tues]day 8th including 2 day differences against Morgan Stanley," JPM-CIO-PSI-H 0002712-717.

791 See 5/10/2012 email from Hema Coombes, JPMorgan Chase, to Jamie Dimon, Douglas Braunstein, John Hogan, JPMorgan Chase, Ina Drew, CIO, and others, "CIO Credit Collateral differences as of COB Wednesday 9th May," JPM-CIO-PSI 0014797.

792 See 5/11/2012 email from Phil Lewis, CIO, to Jamie Dimon, Douglas Braunstein, John Hogan, JPMorgan Chase, Ina Drew, CIO, and others, "CIO Credit Collateral differences as of COB Thursday 10th May," JPM-CIO-PSI 0017989.

793 See 5/14/2012 email from Phil Lewis, CIO, to Jamie Dimon, Douglas Braunstein, John Hogan, JPMorgan Chase, Ina Drew, CIO, and others, "CIO Credit Collateral differences as of COB Friday 11th May," JPM-CIO-PSI 0032235.

794 See 5/15/2012 email from Phil Lewis, CIO, to Jamie Dimon, Douglas Braunstein, John Hogan, JPMorgan Chase, Ina Drew, CIO, and others, "CIO Credit Collateral differences as of COB Monday 14th May," JPM-CIO-PSI 0018281.

795 See 5/16/2012 Synthetic Credit Daily Risk Report, OCC-SPI-00114068, at 11.

796 See 5/22/2012 Synthetic Credit Daily Risk Report, OCC-SPI-00089239, at 15.

797 See 5/23/2012 Synthetic Credit Daily Risk Report, OCC-SPI-00089295, at 18.

798 See 5/24/2012 Synthetic Credit Daily Risk Report, OCC-SPI-00088644, at 18. Negative number implies that JPM marks are too low. Positive number implies that the marks are too high.

799 See 5/25/2012 Synthetic Credit Daily Risk Report, OCC-SPI-00089351, at 18. Negative number implies that JPM marks are too low. Positive number implies that the marks are too high.

800 See 5/29/2012 Synthetic Credit Daily Risk Report, OCC-SPI-00089407, at 18.

Despite the extent and number of these collateral disputes generating questions about the CIO's valuation process in March and April 2012, Ms. Drew and other JPMorgan personnel told the Subcommittee that the bank remained unaware at that time of the deliberate mismarking of the CIO's books.

On April 27, 2012, JPMorgan Chase sent its Deputy Chief Risk Officer Ashley Bacon to the London CIO office to examine the marks in the SCP book. Mr. Bacon told the Subcommittee that, sometime in May, he required the CIO to mark its positions at the midpoint and to use the same independent service used by the Investment Bank to value its derivative positions.[801] This change in valuation methodology erased the differences between the CIO and Investment Bank valuations and ultimately resolved the collateral disputes with Morgan Stanley and other counterparties by the end of May.[802]

D. Reviewing the SCP Valuations

The Valuation Control Group (VCG) of the Chief Investment Office was charged with reviewing the accuracy of the CIO's marks at both month-end and quarter-end. In April 2012, the CIO VCG conducted its regular review of the SCP book as of the last day in March.[803] That same month, the bank conducted a special, four-month assessment of the CIO's P&L figures, from January to April 2012, essentially reviewing the VCG's work. According to the bank, this special assessment was performed by "a combination of individuals from CIO Finance, the Firm's internal accounting department, valuation experts from the Investment Bank, and others."[804] The effort was headed by the bank's Controller, Shannon Warren.[805] The assessment uncovered evidence that the CIO, rather than marking at the midpoint, had used more "advantageous" prices, had exceeded some variance limits, and used increasingly "aggressive" marks over the course of the quarter. It also reported that, by the end of the quarter, the CIO had reported $512 million less in losses than it would have reported using midpoint prices. At the same time, because the CIO had generally used prices that fell within the relevant bid-ask spread for the derivatives being valued, the Controller validated the CIO's quarter-end credit

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[801] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
[802] Id. See also Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012) (Mr. Braunstein: "Ashley Bacon abandoned the traders' marks in early May because we directed them to mark at the mid. The collateral disputes were noise in the markets that could be problematic.").
[803] See 2013 JPMorgan Chase Task Force Report, at 54.
[804] Id., at 73.
[805] Ms. Warren issued the memorandum summarizing the assessment. See 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, JPM-CIO 0003637-654.

derivative marks as "consistent with industry practices" and acceptable under bank policy, and offered no criticism of its valuation practices.

VCG Deficiencies. At the time that the VCG conducted its regular review of the SCP prices and the Controller's office conducted its special assessment, the CIO VCG itself was under criticism. On March 30, 2012, JPMorgan Chase's internal audit group released a report criticizing the VCG, noting among other problems that it was using unreviewed risk models, unsupported and undocumented pricing thresholds, inadequate procedures for evaluating pricing sources, and inadequate procedures for requiring reserves.[806] For example, the internal audit report rated the following as "Needs Improvement"[807]:

> "CIO VCG practices where a number of risk & valuation models have not been reviewed by Model Review Group and included the absence of a formally applied price sourcing hierarchy, insufficient consideration of potentially applicable fair value adjustments (e.g. concentration reserves for significant credit indices positions) and the lack of formally documented/consistently applied price testing thresholds."[808]

With respect to price testing "thresholds," which determined how much a booked value could deviate from a specified midprice, the internal audit report concluded that the CIO VCG thresholds had been applied "without sufficient transparency or evidence." It also found that the "root cause" of the problems with the CIO VCG's price testing practices was an "insufficient assessment/formalization of certain price testing methodologies and poorly documented CIO VCG practices."[809]

The audit report should have encouraged the VCG to conduct a more careful review of the CIO valuations at quarter's end. In addition, the CIO itself was experiencing an unusual series of escalating losses and an unprecedented amount of collateral disputes, both of which also should have raised red flags about the CIO's valuations and led to a more careful review. Adding still more sensitivity was that both the VCG quarter-end review and the Controller's special assessment were undertaken in April 2012, just after the whale trades attracted media attention and raised multiple concerns within the bank.

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[806] See March 2012 Continuous Audit Quarterly Summary of Global Chief Investment Office, OCC-SPI-00033688, at 692.
[807] JPMorgan's internal audit group used three ratings in its reports: Satisfactory, Needs Improvement, and Inadequate. "The latter two are considered 'adverse' ratings." 2013 JPMorgan Chase Task Force Report, at 55, footnote 69.
[808] March 2012 Continuous Audit Quarterly Summary of Global Chief Investment Office, OCC-SPI-00033688, at 692. The internal audit report also noted that the CIO's London office was "using unapproved models in the calculation of risk including VaR," and that "associated risk measurement methodologies ha[d] not been appropriately documented and or catalogued." Id.
[809] Id. See also 2013 JPMorgan Chase Task Force Report, at 55-56.

Controller's Assessment. The Controller's office began its work reviewing the CIO's marks in early April 2012. In a late April email responding to a bank colleague's inquiry into the CIO's valuation practices, an analyst described how the CIO had valued the SCP positions in March:

> "There were differences between the [CIO] desk and the independent marks at month end. The desk marked the book at the boundary of the bid/offer spread depending on whether the position was long or short. We then applied a tolerance to make sure the prices were within tolerance and the majority of positions were. We had a small number of positions where they fell outside these tolerances and hence the adjustment that was passed."[810]

In another email, the same analyst wrote: "At March month end the CIO FO [front office] marked their book at the most advantageous levels based on the positions they held in specific indices and tranches."[811] These emails show that, by late April, the Controller's office was fully aware that, in March 2012, the CIO had used the "most advantageous" prices "at the boundary" of the relevant bid-ask spread to value its derivative positions, and that the CIO prices differed from the values being assigned to the same positions by "independent" pricing services.

As part of its review, the Controller's office analyzed key credit derivative positions in the SCP book during the covered time period. Specifically, of the more than 100 credit derivative positions that appeared in the SCP book, the Controller's office selected 18 that were present in the portfolio throughout the covered period. For each of those 18 positions, together with other information, the Controller's office compiled data on the value or "mark" that appeared in the SCP book on the last day of each of the relevant months, the corresponding midpoint price and price range (bid-ask spread) for that same day, and whether the CIO mark – compared to the midpoint price – provided more or less of a financial benefit to the SCP book.

The memorandum summarizing the special review presented the data in four charts, each of which presented data on the selected CIO marks on the last days in January, February, March, and April.[812] Excerpts from three of those charts are presented below, covering the

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[810] 4/20/2012 email from Jason Hughes, CIO, to Rory O'Neill, JPMorgan Chase, and others, "URGENT ::: Huge Difference for iTraxx & CDX trades," JPM-CIO 0003582-587, at 586.
[811] See 4/20/2012 email from Jason Hughes, CIO, to Edward Kastl, JPMorgan Chase, "Credit Index and Tranche Book," JPM-CIO-PSI-H 0006636-639, at 637.
[812] See 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, at 17, JPM-CIO 0003637-654, at 653. These marks do not encompass all of the credit derivative positions in the synthetic credit book.

months of January, February, and March 2012. In each chart, the first column identifies the relevant credit derivative, and the second column presents the relevant CIO daily mark. The next three columns contain the extreme low end of the daily price range (bid-ask spread), the midpoint price, and the extreme high end of the daily price range (bid-ask spread). The sixth column, which the Controller's office entitled, "Benefit," indicates what type of price (compared to the midpoint) would have produced a more favorable financial result for the SCP.

CIO Marks of 18 Positions as of January 31, 2012

Credit Default Swap Indices and Tranches	CIO Mark	Broker Bid	Broker Mid Price	Broker Offer	Benefit
CDX.NA.HY 10-15% S08 05Y	**70.000**	69.625	70.313	71.000	lower price
CDX.NA.HY 10-15% S10 07Y	**20.750**	19.700	20.538	21.375	higher price
CDX.NA.HY 15-25% S10 05Y	**93.375**	92.875	93.313	93.750	higher price
CDX.NA.HY 15-25% S11 05Y	**86.250**	85.438	86.063	86.688	higher price
CDX.NA.HY 35-100% S10 05Y	**106.313**	106.170	106.315	106.460	higher price
CDX.NA.HY IDX S11 07Y	**101.000**	100.688	101.000	101.313	higher price
CDX.NA.HY IDX S14 05Y	**100.625**	100.375	100.625	100.875	lower price
CDX.NA.HY IDX S15 05Y	**100.125**	99.938	100.125	100.313	lower price
CDX.NA.IG 0-3% S09 05Y	**26.813**	26.460	26.680	26.900	lower price
CDX.NA.IG 0-3% S09 10Y	**60.750**	60.563	60.813	61.063	higher price
CDX.NA.IG IDX S09 07Y	**102.000**	101.500	103.500	105.500	lower spread
CDX.NA.IG IDX S09 10Y	**119.500**	119.000	120.750	122.500	lower spread
iTraxx.Main 0-3% S09 10Y	**66.563**	66.290	66.620	66.950	higher price
iTraxx.Main 22-100% S09 07Y	**19.750**	18.160	19.495	20.830	lower spread
iTraxx.Main 22-100% S09 10Y	**40.000**	39.400	40.600	41.800	lower spread
iTraxx.Main IDX S09 07Y	**148.500**	146.750	148.750	150.750	lower spread
iTraxx.Main IDX S09 10Y	**158.000**	156.500	158.500	160.500	lower spread
iTraxx.Main IDX S16 05Y	**143.000**	142.500	143.000	143.500	lower spread

Source: 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, JPM-CIO 0003637-654, at 653.

CIO Marks of 18 Positions as of February 29, 2012

Credit Default Swap Indices and Tranches	CIO Mark	Broker Bid	Broker Mid Price	Broker Offer	Benefit
CDX.NA.HY 10-15% S08 05Y	**89.750**	89.500	90.000	90.500	lower price
CDX.NA.HY 10-15% S10 07Y	**17.000**	15.160	16.245	17.330	higher price
CDX.NA.HY 15-25% S10 05Y	**95.375**	94.660	95.120	95.580	higher price
CDX.NA.HY 15-25% S11 05Y	**86.250**	85.660	86.330	87.000	higher price
CDX.NA.HY 35-100% S10 05Y	**106.188**	106.000	106.145	106.290	higher price
CDX.NA.HY IDX S11 07Y	**102.000**	101.063	101.563	102.063	higher price
CDX.NA.HY IDX S14 05Y	**101.375**	101.250	101.500	101.750	lower price
CDX.NA.HY IDX S15 05Y	**100.563**	100.313	100.500	100.688	lower price
CDX.NA.IG 0-3% S09 05Y	**24.188**	23.830	24.060	24.290	higher price
CDX.NA.IG 0-3% S09 10Y	**59.875**	59.625	59.853	60.080	lower price
CDX.NA.IG IDX S09 07Y	**92.000**	89.613	91.813	93.813	lower spread
CDX.NA.IG IDX S09 10Y	**112.500**	111.063	113.313	115.563	lower spread
iTraxx.Main 0-3% S09 10Y	**66.125**	65.875	66.138	66.400	lower price
iTraxx.Main 22-100% S09 07Y	**15.500**	15.250	16.125	17.000	lower spread
iTraxx.Main 22-100% S09 10Y	**34.500**	34.400	35.115	35.830	lower spread
iTraxx.Main IDX S09 07Y	**131.750**	130.750	132.750	134.750	lower spread
iTraxx.Main IDX S09 10Y	**146.750**	144.250	146.250	148.250	lower spread
iTraxx.Main IDX S16 05Y	**128.250**	126.000	128.250	128.500	lower spread

Source: 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, JPM-CIO 0003637-654, at 653.

CIO Marks of 18 positions as of March 31, 2012

Credit Default Swap Indices and Tranches	CIO Mark	Broker Bid	Broker Mid Price	Broker Offer	Benefit	Month-End CIO Trade (date and price)[813]
CDX.NA.HY 10-15% S08 05Y	**91.500**	91.500	92.000	92.500	lower price	Info not available.
CDX.NA.HY 10-15% S10 07Y	**13.125**	10.625	11.875	13.125	higher price	Info not available.
CDX.NA.HY 15-25% S10 05Y	**93.375**	92.875	93.125	93.375	higher price	Info not available.
CDX.NA.HY 15-25% S11 05Y	**83.750**	82.875	83.313	83.750	higher price	Info not available.
CDX.NA.HY 35-100% S10 05Y	**106.000**	105.625	105.813	106.000	higher price	Info not available.
CDX.NA.HY IDX S11 07Y	**102.000**	101.250	101.625	102.000	higher price	Info not available.
CDX.NA.HY IDX S14 05Y	**101.438**	101.438	101.688	101.813	lower price	Info not available.
CDX.NA.HY IDX S15 05Y	**100.500**	100.500	100.688	100.875	lower price	Info not available.
CDX.NA.IG 0-3% S09 05Y	**18.375**	17.750	18.063	18.375	higher price	Info not available.
CDX.NA.IG 0-3% S09 10Y	**62.750**	62.750	63.125	63.500	lower price	3/30 @ 63.250
CDX.NA.IG IDX S09 07Y	**88.000**	88.000	89.500	91.000	lower spread	3/30 @ 90.000
CDX.NA.IG IDX S09 10Y	**110.750**	110.750	112.250	113.750	lower spread	3/30 @ 113.000
iTraxx.Main 0-3% S09 10Y	**65.875**	**65.750**	66.250	66.625	lower price	3/30 @ 66.375
iTraxx.Main 22-100% S09 07Y	**12.000**	12.000	13.300	14.500	lower spread	3/30 @ 12.750
iTraxx.Main 22-100% S09 10Y	33.000	33.000	34.700	36.750	lower spread	3/30 @ 33.625
iTraxx.Main IDX S09 07Y	**119.750**	123.250	127.250	131.250	lower spread	3/30 @ 129.000
iTraxx.Main IDX S09 10Y	144.250	144.250	147.750	151.250	lower spread	3/30 @ 149.000
iTraxx.Main IDX S16 05Y	121.750	121.250	121.750	122.250	lower spread	Info not available.

Source: 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, JPM-CIO 0003637-654, at 653.

[813] Trades executed by CIO at or near month-end (Friday, March 30, 2012). See JPM-CIO-PSI 0037501.

The data in the Controller office's charts showed that, over the course of the first three months of 2012, the CIO changed how it marked the value of the 18 positions, moving its marks away from the midpoint and closer to the extreme boundaries of the relevant price range. The data in the January chart showed, for example, that the CIO marks were generally close to the midpoint values. In two cases, however, the CIO marks were more than one basis point away from the midpoint price. In contrast, the February chart showed that five of the 18 marks, or nearly one-third, deviated noticeably from the midpoint prices. In March, the chart showed that all 18 CIO marks had moved to the extreme boundaries of the bid-ask spread. Sixteen of those marks reflected the most extreme price within the bid-ask spread; one mark was almost at the extreme; and one mark even fell outside the bid-ask spread. In addition, every one of the CIO marks that deviated noticeably from the midpoint price did so in a way that benefited the SCP book financially.

To further test the accuracy of the CIO marks, for the month of March, the Subcommittee examined whether the CIO had engaged in any actual trades involving the 18 listed positions, and added a seventh column to the chart with the results. The Subcommittee analysis found 8 instances in which the CIO executed trades involving the positions examined by the VCG. In every case, the CIO executed those trades at prices that were noticeably closer to the midpoint prices than to its reported marks, even though the stated objective of the CIO's valuation process was to reflect the CIO's exit prices. The fact that the CIO used marks that produced more favorable financial results than if it had used its actual exit prices is additional proof that the CIO's marks did not accurately reflect the credit derivatives' fair value.

The Controller's assessment also made it clear that the CIO was aware of the financial consequences of its using more favorable prices than those at the midpoint. The assessment observed that the CIO had calculated that, by using the marks it did, it was able to report half a billion dollars in fewer losses at the end of the first quarter:

> "CIO estimated that as of March 31, 2012, the sum total of the differences between the front office marks and the CIO VCG mid market estimates was $512 million before adjustment to the boundary of the VCG valuation range … and $495 million after adjustment."[814]

In other words, after finding a $512 million difference between what the CIO reported and what would have been reported if the CIO had used

[814] 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at 9, JPM-CIO 0003637-654, at 645. See also Subcommittee briefing by JPMorgan Chase (8/15/2012) (JPMorgan Chase also informed the Subcommittee the CIO marks had varied from VCG allowable prices by $30 million in December 2011.).

the midpoint prices, the Controller then shaved off $17 million from that difference by disallowing certain reported marks that were so extreme they fell outside the VCG's range of permitted deviations from the midpoint prices.[815] After changing those marks to reflect the extreme edge of the VCG's allowed valuation range,[816] the Controller's office determined that the CIO's reported losses were still $495 million less than what would have been reported if the book had been marked at the midpoint.[817]

Internally, two days before it issued the memorandum summarizing its assessment, a senior official in the Controller's office confronted the head of the CIO's equity and credit trading office in London about the data showing the CIO had changed the way in which it valued the SCP book, providing more favorable marks in March than in January.[818] In a telephone conversation, Alistair Webster, head of Corporate Accounting Policies for Europe, the Middle East, Africa and Asia, had the following exchange with Javier Martin-Artajo:

> **Mr. Webster:** "So if I look at those back in January, the front office marks were all either mid or somewhere, you know, close to mid."
>
> **Mr. Martin-Artajo:** "Right."
>
> **Mr. Webster:** "That ..."
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> **Mr. Martin-Artajo:** "In terms of conservative and aggressive. ...[T]hat's what you're asking?"
>
> **Mr. Webster:** "Well, it's subtly different, subtly different."
>
> **Mr. Martin-Artajo:** "Okay."

[815] For a number of credit derivatives, the VCG had established an explicit "threshold" which allowed the CIO mark to deviate from the midpoint price by no more than a specified number of basis points. See, e.g., 4/20/2012 email from Edward Kastl, JPMorgan Chase, to Jason Hughes, CIO, "Credit Index and Tranche Book," JPM-CIO-PSI-H 0006636-639, at 636 (noting that the accepted deviation for the iTraxx Main Series 9 7-year index was a six-basis-point deviation from the midpoint of the relevant bid-ask spread).
[816] See 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, at 8, JPM-CIO 0003637-654, at 644 ("If the front office mark is outside the VCG valuation range, the position mark is adjusted to the outer boundary of the range.").
[817] The bank also determined that the VCG used formulas in its spreadsheets that had not been properly vetted, "introduced two calculation errors," and resulted in the VCG's understating the difference between the VCG mid-prices and the SCP marks. See 2013 JPMorgan Chase Task Force Report, at 56. The Controller later increased the amount of unreported losses to $677 million in July, then reduced that total due to certain price adjustments and the application of a liquidity reserve. See 2013 JPMorgan Chase Task Force Report, at 55, footnote 68.
[818] See 5/8/2012 recorded telephone conversation between Alistair Webster, JPMorgan Chase, and Javier Martin-Artajo, CIO, JPM-CIO-PSI-A 0000164; 5/8/2012 transcript of the same recorded telephone conversation, JPM-CIO 0003631-636, at 631-634.

Mr. Webster: "But they were, none of them were actually at the boundaries of the bid or offer."

Mr. Martin-Artajo: "Right."

Mr. Webster: "So then when, if we roll forward to March, if the front office marks had migrated, not all of them, to the aggressive side, most of them, but not all of them to the aggressive side, but they've also migrated from either mid or somewhere close to being at the, you know, the bounds of the bid or offer."

Mr. Martin-Artajo: "Yeah, but I think that's because we were trading there. I think that's because we were trading them, quite heavily."

Mr. Webster: "In March?"

Mr. Martin-Artajo: "Yeah, in March."[819]

This conversation indicates that, in early May 2012, senior JPMorgan Chase personnel viewed the CIO as having changed its valuation practices over the course of the first quarter and, in March 2012, used "aggressive" prices to minimize its losses.

Despite this internal exchange and the April 20 emails observing that the CIO had marked its book "at the most advantageous levels," the Controller's assessment contained no mention of a shift in valuation methodology or the use of more aggressive marks towards the end of the quarter. To the contrary, the assessment concluded that "the CIO valuation process is documented and consistently followed period to period" and "market-based information and actual traded prices serve as the basis for the determination of fair value."[820] The assessment also stated:

"The Firm believes that its valuation practices in CIO are consistent with industry practices for other no-dealer investors/managers. CIO, like other non-dealer

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[819] 5/8/2012 transcript of recorded telephone conversation between Alistair Webster, JPMorgan Chase, and Javier Martin-Artajo, CIO, JPM-CIO 0003631-636 (**Mr. Martin-Artajo:** "I mean are you saying, are you saying that we had a trend at the end of the month to mark a little bit towards more, more one side of the bid offer as opposed to the trend that we had at the beginning of the year? That's what you're saying, right?" **Mr. Webster:** "Yeah ..." **Mr. Martin-Artajo:** "Okay, two things. One is that at the end of March we really traded a lot and second, that, I don't think the traders have that bias to be honest with you. I don't think so."). See also 2013 JPMorgan Chase Task Force Report, at 74 ("And, when questioned about the March 30 marks, the traders all confirmed that the marks at March 30 reflected their good-faith estimation of the positions' value, and one of them explicitly denied any bias.").

[820] 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, at 11, JPM-CIO 0003637-654, at 647.

> investor/managers, relies more heavily on transaction-level data available through its own market activity, and its valuation process reflects its exit market and the participants in that market."[821]

The last page of the memorandum stated that the bank had shared its memorandum with JPMorgan Chase's outside auditor, PricewaterhouseCoopers, which had "concur[red] with the conclusions."[822]

On May 9, 2012, the day before the Controller's memorandum summarizing its assessment was released and the bank certified its first quarter results and conducted a business update call, the bank met with OCC examiners to discuss the SCP.[823] Representing the bank were Chief Financial Officer Douglas Braunstein, General Counsel Stephen Cutler, Chief Investment Officer Ina Drew, Chief Risk Officer John Hogan, and the head of Corporate & Regulatory Affairs Barry Zubrow. At that meeting, among other matters, the bank informed the OCC of the CIO's ongoing collateral disputes relating to SCP valuations. When the OCC asked about whether the CIO had mismarked the SCP book, Mr. Hogan flatly denied it.[824] His deputy, Ashley Bacon, told the Subcommittee that the collateral disputes led him to investigate the marks, and after the bank took away the CIO's discretion in marking its positions so that, instead, its marks aligned with Markit valuation data, the disputes were resolved.[825]

When later asked about the bank's special assessment of the SCP marks, a senior OCC examiner told the Subcommittee that "it was

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[821] 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, at 10, JPM-CIO 0003637-654, at 646.
[822] Id., at 647. See also 2013 JPMorgan Chase Task Force Report, at 6, 74.
[823] See 5/10/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, "Braunstein / Cutler call on CIO," OCC-SPI-00000018-020, at 020.
[824] Subcommittee interview of Michael Kirk, OCC (8/22/2012); Subcommittee interview of Scott Waterhouse, OCC (9/17/2012) (when discussing the CIO's collateral dispute with Morgan Stanley, "Hogan told us that there were no problems with the CIO's marks"). See also 6/29/2012 email from Michael Kirk, OCC, to Elwyn Wong, Scott Waterhouse, Fred Crumlish, OCC, and others, "2nd Wilmer Hale Call," OCC-SPI-00071386-388, at 386 ("Section 1 on Traders is damaging to Hogan's reputation in respect to his interaction with regulators, in my opinion. On the very first daily call, Hogan discussed that earlier there had been a large collateral dispute with their counterparties. I questioned him on how it was resolved and he said JPM eventually agreed to the counterparties marks. ... I then followed with a question relating to what I described as mismarked books to which Hogan forcefully stated JPM books were not mismarked; leaving both Elwyn and me ... puzzled over how a collateral dispute could be resolved by agreeing to the counterparties marks, without admitting your own marks were incorrect."). See also Hogan email from two weeks earlier expressing concern about the CIO collateral disputes and CIO valuation process, 4/20/2012 email from John Hogan, JPMorgan Chase, to Douglas Braunstein, JPMorgan Chase, "Collateral Disputes," JPM-CIO 0003597-598, at 597 ("This isn't a good sign on our valuation process on the Tranche book in CIO. I'm going to dig further.").
[825] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) (Ashley Bacon).

garbage."[826] The OCC said that the VCG itself "should have picked up the marking issue" during its review of the February valuations, and taken action then to stop the aggressive marking practices.[827] The OCC told the Subcommittee that it was clear the CIO traders were "gaming the system."[828] The OCC indicated that, by the end of March, the CIO traders were marking virtually all of the SCP positions at the very edge of "what they could get away with" and were booking "fictitious profits."[829] Yet neither the VCG nor the special assessment raised any objection to the SCP marks. The OCC disagreed that the SCP marks accurately reflected the fair market value of the SCP's credit derivatives.

The sole purpose of the Controller's special assessment was to ensure that the CIO was accurately reporting the value of its derivative holdings, since those holdings helped determine the bank's overall financial results. As part of its assessment, the Controller approved of the CIO's failing to include $512 million in losses, which would have led to a 70% increase in the $719 million in SCP losses that the CIO did report.[830] That the Controller concluded that the SCP's losses could legitimately be reported at anywhere between $719 million and $1.2 billion at the end of March exposes the imprecise, malleable, and potentially biased nature of the credit derivative valuation process.

The same prices upheld by the Controller had been privately disparaged by the CIO trader who played a key role in the marking process. In March 2012, Bruno Iksil called the SCP marks "idiotic."[831] At another point, he said that his supervisor would have to "decide[ ] what we show. [B]ecause me, I don't know anymore."[832] That type of undisciplined pricing process should not have received the bank's seal of approval.

The bank's Controller could have but did not criticize the CIO's valuation process or modify the reported derivative values,[833] based upon the change in pricing practices over the quarter, the "aggressive" nature of the prices, their failure to reflect the prices used in executed

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[826] Subcommittee interview of Michael Kirk, OCC (8/22/2012).
[827] Subcommittee interview of Elwyn Wong, OCC (8/20/2012).
[828] Subcommittee interview of Michael Kirk, OCC (8/22/2012).
[829] Id.
[830] JPMorgan Chase later restated its financial results to attribute $660 million in additional losses to the SCP by the end of March. See 7/13/2012 "Form 8-K," JPMorgan Chase & Co., at 2, http://files.shareholder.com/downloads/ONE/2261741819x0xS1193125-12-301391/19617/filing.pdf.
[831] 3/16/2012 transcript of a recorded telephone conversation between Julien Grout, CIO, and Bruno Iksil, CIO, JPM-CIO-PSI-A 0000162.
[832] 3/23/2012 instant messaging session between Bruno Iksil, CIO, and Julien Grout, CIO, JPM-CIO 0003515-541, at 541.
[833] See 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at 8, JPM-CIO 0003637-654, at 644 ("any difference between front office mark and the mid-market price may be adjusted, at CIO VCG's discretion").

trades, or their role in minimizing the SCP losses. Instead, the bank's Controller found that the CIO's actions were "consistent with industry practices" and acceptable under bank policy.[834] The Controller's conclusion is all the more perplexing in light of the fact that the original authorization for the CIO to trade in derivatives indicated that the CIO would follow the Investment Bank's lead on prices, since it was often a market-maker. If the CIO had done so, it would have effectively used the midpoint prices, and the price deviation between the CIO and Investment Bank would have been effectively eliminated. The Controller also failed to note that the CIO was not using the Investment Bank's marks, contrary to the authorizing document, and that the two lines of business had very different valuations for the same credit derivatives.

That the bank's Controller found the SCP valuations permissible under bank policy, industry practice, and generally accepted accounting principles demonstrates how imprecise and open to manipulation the current process is for valuing credit derivatives. The Controller's support for the CIO's pricing practices, which was further backed by the JPMorgan Chase Task Force Report, indicates that all of JPMorgan Chase's lines of business are free to use those same derivatives pricing practices, without censure.[835]

On May 11, 2012, the day after the Controller's assessment was issued and JPMorgan Chase disclosed that the SCP's losses had climbed to $2 billion, the SCP reported internally a daily loss of another $570 million.[836] That $570 million was the largest single daily loss reported by the SCP up to that point in 2012. While it may have reflected

[834] 5/10/2012 JPMorgan Chase Controllers special assessment of CIO's marks, January to April 2012, at JPM-CIO-0003646. See also 2013 JPMorgan Chase Task Force Report, at 55, 74.

[835] In its 2013 report, the JPMorgan Chase Task Force did not criticize either the CIO VCG or the Controller's special assessment for upholding the original SCP marks, explaining: "Individuals working on the review understood that, although the March 30 trader marks for the Synthetic Credit Portfolio were aggressive, they were predominantly within the VCG thresholds." 2013 JPMorgan Chase Task Force Report, at 74. See also id., at 55. In other words, presuming that the CIO personnel making the marks acted in good faith, the bank viewed the SCP marks as acceptable, even though they deviated from the midpoint prices by hundreds of millions of dollars and were used to minimize the CIO's losses. The Task Force found no fault with the change in pricing practices over the quarter, the size of the pricing deviation, the use of prices at the extreme edge of the bid-ask spread, or the consistent bias in favor of the bank. The Task Force did criticize the bank for failing "to ensure that the CIO VCG price-testing procedures – a important financial control – were operating effectively," noting such "operational deficiencies" as the VCG's failure to document its price-testing thresholds and its use of time-consuming manual input procedures. Id., at 96-97. See also id., at 55-56. The Task Force report also announced formation of a new "CIO Valuation Governance Forum" responsible for "understanding and managing the risks arising from valuation activities within the CIO and for escalating key issues to a Firm-wide VCF," established in 2012 to strengthen the bank's valuation activities. Id., at 108. But the report contains no acknowledgement of any of the problems inherent in the derivatives valuation process itself which, in the case of the whale trades, was easily manipulated to hide substantial losses.

[836] See OCC spreadsheet, OCC-SPI-00000298, printed as a Subcommittee chart earlier in this chapter. Numbers do not reflect restated P&L figures.

negative market developments following the bank's public filing, it is also possible the CIO used an inflated mark to take into account the $512 million in unreported losses that had been identified in the Controller's assessment. During the May 10 call in which Mr. Dimon disclosed the $2 billion loss, he stated that he was "not going to make calls every time the number moves around, by $0.5 billion,"[837] and, in fact, he did not disclose publicly the next day's loss, even though it increased the SCP's reported losses after a single day by another 25%. In July 2012, JPMorgan Chase restated the SCP's first quarter losses, pushing the $660 million in losses that would have been reported in the second quarter back to the first quarter instead.

Liquidity and Concentration Reserves. Even before completing its special assessment of the SCP marks, in April 2012, the bank's Chief Financial Officer increased the CIO's liquidity reserve fivefold from $33 million to $186 million.[838] The bank told the Subcommittee that it expanded the reserve, because the SCP had increased holdings of illiquid credit derivatives, primarily credit tranches in "off-the run" – or older – credit indices. As the CIO CFO John Wilmot explained to Mr. Dimon and Mr. Braunstein:

> "Credit Tranche markets have always been considered less liquid (compared to Index markets) and Liquidity reserves are therefore computed and taken. However, in the past, the Liquidity Reserve associated with these 6 Series-9 Tranche positions was not taken because their markets were deemed sufficiently liquid. The additional +$155 Million Liquidity Reserve was taken due to the inclusion of these 6 Series-9 tranche positions; this reflects the market's reduced liquidity."[839]

When asked about the reserve, CIO head Ina Drew professed not to know its purpose. She told the Subcommittee that in December 2011, a "$30 million reserve was taken by finance at year-end against the position. I don't know what kind of reserve it was, exactly. There hadn't been reserves previously. This was probably a liquidity reserve."[840]

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[837] 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 8, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf.

[838] See 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, JPM-CIO 0003637-654, at 645-646; 4/13/2012 CIO Valuation Summary Memo, March 2012 Month-End Results, OCC-SPI-00021381-388, at 386 ("For March month end the level of the Liquidity Reserve, which represents the illiquidity of off-the run positions, was $(186.4)mm.").

[839] 4/9/2012 email from John Wilmot, CIO, to Jamie Dimon and Douglas Braunstein, JPMorgan Chase, "Series 9 forward tranche liquidity reserves," JPM-CIO-PSI 0000960.

[840] Subcommittee interview of Ina Drew, CIO (9/7/2012). OCC examiner Elwyn Wong told the Subcommittee that the $33 million reserve had been a "severe underestimate." Subcommittee interview of Elwyn Wong, OCC (8/20/2012).

The CIO's Valuation Control Group (VCG) had the initial responsibility for calculating the CIO's liquidity and concentration reserves and monitoring them to ensure their adequacy, taking into account such factors as whether the CIO maintained "significant" or "concentrated" positions and did so in markets that were "less liquid."[841] Mr. Braunstein, by virtue of his position as Chief Financial Officer, had the responsibility for approving the establishment and size of the reserves.[842]

Liquidity and concentration reserves have a direct impact on financial results, since they subtract, dollar for dollar, from reported revenues. The size of the SCP reserve would, thus, presumably be of interest to CIO and bank management, since it would reduce the CIO and bank's reported revenues. The fivefold increase in the SCP's liquidity reserve in April 2012, for example, would have increased the CIO's losses by more than $150 million.

When the OCC was asked about the SCP liquidity reserve, one OCC examiner told the Subcommittee that even the increased amount in April 2012 was "wholly inadequate," noting that the reserve had risen to "over $700 million" by August 2012.[843] Another OCC examiner noted that the bank had not set up any "concentration reserve" for the SCP, even though the SCP held highly concentrated positions, including over $80 billion in one credit index.[844]

E. Admitting the Mismarking

Sometime in May 2012, after the memorandum summarizing the Controller's special assessment was issued, JPMorgan Chase's Chief Market Risk Officer Ashley Bacon ordered the CIO to begin using the Markit independent pricing service to value its credit derivatives.[845] That change meant that CIO derivative positions would generally be valued at or near the midpoint in the relevant bid-ask spread. It also meant that the CIO could no longer manipulate its marks to minimize its losses.

[841] 5/21/2010 CIO-VCG Procedure: Valuation Process, OCC-SPI-00052685, at 6.
[842] See 4/6/2012 email from Douglas Braunstein, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, "Follow up," JPM-CIO 0000547 (proposing $155 million increase in SCP liquidity reserve due to less liquid market for IG9 credit tranches). See also 4/6/2012 email from John Wilmot, CIO, to Jamie Dimon and Douglas Braunstein, JPMorgan Chase, copy to Ina Drew, CIO, "synthetic credit tranche reserve," JPM-CIO 0000576; 4/9/2012 email from John Wilmot, CIO, to Douglas Braunstein and Jamie Dimon, JPMorgan Chase, "Series 9 tranche liquidity reserves," JPM-CIO 0000987; Subcommittee interview of Elwyn Wong, OCC (8/20/2012).
[843] Subcommittee interview of Michael Kirk, OCC (8/22/2012).
[844] Subcommittee interview of Elwyn Wong, OCC (8/20/2012).
[845] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) (Ashley Bacon).

The bank told the Subcommittee that, due in part to the Controller's special assessment in May, it had viewed the SCP marks as acceptable, even though they deviated by half a billion dollars from the relevant midpoint prices. The bank told the Subcommittee that its view of the marks did not change until early June, when the internal investigation being conducted by the JPMorgan Chase Task Force began reviewing CIO recorded telephone calls and listened to the traders criticizing the very marks they were reporting.[846] Michael Cavanagh, the Task Force head, told the Subcommittee that he was convinced the traders thought they had a winning trading strategy, viewed the market as "wrong" in how it was valuing the SCP credit derivative positions, and believed the SCP positions would recover their value. He also indicated that he was convinced that the London CIO personnel, with varying degrees of culpability, had deliberately mismarked the value of the SCP positions.[847] In its 2013 report, the JPMorgan Chase Task Force wrote: "From at least mid-March through at least March 30, the traders did not provide good-faith estimates of the exit prices for all the positions in the Synthetic Credit Portfolio."[848]

On July 13, 2012, JPMorgan Chase & Co., the holding company for JPMorgan Chase Bank, reported that it was restating its first quarter 2012 financial results and reduced the bank's previously-reported total net revenue by $660 million,[849] an amount which it said fell to $459 million after taxes. The bank blamed the reduced earnings on inappropriate SCP valuations by the CIO:

> "JPMorgan Chase & Co. ... restated its previously-filed interim financial statements for the quarterly period ended March 31, 2012. The restatement related to valuations of certain positions in the synthetic credit portfolio held by the Firm's Chief Investment Office ('CIO') and reduced the Firm's reported net income by $459 million for the three months ended March 31, 2012."[850]

JPMorgan Chase told the Subcommittee that the decision to restate its financial results was a difficult one, since neither $660 million nor $459 million was clearly a "material" amount for the bank.[851] In addition, the bank told the Subcommittee that the valuations used by the

[846] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012). See also 2013 JPMorgan Chase Task Force Report, at 75, 89.
[847] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012).
[848] 2013 JPMorgan Chase Task Force Report, at 89.
[849] 7/13/2012 "Form 8-K," JPMorgan Chase & Co., at 2, http://files.shareholder.com/downloads/ONE/2261741819x0xS1193125-12-301391/19617/filing.pdf.
[850] JPMorgan Chase & Co. 10-Q filing with the SEC for the second quarter of 2012, at 4, http://www.sec.gov/Archives/edgar/data/19617/000001961712000264/jpm-2012063010q.htm.
[851] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012).

CIO did not, on their face, violate bank policy or GAAP, because the CIO had generally used prices that fell within the bid-ask spread to value its credit derivative positions.[852] The bank told the Subcommittee that it finally decided, however, that the telephone calls, instant messages, and emails indicated that the London CIO personnel had not acted in "good faith" when selecting prices for the SCP positions, and so the SCP valuations had to be revised.[853]

Ina Drew resigned on May 13, 2012. On July 12, 2012, the day before the restatement was announced, the bank sent termination letters to Achilles Macris, Javier Martin-Artajo, and Bruno Iksil. Mr. Martin-Artajo's letter included the following explanation for his termination:

> "During March and April 2012, when the Book began to show significant losses, you directed Bruno Iksil and/or Julien Grout to show modest daily losses in the marking of the Book rather than marking the Book in a manner consistent with the standard policies and procedures of JP Morgan Chase & Co … and/or to provide daily profit and loss reports that would show a long-term trend in the value of the Book's positions that did not necessarily reflect the exit price for those positions under the Firm's standard policies and procedures."[854]

Bruno Iksil's termination letter included a similar explanation:

> "During March and April 2012, when the Book began to show significant losses, you received or were aware of instructions from Javier Martin-Artajo (i) to show modest daily losses in the marking of the Book rather than marking the Book in a manner consistent with the standard policies and procedures of JP Morgan Chase & Co … and/or (ii) to provide daily profit and loss reports that would show a long-term trend in the value of the Book's positions that did not necessarily reflect the exit price for those positions under the Firm's standard policies and procedures. You complied with, or permitted the compliance by Julien Grout with, such instructions in whole or in part with the result that there was a significant divergence between values under the Firm's

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[852] Id. See also 5/10/2012 JPMorgan Chase Controller's special assessment of CIO's marks, January to April 2012, at 10, JPM-CIO 0003637-654, at 646 ("CIO book marks on individual positions were generally within the bid offer spread."); 2013 JPMorgan Chase Task Force Report, at 6, 55, 74.
[853] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012). See also 2013 JPMorgan Chase Task Force Report, at 7-8, 89.
[854] 7/12/2012 letter from JPMorgan Chase to Javier Martin-Artajo, CIO, JPM-CIO-PSI-H 0002744-745, at 744.

standard policies and procedures in the Book's stated value."[855]

The bank told the Subcommittee that it did not terminate Julien Grout at the time, because it wanted to consider whether, as a junior trader, he had been coerced into marking the SCP book improperly.[856] Mr. Grout later resigned from the bank in December 2012.

F. Analysis

While JPMorgan Chase has essentially conceded that the CIO mismarked the SCP book to hide losses, it has chosen to rest its analysis on the subjective intent of the traders involved with the mismarking, rather than on the objective evidence. That evidence shows that the CIO had changed its valuation practices over time, began using more favorable marks than the midpoint prices in ways that consistently benefited the bank, and used those more favorable prices to avoid reporting hundreds of millions of dollars in losses over a three-month period. The CIO's mismarking was also evident from the hundreds of millions of dollars in collateral disputes it had with its counterparties, including JPMorgan Chase Investment Bank.

Detecting the mismarking of derivatives does not require analysis of a person's subjective opinions; it requires analysis of the marks themselves to determine the extent to which they deviate from the midpoint prices and the extent to which that deviation benefits the financial institution marking the values. Calculating those two objective factors is not only possible, but provides a cost-effective option for bank managers and regulators to exercise better oversight of the derivative valuation process.

While JPMorgan Chase has admitted the misconduct of the CIO personnel engaged in the mismarking, it has yet to acknowledge the deficiencies in the SCP pricing reviews conducted by the VCG and Controller's offices. These reviews failed to use the objective information at hand to expose the SCP's mismarking, to condemn the CIO's use of overly favorable derivative prices to minimize losses, and to prohibit other bank business lines from engaging in similar derivative valuation practices. Instead, the bank expressed support for the two internal reviews that upheld the CIO's pricing practices. By failing to provide any criticism of those reviews, the bank has essentially signaled that its businesses can continue to game derivative prices, as long as they select prices from the daily bid-ask spread and disguise their motives.

[855] 7/12/2012 letter from JPMorgan Chase to Bruno Iksil, CIO, JPM-CIO-PSI-H 0002740-741, at 740. See also 7/12/2012 letter from JPMorgan Chase to Achilles Macris, CIO, JPM-CIO-PSI-H 0002742-743, at 742.

[856] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012) (Harry Weiss).

That troubling message should be counteracted with a clear policy statement prohibiting the gaming of derivative values to benefit the bank.

Given the ongoing importance of derivative holdings in large, federally insured financial institutions, strengthening the derivative valuation process is essential, including through improved oversight measures to detect and stop mismarking and stronger policies that prohibit the gaming of derivative valuations.

V. DISREGARDING RISK

In contrast to JPMorgan Chase's reputation for best-in-class risk management, the whale trades exposed a bank culture in which risk limit breaches were routinely disregarded, risk metrics were frequently criticized or downplayed, and risk evaluation models were targeted by bank personnel seeking to produce artificially lower capital requirements.

The CIO used five key metrics and limits to gauge and control the risks associated with its trading activities, including a Value-at-Risk (VaR) limit, Credit Spread Widening 01 (CS01) limit, Credit Spread Widening 10% (CSW10%) limit, stress loss limits, and stop loss advisories. During the first three months of 2012, as the CIO traders added billions of dollars in complex credit derivatives to the Synthetic Credit Portfolio, the SCP trades breached the limits on all five of the risk metrics. In fact, from January 1 through April 30, 2012, CIO risk limits and advisories were breached more than 330 times.

In January 2012, the SCP breached the VaR limit for both the CIO and the bank as a whole. That four-day breach was reported to the bank's most senior management, including CEO Jamie Dimon. In the same month, the SCP repeatedly breached the Credit Spread 01 (CS01) risk limit, exceeding the limit by 100% in January, by 270% in early February, and by more than 1,000% in mid-April. In February 2012, a key risk metric known as the Comprehensive Risk Measure (CRM) warned that the SCP risked incurring a yearly loss of $6.3 billion, but that projection was dismissed at the time by CIO personnel as "garbage." In March 2012, the SCP repeatedly breached the Credit Spread Widening 10% (CSW10%) risk limit, as well as certain stress loss limits signaling possible losses in adverse market conditions, followed by stop loss advisories that were supposed to set a ceiling on how much money a portfolio was allowed to lose over a specified period of time. Concentration limits that could have prevented the SCP from acquiring outsized positions were absent at the CIO despite being commonplace for the same instruments at JPMorgan Chase's Investment Bank.

The SCP's many breaches were routinely reported to JPMorgan Chase and CIO management, risk personnel, and traders. The breaches did not, however, spark an in-depth review of the SCP or require immediate remedial actions to lower risk. Instead, the breaches were largely ignored or ended by raising the relevant risk limit.

In addition, CIO traders, risk personnel, and quantitative analysts frequently attacked the accuracy of the risk metrics, downplaying the riskiness of credit derivatives and proposing risk measurement and model changes to lower risk results for the Synthetic Credit Portfolio. In the case of the VaR, after analysts concluded the existing model was too conservative and overstated risk, an alternative CIO model was hurriedly adopted in late January 2012, while the CIO was in breach of its own and the bankwide VaR limit. The CIO's new model immediately lowered the SCP's VaR by 50%, enabling the CIO not only to end its breach, but to engage in substantially more risky derivatives trading. Months later, the bank determined that the model was improperly implemented, requiring error-prone manual data entry and incorporating formula and calculation errors. On May 10, the bank backtracked, revoked the new VaR model due to its inaccuracy in portraying risk, and reinstated the prior model.

In the case of the bank's CRM risk metric and model, CIO quantitative analysts, traders, and risk managers attacked it for overstating risk compared to their own far more optimistic analyses. The CIO's lead quantitative analyst also pressed the bank's quantitative analysts to help the CIO set up a system to categorize the SCP's trades for risk measurement purposes in a way designed to produce the "optimal" – meaning lowest – Risk Weighted Asset total. The CIO analyst who pressed for that system was cautioned against writing about it in emails, but received sustained analytical support in his attempt to construct the system and artificially lower the SCP's risk profile.

The head of the CIO's London office, Achilles Macris, once compared managing the Synthetic Credit Portfolio, with its massive, complex, moving parts, to flying an airplane. The OCC Examiner-in-Charge at JPMorgan Chase told the Subcommittee that if the Synthetic Credit Portfolio were an airplane, then the risk metrics were the flight instruments. In the first quarter of 2012, those flight instruments began flashing red and sounding alarms, but rather than change course, JPMorgan Chase personnel disregarded, discounted, or questioned the accuracy of the instruments instead. The bank's actions not only exposed the many risk management deficiencies at JPMorgan Chase, but also raise systemic concerns about how many other financial institutions may be disregarding risk indicators and manipulating models to artificially lower risk measurements and capital requirements.

A. Background

Until news of the synthetic credit derivative trading losses broke in April 2012, JPMorgan Chase was widely regarded as having among the best risk management practices in the financial industry. The bank had consistently outperformed its peers during periods of economic turmoil. As CEO, Jamie Dimon developed a reputation as a "risk-averse manager who demands regular and exhaustive reviews of every corner of the bank."[857] During the financial crisis, government officials, investors, and depositors alike viewed JPMorgan Chase as a safe harbor in the storm. In 2008, bank regulators brokered JPMorgan Chase acquisitions of Washington Mutual and Bear Stearns as those institutions failed.[858] While JPMorgan Chase accepted $25 billion in bailout funds during the crisis, it was among the first of the banks to fully repay the loans.[859] In 2009, during the worst recession in generations, JPMorgan Chase's performance was buoyed by more than $1 billion in profits from the Synthetic Credit Portfolio.[860]

When word broke of hundreds of millions of dollars in CIO losses due to high risk synthetic credit derivatives trading, questions immediately focused on JPMorgan Chase's risk management practices. At a hearing before the Senate Banking, Housing, and Urban Affairs Committee in June 2012, Mr. Dimon admitted to risk management failures:

> "CIO's strategy for reducing the synthetic credit portfolio was poorly conceived and vetted. In hindsight, the CIO traders did not have the requisite understanding of the new risk 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 firm wide risk control function."[861]

Later in the same hearing, in response to a question by Committee Chairman Tim Johnson about specific risk limits, Mr. Dimon stated:

> "CIO had its own limits around credit risk and exposure. At one point, in March, some of those limits were triggered.

[857] "House of Dimon Marred by CEO Complacency Over Unit's Risk," Bloomberg, Erik Schatzker et al. (6/12/2012), http://www.bloomberg.com/news/2012-06-12/house-of-dimon-marred-by-ceo-complacency-over-unit-s-risk.html.
[858] See, e.g., "JPMorgan Chase & Company," New York Times, (Updated 11/16/2012), http://topics.nytimes.com/top/news/business/companies/morgan_j_p_chase_and_company/index.html.
[859] Id.; "JPMorgan and 9 Other Banks Repay TARP Money," New York Times, Dealbook (6/17/2009), http://dealbook.nytimes.com/2009/06/17/jpmorgan-repays-treasury-as-tarp-exits-continue/.
[860] See 6/21/2012 "CIO Compensation – Revenue to Compensation Historical Lookback," JPM-CIO-PSI-H 0002746, at 749.
[861] Testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012), http://www.cq.com/doc/congressionaltranscripts-4105471.

> The CIO at that point did ask the traders to reduce taking risk and [Ms. Drew] started to look very heavily into the area which would be 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."[862]

While it may be true that additional risk limits and greater scrutiny from senior management would have helped, Mr. Dimon's testimony belies the fact that the Synthetic Credit Portfolio did, in fact, cause multiple breaches of both CIO and bankwide risk limits during the first three months of 2012. Senior management, at times including Mr. Dimon, were notified of those breaches but did not initiate an effective investigation into the nature of the risk facing the bank. Despite JPMorgan Chase's reputation for careful risk management, in the case of the CIO losses, the warning signs were clear, but they were disregarded or rationalized. Even Mr. Dimon acknowledges that it was not until March that the CIO instructed the traders to stop taking on additional positions.

The Chief Investment Office, which managed a \$350 billion investment portfolio consisting, in part, of federally insured deposits, had an inadequate risk management function. The CIO did not have a Chief Risk Officer until far too late, and even before then the senior-most risk officer viewed it as his responsibility merely to observe and report risk, not to lower it. The person most responsible for managing the CIO's risk profile, Chief Investment Officer Ina Drew, was afforded great deference by Mr. Dimon and the bank's operating committee.[863] Inside her office, the traders were much more influential than the risk managers. At the same time, policing risk conflicted with her interest in generating gains.

The bank's reliance on Ms. Drew to police risk within the CIO was so excessive that some senior risk personnel first became aware of the CIO's outsized synthetic credit positions from the media. John Hogan, the bank's Chief Risk Officer, for example, told the Subcommittee that the articles about the "London Whale," which first appeared on April 6, 2012, surprised him.[864] Mr. Hogan said that the Synthetic Credit Portfolio was not on his radar in an "alarming way" prior to that date.[865] It speaks volumes that the financial press became aware of the CIO's risk problems before JPMorgan Chase's Chief Risk Officer.

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[862] Id.

[863] Subcommittee interviews of Jamie Dimon, JPMorgan Chase (9/19/2012) and Michael Cavanagh, JPMorgan Chase (12/12/2012). See also 2013 JPMorgan Chase Task Force Report, at 22.

[864] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

[865] Id.

While the bank's Chief Risk Officer was apparently left in the dark, by April 2012, senior CIO management was well aware that the Synthetic Credit Portfolio had lost money on most days during the first quarter of the year, had cumulative losses of at least $719 million, and had massively increased the portfolio size with tens of billions of dollars of new synthetic credit positions threatening additional losses. Ms. Drew was so concerned that on March 23, she had ordered the traders to stop trading. Yet in the week following publication of the "London Whale" articles, Mr. Dimon, Mr. Hogan, Chief Financial Officer Douglas Braunstein, and others, gave the impression that the press reports were overblown. On the bank's April 13 quarterly earnings call, Mr. Dimon referred to the press accounts as a "complete tempest in a teapot,"[866] and Mr. Braunstein stated that the bank was "very comfortable with our positions."[867] Those statements did not reflect the magnitude of the problems in the Synthetic Credit Portfolio. Mr. Dimon publicly withdrew his comment a month later.[868]

Prudent regulation of the U.S. financial system depends in part on understanding how a small group of traders in the London office of a global bank renowned for stringent risk management were able to purchase such a large volume of synthetic credit derivatives that they eventually led to losses of more than $6 billion. This case study elucidates the tension between traders and risk managers. Traders are incentivized to be aggressive and take on significant risk. Risk managers are supposed to be a voice of caution, limiting and reigning in that risk. Just because trading strategies sometimes succeed does not mean they are prudent. Bad bets sometimes pay off, and it is easy to confound profits with successful trading strategies. At the CIO, initial success in high risk credit derivative trading contributed to complacent risk management, followed by massive losses.

CIO synthetic credit traders were able to take on positions of enormous risk because, despite its reputation, JPMorgan Chase's Chief Investment Office lacked adequate risk management. The risk metrics that were in place at the CIO were sufficient to limit, if not prevent entirely, the losses to the bank caused by the Synthetic Credit Portfolio, had they been heeded. Understanding the risk management failures at JPMorgan Chase's CIO requires an analysis of its risk management

[866] See 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 10, JPM-CIO-PSI 0001151.
[867] Id., at 7.
[868] See 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 2, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf (Mr. Dimon: "But in hindsight, the new strategy was flawed, complex, poorly reviewed, poorly executed and poorly monitored. The portfolio has proven to be riskier, more volatile and less effective [an] economic hedge than we thought.").

structure, risk personnel, and why specific risk metrics in place at the time of the trades were disregarded.

B. Risk Management Structure at CIO

JPMorgan Chase provides a broad overview of its risk management practices in its Annual Report. The 2011 Annual Report describes risk management at the firm in the following way:

> "Risk Management operates independently of the lines of businesses to provide oversight of firmwide risk management and controls, and is viewed as a partner in achieving appropriate business objectives. Risk Management coordinates and communicates with each line of business through the line of business risk committees and chief risk officers to manage risk. The Risk Management function is headed by the Firm's Chief Risk Officer, who is a member of the Firm's Operating Committee and who reports to the Chief Executive Officer and is accountable to the Board of Directors, primarily through the Board's Risk Policy Committee. The Chief Risk Officer is also a member of the line of business risk committees. Within the Firm's Risk Management function are units responsible for credit risk, market risk, country risk, private equity risk and operational risk, as well as risk reporting, risk policy and risk technology and operations. Risk technology and operations is responsible for building the information technology infrastructure used to monitor and manage risk."[869]

JPMorgan Chase maintained a number of bankwide risk limits as well as risk limits for each major business unit. Bankwide risk limits were set by the bank's CEO and CRO,[870] and were regularly discussed with the Risk Policy Committee of the Board of Directors.[871] The business unit risk limits were developed by each unit's head and risk management personnel,[872] in consultation with the bank's Chief Risk Officer.[873] The CIO's limits depended on overall firm risk appetite as well as its own mandate, which required a dialogue between the CIO

[869] See 3/30/2012, "2011 Annual Report," JPMorgan Chase publication, at 125, http://files.shareholder.com/downloads/ONE/1839748086x0x556139/75b4bd59-02e7-4495-a84c-06e0b19d6990/JPMC_2011_annual_report_complete.pdf.
[870] 3/2012 presentation prepared by JPMorgan Chase entitled "Market Risk Limits," at 12, OCC-SPI-00117682.
[871] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012). See also 3/20/2012 Directors Risk Policy Committee meeting minutes for JPMorgan Chase, JPM-CIO-PSI-0013563.
[872] 3/2012 presentation prepared by JPMorgan Chase entitled "Market Risk Limits," at 12, OCC-SPI-00117682.
[873] Subcommittee interview of Peter Weiland, CIO (8/29/2012).

and firm managers.[874] Risk limits were a topic of discussion at the CIO's annual "Business Review," a formal meeting attended by top executives of the bank and CIO.[875] The CIO's 2012 Business Review was held in February and attended by Mr. Dimon, Mr. Braunstein, Mr. Zubrow, and Mr. Hogan, as well as Ms. Drew, Mr. Goldman, Mr. Macris, and Mr. Wilmot.[876]

For both the bank and its business units, risk limits were categorized as either Level 1 or Level 2 limits. Breaches of Level 1 limits were viewed as more serious. According to a March 2012 JPMorgan Chase presentation on market risk limits, the "[CIO] Risk Committee reviews Level 1 and Level 2 limits for each business on a monthly basis."[877] When Level 1 firm limits were breached, the firm Operating Committee was notified by email. Changes in or waivers of bankwide Level 1 limits required the approval of the CEO and CRO. Changes in or waivers of a business unit's Level 1 limits also required the approval of the unit head and its CRO.[878] For example, the bankwide 10Q VaR limit was a Level 1 limit; its waiver or adjustment required Mr. Dimon's approval.[879] The CIO 10Q VaR limit was a Level 1 limit inside the CIO; its waiver or adjustment required the approval of Ina Drew.[880]

Documents obtained by the Subcommittee indicate that, in theory, breaches of Level 1 and Level 2 risk limits – "excessions" in the bank's parlance – required immediate remedial action. A March 2012 JPMorgan Chase presentation provided to the OCC, for example, outlines the actions that were supposedly mandatory when those risk limits were breached. It states that, for breaches of Level 1 and Level 2 limits: "Business unit must take immediate steps toward reducing the

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[874] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012).
[875] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
[876] 2/2012 presentation prepared by JPMorgan Chase entitled "CIO February 2012 Business review," at 1, JPM-CIO-PSI 0001940, at 942.
[877] 3/2012 presentation prepared by JPMorgan Chase entitled, "Market Risk Limits," at 1, OCC-SPI-00117682.
[878] Id., at 13.
[879] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
[880] See also 2013 JPMorgan Chase Task Force Report, at 75-76 (describing the CIO's risk limit policy: "The three categories of risk metrics applicable to CIO were VaR, stress, and non-statistical credit-spread widening metrics (Credit Spread Basis Point Value ('CSBPV') and CSW 10%). Pursuant to Firm policy, each of these metrics was subject to certain limits. Limits are classified by type, as Level 1, Level 2, or 'threshold.' A limit's type determines who is responsible for approving the limit, who receives notice of any excessions, and who within the Firm is responsible for approving any increases. The CIO Global 10-Q VaR and CIO stress limits were Level 1 limits, while the CIO CSBPV and CSW 10% limits were Level 2 limits. Any excessions of Level 1 or Level 2 limits had to be reported to the signitories to the limit, the risk Committee for the line of business, and the Market Risk Committee or Business Control Committee for the line of business. Under Firm policy, all excession notifications should include (1) a description of the limit excess, (2) the amount of the limit, (3) the exposure value (*i.e.* the amount by which the limit has been exceeded) and the percentage by which the limit has been exceeded, and (4) the number of consecutive days the limit has been exceeded.").

exposure to be within the limit, unless a One-off Approval is granted by all Grantors and Grantees of limits."[881] JPMorgan Chase's 2011 Annual Report states: "Limit breaches are reported in a timely manner to senior management and the affected line-of-business is required to reduce trading positions or consult with senior management on the appropriate action."[882]

In practice, the bank told the Subcommittee that its risk metrics were intended to act, not as ironclad limits, but as guidelines and red flags. Mr. Dimon told the Subcommittee that a breach in a risk "limit" was intended to lead to a conversation about the situation, not to an automatic freeze or unwinding of positions.[883] The CIO used the same approach. If a risk limit were breached, CIO traders were expected to express a view about the risk in the portfolio and what should be done, but not to immediately reduce the portfolio's holdings to end the breach.[884]

Over the course of 2011 and 2012, the SCP breached every risk limit that the Subcommittee examined, but none of those breaches led to an analysis of whether the portfolio was engaged in overly risky trading activities. Instead, CIO personnel, including Javier Martin-Artajo, head of the CIO's equity and credit trading operation and the first line manager of the SCP, repeatedly challenged and downplayed the significance, validity, and relevance of the various metrics used to quantify the risk in the SCP.[885] Ms. Drew and Mr. Macris held Mr. Martin-Artajo in high regard, and put a great deal of confidence in his analysis.[886] The CIO's risk personnel did not express a countervailing view.[887]

With hindsight, the JPMorgan Chase Task Force provided this negative assessment of the CIO's risk management structure:

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[881] See, e.g., 3/2012 presentation prepared by JPMorgan Chase entitled, "Market Risk Limits," at 13, OCC-SPI-00117682.
[882] 3/30/2012, "2011 Annual Report," JPMorgan Chase publication, at 162, http://files.shareholder.com/downloads/ONE/1839748086x0x556139/75b4bd59-02e7-4495-a84c-06e0b19d6990/JPMC_2011_annual_report_complete.pdf. See also 2013 JPMorgan Chase Task Force Report, at 76 (describing how the CIO was supposed to respond to risk limit breaches: "Excessions are addressed differently depending on type, but in the event of 'active limit excess,' which occurs when a business unit exceeds its own limit, the business unit 'must take immediate steps to reduce its exposure so as to be within the limit,' unless a 'one-off approval' is granted. A 'one-off approval' refers to a temporary increase for a limited period of time; it must be provided by the persons who were responsible for setting the original limit.").
[883] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
[884] Subcommittee interview of Ina Drew, CIO (12/11/2012).
[885] See, e.g., 3/8/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0008773-775, and discussion below.
[886] Subcommittee interview of Ina Drew, CIO (9/7/2012); JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012).
[887] See 2013 JPMorgan Chase Task Force Report, at 100, and discussion below.

"For a significant period of time prior to the first quarter of 2012, CIO was subjected to less rigorous scrutiny than client-facing lines of business. The lower level of oversight engendered weak risk management and infrastructure within CIO, which performed ineffectively at a time when robust, effective controls were most needed. Granular limits were lacking, and risk managers did not feel adequately empowered."[888]

C. CIO Risk Management Personnel

Although the CIO was not a client-facing business, it managed as much as $350 billion in assets and oversaw a trading book that was among the largest in the industry.[889] Yet the CIO did not have a Chief Risk Officer until 2012. The position of CIO Chief Risk Officer was vacant through 2011.[890] During the key months of January through March 2012, Irvin Goldman was new to the position, still learning the ropes, and did not respond in a vigorous way to CIO breaches of various risk metrics. Peter Weiland, the CIO's senior market risk officer, told the Subcommittee that it was not his job to enforce the risk limits.[891] When he was informed of limit breaches, bank documents indicate that his reaction was to challenge the metrics, not the CIO traders.[892] The same was true of the CIO's top risk quantitative analyst, Patrick Hagan.[893]

Peter Weiland served as the senior-most risk officer at CIO from 2008 until January 2012. Mr. Weiland had been hired by Ms. Drew, in 2008, to serve as the CIO's Chief Market Risk Officer.[894] Mr. Weiland initially reported directly to Ms. Drew. The top traders at CIO also reported directly to Ms. Drew, creating a situation where the final authority on risk management at the CIO was in the hands of the person who was also in charge of the top trading strategist, resulting in a lack of independence in the risk management function.

That lack of independence raised concerns with regulators. In 2009, JPMorgan Chase changed the CIO's reporting lines, and Mr.

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[888] 2013 JPMorgan Chase Task Force Report, at 94.
[889] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012). See also testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012), http://www.cq.com/doc/congressionaltranscripts-4105471 ("Here -- here are the facts. We have $350 billion of assets in CIO.").
[890] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
[891] Subcommittee interview of Peter Weiland, CIO (8/29/2012).
[892] See Chapter V, Section D, "Disregarding CIO Risk Metrics," below.
[893] Id.
[894] Subcommittee interview of Peter Weiland, CIO (8/29/2012). Mr. Weiland resigned from JPMorgan Chase in October 2012. 2013 JPMorgan Chase Task Force Report, at 20.

Weiland ostensibly began reporting directly to Barry Zubrow, the bankwide Chief Risk Officer, while maintaining a "dotted-line," or indirect, reporting relationship with Ms. Drew. Mr. Weiland told the Subcommittee that the changes were made in response to regulatory pressure. When asked if the reorganization made a difference functionally, Mr. Weiland answered, "Not really."[895]

As a result, CIO risk managers were, in practice, more beholden to CIO management than the Firm's risk organization. According to the 2013 JPMorgan Chase Task Force Report:

> "The CIO Risk function had been understaffed for some time, and CIO management, rather than the Risk function, had been the driving force behind the hiring of at least some of the risk personnel. Although the CIO had long-tenured Risk personnel in less senior positions … they appear not to have been expected, encouraged or supported sufficiently by CIO management or by the Firm-wide Risk organization to stand up forcefully to the CIO front office and to vigorously question and challenge investment strategies within the CIO. Rather, at least with respect to some Risk managers, such as Messrs. Goldman and Weiland, there was a sense that they were accountable first and foremost to CIO managers rather than to the Firm's global Risk organization. They generally did not feel empowered to take the kinds of actions that risk managers elsewhere within the Firm believed they could and should take. Responsibility for this failure lies not only with CIO Risk managers, but with Ms. Drew as well."[896]

As the Chief Investment Officer, Ina Drew was ultimately responsible for the risks taken by the CIO traders. Ms. Drew was an experienced risk manager herself, and had been widely credited for devising the macro hedge that saved Chemical Bank during the recession of 1987.[897] Many senior bank managers were not even aware that the position of CIO Chief Risk Officer was vacant. One telling indication of the lack of a robust risk management culture at JPMorgan Chase's CIO is that to the Subcommittee's question, "Who was the Chief Risk Officer at CIO in 2011?" Different bank managers, current and former, gave different answers.

While Mr. Weiland was the head of Market Risk at CIO,[898] many in the CIO were under the impression that Mr. Weiland was, in fact, the

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[895] Subcommittee interview of Peter Weiland, CIO (8/29/2012).
[896] 2013 JPMorgan Chase Task Force Report, at 99-100.
[897] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[898] See, e.g., Subcommittee interview of Peter Weiland, CIO (8/29/2012); 2013 JPMorgan Chase Task Force Report, at 20; undated ("Effective Pre-June 2011") chart produced by JPMorgan

CIO's Chief Risk Officer prior to the hiring of Irvin Goldman in January 2012. Joseph Bonocore served as the Chief Financial Officer (CFO) of CIO during Mr. Weiland's tenure before Mr. Wilmot took over and Mr. Bonocore became JPMorgan Chase's Corporate Treasurer.[899] Mr. Bonocore was unambiguous that Mr. Weiland served as the Chief Risk Officer for CIO, telling the Subcommittee, "I knew Pete as the CRO during my time there."[900] David Olson was the head of credit trading for the CIO's Available for Sale portfolio from 2006 until 2011 (which did not include synthetic credit derivatives). Mr. Olson and Mr. Weiland had desks near each other on the CIO trading floor in New York, and they spoke regularly.[901] Mr. Olson also told the Subcommittee that Mr. Weiland was the CIO's Chief Risk Officer.[902] Likewise, CIO's head of Quantitative Analytics, Patrick Hagan, said that he thought Mr. Weiland was the CIO's Chief Risk Officer.[903] Even Mr. Weiland's 2010 performance review, conducted by Ms. Drew, referred to him as the CIO's CRO, though Ms. Drew told the Subcommittee that this characterization was imprecise.[904] In other words, in late 2011, when CIO International began putting on the synthetic credit positions that would lead to the $6 billion loss, the CIO Chief Risk Officer position was vacant; and the person that some at CIO thought to be the Chief Risk Officer, was not, in fact, serving in that capacity.

In January 2012, the bank made several changes to its risk personnel. Mr. Zubrow became the head of Corporate and Regulatory Affairs and John Hogan, who had previously served as the Chief Risk Officer in the Investment Bank, took his place as the bankwide Chief Risk Officer.[905] Mr. Hogan told the Subcommittee that, while he was appointed to the new position in January 2012, he continued to serve as the Chief Risk Officer of the Investment Bank through February.[906] Also in February, Ashley Bacon was appointed the bankwide Chief Market Risk Officer reporting to Mr. Hogan.[907]

Chase in response to a Subcommittee request, "CIO Risk Management Team," JPM-CIO-PSI-H 0002813; 1/30/2012 email from Irvin Goldman, CIO, to Ashley Bacon, JPMorgan Chase, "CIO VaR heads up and update," JPM-CIO-PSI 0020168 ("Pete as head of market risk ….").

[899] Subcommittee interview of Joseph Bonocore, JPMorgan Chase (9/11/2012). Mr. Bonocore served as CFO for CIO from September 2000 to November 2010, after which time he served as firmwide Corporate Treasurer until his departure from JPMorgan Chase in October 2011 for personal reasons. Id.

[900] Subcommittee interview of Joseph Bonocore, JPMorgan Chase (9/11/2012).

[901] Subcommittee interview of David Olson, CIO (9/14/2012).

[902] Id.

[903] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

[904] 1/10/2011 email from Ina Drew, CIO, to Peter Weiland, CIO, "Confidential – 2010 Performance Evaluation" JPM-CIO-PSI-H 0002801.

[905] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

[906] Id.

[907] Id.

With regard to the CIO, the risk management apparatus that Mr. Hogan inherited from Mr. Zubrow was dysfunctional. The 2013 JPMorgan Chase Task Force Report found:

> "[Mr. Zubrow] bears significant responsibility for failures of the CIO Risk organization, including its infrastructure and personnel shortcomings, and inadequacies of its limits and controls on the Synthetic Credit portfolio. The CIO Risk organization was not equipped to properly risk-manage the portfolio during the first quarter of 2012, and it performed ineffectively as the portfolio grew in size, complexity and riskiness during that period."[908]

In January, Mr. Hogan appointed Irvin Goldman as the CIO's first official Chief Risk Officer. Mr. Goldman reported to both Ms. Drew and Mr. Hogan. Mr. Hogan told the Subcommittee that he selected Mr. Goldman, who already worked for Ms. Drew in another capacity, on the advice of Ms. Drew and Mr. Zubrow, who is a brother-in-law to Mr. Goldman.[909] Mr. Goldman had not served in a risk management capacity at JPMorgan Chase prior to his promotion. Ms. Drew had hired him as a portfolio manager in 2008, and hired him again in 2010 to be a senior advisor.[910] Mr. Weiland, who remained the CIO's Chief Market Risk Officer, began reporting to Mr. Goldman.[911] The end result was that, just as the CIO's SCP began rapidly increasing its risk and incurring significant losses, the top risk positions were shuffled and the new risk management leadership team was just settling into place.[912]

By March 20, 2012, as a result of the trading strategy, the SCP had nearly tripled in size, incurred hundreds of millions of losses, and triggered bankwide VaR and CIO CS01 risk limit breaches. Yet when Ms. Drew, Mr. Goldman, Mr. Hogan, and Mr. Bacon all attended a March 20 meeting of the Risk Policy Committee of JPMorgan Chase's Board of Directors, chaired by James Crown, the SCP trading strategy, its mounting losses, and the risk limit breaches were not disclosed.[913]

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[908] 2013 JPMorgan Chase Task Force Report, at 8.

[909] Id., at 98, footnote 109. ("In late 2010/early 2011, Ms. Drew and Mr. Zubrow, whose wife's sister is married to Mr. Goldman, began a search to fill the newly created position of Chief Risk Officer of CIO.").

[910] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).

[911] See 4/26/2012 email from Gina Serpico, CIO, to Manish Jain, JPMorgan Chase, "Org Chart," conveying presentation entitled "CHIEF INVESTMENT OFFICE – ORGANIZATION," JPM-CIO-PSI 0001885.

[912] See also 2013 JPMorgan Chase Task Force Report, at 12 ("With respect to personnel, a new CIO Chief Risk Officer was appointed in early 2012, and he was learning the role at the precise time the traders were building the ultimately problematic positions.")

[913] 3/20/2012 presentation for JPMorgan Chase Directors Risk Policy Committee (DRPC) meeting, JPM-CIO-PSI 0013890; 3/20/2012 Risk Policy Committee meeting minutes for JPMorgan Chase, JPM-CIO-PSI-0013563. See also 2013 JPMorgan Chase Task Force Report, at 42-43 (finding that, at the March 20th meeting of the DPRC, "CIO management did not disclose the increasing mark-to-market losses, the recent breaches in certain of CIO's risk limits, the

The CIO's own Risk Committee, typically chaired by the head risk officer at CIO and attended by the CIO's top managers and risk officers, should also have provided a venue to address the burgeoning risks of the Synthetic Credit Portfolio.[914] But the CIO Risk Committee met only three times in 2011, and held its first 2012 meeting on March 28, 2012, by which time the ill-fated trades had already been made.[915] In addition, unlike other JPMorgan Chase lines of business, the CIO's Risk Committee typically did not invite outside personnel to its meetings to review its trading strategies and risk profile. According to the 2013 JPMorgan Chase Task Force Report: "There was no official membership or charter for the CIO Risk Committee and attendees typically included only personnel from CIO .... Had there been senior traders or risk managers from outside CIO or had the CIO Risk Committee met more often, the process might have been used to more pointedly vet the traders' strategies in the first quarter of 2012."[916]

Even if the role of CIO Chief Risk Officer had been filled earlier, the reporting lines had been clear, and the CIO Risk Committee had met more often, there is little evidence that these changes would have prevented Mr. Iksil from pursuing the trading strategy that he and Mr. Martin-Artajo had devised. Mr. Macris had approved the strategy, which was within the authority that Ms. Drew had delegated to him.[917] At the CIO, in 2011 and early 2012, risk managers played no role in evaluating and approving trading strategies.[918] Mr. Weiland explained to the Subcommittee that his role as a risk manager was descriptive, rather than prescriptive.[919] He said that he acted as a "middleman" who "coordinated" between the risk modelers and the traders and managers to ensure that the risk metrics were properly calculated and disseminated to decision makers. Mr. Weiland told the Subcommittee that he described the risks that existed in the portfolio, but did not challenge trading decisions. According to Mr. Weiland, the CIO's risk appetite was set by members of the bank's Operating Committee, and it was up

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substantial increase in RWA, the significant growth in the Synthetic Credit Portfolio's notionals, or the breaches in the VaR limit earlier in the year."). See also id., at 43, footnote 53.

[914] 2013 JPMorgan Chase Task Force Report, at 100.

[915] See 2013 JPMorgan Chase Task Force Report at 100; 3/28/2012 Outlook Calendar Appointment, "CIO RISK COMMITTEE (Attachment Below)," JPM-CIO-PSI-H 0006401-437.

[916] 2013 JPMorgan Chase Task Force Report, at 100.

[917] Subcommittee interview of Ina Drew, CIO (9/7/2012).

[918] Subcommittee interview of Peter Weiland, CIO (8/29/2012); 2013 JPMorgan Chase Task Force Report, at 100 ("Although the CIO had long tenured risk personnel in less senior positions ... they appear not to have been expected, encouraged or supported sufficiently by CIO management or by the Firm-wide Risk organization to stand up forcefully to the CIO front office and to vigorously question and challenge investment strategies within the CIO."). In addition, although risk managers were asked to provide input for the CIO traders' 2011 annual performance review, their input did not raise any risk management concerns. 2013 JPMorgan Chase Task Force Report, at 92.

[919] Subcommittee interview of Peter Weiland, CIO (8/29/2012).

to Ms. Drew rather than to the risk personnel to enforce the risk limits.[920]

Mr. Weiland's passive role as a risk manager meant that when the SCP began causing the CIO to breach its risk limits in January 2012, he did not enforce those limits, or direct the traders to exit any positions. In fact, beginning with the VaR breaches in January, he repeatedly worked with CIO traders and quantitative analysts to challenge or modify the risk metrics, or approve limit increases or exemptions.[921]

Given Mr. Weiland's perception of his role and Mr. Goldman's inexperience as a risk manager, neither attempted to constrain the CIO trading strategies. In addition, by his own admission, Mr. Hogan told the Subcommittee that he was not focused on the Synthetic Credit Portfolio until after the media broke the news of the whale trades in April.[922] Mr. Hogan stated that until the stories broke, his first priority had been to understand the bank's consumer business.[923] As a result, bank management had placed itself in an inadequate position to assess the CIO trading problems.

In its review of the CIO, the JPMorgan Chase Task Force summarized the many shortcomings in the CIO's risk management efforts as follows:

> "CIO Risk Management lacked the personnel and structure necessary to manage the risks of the Synthetic Credit Portfolio. ... More broadly, the CIO Risk function had been historically understaffed, and some of the CIO risk personnel lacked the requisite skills. With respect to structural issues, the CIO Risk Committee met only infrequently, and its regular attendees did not include personnel from outside CIO. As a result, the CIO Risk Committee did not effectively perform its intended role as a forum for constructive challenge of practices, strategies and controls. Furthermore, at least some CIO risk managers did not consider themselves sufficiently independent from CIO's business operations and did not feel empowered to ask hard questions, criticize trading strategies or escalate their concerns in an effective manner to Firm-wide Risk Management. And finally, the Task Force has concluded that CIO management, along with Firm-wide Risk Management, did not fulfill their responsibilities to ensure that CIO control functions were

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[920] Id.
[921] See Section D "Disregarding CIO Risk Metrics," below.
[922] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
[923] Id.

effective or that the environment in CIO was conducive to their effectiveness."[924]

The fact that these systemic risk management failures at the CIO, which controlled a $350 billion portfolio, the second largest at JPMorgan Chase, became known to bank management, regulators, policymakers, and investors more or less by chance – when the SCP's enormous whale trades attracted media attention – exposes not only the fact that good banks can have poor quality risk controls, but also that lax risk management practices are too often neither detected nor prevented by bank regulators.

D. Disregarding CIO Risk Metrics

JPMorgan Chase, like all major financial institutions today, uses various risk metrics and mathematical models to measure, track, and evaluate the risks presented by its trading activities. Those activities typically involve numerous, complex financial instruments around the globe, with different time horizons, risk characteristics, and potential interactions. They also often feature daily trading and quick asset turnovers. The models needed to track and analyze the risks posed by those trading activities and the resulting financial instruments are usually designed by quantitative analysts with doctorates in mathematics, finance, or even physics. For example, Patrick Hagan, head of quantitative analytics at the CIO, received a B.S. and Ph.D. in Applied Mathematics from the California Institute of Technology. Before entering finance, Mr. Hagan helped design chemical reactors for Exxon, was a scientist for Los Alamos's Theory and Computer Research & Applications groups, and was the Deputy Director for the Los Alamos Center for Nonlinear Science.[925] He then worked for several financial research firms and financial institutions.[926]

Increasingly, for regulators to evaluate the risks and quality of risk management at a financial institution, they have to understand the institution's risk metrics and models. Regulators also rely on mathematical models to help determine, among other matters, how much capital a financial institution must hold to mitigate its risks. Regulators' duties today include determining whether proposed models meet detailed regulatory requirements, overseeing model changes and variations, examining model implementation which can raise complex operational issues, and overseeing back-testing of the models to evaluate their accuracy.[927] These complex tasks are made more difficult if banks'

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[924] 2013 JPMorgan Chase Task Force Report, at 12-13.
[925] See 12/5/2012 biographical information on Patrick Hagan, course tutor for Incisive Training, "Patrick Hagan on Fixed Income," http://ev888.eventive.incisivecms.co.uk.
[926] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
[927] See, e.g., 12 C.F.R. Part 3, Appendix B. The OCC, Federal Reserve, and FDIC have also

quantitative experts are developing new or revised models to artificially lower the bank's risk ratings and capital requirements.

JPMorgan Chase uses a variety of models to track and measure risk for specific lines of business and business units as well as for the bank as a whole. At the CIO, during the first quarter of 2012, the CIO's risk limits were repeatedly breached by the Synthetic Credit Portfolio, even triggering a breach of a bank-wide limit. But instead of investigating and reducing the high risk trading activities that triggered the breaches, the CIO's traders, risk management personnel, and senior managers criticized the risk metrics as inaccurate and pushed for model changes that would portray credit derivative trading activities as less risky.

(1) Disregarding the VaR Limit

One of the early red flags about the risk being taken on by the Synthetic Credit Portfolio was the CIO's breach of the Value-at-Risk (VaR) limit. In January 2012, the CIO's SCP breached not only the CIO's individual VaR limit, but also the VaR limit for the bank as a whole. The breach continued for four days, and ended only after the bank temporarily increased the limit. The CIO's traders and quantitative analysts then rushed approval of a new CIO VaR model which, when it took effect, portrayed the Synthetic Credit Portfolio as 50% less risky than the prior VaR model. The new VaR model not only ended the SCP's breach, but also freed the CIO traders to add tens of billions of dollars in new credit derivatives to the SCP which, despite the supposedly lowered risk, led to additional massive losses. Those losses helped expose both substantive and serious operational flaws in the new VaR model. As a result, in May 2012, the bank backtracked, revoked the CIO's new VaR model, and restored the old one.

(a) Background

VaR models use historical profit and loss data to calculate a dollar figure that is supposed to represent the most money that a portfolio of assets could be expected to lose over a fixed period of time to a certain degree of confidence.[928] The OCC provides detailed guidance on how regulatory VaR models should function, but allows individual banks to design their own models.[929] The OCC also requires all of the banks it

proposed new regulations to comply with new capital, risk, and liquidity standards issued by the Basel Committee on Banking Supervision. See 8/30/2012, Joint Final Rule, "Risk-Based Capital Guidelines: Market Risk," Federal Register, http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16759.pdf.

[928] See OCC definition of VaR, 12 C.F.R. Part 3, Appendix B, Section 2 ("*Value-at-Risk (VaR)* means the estimate of the maximum amount that the value of one or more positions could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.").

[929] See 12 C.F.R. Part 3, Appendix B, Sections 4 and 5; Subcommittee briefing by OCC

oversees to obtain its approval of VaR models used to calculate regulatory capital.[930] Banks also use VaR models for internal risk management. While the OCC has broad authority to oversee the risk management and model development process, banks are not required to submit internal risk management VaR models for OCC approval.[931]

JPMorgan Chase defines VaR as a "measure of the dollar amount of potential loss from adverse market moves in an ordinary market environment."[932] JPMorgan Chase's 2011 Annual Report explained the bank's use of VaR as a risk metric as follows:

> "JPMorgan Chase utilizes VaR, a statistical risk measure, to estimate the potential loss from adverse market moves. Each business day, as part of its risk management activities, the Firm undertakes a comprehensive VaR calculation that includes the majority of its material market risks. VaR provides a consistent cross-business measure of risk profiles and levels of diversification and is used for comparing risks across businesses and monitoring limits. These VaR results are reported to senior management and regulators, and they are utilized in regulatory capital calculations."[933]

According to public filings, JPMorgan Chase "has one overarching VaR model framework used for risk management purposes across the Firm,"[934] but Mr. Dimon told the Subcommittee that the bank has hundreds of individual VaR models used by various lines of business and business segments.[935] For the purposes of this chapter, the relevant VaR is known as the "95%" or "10Q" VaR. The "95%" refers to the confidence level in the computation, and the "10Q" indicates it is the VaR that JPMorgan Chase reports in its 10-Q quarterly filings with the SEC. According to JPMorgan Chase's 2011 Annual Report:

> "The Firm calculates VaR to estimate possible economic outcomes for its current positions using historical simulation,

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(3/4/2012).

930 12 C.F.R. Part 3, Appendix B, Section 3(c)(1) ("(c) Requirements for internal models. (1) A bank must obtain the prior written approval of the OCC before using any internal model to calculate its risk-based capital requirement under this appendix.").

931 See 12 C.F.R. Part 3, Appendix B, Section 3(d) ("(2) The bank must validate its internal models initially and on an ongoing basis. The bank's validation process must be independent of the internal models' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness.").

932 3/30/2012, "2011 Annual Report," JPMorgan Chase publication, at 311, http://files.shareholder.com/downloads/ONE/1839748086x0x556139/75b4bd59-02e7-4495-a84c-06e0b19d6990/JPMC_2011_annual_report_complete.pdf.

933 Id., at 158.

934 JPMorgan Chase & Co. Form 10-Q (for period ending 9/30/2012), filed with the SEC (11/08/2012), at 96, http://files.shareholder.com/downloads/ONE/2252595197x0xS19617-12-308/19617/filing.pdf.

935 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

> which measures risk across instruments and portfolios in a consistent, comparable way. The simulation is based on data for the previous 12 months. This approach assumes that historical changes in market values are representative of the distribution of potential outcomes in the immediate future. VaR is calculated using a one day time horizon and an expected tail-loss methodology, and approximates a 95% confidence level. This means that, assuming current changes in the market are consistent with the historical changes used in the simulation, the Firm would expect to incur losses greater than that predicted by VaR estimates five times in every 100 trading days, or about 12 to 13 times a year. However, differences between current and historical market price volatility may result in fewer or greater VaR exceptions than the number indicated by the historical simulation. The firm's VaR calculation is highly granular and incorporates numerous risk factors, which are selected based on the risk profile of each portfolio."[936]

According to the OCC's Examiner-in-Charge at JPMorgan Chase, the bank's 10-Q VaR estimated the potential loss to the bank's portfolio over the course of a day by looking at the previous 264 trading days and taking the average loss of the worst 33 days.[937]

At JPMorgan Chase, risk models, including VaR models, were normally developed or overseen by the Model Risk and Development (MRAD) group, also referred to as the Quantitative Research (QR) team within the bank's risk management division.[938] Some models required review and testing by MRAD before they were put into effect; tier two models were scheduled for periodic review and could be implemented by business units prior to approval by MRAD.[939] In addition, the Subcommittee was told that, normally, a new model is analyzed concurrently with an existing model for several months to evaluate how the new model performs and examine any diverging results between the two.[940]

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[936] 3/30/2012, "2011 Annual Report," JPMorgan Chase publication, at 158, http://files.shareholder.com/ downloads/ONE/1839748086x0x556139/75b4bd59-02e7-4495-a84c-06e0b19d6990/ JPMC_2011_annual_report_complete.pdf.
[937] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012); see also Subcommittee briefing by JPMorgan Chase (8/15/2012).
[938] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
[939] Id.
[940] Id.

(b) Developing a New VaR Model

JPMorgan Chase told the Subcommittee that the new VaR model adopted by the CIO in January 2012, was not produced at short notice, but was the product of more than a year of planning and development.

The bank told the Subcommittee that the CIO had embarked upon the project to reformulate the methodology for calculating its VaR results in 2011.[941] The CIO 10-Q VaR model then in effect had been designed by Keith Stephan, a member of the CIO's risk management team in London.[942] Although Mr. Stephan remained employed by the CIO in a risk management capacity, he was not the primary developer of the new VaR model; instead, that task was assigned to Patrick Hagan, the CIO's senior quantitative analyst who worked with the CIO traders.[943] Mr. Hagan had never previously designed a VaR model.[944] According to JPMorgan Chase, having an employee from a business unit design the unit's risk model was somewhat unusual,[945] but it did not violate bank policy.[946] The new VaR model, when finalized, indicated that it had been created by both Mr. Hagan and Mr. Stephan.[947]

Mr. Hagan told the Subcommittee that he initially began work on two other VaR models, a "stress VaR" model and then a "historical" VaR model with a 99% confidence level, both of which were intended to be used in a model designed to calculate Risk Weighted Assets (RWA) for the CIO.[948] Mr. Hagan told the Subcommittee that he was told the objective of his research was to design VaR models that, when fed into the RWA model, would produce lower RWA results for the CIO, since both he and the CIO traders viewed the bank's standard RWA model as overstating CIO risk.[949] Mr. Hagan said that he began work on the stress VaR and VaR-99 models in the early summer of 2011, wrote algorithms for them, and worked to refine the models over the next few months.

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941 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
942 Subcommittee interviews of Elwyn Wong, OCC (8/20/2012); Michael Kirk, OCC (8/22/2012); and C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
943 Subcommittee interview of Patrick Hagan, CIO (2/7/2013); Levin Office briefing by JPMorgan Chase (7/5/2012).
944 Subcommittee interview of Patrick Hagan, CIO (2/7/2013); 2013 JPMorgan Chase Task Force Report, at 104.
945 Levin Office briefing by JPMorgan Chase (7/5/2012); Subcommittee briefing by JPMorgan Chase (8/15/2012).
946 Levin Office briefing by JPMorgan Chase (7/5/2012).
947 See 10/10/2011 memorandum by Patrick Hagan and Keith Stephan, CIO, "VAR METHODOLOGY," JPM-CIO-PSI 0000041-47.
948 Subcommittee interview of Patrick Hagan, CIO (2/7/2013). A "stress VaR" is a VaR designed to reflect market conditions similar to the 2007-2008 financial crisis. The "historical VaR" for calculating RWA is based on a ten day time horizon and 99% confidence level.
949 Id. Mr. Hagan explained that the bank's VaR-95 model was designed so that traders were expected to exceed the VaR total produced by the model on at least 5 days out of 100, but, in fact, the bank had not exceeded the total on a single day during the prior year, proving that the VaR-95 model "overstated the risk." Id.

Mr. Hagan told the Subcommittee that his supervisor, Javier Martin-Artajo, then asked him to design a new 10-Q 95% VaR model for the CIO. Mr. Hagan explained that he was able to develop that model quickly, because he derived the VaR-95 model from the VaR-99 model he had already been working on. He explained that the VaR-99 and VaR-95 models were nearly identical, since they drew from the same historical data sets and used very similar mathematical functions. He said that he worked on the VaR-95 model for a two-month period, from October to November 2011, designing both the model and a computer program to run it during that time period.[950] Mr. Hagan said that he felt "rushed" and "under a lot of pressure" from Mr. Martin-Artajo to get the new VaR-95 model completed and implemented quickly.[951]

According to JPMorgan Chase, the impetus for the new VaR models was to render the CIO's VaR models compliant with Basel III requirements.[952] Basel III refers to a set of international banking standards issued by the Basel Committee on Banking Supervision addressing capital, risk, and liquidity issues; the new Basel III standards were intended to be phased in globally beginning in 2013, but according to the bank, the CIO wanted to "pre-adopt" them.[953]

In addition to citing compliance with Basel III as a motivation for changing the VaR models, JPMorgan Chase also told the Subcommittee that the CIO's old VaR-95 model was "too conservative."[954] That is, the old VaR model overstated risk.[955] As the 2013 JPMorgan Chase Task Force put it: "The trader who had instructed the modeler to develop the new VaR model, CIO Market Risk, and the modeler himself also believed that the [old] model was too conservative – that is, that it was producing a higher VaR than was appropriate."[956] Both JPMorgan Chase and Mr. Hagan informed the Subcommittee that the new model

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[950] Id. See also 2013 JPMorgan Chase Task Force Report, at 122-123 (stating the CIO worked on the new VaR model from August to November 2011).
[951] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
[952] Levin Office briefing by JPMorgan Chase (7/5/2012). For more information on Basel III, see Chapter II.
[953] Levin Office briefing by JPMorgan Chase (5/25/2012). See also 2013 JPMorgan Chase Task Force Report, at 121-122 (explaining that the new VaR model was developed to bring the CIO in compliance with Basel 2.5). Recently, the Basel Committee announced plans to delay implementation of the Basel III rules to January 1, 2019. See "Banks Win an Easing of Rules on Assets," New York Times, Jack Ewing (1/6/2013), http://www.nytimes.com/2013/01/07/business/global/07iht-banks07.html?src=twrhp. For more information about the Basel Accords generally, see Chapter II.
[954] Subcommittee briefing by JPMorgan Chase (8/15/2012). See also 2013 JPMorgan Chase Task Force Report, at 79, footnote 98 ("The previous model was viewed as too conservative and the VaR that it was producing thus was considered to be too high. The new model was thought to be a substantial improvement that would more accurately capture the risks in the portfolio.").
[955] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[956] 2013 JPMorgan Chase Task Force Report, at 122.

was designed to consider and reflect additional types of risks compared to the prior model, and would produce more accurate results.[957]

In a document authored by Mr. Hagan explaining his new VaR-99 model, which also formed the basis for the new VaR-95 model, he wrote that the new model was a "conservative" one that was expected to produce "higher" VaR results.[958] When asked about that description, Mr. Hagan told the Subcommittee that he had thought that might be the result, although in practice, the new VaR model typically produced lower results – generally 20% lower – than the prior model. He said that he never fully understood the prior VaR model and so did not know exactly why his model produced lower results.[959]

Bank documents, emails, and recorded telephone conversations are clear that a key motivation for developing the new VaR model was to produce lower VaR and Risk Weighted Assets (RWA) results for the CIO. Earlier in 2011, JPMorgan Chase had directed the CIO to reduce its RWA in order to lessen the bank's capital requirements under the upcoming Basel III rules.[960] Under those rules, a higher RWA required greater capital to protect against the higher risk; the bank wanted to minimize its mandatory capital requirements and so ordered the CIO to bring down its RWA. Normally, the most direct way to reduce a portfolio's RWA is to reduce the size and riskiness of its holdings, but key CIO personnel proposed another approach as well, modifying its VaR model and certain other risk related models used to calculate its RWA in order to produce lower RWA results. This objective was not necessarily in conflict with the bank's stated goal of producing more accurate risk analysis, since the CIO personnel advocating the model changes viewed credit derivatives trading as less risky than portrayed by the existing models.

A key document providing insight into the thinking of the CIO traders and analysts is an internal presentation prepared for CIO head Ina Drew in late 2011. On December 22, 2011, Javier Martin-Artajo, head of the CIO's equity and credit trading operation and charged with overseeing SCP trading, sent an email to Ms. Drew laying out a plan for reducing the CIO's RWA by $13 billion by the end of the first quarter of

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[957] Subcommittee interviews of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) and Patrick Hagan, CIO (2/7/2013).
[958] See "VaR Methodology," prepared by Patrick Hagan and Keith Stephan, JPM-CIO-PSI 0000041, at 045 ("All the above problems with our methodology generally lead to higher VAR, which is unsurprising since VAR can be considered as a measure of noise. Accordingly, we believe that our VAR-99 calculation is decidedly conservative."). Mr. Hagan told the Subcommittee that it was his standard practice to prepare a written explanation of his models to communicate his reasoning. Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
[959] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
[960] RWA is a dollar measure of a bank's assets, adjusted according to the assets' risk. For more information, see Chapters II and III.

2012. The email recommended achieving that reduction in large part by modifying the VaR and other models and procedures used to calculate the CIO's RWA. Mr. Martin-Artajo wrote:

> "The estimates of reductions will be:
>
> Model reduction QR CRM (ackno[w]ledged already) 5 (Pat [Hagan] estimate)
> Model reduction QR VaR 0.5 (Pat estimate)
> Model Reduction QR Stress 1.5 (Pat estimate)
> Reduction for duration shortening 1 Actual
> Book optimization 3 Estimate
> Book reduction 2 Trading reduction
>
> TOTAL 13 Billion RWA end Q1 2012"[961]

The email indicates that Mr. Martin-Artajo estimated that $7 billion, or more than 50% of the total $13 billion RWA reduction, could be achieved by modifying risk related models.[962] While changing the VaR model was only one of the proposed changes and was estimated to have the smallest effect, it was nevertheless characterized as capable of producing half of a billion dollars in RWA reduction. That the Martin-Artajo email included specific estimates for RWA reductions from Mr. Hagan in connection with changing, not only the VaR model, but also other QR models that fed into the RWA calculation, shows that the CIO viewed Mr. Hagan's work, at least in part, as a way of producing lower – as opposed to simply more accurate – SCP risk results.[963]

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[961] 12/22/2011 email from Javier Martin-Artajo, CIO, to Ina Drew and John Wilmot, CIO, "RWA – Tranche Book," JPM-CIO-PSI 0000032-034, at 033. See also 12/22/2012 email from Javier Martin-Artajo, CIO, to Bruno Iksil, Patrick Hagan, Julien Grout and Samir Ratel, CIO, "urgent -- --- : Rwa," JPM-CIO-PSI 0001227 (requesting specific estimates for the amount of RWA reduction that could be achieved by each of the listed "model reduction[s]" by the end of the first quarter of 2012).

[962] The email estimated that a $5 billion reduction in the SCP's composite RWA could be achieved by modifying the QR model used to calculate the CIO's Comprehensive Risk Measurement (CRM), and another $500 million reduction could be achieved by modifying the QR model used to calculate its VaR. CRM and VaR are both key contributors to RWA calculations. The email also estimated that a $1.5 billion reduction in the SCP's composite RWA could be achieved by modifying the QR model used to calculate its "Stress" VaR, another key contributor to the RWA model. Mr. Hagan confirmed to the Subcommittee that he had provided all three of these estimates. Subcommittee interview of Patrick Hagan, CIO (2/7/2013). The recommended model changes, projected to reduce the CIO's RWA by $5 billion, $500 million, and $1.5 billion, added up to an RWA reduction of $7 billion. See also 5/3/2012 email from Irvin Goldman, CIO, to Douglas Braunstein, JPMorgan Chase, and others, "CSW 10%," with attached JPMorgan Chase presentation entitled "CIO Synthetic Credit: Risk background information for upcoming meetings," slide entitled "Capital Metrics History, chart entitled "Synthetic Credit RWA," at 8, JPM-CIO-PSI-H 000546-556, at 555 (identifying the key components in calculating the SCP's RWA as VaR, Stress Var, CRM, and IRC).

[963] See, e.g., 3/8/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000373 (indicating that the CIO traders had deliberately worked to change the VaR model: "We are not going to do with ... RWA yet what we have done with the VaR that is to challenge the current methodology and have the model changed.").

Several weeks later, on January 18, 2012, Mr. Iksil provided Ms. Drew a written presentation that included a comparison of the CIO's RWA results using the bank's standard "QR" model versus results from using the CIO's own, newly developed model.[964] Mr. Hagan told the Subcommittee that he was not shown this document at the time, but observed that it used figures that had been developed by his staff.[965] Mr. Hagan told the Subcommittee that he had not developed a fully working RWA model for the CIO when the estimates were provided, but acknowledged that, while at the CIO, he worked on each of the key contributors to a RWA model.[966] The Iksil presentation stated that the CIO's "Core Credit Book RWA" under the bank's standard QR model was $40.3 billion, while under the CIO's model it would be about half that amount, at $20.9 billion.[967] The next day, January 19, Mr. Martin-Artajo sent Ms. Drew an email describing four scenarios for reducing the SCP's RWA.[968] The four options revolved in large part around whether the CIO could convince bank management to allow it to use its own "shadow" RWA model.[969] Changing the CIO's VaR model was one element in that larger plan.

(c) Breaching the VaR Limit

As explained earlier, during the first three weeks of January 2012, the CIO traders purchased a variety of short credit instruments in order to ensure that the Synthetic Credit Portfolio "maintained its upside on defaults."[970] Those purchases pushed up the SCP's VaR total and eventually resulted in the four-day breach of not only the CIO's VaR limit, but also the VaR limit for the entire bank.

On January 10, 2012, the firmwide VaR daily update stated: "The Firm's 95% 10Q VaR as of cob [close of business] 01/09/2012 is $123mm [million] or 98% of the $125mm limit, an increase of $5mm

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964 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," JPM-CIO-PSI 0000098-104, conveying presentation entitled, "Core Credit Book Highlights."

965 Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

966 Id. Mr. Hagan told the Subcommittee that, while at the CIO, he worked on models to produce Comprehensive Risk Measurement (CRM), stress VaR, VaR-99, and Incremental Risk Charge (IRC) results. Id.

967 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," JPM-CIO-PSI 0000098-104, conveying presentation entitled, "Core Credit Book Highlights." Mr. Hagan told the Subcommittee that the $20.9 billion figure was "not realistic," because it was far from clear that the bank's QR group would adopt the model changes he was advocating. Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

968 1/19/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario Clarification," at JPM-CIO-PSI 0000106.

969 The term "shadow model" was used by the CIO's senior market risk officer when describing the CIO model to the Subcommittee. Subcommittee interview of Peter Weiland, CIO (8/29/2012).

970 For more information, see Chapter III.

from the prior day's revised VaR."[971] The daily update also reported that the CIO had utilized $88 million of its $95 million limit.[972] Later that day, apparently concerned with the CIO's approaching its 10Q VaR limit, Ms. Drew emailed Mr. Weiland the notification and asked: "This says cio var still 88? Can u give me breakdown tomorrow." Mr. Weiland responded:

> "Yes, I have details and can give you tomorrow. Short story is that the increase in VaR corresponds to increased credit protection on HY [High Yield credit index], in particular trades executed between Dec. 19 and January 6. ... This has obviously been a significant increase and I sent Javier an email today to highlight the RWA implications."[973]

His email indicates that, while the CIO bought a variety of long and short positions in January, it was the short positions – the "increased credit protection" – that drove up the VaR.

The following day, January 11, 2012, Mr. Weiland forwarded the email exchange to Keith Stephan, the Chief Market Risk Officer for CIO International. Mr. Stephan responded by forwarding the explanation he had provided on January 10th to Messrs. Martin, Iksil, Grout, and others:

> "**[S]ince 21 December, the [Core Credit] book var has moved from $76mm [million] to $93mm,** nearly +25% increase driven by position changes and through the inclusion of m[ar]k[e]t data in the last week of 20[1]1 with rally in OTR [on-the-run] HY [High Yield] indicies. ... The big drivers, are increases in notional of HY OTR short risk in indicies +2.6bio not'l [notional], +14MM VAR."[974]

In other words, Mr. Stephan explained that the increased credit derivative positions – specifically, the short positions – acquired by the SCP in December and January had caused the increase in VaR, which was quickly approaching its limit.

[971] 1/10/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI 0000095.
[972] Id.
[973] 1/10/2012 email from Peter Weiland, CIO, to Ina Drew, CIO, and others, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI 0000094. The email mentions RWA, because a version of the VaR is used, in part, to calculate RWA scores. Therefore, risks that increase the VaR also increase the RWA, and could potentially trigger increased capital reserve requirements.
[974] 1/10/2012 email from Keith Stephan, CIO, to Bruno Iksil, CIO, and others, "Core Credit Var Summary 06 January," JPM-CIO-PSI 0000093, [emphasis in original].

On January 12, 2012, Mr. Weiland emailed Mr. Martin-Artajo, head of the CIO's equities and credit trading operation, asking about Mr. Stephan's explanation: "Is this not correct?"[975] Mr. Martin-Artajo replied: "No, in terms of VAR." Mr. Martin-Artajo continued:

> "Will come back to you with a better explanation. From our point of view we did not have any P/L [profit/loss] vol[ume] to increase the overall VAR so much. Pat [Hagan]'s model is in line with the 70 VAR and has a much better explanation for these changes. Hopefully we get this [model] approved as we speak."[976]

Mr. Martin-Artajo essentially contended that the purchases made by the CIO traders had not been so voluminous that they would have increased the "overall VaR so much."[977] He also noted that the new VaR model being developed by Mr. Hagan would produce a lower VaR – which he predicted would be in the range of $70 million – and the CIO was attempting to finalize its approval "as we speak."[978]

Despite inquiring into the CIO's increasing VaR and noting that the CIO was approaching its limit, neither Ms. Drew nor Mr. Weiland instructed the CIO traders to stop trading or reduce the SCP holdings. Their inaction is especially puzzling since Mr. Dimon, Mr. Braunstein, and Ms. Drew all told the Subcommittee that, in December 2011, bank management had instructed the CIO to reduce its RWA, and had taken the view that, in an improving macroeconomic environment, less credit protection was necessary.[979] The CIO and bank's senior management nevertheless stood by and allowed the CIO traders to purchase additional short credit protection in such quantities that it would cause a VaR breach.

On January 16, 2012, CIO exceeded its VaR limit.[980] While several JPMorgan Chase officials minimized the relevance of VaR

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[975] 1/12/2012 email from Peter Weiland, CIO, to Javier Martin-Artajo, CIO, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI 0000093.
[976] 1/12/2012 email from Javier Martin-Artajo, CIO, to Peter Weiland, CIO, and others, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI 0000093.
[977] Id.
[978] Id.
[979] Subcommittee interviews of Jamie Dimon, JPMorgan Chase (9/19/2012), Douglas Braunstein, JPMorgan Chase (9/12/2012), and Ina Drew, CIO (9/7/2012). For more information, see Chapter III.
[980] 1/20/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% 10Q – VaR – Limit Excession Notification (COB 1/19/12)," JPM-CIO-PSI 0001890; 1/16/2012, JPMorgan Chase spreadsheet "Position Limit and Loss Advisory Summary Report," JPM-CIO-PSI 0037534 (showing excession of the $95 million MTM 10Q VaR limit for close of business January 16, 2012).
[980] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

breaches in interviews with the Subcommittee, VaR measurements are considered significant enough within the bank that the bank's Operating Committee received daily VaR updates from the firm's Market Risk Management (MRM) Reporting group detailing the VaR levels for various business lines and business segments and explaining the basis for any significant changes. In addition, a breach of the firmwide VaR was treated within the bank as a "Level 1" notification, and was reported to the highest levels of bank management, including to CEO Jamie Dimon and the rest of the Operating Committee.[981]

On January 16, 2012, the CIO's purchases of additional short positions triggered not only a breach of the CIO VaR limit,[982] but also a breach of the bankwide VaR limit, a breach that continued for the next three days.[983] These VaR breaches caused real concern within the CIO. On January 20, 2012, the CIO Chief Risk Officer, Irvin Goldman, emailed two of his subordinates with this instruction:

> "This is the third consecutive breach notice ... that has gone to Jamie [Dimon] and [Operating Committee] members. We need to get Ina [Drew] specific answers to the cause of the breach, how it will be resolved, and by when."[984]

One of Mr. Goldman's subordinates, Mr. Stephan – the chief market risk officer in London and designer of the VaR model then in use – responded:

> "The VaR increase is driven by Core Credit (tranche) .... We are in late stages of model approval ... which will have the effect [of] reducing the standalone VaR for Core Credit from circa $96MM [million] to approx[imately] $70MM .... My recommendation therefore is that we continue to manage to the current ... limit ... and that we discuss further with the model review group (MRG) today the schedule for completion of approval of the new model with a view toward implementation next week if possible."[985]

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[981] Id.

[982] 1/16/2012, JPMorgan Chase spreadsheet "Position Limit and Loss Advisory Summary Report," JPM-CIO-PSI 0037534 (showing excession of the $95 million MTM 10Q VaR limit for close of business January 16, 2012).

[983] See 1/19/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% VaR – Limit Excession Notification (COBs 1/16/12 and 1/17/12)," JPM-CIO-PSI 0005264; 1/23/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI 0001337; 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Breach of firm var," JPM-CIO-PSI 0000141.

[984] 1/20/2012 email from Irvin Goldman, CIO, to Keith Stephan, CIO, and others, "Breach of firm var," JPM-CIO-PSI 0000149.

[985] 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, "Breach of firm var,"

Once again, changing the model – not modifying the risky positions – was presented as the solution to the VaR breach.

Mr. Goldman conveyed the same argument to his boss, Chief Risk Officer John Hogan:

> "Two important remedies are being take[n] to reduce VaR .... 1. Position offsets to reduce VaR are happening daily. 2. Most importantly, a new improved VaR model that CIO has been developing is in the near term process of getting approved by MRG and is expected to be implemented by the end of January. <u>The estimated impact of the new VaR model based on Jan 18 data will be a CIO VaR reduction in the tranche book by 44% to [$]57mm [million], with CIO being well under its overall limits</u>."[986]

This email repeats Mr. Martin's previously-stated hierarchy for addressing risk reduction in the Synthetic Credit Portfolio: changing the model was "most" important, while position "offsets" were secondary. Moreover, it was not clear what Mr. Goldman meant by position offsets. Mr. Hogan told the Subcommittee that position "offsets" could involve either disposing of positions or adding new positions designed to offset the risk of other positions.[987] In either case, it was clear that having a new model that produced a lower VaR value was viewed as key.

After receiving Mr. Goldman's email, Mr. Martin-Artajo forwarded it to Patrick Hagan, the CIO VaR model developer, and said: "Dual plan ... as discussed keep the pressure on our friends in Model Validation and QR [Quantitative Research]."[988] JPMorgan Chase has since indicated: "There is some evidence that the Model Review Group accelerated its review as a result of this pressure, and in so doing it may have been more willing to overlook the operational flaws apparent during the approval process."[989]

JPM-CIO-PSI 0000147.

[986] 1/20/2012 email from Irvin Goldman, CIO, to John Hogan, JPMorgan Chase, "CIO VaR," JPM-CIO-PSI 0000151. [Emphasis in original.] Mr. Goldman's prediction of a $57 million VaR for the SCP was even lower than the $70 million VaR that had been predicted by Mr. Martin-Artajo and Mr. Stephan. See 1/12/2012 email from Peter Weiland, CIO, to Javier Martin-Artajo, CIO, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI-000093; 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, "Breach of firm var," JPM-CIO-PSI 0000147.

[987] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

[988] 1/23/2012 email from Javier Martin-Artajo, CIO, to Patrick Hagan, "CIO VaR," JPM-CIO-PSI 0000151. "QR" refers to Quantitative Research, a part of the bank's risk division that worked on model development. Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

[989] 2013 JPMorgan Chase Task Force Report, at 125.

On January 20, 2012, the Market Risk Management Reporting group notified the Operating Committee of the CIO's ongoing breach of the firmwide 10Q VaR limit. The notification stated:

> "The Firm's 95% 10Q VaR breached its $125mm [million] limit for the fourth consecutive day on January 19th, 2012, primarily driven by CIO.
>
> CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-Off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.
>
> Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG [Model Review Group] to gain approval, which is expected to be implemented by the end of January.
>
> The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm."[990]

A four-day breach of the firm's 10Q VaR – the VaR that JPMorgan Chase reported in its SEC filings – driven by trades in the CIO's Synthetic Credit Portfolio ought to have been enough to trigger an intensive internal review of the SCP trading strategy, but it did not. The Subcommittee could identify no significant action taken by the bank to reduce the VaR other than by changing the model.

(d) Raising the VaR Limit Temporarily

Ashley Bacon, John Hogan's deputy in risk management, told the Subcommittee that, on some occasions when a firmwide limit is breached, "people were told to get back under their limit."[991] The CIO's breach of the firmwide VaR limit in January 2012, however, was not such an occasion. If JPMorgan Chase had ordered the CIO to reduce the Synthetic Credit Portfolio to get back under its VaR limit, the bank would have limited – and perhaps prevented – the whale trade losses. Instead, the bank elected to raise the bankwide VaR limit on a temporary

[990] 1/20/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% 10Q – VaR – Limit Excession Notification (COB 1/19/12)," JPM-CIO-PSI 0001890.
[991] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

basis to buy the CIO enough time to get a new VaR model in place to produce a more favorable risk analysis.

On January 23, 2012, the Market Risk Management Reporting group sent an email to Mr. Dimon and Mr. Hogan asking them to approve a temporary increase in the firmwide VaR limit from $125 million to $140 million, an increase of more than 10%. The group proposed increasing the firmwide limit for a little over a week, until the end of the month, predicting that, by then, the CIO's new VaR model would be approved, would dramatically reduce the CIO's VaR, and would end the breach.

> "This email is to request your approval to implement the temporary increase of the Firm's 95% 10Q VaR limit from $125mm [million] to $140mm, expiring on January 31st, 2012. There is a pending approval for a new model for the CIO Intl Credit Tranche book. If the new model is approved and implemented prior to January 31st, the Firm's 95% 10Q VaR limit will revert back to the original $125mm level .... CIO has increased its overall credit spread protection .... Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model .... The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm."[992]

This email shows that Mr. Dimon was informed about the new VaR model and the expectation that it would have the effect of lowering the apparent risk of the CIO's portfolio by a dramatic amount.

When asked about this email, Mr. Dimon told the Subcommittee that he did not recall whether he was required to approve a temporary increase in the bankwide VaR limit or approve a request by a business segment to exceed an existing bankwide VaR limit.[993] He indicated that he did not view raising the bankwide VaR limit as a decision that required his personal attention and analysis, but as one which he could normally make in a matter of "seconds" relying on the recommendation of his risk management team. He also told the Subcommittee that he could not recall any details in connection with approving the VaR limit increase in January 2012. However, an email dated January 23, 2012, shows that both he and Mr. Hogan replied to the email requesting the limit increase by writing simply: "I approve."[994]

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[992] 1/23/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI 0001337-338.

[993] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

[994] 1/23/2012 email from Jamie Dimon, JPMorgan Chase, to John Hogan, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI

The temporary limit increase in the bankwide VaR limit provided immediate relief to the CIO by enabling its traders to take on more risk in their gamble to overcome an unprecedented cascade of losses in the SCP which had begun earlier in January.[995] On January 23, 2012, the same day the VaR limit was raised, the SCP recorded a loss of $15 million.[996] The next day, the CIO trader charged with managing the Synthetic Credit Portfolio, Bruno Iksil, wrote in an internal document that by January 24th the book had begun to "lose money in an uncontrollable way."[997] Altogether, during the last nine days in January, the SCP incurred losses every day, totaling in excess of $75 million.[998]

Mr. Weiland, the CIO Chief Market Risk Officer, told the Subcommittee that the CIO traders responded to the SCP losses by making a decision to purchase the long side of a variety of credit derivatives, collecting the equivalent of insurance premiums from their short counterparties, and using those incoming cash premiums – which they called "carry" – to offset some of the losses.[999] In addition, just as short positions decline in value during a market rally, long positions increase in value during a market rally. Thus, there was a dual benefit to going long: generating carry, but also allowing the CIO to post mark-to-market profits on the long positions, both of which the CIO could use to offset the mark-to-market losses on the SCP's short positions. The CIO traders were able to carry out that trading strategy – go long – because Mr. Dimon and Mr. Hogan had temporarily increased the VaR limit and allowed the additional credit derivative purchases.

By January 27, 2012, the SCP's rapid purchase of long positions[1000] were threatening yet another breach of the bankwide VaR

0001337. See also 1/25/2012 email from Ina Drew, CIO, to MRM Reporting and others, "ACTION NEEDED: CIO International-One-off Limits Approval, JPM-CIO-PSI 0000157-158 (containing Ms. Drew's approval of the temporary increase in the CIO's VaR limit); 2013 JPMorgan Chase Task Force Report, at 79 ("Messrs. Dimon and Hogan approved the temporary increase in the Firm-wide VaR limit, and Ms. Drew approved a temporary increase in CIO's 10-Q VaR limit.").

995 For more information about these losses, see Chapter IV.

996 See chart, prepared by the Subcommittee and printed in Chapter IV, tracking SCP's daily reported profit and loss (P&L) from January to May 15, 2012, derived from an OCC spreadsheet, OCC-SPI 00000299. Numbers do not reflect restated P&L figures after JPMorgan Chase's restatement in July 2012. See also JPMorgan Chase & Co. Form 10-Q (for period ending 9/30/2012), filed with the SEC (11/08/2012), at 10, 220, http://files.shareholder.com/downloads/ONE/2252595197x0xS19617-12-308/19617/filing.pdf.

997 Undated internal document authored by Bruno Iksil with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021879-917, at 882.

998 See chart, prepared by the Subcommittee and printed in Chapter IV, tracking SCP's daily reported profit and loss (P&L) from January to May 15, 2012, derived from an OCC spreadsheet, OCC-SPI-00000298-299. Numbers do not reflect restated P&L figures.

999 Subcommittee interview of Peter Weiland, CIO (8/29/2012).

1000 See undated spreadsheet of trades produced by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037501. See also 1/27/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Update on *old/current methodology VaR* increase for COB 27 Jan," JPM-CIO-PSI 0000177.

limit, despite the temporarily higher limit. Mr. Stephan, chief market risk officer in London, informed the CIO's Chief Risk Officer, Irvin Goldman, about what was happening:

> "CIO is over its temporary limit, and could cause the Firm to do the same. ... VaR has increased by +3mm [million], to $107.6mm driven by increase in CDX IG S9 10Y index long risk[1001] .... This is consistent w/ the VaR increases of the last several days ... wherein the VaR increases approx 1mm per billion of notional in IG9 10y. ... We anticipate approval on Monday [January 30], and that the ***new methodology *should* become the official firm submission from Monday, for 27 Jan COB [close of business].*** Limit issues should therefore cease beginning from Monday."[1002]

In his email, Mr. Stephan explained that for every billion-dollar increase in the size of the SCP's notional holdings of the IG9 long positions, its VaR score was increasing by $1 million. He also disclosed that the SCP's long purchases had already caused a breach of the CIO's temporarily increased VaR limit and was threatening to breach the new bankwide VaR limit as well. In addition, Mr. Stephan explained that the anticipated approval of the CIO's new VaR model on Monday, January 30, which was intended to apply to the most recent trading day, January 27, should put an end to the VaR "limit issues."[1003]

By the end of the day on January 27, the SCP's VaR totaled $125.7 million,[1004] breaching the CIO's temporary VaR limit of $105 million[1005] but not yet the bankwide limit of $140 million. The CIO traders continued their buying spree, expanding the size of the SCP and the CIO's VaR. As the CIO's VaR continued to climb, the documentation produced to the Subcommittee contains few emails, messages, or telephone calls asking whether the CIO's trading strategy made sense. On January 28, 2012, Barry Zubrow, former Chief Risk Officer for JPMorgan Chase, did send an email to the CIO Chief Risk Officer Irvin

[1001] "CDX IG S9 10Y" and "IG9 10y" refer to credit derivative indices acquired by the SCP. For more information about these indices, see Chapter II.
[1002] 1/27/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Update on *old/current methodology VaR* increase for COB 27 Jan," JPM-CIO-PSI 0000177, at 178 [emphasis in the original].
[1003] JPMorgan Chase has explained that the purpose of the long positions was to offset the shorts and thereby reduce risk, in lieu of unwinding the short positions. However, according to JPMorgan Chase's own internal documents, the purchases of the long positions at the end of January themselves *raised* the VaR instead of lowering it. Therefore, it is difficult to see how JPMorgan Chase could have believed the long positions were, in fact, reducing the risk associated with the short positions.
[1004] See 5/2012 JPMorgan Chase spreadsheet of VaR levels in the Synthetic Credit Portfolio, FDICPROD-0024286.
[1005] 1/23/2012 email from Ina Drew, CIO, to MRM Reporting, and others, "ACTION NEEDED: CIO Global 10Q VaR Limit One-off Limit Approval," JPM-CIO-PSI-H 0002880.

Goldman and the bank Chief Risk Officer John Hogan asking: "Why is the CIO VAR so elevated?" but took no further action to evaluate the CIO trading strategy causing the VaR increase.[1006] Even if the existing VaR model was viewed as overstating the risk, at a minimum the precipitous upward trend in the CIO's VaR should have given bank management pause.[1007] Ms. Drew conceded as much to the Subcommittee.[1008]

(e) Winning Approval of the New VaR Model

On January 30, 2012, the CIO won bank approval of its new VaR model.[1009] The impact of the new model was even greater than the 44% described in the emails to firm management: it immediately reduced the CIO's VaR by 50%, from $132 million to $66 million.[1010]

JPMorgan Chase told the Subcommittee that the change in the CIO VaR model was not motivated by a desire to give the CIO traders more room to take risk.[1011] However, the evidence is clear that the January 2012 pressure to expedite approval of the model change was motivated by the CIO traders' desire to end the CIO's VaR breach and produce a much lower VaR, which then enabled them to take on more risk. An OCC model expert told the Subcommittee that it was "no coincidence" that the CIO's new VaR model was implemented at the same time the CIO traders were increasing their acquisitions; rather, instituting the new VaR model was part of the trading strategy.[1012] Mr. Dimon acknowledged as much during his testimony before Congress when, in discussing the SCP losses, he stated: "In January, the new model was put in place that allowed them to take more risk and it contributed to what happened."[1013]

JPMorgan Chase has acknowledged to the Subcommittee that the internal approval process for the new CIO VaR model was "hurried."[1014] All of the bank's VaR models were supposed to be reviewed and

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[1006] 1/28/2012 email from Barry Zubrow, JPMorgan Chase, to John Hogan, JPMorgan Chase and Irvin Goldman, CIO, "JPMC Firmwide VaR – Daily Update – COB 01/26/2012," JPM-CIO-PSI-H 0002897.
[1007] This trend was not visible to investors, because the change in the VaR model was not disclosed in JPMorgan Chase's April 8-k filing. For more information, see Chapter VII.
[1008] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[1009] See 1/30/2012 email from Ashish Dev, JPMorgan Chase, to Peter Weiland, CIO, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM-CIO-PSI 0000187.
[1010] See undated spreadsheet of CIO 10Q VaR from 12/1/2011 to 5/10/2012, JPMC-Senate/Levin 000155.
[1011] Levin Office briefing by JPMorgan Chase (6/26/2012).
[1012] Subcommittee interview of Michael Sullivan, OCC (11/7/2012).
[1013] Testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S.Hrg. 112-715 (June 13, 2012), http://www.cq.com/doc/congressionaltranscripts-4105471.
[1014] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).

approved by its internal Model Review Group, which was part of its risk division.[1015] When the bank's Model Review Group undertook its evaluation of the CIO's new VaR model, it found a number of operational and mathematical problems and asked the developers to provide action plans to address the problems as well as provide dates for when the action plans would be completed.[1016] No dates were set for completing the action plans, however,[1017] and the action plans were, in fact, never completed.[1018] A later OCC internal review described the action plans as identifying essential requirements that should have been completed before the model was placed into use.[1019]

In addition, the Subcommittee was told that, normally, a new model is run concurrently with an existing model for several months to evaluate how the new model performs and examine any diverging results between the two.[1020] When asked about testing, JPMorgan Chase responded that the question "touched a nerve," and the bank was "not proud" of the inadequate backtesting performed in this situation.[1021] The Subcommittee found no evidence that the Model Review Group expressed any concerns at the time about how and why the new model produced such dramatically lower VaR results for the SCP's trading activity compared to the prior model. Mr. Hagan told the Subcommittee that the 50% drop in the CIO's VaR results was surprising and "very significant," yet at the time the new VaR totals went unchallenged.[1022]

Despite the operational problems identified by the Model Review Group and the obvious questions raised by the new VaR model results, a lax approval process at the bank allowed the model to be put into effect immediately, prior to the specified corrective actions being completed. Bank and CIO personnel agreed in an email that "if [the] January tests look all right, we should go ahead and implement the new model even before the MRG [Model Review Group] review is completed."[1023] On

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1015 Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
1016 See, e.g., 1/25/2012 email from Dan Pirjol, JPMorgan Chase, to Patrick Hagan, CIO, and others, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM CIO-PSI 0000190-191.
1017 See 1/27/2012 email from Keith Stephan, CIO, to Dan Pirjol, JPMorgan Chase, and others, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM CIO-PSI 0000189.
1018 Subcommittee briefing by JPMorgan Chase (8/15/2012); 2013 JPMorgan Chase Task Force Report, at 127.
1019 Subcommittee interview of Michael Sullivan, OCC (8/20/2012); 12/12/2012 OCC Supervisory Letter to JPMorgan Chase, "CIO Oversight and Governance Examination," PSI-OCC-18-000001 [Sealed Exhibit].
1020 Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
1021 Levin Office briefing by JPMorgan Chase (6/26/2012) (Greg Baer). See also 2013 JPMorgan Chase Task Force Report, at 104 (stating that the MRG did not compare the two model results at all) and 123 (stating the Model Review Group "performed only limited back-testing of the model," because the CIO "lacked the data necessary for more extensive back-testing").
1022 Subcommittee interview of Patrick Hagan. CIO (2/7/2013).
1023 1/27/2012 email from Ashish Dev, JPMorgan Chase, to Peter Weiland, CIO, and others,

January 30, 2012, Ashish Dev, a member of the Model Risk and Development Group reporting to Mr. Venkatakrishnan informed CIO Chief Market Risk Officer Peter Weiland that the new VaR model was approved.[1024]

Documents obtained by the Subcommittee show that the bank did send contemporaneous copies of its internal emails to the OCC about the proposed VaR model change. Despite those emails, the OCC asked no questions and took no steps to investigate the new model at the time it was approved by the bank for use by the CIO. A review conducted by the OCC subsequent to the SCP trading losses identified failures in the model review process. A November 6, 2012 OCC Supervisory Letter stated that one "Matter Requiring Attention" was that "[t]he bank was using several VAR models that were not properly reviewed internally and others did not receive required regulatory approval."[1025] The OCC concluded that JPMorgan Chase's "VaR Model risk management is weak and constitutes an unsafe and unsound banking practice."[1026]

(f) Using the New VaR Model to Increase Risk

As soon as it was approved internally, the new model produced a dramatically lower VaR for the CIO. On January 27, 2012, for example, the same day the new VaR model took effect, the CIO's VaR was $66 million, whereas under the prior model, its VaR was $132 million.[1027]

Mr. Hagan told the Subcommittee, when shown emails predicting that his new VaR model would lower the CIO's VaR results by 44%, that the CIO traders were "dreaming."[1028] When informed that on the first day the model was implemented, it actually reduced the CIO's VaR results by 50%, he mouthed the word "wow," said he was "very surprised," and characterized it as a "very significant" reduction that he didn't know about at the time.[1029]

The sizeable difference between the two figures – the VaR remained between 30 and 50% lower than it would have been under the

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"draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM-CIO-PSI 0000187.

[1024] 1/30/2012 email from Ashish Dev, JPMorgan Chase, to Peter Weiland, CIO, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM-CIO-PSI 0000187. See also 2013 JPMorgan Chase Task Force Report, at 126 (stating new VaR model was authorized by the MRG on January 30, and received "[f]ormal approval" on February 1, 2012).

[1025] 11/6/2012 OCC Supervisory Letter to JPMorgan Chase, "Examination of VaR Model Risk Management," at 2, PSI-OCC-17-000019 [Sealed Exhibit].

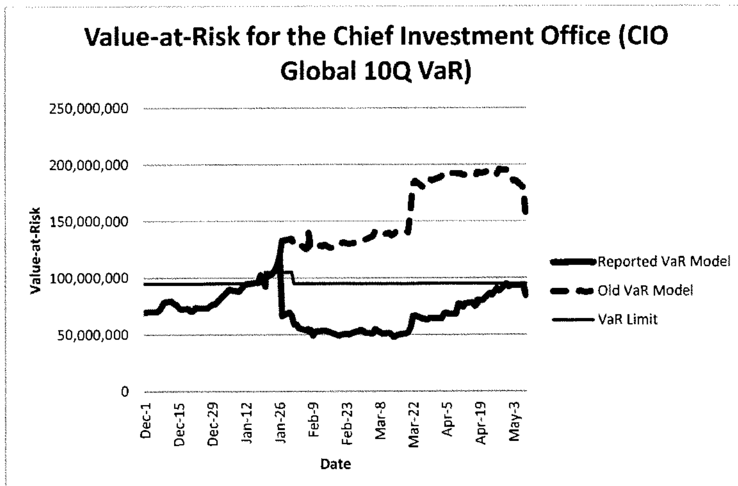
[1026] Id.

[1027] See undated spreadsheet of CIO 10Q VaR from 12/1/2011 to 5/10/2012, JPMC-Senate/Levin 000155. This spreedsheet also indicated that, on April 6, 2012, the new VaR was $68 million and the prior VaR was $192 million. Id.

[1028] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

[1029] Id.

prior model[1030] – continued until the new VaR model was abandoned in May 2012.[1031] The following chart shows the calculations produced by the new VaR model compared to the previous model and the CIO VaR limit.[1032]



Source: Subcommittee chart created from data provided by JPMorgan Chase, JPMC-Senate/Levin 000155-6.

The chart shows, not only the wide discrepancy between the two VaR models, but also that the old model produced much higher VaR numbers for the CIO than the new model. The chart also shows that, beginning in mid-January, the old VaR model would have shown the CIO as consistently and continuously in breach of its VaR limit, while the new model showed no breach at all through May 2012. In addition, the old VaR model would have shown the CIO in breach of the bankwide VaR limit in February, March, April, and May.

(g) Failing to Lower the VaR Limit

When JPMorgan Chase approved the CIO's new VaR model on January 30, 2012, it should have acted at the same time, but did not, to lower the CIO's VaR limit. As a consequence, the new model enabled

[1030] Subcommittee chart created from data provided by JPMorgan Chase, JPMC-Senate/Levin 000155-6; Levin Office briefing by JPMorgan Chase (7/5/2012) (Greg Baer).
[1031] See 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 2, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf (Mr. Dimon: "In the first quarter, we implemented a new VAR model, which we now deemed inadequate. And we went back to the old one, which had been used for the prior several years, which we deemed to be more adequate."); 5/12/2012 email from Peter Weiland, CIO, to John Hogan, CIO, and others, "NON IB VaR Bandbreak Summary Report – CIB 4/30/2012," JPM-CIO-PSI 0007884.
[1032] This chart was prepared by the Subcommittee using data provided by JPMorgan Chase, JPMC-Senate/Levin 000155-6.

the CIO to engage in substantial additional risky trading without violating its own or the bankwide VaR limit. The end result was that, when the CIO triggered the VaR limit breaches in January, rather than remove the offending credit derivative positions to reduce the amount of risk in the SCP, JPMorgan Chase removed the brakes instead.

JPMorgan Chase told the Subcommittee that a "recommendation" had been made to lower the CIO's VaR limit from $95 million to $70 million at the time the new model was approved, but that limit change was not made.[1033] When asked why not, Ms. Drew explained that "everything can't happen at once," and "models get changed all the time."[1034]

As Mr. Dimon acknowledged during his Congressional testimony, the change in the VaR model allowed the CIO traders to take on more risk. However, the model change is not alone responsible for the SCP's growing risk: the bank's failure to adopt a limit appropriate to the model change represents an additional failure in its risk management.

JPMorgan Chase told the Subcommittee that the failure to impose a new VaR limit in January was a consequence of the fact that the CIO was then in the process of reconsidering all of its limits across its entire complement of risk metrics, and that its VaR limit was already due to be considered in March.[1035] In addition, Mr. Goldman told the Subcommittee that when he assumed the role of Chief Risk Officer of the CIO in January, he initiated a review of all of the CIO's risk metrics at that time, but did not implement new risk limits due to the ongoing process to review them.[1036] At the end of March, the CIO's Risk Operating Committee received a presentation regarding a new "proposed limits framework," but planned additional weeks of review, leaving both the new VaR model and the old VaR limit in place.[1037] Mr. Dimon told the Subcommittee that a discussion as to whether the VaR limit should have been lowered at the same time as the VaR model change should have taken place.[1038] The OCC Examiner-in-Charge at JPMorgan Chase told the Subcommittee that he would have expected the firm to

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[1033] Subcommittee briefing by JPMorgan Chase (8/15/2012); 3/8/2012 email from Ashley Bacon, JPMorgan Chase, to John Hogan, JPMorgan Chase, Peter Weiland, CIO, and others, "Firmwide VaR overlimit," JPM-CIO-PSI 0000379 ("Also CIO is contemplating a possible reduction in VaR limit to $70 mil (factored in here but not yet agreed.)").
[1034] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[1035] Subcommittee briefing by JPMorgan Chase (8/15/2012).
[1036] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
[1037] The CIO Risk Operating Committee Minutes noted that the "proposed limits framework was presented to the committee noting that a full overhaul of all limits is underway. Over the next few weeks the limits will be discussed with the individual regions and presented back to the group for approval." See 3/28/2012, "CIO Risk Operating Committee Minutes – March 28th, 2012," JPMorgan Chase document produced to the OCC, OCC-SPI-00004734.
[1038] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

"recalibrate" the VaR limit given the major decline in the VaR resulting from the model change.[1039] But the limit was not lowered.

After the new VaR model was put in place, the CIO traders increased the size of the SCP. Mr. Iksil, who headed the SCP trading strategy, later looked back on the SCP debacle and explained that he had wanted to take the SCP book even "longer" in January, but could not due in part to the VaR limit: "the need to reduce VaR – RWA ... prevented the book from being long risk enough."[1040] Once the VaR was removed as an obstacle, Mr. Iksil, in fact, purchased substantially more long credit derivatives and caused the SCP book to change from a net short to a net long position. On January 31, 2012, the day after the new VaR model was approved, he told his supervisor, Mr. Martin-Artajo: "[W]e set the book for long risk carry. ... I hope I did right. Let me know your thoughts."[1041]

At the end of 2011, the SCP contained synthetic credit derivatives whose net notional value totaled over $51 billion. By the end of March 2012, that total was over $157 billion. That tripling of the size of the SCP would not have been possible without the new VaR model which allowed the CIO to increase its trades and risk without breaching its VaR limit. Notwithstanding accumulations in positions that the traders themselves considered "huge,"[1042] the CIO never breached its VaR limit after the model change. In April 2012, Mr. Stephan discovered that the CIO was then on the verge of pushing the entire bank to the brink of another VaR breach, even though the CIO itself remained within its own limit because of the model change. In an April 18, 2012, email to Mr. Macris, Mr. Stephan wrote:

> "FYI – we discovered an issue related to the VAR market data used in the calculation .... This means our reported standalone var for the five business days in the period 10-16th April was understated by appr[o]x[imately] $10m[illion] .... The unfortunate part is the firm is running close to its limit (CIO is within it[s] limit as it stands)."[1043]

[1039] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1040] 3/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "First draft of the presentation," with attachment entitled "CIO Synthetic Credit Update," at slide entitled "Core Credit Book: Summary," at 6, JPM-CIO-PSI 0001247.
[1041] 1/31/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "hello, quick update in core credit," JPM-CIO-PSI 0001229.
[1042] 3/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "First draft of the presentation," with attachment entitled "CIO Synthetic Credit Update," at slide entitled "Core Credit Book: summary," at 1, JPM-CIO-PSI 00001247 ("the book is huge").
[1043] 4/18/2012 email from Keith Stephan, CIO, to Achilles Macris, CIO, and others, "CIO VaR," JPM-CIO-PSI 0001205.

The OCC told the Subcommittee that if the new VaR model approval had not been hurried in January, the CIO traders would have been forced to "derisk" rather than load up with new risk.[1044] The OCC said that when the pressure mounted in late January to address the SCP losses, that was precisely when the model reviewers should have held firm instead of activating a flawed model intended primarily to artificially lower the CIO's risk profile and give its traders more room to purchase even higher risk instruments.

(h) Operating and Implementation Failures

The bank made the new CIO VaR model effective as of January 27, 2012. Once it was in place, however, serious operational and implementation problems gave rise to understated VaR results, which continued undetected for months.

Mr. Hagan told the Subcommittee that he was personally charged with implementing and running the VaR model for the CIO.[1045] He said that one of the key problems was that he was never given sufficient funds to construct a database to feed trading data into the CIO's VaR model on an automated basis. Instead, he said that he had to manually enter data into multiple spreadsheets each trading day, which often took hours. He said that the amount of data entry and problems with how the spreadsheets integrated that data produced faulty VaR results which he did not detect until April or May 2012.[1046]

The 2013 JPMorgan Chase Task Force Report summarized the operational and implementation problems with the new CIO VaR model as follows:

> "[T]he model was approved despite operational problems. The Model Review Group noted that the VaR computation was being done on spreadsheets using a manual process and it was therefore 'error prone' and 'not easily scalable.' Although the Model Review Group included an action plan requiring CIO to upgrade its infrastructure to enable the VaR calculation to be automated contemporaneously with the model's approval, the Model Review Group had no basis for concluding that the contemplated automation would be possible on such a timetable. Moreover, neither the Model Review Group nor CIO Risk followed up to determine whether the automation had in fact taken place. …

[1044] Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
[1045] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
[1046] Id.

> CIO's implementation of the model was flawed. CIO relied on the model creator [Patrick Hagan], who reported to the front office, to operate the model. Data were uploaded manually without sufficient quality control. Spreadsheet-based calculations were conducted with insufficient controls and frequent formula and code changes were made. Inadequate information technology resources were devoted to the process. Contrary to the action plan contained in the model approval, the process was never automated."[1047]

Still another problem was that the new VaR model included an unapproved model component designed by Mr. Hagan, but never tested or approved by the Model Risk Group,[1048] as well as calculation errors involving hazard rates and correlation estimates that improperly lowered the VaR results.[1049]

In other words, a critical risk model for a portfolio containing hundreds of billions of dollars of financial instruments, operated by the man who developed the model at the behest of the portfolio manager, included flawed and untested components, and depended upon manual uploads of key trading data daily for its calculations. This untested, unautomated, error-prone VaR model was nevertheless put into place at a bank renowned for its risk management.

At the time it was implemented, the new VaR model produced no objections from the bank's regulators. Later, however, after the agency conducted an intensive review of the VaR model and learned of the operational problems, the OCC head capital markets examiner told the Subcommittee that the bank's poor implementation efforts were "shocking" and "absolutely unacceptable."[1050]

In May 2012, four months after activating it, JPMorgan Chase revoked the CIO's new VaR model and replaced it with the prior model. Four months after that, JPMorgan Chase revised the VaR model used for the CIO for a third time.[1051] The newest VaR model "resulted in a reduction to average fixed income VaR of $26 million, average Total IB [Investment Bank] VaR of $26 million, average CIO VaR of $17 million, and average Total VaR of $36 million" for the third quarter of 2012.[1052] Bank officials told the Subcommittee that the new VaR model had the

[1047] 2013 JPMorgan Chase Task Force Report, at 105.
[1048] Id., at 125, 128.
[1049] Id., at 128 (explaining that this error "likely had the effect of muting volatility by a factor of two and of lowering the VaR").
[1050] Subcommittee briefing by OCC (3/4/2013) (Fred Crumlish).
[1051] See JPMorgan Chase & Co. Form 10-Q for period ending 9/30/2012, filed with the SEC (11/08/2012), at 22, http://files.shareholder.com/downloads/ONE/2252595197x0xS19617-12-308/19617/filing.pdf.
[1052] Id., at 98.

effect of reducing the bank's overall VaR by 20%.[1053] This action by the bank indicates that lowering VaR results by changing the VaR model is part of an ongoing pattern at JPMorgan Chase.

(2) Ignoring Comprehensive Risk Measure

The VaR was not the only risk metric that flagged the increasing risk in the Synthetic Credit Portfolio; nor was it the only risk metric that was disregarded. Another example of a risk metric that was triggered but disregarded by CIO traders, risk personnel, and management alike is the Comprehensive Risk Measure, or CRM. After the SCP exploded in size at the beginning of 2012, the portfolio's CRM projected, at the end of February 2012, that the SCP risked annual losses totaling $6.3 billion. A key CIO risk manager immediately dismissed the CRM figure as "difficult for us to imagine" and "garbage." The CIO's senior risk analyst also attacked the CRM model as inaccurate and sought to game the method used to determine which SCP assets would be subjected to that model in order to produce the "optimal" – meaning lowest possible – CRM and RWA totals for the SCP.

(a) Background

CRM, like VaR, produces a dollar figure representing potential losses. While VaR quantifies possible losses over the course of day in the context of ordinary markets, CRM quantifies possible losses over the course of a year in markets undergoing a high level of stress. As the bank's top quantitative analyst told the Subcommittee, CRM represents how much money a portfolio can lose in a worst case scenario over the course of a year, with a 99% level of confidence.[1054]

Along with VaR and several other risk metrics, CRM is a key component used to calculate a bank's overall Risk Weighted Assets (RWA) which, in turn, is used to determine how much capital the bank is required to have on its books to absorb any losses generated by those assets.[1055] The CRM metric was created by Basel 2.5, "a complex package of international rules that imposes higher capital charges on banks for the market risks they run in their trading books, particularly credit-related products."[1056] Basel 2.5 established four new risk measures to help calculate RWA:

[1053] Subcommittee briefing by JPMorgan Chase (1/28/13) (Neila Radin).
[1054] Subcommittee interview of C. S. Venkatakrishnan, JPMorgan Chase (10/25/2012). A new Federal regulation, that took effect on January 1, 2013, defines CRM as a measure of risk "over a one-year time horizon at a one-tail, 99.9 percent confidence level, either under the assumption of a constant level of risk, or under the assumption of constant positions." See 8/30/2012, Joint Final Rule, "Risk-Based Capital Guidelines: Market Risk," Federal Register, at 53106, http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16759.pdf.
[1055] Subcommittee briefing by JPMorgan Chase (8/15/2012).
[1056] 5/14/2012 "Basel 2.5 Increases The Squeeze On Investment Banking Returns," Standard &

- "A stressed value-at-risk (SVaR) model, which adds to the VaR-based capital requirements in Basel II. SVaR is intended to capture more adequately the potential consequences of more volatile market conditions than those encountered in the historical prices on which their VaR models are based.
- The incremental risk charge (IRC), which aims to capture default and credit migration risk.
- New standardized charges for securitization and resecuritization positions.
- The comprehensive risk measure (CRM) for correlation trading positions, which assesses default and migration risk of the underlying exposures."[1057]

Because these measures were relatively new,[1058] JPMorgan Chase's revised RWA model, together with its component CRM model, were put into effect for the first time in 2011, and were still being evaluated and fine-tuned in 2012.[1059] In addition, some business segments, like the CIO, were attempting either to modify the bankwide models or win approval to use their own variations.[1060]

At the CIO, CRM was used to measure risk and capital requirements related to credit tranche positions and their associated hedges.[1061] While CRM is a component of RWA and thus used to determine capital requirements, Mr. Venkatakrishnan told the Subcommittee that it can also be used to gauge the risk of a portfolio.[1062]

(b) Challenging the CRM Results

JPMorgan Chase applied the CRM risk metric to the Synthetic Credit Portfolio beginning in 2011.[1063] In December 2011, the bank decided to combine the CIO's CRM results with those of the Investment Bank, which "produced a diversification benefit" and lowered the CRM totals for both.[1064] In January 2012, however, the CIO's CRM totals suddenly began to skyrocket. On January 4, CRM was calculated at

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Poors publication, https://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245334380388.

[1057] Id.

[1058] See 2/2011 "Revisions to the Basel II Market Risk Framework," Basel Committee on Banking Supervision, http://www.bis.org/publ/bcbs193.pdf.

[1059] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

[1060] See, e.g., 12/22/2011 email from Javier Martin Artajo, CIO, to Ina Drew, CIO, and others, "RWA – Tranche Book," JPM-CIO-PSI 0000032 (advocating a change in the QR CRM model to produce an estimated $5 billion reduction in the SCP's RWA total); Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

[1061] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

[1062] Id.

[1063] Subcommittee interview of Peter Weiland, CIO (8/29/2012).

[1064] See 1/9/2012 email from Keith Enfield, CIO, to Achilles Macris, CIO, and others, "CRM Results for Q4," JPM-CIO-PSI 0000085. See also 1/9-10/2012 email exchanges among CIO personnel, "CRM results for Q4," JPM-CIO-PSI 0000083-84.

$1.966 billion.[1065] On January 11, it was $2.344 billion.[1066] On January 18, it reached $3.154 billion.[1067]

As discussed earlier and as outlined in more detail in Chapter III, on December 22, 2011, Javier Martin-Artajo sent an email to Ina Drew recommending that the SCP's RWA be reduced primarily by modifying the models used to calculate the CIO's RWA.[1068] The largest single reduction he advocated was a change in the model for calculating CRM, which is a key component of RWA. His email stated that changing the CRM model could reduce the CIO's overall RWA by as much as $5 billion.[1069]

Patrick Hagan, the CIO's lead quantitative expert, told the Subcommittee that, at the direction of Mr. Martin-Artajo, his supervisor, he had begun work on developing a new CRM model for the CIO during the summer of 2011.[1070] He confirmed to the Subcommittee that he provided the estimate that the new CRM model he was developing could lower the CIO's RWA by $5 billion.[1071]

As explained above, a few weeks later, on January 18, 2012, Mr. Iksil provided a written presentation to Ms. Drew and others related to reducing the SCP's RWA. The presentation showed that, while the bank's standard "QR" model produced a CIO RWA of $40.3 billion, an RWA model – a "shadow model" in Mr. Weiland's words[1072] – developed by the CIO would produce an RWA of just $20.9 billion, a reduction of nearly 50%.[1073] In addition, Mr. Iksil's presentation projected that if the QR model prevailed, and the SCP had to be actively reduced in size, it would cost $590 million; whereas, if the CIO model prevailed, reduction of the portfolio could cost as little as $100 million.[1074] These projections show that the CIO had a strong incentive

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[1065] 3/2/2012 email from Kevin Krug, JPMorgan Chase, to Peter Weiland, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000338-339, at 339.
[1066] Id.
[1067] Id. See also 3/8/2012, email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0008773-775, at 775; 3/22/2012 email from C.S. Venkatakrishnan, JPMorgan Chase, to Bruce Broder, JPMorgan Chase, "Privileged and Confidential," JPM-CIO-PSI 0036179-181, at 180-181.
[1068] See 12/22/2011 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and John Wilmot, CIO, "RWA – Tranche Book," JPM-CIO-PSI 0000032-034, at 033. See also 12/22/2012 email from Javier Martin-Artajo, CIO, to Bruno Iksil, Patriek Hagan, Julien Grout and Samir Ratel, CIO, "urgent ----- : Rwa," JPM-CIO-PSI 0001227 (listing similar "model reduction[s]").
[1069] See 12/22/2011 email from Javier Martin-Artajo, CIO, to Ina Drew and John Wilmot, CIO, "RWA – Tranche Book," JPM-CIO-PSI 0000032-034, at 033 ("Model reduction QR CRM (ackno[w]ledged already) 5 (Pat [Hagan] estimate).").
[1070] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
[1071] Id.
[1072] Subcommittee interview of Peter Weiland, CIO (8/29/2012).
[1073] See 1/18/2012 email from Bruno Iksil to Julien Grout, CIO, "Meeting materials for 11am meeting," conveying a presentation entitled, "Core Credit Book Highlights," prepared by Mr. Iksil, JPM-CIO-PSI 0000098-104.
[1074] Id.

to see its shadow RWA model approved, including its revised method for calculating CRM.

Soon after the January 18 presentation, however, the bank's QR team experienced technical difficulties and did not provide new CRM results for the CIO for five weeks.[1075] CRM results for the CIO were not calculated again until the beginning of March.[1076] At that time, the QR team calculated the CRM for CIO positions as of February 22, 2012. The result was the $6.3 billion total, representing an increase of more than 300% in less than seven weeks.[1077]

On March 1, 2012, Mr. Macris emailed Mr. Martin-Artajo to discuss the SCP's dilemma when confronting an increased CRM: "If we need to [a]ctually reduce the book, we will not be able to defend our positions."[1078] His statement expressed the concern, examined in Chapter III, that credit derivative prices were not following historical norms; that the CIO had to continue trading in volume to prop up the value of its credit positions; and that reducing the SCP's positions in order to reduce its RWA would cause the values to plummet. In the email, Mr. Macris offered a potential solution: "We need to win on the methodology ...."[1079] The 2013 JPMorgan Chase Task Force Report explains: "This phrase refers to the traders' goal ... to convince the Firm that it should change the methodology of the model used to calculate RWA for the Synthetic Credit Portfolio."[1080] Given the key role of CRM in calculating RWA, having to accept what the CIO traders saw as an inflated CRM would have been a major setback.

On March 2, 2012, a QR quantitative expert, Kevin Krug, who was responsible for running the CRM calculations, emailed Pete Weiland, the CIO's Chief Market Risk Officer, with the CRM results for January and February.[1081] Mr. Weiland expressed surprise at the huge CRM figure and questioned the results:

[1075] See 5/3/2012 email from Irvin Goldman, CIO, to Douglas Braunstein, JPMorgan Chase, and others, "CSW 10%," with attached JPMorgan Chase presentation entitled "CIO Synthetic Credit: Risk background information for upcoming meetings," slide entitled "Capital Metrics History," at 8, JPM-CIO-PSI-H 0000546-556, at 555 ("From late January through February model output was halted due to technology issues. ... QR could not provide information for 5 weeks.").
[1076] See 3/2/2012 email exchanges among Peter Weiland, CIO, and Javier Martin-Artajo, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000338-339. See also 3/8/2012 email exchanges among Ina Drew, CIO, and Javier Martin-Artajo, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000373-375.
[1077] See, e.g., 3/8/2012 email from Ina Drew, CIO, to Javier Martin-Artajo, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000373-375, at 374. See also 3/22/2012 email from C.S. Venkatakrishnan, JPMorgan Chase, to Bruce Broder, JPMorgan Chase, "Privileged and Confidential," JPM-CIO-PSI 0036179-181, at 180-181.
[1078] 3/1/2012 email from Achilles Macris, CIO, to Javier Martin-Artajo, CIO, "priorities," JPM-CIO-PSI 0001219.
[1079] Id.
[1080] 2013 JPMorgan Chase Task Force Report, at 39.
[1081] 3/2/2012 email from Kevin Krug, JPMorgan Chase, to Peter Weiland, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000338.

"These results, if I understand them, suggest that there are scenarios where the CIO tranche book could lose $6 billion in one year. That would be very difficult for us to imagine given our own analysis of the portfolio."[1082]

Mr. Weiland forwarded the results to Mr. Martin-Artajo, head of the CIO's equity and credit trading, stating: "We got some CRM numbers and they look like garbage as far as I can tell, 2-3x what we saw before."[1083] Mr. Weiland told the Subcommittee that by "garbage" he meant, not that the results were negative, but rather that they were unreliable.[1084] Faced with calculations that the Synthetic Credit Portfolio was much riskier than the traders had portrayed, Mr. Weiland's first reaction was to dismiss the risk metric and seek reassurance from the traders.

In an effort to understand why the CRM results were much larger than expected, Mr. Weiland also contacted C.S. "Venkat" Venkatakrishnan, who was the new head of the bank's Model Risk and Development Group and reported to Chief Risk Officer John Hogan. On March 7, 2012, Mr. Venkatakrishnan explained in an email to Ina Drew, John Hogan, Ashley Bacon, Irvin Goldman, and Peter Weiland that the $3 billion increase in the CRM metric was due primarily to the $33 billion increase in the size of the CIO portfolio over the same period:

"There are two related issues. The first is the $3b[illio]n increase in CRM RWA between January and February, from $3.1bn to $6.3bn. The second is that your group believes that the absolute level of CRM RWA we calculate was high to begin with in Jan[uary]. The second question requires us to explain our models to the satisfaction of your team. I am in London and spoke with Javier today and we will make this an urgent matter.

Based on our models, though, we believe that the $3bn increase in RWA is entirely explained by a $33bn notional increase in short protection (long risk) in your portfolio between Jan[uary] and Feb[uary]. ...

Peter Weiland and your mid-office confirm this $33bn notional increase in long index risk. Further we both agree that this position change results in a change of about

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[1082] 3/2/2012 email from Peter Weiland, CIO, to Kevin Krug, JPMorgan Chase, and others, "CIO CRM Results," JPM-CIO-PSI 0000338.
[1083] 3/2/2012 email from Peter Weiland, CIO, to Javier Martin-Artajo, CIO, and others, "CIO CRM Results," JPM-CIO-PSI-0000338.
[1084] Subcommittee interview of Peter Weiland, CIO (8/29/2012).

> $150mm[million] (a decrease) in 10%CSW. Per our models, a roughly 10% capital charge ($3bn) on this $33bn increase in risk is reasonable.
>
> Also, to be clear, there has been no model change on our end; the change in RWA for tranches has hardly changed over the month.
>
> I understand that we have to build your confidence in our models themselves but, given our models, we believe the increase in RWA is well explained by the build up in your risk positions."[1085]

Mr. Venkatakrishnan attributed the increase in CRM directly to the additional long positions in the SCP, and denied any fault in the QR model. Ms. Drew emailed his explanation to Mr. Macris and Mr. Martin-Artajo, copying Mr. Goldman and Mr. Weiland, and added: "Not consistent with your take. Let's discuss thurs."[1086] Expressing concern at the discrepancy, Mr. Macris forwarded the email exchange to Mr. Martin-Artajo appending the question: "what is going on here?"[1087]

The next day, March 8, 2012, Mr. Martin-Artajo disputed Mr. Venkatakrishnan's explanation of the CRM calculation in an email to Ms. Drew and Mr. Macris, copied to Mr. Goldman and Mr. Weiland. He denied that the portfolio had increased by $33 billion and also asserted that SCP's increased long index positions did not involve the type of credit tranche positions normally analyzed by the CRM:

> "The change in notional is not correct and the CRM is therefore too high. We need to understand better the way they are looking at the scenario that creates the CRM and we also disagree with them on this. More work in progress until we can understand how to improve the number[1088] but if the result of an increase is due to an increase in the long index but not on the tranches this makes no sense since this is not part of the CRM measure and once we reconcile the portfolio this should be very clear of what we would do. First, go back to the results of end of year so that we go to a more neutral

[1085] 3/7/2012 email from C.S. Venkatakrishnan, JPMorgan Chase, to Ina Drew, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0001815.
[1086] 3/8/2012 email from Ina Drew, CIO, to Achilles Macris, CIO, and others, "CIO CRM Results," JPM-CIO-PSI-0001815.
[1087] 3/8/2012 email from Achilles Macris, CIO, to Javier Martin-Artajo, CIO, "CIO CRM Results," JPM-CIO-PSI-0001815.
[1088] Four months earlier, in December 2011, Mr. Martin-Artajo had advocated taking steps to change the model used to calculate CRM to produce a $5 billion reduction in the CIO's RWA. See 12/22/2011 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "RWA – Tranche Book," JPM-CIO-PSI 0000032.

> position before trying to do what we have done with the reduction of RWA due to VAR and StressVAR. (We are getting positive results here in line with expectations)."[1089]

This exchange reveals that when confronted with a metric signaling a huge increase in risk, the CIO manager responsible for the Synthetic Credit Portfolio not only disputed the metric, but also, as with the VaR results in January, questioned the model itself.

The CRM results signaling increasing risk in the SCP throughout January and February weren't circulated within the bank until early March. But, even then, had the CIO heeded them, it would have been in time to prevent the disastrously large synthetic credit trades made in the second half of March which increased the portfolio's risk and subsequent losses. But the CIO traders, risk personnel, and management discounted the CRM's warning. They simply did not believe that the SCP could be risking a $6.3 billion loss. By the time Mr. Venkatakrishnan prevailed upon Ms. Drew to accept the accuracy of the bank's CRM model, it was too late.

(c) Gaming the CRM Model

The CIO's efforts to question the CRM results were not limited to challenging the accuracy of the $6.3 billion risk projection. The CIO also sought to game the method used to determine which assets in the Synthetic Credit Portfolio would be subjected to CRM analysis as well as to analysis using another key risk measure known as the Incremental Risk Charge or IRC. Like CRM, the IRC risk metric is used to calculate a bank's Risk Weighted Assets (RWA) and its capital requirements.[1090]

As mentioned earlier, all three of these risk metrics were relatively new. The bank's Quantitative Research (QR) personnel completed work on new models to calculate CRM and IRC, as well as revised RWA outcomes in 2011, rolled them out bankwide that year, and were still fielding questions about the models and testing their accuracy.[1091]

On March 7, 2012, when the adverse CRM results for the SCP were first circulated, Patrick Hagan, the CIO's head of quantitative analytics, sent an aggressive email to the QR criticizing the structure, mathematics, and merits of the new, bankwide CRM risk model. "Hoping that the model is somehow valid for extrapolating down to the

[1089] 3/8/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000371.
[1090] See, e.g., 12 C.F.R. Part 3, Appendix B (discussing calculation of both CRM and IRC).
[1091] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

0.001 level risks is madness," Mr. Hagan wrote, "the only conceivable excuse for it is institutional inertia."[1092]

After meeting with the QR analysts who defended the model as accurate,[1093] Mr. Hagan changed his tactics. On March 14, he began a campaign to convince the QR to reduce the CIO's CRM and IRC totals, not by modifying its models, but by establishing a system for "optimizing" which of the CIO's credit derivative positions would be subject to the CRM calculation and which positions would be subject to the IRC calculation.

While Federal regulators have allowed banks leeway in determining whether specific trading positions should be subject to the CRM or IRC calculation, the appropriate calculation to apply depends largely on the nature of the trades. According to Mr. Venkatakrishnan, credit tranche positions and their associated hedges should be subjected to the CRM calculation.[1094] He indicated that other, more liquid, credit derivative positions could appropriately undergo the IRC calculation. In practice, the CIO maintained two books, or "buckets," inside the Synthetic Credit Portfolio: a tranche book that was subject to CRM, and an index book that was subject to IRC.

Mr. Hagan sought to apply the CRM or IRC models to individual positions, not on the basis of which book they were in, or the nature of the trades, but rather on the basis of what arrangement would result in the lowest CRM and IRC totals and, therefore, the lowest RWA and the lowest capital charge for the bank.

On March 21, 2012, Mr. Hagan outlined his approach in an email he sent to Mr. Goldman, Mr. Venkatakrishnan, and others, copying Mr. Martin-Artajo and Mr. Weiland. Under the subject heading, "Optimizing regulatory capital," Mr. Hagan wrote:

> "To optimize the firm-wide capital charge, I believe we should optimize the split between the tranche and index books. The bank may be leaving $6.3bn [billion] on the table, much of which may be recoverable ....
>
> Here's what I think can be done .... The split between the index book (subject to IRC) and the tranch[e] book (subject to CRM) should be a theoretical split, a matter of labeling for the capital calculations. If there is a natural split which helps us

[1092] 3/7/2012 email from Patrick Hagan, CIO, to Javier Martin-Artajo, CIO, and others, "New CRM numbers," JPM-CIO-PSI 0036342-344.
[1093] See 3/7/2012 emails among QR personnel, "New CRM numbers," JPM-CIO-PSI 0036342-344.
[1094] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

think about the positions, that's different, but for the purposes of the capital calculation, the books should be combined and split on the optimal basis ....

But the idea would be for QR [Quantitative Research] to find the value ... which results in the minimum post-diversification capital charge for the bank as a whole ....

The new rules have too many arbitrary factors of three for the regulatory capital to rationally reflect our risks. I don't think we should treat this as a regulatory arbitrage. Instead we should treat the regulatory capital calculation as an exercise of automatically finding the best results of an immensely arbitrary and complicated formula."[1095]

Mr. Hagan's email expressed the concern, pervasive at the CIO, that the regulatory capital models overstated the risks in the SCP, that they produced arbitrarily high results, and that the traders knew better. Mr. Hagan sought to engineer a way to get the capital calculations to better reflect the opinion of the traders.

Some recipients of Mr. Hagan's email were apparently uncomfortable seeing in writing a strategy that depended in part on manipulating the grouping of trades to produce the lowest possible RWA and capital charges. That discomfort was expressed in recorded phone conversations with Mr. Hagan later that same day. Anil Bangia, a subordinate of Mr. Venkatakrishnan, called Mr. Hagan in London and warned him about sending the type of email he did:[1096]

Mr. Bangia: "I think, the, the email that you sent out, I think there is a, just FYI, there is a bit of sensitivity around this topic. So –"

Mr. Hagan: "There, there is a lot of sensitivity."

Mr. Bangia: "Exactly, so I think what I would do is not put these things in email."

Mr. Hagan: "That's exactly what I was told. Javier, Javier is the guy that asked me to send out the email this morning. And then he found out from, from Pete and – yeah, and he found out from some – and Irv that this is ..."

[1095] 3/21/2012 email from Patrick Hagan CIO, to Irvin Goldman, CIO, and others, "Optimizing regulatory capital," JPM-CIO-PSI 0011025-026.

[1096] The call was at 10:42 Eastern Daylight Savings Time, because UK daylight savings time didn't start until March 25, 2012. It was 2:42 Greenwich Mean Time, only four hours ahead, in London.

Mr. Bangia: "Yeah, yeah, I wouldn't put this you know in . . . ."[1097]

Later that day, despite Mr. Bangia's qualms about sending written communications on optimizing the CRM/IRC split, he nonetheless discussed pursuing the issue with Mr. Hagan:

Mr. Hagan: "Hi Anil, this is Pat."

Mr. Bangia: "Hi Pat."

Mr. Hagan: "Um, you know that email that I should not have sent?"

Mr. Bangia: "Um hum."

Mr. Hagan: "Have you read it? Is that a feasible thing to do or is that impossible?"

Mr. Bangia: "Well it's, in some ways it's somewhat feasible, once we have a bit more of [indecipherable] development. So, a lot of the IRC tools that I was showing you are really based on a new model that is not in production yet. There is an old model that Bruce [Broder] has run, so that's the official model. So that has a very different offline manual process that complicates things."

Mr. Hagan: "I see."

Mr. Bangia: "And beyond that it's a matter of also, how much you guys should do it independently versus what, how much we can actually do on optimizing it, right, so, there's that side of that as well."

Mr. Hagan: "Yeah, I mean, the feeling from the risk managers was that … treating the capital charge is this incredibly complicated mathematical function that we're, of course, going to optimize. And uh, they were less concerned about physically moving things from one physical book to another physical book."

Mr. Bangia: "Yeah. Yeah. I think we should also make sure we don't oversell this in the sense that the stability of

[1097] 3/21/2012 recorded telephone conversation between Anil Bangia, JPMorgan Chase, and Patrick Hagan, CIO, JPM-CIO-PSI-A 0000089.

this, we have to see over time. So I, I would also not quote any numbers on how much we think we can save, right?"

Mr. Hagan: "Yeah, the thing is I was hoping we could save about half that and that's got to be split between the investment bank and us, so ..."

Mr. Bangia: "Hmm."

Mr. Hagan: "It's not clear, it's not clear."

Mr. Bangia: "Yeah, yeah, it's not clear."[1098]

The CIO's Chief Market Risk Officer Peter Weiland also called Mr. Hagan:

Mr. Weiland: "I keep getting banged up .... I know you've had some emails back and forth with Venkat and Anil or whoever on the optimization of the IRC and CRM and everything else. Everyone is very, very – I told this to Javier the other day but maybe he didn't mention it to you – everyone is very, very sensitive about the idea – writing emails about the idea of optimizing –"

Mr. Hagan: "I got that sort of mentioned. I'd say it was mentioned to me [laughter]."

Mr. Weiland: "Okay, so, I don't know, Irv just came by again and said, Oh, Venkat was telling me he got another email from Pat you know –"

Mr. Hagan: "From me?"

Mr. Weiland: "Maybe it's from a couple of days ago, I don't know, but .... if you're sensitive to it, that's all I wanted to know."

Mr. Hagan: "Okay."

Mr. Weiland: "So I think we can talk about, you know, allocation –"

Mr. Hagan: "Okay, so nothing about allocation. I understand –"

[1098] 3/21/2012 recorded telephone conversation between Patrick Hagan, CIO, and Anil Bangia, JPMorgan Chase, JPM-CIO-PSI-A 0000090.

Mr. Weiland: "Uh, you see, the work of the risk manager has very broad and unclear borders sometimes. Anyway –"

Mr. Hagan: "Okay. I did write an email message. I didn't realize it was sensitive to that extent .... Ah, it's all mathematics."

Mr. Weiland: "– Yeah, well that's, you know, the funniest thing is, the first time that someone mentioned it to me I said, you know, 'I'm sure that Pat just sees this as like a math problem, an interesting and a complicated math problem. And all this other crap that goes on about, like, the implications of regulatory arbitrage and stuff like that is like, completely boring' [laughter]."

Mr. Hagan: "– No it's not that. I just get annoyed when I see us creating risks when there were no risks –"

Mr. Weiland: "Yeah, I know."

Mr. Hagan: "– that's annoying. Ok, I understand the sensitivity. Tell Irv I'm sorry."[1099]

Over the next two weeks, Mr. Hagan worked with the QR analysts to come up with a way to categorize the CIO's trades in a way that would reduce its CRM and IRC results. Ultimately, the bank reached a compromise with Mr. Hagan over how to split the portfolio between the tranche and index books. At the end of March, Mr. Hagan was allowed to design the initial split of the portfolio as it existed in order to optimize RWA, but once a trade was placed in either the tranche or index book, it had to stay there.[1100] As new trades were made, the CIO would be allowed to categorize them in order to optimize RWA, but existing trades could not be re-categorized.[1101]

The CIO's efforts to understand and influence the CRM, IRC, and RWA models continued into April 2012. In an email dated April 3, 2012, Achilles Macris informed Ina Drew that a QR analyst "is now in our office and he is 100% involved with the RWA projections of our

[1099] 3/21/2012 recorded telephone conversation between Peter Weiland, CIO, and Patrick Hagan, CIO, JPM-CIO-PSI-A 0000091.
[1100] Subcommittee interview of Patrick Hagan, CIO (2/7/2013). See also, 2/4/2012 email exchanges among QR personnel, CIO personnel, and Mr. Hagan, CIO, "Final split?" JPM-CIO-E 00033939-941. ("For perfect clarity, I am forwarding back what I understand has been selected as the final split. Please let me know if this is not the correct one. Otherwise, this is what we'll proceed with.").
[1101] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

book and ways to bringing it lower."[1102] Ms. Drew forwarded the email to the CIO's Chief Financial Officer John Wilmot who responded: "I don't get the sense of clarity that we know what is driving the RWA (economic risk versus VaR, stress VaR, CRM and IRC) or the p&l [profit and loss] – or more importantly that either will be manageable going forward."[1103] Mr. Wilmot also wrote: "We haven't made the case of how this book runs off and whether risk can be managed effectively."[1104]

A recent article sponsored by the International Monetary Fund on why RWA totals differ across countries and banks observed that, due to the great variance in RWA totals, "Confidence in reported RWAs is ebbing."[1105] It discussed a wide range of factors contributing to RWA variances, mentioning near the end of the article, almost in passing, allegations that financial institutions might be "gaming the system":

> "The current set-up for RWA calculation leaves considerable scope for subjectivity and interpretation. Most banks rely on a combination of approaches to calculate RWAs, which inevitably brings complexity and opacity. Pillar 3 individual reports often refer to 'model changes,' 'data cleansing,' 'RWA optimization,' 'parameter update' or other techniques that could suggest that banks may be 'tampering' with their RWAs in order to lower capital requirements. However, it is prudent to guard against any simplistic conclusion, and against inferring that any bank with a low RWA density is necessarily 'gaming the system.'"[1106]

At JPMorgan Chase, however, emails, telephone conversations, and internal presentations offer evidence that efforts to manipulate RWA results to artificially lower the bank's capital requirements were both discussed and pursued by the bank's quantitative experts.

[1102] 4/3/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, no subject line, JPM-CIO-PSI 0000497-498.

[1103] 4/3/2012 email from John Wilmot, CIO, to Ina Drew, CIO, no subject line, JPM-CIO-PSI 0000497.

[1104] Id.

[1105] 3/2012 "Revisiting Risk-Weighted Assets," IMF Working Paper No. WP/12/90, Vanessa Le Leslé and Sofiya Avramova, at 4, http://www.imf.org/external/pubs/ft/wp/2012/wp1290.pdf.

[1106] Id., at 26. See also January 2013 "Regulatory consistency assessment programme (RCAP) – Analysis of risk-weighted assets for market risk," Basel Committee on Banking Supervision (documenting wide RWA variances across banks and countries); "Banks' Risk Measurements Rarely Off By Much More Than A Factor Of Ten," Dealbreaker.com, Matt Levine (1/31/2013), http://dealbreaker.com/2013/01/banks-risk-measurements-rarely-off-by-much-more-than-a-factor-of-ten/, (discussing evidence that banks are "optimizing" their RWA models to artificially lower their RWA results and that each bank's model is designed "to require as little capital as possible for its particular portfolio of assets").

(3) Ignoring Repeated Breaches of Credit Spread Risk Limits

The VaR and CRM results were not the only risk metrics that warned the CIO of increasing risk in the Synthetic Credit Portfolio. So did two additional risk metrics that JPMorgan Chase used to track how its portfolios would perform based on changes in "credit spreads," meaning risks linked to changes in credit derivative premiums. The credit spread risk limits were repeatedly breached in the first quarter of 2012, with the SCP exceeding one limit by 100% in January, by 270% in early February, and by more than 1,000% in mid-April. But instead of heeding those risk warnings, which came on top of the VaR and CRM warnings, the CIO traders, risk managers, and management criticized the credit spread risk metrics as faulty and pushed for them to be replaced.

The two credit spread risk metrics were known within the bank as, first, "Credit Spread Widening 01" (CS01), also often referred to as "Credit Spread Basis Point Value" (CSBPV) or Spr01; and second, the "Credit Spread Widening 10%" (CSW10%). As with VaR, each of these metrics produced a dollar value signifying the amount of money that could be lost by a portfolio in a single day under specified market conditions. The bank established the CS01 and CSW10% risk limits for the CIO.[1107]

(a) Breaching CS01 Risk Limit

The Synthetic Credit Portfolio first breached the CS01 risk limit in January 2012.[1108] To understand how the CS01 works, it helps to understand how positions on a credit index are priced. Most credit positions operate somewhat like insurance.[1109] The "short" party makes periodic premium payments to the "long" party over a specified period of time to obtain credit protection. If a "credit event" like a bankruptcy or loan default takes place during the covered period, the long party is required to make a sizeable payment to the short party.

The amount of the premium payments paid by the short party is typically expressed in basis points. A basis point is equal to one-hundredth of one percent. So if the CIO purchased a $1 billion short position in a credit index for 150 basis points, the CIO was required to pay its long counterparty $15 million per year (1.5% of $1 billion) for the credit protection.

[1107] Subcommittee interviews of Ina Drew, CIO (9/7/2012, 12/11/2012).
[1108] See 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Breach of firm var," JPM-CIO-PSI 0000141.
[1109] For more information about credit products, see Chapter II.

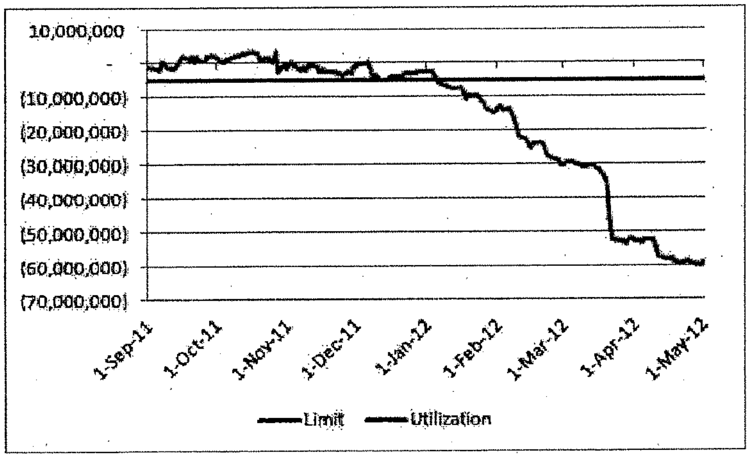
Credit positions are often priced by looking at the amount of position's premium payment, also called the "coupon" payment or "credit spread." If the credit spread "widens," as happens in a worsening credit environment, it means the value of the existing short position increases, because the premium amount that was contractually agreed to be paid for the existing position will be less than the premium required to obtain the same credit protection in the worsening marketplace. If the credit spread "narrows," as happens in an improving credit environment, the value of the existing short position falls. That's because the premium amount paid for that existing short position will likely be greater than the premium that could be paid to obtain the same type of credit protection in the improving market. In addition, because credit derivatives have to be marked-to-market on a daily basis, the credit spread movements and the corresponding changes in the market value of the affected positions have to be recorded in the daily profit and loss statements of the parties holding the positions.

At JPMorgan Chase, CS01 measured the expected profit or loss to a portfolio if the credit spread on a credit position widened by 1 basis point over the course of a day.[1110] The CIO used two CS01 measures, one for their global credit portfolio, and one more specific to their mark-to-market (MTM) portfolio. According to JPMorgan Chase, "[t]he Global CIO MTM CS BPV (CS01) limit was $5,000,000 from mid-August 2008 through early-May 2012, when it was deactivated because management determined the limit was no longer valid in terms of measuring the risk appropriately."[1111] This limit meant that if the CIO held credit positions in its mark-to-market book and the credit spread widened by 1 basis point, a loss of more than $5 million would trigger a discussion as to whether the positions had to be unwound.[1112]

A presentation later prepared by JPMorgan Chase shows that the CIO breached the $5 million MTM CS01 limit in early January and quickly incurred more and more risk.[1113]

[1110] See 2013 JPMorgan Chase Task Force Report, at 80.
[1111] 12/7/2012 letter from JPMorgan Chase legal counsel to Subcommittee, PSI-JPMC-24-000001.
[1112] 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Breach of firm var," JPM-CIO-PSI 0000141. See also 2013 JPMorgan Chase Task Force Report, at 80 ("With respect to the Synthetic Credit Portfolio, it reflected an aggregation of the CSBPV sensitivities of all the credit products (e.g., investment-grade and high-yield), unadjusted for correlations.").
[1113] 5/7/2012 email from Peter Weiland, CIO, to Ina Drew, CIO, and others, "CSBPV History," attached presentation entitled "CIO Global Credit CSBPV Limits," JPM-CIO-PSI-H 0000810-811, at 811. See also 2013 JPMorgan Chase Task Force Report, at 80 (indicating CSBPV limit was first breached on January 6, 2012).

CIO MTM CS01 Limit Breaches, Sept. 2011-May 2012



Source: JPMorgan Chase presentation entitled "CIO Global Credit CSBPV Limits," JPM-CIO-PSI-H 0000811.

The Synthetic Credit Portfolio first breached the $5 million MTM CS01 limit on January 6, 2012, a breach that continued for months, until the limit was replaced in May.[1114] Over the same period of time, the CIO's Global CS01 limit was $12 million. The SCP first breached the CIO Global CS01 limit on January 18, 2012, breached it again on January 25, and stayed in breach until May when that risk limit, too, was replaced.[1115]

In response to the January breaches, the CIO traders requested an increase in the CS01 risk limits to end the breaches. On January 27, 2012, CIO trader Bruno Iksil, apparently confused over the level of the limit, emailed Mr. Martin-Artajo with the request:

> "I will need an increase in the CS01 limit in order to reduce further the notionals and set the book for a smoother P&L path. I am currently constrained by this limit of [$]10M[illion] CS01 that prevents me from having a decent convexity of spreads tighten mostly."[1116]

According to the JPMorgan Chase Task Force Report, "At various times, beginning in February, CIO Market risk suggested a temporary

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[1114] 5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, "Information Needed," JPM-CIO-PSI-H 0000627, at 636.
[1115] Id.
[1116] Undated internal document authored by Bruno Iksil with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021884. See also 2013 JPMorgan Chase Task Force Report, at 37, footnote 48.

increase in the mark-to-market (MTM) CSBPV limit, from $5 million to $20 million, $25 million or $30 million."[1117] These Global CS01 limit increases were not granted. However, the CIO traders were also not required to exit any positions in order to end the breach. Instead, the dual CS01 breaches were allowed to continue and grew more and more egregious. In fact, despite written guidelines requiring the CIO to "take immediate steps toward reducing its exposure to be within the limit,"[1118] the CIO traders pressed on in their trading strategy and continued to purchase additional credit derivatives. Indeed, on January 30, 2012, Mr. Iksil sent Mr. Martin-Artajo an email with the subject line, "there is more loss coming in core credit book," warning of losses due to other market participant aligning against the CIO to "go for the fight." Mr. Iksil wrote: "Now I just grow the exposure and the CS01 moves up."[1119]

On February 13, 2012, Syed Hassan in the bank's Market Risk Management group sent an email with the subject line, "CIO Global Credit spread BPV limit breach- COB 02/09/2012," to Keith Stephan, the Chief Risk Officer in the CIO's London office, and others, asking them about the ongoing CS01 breaches and requesting an explanation. Mr. Hassan wrote:

> "The following CIO Global Credit Spread BPV limits have been breaching since the aforementioned period. Can you please examine and confirm the breaches as valid? If so, please also provide some commentary surrounding the breaches. Thanks."[1120]

The email included a chart, excerpted below, showing that, starting on January 18, 2012, the $12 million "CIO Global Credit CSBPV" limit was repeatedly breached and, by the date of the email, had surpassed $20.5 million, a breach 70% greater than the limit. The chart also tracked the more granular "CSBPV–MTM" limit of $5 million, which was first breached on January 6; by January 18 it was in breach by more than 100%. On February 9, the CIO's CSBPV-MTM exceeded $18.6 million, a breach of greater than 270%.[1121]

[1117] 2013 JPMorgan Chase Task Force Report, at 81.

[1118] See, e.g., 3/2012 presentation prepared by JPMorgan Chase entitled, "Market Risk Limits," at 13, OCC-SPI-00117682.

[1119] 1/30/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "there is more loss coming in core credit book," JPM-CIO-PSI 0001225.

[1120] 2/13/2012 email from Syed Hassan, CIO, to Keith Stephan, CIO, and others, "CIO Global Credit spread BPV limit breach- COB 02/09/2012," JPM-CIO-PSI 0001825.

[1121] See, e.g., 2/2012 chart of CIO limit breaches prepared by Subcommittee using data provided by JPMorgan Chase, JPM-CIO-PSI 0001832 (reformatted for clarity). Note: because of a data error at the CIO North America desk, this document actually understates the Jan. 18th CIO Global Credit CSBPV limit utilization by $848,000; the error was later corrected by the CIO middle office. See 3/3/13 email from JPMorgan Chase outside counsel to the Subcommittee, "Crossing the t's," PSI-JPMC-37-000001.

Excerpt From JPMorgan Chase Chart
Tracking CIO MTM and Global CS01 Breaches
January – February 2012

Date of Breach	Limit Type	Current Limit	Limit Utilization
01/18/2012	CIO Global Credit CSBPV	12,000,000	12,476,463.89
01/25/2012	CIO Global Credit CSBPV	12,000,000	12,795,898.84
02/02/2012	CIO Global Credit CSBPV	12,000,000	14,015,706.12
02/09/2012	CIO Global Credit CSBPV	12,000,000	20,551,039.63

Date of Breach	Limit Type	Current Limit	Limit Utilization
01/06/2012	CIO Global Credit CSBPV - MTM	5,000,000	5,767,816.27
01/18/2012	CIO Global Credit CSBPV - MTM	5,000,000	10,501,915.86
01/25/2012	CIO Global Credit CSBPV - MTM	5,000,000	10,974,965.09
02/02/2012	CIO Global Credit CSBPV - MTM	5,000,000	12,096,601.27
02/09/2012	CIO Global Credit CSBPV - MTM	5,000,000	18,659,019.36

Source: Subcommittee chart created from data provided by JPMorgan Chase, JPM-CIO-PSI 0001832.

Ms. Drew was informed of the CIO Global Spread CSBPV limit breaches in an email from Mr. Goldman on February 13, 2012.[1122] In the email Mr. Goldman wrote: "We will need a one off limit increase."[1123] Ms. Drew replied later that day: "I have no memory of this limit. In any case it need[s] to be recast with other limits. [It is] old and outdated."[1124]

On February 15, 2012, the CIO's Chief Market Risk Officer, Mr. Weiland, discussed the CS01 breaches in an email with the CIO's Chief Risk Officer in London, Keith Stephan. His email was, in part, seeking assistance in drafting language to request an increase in the Global CS01 limit. Mr. Weiland wrote:

> "Since mid-January CIO has been in breach of its global csbpv limits, driven primarily by position changes in the tranche book.

[1122] 2/13/2012 email from Irvin Goldman, CIO, to Ina Drew, CIO, "Csbpv limit- please read," JPM-CIO-PSI-H 0002936.
[1123] Id.
[1124] Id.

> The csbpv methodology adds the csbpv sensitivities of all of the credit products, unadjusted for correlations. As IG [Investment Grade credit index] and HY [High Yield credit index] positions have been added in January (with a hedge ratio of roughly 5x) the net csbpv prints a positive number even though on a beta-adjusted basis the book is relatively flat.
>
> Market Risk is currently reviewing all limits and most likely will remove the csbpv limit to be replaced with a set of credit-spread-widening (CSW) limits to better reflect the risk of the portfolio in material market moves. Until the new limits are implemented we will propose a one-off to the csbpv, as we find that the stress and csw measures are more appropriate indicators of the risk of the portfolio."[1125]

At the time of this email, Mr. Weiland was the head of Market Risk management at the CIO. Though he reported to Irvin Goldman, Mr. Goldman had only been Chief Risk Officer at the CIO for a few weeks.[1126] As the CIO's longstanding risk manager, and as someone who previously had the authority to approve Level 2 limit exceptions,[1127] Mr. Weiland might have been expected to raise concerns about the months-long breaches of the CS01 limits, but instead his reaction was to criticize the risk metric and recommend another limit increase. He downplayed the importance of the breaches, expressing the view that the Synthetic Credit Portfolio was "relatively flat," and should not have triggered the breaches even though, by February, the size of the SCP was expanding rapidly, the CIO had already changed the VaR model to end that limit breach, and the CRM was climbing.

The next day, February 16, 2012, in reply to Mr. Weiland, Mr. Stephan also downplayed the importance of the breaches and further challenged the value of the CS01 metric by including his own analysis that another risk metric, "10% CSW shows that the book has been reasonably balanced despite the headline [cs] bpv looking much longer."[1128] The following day, February 17, Mr. Stephan sent the email chain regarding the CS01 breaches to Bruno Iksil, the CIO trader who had designed the trading strategy that was causing the risk limit breaches in the first place. Mr. Stephan wrote: "Bruno – can you read the below

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[1125] 2/15/2012 email from Peter Weiland, CIO, to Keith Stephan, CIO, and others, "CIO Global Credit spread BPV limit breach – COB 02/09/2012," JPM-CIO-PSI 0001824.
[1126] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
[1127] Id.
[1128] 2/16/2012 email from Keith Stephan, CIO, to Peter Weiland, CIO, and others, "CIO Global Credit spread BPV limit breach – COB 02/09/2012," JPM-CIO-PSI 0001823.

draft and let me know if you agree /w the points – think we need to get Javier on board w/ this before we send out formal limit request."[1129]

According to the JPMorgan Chase Task Force Report:

> "On March 1, Firm-wide Market Risk Management e-mailed Mr. Weiland and [Mr. Macris] (the signatories to the limit) requesting their approval to temporarily increase the aggregate and MTM CSBPV limits until March 31. Although Mr. Weiland agreed with the suggestion to increase the limit, neither he nor [Mr. Macris] approved the request for a temporary increase and no such increases were implemented. An email from Market Risk Management to the same signatories on March 26 advised that CIO had been breaching its aggregate and MTM CSBPV limits from February 21 through March 21 and that the breaches were 'the result of portfolio and hedge rebalancing since start of 2012.'"[1130]

By March 30, 2012, the CIO had been in breach of the CS01 limit for 59 trading days, and the breach had grown to more than 900%.[1131] Two weeks later, on April 17, 2012, a JPMorgan Chase close of business email notification stated: "MtM cs bpv limit is in excession by 1074% and has been in excession for 71 days."[1132]

By then, the whale trades had been exposed to the public, and the bank's regulators began to take notice of the CS01 and other ongoing breaches. On April 19, James Hohl, a bank examiner with the OCC, emailed CIO Chief Market Risk Officer Pete Weiland about three different breaches, asking, "Would you have any color around some observations about the CIO VaR, the CSBPV, and stress results?"[1133] That same day, Mr. Weiland responded:

> "With respect to the CS01 limit, it is correct that we have been in excess for some time. This is a limit under review. ... We are working on a new set of limits for synthetic credit and the current CS01 will be replaced by something more sensible and granular."[1134]

1129 2/17/2012 email from Keith Stephan, CIO, to Bruno Iksil, CIO, and others, "CIO Global Credit spread BPV limit breach – COB 02/09/2012," JPM-CIO-PSI 0001823.

1130 2013 JPMorgan Chase Task Force Report, at 81.

1131 6/8/2012 email from Elwyn Wong, OCC, to Jairam Kamath, OCC, and others, "Weekly Capital and RWA Schedule," OCC-SPI-00085027.

1132 4/19/2012 email from Jairam Kamath, OCC, to Fred Crumlish, OCC, and others, "CIO and firm VaR excessions COB 4 17 12," OCC-SPI-00004177.

1133 4/19/2012 email from James Hohl, OCC, to Peter Weiland, CIO, "Info on VaR, CSBPV, and stress status and limits," OCC-SPI-00022341.

1134 4/19/2012 email from Peter Weiland, CIO, to James Hohl, OCC, "Info on VaR, CSBPV, and

Instead of acting to reduce the risk in the SCP by exiting positions, CIO risk management indicated it planned to replace the risk metric. Nevertheless, any accurate metric would have shown the same thing: the risks in the SCP were increasing dramatically.

The CS01 is another example of a risk-related red flag that was disregarded. Though Mr. Weiland wrote in his email that team was reviewing, and would likely replace the CS01 limit, in fact, it was not replaced before the entire Synthetic Credit Portfolio was sunk by losses.[1135]

Prior to May 2011, JPMorgan Chase policy required its lines of business to conduct an annual review of their major risk limits.[1136] In May 2011, the policy was changed to require the reviews to be conducted semi-annually.[1137] Contrary to both policies, however, the CIO failed to conduct any review of the adequacy of its risk limits "between 2009 and 2011."[1138] According to the bank, in the first quarter of 2012, Mr. Weiland was still developing a proposal to review and revise the CIO risk limits.[1139]

Ultimately the plan to review the limits in 2012 was overtaken by events, and the CS01 red flag was still waving when the Synthetic Credit Portfolio collapsed under its own weight. A later review of the CSBPV limits, conducted in May by Mr. Weiland, determined that the CSBPV value had "increased dramatically as IG [Investment Grade credit index] positions were added."[1140]

The Subcommittee was told that Mr. Weiland and others within the CIO criticized the CS01 metric in part because it did not take into account the correlations in credit spreads between positions in the SCP.[1141] For example, investment grade (IG) indexes typically have much lower credit spreads than high yield (HY) indexes, so a market event that moves IG indexes by one basis point would likely move HY indexes by more than a basis point. The CS01 in use by CIO assumed all of the positions moved by one basis point.

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stress status and limits," OCC-SPI-00022340.

1135 Subcommittee interview of Peter Weiland, CIO (8/29/2012).

1136 2013 JPMorgan Chase Task Force Report, at 101, footnote 112.

1137 Id.

1138 Id.

1139 Id., at 101.

1140 5/7/2012 email from Peter Weiland, CIO, to Ina Drew, CIO, and others, "CSBPV History," attached presentation entitled "CIO Global Credit CSBPV Limits," JPM-CIO-PSI-H 0000810-811, at 811.

1141 Mr. Weiland considered the non-beta-adjusted CS01 version unsophisticated, so he ignored it. Subcommittee interview of Elwyn Wong, OCC (8/20/2012); Subcommittee interview of Peter Weiland, CIO (8/29/2012).

This criticism doesn't explain why the CIO didn't use a version of the CS01 that took correlations into account. That metric, known as the "beta-adjusted" CS01, was already in use at JPMorgan Chase's Investment Bank.[1142] In fact, the CIO managed to report a beta-adjusted CS01 to senior management two days before the earnings call on April 13, 2012, indicating they easily could have devised one back in January.[1143] CIO risk managers claim to have disregarded the CS01 risk limit because it was a blunt instrument, but they could easily have sharpened it, instead of dismissing it. Likewise, the May review of CSBPV by Mr. Weiland found that, "The limit usage was calculated correctly; the issue was simply that we decided that given the mix of underlyings it would be better to look at sensitivities in a more granular way." But those more granular limits were not implemented until May 1,[1144] and they would have been in breach had they been in place at the time.

JPMorgan Chase personnel, from Mr. Dimon on down, all told the Subcommittee that the risk limits at CIO were not intended to function as "hard stops," but rather as opportunities for discussion and analysis. But when the CIO repeatedly breached the CS01 limits over the course of several months, exceeding those limits by 100%, 270%, even 1,000%, little discussion took place about the nature of the trades triggering the breaches. Instead, CIO personnel focused only on how high the limits should be reset and whether and how to replace the metric entirely.

(b) Breaching CSW10% Risk Limit

The second credit spread risk limit that was breached and then disregarded by the CIO was the CSW10%. Whereas CS01 measured the expected profit or loss to a portfolio over the course of a single day if the credit spread on a credit position widened by one basis point, CSW10% measured the expected daily profit or loss to a portfolio if the credit spread widened by 10%.[1145] According to Mr. Weiland and Mr. Stephan, credit spread widening measures like CSW10% and CSW50% "better reflect[ed] the risk of the portfolio in material market moves."[1146] Ms. Drew told the Subcommittee that she considered the CSW10% to be an "overriding" risk limit of key importance.[1147]

1142 Subcommittee interview of Peter Weiland, CIO (8/29/2012).
1143 See 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701.
1144 See 5/7/2012 email from Peter Weiland, CIO, to Ina Drew, CIO, and others, "CSBPV History," attached presentation entitled "CIO Global Credit CSBPV Limits," JPM-CIO-PSI-H 0000810-811, at 811.
1145 2013 JPMorgan Chase Task Force Report, at 3, 82.
1146 2/16/2012 email from Keith Stephan, CIO, to Peter Weiland, CIO, "CIO Global Credit spread BPV limit breach – COB 02/09/2012," JPM-CIO-PSI 0001826-31.
1147 Subcommittee interview of Ina Drew, CIO (9/7/2012).

On March 22, 2012, the SCP breached the CIO's mark-to-market CSW10% limit.[1148] Ms. Drew expressed immediate concern.[1149] The next day, Ms. Drew halted all trading in the SCP, but the SCP remained in breach of the CSW10% limit for over a month, through April 30.[1150]

Unlike the CS01 breach, which appears to have been simply ignored for several months, the CSW10% breach was promptly noticed and acted upon by Ms. Drew. At the same time, while Ms. Drew stopped the SCP from growing larger, neither she nor any other bank manager ordered the immediate reduction of any existing SCP position in order to end the CSW10% breach. Instead the SCP was allowed to maintain its portfolio and continue to breach the CSW10% limit for another month – a breach which was on top of its CS01 breach. The order to dismantle existing SCP positions came only after the whale trades became public, lost billions of dollars, and drew the attention of investors, regulators, and policymakers.

The CSW10% risk metric is also another example of a risk metric whose validity was challenged by CIO personnel and whose calculation by the CIO's risk analysts just happened to result in lower risk results than when calculated by the bank's risk analysts. Soon after the CSW10% limit was breached on March 22, 2012, the bank's risk analysts discovered that the CIO differed from the Quantitative Research team in how it calculated the CSW10% metric. And as with VaR and CRM, the CIO's CSW10% model produced a lower risk profile for the SCP than the bank's standard approach.[1151]

On March 30, 2012, eight days into the CIO's CSW10% limit breach, the head of the QR group, Mr. Venkatakrishnan, emailed Chief Risk Officer John Hogan, questioning the divergent results of the two models, but also noting that risk was increasing under both:

> "John: CIO's 10% CSW by my group's model estimate is long 245mm of risk; their own models (run by Weiland) quote $145mm. I don't understand the difference in the models and don't know how good a measure of risk 10%CSW is for their book. But I spoke to Ashley and we

[1148] See 5/10/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, "Braunstein / Cutler call on CIO," OCC-SPI-00000018 ("The CIO global credit 10% credit spread widening (CSW) limit was breached on March 22, 2012. At that time CIO Ina Drew suspended active trading in the instruments."). See also 2013 JPMorgan Chase Task Force Report, at 82.
[1149] Subcommittee interview of Ina Drew, CIO (12/11/2012).
[1150] See 5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, "Information Needed," JPM-CIO-PSI-H 0000627, at 636. See also 2013 JPMorgan Chase Task Force Report, at 82.
[1151] JPMorgan Chase did not have a standard CSW10% model that it applied bankwide, in the same sense as its VaR model. Instead, the QR team had developed a CSW10% calculation as part of another model. Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

agree that 10%CSW has been trending up for CIO, by either their model or ours."[1152]

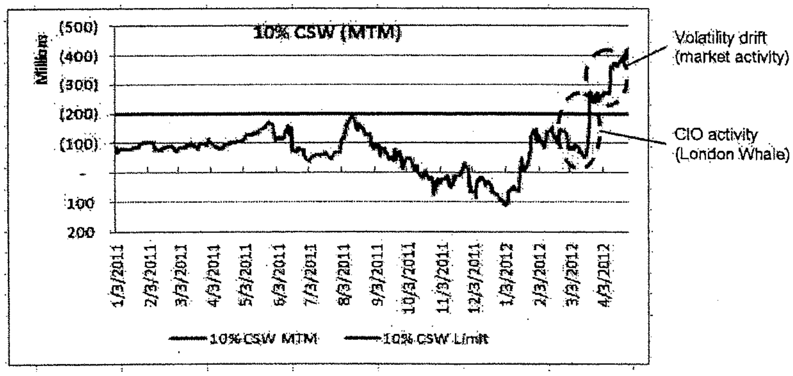
A few days later, on April 2, 2012, Mr. Venkatakrishnan announced that he had identified one source of the discrepancy between the two versions of the CSW10% model: "One source of the model difference is that the capital models operate at the level of individual names but the CIO's desk models operate at the level of indices---so the effect of name concentrations may be captured differently."[1153]

When the Subcommittee asked the OCC about the two models, Michael Sullivan, the OCC Deputy Comptroller for Risk Analysis, told the Subcommittee that the risk metric was a straightforward measure of price movements in derivatives, and there was no legitimate reason for a discrepancy in how the CSW10% metric was calculated.[1154] As with the VaR and CRM, subsequent developments showed Mr. Venkatakrishnan's model to be more accurate in measuring risk.

At the same time the accuracy of the CSW10% metric was under scrutiny, the trend in its movement was clear and should have been alarming. The graph reprinted below was developed by JPMorgan Chase and included in a May 2012 presentation to provide bank managers with background on the risk profile of the Synthetic Credit Portfolio. In the graph, losses increase as the curve moves up the y-axis.[1155]

[1152] 3/30/2012 email from C.S. Venkatakrishnan, JPMorgan Chase, to Oliver Vigneron, JPMorgan Chase, "CIO 10% CSW," OCC-SPI-00070715.
[1153] 4/2/2012 email from C.S. Venkatakrishnan, JPMorgan Chase, to John Hogan, JPMorgan Chase, and others, "CIO DAY 1," OCC-SPI-00070715.
[1154] Subcommittee interview of Michael Sullivan, OCC (11/7/2012).
[1155] 5/3/2012 email from Irvin Goldman, CIO, to Douglas Braunstein, JPMorgan Chase, and others, "CSW 10%," with attached JPMorgan Chase presentation entitled "CIO Synthetic Credit: Risk background information for upcoming meetings," slide entitled "Risk metrics and limits: CIO limits structure," JPM-CIO-PSI-H 0000546-556, at 551.

CIO Mark-to-Market CSW10% Breaches
January 2011-April 2012



Source: JPMorgan Chase presentation entitled "CIO Synthetic Credit: Risk background information for upcoming meetings," slide entitled "Risk metrics and limits: CIO limits structure," JPM-CIO-PSI-H 0000551.

The pattern of increasing risk is unmistakable beginning in January 2012, even as the CIO traders and risk managers were citing CSW10% as a more reliable risk indicator than the CS01.

(4) Overlooking Stress Loss Limit Breaches

On March 29, 2012, one week after the CSW10% limit was breached, the SCP's credit derivative positions caused a breach in the CIO's mark-to-market stress limits, the fourth type of CIO risk limit not yet exceeded.[1156] The 2013 JPMorgan Chase Task Force Report described this set of breaches as follows:

> "Stress testing is used to measure the Firm's vulnerability to losses under adverse and abnormal market environments. Its purpose is to assess the magnitude of potential losses resulting from a series of plausible events in these hypothetical abnormal markets. Stress testing is performed by applying a defined set of shocks, which vary in magnitude and by asset class, to a portfolio. For example, weekly testing stresses the Firm's positions under a number of hypothetical scenarios such as a credit crisis, an oil crisis, and an equity collapse.
>
> On March 29, CIO exceeded its aggregate stress loss limit threshold, with the 'oil crisis' stress test resulting in the

[1156] See 5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, "Information Needed," JPM-CIO-PSI-H 0000627, at 636.

'worst case scenario.' This excession and those that followed reflected the potential loss that was calculated by stressing the underlying positions. As described above, the notional value of the Synthetic Credit Portfolio grew over time during the months preceding March 29. The increase in notional value in turn resulted in a higher hypothetical stress loss when the Firm ran the Synthetic Credit Portfolio through its various stress scenarios. The stress loss excessions were reported in the first weekly stress report that followed, on April 6, 2012. CIO's mark-to-market stress limit continued to be exceeded throughout April. By then, however, the trading that precipitated the losses in the Synthetic Credit portfolio had ceased."[1157]

When the SCP exceeded its stress loss limit, the CIO should have reconfigured the SCP to end the breach; instead, the CIO allowed the breach to continue unabated for a month. With the breach of the CIO's stress limits, the SCP had caused the breach of all of the Level 1 and Level 2 risk limits used by the bank to monitor the portfolio.

Mr. Macris analogized managing the Synthetic Credit Portfolio to flying a plane. Mr. Dimon's public statements suggested that the flight alarms didn't sound until too late.[1158] But the risk metrics tell a different story. The VaR and CS01 alarms sounded in January; the CRM sounded in early March; the CSW10% sounded three weeks later, and the stress loss limits sounded a week after that. An internal bank document listing the many breaches of the CIO's risk limits is nine pages long.[1159] But no one in the CIO or JPMorgan Chase risk management function heeded the multiple warnings and took action to exit the offending positions. It wasn't an instrument failure that caused the portfolio to crash; it was the pilots' decision to disregard the instrument readings that were provided.

(5) Disregarding Stop Loss Advisories

The four risk metrics discussed above are based on projections of how a portfolio will perform under certain market conditions. In contrast, stop loss advisories are risk limits established on the basis of actual daily profit and loss reports for a portfolio. A stop loss advisory sets a limit on how much money a portfolio is actually allowed to lose

[1157] 2013 JPMorgan Chase Task Force Report, at 82-83.
[1158] See, e.g., testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg. 112-715 (June 13, 2012), http://www.cq.com/doc/congressionaltranscripts-4105471. ("CIO had its own limits around credit risk and exposure. At one point, in March, some of those limits were triggered.").
[1159] 05/04/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, "Information needed," JPM-CIO-PSI-H 0000627-636.

over a specified period of time, typically one, five, or twenty days. An advisory also sets a threshold for increased risk monitoring. If one of the advisories is breached, in theory, the portfolio exceeding the advisory should receive increased monitoring and attention from senior management. Stop loss advisories are a longstanding, easy to understand, and effective risk limit.

The CIO had one, five, and twenty-day stop loss advisories in place during the accumulation of the credit index positions in the Synthetic Credit Portfolio that produced the losses incurred by the bank. Over the course of the period under review, the one, five, and twenty-day loss advisories were set at the same level, a decision regulators would later question. In early December 2011 these stop loss advisory limits were increased from \$60 million to \$70 million.[1160]

However, like the CIO's VaR, the procedure used by the CIO to calculate the losses for purposes of complying with the stop loss advisories understated the risks; and like the CRM, CS01 and CSW10% limits, even when the stop loss advisories were breached, the CIO made no serious effort to investigate or remediate the breaches. If the CIO stop loss advisories had been properly calculated and respected, the CIO losses could have been mitigated well before they became international headlines.

Calculating the utilization and breach of stop loss advisories should be straightforward. If a portfolio loses more money than the limit allows in a given day, for example, it has breached the one-day advisory. At the CIO, from December 2011 through March 2012, the one-day stop loss advisory for its mark-to-market portfolio was established at \$70 million.[1161] Daily losses that exceeded this amount should have been treated as a breach of the stop loss limit. Calculating the five-day and twenty-day stop loss levels should have been as easy as adding up the profit and loss reports for the SCP over five and twenty days, respectively. To the surprise of their regulators, however, JPMorgan Chase calculated it differently.

After the CIO's losses became public, OCC examiners reviewing JPMorgan Chase's stop-loss calculations for the CIO portfolio noticed a discrepancy. On May 17, 2012, Jairam Kamath, an OCC examiner on the Capital Markets team, emailed Lavine Surtani, a member of JPMorgan Chase's Corporate Market Risk Reporting group, to express his confusion:

[1160] 12/01/2011 JPMorgan Chase spreadsheet "Position Limit and Loss Advisory Summary Report," OCC-SPI-00134805; 12/9/2011 JPMorgan Chase spreadsheet "Position Limit and Loss Advisory Summary Report," OCC-SPI-00134832.

[1161] "Position Limit and Loss Advisory Summary Report," OCC-SPI-00134902; "Position Limit and Loss Advisory Summary Report," OCC-SPI-00024212.

"I know this should be fairly obvious but we'd like to know how MRM [Market Risk Management] defines 1-day, 5-days, and 20-days stop loss thresholds. From looking at some of the risk reports we are not getting a good sense of how the 5-day and 20-day stop loss numbers are derived."

On May 23, Ms. Surtani replied to Mr. Kamath, explaining CIO's methodology:

"The five day loss advisory is an arithmetic sum of the last 5 1-day utilizations. Any of these underlying utilizations that have caused an excession are NOT included in the sum for the following reason: including utilizations that caused excessions would result in a double-penalty. A business would break both their 1 day and five day loss advisory. Rather, this type of loss advisory is used to capture small leaks in loss over a larger period of time .... The same logic would be implemented for the 20-day."[1162]

At the end of her explanation, Ms. Surtani included a comment minimizing the importance of stop loss advisories compared to another form of loss-limits: "while some LOBs [lines of business] continue to show the loss advisories as thresholds, Market Risk Management overall favors the Drawdown measure of P&L performance for limit purposes."[1163]

Not satisfied with the explanation, Mr. Kamath emailed it to his supervisor, Senior Bank Examiner Fred Crumlish, noting:

"This makes no sense and gives a misleading picture of the 5-day and 10-day stop losses. Perhaps if they had reported cumulative losses in the 5-day and 20-day lines, management would have been apprised of the gravity of the situation much earlier."[1164]

Mr. Kamath also observed: "Incidentally, CIO does not have drawdown limits."[1165] In other words, JPMorgan Chase admitted calculating losses for the purpose of its stop loss advisories in a way that minimized the losses and therefore the number of notifications to management. By way of justifying that decision, Ms. Surtani referred instead to a limit that did not even exist for the portfolio in question. Mr. Kamath told the

[1162] 5/23/2012 email from Lavine Surtani, JPMorgan Chase, to Jairam Kamath, OCC, and others, "Stop Loss Definitions," OCC-00003917. [emphasis in the original]
[1163] Id.
[1164] 5/23/2012 email from Jairam Kamath, OCC, to Fred Crumlish, OCC, "Stop Loss Definitions," OCC-00003917.
[1165] Id. A drawdown is the measurement of the loss from a recent peak in the value of a position.

Subcommittee that JPMorgan Chase had deliberately structured the stop loss algorithm in this way, and that it was not merely an error in arithmetic. He said that the bank's method of calculation didn't make sense to anyone at the OCC.[1166]

Despite the fact that JPMorgan Chase's aberrant stop loss calculations at times underreported the relevant losses, the CIO International mark-to-market portfolio nevertheless repeatedly breached the advisories.[1167] The five-day stop loss advisory was breached on March 26, 2012. By March 29, the five-day stop loss utilization for the portfolio exceeded $180 million, while the limit was $70 million.[1168] In addition, in June, JPMorgan Chase told the FDIC that, at the end of March: "The Mark-to-Market Stop-Loss limit was exceeded by 158% for 5 business days."[1169]

Even if the stop loss advisories had been properly calculated, it's not clear they would have curtailed the trading in the Synthetic Credit Portfolio. According to the FDIC, breaches in the stop loss advisories did not automatically trigger an active response.[1170] The OCC told the Subcommittee that the CIO's approach contrasted with that of the JPMorgan Chase Investment Bank which actively enforced its stop loss limits.[1171] Another OCC Bank examiner told the Subcommittee that the evidence indicated JPMorgan Chase was either ignoring the stop loss advisories, or simply not doing anything about the CIO breaches. He said that senior CIO traders had clearly been given leeway with respect to the stop loss advisories; in other words, the CIO was allowed to exceed them.[1172]

The stop loss advisories, like the VaR, CRM, and credit spread limits, became still more flashing red lights that were disregarded by the bank. All told, from January 1 through April 30, 2012, CIO risk limits and advisories were breached more than 330 times.[1173] A list of those breaches also shows that, in the fourth quarter of 2011, the Synthetic Credit Portfolio caused the CIO to breach its risk limits only six times; in the first quarter of 2012, the risk limit breaches totaled 170; in April, the risk limit breaches totaled 160, almost as much in one month as the three prior months combined. But even that startling increase in the

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1166 Subcommittee interview of Jairam Kamath, OCC (8/24/2012).
1167 5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, "Information Needed," JPM-CIO-PSI-H 0000627, at 636.
1168 "Position Limit and Loss Advisory Summary Report," OCC-SPI-00134902.
1169 6/2012 FDIC presentation, "JPMC & COMPANY CIO Synthetic Credit Portfolio," FDICPROD-0001783, at 33.
1170 Id. (Breach of the SCP's stop loss limit "was not escalated as this limit was only 'advisory' (e.g. not a hard limit which would require hedging or cutting of the positions).").
1171 Subcommittee interview of Elwyn Wong, OCC (8/20/2012).
1172 Id.
1173 See 5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, "Information Needed," JPM-CIO-PSI-H 0000627-636 (providing a list of CIO breaches).

number of risk limit breaches was disregarded by both the bank and its regulator.

(6) Missing Concentration Limits

Like beta-adjusted CS01, JPMorgan Chase's Investment Bank utilized other risk management tools that the CIO did not. The most important were concentration limits and the so-called "Single Name Position Risk" (SNPR, pronounced "snapper") limit to restrict total exposures to specific credit instruments and counterparties.[1174] The CIO initially lacked Single Name Position Risk limits, because prior to 2009, the CIO did not trade any single name credit default swaps. By 2011, however, the exposure was significant.[1175] Nevertheless, according to the JPMorgan Chase Task Force Report, "There were no limits by size, asset type or risk factor for the Synthetic Credit Portfolio; indeed, there were no limits of any kind specific to the Synthetic Credit Portfolio."[1176] Such concentration limits, if appropriately set, would have prevented the CIO from taking on the outsized positions in specific credit derivative indices that later generated outsized losses. JPMorgan Chase's Deputy Chief Risk Officer Ashley Bacon told the Subcommittee that if the CIO's notional positions were perfectly hedged and netted out, then the size might not be very relevant, but at the least the concentration limits would have ensured that the growing positions would have drawn scrutiny from the risk managers.[1177]

Concentration limits, if used by the CIO, would not only have reduced risk, they might also have prevented the situation in which the CIO's credit index positions became so large that they attracted market attention, began to raise questions and affect market prices, and eventually became the subject of news reports. The Wall Street Journal article that broke the story about the CIO's investment activities was headlined, "'London Whale' Rattles Debt Market," and reported: "In recent weeks, hedge funds and other investors have been puzzled by unusual movements in some credit markets, and have been buzzing about the identity of a deep-pocketed trader dubbed 'the London whale.'"[1178] The article identified the "London whale" as Bruno Iksil,

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[1174] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012). A "single name" is a credit default swap with just one reference entity.

[1175] 2013 JPMorgan Chase Task Force Report, at 103. "By late 2011 and early 2012, CIO's exposure to single names grew to the point that Mr. Weiland and Firm-wide Market Risk agreed that it made sense to include the calculation of that exposure within SNPR policy …." The SCP collapsed, however, before the SNPR policy was implemented at CIO.

[1176] Id.

[1177] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

[1178] "'London Whale' Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne (4/6/2012).

reporting that, "Mr. Iksil has done so much bullish trading that he has helped move the index, traders say."[1179]

After that and other articles were published on April 6, and in preparation for an earnings call on April 13, 2012, the bank's Operating Committee was informed about the size of the positions in the Synthetic Credit Portfolio.[1180] On April 11, 2012, the CIO's Chief Financial Officer John Wilmot emailed Mr. Dimon a presentation about the portfolio that included an analysis of the notional positions. He wrote: "Attached please find a presentation on the synthetic credit book that was reviewed this afternoon with Doug [Braunstein], Jes [Staley], Ina [Drew], Barry [Zubrow] and John [Hogan]. It covers the relevant data requests from the past several days."[1181]

The first page of the presentation was entitled, "Synthetic Credit Summary: Notional Exposure."[1182] The presentation included the following bullet points:

> "Gross external (to CIO, including IB) notional is $836bio [billion] long risk vs. $678bio short risk across all index and tranche products....
>
> CDX.IG.9 net position for CIO is $82.2bio, which is approximately 10-15 days of 100% trading volume[.]
>
> ITX.9 net position for CIO is $35bio, which is approximately 8-12 days of 100% trading volume."

JPMorgan Chase personnel acknowledged to the Subcommittee that these figures represented enormous concentrations in specific credit instruments, including an $82 billion net long position in the IG9 credit index and a $35 billion net long position in the ITX.9 credit index. In addition, John Hogan and Douglas Braunstein separately explained to the Subcommittee that, while it is theoretically possible to trade 100% of the average daily volume of an instrument in a single day, it is impractical to do so, since a single party trading that volume in a day would cause significant adverse movements in the price of the instruments.[1183] They explained that, while the IG9 and iTraxx indices were normally considered liquid instruments, in that they are easily traded, the massive volume of the CIO's positions made them relatively

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[1179] Id.

[1180] See 5/3/2012 JPMorgan Chase presentation, "CIO Synthetic Credit," JPM-CIO-PSI-H 0000547, at 550 ("Significant increase in net notional position (not indicative of risk position)".).

[1181] 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701.

[1182] Id., at 702.

[1183] Subcommittee interviews of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) and Douglas Braunstein, JPMorgan Chase (9/12/2012).

illiquid in terms of how long it would take to exit the positions. Mr. Hogan said that if concentration limits like those in use at the Investment Bank had been in use at the CIO, it would have prevented the CIO from accumulating positions of that size.[1184]

On April 13, 2012, Mr. Hogan emailed Mr. Dimon that concentration limits similar to those at the Investment Bank would be implemented at the CIO within a matter of weeks:

> "I spoke with Ashley [Bacon] this morning who is working with Achilles [Macris] to implement a similar limit/governance structure on this book to the one that we have in the IB [Investment Bank] – we will do this for all of CIO over coming weeks and I will keep you posted on that."[1185]

Concentration limits are such a well-known, fundamental risk tool, that their absence at the CIO is one more inexplicable risk failure.

D. Responding to the Risk Limit Failures

In the aftermath of the Synthetic Credit Portfolio losses, the OCC conducted an examination of the CIO's risk management practices. On November 6, 2012, the OCC sent JPMorgan Chase a Supervisory Letter outlining the shortcomings in CIO risk management that led to the losses. The OCC wrote:

> "Management oversight of CIO was inadequate. Business management was allowed to operate with little effective challenge from either the board or executive management. Risk reports did not communicate the nature of risk or the pace of change in positions, and limits were inadequate for the risks. CIO management did not understand the magnitude of the risk and dismissed outside questions about the book. Senior management permitted CIO to operate under less stringent controls than permitted analogous activities in other parts of the bank. As a result, management allowed CIO synthetic credit desk to operate in an unsafe and unsound manner.
>
> "CIO Risk Management was ineffective and irrelevant. Independent risk management lacked the requisite staffing and stature to effectively oversee the synthetic credit desk.

[1184] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
[1185] 4/13/2012 email from John Hogan, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, "CIO," JPM-CIO-PSI 0001753.

> Processes were inadequate for the nature of the risks, and the limit structure was insufficient and not effectively enforced."[1186]

In total, the OCC identified 20 Matters Requiring Attention (MRAs) which required the bank to address risk, valuation, and model failures, among other problems.[1187]

JPMorgan Chase did not dispute the November 6, 2012, OCC Supervisory Letter's findings or recommendations. Instead, in response, the bank outlined the risk management changes it had implemented or was planning to implement.[1188]

One of the steps it took to address its shortcomings was to establish a suite of new risk measures and limits for the CIO.[1189] According to the bank, the "CIO now has in place a total of 260 limits," including "67 redesigned VaR, stress and non-statistical limits," and new asset class, single name, and country concentration limits.[1190] In addition, "29 new limits specific to the Synthetic Credit Book have been implemented to create consistency with JPMC's IB [Investment Bank] approach."[1191] All of these new SCP limits focused on the risks inherent in credit derivatives. The new risk measures were designed to address six dimensions of risk: directionality (exposure to spread widening), curve (long versus short), decompression (IG versus HY), off-the-run (older versus newer credit derivative index issues), tranche risk (senior versus equity tranches), and risks caused by individual corporate defaults.[1192] While these 260 risk limits promise to provide greater information to the bank's risk managers, it is far from clear how they will solve the CIO's risk management problems; after all, when the SCP had just five risk metrics, CIO management and risk personnel generally ignored or rationalized the breaches that took place.

[1186] 11/6/2012 OCC Supervisory Letter to JPMorgan Chase, "Examination of VaR Model Risk Management," PSI-OCC-17-000015 [Sealed Exhibit].
[1187] See 8/14/2012 OCC Supervisory Letter, JPM-2012-37, PSI-OCC-17-000001 [Sealed Exhibit]; 8/31/2012 OCC Supervisory Letter, JPM-2012-40, PSI-OCC-17-000005 [Sealed Exhibit]; 11/6/2012 OCC Supervisory Letter, JPM-2012-52, PSI-OCC-17-000015 [Sealed Exhibit]; 11/6/2012 OCC Supervisory Letter, JPM-2012-53, PSI-OCC-17-000019 [Sealed Exhibit]; 11/27/2012 OCC Supervisory Letter, JPM-2012-59, PSI-OCC-17-000025 [Sealed Exhibit]; 12/12/2012 OCC Supervisory Letter, JPM-2012-66, PSI-OCC-18-000001 [Sealed Exhibit].
[1188] 12/4/2012 letter from JPMorgan Chase to OCC, "Chief Investment Office Risk Management Review," PSI-OCC-17-000029.
[1189] See 6/2012 FDIC presentation, "JPMC & COMPANY CIO Synthetic Credit Portfolio," at 34, FDICPROD-0001783. 5/18/2011 Risk Policy memo, "Market Risk Limits, Firm-wide," JPMC-Senate/Levin 000157.
[1190] 2013 JPMorgan Chase Task Force Report, at 115.
[1191] See 6/2012 FDIC presentation, "JPMC & COMPANY CIO Synthetic Credit Portfolio," at 34, FDICPROD-0001783.
[1192] Id., at 26.

To ensure more attention is paid to the breaches that occur, the bank reported that it has also "strengthened its processes across all businesses to deal with limit excessions." It explained that significant excessions would be escalated further and faster than before. For example, any excessions of greater than 30% or lasting three days or longer would have to be escalated to the line of business CEO, CRO, and Market Risk Head, "as well as to the Firm's CEO, CRO, co-COO and Deputy CRO/Head of Firm-wide Market Risk, and to the Firm-wide Risk Committee."[1193] In addition, the bank explained that the CIO Risk Committee had been reconstituted as a CIO, Treasury and Corporate Risk Committee, requiring weekly meetings of senior risk and corporate management.[1194] Escalating breaches to senior management and broadening the CIO Risk Committee are of questionable utility, however, since the SCP breaches were already escalated to Mr. Dimon and other senior bank and CIO management, but did not result in anyone investigating or curbing the SCP's risky holdings until the whale trades attracted media attention. If limits are to be meaningful, then a better approach would have been to require those alerted to a risk limit breach to investigate the cause, and to require the position causing the breach to be reduced or unwound to ensure the breach is ended within a few days, without raising the relevant risk limit.

A third set of risk management reforms reported by the bank focused on strengthening its "model risk policy," including by "minimize[ing] model differences for like products," cataloguing its models in a central database, and emphasizing "model implementation testing and comparisons to benchmark models."[1195] In addition, the bank reported that it had revamped the CIO's risk managers and risk committee, and established four new firmwide risk committees focusing on risk policy and analytics, business activities, risk controls and audits, and risk management.[1196] While each of these steps is important, the bank did not mention taking any steps to reduce the number of and variations in its risk models or to prohibit bank personnel from gaming its risk metrics and models to produce artificially lower risk profiles, RWAs, and capital requirements.

E. Analysis

Despite JPMorgan Chase's reputation for strong risk management, little attention was paid by bank personnel – including Mr. Dimon – to the many breaches and risk warning signals that should have led to an early review of the CIO's risky trades. This lack of attention was due, in part, to the fact that Ina Drew exercised nearly unfettered discretion as a

[1193] 2013 JPMorgan Chase Task Force Report, at 115.
[1194] Id., at 116.
[1195] Id., at 113.
[1196] Id., at 116, 118-119.

manager. She also granted broad discretion to her risk management personnel and traders. When risk limits are breached, bank management should react, not by dismissing the breach or questioning the risk metrics, but by requiring independent risk experts to investigate the risky activity, even when trusted managers are involved. Risk managers should verify the causes of the risk limit breaches. This trust-but-verify approach is essential to ensure breaches are investigated and corrective action taken. Regulatory oversight into the frequency and nature of risk breaches and how they are resolved, as examined in the next chapter, is also critical.

Another problem involves modern reliance by both banks and regulators on mathematical metrics and models to measure risk, especially with respect to synthetic derivatives, which are inherently hard to value, have no underlying assets to stem losses, offer unreliable past performance data, and often undergo split-second trading and price changes. Risk metrics and models with complex variations can proliferate at a financial institution with the size and variety of JPMorgan Chase, and the pressure on analysts to reconfigure those metrics and models to produce lower risk results is difficult to counteract. OCC regulations already contain numerous safeguards against manipulation, requiring risk models to be developed by independent experts, tested to see if they detect specific risk problems, and backtested for accuracy. Proliferation of models and metrics, however, make meaningful oversight and enforcement difficult. New models that produce dramatically lower risk profiles of derivatives trading activity compared to prior models should be viewed with extreme skepticism by regulators who should require proof that the lower risk profiles are accurate. Regulators should also respond to evidence of risk model manipulation with severe consequences.

In addition to risk models, banks should continue to employ such fundamental risk controls as stop loss limits and concentration limits to curb risky trading. Such controls, when breached, should be treated as requiring immediate corrective action, rather than casual conversation or study. Regulators should ensure those risk controls are established, used, and heeded.

VI. AVOIDING AND CONDUCTING OCC OVERSIGHT

Prior to media reports of the whale trades in April 2012, JPMorgan Chase provided almost no information about the CIO's Synthetic Credit Portfolio to its primary regulator, the Office of the Comptroller of the Currency (OCC), despite the SCP's supposedly important role in offsetting the bank's credit risks, its rapid growth in 2011 and 2012, and its increasingly risky credit derivatives. While the OCC, in hindsight, has identified occasional references to a "core credit portfolio" in bank materials, the OCC told the Subcommittee that the earliest explicit mention of the SCP did not appear until January 27, 2012, in a routine VaR report. By then, the SCP had already lost nearly $100 million. The lack of prior bank disclosures essentially precluded effective OCC oversight of the portfolio's high risk excesses and unsafe and unsound practices.

Because the OCC was unaware of the risks associated with the SCP, it conducted no reviews of the portfolio prior to 2012. Both the OCC and JPMorgan Chase bear fault for the OCC's lack of knowledge – at different points, the bank was not forthcoming and even provided incorrect information, and at other points the OCC failed to notice and follow up on red flags signaling increasing CIO risk in the reports it did receive from the bank. During 2011, for example, the notional size of the SCP grew tenfold from about $4 billion to $51 billion, but the bank never informed the OCC of the increase. At the same time, the bank did file risk reports with the OCC disclosing that the SCP repeatedly breached the CIO's stress limits in the first half of 2011, triggering them eight times, on occasion for weeks at a time, but the OCC failed to follow up with the bank. Later in 2011, the CIO engaged in a $1 billion high risk, high stakes credit derivatives bet that resulted in a payout of roughly $400 million to the CIO. The OCC learned of the $400 million gain, but did not inquire into the reason for it or the trading activity behind it, and so did not learn of the extent of credit derivatives trading going on at the CIO.

In January 2012, in its first quarterly meeting with the OCC after disclosing the existence of the SCP, the CIO downplayed the portfolio's importance by misinforming the OCC that it planned to reduce the SCP. Instead, over the course of the quarter, the CIO tripled the notional size of the SCP from $51 billion to $157 billion, buying a high risk mix of short and long credit derivatives with varying reference entities and maturities. The increase in the SCP's size and risk triggered a breach of the CIO's and bankwide VaR limits, which the bank disclosed to the OCC in routine risk reports at the time, but which did not trigger an inquiry by the agency. Also in January, the bank sent routine risk management notices which informed the OCC of the bank's implementation of a new VaR model for the CIO that would dramatically lower the SCP's risk profile, but the OCC did not inquire into the reasons for the model change, its impact on risk, or how the CIO was able to reduce its risk results overnight by 50%.

In February and March, the bank began to omit key CIO performance data from its standard reports to the OCC, while simultaneously failing to provide timely copies of a new CIO management report. The OCC failed to notice the missing reports or request the new CIO management report until after the April 6 press articles exposed the CIO's risky trades. By minimizing the CIO data it provided to the OCC about the CIO and SCP, the bank left the OCC misinformed about the SCP's risky holdings and growing losses.

Beginning in January and continuing through April 2012, the SCP's high risk acquisitions triggered multiple breaches of CIO risk limits, including its VaR, credit spread, stress loss, and stop loss limits. Those breaches were disclosed on an ongoing, timely basis in standard risk reports provided by the bank to the OCC, yet produced no reaction at the time from the agency. The Subcommittee found no evidence that the OCC reviewed the risk reports when received, analyzed the breach data, or asked any questions about the trading activity causing the breaches to occur.

On April 6, 2012, when media reports unmasked the role of JPMorgan Chase in the whale trades, the OCC told the Subcommittee that it was surprised to read about them and immediately directed inquiries to the bank to obtain more information. The OCC told the Subcommittee that it initially received such limited data about the trades and such blanket reassurances from the bank about them that, by the end of April, the OCC considered the matter closed.

It was not until May 2012, a few days before the bank was forced to disclose $2 billion in SCP losses in its public SEC filings, that the OCC learned of the problems besetting the portfolio. On May 12, OCC staff told staff for a member of the Senate Banking Committee that the whale trades would have been allowed under the draft Volcker Rule, an assessment that, a few days later, the OCC disavowed as "premature." At the instruction of the OCC's new Comptroller, Thomas Curry, the OCC initiated an intensive inquiry into the CIO's derivatives trading activity. Even then, the OCC told the Subcommittee that obtaining information from JPMorgan Chase was difficult, as the bank resisted and delayed responding to OCC information requests and sometimes even provided incorrect information. For example, when the OCC inquired into whether the CIO had mismarked the SCP book, the bank's Chief Risk Officer initially denied it and the bank delayed informing the OCC of later evidence indicating that CIO personnel had acted in bad faith and deliberately understated the SCP losses.

On January 14, 2013, the OCC issued a Cease and Desist order against the bank, on top of six Supervisory Letters it had issued in 2012, detailing 20 "Matters Requiring Attention" that required corrective action by the bank. In addition, the OCC conducted a review of its own missteps and regulatory "lessons learned," described in an internal report completed in October 2012. Among multiple failures, the OCC internal report concluded that the OCC had failed to monitor and investigate multiple risk limit breaches by the CIO and improperly allowed JPMorgan Chase to submit aggregated portfolio performance data that obscured the CIO's involvement with derivatives trading.

The JPMorgan Chase whale trades demonstrate how much more difficult effective regulatory oversight is when a bank fails to provide routine, transparent performance data about the operation of a large derivatives portfolio, its related trades, and its daily booked values. JPMorgan Chase's ability to dodge effective OCC oversight of the multi-billion-dollar Synthetic Credit Portfolio until massive trades, mounting losses, and media reports exposed its activities, demonstrates that bank regulators need to conduct more aggressive oversight with their existing tools and develop more effective tools to detect and stop unsafe and unsound derivatives trading. In addition, the bank's lack of transparency and resistance to OCC information requests indicates that the OCC has failed to establish an effective regulatory relationship with the bank and must take new measures to recalibrate that relationship and ensure good faith cooperation by the bank with OCC oversight. The OCC has begun that effort by issuing the Cease and Desist order, multiple Supervisory Letters requiring corrective action, and a downgrade of the bank's management rating, but more may be needed.

A. Overview of OCC's Oversight Role

Because JPMorgan Chase Bank, N.A. holds a national charter, its primary Federal regulator is the OCC which oversees all nationally chartered banks in the United States.[1197] The OCC does not supervise the bank's holding company, JPMorgan Chase & Co., which is overseen primarily by the Federal Reserve. Nor does the OCC supervise the holding company's non-bank affiliates like J.P Morgan Broker-Dealer Holdings, J.P. Morgan Ventures Energy Corp, or Bear Stearns Companies, LLC, which are overseen primarily by the SEC. Since the Chief Investment Office (CIO) sits within the national bank, however, the OCC is the regulator with primary responsibility for supervising the CIO's activities.[1198]

[1197] See "About the OCC," OCC website, http://www.occ.gov/about/what-we-do/mission/index-about.html.

[1198] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012); see also Subcommittee interview of Julie Williams, OCC (9/13/2012).

Within the OCC, the Large Bank Supervision division, which typically regulates banks with assets of $50 billion or more, provides supervisory personnel to oversee JPMorgan Chase.[1199] The OCC has assigned approximately 65 OCC examiners and related personnel to JPMorgan Chase; all are physically located at the bank.[1200] The OCC supervisory team conducts both ongoing supervision, such as monitoring routine reports to the bank's board, management, and audit function, as well as regular reviews of the bank's business performance, risk trends, and regulatory compliance. Also, the OCC conducts a continuous examination program at the bank, which consists of approximately 60 examinations each year targeting specific areas of operation at the bank, with each lasting approximately three to six weeks.[1201]

At the end of each examination, the OCC issues a Supervisory Letter to the bank's senior management to communicate examination findings, and if appropriate, requirements or recommendations for improvements. If a Supervisory Letter identifies an apparent violation of law or a "Matter Requiring Attention" (MRA), the OCC requires the bank to promptly respond and remedy the problem. If the Supervisory Letter includes a "recommendation," the OCC encourages, but does not require, corrective action by the bank. In addition to Supervisory Letters, the OCC issues an annual Report on Examination summarizing its examinations over the prior year, provides a copy to the bank's board of directors, and meets with the board members on at least an annual basis to discuss specific concerns.

The OCC's examination effort at each national bank is headed by an Examiner-in-Charge, and includes on-site examination staff, risk analysis division staff, and economic experts.[1202] During the period in question, the OCC Examiner-in-Charge at JPMorgan Chase was Scott Waterhouse. The most senior member of the capital markets examination team, which had responsibility for overseeing derivatives and other trading activities by the CIO as well as the Investment Bank, was Fred Crumlish, Capital Markets National Bank Examiner.[1203] Mr. Crumlish had ten staff on the capital markets team, some of whom were assigned specific responsibilities regarding CIO activity, but the team spent most of its time on Investment Bank supervision since it held more

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[1199] Subcommittee briefing by OCC (7/30/2012).

[1200] See 7/30/2012 OCC Large Bank Supervision presentation to Subcommittee re Chief Investment Office Discussion, at PSI-OCC-06-0000009; testimony of Thomas J. Curry, Comptroller of the Currency, "Implementing Wall Street Reform: Enhancing Bank Supervision and Reducing Systemic Risk," before the Senate Committee on Banking, Housing, and Urban Affairs, S.Hrg. 112-714 (June 6, 2012), at 26.

[1201] See 7/30/2012 OCC Large Bank Supervision presentation to Subcommittee re Chief Investment Office Discussion, PSI-OCC-06-0000011.

[1202] Testimony of Thomas J. Curry, Comptroller of the Currency, "Implementing Wall Street Reform: Enhancing Bank Supervision and Reducing Systemic Risk," before the Senate Committee on Banking, Housing, and Urban Affairs, S.Hrg 112-714 (June 6, 2012), at 17-18.

[1203] See 2012 OCC Organizational Chart, JPMC Resident Staff, OCC-00004227.

assets than the CIO.[1204] The OCC also has a London office staffed in part by examiners with derivatives expertise, but did not task any of its London staff to conduct examinations of the CIO's London operations.[1205]

The OCC's senior leadership team also played a role in overseeing JPMorgan Chase. Mike Brosnan, then Senior Deputy Comptroller in charge of OCC Large Bank Supervision, and Julie Williams, then OCC Chief Counsel, were informed of key developments and helped advise OCC senior leadership regarding the Chief Investment Office and its Synthetic Credit Portfolio. During the first few years of the Synthetic Credit Portfolio's existence, the OCC was headed by John C. Dugan. When he left office in 2010, he was replaced on an acting basis by John Walsh.[1206] On April 9, 2012, the Senate confirmed a new Comptroller of the Currency, Thomas Curry.[1207] News of JPMorgan Chase's whale trades broke three days before he took office.[1208] Mr. Curry later formed a two-pronged review: one led by the bank's supervision team to evaluate the bank's conduct, and the other an internal review effort headed by an OCC risk expert to evaluate the agency's own actions.[1209] That second review issued an internal report in late October 2012, with recommendations for improving the OCC's supervisory efforts.[1210]

The OCC's primary examination role is to ensure that banks operate in a safe and sound manner,[1211] including by assessing and monitoring the risks that a bank poses to the FDIC's Deposit Insurance Fund. The OCC told the Subcommittee that, while the CIO's $6 billion losses were significant, the OCC's overriding concern at JPMorgan Chase was that the bank was conducting very risky activity – derivatives trading financed with billions of dollars of bank deposits – in an unsafe and unsound manner. The OCC told the Subcommittee that it had concluded, in particular, that the so-called "whale trades" had been

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[1204] Subcommittee interview of James Hohl, OCC (9/6/2012). James Hohl and Jaymin Berg were two of the OCC examiners assigned responsibility for overseeing CIO capital markets activity during the period reviewed by the Subcommittee.
[1205] See 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000045-046 [Sealed Exhibit].
[1206] See John G. Walsh, Office of the Comptroller of the Currency, http://www.occ.gov/about/who-we-are/comptroller-of-the-currency/bio-john-walsh.html.
[1207] See Thomas J. Curry, Office of the Comptroller of the Currency, http://occ.gov/about/who-we-are/comptroller-of-the-currency/bio-thomas-curry.html.
[1208] See, e.g., "JPMorgan Trader's Positions Said to Distort Credit Indexes," Bloomberg, Stephanie Ruhle, Bradley Keoun, and Mary Childs (4/6/2012), http://www.bloomberg.com/news/2012-04-05/jpmorgan-trader-iksil-s-heft-is-said-to-distort-credit-indexes.html.
[1209] Testimony of Thomas J. Curry, Comptroller of the Currency, "Implementing Wall Street Reform: Enhancing Bank Supervision and Reducing Systemic Risk," before the Senate Committee on Banking, Housing, and Urban Affairs, S.Hrg. 112-714 (June 6, 2012), at 29-31; Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
[1210] 10/26/2012 Confidential Supervisory Report, PSI-OCC-13-000014 [Sealed Exhibit].
[1211] See "About the OCC," OCC website, http://www.occ.gov/about/what-we-do/mission/index-about.html.

conducted in an unsafe and unsound manner.[1212] More broadly, the OCC told the Subcommittee that the OCC's internal review had concluded that internal control groups – both in the CIO risk management function as well as in bankwide valuation, risk, and audit functions – were ineffective; that the bank's executive management "undercut" the effectiveness of the CIO's risk limits; that the CIO VaR model change was not implemented with proper review; and that the bank used unapproved internal capital models.[1213]

The OCC also initiated a review to determine whether similarly risky activities were being conducted in the asset management functions at other banks, but found "no activity similar to the scale or complexity" of the credit derivatives trading that took place at JPMorgan Chase.[1214]

B. Pre-2012: Avoiding OCC Oversight As the SCP Develops

Prior to 2012, the OCC had very little understanding of the strategies, size, or risk profile of the CIO's Synthetic Credit Portfolio (SCP). The OCC's lack of understanding was due primarily to a lack of disclosure by the bank about the SCP when it was established, when it delivered unexpected revenues, or when it began to increase in size and risk in 2011. The OCC told the Subcommittee that, in 2010, as part of an examination of the SCP's investment portfolios, the examination staff had a vague understanding that a CIO portfolio had been established to provide stress loss protection for the bank and earn some profit,[1215] as the CIO had done in the financial crisis, but did not know the portfolio's name, the extent of its derivatives trading, or its risk profile. While the OCC, in hindsight, identified occasional references to a "core credit portfolio" in bank materials, it determined that the earliest explicit mention of the SCP as a CIO portfolio was when it was mentioned in a routine bankwide Value-at-Risk (VaR) report on January 27, 2012.[1216]

[1212] Subcommittee interviews of Scott Waterhouse, OCC (9/17/2012), Fred Crumlish, OCC (8/28/2012) (describing a fundamental breakdown in basic OCC safety and soundness requirements, including inadequate risk management, auditing, reporting, and oversight by senior management), and Michael Kirk, OCC (8/22/2012). See also OCC Supervisory Letters issued to JPMorgan Chase, described below.

[1213] 10/26/2012 Confidential Supervisory Report, OCC at PSI-OCC-13-000014 [Sealed Exhibit].

[1214] Testimony of Thomas J. Curry, Comptroller of the Currency, "Implementing Wall Street Reform: Enhancing Bank Supervision and Reducing Systemic Risk," before the Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg 112-714, (June 6, 2012), at 27 ("Beyond JPMC, we have directed OCC examiners to evaluate the risk management strategies and practices in place at other large banks, and examiners have reported that there is no activity similar to the scale or complexity of JPMC. However, this is a continuing focus of our supervision.").

[1215] See 12/31/2010 OCC Report of Examination, OCC-SPI-00036145, at 163 [Sealed Exhibit] ("As part of its business mandate, the CIO is allowed to take discretionary positions within approved limits to manage economic returns. Appropriate limits are used to measure and control the risks in MTM positions.").

[1216] 10/26/2012 Confidential Supervisory Report, OCC at PSI-OCC-13-000025 [Sealed Exhibit].

That report identified the SCP for the first time as a distinct portfolio accounting for over 90% of the CIO's VaR.[1217] The lack of bank disclosures essentially made it more difficult for OCC to effectively oversee this high risk portfolio in its early years.

(1) 2006-2009: Minimizing OCC Oversight As SCP Expands

In 2006, JPMorgan Chase approved a request by the CIO to create a new credit derivatives trading portfolio as part of an internal "New Business Initiative Approval" (NBIA).[1218] Typically, the bank does not share NBIAs with the OCC, and the OCC told the Subcommittee that it was unaware of whether it received a copy of the 2006 NBIA that gave rise to the CIO's Synthetic Credit Portfolio.[1219] The OCC also told the Subcommittee that, even if it had known at the time, it would have had no role in approving and could not have prohibited establishment of the new Synthetic Credit Portfolio as proposed in 2006,[1220] although it could have monitored its activities and development. The OCC told the Subcommittee that it did not know exactly when, after receiving approval, the CIO actually began to buy and sell credit derivatives. The OCC did determine that it was in 2008, that the CIO portfolio was given its current name, the Synthetic Credit Portfolio.[1221] The OCC also determined that the 2006 NBIA was not updated then or later, even as the SCP significantly expanded its credit derivatives trading activity.[1222]

The OCC told the Subcommittee that one reason it had only a rudimentary understanding of the SCP was because the CIO made numerous name and organizational changes to its investment portfolios over the years, making them difficult to track.[1223] In addition, the SCP was not named in any portfolio lists that the CIO provided to the OCC from 2007 through 2012, although the CIO occasionally referred to a "core credit portfolio,"[1224] which was one part of the SCP.[1225]

[1217] Id.; Subcommittee interview of Doug McLaughlin and Michael Sullivan, OCC (8/30/2012) (Mr. McLaughlin).

[1218] See 7/17/2006 New Business Initiative Approval Chief Investment Office, JPM-CIO-PSI-H 0001142; see also Chief Investment Office New Business Initiative Approval Executive Summary, JPM-CIO-PSI-H 0001354.

[1219] Subcommittee briefing by the OCC (11/29/2012) (Fred Crumlish). See also, e.g., 5/16/2012 email from Fred Crumlish, OCC, to Elwyn Wong, OCC, "here is redline and new final," OCC-00003507 at 508 (describing the OCC's general awareness of a "macro-hedge against the credit risk of the bank's balance sheet using credit default swaps" starting in 2007 and 2008).

[1220] Subcommittee briefing by the OCC (11/29/2012) (Scott Waterhouse).

[1221] See Subcommittee interview of Doug McLaughlin and Mike Sullivan, OCC (8/30/2012).

[1222] Id.

[1223] Subcommittee interview of Fred Crumlish, OCC (8/28/2012). In addition, JPMorgan Chase has acknowledged to the Subcommittee that, despite years of operation, the CIO has never detailed the purpose or workings of the SCP in any document nor issued any specific policy or mandate for it. Levin Office briefing by JPMorgan Chase (Greg Baer) (8/15/2012).

[1224] Subcommittee briefing by JPMorgan Chase (8/15/2012).

The bank and the OCC told the Subcommittee that, instead of focusing on the SCP, the CIO typically discussed its Tactical Asset Allocation (TAA) mark-to-market portfolio, a broader investment portfolio which included the SCP.[1226] Consistent with that explanation, several internal CIO documents indicate that when CIO head Ina Drew discussed the CIO's investment portfolios with the JPMorgan Chase Board of Director's Risk Policy Committee, she talked about the larger TAA portfolio, and did not mention the SCP.[1227] In addition, the CIO and OCC told the Subcommittee that a few years earlier, the TAA portfolio had been called the "Discretionary Trading" portfolio.[1228] Moreover, the CIO told the Subcommittee that in January 2012, it merged the TAA with another portfolio of mark-to-market assets called the Strategic Asset Allocation portfolio, and called the product of that merger the "MTM Overlay" portfolio.[1229] Ms. Drew said the frequent name changes and portfolio reconfigurations were made for business reasons and not to evade regulatory oversight.[1230]

JPMorgan Chase also produced to the Subcommittee a sample of emails dating from 2009 to 2012, reporting routine risk information, copies of which were sent to the OCC. One set of emails summarizing the bank's daily VaR results contained references to the "EMEA Credit Tranche" and "CIO International credit tranche book."[1231] A second set of emails summarizing the bank's weekly stress results contained one July 2011 email referencing the "synthetic tranche book"[1232] and one November 2011 email referencing the "synthetics credit portfolio."[1233] These varying descriptions of the Synthetic Credit Portfolio provided multiple hints but, again, no straightforward, comprehensive disclosure of the SCP to the OCC.

[1225] One key OCC examiner for the CIO in early 2012 was not even familiar with the term, "core credit portfolio." Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
[1226] Id.
[1227] See, e.g., 12/2010 Presentation to the Directors Risk Policy Committee, prepared by Ina Drew, CIO, OCC-SPI-00135422, at 2 (describing the "Tactical Investing & Risk Management" portfolio as one type of portfolio with a short term "investment horizon"). The presentation also explained that "Tactical Positioning" referred to the CIO positioning its investments "tactically to complement the core investment portfolio. One example is a synthetic (or derivative) credit position established in 2008 to protect the Firm from the anticipated impact of a deteriorating credit environment." Id., at 6.
[1228] See Subcommittee interviews of Jaymin Berg, OCC (8/31/2012) and Ina Drew, CIO (9/7/2012); but see 1/2011 Executive Management Report, OCC-SPI-00000250 (still reporting the TAA portfolio as "Discretionary" even after the name had changed.).
[1229] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[1230] Id.
[1231] JPMorgan Chase sample of emails provided to bank regulators, entitled "Firmwide Risk Daily," emails dated 2009-2012, JPM-CIO-PSI-H-BEP 0006817-895.
[1232] 7/16/2011 email from "JPMorgan Chase Market Risk Management – Reporting" to numerous JPMorgan Chase managers and colleagues and a "Regulatory Coordinator," "Firm's Stress Results – COB: July 7th, 2011," JPM-CIO-PSI-H-BEP 0006896-897.
[1233] 11/18/11 email from "JPMorgan Chase Market Risk Management – Reporting" to numerous JPMorgan Chase managers and colleagues and a "Regulatory Coordinator," "Firm's Stress Results – COB: November 10th, 2011," JPM-CIO-PSI-H-BEP 0006898-899.

According to the OCC, it was very unusual for a bank to do what JPMorgan Chase did with the SCP – use its excess deposits to engage in short term credit derivatives trading – an approach no other major U.S. bank employs.[1234] JPMorgan Chase claimed that the SCP represented a "successful" way to hedge the bank's credit risks.[1235] The bank was unable to explain, however, why it had failed for years to notify its primary regulator of that new and effective hedge, generate documents laying out the SCP's hedging objectives and strategies, or accumulate hedging related performance data.[1236] The bottom line is that the bank did not disclose and the OCC did not learn of the extent and associated risks of the CIO's growing Synthetic Credit Portfolio until media reports on April 6, 2012 described the book's outsized credit derivative holdings.[1237]

(2) 2010: Resisting OCC Examination Results

In 2010, as part of its routine examination process, the OCC conducted a detailed review of the CIO's investment activities, focusing in particular on the $350 billion Available for Sale portfolio, and warned that the CIO needed to do a better job documenting portfolio decisions and managing the risks associated not only with that investment portfolio but with several others as well.

On December 8, 2010, after concluding its examination of the CIO's investment activities, the OCC sent a Supervisory Letter to CIO head Ina Drew with its findings, requirements, and recommendations.[1238] The Supervisory Letter included a Matter Requiring Attention (MRA) – meaning a matter that required corrective action by the bank – stating that CIO management needed to "document investment policies and portfolio decisions."[1239] The Supervisory Letter also found that the "risk management framework for the investment portfolios (Strategic Asset Allocation and Tactical Asset Allocation)" lacked "a documented methodology," "clear records of decisions," and other features to ensure that the CIO was making investments and controlling associated risks in line with the expectations of senior management and the appropriate

[1234] Subcommittee interview of Fred Crumlish OCC (8/28/2012); testimony of Thomas J. Curry, Comptroller of the Currency, "Implementing Wall Street Reform: Enhancing Bank Supervision and Reducing Systemic Risk," before the Senate Committee on Banking, Housing, and Urban Affairs, S. Hrg 112-714, (June 6, 2012), at 27.
[1235] 2/13/2012 letter from Barry Zubrow, JPMorgan Chase, to Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and Office of the Comptroller of the Currency, "Comment Letter on the Notice of Proposed Rulemaking Implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," at 56-57, http://www.sec.gov/comments/s7-41-11/s74111-267.pdf.
[1236] For more information on the bank's description of the SCP as a hedge, see Chapter III.
[1237] Subcommittee interview of Doug McLaughlin and Michael Sullivan, OCC (8/30/2012).
[1238] See 12/8/2010 Supervisory Letter JPM-2010-80, OCC-SPI-00011201 [Sealed Exhibit].
[1239] Id.

Board of Directors committee.[1240] The Supervisory Letter made no explicit mention of the Synthetic Credit Portfolio, but because the SCP was part of the TAA portfolio, which was mentioned in the MRA, the MRA also applied to the SCP.[1241]

Prior to the OCC's issuance of a Supervisory Letter, it is standard practice for the OCC to hold a close-out meeting with the bank to discuss the examination findings, requirements, and recommendations, and receive bank management's response. The OCC's head capital markets examiner at JPMorgan Chase held that meeting with CIO head Ina Drew, whom he said did not react well to the examination's criticisms. According to a later email by his supervisor, the OCC Examiner-In-Charge, Ms. Drew "'sternly' discussed [the OCC's] conclusions with him for 45 minutes."[1242] The OCC told the Subcommittee that, among other objections, she complained that the regulator was trying to "destroy" JPMorgan Chase's business, and that its requirements would take away necessary flexibility from the CIO.[1243] Moreover, according to the Examiner-In-Charge's email, Ms. Drew informed the OCC "that investment decisions are made with the full understanding of executive management including Jamie Dimon. She said that everyone knows what is going on and there is little need for more limits, controls, or reports."[1244]

The OCC's head capital markets examiner told the Subcommittee that he was "surprised" at the time by her reaction, because that level of "pushback" for an MRA regarding "basic banking" expectations was "extreme."[1245] The OCC Examiner-In-Charge characterized Ms. Drew's response as an attempt to invoke Mr. Dimon's authority and reputation in order to try to avoid implementing formal documentation requirements.[1246] When asked about the meeting, Ms. Drew told the Subcommittee that her recollection was, while she disagreed with the OCC's recommendations, it was a good "two way" discussion.[1247]

The CIO's formal response to the OCC's 2010 Supervisory Letter, signed by Ms. Drew in January 2011, committed to documenting investment and risk decisions for the SAA portfolio, but never

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[1240] Id.

[1241] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

[1242] 5/11/2012 email from Scott Waterhouse, OCC, to Mike Brosnan, OCC, and Sally Belshaw, OCC, "J.P. Morgan Chase," OCC-00001746. The OCC Capital Markets head examiner Fred Crumlish told the Subcommittee that the Waterhouse email provided an accurate description of his telephone call with Ms. Drew. Subcommittee interview of Fred Crumlish, OCC (8/28/2012).

[1243] Subcommittee interview of Fred Crumlish, OCC (8/28/2012).

[1244] 5/11/2012 email from Scott Waterhouse, OCC, to Mike Brosnan, OCC, and Sally Belshaw, OCC, "J.P. Morgan Chase," OCC-00001746; confirmed as an accurate description of the telephone call with Ms. Drew. See Subcommittee interviews of Fred Crumlish, OCC (8/28/2012) and James Hohl, OCC (9/6/2012).

[1245] Subcommittee interview of Fred Crumlish, OCC (8/28/2012).

[1246] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

[1247] Subcommittee interview of Ina Drew, CIO (9/7/2012).

mentioned the TAA portfolio in which the SCP was then located.[1248] Ms. Drew told the Subcommittee that the failure to mention the TAA portion of the MRA was not intentional; the SAA was simply a bigger portfolio.[1249] The OCC told the Subcommittee that it should have noticed at the time that the CIO's response was limited to the SAA portfolio,[1250] but said it did not, characterizing its failure to notice as an "oversight" by the OCC.[1251]

According to the OCC, it usually performs a check one year after an MRA is issued to evaluate whether the bank has taken the required corrective action. In this case, however, the OCC told the Subcommittee that it did not provide a timeframe for completion of the corrective action and did not check on the status of actions taken by the CIO to document its investment and risk decisions.[1252] The OCC told the Subcommittee that the MRA should have been reviewed by December 2011, but because of competing priorities, it had delayed conducting that review until the fall of 2012. The OCC also told the Subcommittee that it must officially "clear" any given MRA on its internal tracking system, and does not do so unless examiners confirm that the matter has been resolved.[1253] Ms. Drew, however, told Subcommittee staff that she believed the MRA had been closed out,[1254] though, in fact, it had not and the OCC had not told the bank it was closed. The OCC indicated that, while it had not cleared the CIO's 2010 MRA and would have examined the status of the MRA as part of a CIO examination in the fall of 2012, an examination that was overcome by events, it still viewed its mishandling of the 2010 MRA as a "fail from OCC."[1255]

When asked if the CIO's aggressive reaction to the 2010 examination of the CIO was unique, the OCC indicated that it was not. In fact, the OCC Examiner-In-Charge at JPMorgan Chase told the Subcommittee that it was "very common" for the bank to push back on examiner findings and recommendations.[1256] He recalled one instance in which bank executives even yelled at OCC examiners and called them "stupid."[1257] In another example, in early 2012, according to the OCC, the most junior capital markets OCC examiner arrived at a meeting at the bank to discuss with his bank counterpart the results of a recent OCC

[1248] 1/7/2011 letter from Ina Drew, CIO, to Scott Waterhouse, OCC, OCC-SPI-00011198 at 199.
[1249] Subcommittee interview of Ina Drew, CIO (9/7/2012). Other bank officials describing the difference between the two portfolios characterized the SAA as a high credit quality, liquid portfolio for investing excess corporate deposits, while the TAA was an "idea" book for "testing" new strategies. Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer, Chetan Bhargiri).
[1250] Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).
[1251] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1252] Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).
[1253] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1254] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[1255] Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).
[1256] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1257] Id.

stress examination.[1258] But instead of meeting with a single risk manager, he was, in his words, "ambushed" by all the heads of risk divisions from all the lines of business at the bank, including JPMorgan Chase's Chief Risk Officer, John Hogan.[1259] Given the senior rank of the bank officials, the junior OCC examiner normally would not have led the meeting, but the bank officials pressed him to disclose the OCC's preliminary conclusions. According to the OCC examiner, on every issue, the bank's risk personnel criticized the OCC's findings and recommendations,[1260] and the meeting assumed a loud and "combative" tone.[1261] The OCC examiner recalled that Peter Weiland, the CIO's Chief Market Risk Officer, agreed with the OCC's suggestion on one point, which had the effect of quieting the executives in the room, but said it was the only issue on which anyone from the bank supported an OCC recommendation from that examination.[1262] After the meeting ended, he said that, despite the bank's aggressive response, the OCC issued its Supervisory Letter largely in line with the original conclusions the examiner had presented.[1263]

Still another instance involved profit and loss reports. The OCC said that, in August 2011, the daily Investment Bank P&L report stopped arriving in OCC electronic inboxes. The OCC explained that when it brought up what it thought was simply a glitch in JPMorgan Chase's email delivery, the bank responded that the bank would no longer be providing the Investment Bank's daily P&L reports, because it was too much information to provide to the OCC.[1264] The OCC said that the bank explained further that it had experienced a series of unauthorized data disclosures and the bank, not knowing who was leaking the data, sought to limit the information it provided to the OCC, even though OCC had not been responsible for the leaks.[1265] According to the OCC, when it requested resumption of the daily Investment Bank P&L reports, Douglas Braunstein, JPMorgan Chase's Chief Financial Officer, agreed to the request, but had apparently not informed Mr. Dimon. At a meeting shortly thereafter, attended by Mr. Braunstein, Mr. Dimon, and OCC Examiner-in-Charge Scott Waterhouse, according to Mr. Waterhouse, when Mr. Braunstein stated that he had ordered resumption of the reports, Mr. Dimon reportedly raised his voice in anger at Mr.

[1258] Subcommittee interview of Jaymin Berg, OCC (8/31/2012). The examination was regarding the Firm Wide Stress Initiative, which concluded with an OCC Supervisory Letter. See 3/9/2012 OCC Supervisory Letter JPM-2012-09 to JPMorgan Chase, "Examination of FSI Stress Testing Framework" [Sealed Exhibit].
[1259] Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
[1260] Id.
[1261] Id.
[1262] Id.
[1263] See 3/9/2012 OCC Supervisory Letter JPM-2012-09 to JPMorgan Chase, "Examination of FSI Stress Testing Framework" [Sealed Exhibit]; Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
[1264] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1265] Id.

Braunstein.[1266] Mr. Waterhouse said that Mr. Dimon then disclosed that he was the one who had ordered a halt to the reports and expressed the opinion that the OCC did not need the daily P&L figures for the Investment Bank.[1267] The bank estimated that the OCC was without the reports for about two weeks altogether.

(3) 2011: Missing SCP Red Flags

In 2011, the SCP expanded dramatically, acquired a complex mix of credit derivatives, and bankrolled a high risk series of credit trades that produced substantial unexpected revenues. Along the way, several red flags highlighted risks associated with the growing SCP, which should have caught the OCC's attention and led to a regulatory inquiry into the CIO's growing synthetic credit trading, but the OCC missed those red flags.

In 2011, the SCP expanded tenfold in size, from about $4 billion in notional positions at the beginning of the year to $51 billion at the end of the year.[1268] As explained earlier, it acquired a complex mix of long and short credit instruments with varying reference assets and maturities, and the portfolio began to trigger breaches of the CIO's stress loss limit.[1269]

For example, in the first half of 2011, the CIO reported multiple, sustained breaches of its stress limits and attributed those breaches to increased activity in its "synthetic credit (tranche) book."[1270] The CIO's stress limits were triggered eight times, sometimes for weeks at a stretch, from January to June 2011.[1271] The bank notified the OCC about those stress limit breaches, like other internal risk limit breaches, in the bank's regular Market Risk Management (MRM) Reporting emails which listed risk limit breaches and in its weekly Market Risk Stress Testing reports.[1272] In those reports, the CIO attributed all of the CIO's stress limit breaches to changes in its "synthetic credit (tranche book)."[1273] In the first breach of the year, for example, which occurred on January 27,

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[1266] Id.
[1267] Id.
[1268] See "Summary of Positions by Type," prepared by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037609.
[1269] Stress loss limits are dollar amounts projecting losses under specified "adverse and abnormal market environments." 2013 JPMorgan Chase Task Force Report, at 82. Stress testing was applied on a weekly basis to the SCP to determine whether it would exceed its stress loss limit. If the limit was exceeded, the CIO was supposed to reconfigure the SCP to end the breach. For more information, see Chapter V.
[1270] Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012); 10/26/2012 OCC Confidential Supervisory Report, Appendix 4 (summary of CIO limit exceptions Jan. – June 2011), PSI-OCC-13-000067 [Sealed Exhibit].
[1271] See 10/26/2012 OCC Confidential Supervisory Report, Appendix 4 (summary of CIO limit exceptions Jan. – June 2011) at PSI-OCC-13-000067 [Sealed Exhibit].
[1272] Id.
[1273] Id.

2011, the CIO continued to breach the limit for seven weeks in a row, peaking at 50% over the limit.[1274]

The CIO's stress limit breaches were dramatic and sustained during the first half of 2011, yet when the OCC inquired into the reason for the breaches, the bank "failed to offer any details about the source," and the OCC did not pursue additional information.[1275] In hindsight, the OCC identified its failure to follow up on the results of the stress limit breaches – whose very purpose was to identify portfolio risk – as "one of our misses."[1276] In fact, it was a major misstep. By failing to insist on bank answers about the synthetic credit tranche book, the OCC missed a key opportunity to examine and perhaps curb the excesses of the SCP prior to its incurring losses in 2012. The OCC also told the Subcommittee that the multiple breaches of the 2011 stress limit provided evidence that the SCP was not, even then, providing stress loss protection to the bank, or acting as a hedge, but was engaging in a strategy to earn profits for the bank.[1277]

Later in 2011, the SCP entered into a high risk derivatives bet which, due to an American Airlines declaration of bankruptcy, produced roughly $400 million in unexpected revenues for the CIO in late November.[1278] One of the CIO traders, Bruno Iksil, purchased tranches in a soon-to-expire credit index series, which leveraged the CIO's position to produce the gain. The bank reportedly spent $1 billion acquiring those positions.[1279] Despite the enormous size of those transactions and the hundreds of millions of dollars they generated, the bank did not alert the OCC to the trading activity and the OCC did not inquire into the source of the gain.

In hindsight, the OCC characterized the trading profits as "outsized"[1280] and due to an "idiosyncratic" trade that the CIO should not have been making, especially since the American Airlines loss protection had no link to any credit exposure at the bank.[1281] Given that

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[1274] Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012); 10/26/2012 OCC Confidential Supervisory Report, Appendix 4 (summary of CIO limit exceptions Jan. – June 2011), PSI-OCC-13-000067 [Sealed Exhibit].

[1275] See 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000042 [Sealed Exhibit].

[1276] Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012) (Doug McLaughlin).

[1277] Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).

[1278] See 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "CIO," JPM-CIO-PSI 0000539 ("The fourth quarter 400 million gain was the result of the unexpected american airlines default."). For more information about this bet, see Chapter III.

[1279] OCC data analysis derived from DTCC data for JPMorgan Chase, described in "JPMC-CIO timeline of Significant Events and OCC Discovery," prepared by the OCC, OCC-SPI-00038895, at 6 [Sealed Exhibit]; see also 10/26/2012 OCC Confidential Supervisory Report, Appendix 11 at PSI-OCC-13-000113 [Sealed Exhibit].

[1280] 5/31/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, "QA," OCC-SPI-00026410.

[1281] Subcommittee interview of Fred Crumlish, OCC (8/29/2012); 10/26/2012 OCC Memorandum from Sally Belshaw, OCC, to Michael Brosnan, OCC, "Review of Events the bank admitted that the "CDX[.]HY positions were set up to take advantage of [a] key bankruptcy credit related event[],"[1282] this $400 million gain was a red flag signaling high risk, proprietary trading by the CIO, but it was a red flag that, again, was missed by the OCC.

C. 2012: Dodging OCC Oversight While SCP Losses Mount

In its initial years of operation, the Synthetic Credit Portfolio did not attract OCC notice, in part because the CIO did not name the portfolio in any of its submissions to the agency. In January 2012, the CIO named the SCP in a VaR report to the OCC, only to inform the OCC that it was planning to reduce the portfolio. Despite that representation, in the first three months of the year, the CIO tripled the size of the SCP, buying tens of billions of dollars of a high-risk mix of short and long credit derivatives in credit derivatives, only to see their value crash, resulting in mounting losses. As the OCC later described it: "SCP was obscure but not hidden as it went from operating outside of control limits in 2011 to operating out of control in 2012."[1283] Until the SCP's losses escalated, the CIO minimized the data it provided to the OCC about the SCP, leaving the OCC misinformed and therefore blind to the portfolio's excesses. In addition, the OCC failed to take notice of or act on the CIO's multiple, sustained risk limit breaches.

(1) Misinforming OCC that SCP Book to be Reduced

In the last week of January 2012, OCC examiners set up a standard quarterly meeting with the CIO's Chief Financial Officer John Wilmot to review the prior quarter and get an update on the CIO's plans for the new quarter.[1284] One of the OCC examiners who attended the meeting prepared notes summarizing what was discussed and circulated them among OCC staff with CIO supervision responsibility.[1285] According to the OCC summary, during the meeting, Mr. Wilmot discussed the MTM book, which was the trading book whose assets were valued on a mark-to-market basis and consisted mostly of the SCP.[1286] He said that the CIO's "MTM" book was "decreasing in size in 2012. It's expected that

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Surrounding Losses at CIO and Lessons Learned," PSI-OCC-13-000003 [Sealed Exhibit] (identifying the American Airlines gain as an "outsize gain" that OCC should have "investigate[d].").

[1282] 12/2011 "Chief Investment Office Executive Management Report," JPMorgan Chase, OCC-SPI-0003247, at 248.

[1283] 10/26/2012 OCC Confidential Supervisory Report, PSI-OCC-13-000020 [Sealed Exhibit].

[1284] See 1/24/3012 email from James Hohl, OCC, to Jaymin Berg, OCC, "CIO meeting," OCC-00004746; Subcommittee interview of Jaymin Berg, OCC (8/31/2012).

[1285] See 1/31/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, "CIO Quarterly Meeting," OCC-SPI-00004695.

[1286] Subcommittee interview of John Wilmot, CIO (9/11/2012) (explaining the name change from the TAA to the new name, MTM, a portfolio that was mostly the synthetic credit portfolio); Subcommittee interview of James Hohl, OCC (9/6/2012)..

RWA [Risk Weighted Assets] will decrease from $70B [billion] to $40B."[1287]

The OCC told the Subcommittee that, as a result of this meeting, it understood that the MTM book would be "de minimus" within a year or two.[1288] Another OCC examiner who attended the meeting with Mr. Wilmot told the Subcommittee that Mr. Wilmot conveyed the CIO's plan to reduce its MTM positions and decrease the volume of its trading.[1289] While Mr. Wilmot did not explain whether the CIO would reduce the portfolio's RWA by selling positions or letting positions naturally expire, the OCC told the Subcommittee that its interpretation was that, overall, the notional size of the portfolio would decrease because RWA typically reflects the size of the book. The OCC told the Subcommittee that the converse scenario – reducing RWA by *increasing* notionals – would be "very unusual."[1290] The CIO's counterintuitive strategy prompted even Mr. Dimon to ask later on: "Why didn't they just sell vs offset[?]"[1291] Likewise, the OCC's Examiner-in-Charge at JPMorgan Chase told the Subcommittee that he had the same understanding: "We were informed at year end 2011 that they were going to 'take the book down, reduce the risk.' That meant getting

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[1287] See 1/31/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, "CIO Quarterly Meeting," OCC-SPI-00004695. Mr. Wilmot told the Subcommittee that these notes were accurate. Subcommittee interview of John Wilmot, CIO (9/11/2012). The only contrary evidence provided to the OCC contradicting the representation made in the January 2012 meeting that the SCP would be "decreasing in size" was in a CIO internal audit report that was forwarded to the OCC two months later. See 2011 4th Quarter JPMorgan Chase CA Quarterly Summary of Global Chief Investment Office, OCC-SPI-00002481. This audit report stated: "Going into the new year [2012], the plan is to expand the derivatives trading book to nominal of at least $47 billion by the end of January 2011." Id., at 2. When reviewing that audit report, Mr. Wilmot explained, first, that the date given in the report, "January 2011," was likely a typographical error given that the document was prepared in the fourth quarter of 2011. Subcommittee interview of John Wilmot, CIO (9/11/2012). Secondly, he explained that the stated plan to increase the SCP by $47 billion was not familiar to him; he stated there was no such plan to increase notionals. Id. From the OCC's perspective, while the OCC did not directly confront the bank about the audit report's plan for the SCP, Mr. Hohl told the Subcommittee that when the OCC received the fourth quarter 2011 audit in March 2012, it was already out of date, and he dismissed the stated plan to increase notionals because Mr. Wilmot had already told him differently at the end of January 2012. Subcommittee interview of James Hohl, OCC (9/6/2012).

[1288] Subcommittee interview of Jaymin Berg, OCC (8/31/2012). During the meeting, the bank did not disclose, as it should have, just how enormous the Synthetic Credit Portfolio was at the time. It then included, for example, a $278 billion notional position in the IG9 credit index, a $115 billion notional position in the HY10 and 11 credit indices; and a $90 billion notional position in the Main ITraxx S9 index. See 1/18/2012 email from Bruno Iksil, CIO to Julien Grout, CIO, "Meeting materials for 11am meeting," conveying presentation entitled, "Core Credit Book Highlights" (January 2012), prepared by Mr. Iksil, at JPM-CIO-PSI 0000098, at 101. Reducing these positions to a de minimus amount would also have been very expensive; the CIO traders had earlier calculated that reducing tbe CIO's RWA by just $10 billion would cost $516 million. 1/4/2012 email from Julien Grout, CIO, to Ina Drew, John Wilmot, and Javier Martin-Artajo, CIO, "RWA reduction for Core Credit- scenario analysis summary," JPM-CIO-PSI 0001259, at 260. The notes of the quarterly meeting do not contain any reference to that expense.

[1289] Subcommittee interview of James Hohl, OCC (9/6/2012).

[1290] Subcommittee interview of Jaymin Berg, OCC (8/31/2012).

[1291] 4/13/2012 email from Jamie Dimon, JPMorgan Chase, to John Hogan, JPMorgan Chase, "CIO," JPM-CIO-PSI 0001753.

RWA down. My understanding, in my mind, they were going to reduce the book."[1292] When asked about his statements to the OCC during the January 2012 meeting, Mr. Wilmot told the Subcommittee that when he spoke of "decreases," it was only in terms of RWA, and that he was unaware of the tactics the CIO traders planned to use to decrease the RWA.[1293]

A few days earlier on January 26, 2012, the CIO traders had proposed lowering the SCP's RWA, not by reducing the size of the trading book, but by purchasing increased amounts of long credit instruments to offset the book's short positions.[1294] The notes of the quarterly meeting do not contain any reference to that proposal, and the OCC examiners informed the Subcommittee that the bank never raised it.[1295] Because the bank's strategy for reducing the CIO's RWA – by *adding* long positions – would increase risk, and because it was contrary to usual practice for "decreasing" the portfolio, JPMorgan Chase should have told the OCC about its plans at the time.

Moreover, at the time of the quarterly meeting on January 31, 2012, CIO trader Bruno Iksil had already informed CIO management that the SCP had lost $100 million and was expected to lose another $300 million.[1296] Together, that huge loss would eliminate the CIO's entire fourth quarter 2011 gains and, according to the OCC examiner, constituted "material" information that the bank should have shared, but which Mr. Wilmot did not disclose.[1297] Mr. Wilmot told the Subcommittee that, even though he was the CIO's Chief Financial Officer, he did not review the SCP's daily profit and loss numbers, and that even if he had, the profits and losses for the book would have "moved around."[1298] It was the first of many SCP losses that the bank did not disclose to the OCC, but should have.

The bottom line is that the OCC's quarterly meeting with the CIO took place at a critical time. Had the CIO disclosed the size, risk profile, losses, and plans for the SCP to its regulator during the January 2012 meeting – rather than downplayed the portfolio by saying the CIO planned to reduce it – the OCC could have evaluated the trading strategy

[1292] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1293] Subcommittee interview of John Wilmot, CIO (9/11/2012).
[1294] 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," JPM-CIO-PSI 0000159, conveying "Core Credit Book Highlights," (1/2012), prepared by Mr. Iksil; Subcommittee interview of Peter Weiland, CIO (8/29/2012). For more information about this proposal and its approval, see Chapter III.
[1295] Subcommittee interviews of Scott Waterhouse, OCC (9/17/2012) and Jaymin Berg, OCC (8/31/2012).
[1296] 1/26/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "credit book last version," conveying "Core Credit Book Highlights," (1/2012), prepared by Mr. Iksil, JPM-CIO-PSI-0000159. The $100 million in losses was also reported in the daily profit and loss reports recorded internally by the CIO.
[1297] Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
[1298] Subcommittee interview of John Wilmot, CIO (9/11/2012).

and raised questions about the rapid expansion in size and risk that took place over the next two months and later led to multi-billion-dollar losses.

(2) Failing to Provide OCC with CIO Data

The CIO managed $350 billion in excess deposits, a portfolio whose size was second only to that managed by the Investment Bank within JPMorgan Chase. To keep apprised of CIO activity, the OCC required the bank to share a number of standard internal reports tracking the CIO's asset, risk, and profit/loss data. In early 2012, however, the bank's standard reports began to omit critical CIO data. Those data gaps meant the OCC did not have comprehensive or up-to-date information about the CIO's trading activities, including with respect to the SCP.

Executive Management Reports. One of the regular reports the bank supplied to the OCC was a monthly Treasury Executive Management Report (EMR), which included a section with basic performance data for the CIO. According to the OCC, over time, those reports became thinner and thinner with less useful information about the CIO.[1299] The OCC told the Subcommittee that it approached JPMorgan Chase's Chief Financial Officer, Douglas Braunstein, as well as the bank's Corporate Treasury division about the lack of sufficient information in the EMR.[1300] The OCC explained that it was concerned because "less information mean[t] less questions" that regulators could pose.[1301] Then, in January 2012, the OCC noted that the usual monthly Treasury EMR did not include any section on the CIO, as it had in the past. The OCC said it later learned that, without any notice to the agency, the CIO had begun issuing its own Executive Management Report.[1302] The OCC said that the CIO did not provide the OCC with copies of the CIO's new EMR in January, February, March, or April, the same four-month period during which the SCP losses exploded.[1303] When the OCC finally learned of and requested a copy of the CIO's monthly EMR report in April, after the London whale stories appeared in the press,[1304] it promptly received a copy.[1305] It is difficult to understand how the bank could have failed to provide, and the OCC failed to request, basic CIO performance data for a four month period.

1299 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
1300 Id.
1301 Id.
1302 4/19/2012 email from John Wilmot, CIO, to James Hohl, OCC, "CIO EMR?," OCC-00004723.
1303 4/19/2012 email from James Hohl, OCC, to Geralynn Batista, OCC, "CIO portfolio," OCC-SPI-00021700. The bank told the Subcommittee that it provided the new CIO EMR to the FDIC and Federal Reserve, and it was simply an oversight that it was not also sent to the OCC.
1304 4/13/2012 email from Thomas Fursa, OCC, to James Hohl, OCC, "CIO Deck," OCC-00004720.
1305 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).

Valuation Control Group Reports. A second type of report that the bank routinely provided to the OCC was the CIO's Valuation Control Group (VCG) reports, which were monthly reports containing verified valuations of its portfolio assets. The OCC used these reports to track the performance of the CIO investment portfolios. But in 2012, the OCC told the Subcommittee that the CIO VCG reports for February and March failed to arrive.[1306] These are the same months during which it was later discovered that the CIO had mismarked the SCP book to hide the extent of its losses.[1307] On April 13, 2012, after the London whale trades appeared in the press, the OCC requested copies of the February and March VCG reports, which were provided on the same day.[1308] Again, it is difficult to understand how the bank could have failed to provide those basic reports on a timely basis, and how the OCC could have failed to notice, for two months, that the reports had not arrived. Moreover, when the March VCG report was later revised to increase the SCP liquidity reserve by roughly fivefold, that revised report was not provided to the OCC until May 17.[1309]

P&L Reports. Though the bank provided P&L reports for the CIO on a monthly basis to the OCC, they failed to break out the Synthetic Credit Portfolio as a line item, which, the OCC explained, made reviewing that individual portfolio virtually impossible. In addition to omitting any mention of the SCP's losses from the P&L reports supplied to the OCC, no senior bank official provided any separate oral or written disclosure to the OCC about the SCP's mounting losses. For more than four months, the OCC remained uninformed about the hundreds of millions and then billions of dollars being lost. Those losses totaled $100 million in January, increased by $69 million in February, climbed another $550 million in March, and exploded with another $1.5 billion in April, producing a cumulative loss figure of $2.1 billion by the end of that month. The OCC told the Subcommittee that losses of that magnitude should have been disclosed by the bank to the OCC Examiner-in-Charge.[1310]

For its part, the OCC did not insist on obtaining more detailed information about the SCP until May 2012, after the bank told the OCC that the SCP had lost $1.6 billion, and that the bank would "make some

1306 4/13/2012 email from John Bellando, JPMorgan Chase, to James Hohl, OCC, "CIO January 2012 valuation memo and metri[c]s," OCC-00004735; Subcommittee interview of James Hohl, OCC (9/5/2012).
1307 For more information about the mismarking that took place during these months, see Chapter 4.
1308 4/13/2012 email from John Bellando, JPMorgan Chase, to James Hohl, OCC, "CIO January 2012 valuation memo and metri[c]s," OCC-00004735.
1309 Subcommittee interview of James Hohl, OCC (9/5/2012); 5/17/2012 email from George Banks, OCC, to Fred Crumlish, OCC, "CIO Valuation Summary Memo – March 2012 Months End Results REVISED," OCC-SPI-00021894-895 ("Just received a revised CIO March 2012 Valuation Summary .... Appears that they are revising 1Q12 results?").
1310 Subcommittee interview of Scott Waterhouse, OCC (9/17/2013).

comment" about it in a public filing due in a few days.[1311] The OCC examiners then made multiple requests to the bank for SCP-level profit and loss data to monitor SCP performance going forward.[1312] At the time, the OCC head capital markets examiner told his colleagues, "[the] Bank will likely object to this."[1313] That the OCC expected JPMorgan Chase to resist providing data about a portfolio losing billions of dollars and raising questions about the bank's entire risk management system is disturbing evidence of not only the bank's resistance to OCC oversight, but also the OCC's failure to establish a regulatory relationship in which the bank accepted its obligation to readily provide data requested by its regulator.

The OCC told the Subcommittee that when the bank finally provided daily P&L data for the CIO's individual portfolios, it again provided aggregated data that made it difficult to track and analyze the trading activity and individual assets. The OCC noted that the aggregated SCP data was in marked contrast to the daily P&L data that JPMorgan Chase's Investment Bank provided to the OCC on a routine basis for the same types of credit derivatives.[1314]

Later on, the OCC learned that the P&L reporting for the SCP included mismarked derivative values which produced quarter-end SCP losses that, as a whole, were understated by $660 million.[1315] While the OCC told the Subcommittee that it concluded that the bank had not undertaken a deliberate effort to mislead its regulator, the bank's improper valuation practices had resulted in misleading P&L information being sent to the OCC.[1316]

Late, missing, and misleading CIO information in the EMR, VCG, and P&L reports sent to the OCC meant that the OCC was supervising

[1311] 5/4/2012 email from Scott Waterhouse, OCC, to Fred Crumlish, OCC, CIO Synthetic Position, OCC-SPI-00021853 ("Doug Braunstein and John Hogan called to provide an update on the CIO position. ... Current losses are approximately $1.6 billion."). SCP profit-loss reports indicate, however, that as of the day of the call, SCP cumulative losses were actually $2.3 billion. See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee in Chapter IV.

[1312] See 5/16/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, OCC and others, "CSO1," OCC-SPI-00023929; 5/14/2012 email from James Hohl, OCC, to John Wilmot, CIO, "CIO P&L Reporting," OCC-00004759 (stating that an OCC request for SCP P&L for prior five weeks was made on May 7, 2012 and repeated on May 14, 2012); 5/17/2012 email from James Hohl, OCC, to Fred Crumlish, OCC, "Not Getting CIO Daily P&L after only one day," OCC-00004540 (Mr. Hohl: "I got one CIO daily P&L distribution and then didn't yesterday. I inquired about it this morning, but haven't heard back.").

[1313] 5/7/2012 email from Fred Crumlish, OCC, to Scott Waterhouse and others, OCC, "CIO information for Wednesday," OCC-SPI-00013737, ("[W]e haven't historically gotten P&L from them [CIO] as we do the IB [Investment Bank] .... However, I asked James [Hohl] to first, put in a request for more granular daily P&L on the synthetic credit to help us prepare for Wednesday's meeting, and, more generally, put out the request that going forward we get daily P&L in a form such as they provide to (say) Ina Drew. Bank will likely object to this.").

[1314] See Subcommittee interview of Jairam Kamath, OCC (8/24/2012).

[1315] See Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). For more information about this mismarking, see Chapter IV.

[1316] Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).

the CIO using incomplete and inaccurate information.[1317] The lack of accurate data also impeded effective OCC oversight of the high risk trading strategies used in the SCP that eventually caused the bank to lose over $6 billion. The absence of transparent, detailed, and accurate information about the Synthetic Credit Portfolio is exactly the type of documented investment and risk information that the OCC called for after its 2010 examination of the CIO, information requirements which Ina Drew railed against as unnecessary and intrusive.

(3) Failing to Investigate Risk Limit Breaches

During the first quarter of 2012, while JPMorgan Chase omitted critical CIO data from key reports sent to the OCC and failed to send some reports altogether, it did regularly report to the OCC another type of data – ongoing breaches of the CIO's risk limits – that warned of the escalating risk in the CIO's trading book. The OCC has acknowledged internally that its examiners received that data from the bank, but inexplicably failed to take notice of it or to investigate the causes of the ongoing breaches.

In its October 2012 internal report summarizing oversight failures and lessons learned from the JPMorgan Chase whale trades, the OCC found that its examiners had received the bank's regular market risk reporting emails on a daily basis, which included reported breaches of risk limits and risk advisories.[1318] For example, the Market Risk Reporting System (MaRRS) report provided the OCC with weekly stress loss data for different scenarios,[1319] and Market Risk Management (MRM) Reporting emails provided notice of risk limit breaches.[1320] The MRM Reporting emails were typically sent to the OCC with attached spreadsheets detailing risk limits at different lines of business, including the CIO, and when those limits were breached. Thus, the OCC received contemporaneous notice when all five of the risk limits covering the SCP were breached in the first quarter of 2012: VaR, CS01, CSW10%, stress loss, and the stop loss advisories.[1321]

[1317] See 7/30/2012 OCC Large Bank Supervision presentation to Subcommittee re Chief Investment Office Discussion, at PSI-OCC-06-000003 ("We rely on bank MIS (CIO MIS was misleading.)"). "MIS" stands for Management Information Systems, that is, regular reports and data that the bank generates and provides to the OCC. See, e.g., 2012 Memo from Patti Spellacy, OCC, to Michael Brosnan, OCC, "Response to Senate Banking Committee," OCC-SPI-00074914, at 11.
[1318] See 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000042 [Sealed Exhibit]; Subcommittee interview of Jairam Kamath, OCC (8/24/2012).
[1319] See, e.g., 4/13/2012 email from Jairam Kamath, OCC, to Fred Crumlish, OCC, "CIO stress loss trend chart," OCC-SPI-00021724; Subcommittee interview of Jairam Kamath, OCC (8/24/2012); 4/5/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, "reports list," OCC-00005405.
[1320] See, e.g., 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000069 [Sealed Exhibit].
[1321] See, e.g., 4/4/2012 email from MRM Firmwide Reporting, JPMorgan Chase, to Fred Crumlish, OCC, and others, "Firmwide Risk Daily: Market Risk Limits and VAR Reports – Regulators (COB 4/3/2012)," at OCC-SPI-00132363 (see tab: CIO_Global_Credit, listing VaR

The bank began reporting the CIO breaches in January and continued to report multiple breaches for months. While the OCC maintained all of the bank's regular reports, including the MaRRS and MRM reports, in a central database, the Subcommittee found no evidence that the OCC made use of the risk limit reports in its routine regulatory oversight efforts. For example, the Subcommittee found no evidence that OCC examiners analyzed the data to identify the most serious breaches or attempted to investigate why the breaches were occurring. Had the OCC reviewed it, the data would have disclosed over 330 risk limit breaches from January to April 2012, including a jump from the fourth quarter of 2011 to the first quarter of 2012 of 6 to 170 risk limit breaches.[1322] Given that the OCC did not appear to notice when other regular CIO reports stopped arriving until press articles on April 6 drew attention to the CIO, as detailed above, it is possible that the OCC examiners were not even reviewing the regular MaRRS and MRM reports during the first quarter of 2012.

The OCC also failed to inquire into the CIO's implementation in January 2012, of a new VaR model that, overnight, lowered the CIO's VaR by 50%. The bank's regular MRM report emails, which OCC received contemporaneously, provided the OCC with timely notice of three significant facts: that the CIO had breached the bankwide VaR limit for four days running in January; that the CIO was poised to implement a new VaR model on January 27; and that the new model would significantly reduce the CIO's VaR results.[1323] The Subcommittee found no evidence, however, that the OCC noticed the emails at the time they were sent, asked about the reasons for the VaR breach, requested information about the new model, or made any inquiry into how the new model could produce such a dramatically lower VaR. About a month later, on March 1, 2012, according to OCC notes, the bank held a meeting with the OCC and mentioned the January CIO VaR model change, but the OCC's notes contain no reference to the earlier

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Limits, 10% Credit Spread Widening, Credit Spread BPV, and Stop Loss Advisory Limits for MTM One Day, Five Day, and Twenty Day, among other listed risk limits). For more information about the breaches of the CIO risk limits, see Chapter V.

[1322] 5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, "Information Needed," JPM-CIO-PSI-H 0000627-636.

[1323] See 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000042 [Sealed Exhibit] ("The change in the VaR model and its large reduction in measured risk was noted in reports received by the OCC."); 5/21/2012 email from Jairam Kamath, OCC, to Fred Crumlish, OCC, and others, "cio var change," OCC-SPI-00021932 ("Here are a few comments from the days preceding the synthetic credit VaR model change that became effective 1/27/12. Note the reduction of CIO VaR by 44% to $57mm."), citing to MRM Reporting emails from JPMorgan Chase, e.g., 1/25/2012 email from MRM Reporting, JPMorgan Chase, to Peter Weiland, CIO, and others, "ACTION NEEDED: CIO International-One-Off Limits Approval," JPM-CIO-PSI 0000157.

bank reports about it and no indication that the OCC asked any questions about the model change, lower VaR, or earlier breach.[1324]

The OCC was also aware that, although the VaR model had changed, the bank had not made any corresponding change in the VaR limit for the CIO, which meant that the CIO would be able to take on new risk.[1325] An OCC examiner told the Subcommittee that a model change was "typically" accompanied by a limit change, and the VaR model change was a "significant" one, so the VaR "limit should have changed" when the new VaR model was implemented.[1326] The OCC told the Subcommittee, however, that the bank proposed waiting to change the CIO VaR limit until it had revised all of CIO's risk limits, and the OCC did not challenge that proposal. As a result, during the months of February, March, and April, the CIO's VaR rose steadily, unimpeded by a limit that was effectively 50% too high. The OCC raised no objection and allowed the bank to continue to delay revising the CIO VaR limit.

Timely information on when a bank's risk limits are breached provides a valuable, cost-effective tool for regulators to monitor risk at a large financial institution. Had the OCC investigated the multiple breaches reported by the bank relating to the CIO, it is possible that the agency would have uncovered the SCP's rapidly expanding holdings, examined the risks being incurred, and placed limits on the unsafe and unsound derivatives trading in the SCP. The OCC appears not to have reviewed this data, because it viewed the CIO as low risk.[1327] While OCC has internally concluded that the bank's risk reports were "poor and non-transparent,"[1328] it needs to rectify its own approach to be more responsive to red flags where they do exist.

(4) Miscasting Long Acquisitions As Risk Reducing

Contemporaneous OCC documentation indicates that many senior OCC personnel initially accepted the bank's characterization of the SCP as a hedging mechanism intended to reduce bank risk. When questions

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[1324] See 3/1/2012 Memo from Jaymin Berg, OCC, to OCC File, "Market Risk Reporting," OCC-SPI-00035322, at 323 (memo from meeting with bank noted that "Firmwide VaR averaged $109mm in February versus $126mm in January. The decrease is due to CIO credit tranche methodology changes, which were implemented on January 27th."); meeting minutes were circulated in 3/6/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, James Hohl, OCC, and others, "Market Risk Minutes," OCC-SPI-00035319-321.

[1325] Subcommittee interviews of Fred Crumlish, OCC (8/28/2012) and Jairam Kamath, OCC (8/24/2012). For more information, see Chapter V.

[1326] Subcommittee interview of Jairam Kamath, OCC (8/24/2012); see also Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

[1327] 10/26/2012 memorandum from Sally Belshaw, OCC, to Mike Brosnan, OCC, "Surrounding Losses at CIO and Lessons Learned," at PSI-OCC-13-000003 [Sealed Exhibit] ("Our CIO supervisory strategy had been focused on what we perceived to be the higher risk areas. The CIO synthetic credit desk was understood to be a low risk, hedge-management activity, and thus not a high supervisory priority.").

[1328] Id.

arose about how the SCP could be characterized as a hedge when it purchased so many long credit derivative positions, OCC examiners initially accepted the bank's explanation that the long positions were acquired in order to offset, or hedge, the SCP's own existing short positions, which the CIO wanted to reduce, but viewed as too illiquid to simply sell off.[1329] What was not offered as an explanation at the time, but which has become apparent in contemporaneous bank documents is that the CIO's motive for purchasing IG long credit derivatives in January 2012, was not just to offset the CIO's short positions, but also to generate cash premiums, or "carry," which it could then use to finance the purchase of still more high yield shorts.[1330] As 2012 wore on, another motive for acquiring long derivatives was to use the incoming cash premiums to offset the daily mark-to-market losses the CIO was having to record for the SCP.[1331]

[1329] See, e.g., 4/17/2012 email from Fred Crumlish, OCC, to Mike Brosnan, OCC, and others, "JPM/CIO / IG9 'whale trade,'" OCC-00012521 ("CIO managers thought it wouldn't be possible to reduce the high yield credit derivative position by using the indices that created it; the best available hedge product was the IG 9 index.... This was the reason that JPMCB began selling IG 9 CDSs; going long IG9 credit risk (selling CDSs) would neutralize some of the short high yield credit risk position (long CDSs)."); 5/11/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, OCC, "CDX IG Series 18 vs. CDX HY vs. CDX IG 9," OCC SPI 00081266 ("Based on my understanding, CIO was trying to pare down their long protection (short credit risk) in HY. To do so, they would sell protection (long credit risk). ... [T]hey took the basis risk by continuing to be long HY protection and short IG protection as a proxy."); 5/16/2012 email from Fred Crumlish, OCC, to Elwyn Wong, OCC, "here is redline and new final," OCC-00003507, at 508 (attaching talking points, signed off by Mike Brosnan, head of OCC Large Bank Supervision, indicating: "As the economy improved, in late 2011 and early 2012 executive management felt that the credit cycle was less risky and made the strategic decision to reduce the high yield debt credit protection position. However, ... the markets for high yield indices were not, according to the bank, liquid enough to use to unwind the existing short credit protection position. Consequently, the bank looked for alternatives to offset the positions via other instruments that were presumed to have offsetting risk characteristics. ... The bank began selling IG 9 credit default swaps – going long on IG 9 credit risk (selling CDS) – to neutralize some of its short high yield credit risk position (the original credit default swaps)."). It is important to note, however, that purchasing longs to offset the SCP's own shorts did not position the SCP as a whole to act as a hedge for bank credit losses outside the confines of the Synthetic Credit Portfolio. In fact, the CIO's continued acquisition of long positions eventually converted the SCP from a net short to a net long posture, eliminating its ability to hedge loan or other credit losses incurred by the bank. For more information, see Chapters III and VII.

[1330] See discussion in Chapter III; 2013 JPMorgan Chase Task Force Report, at 30 ("The traders, in late January, also added to their long positions .... Those long positions generated premiums, and ... would help to fund high-yield short positions ...."); 1/26/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "credit book last version," JPM-CIO-PSI 0000159, at 170 (showing estimated carry produced by key long positions).

[1331] See discussion in Chapter III; JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012) ("We can lose money on a daily basis, but correct with carry of the book. Month-end is not as important as quarter-end."); 2/22/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, and others, "core credit latest version," JPM-CIO-PSI 0001784, at 800 (showing carry produced by three positions: iTraxx: 500,276; cdx ig: 891,954; cdx hy: -825,139, with the positive carry for cdx ig, which was generally a long position, barely offsetting the negative carry of the cdx hy, which was generally a short position); 3/16/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo and Julien Grout, CIO, "strategy for core," JPM-CIO-PSI-H 0006017 ("IG trades will improve the carry[.]").

The OCC told the Subcommittee that its examination team was not aware that the CIO was purchasing IG longs, in part, to produce carry that could be used to purchase additional high yield shorts and offset SCP reported losses.[1332] The OCC told the Subcommittee that its examiners had believed the bank's assertion that the IG longs were acquired to offset the risks of its high yield shorts.[1333]

As late as September 2012, the OCC's Chief Counsel, Julie Williams, was under the impression that the purpose of the IG longs was to offset the risks of the SCP's high yield shorts – in other words, to lower risk.[1334] When drafting an internal OCC memorandum explaining the SCP, for example, Ms. Williams wrote: "[T]he IG trades initially appear to have been designed to hedge market risks arising in connection with and related to the HY trades."[1335] When questioned by the Subcommittee, she was not aware of the CIO's other motives for purchasing the IG longs and was surprised by evidence that CIO traders purchased the IG longs in order to finance the HY shorts. She responded to the Subcommittee by criticizing her earlier explanation, saying: "We wouldn't say this [now]: We would say it was something more complicated."[1336]

By characterizing the SCP long purchases as offsets or hedges, the CIO was portraying them as trades undertaken to lower bank risk when, in fact, they raised risk. Characterizing the trades as lowering risk was critical to the CIO's assertion that its trades were consistent with the Volcker Rule which bans high risk proprietary trading by federally insured banks, but permits "risk-mitigating hedging activities."[1337] Ms. Williams acknowledged to the Subcommittee that purchasing IG longs as a financing mechanism for other positions would not qualify as the type of "risk mitigating" hedge envisioned by the Volcker Rule.[1338]

[1332] Subcommittee interview of Mike Sullivan, OCC (11/7/2012).
[1333] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1334] Subcommittee interview of Julie Williams, OCC (9/17/2012).
[1335] 6/29/2012 email and attached undated memorandum from Julie Williams, OCC, to Thomas Curry, OCC, "JPMC Trades and the Volcker Rule Proposal," OCC-SPI-00065656, at 9 ("[T]he IG trades initially appear to have been designed to hedge market risks arising in connection with and related to the HY trades. It was subsequently that the IG trades were not effective hedges due to what were described as market aberrations."). During her interview, Ms. Williams explained that she edited this memorandum in late June 2012, drawing from a draft prepared by Ellen Broadman, Ursula Pfeil, and Roman Goldstein at the OCC. Subcommittee interview of Julie Williams, OCC (9/17/2012). She said that the memorandum was prepared at the request of Comptroller Curry, but was not finalized because of other ongoing OCC reviews. Id.
[1336] Subcommittee interview of Julie Williams, OCC (9/17/2012).
[1337] See Section 13 of the Bank Holding Company Act, added by Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, P.L. 111-203
[1338] Subcommittee interview of Julie Williams, OCC (9/13/2012). The Volcker Rule was enacted into law in 2010, and implementing regulations were proposed in 2011, but those regulations have yet to be finalized. The banking industry continues to press regulators about the contours of the final regulations and whether particular trading activities would continue to be allowed.

D. 2012: Resisting OCC Oversight Even After Whale Trades Became Public

On April 6, 2012, the first major stories about JPMorgan Chase's whale trades appeared in the media.[1339] The OCC told the Subcommittee that it was surprised by the stories and immediately directed inquiries to the bank to obtain more information. The OCC initially received such limited information about the trades and such blanket reassurances from the bank that it actually considered the matter closed in late April.[1340] Not until May, when the bank was forced to disclose a $2 billion loss in its SEC filings, did the OCC begin to learn about the severity of the SCP's mounting losses, and actions taken by CIO traders in late March to "double down" on the CIO's credit derivatives trading strategy in an effort to stem those losses. Despite that $2 billion disclosure, the spotlight of public attention, and repeated examiner requests, the OCC told the Subcommittee that obtaining the necessary information from the bank was not easy; the bank resisted and delayed responding to SCP requests and sometimes provided incorrect information. While the OCC eventually obtained the information it needed, it failed to impose any immediate penalty in response to the bank's delays and obstructive actions.

(1) Providing OCC with Limited or Incorrect Information

After the media began to report on the whale trades in early April 2012, the OCC and Federal Reserve sought additional information about those trades from the bank, but were provided with inadequate information that delayed effective oversight.

Positions Table. According to the OCC, on Monday, April 9, 2012, in the regulators' first call with JPMorgan Chase following the media reports on the prior Friday, the bank downplayed the seriousness of the whale trades, reassuring its regulators, including the OCC, that the bank was unconcerned about the SCP's positions and possible losses.[1341] The next day, April 10th, in response to a request from the OCC and Federal Reserve for more information about the whale trades, the bank provided a table entitled, "Summary of Positions," identifying an incomplete group of CIO positions in various credit indices and tranches

[1339] See "JPMorgan Trader's Positions Said to Distort Credit Indexes," Bloomberg (4/6/2012), http://www.bloomberg.com/news/2012-04-05/jpmorgan-trader-iksil-s-heft-is-said-to-distort-credit-indexes.html; "London Whale Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne, (4/6/2012).

[1340] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

[1341] See, e.g., 4/10/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, "JPM CIO trades --- JPMorgan's Iksil May Spur Regulators to Dissect Trading – Bloomberg News – 4/9/12," OCC-00001827 ("As you know we had a call with the Chief Investment Officer Ina Drew and others in JPM yesterday .... JPMC's credit stress hedge is again where they want it, and there is no significant further trading planned on this strategy.").

by notional amount.[1342] The table did not provide basic P&L data for the positions or other risk information, leading OCC examiners to describe the table in an internal email as "useless"[1343] and in a Subcommittee interview as "absolutely unhelpful" and seemingly designed to make regulators "go away."[1344]

Dedicated Hedge. The bank also told the OCC that the SCP trades were a hedge intended to lower bank risk. The April 10, 2012 email from the bank accompanying the Summary of Positions table stated: "The book, as a dedicated hedge, continues to be short HY and to provide default protection."[1345] On its face, however, calling the SCP book a "dedicated hedge" contradicted the Summary of Positions table which showed that the portfolio held an overall net *long* position, the opposite of what would be expected for a hedge.[1346] Nearly one week later, when the bank was explaining in an email a nearly identical table in a more comprehensive presentation,[1347] the Chief Financial Officer of the CIO confirmed that the book was in a net long position.[1348] Moreover, in response to the bank's assertion that the SCP was functioning as a "dedicated hedge," the OCC repeatedly asked the bank to identify the bank assets being hedged by the SCP,[1349] but the bank did

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1342 See 4/10/2012 email from Joe Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, and others, "Background and Supporting Data for CIO Discussion of April 9, 2012," OCC-SPI-00004312.

1343 5/18/2012 email from Michael Kirk, OCC, to Elwyn Wong, OCC, "CIO Call With Mike Brosnan," OCC-SPI-00021628 at 630 (quoting 05/17/2012 email from Fred Crumlish stating: "I told Mike B [Brosnan] that the Joe Sabatini emails with selected position information were sent by the bank after initial OCC and FRB enquiries. We concluded this information was pretty much useless, as it did not tell us what was happening risk wise.").

1344 Subcommittee interview of Fred Crumlish, OCC (8/29/2012).

1345 4/10/2012 email from Joe Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, and others, "Background and Supporting Data for CIO Discussion of April 9, 2012," OCC-SPI-00004312. See also 4/10/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, "JPM CIO Trades—JPMorgan's Iksil May Spur Regulators to Dissect Trading – Bloomberg News- 4/9/12," OCC-00004087 ("As you know we had a call with Chief Investment Officer Ina Drew and others in JPM yesterday. ... JPMC's credit stress hedge is again where they want it. ... We asked the bank for a number of items yesterday that reflect details on the trades and support the stress loss hedge rationale associated with this specific strategy. We expect this sometime today.").

1346 See 4/10/2012 email from Joe Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, and others, "Background and Supporting Data for CIO Discussion of April 9, 2012," OCC-SPI-00004312 (The far right column, entitled "grand total," indicates positive totals, signifying long positions. The only negative subtotal, signifying a short position, was for "all other index positions," and was smaller than any of the long positions, which meant that the overall net position remained long.).

1347 4/16/2012 email from Joseph Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, "materials for Fed/OCC/FDIC call at noon today," OCC-SPI-00009712, at 716.

1348 See 4/17/2012 email from John Wilmot, CIO, to James Hohl, OCC, "Quick questions on pp 4 and 5," OCC-SPI-00023815 ("I believe there is a modest long credit risk sensitivity to the portfolio now."). This email referenced "pp 4 and 5" of the above presentation: 4/16/2012 email from Joseph Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, "materials for Fed/OCC/FDIC call at noon today," OCC-SPI-00009712, at 716.

1349 See, e.g., Subcommittee interview of Michael Kirk, OCC (8/22/2012); 4/10/2012 email exchange among Michael Kirk, OCC, Fred Crumlish, OCC, and others, "CIO info on elephant trade," OCC-00004730 (Mr. Crumlish: "In my response on JPM email .... I also said it would be useful if they provided analytics or a summary that recapped the hedge strategy, such as the not provide the requested data.[1350] The bank also never ran any stress scenarios against the Available-for-Sale (AFS) book, which the SCP was purportedly then hedging, to derive an estimated loss figure that needed to be hedged.[1351]

April Presentation. During the JPMorgan Chase earnings call with investors on April 13, 2012, when asked about the whale trades, Mr. Dimon told investors the CIO stories in the press were a "complete tempest in a teapot," and CFO Douglas Braunstein announced that "[w]e are very comfortable with our positions …."[1352]

Three days later, on April 16, 2012, the bank provided a 13-page presentation to regulators about the whale trades, its first written description about what happened. In it, the bank told regulators that the objective of the SCP was to "protect against a significant downturn in credit, offsetting natural credit exposures in CIO and the firm,"[1353] though it did not describe the particular credit exposures being offset or the risks or vulnerabilities involved in the whale trades themselves.[1354] This representation, which, again, portrayed the SCP book as designed to lower bank risk, was, again, inconsistent with the SCP book itself, since it continued to hold a net long position, meaning it was exposed to credit risk, just as the CIO's portfolio and the bank as a whole were exposed to credit risk.

The OCC told the Subcommittee that its examiners knew at this point that, given the book's long risk posture, the SCP was not performing a hedging function.[1355] The OCC told the Subcommittee that the bank's assertion that the SCP was a "dedicated hedge" had actually raised "alarm bells" for the OCC, because it should have been, but was not reported as such, like other instruments in the CIO that served a "dedicated hedge" function, such as the hedges against Mortgage Servicing Rights and interest rate risk.[1356] The OCC was unable to

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expected impact of the hedge on the projected stress loss identified. I asked for this on the call as well."); 4/10/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, and others, "JPM CIO trades," OCC-00004087 ("We asked the bank for a number of items yesterday that reflect details on the trades and support the stress loss hedge rationale associated with this particular strategy.").

[1350] Subcommittee interviews of Michael Kirk, OCC (8/22/2012) and Scott Waterhouse, OCC (9/17/2012) (describing how OCC made multiple requests for documentation about what the SCP was hedging but never received the requested information).

[1351] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). For more information about the bank's representation of the SCP as a hedge, see Chapter III.

[1352] See 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 7, JPM-CIO-PSI 0001151.

[1353] 4/16/2012 email from Joseph Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, "materials for Fed/OCC/FDIC call at noon today," OCC-SPI-00009712, at 714.

[1354] Levin Office briefing by JPMorgan Chase (5/25/2012) (Greg Baer) (noting that if the regulators were comfortable as a result of that briefing, "we probably gave them reason to be comfortable.").

[1355] Subcommittee interview of James Hohl, OCC (9/6/2012).

[1356] Subcommittee interview of Fred Crumlish, OCC (8/28/2012).

explain why it did not, at that point, confront the bank with its analysis that the SCP was not, in fact, a hedge.

The OCC also told the Subcommittee that it later determined that the CIO's April 16 presentation contained "material misrepresentations,"[1357] including a misrepresentation that the 2012 first quarter SCP losses totaled $580 million,[1358] when first quarter losses had actually been internally reported as $719 million.[1359] More significantly, at the time the bank briefed the OCC in April, the SCP losses were more than double the $580 million figure provided by the bank; the bank should have told the OCC that the losses by then totaled $1.25 billion.[1360] The OCC told the Subcommittee that the bank's presentation also included "unrealistic scenarios" for the second quarter, promising overly optimistic future recovery of the SCP assets' value.[1361] The OCC told the Subcommittee that, at the time it received the presentation in April, it had viewed the presentation as providing additional information "in good faith."[1362]

Risk and Stress Limit Breaches. A few days later, on April 19, the OCC asked the bank, for what appears to be the first time since the beginning of 2012, about the significance of information that the SCP had breached several risk and stress loss limits. After receiving reassurances from the bank regarding these breaches, the OCC let the matter drop instead of investigating the trading activities that caused the breaches.

In the OCC's initial inquiry on April 19, 2012, an OCC examiner asked the CIO Market Risk Officer for additional information about data indicating that the CIO had breached three of the bank's primary risk limits:

> "Would you have any color around some observations about the CIO VaR [Value-at-Risk], CSBPV [Credit Spread Basis Point Value, also known as the CS01 risk limit] and stress results? I received the following from another examiner this morning. Thanks.
>
> [']The increase in the Firm's Var is primarily driven by CIO Synthetic Credit portfolio.

[1357] Subcommittee interview of Michael Kirk, OCC (9/22/2012).
[1358] 4/16/2012 email from Joseph Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, and others, "materials for Fed/OCC/FDIC call at noon today," OCC-SPI-00009712, at 724.
[1359] See OCC spreadsheet, OCC-SPI-00000298, printed as a Subcommittee chart in Chapter IV. Numbers do not reflect restated P&L figures.
[1360] SCP losses were internally reported to be $1.25 billion on April 13, a Friday, the last trading day before the April 16 briefing, which was a Monday. Id.
[1361] Subcommittee interview of Michael Kirk, OCC (9/22/2012).
[1362] Subcommittee interview of Fred Crumlish, OCC (8/28/2012).

> CIO aggregate stress is over 23% of its $15B [billion] limit. Also MtM [mark-to-market] cs bpv limit is in excession by 1074% and has been in excession for 71 days.[']"[1363]

The CIO's Chief Market Risk Officer, Peter Weiland, responded by email to the OCC's inquiry, downplaying the significance of the breaches. First, Mr. Weiland wrote that the VaR breach was not related to new CIO trading activity, but to "market data," essentially attributing the breach to older SCP trades, even though those older trades were very risky and would continue to generate losses.[1364]

Secondly, Mr. Weiland explained that the CIO had ended the stress breach by raising its aggregate stress limit, so that the trades aggregating $12.67 billion were actually under rather than over its new $15 billion limit. He acknowledged, however, that the CIO's $1 billion MTM (mark-to-market) stress limit (i.e., the stress limit that covered the SCP) was still in breach at $1.53 billion,[1365] but provided no explanation as to the reason for the breach or how the bank planned to get back under the limit. When asked why the OCC did not pursue the stress breach at the time, an OCC examiner told the Subcommittee that he had assumed that Ms. Drew would have had to sign off on the breach of the MTM stress limit, which would have engendered a discussion about it within the bank.[1366] Basically, he indicated that as long as the CIO knew about the breach, the OCC had trusted the CIO to take appropriate steps to deal with it, and did not view the OCC as having an obligation to verify that the CIO's risk management was actually doing its job.

Lastly, in response to the CSBPV breach of 1074% over 71 days, Mr. Weiland told the OCC: "We are working on a new set of limits for synthetic credit and the current CS01 will be replaced by something more sensible and granular."[1367] He, again, downplayed the importance of the CSBPV breaches by promising a more "sensible" replacement limit in the near future. OCC examiners told the Subcommittee that they later realized the CSBPV breach was "a huge red flag,"[1368] and "egregious,"[1369] but acknowledged that, at the time, the OCC reacted by tolerating that and the other ongoing breaches, accepting the bank's

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[1363] 4/19/2012 email from James Hohl, OCC, to Peter Weiland, CIO, "Info on VaR, CSBPV, and stress status and limits," OCC-SPI-00022340.
[1364] Mr. Weiland explained that the increase in firm VaR "was not due to any new trades, but rather to market data." 4/19/2012 email from Peter Weiland, CIO, to James Hohl, OCC, "Info on VaR, CSBPV, and stress status and limits," OCC-SPI-00022340.
[1365] Id.
[1366] Subcommittee interview of James Hohl, OCC (9/6/2012).
[1367] 4/19/2012 email from Peter Weiland, CIO, to James Hohl, OCC, "Info on VaR, CSBPV, and stress status and limits," OCC-SPI-00022340 (stated by Peter Weiland).
[1368] Subcommittee interview of Jairam Kamath, OCC (8/24/2012).
[1369] Subcommittee interview of Elwyn Wong, OCC (8/20/2012); see also Subcommittee interview of Fred Crumlish, OCC (8/28/2012) (describing the breaches as a big problem that should have been pursued.).

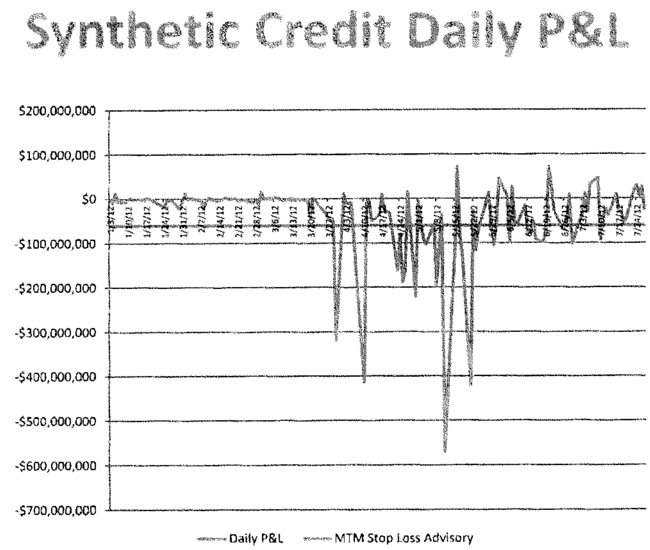
reassurance regarding their insignificance, and failing to press the bank to identify and remedy the underlying risks.

So, by late April 2012, the bank had provided the OCC with repeated assurances that the SCP functioned as a hedge designed to lower bank risk, supplied one "useless" chart and another less-than-complete briefing detailing the trades, and offered multiple excuses for the CIO's breaching its risk limits. In addition, the bank did not disclose in April the portfolio's escalating losses or the fact that it had lost money on most days since January. The OCC told the Subcommittee that the bank's repeated expressions of unconcern about the SCP, together with the limited data provided about its size, risk profile, and losses, had persuaded the OCC to deem the whale trades issue "closed" in an internal email on April 23, 2012.[1370] Ultimately, OCC's excessive trust in the bank allowed the bank to avoid scrutiny about the status of the SCP, and was a central reason for the OCC's failure to challenge the unsafe and unsound derivatives trading activity by the CIO.

(2) Updating OCC Only When Losses About to Become Public

At the same time it was reassuring its regulators, JPMorgan Chase ramped up its internal efforts to address the rapidly escalating losses in the SCP. As shown in the below chart tracking the SCP's daily profit-loss reports, which the bank recorded but did not provide to the OCC at the time, the SCP went from a pattern of steady losses from January through most of March, to a volatile pattern of much larger losses starting on March 27, 2012.[1371] Those larger losses began after the CIO traders had "doubled down" on the SCP's credit derivatives trading strategy by placing a series of enormous trades in March, in which the CIO acquired $40 billion of notional long positions in several credit indices which rapidly lost value. Starting on April 27, 2012, the effort to understand and stop the SCP losses became, in the words of JPMorgan Chase's Deputy Chief Risk Officer Ashley Bacon "all consuming."[1372]

[1370] See 4/23/2012 email from Jairam Kamath, OCC, to Geralynn Batista, OCC, "Weekly Market Summary Period Ending 4/13," OCC-SPI-00023057-060, at 059.
[1371] 7/31/2012 chart included in a presentation prepared by the OCC for a Subcommittee briefing, at 8, PSI-OCC-06-000026.
[1372] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).



Source: 7/30/2012 OCC Large Bank Supervision presentation to Subcommittee re Chief Investment Office Discussion, at PSI-OCC-06-000026 (showing the MTM Stop Loss Advisory as a horizontal line).

For ten days, from April 9 to April 19, the bank repeatedly assured the OCC that the CIO whale trades were nothing to worry about. JPMorgan Chase did not update the OCC again until May 4, 2012,[1373] despite, as the above chart shows, increasing losses and breaches of the CIO's MTM stop loss limit. The OCC told the Subcommittee that the bank should have alerted the agency when the SCP losses intensified. The bank also did not update the OCC on Achilles Macris' request at the end of March that JPMorgan employees, Ashley Bacon and Olivier Vigneron, who worked in the Investment Bank, be diverted "for help with the synthetic credit book," because Mr. Macris had "lost confidence" in his team.[1374] In addition, the bank did not update the OCC, as it should have, on then-$500 million in CIO collateral disputes indicating that the CIO may have been overvaluing SCP assets and understating its losses.[1375] According to the OCC, for nearly three

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[1373] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1374] See 3/30/2012 email from Achilles Macris, CIO, to John Hogan, JPMorgan Chase, "synthetic credit- crisis action plan," JPM-CIO-PSI 0001220. Mr. Macris' request was granted.
[1375] See, e.g., 4/20/2012 email from Mark Demo, JPMorgan Chase, to John Wilmot, CIO, and others, "Largest OTC Collateral Call Dispute Report plus Update on Collateral Disputes Reported to Supervisors," JPM-CIO-PSI-H 0000141-146, at 142 (reporting that the CIO collateral disputes involving the London trades were over $500 million."). This email was forwarded to Ina Drew, CIO, and Irvin Goldman, CIO, on 4/23/2012. Id., at 141.

weeks, the bank did not call, email, or otherwise update the OCC about any aspect of the SCP's worsening status.[1376]

Then, on May 4, 2012, a few days before JPMorgan Chase had to file a 10-Q report with the SEC publicly disclosing its first quarter financial results, two senior bank executives telephoned the OCC Examiner-In-Charge to inform the OCC that the SCP had incurred "current losses" of "approximately $1.6 billion."[1377] According to the OCC, the bank's Chief Financial Officer, Douglas Braunstein, told the OCC during the call that the losses were the result of "positions established some time ago,"[1378] a characterization that, according to OCC, was "not accurate" because the losses were largely caused by derivative purchases made in the first quarter of 2012.[1379] The Examiner-In-Charge told the Subcommittee that he was taken aback at the time, since the bank should have updated him about the mounting losses prior to that telephone call.[1380]

As a later OCC email explained, the bank had indicated in an April briefing that it was conducting its own review into the trades, and the OCC had asked to be kept informed:

> "Ina Drew indicated that they had begun looking into what happened ... and would keep us informed. ... We told the bank to keep us informed and we would like to see the results. ... The bank didn't provide an incremental update on their work as we requested."[1381]

The OCC had apparently decided to wait for the results of the bank investigation without initiating its own inquiry. While it was waiting, on April 25, 2012, the OCC received a weekly summary showing that the CIO's mark-to-market losses had climbed to $1.4 billion.[1382] The OCC told the Subcommittee that amount of loss was "material" and should have prompted an immediate OCC communication to the CIO.[1383]

[1376] See 5/6/2012 email from Fred Crumlish, OCC, to James Hohl, OCC, and others, "CIO Synthetic Position," OCC-SPI-00021853; Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
[1377] 5/4/2012 email from Scott Waterhouse, OCC, to Fred Crumlish, OCC, "CIO Synthetic Position," OCC-SPI-00021853 ("Doug Braunstein and John Hogan called to provide an update on the CIO position. ... Current losses are approximately $1.6 billion."). In fact, according to SCP profit-loss reports, as of the day before the call, SCP cumulative losses were actually $2.3 billion. See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee in Chapter IV.
[1378] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012) (referencing his own notes of the call from Mr. Braunstein and Mr. Hogan at 5/5/2012 email from Scott Waterhouse, OCC, to Fred Crumlish, OCC, and others, "CIO Synthetic Position," OCC-SPI-00021853).
[1379] Subcommittee interview of James Hohl, OCC (9/6/2012).
[1380] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
[1381] 5/17/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, "Your request of last night, re OCC response on cio," OCC-00005554.
[1382] 4/25/2012 email from Geralynn Batista, OCC, to Fred Crumlish, OCC, and others, "Weekly Market Summary period ending 4/20," OCC-SPI-00023753.
[1383] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

While the OCC examiner who normally reviewed that weekly report was then on vacation, his subordinates failed to notice the size of the loss and no one made any call to the bank to ask about it.[1384]

After the bank's telephone call on May 4 disclosed that the SCP's "current losses" were $1.6 billion, the OCC began to meet with the bank on a daily basis to gain a better understanding of the SCP and its risks to the bank.[1385] The OCC told the Subcommittee that, even then, the bank often provided limited information, with one OCC examiner characterizing the reporting as "terrible."[1386] For example, later in May 2012, the OCC asked for a comprehensive set of SCP positions, instead of the scant summary table provided in April.[1387] The OCC told the Subcommittee that the bank responded by providing a long list of 60,000 positions[1388] in a format useless for data analysis purposes, frustrating the OCC's efforts to understand the portfolio.[1389] Ultimately, after repeated requests, the OCC told the Subcommittee it believed it received the necessary information.[1390] While the OCC's difficulty in obtaining information offers additional proof of the bank's unacceptable conduct, they also highlight, once again, the OCC's failure to establish an effective regulatory relationship with JPMorgan Chase. The OCC has since cited the bank for its inadequate provision of information about the whale trades in a Supervisory Letter, detailing the problem in a Matter Requiring Attention specifically referencing the time period in April and early May 2012.[1391]

(3) Hiding Problems with the Marks

In the spring of 2012, one of the key OCC oversight issues involved questions regarding the accuracy of the profit and loss (P&L) figures for the SCP and whether the CIO had been reporting overly favorable valuations of SCP assets to hide losses. Beginning in late January 2012, the CIO had begun to mismark the SCP book, providing

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1384 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012); Subcommittee interview of Fred Crumlish, OCC (8/28/2012) (noting that no one at the OCC had been watching this report while he was on vacation at this time).

1385 5/6/2012 email from Fred Crumlish, OCC, to James Hohl, OCC, and others, "CIO Synthetic Position," OCC-SPI-00021853 ("But at this point, the remaining position is too large and the bank is trying to reduce risk. ... The bank is taking action now to further reduce the exposure.").

1386 Subcommittee interview of Fred Crumlish, OCC (8/29/2012); see also 5/15/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, "May 15 CIO," OCC-SPI-00010657 ("This update wasn't supported by quantitative information requested yesterday.").

1387 Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012) (explaining that the OCC rarely looks at individual positions and does not have any access to position data without making a specific request to the bank.)

1388 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

1389 See 5/17/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, OCC, and others, "History of Trades" OCC-00004035; Subcommittee interview of Elwyn Wong, OCC (8/20/2012).

1390 Subcommittee interview of Elwyn Wong, OCC (8/20/2012).

1391 See 12/12/2012 OCC Supervisory Letter JPM-2012-66, at PSI-OCC-18-000001, at 003 [Sealed Exhibit].

more favorable asset valuations than its usual practice and understating its losses.[1392] Despite growing evidence of the problem, when the OCC inquired about possible mismarking, the bank initially denied the allegations and only months later acknowledged what had happened.

On May 9, 2012, the OCC held a meeting with JPMorgan Chase about the CIO, which was attended by the bank's Chief Risk Officer John Hogan.[1393] At the meeting, an OCC examiner asked Mr. Hogan when he realized the SCP books had been mismarked, and according to the examiner, Mr. Hogan responded that the books were not mismarked.[1394] The OCC told the Subcommittee that it was not satisfied that his response was accurate.[1395] The bank later conceded that the SCP positions were mismarked.[1396]

The OCC told the Subcommittee that Mr. Hogan's quick dismissal of the mismarking allegation was surprising at the time. Criticisms of the CIO's valuation practices had been reported by the bank's internal auditors[1397] and OCC[1398] since the beginning of the year. In addition, by the time of the meeting in May, the CIO was facing multiple collateral disputes with counterparties claiming the CIO was overvaluing the SCP assets, disputes which, at their largest point, totaled $690 million.[1399] As

[1392] For more information about the mismarking, see Chapter IV.
[1393] See, e.g., 5/10/2012 email from Michael Kirk, OCC, to Fred Crumlish and James Hohl, OCC, "My opinion on yesterday's meeting," OCC-00005302, at 303 ("I wasn't satisfied with the comments made about the valuation process and thresholds yesterday, so we have some follow up here. ... Valuation was one of the things Hogan said they are looking at."); Subcommittee interview of Michael Kirk, OCC (8/22/2012).
[1394] Subcommittee interview of Michael Kirk, OCC (8/22/2012); 5/9/2012 email from Michael Kirk, OCC, to Fred Crumlish, OCC, "today's meeting," OCC-00005509. See also 6/29/2012 email from Michael Kirk, OCC, to Elwyn Wong, Scott Waterhouse, and Fred Crumlish "2nd Wilmer Hale Call," OCC-SPI-00071386 ("On that very first daily call, Hogan discussed that earlier there had been a large collateral dispute with their counterparties. I questioned him on how it was resolved and he said JPM eventually agreed to the counterparties marks.... I then followed with a question relating to what I described as mismarked books to which Hogan forcefully stated JPM books were not mismarked; leaving both Elwyn and me ... puzzled over how a collateral dispute could be resolved by agreeing to the counterparties marks, without admitting your own marks were incorrect.").
[1395] Subcommittee interview of Michael Kirk, OCC (8/22/2012).
[1396] See 2013 JPMorgan Chase Task Force Report, at 89.
[1397] See March 2012, 2012 Continuous Audit Quarterly Summary of Global Chief Investment Office, OCC-SPI-00033688-693, at 692 (identifying as a problem "CIO VCG practices where a number of risk & valuation models have not been reviewed by Model Review Group and included the absence of a formally applied price sourcing hierarchy, insufficient consideration of potentially applicable fair value adjustments (e.g. concentration reserves for significant credit indices positions) and the lack of formally documented/consistently applied price testing thresholds.").
[1398] Subcommittee interview of Jaymin Berg, OCC (8/31/2012); 3/9/2012 Supervisory Letter JPM-2012-09 from Scott Waterhouse, OCC, to Ashley Bacon, JPMorgan Chase, "Examination of FSI Stress Testing Framework," (citing a Matter Requiring Attention: "Methodology for valuation should be described") [Sealed Exhibit].
[1399] See, e.g., 5/14/2012 email from James Hohl, OCC, to Fred Crumlish, OCC, and others, "May 14 minutes," OCC-SPI-00025835. For more information about these collateral disputes, see Chapter IV.

one OCC examiner said at the time, "Does not add up."[1400] Either the CIO's counterparties in the collateral dispute were wrong, or the CIO's pricing was wrong,[1401] and its reserves were inadequate.[1402] Not more than a week later, the CIO began to settle its collateral disputes by agreeing to the prices demanded by its counterparties,[1403] but it took another two months for JPMorgan Chase to reveal to the OCC, as well as to the public, that the CIO traders had, in fact, been mispricing the SCP assets.[1404] The bank told the Subcommittee that it had believed the CIO was using good faith marks for the SCP book until it began reviewing telephone calls by CIO personnel in June and decided it had to restate the SCP values.[1405]

The OCC examiners picked up on red flags signaling that the bank may have been engaged in mispricing, such as its collateral disputes and low reserves amount. What the OCC did not know at that point was whether the mismarking was the result of inadequate procedures and policies at the bank or a deliberate effort to hide or downplay losses in the SCP. While Mr. Hogan may have been sincere in his May 9 assertion that the CIO's books were not mismarked, others at the bank knew better. Yet it was not until July 2012 that the bank came clean. One OCC examiner told the Subcommittee that by withholding information about how the CIO traders had mismarked SCP assets, the bank had "lied to" and "deceived" its regulator.[1406]

[1400] 5/15/2012 email exchange among Fred Crumlish, Scott Waterhouse, Elwyn Wong, and others, OCC, "FW:," OCC-SPI-00009335 (stated by Elwyn Wong). See also 6/29/2012 email from Michael Kirk, OCC, to Elwyn Wong, Scott Waterhouse, and Fred Crumlish, "2nd Wilmer Hale Call," OCC-SPI-00071386.

[1401] Subcommittee interview of Elwyn Wong, OCC (8/20/2012). The OCC's logic was the same as that used by others at JPMorgan Chase, as when Daniel Pinto, then a senior executive with JPMorgan Chase's Investment Bank, argued with SCP trader Javier Martin-Artajo that the Investment Bank's marks were accurate because, unlike the CIO, the Investment Bank had no collateral disputes. See 3/23/2012 recorded telephone conversation among Achilles Macris and Javier Martin-Artajo, CIO, and Daniel Pinto, Investment Bank, JPM-CIO-PSI-A 0000140.

[1402] 5/18/2012 email from Mike Kirk, OCC, to Elwyn Wong, OCC, and others, "CIO Valuation Summary Memo," OCC-SPI-00021894 ("When we questioned the lack of reserves the bank missed the point ...").

[1403] See 5/14/2012 email from James Hohl, OCC, to Fred Crumlish, OCC, "May 14 Minutes," OCC-SPI-00025835 ("At the time of original valuation, the bank thought the book was valued correctly, but have changed their view and have agreed to counter party levels.").

[1404] See JPMorgan Chase Press Release, "JPMorgan Chase to Amend Interim Financial Statements for 2012 First Quarter," (7/13/2012), http://investor.shareholder.com/jpmorganchase/releasedetail.cfm?ReleaseID=691703 (reporting that the bank would reduce its previously-reported net income for the 2012 first quarter by $660 million -- $459 million after taxes -- due to increased CIO losses); JPMorgan Chase Form 8-K (7/13/2012) ("The restatement relates to valuations of certain positions in the synthetic credit portfolio in the Firm's Chief Investment Office [CIO]. ...[T]he recently discovered information raises questions about the integrity of the trader marks, and suggests that certain individuals may have been seeking to avoid showing the full amount of the losses being incurred the portfolio during the first quarter."). For more information, see Chapter IV.

[1405] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012). For more information, see Chapter IV.

[1406] Subcommittee interview of Michael Kirk, OCC (8/22/2012).

E. OCC Aftermath

The whale trades were made public three days before Thomas Curry took office as the new Comptroller of the Currency and head of the OCC. By early May 2012, hardly a month into his new position, Thomas Curry was confronted with the need to initiate an investigation into the whale trades, determine what happened at the bank, and decide what the OCC should do about it.

On May 11, 2012, the day after JPMorgan Chase announced publicly the unexpected increase in losses associated with the whale trades, the head of the OCC's Large Bank Supervision division, Michael Brosnan, advised Comptroller Curry to view the trades as little more than an embarrassing incident: "[O]bviously there isn't a safety issue with these numbers, but there is an embarrassment issue for bank leadership which has overtly expressed pride in their ability to measure and control risk."[1407] The new Comptroller replied: "Isn't it a little more than an embarrassment issue?"[1408] Mr. Brosnan disagreed, responding: "At end of day they are good at financial risk mngt. But they are human and will make mistakes (big loan losses, trading losses, litigation etc)."[1409] Even though JPMorgan Chase had kept the OCC in the dark about the existence of the SCP for years, hid its escalating losses from the agency, rejected the OCC's questions about the mismarking of the book, and provided relatively little useful information about the SCP in response to OCC requests, Mr. Brosnan expressed no misgivings and did not wait to express his confident judgment that JPMorgan Chase was "good at financial risk mngt."[1410] The bank later proved him wrong by publicly admitting a "material weakness" in its "internal control over financial reporting,"[1411] and stating that "CIO Risk Management was ineffective."[1412]

Over the next few days, the U.S. Senate Committee on Banking, Housing, and Urban Affairs sought information from federal financial regulators about the whale trades reported in the press. One issue of concern was whether the whale trades should be viewed as hedges that lowered bank risk or as proprietary bets geared to produce bank profits. That issue was of particular interest, because the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 included the

[1407] 5/11/2012 email from Senior Deputy Comptroller for Large Bank Supervision Mike Brosnan, OCC, to Thomas Curry, OCC, "J.P. Morgan Chase," OCC-SPI-00000031, at 032.
[1408] 5/11/2012 email from Thomas Curry, OCC, to Mike Brosnan, OCC "J.P. Morgan Chase," OCC-SPI-00000031.
[1409] 5/11/2012 email from Michael Brosnan, OCC, to Thomas Curry and Julie Williams, OCC, "J.P.Morgan Chase," OCC-00001746.
[1410] Id.
[1411] 7/13/2012 Form 8-K, JPMorgan Chase & Co., at 4, http://investor.shareholder.com/jpmorganchase/ secfiling.cfm?filingID=1193125-12-301391.
[1412] See 7/13/2012 Form 8-K, JPMorgan Chase & Co., at Exhibit 99.3, p. 2. http://files.shareholder.com/downloads/ONE/1934577619x0xS19617-12-248/19617/filing.pdf.

Merkley-Levin provisions, known as the Volcker Rule, that prohibited high risk proprietary trading by insured banks, but permitted "risk mitigating" hedges. In 2011, regulations were proposed to implement the Volcker Rule, but have yet to be finalized.[1413] On May 12, 2012, when staff for Senator Robert Corker, a member of the Senate Banking Committee, asked the OCC if the proposed Volcker Rule would have permitted the CIO's whale trades, the OCC responded that it would, based upon information provided by Mr. Brosnan.[1414] On Monday, May 14, when Senator Corker, who had been briefed by his staff using the information from the OCC, said as much to the media,[1415] the OCC had to backtrack, stating it was "premature to conclude" whether or not the Volcker Rule would allow such activity.[1416]

On May 18, 2012, multiple Federal financial regulators held a general briefing for Senate staff, hosted by the Senate Banking Committee, regarding issues related to the CIO losses. Ms. Williams, the OCC's Chief Counsel, prepared handwritten talking points for her use at the briefing. Her talking points stated in part: "JPMC transactions at issue involved an effort to hedge the bank's credit risk. Hedging credit risk is not uncommon, and if done properly, reflects sound risk management."[1417]

Later press accounts reported that, according to Senate staff in attendance at the briefing, Ms. Williams characterized the CIO trades as a "risk reducing hedge that would be allowable under the Volcker

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[1413] See, e.g., Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (11/7/2011).
[1414] See 5/12/2012 email from Carrie Moore, OCC, to Michael Bright, with Senator Corker, "JPM," OCC-00005121 ("These trades would have been allowed even if the Volcker Rule was in place."); Subcommittee interview of Julie Williams, OCC (9/13/2012) (stated by Carrie Moore); see also 4/20/2012 email from Michael Brosnan, OCC, to Sally Belshaw and Scott Waterhouse, OCC, "Pls read, edit and send back. Thx," OCC-00002135 ("[T]hey are not running afoul of inappropriate 'proprietary trading' issues."); 5/15/2012 email from Michael Brosnan, OCC, to Bryan Hubbard, OCC, and others, "updated talking points on site team is good with this version various," OCC-00002263 ("Corker was right. It is us/me that will now be reserved and leave some room for interpretation etc later.").
[1415] See, e.g., "JPMorgan Losses: Senators Levin, Corker Debate Implementing Financial Regulation," PBS News Hour (5/14/2012), at http://www.pbs.org/newshour/bb/politics/jan-june12/wallstreet_05-14.html (Senator Corker: "We have been in conversations all weekend with the OCC, the Office of [the Comptroller of the] Currency, and ... they have been very adamant that even if the Volcker rule, which the senator was referring to, was fully implemented, that this would have been permitted activity. During the course of the day, we were just talking, they have altered their position and said that this is more complex than they thought and they really want to hold off.").
[1416] See 5/14/2012 email from Bryan Hubbard, OCC, to Al Zibel, Dow Jones, Ben Protess, New York Times, and others, "OCC on JPMC Trading," OCC-00001361 ("It is premature to conclude whether the Volcker Rule in the Dodd-Frank Act would have prohibited these trades and the hedging activity conducted by JPMC. ... Previous positions attributed to OCC staff were based on incomplete details."); "JPMorgan's Trades Probed by U.S. National Bank Regulator," Bloomberg News, Cheyenne Hopkins (5/14/2012), http://www.bloomberg.com/news/2012-05-14/u-s-national-bank-regulator-examining-jpmorgan-s-risky-trading.html.
[1417] 5/18/2012 handwritten notes of Julie Williams, OCC, "SBC Staff Briefing," PSI-OCC-10-000001.

Rule."[1418] When asked about her remarks, however, Ms. Williams told the Subcommittee that she did not refer to the Volcker Rule during the briefing, asserting that she would not have opined on that issue at all.[1419] Whether or not she referred to the Volcker Rule, her talking points indicate that she had already reached a conclusion that the SCP functioned as a "hedge," despite significant evidence to the contrary.

The initial reactions of Ms. Williams and Mr. Brosnan, two of the OCC's then-most senior officials, were to view JPMorgan Chase as an effective risk manager and to view the Synthetic Credit Portfolio as a hedge that would lower bank risk. The skepticism and demand for hard evidence that might be expected of bank regulators were absent. Also, the OCC did not question JPMorgan Chase's resistance to providing critical information needed for effective bank oversight.

Since the spring of 2012, the OCC has strengthened its oversight of the CIO and JPMorgan Chase. First, it increased the level of staffing, including expert staffing in derivatives, at the bank.[1420] The OCC did not have derivatives experts on their supervision team with CIO responsibility until roughly April, when the lead capital markets examiner tapped one, then two OCC examiners with derivatives expertise.[1421] Most of the credit derivatives in the SCP have since been transferred out of the CIO to the Investment Bank; only a relatively limited group of relatively uncomplicated credit index investments remain. Final implementation of the Volcker Rule will require the OCC to evaluate the remaining portfolio of synthetic credit derivatives to determine whether they, in fact, hedge specific bank assets or function as proprietary trading.

Secondly, the OCC examination team initiated a more rigorous examination of the CIO and related controls through its on-site supervision team. That team conducted reviews of the "level of risk, the quality of risk management, audit coverage, model control processes, regulatory capital reporting, and position valuations" at the CIO.[1422] As a result, in July 2012, OCC downgraded the bank's CAMELS management rating for its "lax governance and oversight in the Chief

[1418] See "Closed-Door Battle Over Volcker Spills Into Public View," American Banker, Kevin Wack (5/22/2012), http://www.americanbanker.com/issues/177_98/Gary-Gensler-Mary-Schapiro-Volcker-Rule-JPMorgan-Chase-1049494-1.html ("OCC Chief Counsel Julie Williams argued at the briefing that the trades were a risk-reducing hedge that would be allowable under the Volcker Rule, though she did not provide information to support that view, according to a Democratic aide who was in attendance.").

[1419] Subcommittee interview of Julie Williams, OCC (9/13/2012).

[1420] Fred Crumlish added examiners Elwyn Wong and Mike Kirk. See Subcommittee interview of Fred Crumlish, OCC (8/28/2012); Subcommittee interview of Elwyn Wong, OCC (8/20/2012); Subcommittee interview of Mike Kirk, OCC (8/22/2012).

[1421] See 5/17/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, "Your request of last night," OCC-00005554.

[1422] 10/26/2012 memorandum from Sally Belshaw, OCC, to Mike Brosnan, OCC, "Surrounding Losses at CIO and Lessons Learned," PSI-OCC-13-000001 [Sealed Exhibit].

Investment Office," as well as other "oversight deficiencies."[1423] In a Supervisory Letter summarizing its examination of CIO oversight and governance structures, the OCC concluded that the JPMorgan Chase "board and management failed to ensure that CIO management was properly supervised, and that an adequate risk management and control infrastructure was in place."[1424]

Altogether, the OCC issued six Supervisory Letters related to the problems detected in connection with the whale trades.[1425] The Supervisory Letters include 20 Matters Requiring Attention (MRAs) which the bank must address by undertaking corrective action, and in some cases, has already taken required steps. Among them, the OCC criticized CIO risk management, which "allowed CIO synthetic credit trading desk to operate in an unsafe and unsound manner."[1426] In its review of the CIO's "VaR Model Risk Management," the OCC concluded that the CIO's practices were not only "weak and constitute[d] an unsafe and unsound bank practice," but also that they resulted in two regulatory violations.[1427] Additionally, the OCC found "unsafe and unsound practices" in the CIO's valuation processes, especially noting that "[t]he CIO did not use collateral differences with its trading counterparties as an information source for potential valuation issues."[1428] The OCC also explicitly criticized the bank for providing inadequate information about the whale trades.[1429] Outside the CIO, OCC criticized JPMorgan Chase's audit coverage and practices for failing to "identify unsafe and unsound practices in the CIO."[1430]

On January 14, 2013, the OCC took a formal enforcement action by issuing a Cease and Desist order against the bank, to which the bank consented.[1431] The OCC is authorized to issue Cease and Desist orders

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[1423] 7/27/2012 OCC Supervisory Letter JPM-2012-33, "JPMorgan Chase Bank, N.A. Management Rating," PSI-OCC-17-000003 [Sealed Exhibit].
[1424] 12/12/2012 OCC Supervisory Letter JPM-2012-66, "CIO Oversight and Governance Examination," PSI-OCC-18-00001 [Sealed Exhibit].
[1425] 10/26/2012 memorandum from Sally Belshaw, OCC, to Mike Brosnan, OCC, "Surrounding Losses at CIO and Lessons Learned," at PSI-OCC-13-000011-012 [Sealed Exhibit]; Subcommittee briefing by the OCC (11/29/2012). The OCC Supervisory Letters address "Model Approvals and Risk Weighted Assets," "Audit Coverage of CIO Activities," "CIO Risk Management Review," "Examination of VaR Model Risk Management," "Examination of CIO Valuation Governance," and "CIO Oversight and Governance."
[1426] 11/6/2012 OCC Supervisory Letter JPM-2012-52, "Chief Investment Office Risk Management Review," PSI-OCC-17-000015 [Sealed Exhibit].
[1427] 11/6/2012 OCC Supervisory Letter JPM-2012-53, "Examination of VAR Model Risk Management," PSI-OCC-17-000019 [Sealed Exhibit]; see also 8/14/2012 OCC Supervisory Letter JPM-2012-37, "Model Approvals and Risk Weighted Assets," PSI-OCC-17-000001 [Sealed Exhibit].
[1428] 11/27/2012 OCC Supervisory Letter JPM-2012-59, "CIO Valuation Governance Examination," PSI-OCC-17-0000025 [Sealed Exhibit].
[1429] See 12/12/2012 OCC Supervisory Letter JPM-2012-66, at PSI-OCC-18-000001, at 003.
[1430] 8/31/2012 OCC Supervisory Letter JPM-2012-40, "Audit Coverage of the Chief Investment Office," PSI-OCC-17-000005 [Sealed Exhibit].
[1431] 1/14/2013 In the Matter of JPMorgan Chase, N.A., OCC Consent Order, http://occ.gov/news-issuances/news-releases/2013/nr-occ-2013-7a.pdf

under 12 U.S.C. § 1818(b), which allows the OCC to take action if it has reasonable cause to believe that an insured depository institution has violated a law or regulation, or engaged in unsafe business practices.[1432] The order requires and the bank has consented to undertake a number of actions to strengthen its risk management and derivatives trading practices, actions which the OCC will need to monitor to ensure needed reforms are made. For example, in one case, the bank has promised to respond to risk limit breaches by requiring "the business [to] promptly take steps to reduce exposure to within limit, unless a one-off approval for a limited period of time is granted,"[1433] a measure which merely restates the same policy the bank had in place prior to the whale trades. Regulators must ensure our largest financial institution strengthens its procedures and policies.

In addition, Comptroller Curry has taken steps to strengthen the OCC's regulatory culture. As a first step, he initiated an independent internal review of both the bank and the OCC supervision, looking to gain "lessons learned."[1434] With respect to the bank, the OCC's internal review identified a number of problems with both the CIO and JPMorgan Chase, such as the bank's use of certain unapproved risk models, and the poor performance of the bank's Legal/Compliance department, which delayed responses to OCC inquiries and provided sometimes incomplete or even incorrect answers.[1435] The OCC appears to have begun the hard work of recalibrating its relationship with JPMorgan Chase to ensure the bank meets its regulatory obligations. For its part, JPMorgan Chase has stated in its Task Force Report that it is working towards a more transparent relationship with its regulators.[1436]

The OCC internal review also presented six recommendations for improvements to its Large Bank Supervision division, which accepted all six. The recommendations required the Large Bank Supervision division to improve its use of appropriate resources, such as derivatives trading experts; incorporate practices to minimize regulatory surprises to the OCC, such as by periodically reviewing desk level reports to catch inconsistencies in information given to senior management; proactively examine banks' regulatory capital models; and institute more disciplined MRA follow-up, among other reforms.[1437] The internal report's analysis and recommendations have been the subject of presentations by the

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[1432] 12 U.S.C. § 1818(b) (2011).
[1433] 1/11/2013 letter from John Hogan, JPMorgan Chase, to Scott Waterhouse, OCC, "JPM-2012-66 CIO Oversight and Governance Examination," PSI-OCC-22-000001, at 006.
[1434] 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000014 [Sealed Exhibit]; Subcommittee interview of Michael Sullivan, OCC (8/30/2012) (report sought by Mr. Curry).
[1435] 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000037-038 [Sealed Exhibit].
[1436] 2013 JPMorgan Chase Task Force Report, at 111.
[1437] 10/26/2012 memorandum from Sally Belshaw, OCC, to Mike Brosnan, OCC, "Surrounding Losses at CIO and Lessons Learned," PSI-OCC-13-000001-013 [Sealed Exhibit].

OCC to both U.S. and international regulators in addition to internal OCC groups of examination staff.[1438]

F. Analysis

The whale trades provide a striking case history of how a major bank, with 65 bank examiners on site, can keep a multi-billion-dollar derivatives portfolio off the radar screen of its regulator for years, at least until it begins to lose money. For nearly six years, JPMorgan Chase failed to disclose key information to its primary regulator about the CIO's Synthetic Credit Portfolio, even though the bank claimed it played an important role in hedging the bank's credit risk. The bank failed to report the existence of the portfolio to the OCC when it was created, during a 2010 examination of CIO investment portfolios, when it expanded in size by tenfold in 2011, and when it produced approximately $400 million in 2011 profits. Along the way, at times, bank personnel lectured OCC examiners about being overly intrusive. The bank first reported the SCP to the OCC in January 2012, when it began breaching the bank's VaR limit and incurring losses, but even then the bank misinformed the OCC about its significance by describing plans to reduce its size. As SCP losses mounted during the first few months of 2012, the bank failed to include information about the SCP in routine reports to the OCC. When the CIO repeatedly breached internal risk and stress limits, the bank downplayed their significance and allowed the breaches to continue. After the whale trades attracted media attention, the bank still resisted providing detailed SCP information to the OCC, disclosing the extent of the SCP losses only when it was legally compelled to disclose its financial results in an SEC filing. The OCC's repeated requests were often ignored and not adequately enforced.

The questionable bank practices that came to light when the whale trades were disclosed includes the CIO's creation of a high risk trading portfolio using bank deposits, using valuation practices to hide losses, disregarding breaches of risk limits, manipulating risk and capital models to artificially lower the portfolio's risk profile, and dodging OCC oversight. Because JPMorgan Chase provided such limited information about the SCP, the OCC remained in the dark about the size and risks of the portfolio for years. When losses began rolling in, it had to exercise oversight on the basis of incomplete, inaccurate, and misleading information. The bank's practices impeded the OCC's ability to detect and stop unsafe and unsound derivatives trading practices.

At the same time, not all the fault should be laid at the foot of the bank. Over the past two years, the OCC failed to notice or investigate bank reports of CIO risk limit breaches, failed to realize when monthly

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[1438] Id.

CIO reports weren't delivered, failed to insist on detailed trading data from the CIO needed for effective oversight, and failed to take firm action when the bank delayed or denied its requests for information. The OCC tolerated resistance by JPMorgan Chase to regulatory requests and failed to establish a regulatory relationship that mandated the bank's prompt cooperation with OCC oversight efforts. The new Comptroller appears to be taking actions to correct that fundamental oversight problem. In its 2012 examinations of the CIO, for example, the OCC adopted a "clean slate" approach, requiring the bank to produce basic information about the CIO from the ground up to support all assertions about its operations.[1439] The question is whether the OCC can recalibrate its regulatory relationship to achieve effective oversight, not only with JPMorgan Chase, but also other large financial institutions.

[1439] Subcommittee interview of Fred Crumlish, OCC (8/28/2012).

VII: MISINFORMING INVESTORS, REGULATORS AND THE PUBLIC

To ensure fair, open, and efficient markets for investors, Federal securities laws impose specific disclosure obligations on market participants. Public statements and SEC filings made by JPMorgan Chase in April and May 2012 raise questions about the timeliness, completeness, and accuracy of information presented about the CIO whale trades.

The CIO whale trades were not disclosed to the public in any way until April 2012, despite more than $1 billion in losses and widespread problems affecting the CIO and the bank, as described in the earlier chapters of this Report. On April 6, 2012, media reports focused public attention on the whale trades for the first time; on April 10, which was the next trading day, the SCP reported internally a $415 million loss. The bank's communications officer and chief investor liaison circulated talking points and, that same day, April 10, met with reporters and analysts to deliver reassuring messages about the SCP. Their primary objectives were to communicate, among other matters, that the CIO's activities were "for hedging purposes" and that the regulators were "fully aware" of its activities, neither of which was true. The following day, April 11, one of the traders told Ms. Drew, "The bank's communications yesterday are starting to work," suggesting they were quieting the markets and resulting in reduced portfolio losses.

At the end of the week, on April 13, 2012, JPMorgan Chase filed an 8-K report with the SEC with information about the bank's first quarter financial results and also hosted an earnings call. On that call, JPMorgan Chase Chief Financial Officer Douglas Braunstein reassured investors, analysts, and the public that the CIO's trading activities were made on a long-term basis, were transparent to regulators, had been approved by the bank's risk managers, and served a hedging function that lowered risk and would ultimately be permitted under the Volcker Rule whose regulations were still being developed. CEO Jamie Dimon dismissed the media reports about the SCP as "a complete tempest in a teapot."

A month later, in connection with its May 10, 2012 10-Q filing finalizing its first quarter financial results, the bank announced that the SCP had lost $2 billion, would likely lose more, and was much riskier than earlier portrayed. The 10-Q filing stated: "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." Though the markets did not react against JPMorgan Chase's stock after the reassuring April 13 8-K filing and earnings call, the bank's stock did drop after the May 10 10-Q filing and call. It dropped again after its announcement on May 15 that Ina Drew was departing the bank,[1440] declining from $40.74/share on May 10 to $33.93/share one week later on May 17, a drop of 17%. The stock continued to decline to $31/share on June 4, representing an overall decline of 24%, without any other apparent intervening event during that time period.

Given the information that bank executives possessed in advance of the bank's public communications on April 10, April 13, and May 10, the written and verbal representations made by the bank were incomplete, contained numerous inaccuracies, and misinformed investors, regulators, and the public about the CIO's Synthetic Credit Portfolio.

More than a Tempest in a Teapot. In the April 13 earnings call, in response to a question, Mr. Dimon dismissed media reports about the SCP as a "complete tempest in a teapot." While he later apologized for that comment, his judgment likely was of importance to investors in the immediate aftermath of those media reports. The evidence also indicates that, when he made that statement, Mr. Dimon was already in possession of information about the SCP's complex and sizeable portfolio, its sustained losses for three straight months, the exponential increase in those losses during March, and the difficulty of exiting the SCP's positions.

Mischaracterizing Involvement of Firmwide Risk Managers. Mr. Braunstein also stated on the April 13 earnings call that "all of those positions are put on pursuant to the risk management at the firm-wide level." The evidence indicates, however, that in 2012 JPMorgan Chase's firmwide risk managers knew little about the SCP and had no role in putting on its positions. For example, JPMorgan Chase's Chief Risk Officer John Hogan told the Subcommittee that prior to the April press reports, he had been unaware of the size and nature of the SCP, much less its mounting losses. Virtually no evidence indicates that he, his predecessor, or any other firmwide risk manager played any role in designing or approving the SCP positions acquired in 2012 until well after the April 13 earnings call when the bank's risk managers effectively took over management of the SCP. In addition, Mr. Braunstein's statement omitted any mention of the across-the-board risk limit breaches triggered by the SCP during the first quarter of 2012, even though those breaches would likely have been of interest to investors.

Mischaracterizing SCP as "Fully Transparent to the Regulators." In the bank's April 13 earnings call, Mr. Braunstein said that the SCP positions were "fully transparent to the regulators," who

[1440] See 5/15/2012 JPMorgan Chase & Co., Form 8-K, at 3, http://files.shareholder.com/downloads/ONE/ 2275559219x0xS1193125-12-233374/19617/filing.pdf ("On May 14, 2012, JPMorgan Chase & Co. ("JPMorgan Chase" or the "Firm") announced that Ina R. Drew, the Firm's Chief Investment Officer, had made the decision to retire from the Firm.").

"get information on those positions on a regular and recurring basis as part of our normalized reporting." In fact, the SCP positions had never been disclosed to the OCC in any regular bank report. The bank had described the SCP's positions to the OCC for the first time, in a general way, only a few days earlier and failed to provide more detailed information for more than a month. Mr. Braunstein's statement also omitted the fact that JPMorgan Chase had dodged OCC oversight of the SCP for years by failing to alert the agency to the establishment of the portfolio and failing to provide any portfolio-specific information in CIO reports. During the April 13 call, the bank led investors to believe that the SCP operated under close OCC supervision and oversight, when the truth was that the bank had provided barely any SCP data for the OCC to review.

Mischaracterizing SCP Decisions as "Made on a Very Long-Term Basis." On the bank's April 13 earnings call, Mr. Braunstein also stated that with regard to "managing" the stress loss positions of the Synthetic Credit Portfolio, "[a]ll of the decisions are made on a very long-term basis." In fact, the CIO credit traders engaged in daily derivatives trading, and the bank conceded the SCP was "actively traded." An internal CIO presentation in March 2012, provided to the bank's executive committee a month before the earnings call, indicated that the SCP operated on a "short" time horizon. In addition, many of the positions producing SCP losses had been acquired just weeks or months earlier. Mr. Braunstein's characterization of the SCP as making long-term investment decisions was contrary to both the short-term posture of the SCP, as well as how it actually operated in 2011 and 2012. His description was inaccurate at best, and deceptive at worst.

Mischaracterizing SCP Whale Trades As Providing "Stress Loss" Protection. During the April 13 call, Mr. Braunstein indicated that the SCP was intended to provide "stress loss" protection to the bank in the event of a credit crisis, essentially presenting the SCP as a portfolio designed to lower rather than increase bank risk. But in early April, days before the earnings call, Ms. Drew told the bank's executive committee that, overall, the SCP was "long" credit, a posture that multiple senior executives told the Subcommittee was inconsistent with providing protection against a credit crisis. Moreover, a detailed analysis reviewed by senior management two days before the April 13 earnings call showed that in multiple scenarios involving a deterioration of credit, the SCP would lose money. While the bank may have sought to reassure investors that the SCP lowered the bank's credit risk, in fact, as then configured, the SCP would have amplified rather than reduced the bank's losses in the event of a credit crisis. The bank's description of the SCP was simply erroneous.

Asserting SCP Trades Were Consistent With the Volcker Rule. The final point made in the April 13 earnings call by Mr. Braunstein was: "[W]e believe all of this is consistent with what we believe the ultimate outcome will be related to Volcker." The Volcker Rule is intended to reduce bank risk by prohibiting high-risk proprietary trading activities by federally insured banks, their affiliates, and subsidiaries. However, the Volcker Rule also allows certain trading activities to continue, including "risk-mitigating hedging activities." Mr. Braunstein's statement gave the misimpression that the SCP was "hedging" risk. When the Subcommittee asked the bank for any legal analyses regarding the Volcker Rule and the SCP, the bank responded that none existed. On the day prior to the earnings call, Ina Drew wrote to Mr. Braunstein that "the language in Volcker is unclear," a statement that presumably refers to the fact that the implementing regulation was then and still is under development. In addition, the bank had earlier written to regulators expressing concern that the SCP's derivatives trading would be "prohibited" by the Volcker Rule and asking for a change to the proposed rule to ensure it would be permitted. The bank omitted that analysis to investors, when asserting that the CIO would be allowed under the Volcker Rule to continue operating the SCP as before.

Omitting VaR Model Change. Near the end of January, the bank approved use of a new CIO Value-at-Risk (VaR) model that cut in half the SCP's purported risk profile, but failed to disclose that VaR model change in its April 8-K filing, and omitted the reason for returning to the old model in its May 10-Q filing. JPMorgan Chase was aware of the importance of VaR risk analysis to investors, because when the media first raised questions about the whale trades, the bank explicitly referred analysts to the CIO's VaR totals in its 2011 annual 10-K filing, filed on February 29, 2012. Yet, days later, on April 13, the bank's 8-K filing contained a misleading chart that listed the CIO's first quarter VaR total as $67 million, only $3 million more than the prior quarter, without also disclosing that the new figure was the product of a new VaR model that calculated much lower VaR results for the CIO than the prior model. An analyst or investor relying on the disclosed VaRs for the end of 2011 and the first quarter of 2012 would likely have believed that the positions underlying those VaRs were similar, since the VaR totals were very similar. The change in the VaR methodology effectively masked the significant changes in the portfolio.

When asked in a May 10 call with investors and analysts why the VaR model was changed, Mr. Dimon said the bank made "constant changes and updates to models, always trying to get them better," but did not disclose that the bank had reinstated the old CIO VaR model because the "update[d]" CIO VaR had understated risk by a factor of two, was error prone, and suffered from operational problems. The May 10-Q filing included a chart showing a revised CIO VaR for the first quarter of $129 million, which was twice the VaR amount initially reported for the first quarter, and also twice the average amounts in 2011 and 2010. The only explanation the May 10-Q filing provided was that the revised VaR "was calculated using a methodology consistent with the methodology used to calculate CIO's VaR in 2011."

Together, these misstatements and omissions about the involvement of the bank's risk managers in putting on SCP positions, the SCP's transparency to regulators, the long-term nature of its decisionmaking, its VaR results, its role as a risk-mitigating hedge, and its supposed consistency with the Volcker Rule, misinformed investors, regulators, and the public about the nature, activities, and riskiness of the CIO's credit derivatives during the first quarter of 2012.

A. Public Disclosure of Whale Trades and SCP

Prior to the media reports in early April 2012, the Synthetic Credit Portfolio (SCP) had not been mentioned by name in any JPMorgan Chase public filing; over the next month, the SCP received sustained attention in the bank's public filings, investor calls, and media communications. In response to media inquiries, the bank initially characterized the SCP as engaged in long-term, risk-reducing hedging activities that were known to its risk managers and regulators, and downplayed its losses. A month later, the bank completely revised its description of the SCP, characterizing it as having "morphed" into a risky trading activity that was poorly conceived and vetted, and which had caused billions of dollars in losses with more to follow.

The earliest evidence identified by the Subcommittee of information about the SCP in the public sphere is an April 5, 2012, internal bank email which informed bank management that reporters from Bloomberg and the Wall Street Journal were planning to publish news articles about trades involving the Synthetic Credit Portfolio and the Chief Investment Office. JPMorgan Chase's chief spokesperson, Joe Evangelisti, managing director and head of worldwide corporate communications and media relations, sent the email warning bank executives, including Jamie Dimon, that the media stories "are saying that JPMorgan basically has a large proprietary trading shop hidden in its CIO .... [and] that with increased capital rules and the upcoming Volcker Rule, these activities could come under pressure."[1441] He recommended that the bank convey the following message about the SCP and CIO:

> "I'd like us to hit hard the points that the CIO's activities are for hedging purposes and that the regulators are fully aware of our activities. I'd like to give them the following on the record:

[1441] 4/5/2012 email from Joseph Evangelisti, JPMorgan Chase, to Ina Drew, CIO, Douglas Braunstein, JPMorgan Chase, and others, "WSJ/Bloomberg CIO Stories," JPM-CIO-PSI 0000543, at 544.

- The Chief Investment Office is responsible for managing and hedging the firm's liquidity, foreign exchange, interest rate and other structural risks.
- Gains in the CIO offset and hedge losses in other parts of the firm.
  - The investments and positions undertaken by the CIO are to hedge positions and losses in other parts of the firm and are done in the context of our overall company risk management framework. Hedging gains reflected in our financial statements represent one side of a transaction that is hedging a loss in one of our main businesses.
- We cooperate closely with our regulators, and they are fully aware of our hedging activities."

Later that same day, Mr. Evangelisti revised the talking points based on comments he received from firm executives, and sent them to Jamie Dimon and Douglas Braunstein, among others.[1442] The revised talking points included two key changes. First, instead of stating that "Gains in the CIO offset and hedge losses," he wrote that the "CIO is focused on managing the long-term structural liabilities of the firm and is not focused on short-term profits. Our CIO activities hedge structural risks and invest to bring the company's assets and liabilities into better alignment."[1443] Secondly, he changed the statement, "We cooperate closely with our regulators, who are fully aware of our hedging activities," by removing the word "fully."[1444] Mr. Dimon responded to Mr. Evangelisti's proposed talking points with "Ok."[1445]

The Evangelisti email and talking points indicate that, from the beginning of the bank's public discussion of the SCP in April 2012, JPMorgan Chase planned to describe the portfolio as a risk-reducing hedge that was transparent to the bank's regulators, even though neither characterization was accurate. Furthermore, by tempering the points about hedging and transparency to regulators, the revision shows that bank was aware that its initial characterizations were not entirely true.

The next day, Friday, April 6, 2012, media reports disclosed that a CIO trader had accumulated massive positions in CDX indices, especially the Investment Grade Series 9. Bloomberg's article was entitled, "JPMorgan Trader Iksil's Heft Is Said to Distort Credit

[1442] 4/5/2012 email from Douglas Braunstein, JPMorgan Chase, to Joseph Evangelisti, JPMorgan Chase, "Revised: WSJ/Bloomberg CIO stories," JPM-CIO-PSI 0000543.
[1443] Id., at JPM-CIO-PSI 0000543-544.
[1444] Id.
[1445] Id.

Market";[1446] the Wall Street Journal's article was entitled, "London Whale Rattles Debt Market."[1447] Both focused on how enormous trades by the CIO were roiling world credit markets and affecting prices. The Wall Street Journal article also stated that a "person familiar with the matter" indicated that any reduction in Mr. Iksil's position could result in losses for the bank.[1448] On April 9, 2012, another Bloomberg article entitled, "JPMorgan Trader Iksil Fuels Prop-Trading Debate With Bets," linked the controversy over the CIO trades to implementation of the Volcker Rule, quoting legal counsel representing certain banks as stating, "I wouldn't be surprised if the pro-Volcker folks used this as a test case."[1449]

JPMorgan Chase's press and investor relations offices fielded a number of questions after the articles were published. Sarah Youngwood, head of investor relations, used Mr. Evangelisti's narrative the following day in a conversation with Ben Hesse,[1450] a research analyst at Fidelity, a JPMorgan Chase shareholder.[1451] According to her email at the time, she told him: "Members of the CIO take long-term hedging positions in the context of our overall asset/liability management," "[h]edging is core to the bank's activities," the CIO is "not focused on short-term profits," and "CIO results are disclosed in our quarterly earnings reports and are fully transparent to our regulators."[1452] The Subcommittee is unaware of any action taken by any personnel within the bank to correct this description of the SCP.

On Tuesday, April 10, the first trading day after the article was published, the Synthetic Credit Portfolio reported internally a loss of $415 million, the biggest SCP loss to date in 2012.[1453] JPMorgan Chase

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[1446] "JPMorgan Trader's Positions Said to Distort Credit Indexes," Bloomberg, Stephanie Ruhle, Bradley Keoun and Mary Childs (4/6/2012), http://www.bloomberg.com/news/2012-04-05/jpmorgan-trader-iksil-s-heft-is-said-to-distort-credit-indexes.html.

[1447] "'London Whale' Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne (4/6/2012). See also "JPMorgan Trader Accused Of 'Breaking' CDS Index Market With Massive Prop Position," Zero Hedge [blog], "Tyler Durden" (4/5/2012), http://www.zerohedge.com/print/446043.

[1448] "'London Whale' Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne (4/6/2012).

[1449] "JPMorgan Trader Iksil Fuels Prop-Trading Debate With Bets," Bloomberg, Shannon D. Harrington, Bradley Keoun and Christine Harper (4/9/2012), http://www.bloomberg.com/news/2012-04-09/jpmorgan-trader-iksil-fuels-prop-trading-debate-with-bets.html.

[1450] 4/6/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "CIO articles – Calls (2)," JPM-CIO-PSI 0000554.

[1451] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).

[1452] 4/6/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon and others, JPMorgan Chase, "CIO articles – Calls (2)," JPM-CIO-PSI 0000554. On her last point, however, CIO results were not separately disclosed in the bank's quarterly earnings reports but rather were reported as part of "Corporate" earnings. See 4/5/2012 email from Ina Drew, CIO, to Joseph Evangelisti, JPMorgan Chase, and Barry Zubrow, JPMorgan Chase, "Jamie's fine with this[,]" JPM-CIO-PSI 0000543 ("We do not disclose cio earnings – part of corporate").

[1453] See chart, prepared by the Subcommittee and printed in Chapter IV, tracking SCP's daily reported profit and loss (P&L) from January 3 to May 15, 2012, derived from an OCC told the Subcommittee that it had expected a large loss due to the press reports, which the bank viewed as exposing its trading positions and making the CIO more vulnerable.[1454]

On the same day as the loss, April 10, Messrs. Braunstein and Hogan were scheduled to provide a "backgrounder" with the Wall Street Journal.[1455] Mr. Evangelisti informed them that JPMorgan Chase had provided additional "background and on-the-record statements explaining the hedging activities of our CIO and putting these activities in the context of our overall asset and liability management. We also said that we now feel that our risks are effectively balanced."[1456] In addition, Sarah Youngwood, head of investor relations, reported that the bank had "4 more conversations on CIO articles" with analysts; she noted that "[a]ll of them understand our CIO activities. Joe [Evangelisti]'s statements [were] very helpful to the conversations."[1457]

The following day, Javier Martin-Artajo, head of the CIO's equity and credit trading operations, wrote to Ms. Drew, describing how JPMorgan Chase's response to the press articles was successfully reducing market pressure:

> "Ina, the market is quiet today. To[o] early to tell but so far about flat P/L [profit/loss]. **The tension has stopped now**. The bank's communications yesterday are starting to work. I hope that it keeps this way tomorrow."[1458]

At the end of that day, the CIO reported a final loss total of only $6 million, compared to $415 million in losses the prior day, and $5 million the next day,[1459] which seemed to confirm that the bank's communications were calming the market.

The next day, April 13, 2012, one week after the initial news reports about the SCP, JPMorgan Chase filed a Form 8-K with the SEC and held an earnings call with analysts, investors, the media, and others to discuss its expected first quarter earnings. The bank's filing and

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spreadsheet, OCC-SPI-00000298-304, at 302. Numbers do not reflect restated P&L figures after JPMorgan Chase's restatement in July 2012.

1454 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

1455 4/10/2012 email from Joseph Evangelisti, JPMorgan Chase, to Douglas Braunstein, JPMorgan Chase, and others, "WSJ call," JPM-CIO-PSI 0017427.

1456 4/10/2012 email from Joseph Evangelisti, JPMorgan Chase, to Operating Committee, JPMorgan Chase, "WSJ tomorrow," JPM-CIO-PSI 0001066.

1457 4/10/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "CIO articles – Calls (7), JPM-CIO-PSI 0001024.

1458 4/11/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, "Single names CDS basis relative to IG 9 CDS – URGENT update," JPM-CIO-PSI-H 0002340 [emphasis in original].

1459 See chart, prepared by the Subcommittee and printed in Chapter IV, tracking SCP's daily reported profit and loss (P&L) from January 3 to May 15, 2012, derived from an OCC spreadsheet, OCC-SPI-00000298-304, at 302. Numbers do not reflect restated P&L figures after JPMorgan Chase's restatement in July 2012. It is unclear whether the CIO calculated these losses using midpoint prices or more favorable prices to minimize the total reported losses.

written materials did not address the SCP or the whale trades directly,[1460] but Mr. Braunstein volunteered a number of comments about them during the earnings call.

On the call, Mr. Braunstein stated that he wanted to "talk about the topics in the news around CIO, and just sort of take a step back and remind our investors about that activity and performance."[1461] In his remarks, Mr. Braunstein described the CIO and its excess deposits portfolio. He then went on to state:

> "[W]e also need to manage the stress loss associated with that portfolio, and so we have put on positions to manage for a significant stress event in Credit. We have had that position on for many years and the activities that have been reported in the paper are basically part of managing that stress loss position, which we moderate and change over time depending upon our views as to what the risks are for stress loss from credit.
>
> All of those decisions are made on a very long-term basis. They are done to keep the Company effectively balanced from a risk standpoint. We are very comfortable with our positions as they are held today.
>
> And I would add that all of those positions are fully transparent to the regulators. They review them, have access to them at any point in time, get the information on those positions on a regular and recurring basis as part of our normalized reporting. All of those positions are put on pursuant to the risk management at the firm-wide level.
>
> The last comment I would make is that ... we believe all of this is consistent with what we believe the ultimate outcome will be related to Volcker."[1462]

Mr. Dimon made the following statements during the April 13, 2012 earnings call about the SCP in response to a reporter's question:

> "It's a complete tempest in a teapot. Every bank has a major portfolio. In those portfolios, you make investments that you think are wise, that offset your exposures. Obviously, it's a

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[1460] The 8-K filing did, however, contain a chart tracking the CIO's VaR totals, as discussed below. See 4/13/2012 JPMorgan Chase & Co., Form 8-K, at 42, http://files.shareholder.com/downloads/ONE/2063348229x0xS1193125-12-161533/19617/filing.pdf.

[1461] 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 7, JPM-CIO-PSI 0001151. See also "Transcript of Audio Recording of JPMorgan Chase Earnings Call With Media on April 13, 2012," prepared by the Subcommittee (transcribing a telephone call earlier in the day in which Mr. Braunstein volunteered similar statements about the SCP).

[1462] Id., at 7.

big portfolio. We're a large company and we try to run it. It's sophisticated, well, obviously, a complex thing. But at the end of the day, that's our job, is to invest that portfolio wisely and intelligently to – over a long period of time to earn income and to offset other exposures we have."[1463]

After the call, the bank's internal communications indicate that, of all the issues discussed on the call, bank personnel focused in particular on gauging the reaction to the bank's CIO commentary, likely because the bank's goal was to reassure the market. Ms. Youngwood emailed Mr. Dimon and Mr. Braunstein several hours after the call with a summary of calls from analysts, noting in the first line of her email: "We are now getting calls. Tone positive. No questions on CIO."[1464] Later that evening, she emailed them that there were "[v]ery few questions on CIO" on the "[l]ast batch of calls."[1465] Three days later, on April 16, the first trading day after the earnings call of April 13, Julien Grout, one of the SCP traders, emailed two other SCP traders, Bruno Iksil and Luis Buraya, crediting the April 13 statements for turning the market around:

"Positive signs start to appear since Jamie and Doug's comments on Friday: [t]he market has stopped going against our positions in an aggressive way. We have not seen the positions trading against us since Apr 10 and we have seen since Friday encouraging signs .... There is finally selling interest on IG 9 5 Yr, though not significant to reverse our loss but significant for the first time since the beginning of April and specially since our loss on Apr 10."[1466]

In describing the SCP on the earnings call, both Mr. Dimon and Mr. Braunstein omitted mention of a number of key facts that they declined to share with investors on the call. First, compared to the prior quarter, the SCP had tripled in size from about $51 billion to $157 billion and contained many new credit derivatives.[1467] Mr. Dimon, Mr.

[1463] Id., at 10.
[1464] 4/13/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon and Douglas Braunstein, JPMorgan Chase, "1Q12 calls – Buyside and Sellside comments (3)," JPM-CIO-PSI 0001137 (She also pointed out one particular analyst's feedback: "Thought CIO comments were very helpful; no questions the topic.").
[1465] 4/13/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon and Douglas Braunstein, JPMorgan Chase, "1Q12 calls – Buyside and Sellside comments (6)," JPM-CIO-PSI 0001200.
[1466] 4/16/2012 email from Julien Grout, CIO, to Luis Buraya and Bruno Iksil, CIO, "CIO Core Credit P&L Predict [16 April]: -$31,405k (dly) -$1,094,241k (ytd)," JPM-CIO-PSI 0017022, at 026.
[1467] "Summary of Positions by Type and Series," prepared by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037609. Prior to the April 13 earnings call, Mr. Braunstein had specifically requested and received data on the growth of the positions in the SCP over the first quarter. On or about April 9, he asked for "some history relative to current positions (long and shorts)." 4/9/2012 email from John Wilmot, CIO, to Ina Drew, CIO and others, "Deliverables for meeting tomorrow," JPM-CIO-PSI 0001646. Later that day, Mr. Maeris sent Mr. Braunstein a presentation that included a chart of the notional amounts of trade positions as of January, February, March, and the current date. See 4/9/2012 email from

Braunstein, and other executives were specifically told how the portfolio's largest position would take 10-15 days of selling at 100% trading volume to exit, so the executives knew that exiting some of the portfolio's positions would take weeks or months.[1468] Messrs. Dimon, Braunstein, and other executives were also informed that the SCP had switched its overall position from short to long,[1469] a direction inconsistent with its purported hedging purpose, as discussed further below. Since the head of the CIO and member of the bank's operating committee, Ina Drew, had forbidden additional trading in the portfolio on March 23, its positions were locked in.[1470] In addition, by that date, all of the risk limits governing the SCP had been breached.[1471] On March 30, 2012, Achilles Macris, who supervised the SCP trading, told the bank's Chief Risk Officer that he had "lost confidence" in his team and was operating in "crisis mode."[1472] Also on March 30, the bank's internal audit department issued a report criticizing CIO's risk management department, with copies sent to Mr. Braunstein, Mr. Hogan, and others.[1473] Finally, the SCP had undergone three straight months of escalating losses, which worsened dramatically in March. None of these facts relating to the SCP's size, risk profile, or losses were mentioned in the April 13 earnings call.

After the earnings call, the bank sought to reduce the risk and losses of the SCP, but did not share any information publicly about those efforts until it filed its required 10-Q form with the SEC on May 10, finalizing its first quarter results. In the midst of preparing for that

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Achilles Macris, CIO, to Douglas Braunstein, JPMorgan Chase, and Ina Drew, CIO, "Synthetic Credit Presentation," JPM-CIO-PSI-H 0002204-213, at 212. On April 12, Ms. Drew sent Mr. Braunstein and other members of senior management an email with a simplified version of the information, showing position increases from January to the current date. 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon and others, JPMorgan Chase, "Synthetic Credit Materials," JPM-CIO-PSI 0001100, at 103.

[1468] 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701, at 702; see also Chapter V discussion, citing Subcommittee interviews of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) and Douglas Braunstein, JPMorgan Chase (9/12/2012). Mr. Hogan and Mr. Braunstein each explained to the Subcommittee that, while it is theoretically possible to trade 100% of the average daily volume of an instrument in a single day, it is economically unwise to do so, since a single party trading that volume in a day would cause significant adverse movements in the prices of the instruments.

[1469] 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "CIO," JPM-CIO-PSI 0000539.

[1470] Subcommittee interviews of Ina Drew, CIO (9/7/2012, 12/11/2012). Mr. Dimon told the Subcommittee that he was not aware at the time that Ms. Drew had ordered the trading to stop. See Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

[1471] See Chapter V, describing the breaches of CIO VaR, CS01, and CSW10%, among other risk limits.

[1472] 3/30/2012 email from Achilles Macris, CIO, to John Hogan, JPMorgan Chase, "synthetic credit- crisis action plan," JPM-CIO-PSI 0001220.

[1473] See 3/30/2012 email from William McManus, JPMorgan Chase, to Douglas Braunstein, JPMorgan Chase, and others, "Audit Report: EMEA CIO Credit- Market Risk and Valuation Practices (Rating Needs Improvement)," JPM-CIO-PSI 0009289. Mr. Braunstein told the Subcommittee that he did not recall reading the report at this time. Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).

disclosure, on May 2, Ms. Drew wrote a note about the bank's internal deliberations: "We are working through the 10-Q disclosure and Doug [Braunstein] and Jamie [Dimon] are weighing the risk reward to the communication plan around a press release and anal[y]st meet[]ing and the potential impact on the market and our ability to reduce this position."[1474] Her note indicated that bank executives were evaluating the consequences of public disclosures related to the SCP, including the financial fallout upon releasing damaging information about the SCP.

Despite the bank's increasing grasp of the SCP's concentrated, complex, and deteriorating positions, after the April 13 earnings call the bank did not publicly discuss the SCP again until nearly a month later, on May 10, 2012, when the bank filed its 10-Q form with the SEC finalizing its first quarter financial results. That day, it also held a "business update" call with analysts, investors, the media, and others. In contrast to the views provided on April 13, 2012, the 10-Q filing and call presented a much more negative picture of the SCP. JPMorgan Chase reported that the SCP had incurred a $2 billion loss in the second quarter, and additional losses were expected.[1475] In addition, the 10-Q provided a chart on the CIO's VaR totals, showing a revised quarter-end VaR total that was nearly double the earlier reported figure.[1476]

During the business update call, Mr. Dimon spoke at length about the SCP:

> "We are also amending a disclosure in the first quarter press release about CIO's VAR, Value-at-Risk. We'd shown average VAR at 67. It will now be 129. In the first quarter, we implemented a new VAR model, which we now deemed inadequate. And we went back to the old one, which had been used for the prior several years, which we deemed to be more adequate. ...
>
> Regarding what happened, the synthetic credit portfolio was a strategy to hedge the Firm's overall credit exposure, which is our largest risk overall .... We're reducing that hedge. But in hindsight, the new strategy was flawed, complex, poorly reviewed, poorly executed and poorly monitored. The portfolio has proven to be riskier, more volatile and less effective [an] economic hedge than we thought. ...
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> We have more work to do, but it's obvious at this point that there are many errors, sloppiness and bad judgment. I do

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[1474] 5/2/2012 email from Ina Drew, CIO, to Ina Drew, CIO, [no subject], JPM-CIO-PSI 0001212-214, at 214.
[1475] 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 1-2, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf.
[1476] See 5/10/2012 JPMorgan Chase & Co., Form 10-Q, at 73, http://investor.shareholder.com/jpmorganchase/secfiling.cfm?filingID=19617-12-213.

remind you that none of this has anything to do with clients.

...

[W]e've already changed some policies and procedures, as we've gone along. In addition you should know that all appropriate corrective actions will be taken, as necessary, in the future. ...

The portfolio still has a lot of risk and volatility going forward. ... It could cost us as much as $1 billion or more.

...

These were grievous mistakes, they were self inflicted, we were accountable and we happened to violate our own standards and principles by how we want to operate the company. ... [W]e admit it, we will learn from it, we will fix it, we will move on, hopefully in the end, it will make us a better company."[1477]

In response to questions during the call, Mr. Dimon also said:

"You should assume that we try to keep our readers update[d] about what we know and when we know it and it's just a constant practice of the company. And when I said, it was caught, we started [to] dig into this more and more, most of the things were bearing big losses in the second quarter. And of course, when you start to see something like that you act probably – obviously we should have acted sooner.

[Analyst question]: [W]hen did the losses accumulate? [W]as this something that happened most recently or this was an era in the past and is just updating your risk amount now?

[Mr. Dimon]: There were small ones in the first quarter, but real ones that we talked about the $2 billion were all in the second quarter. And it kind of grew as the quarter went on. And obviously it got our attention, that and other things, which came to our attention."[1478]

In July, the bank restated its earnings to increase its first quarter losses attributed to the SCP by $660 million, which the bank said fell to $459 million after taxes.[1479]

[1477] 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 2-3, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf.

[1478] Id., at 4.

[1479] 7/13/2012 JPMorgan Chase & Co., Form 8-K, http://files.shareholder.com/downloads/ONE/1934577619x0x582872/d38931ff-a849-41ed-a804-a94aff313272/Restatement_8-K_Cover.pdf ("On July 13, 2012, JPMorgan Chase & Co. reported that it will restate its previously-filed interim financial statements for the first quarter of 2012. The restatement will have the effect of reducing the Firm's reported net income for the

B. Securities Laws

To ensure fair, open, and efficient markets for investors, Federal securities laws impose specific disclosure obligations on market participants. Under Securities and Exchange Commission Rule 10b-5[1480] and Section 17(a) of the Securities Act of 1933,[1481] it is against the law for issuers of securities to make untrue statements or omissions of material facts in connection with the sale or purchase of securities. In the JPMorgan Chase case study examined by the Subcommittee, the bank, as an issuer, has made disclosures that raise significant concerns about the accuracy of the information it provided to investors and about omissions of key information.

(1) Rule 10b-5

Materiality. Disclosures are of concern under Federal securities laws when they involve "material" information. The Supreme Court has ruled that information is "material" when there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[1482] Another court characterized the standard as follows: "Material facts include those that 'affect the probable future of the company and [that] may affect the desire of investors to buy, sell, or hold the company's securities.'"[1483] Courts have found that information about earnings estimates is generally material,[1484] including any misrepresentation of a company's earnings.[1485] Changes in share price are also relevant to a materiality inquiry.[1486] "[W]ith respect to contingent or speculative information or events, ... materiality 'will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'"[1487]

2012 first quarter by $459 million (after-tax). The restatement relates to valuations of certain positions in the synthetic credit portfolio of the Firm's Chief Investment Office.").

[1480] SEC Rule 10b-5 makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. Section 240.10b-5(b) (2011), adopted by the SEC pursuant to Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C § 78(j)(b) (2006).

[1481] 15 U.S.C. § 77q(a) (1976).

[1482] Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

[1483] Castellano v. Young & Rubicam, Inc., 257 F.3d 171, 180 (2d Cir. 2001) (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).

[1484] In re J. Douglas Elliott, Securities Exchange Act Rel. No. 34-40043 (May 29, 1998).

[1485] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

[1486] See Crowell v. Ionics, Inc., 343 F. Supp. 2d 1 (D. Mass. 2004).

[1487] Basic, Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988) (citing SEC v. Texas Gulf Sulphur Co., 401 F. 2d 833, 849 (2d Cir. 1968).).

In connection with buying or selling securities. Disclosures raising concerns under Federal securities laws must also be made in connection with the buying or selling of securities. Courts have held that a statement is made "in connection with" the purchase or sale of securities when it "is reasonably calculated to influence the average investor[.]"[1488] In actions brought by the SEC, this approach "remains as broad and flexible as is necessary to accomplish the statute's purpose of protecting investors."[1489] For example, statements in press releases, annual reports, quarterly and annual public SEC filings, and news articles can satisfy the "in connection with" element, because investors rely on such documents.[1490] False and misleading statements in analyst calls associated with quarter-end earnings releases are also considered "in connection with" the purchase or sale of securities.[1491] A longstanding SEC Release has warned that the prohibitions against false or misleading statements in Rule 10b-5, as well as Section 17 of the Securities Act of 1933, "apply to all company statements that can reasonably be expected to reach investors and the trading markets, whoever the intended primary audience."[1492]

Scienter. In addition to the required components of materiality and a connection to the purchase and sale of securities, disclosures are of concern under Rule 10b-5 only when the issuer has the requisite scienter.[1493] The Supreme Court has ruled that the scienter requirement can be met "by showing that the defendant acted intentionally or recklessly."[1494] One common definition of "reckless conduct" is "highly unreasonable [conduct], involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or

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[1488] SEC v. Rana Research, Inc., 8 F.3d 1358, 1362 (9th Cir. 1993) (quoting SEC v. Hasho, 784 F.Supp. 1059, 1106 (S.D.N.Y. 1992)).
[1489] Id.
[1490] See, e.g., In re Ames Dep't Stores Stock Litig., 991 F.2d 953, 969 (2d Cir.1993) (annual reports, public statements, SEC filings).
[1491] See SEC v. Koenig, No. CIV.A. 04-3370, at *2 (S.D. Tex. 2004) (final judgment); see also 8/25/2004 SEC Litigation Rel. No. 18849, "SEC Charges Mark E. Koenig, Former Executive Vice-President and Director of Investor Relations at Enron," http://www.sec.gov/litigation/litreleases/lr18849.htm (alleging false and misleading statements on an analyst call associated with a quarter-end earnings release).
[1492] "Public Statements by Corporate Representatives," Securities and Exchange Commission Rel. No. 6504 (Jan. 13, 1984) ("The antifraud provisions of the federal securities laws [citing Section 17 of the Securities Act of 1933 and Section 10(b) of the Exchange Act, and the rules thereunder, particularly Rule 10b-5] apply to all company statements that can reasonably be expected to reach investors and the trading markets, whoever the intended primary audience. Thus, as with any communications to investors, such statements should be not materially misleading, as the result of either misstatement or omission. To the extent that the standard for accuracy and completeness embodies in the antifraud provisions is not met, the company and any person responsible for the statements may be liable under the federal securities law.").
[1493] Aaron v. SEC, 446 U.S. 680, 695 (1980).
[1494] Tellabs, Inc. v. Makor Issues & Rights, Ltd. 551 U.S. 308, 319 n.3 (2007) ("Every Court of Appeals that has considered the issues has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required.")

sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."[1495] Recklessness can be the result of management making statements made on the basis of deficient corporate management systems. In such instances, companies "either must refrain from making any such statements about future performance or must disclose the basis on which any such statements are made and any other material information necessary to make such statements not misleading."[1496]

Even if a corporation "discloses[s] the true situation" "within months," it does not prevent a finding of scienter. In Makor Issues & Rights, Ltd. v. Tellabs Inc. (Tellabs II), the court stated that the CEO "may have thought that there was a chance that the situation ... would right itself. If so, the benefits of concealment might exceed the costs[,]" analogizing his conduct to "embezzling in the hope that winning at the track will enable the embezzled funds to be replaced before they are discovered to be missing."[1497]

(2) Section 17(a) of the Securities Act of 1933

In addition to Rule 10b-5, Section 17(a) of the Securities Act of 1933 forbids issuers from making misleading statements in connection with the offer or sale of securities. The courts have determined that Rule 10b-5 and Section 17(a) "prohibit essentially the same type of

[1495] Sunstrand Corp. v. Sun Chem Corp., 553 F.2d 1033, 1045 (7th Cir. 1977). This standard is frequently cited by the courts, which have also either heightened or lowered it. See Donna M. Nagy et al., Securities Litigation and Enforcement, Cases and Materials, 3d Ed., at 116. See also Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir.), cert. denied, 439 U.S. 1039 (1978) (defining reckless conduct in nearly identical language: "Reckless conduct is, at the least, which is 'highly unreasonable' and which represents 'an extreme departure from the standards of ordinary care ... to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'"). The court in Rolf continued: "A representation certified as true .... when knowledge there is none, a reckless misstatement, or an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth, are all sufficient upon which to base liability." Id., at 48 (citing State Street Co. v. Ernst, 15 N.E. 2d 416, 418-19 (1938)).

[1496] In the Matter of Waste Management, Inc., Securities Exchange Act Rel. No. 42968 (June 21, 2000), at *28-29 ("The fact that the deficiencies in WMI's systems prevented management from receiving timely and reliable data about the company's performance does not excuse the company for making statements without a reasonable basis or without disclosing material facts necessary to make the statements not misleading.").

[1497] Makor Issues & Rights, Ltd. v. Tellabs Inc. (Tellabs II), 513 F. 3d 702, 709-710 (7th Cir. 2008) ("The critical question ... is how likely it is that the allegedly false statements ... were the result of merely careless mistakes at the management level based on false information fed it from below, rather than an intent to deceive or a reckless indifference to whether the statements were misleading. ... Against all this the defendants argue that they could have had no motive to paint the prospects for the 5500 and 6500 systems in rosy hues because within months they acknowledged their mistakes and disclosed the true situation of the two products, and because there is no indication that [the CEO] or anyone else who may have been in on the fraud profited from it financially. The argument confuses expected with realized benefits. [The CEO] may have thought there was a chance the situation regarding the two key products would right itself. If so, the benefits of concealment might exceed the costs.").

conduct."[1498] Specifically, Section 17(a) makes it unlawful "in the offer or sale of any securities … (1) to employ any device, scheme, or artifice to defraud; (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary to make the statement made not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[1499] It applies to "any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading."[1500] Unlike Rule 10b-5, however, Sections 17(a)(2) and 17(a)(3) do not require a finding of scienter.[1501]

C. Disclosures and Key Omissions Raising Concerns

JPMorgan Chase's statements to investors, analysts, and the public in its press statements, earnings calls, and securities filings raise multiple questions about whether the bank met its obligations to disclose accurate material information about the Synthetic Credit Portfolio and the activities of its Chief Investment Office in 2012. Issues of concern involve primarily the April 2012 public disclosures which included: (1) mischaracterizing the involvement of the bank's risk managers in SCP positions; (2) mischaracterizing the SCP as "fully transparent to the regulators;" (3) mischaracterizing SCP decisions as "made on a very long-term basis;" (4) mischaracterizing the SCP as a hedge; (5) asserting the SCP whale trades would be allowed under the Volcker Rule; and (6) omitting disclosure of a key VaR model change at the CIO. The mischaracterization of the SCP as a hedge was repeated again publicly in May 2012.

[1498] In the Matter of Leaddog Capital Markets, LLC, F/K/A Leaddog Capital Partners, Inc., Securities Exchange Act Rel. No. 468 (Sept. 14, 2012), at *28 (citing United States v. Naftalin, 441 U.S. 768, 778 (1979); SEC v. Pimco Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454, 469 (S.D.N.Y. 2004)).

[1499] 15 U.S.C. § 77q(a) (1976).

[1500] U.S. v. Naftalin, 441 U.S. 768, 778 (1979); see also S.E.C. v. Am. Commodity Exch., Inc., 546 F.2d 1361, 1366 (10th Cir. 1976) ("Because 17(a) applies to "offer[s] or sale[s] … actual sales [are] not essential for a Section 17(a) claim."); see also Donna M. Nagy et al., Securities Litigation and Enforcement, Cases and Materials, 3d Ed., at 338 ("Section 17(a) provides the SEC with a powerful litigation weapon. Not only can liability be imposed on someone who was merely careless (under Sections 17(a)(2) and (a)(3)), whether in the context of an initial offering or in secondary market trading.").

[1501] Aaron v. SEC, 446 U.S. 680, at 697, 701-02 (1980); S.E.C. v. Pimco Advisors Fund Management LLC, 341 F.Supp.2d 454, 469 (S.D.N.Y. 2004) (internal citations omitted) ("To establish a violation of Section 17(a), the SEC must demonstrate essentially the same elements required by a claim under Exchange Act Section 10(b) and Rule 10b-5 thereunder, although no showing of scienter is required for the SEC to obtain an injunction under subsections (a)(2) or (a)(3) of Section 17(a).").

(1) Mischaracterizing the Involvement of Firmwide Risk Managers

On April 13, 2012, Mr. Braunstein, the bank's Chief Financial Officer, speaking on behalf of JPMorgan Chase on an earnings call, stated that "[a]ll of those positions are put on pursuant to the risk management at the firm-wide level."[1502] The evidence indicates, however, that in 2012, JPMorgan Chase's firmwide risk managers knew little about the SCP and had no role in putting on its positions. In addition, at the moment Mr. Braunstein made his statement on April 13, the SCP had triggered all five of its risk limits, but that key fact was not mentioned. His statement may have misled investors concerned about the recently reported credit derivative positions into believing that the firm's respected risk management team had approved those positions.

JPMorgan Chase's Chief Risk Officer John Hogan told the Subcommittee that, prior to the April 2012 media reports, he had been unaware of the size and nature of the SCP, much less its mounting losses.[1503] He had been appointed to the position in January 2012, and told the Subcommittee that he had been given only an initial introduction to the CIO.[1504] On March 20, 2012, the Risk Policy Committee of JPMorgan Chase's Board of Directors held a meeting to discuss risk issues, which Mr. Hogan and his deputy, Ashley Bacon, attended, but neither the Synthetic Credit Portfolio trading strategy nor its mounting losses were discussed.[1505] Mr. Hogan told the Subcommittee that the articles about the "London Whale," which first appeared on April 6, 2012, surprised him.[1506] Mr. Hogan said that the SCP was not on his radar in an "alarming way" prior to that date.[1507] Virtually no evidence indicates that he, his predecessor, or any other firmwide risk manager played a role in designing, analyzing, or approving the SCP positions acquired in 2012.

Moreover, to the extent that Mr. Braunstein may have been relying on CIO risk management, which reports to the firmwide risk management office, he was careless in doing so, given the deficiencies he knew existed in the CIO's risk management office. Structurally, the CIO did not have a clear Chief Risk Officer until Irvin Goldman was appointed in January 2012.[1508] Mr. Goldman had no risk management experience and was still learning the job during the first quarter of 2012.

[1502] 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 7, JPM-CIO-PSI 0001151 (stated by Douglas Braunstein).
[1503] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
[1504] Id.
[1505] 3/20/2012 presentation for JPMorgan Chase Directors Risk Policy Committee meeting, JPM-CIO-PSI 0013890.
[1506] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
[1507] Id.
[1508] See Chapter V, "CIO Risk Management Personnel" section on the lack of clarity about the role of the CIO Chief Risk Officer prior to 2012.

In addition, although JPMorgan Chase's written policy was to reevaluate the risk limits on an annual basis in all its lines of business,[1509] CIO risk management had failed to review the CIO's risk limits for three years.[1510]

At the same time, as described in Chapter V, the CIO had allowed the SCP to repeatedly breach the risk limits and metrics it had in place. Rather than react to those breaches by reducing the risky trading activities and assets in the SCP, the CIO traders instead reacted to the breaches – of Value-at-Risk, Comprehensive Risk Measure, CS01, CSW10%, and stop loss limits – by disregarding the limit or metric, raising the relevant limit to end the breach, or changing the model evaluating the risk to lower the SCP's risk profile.[1511] In one case, the CIO's risk officers allowed the CIO to breach a credit spread risk limit by more than 1,000% for over two months.[1512]

In addition to problems with its risk limits and metrics, the CIO had an overdue Matter Requiring Attention from the OCC from 2010,[1513] regarding its need to document its portfolio decisionmaking process,[1513] and had recently been told in an Internal Audit report that its asset valuation practices "need[ed] improvement."[1514] Two days before the April 13 earnings call, Chief Risk Officer John Hogan emailed Mr. Braunstein and others about the discrepancy between CIO's risk management procedures and the more robust Investment Bank (IB) system: "This is the governance used in the IB to control what is currently going on in CIO. We (obviously) need to implement this in CIO as soon as possible."[1515]

[1509] 6/29/2010 JPMorgan Chase & Co., "Risk Policy: Model Risk Policy" JPMC-Senate/Levin 000026, at 33 ("Annual Review. Each LOB must ensure all of its models are re-assed annually in light of: new developments in the literature or internal or commercially available models; changes in the market for the product (e.g. availability of liquid quotes for model input or major growth in volume); change in the features of the product or portfolio; back-testing of the model and experience with effectiveness of its application; the materiality of model risk.").

[1510] Prior to Mr. Braunstein's statement, risk limits were last reviewed in 2009. See 2013 JPMorgan Chase Task Force Report, at 101, footnote 112, ("Under the Market Risk Limits Policy applicable to CIO before May 2011, the review of limits and limit utilizations was required only annually, as opposed to semi-annually. Notwithstanding this requirement, prior to May 2011, the last review of all CIO limits was conducted by CIO in 2009.").

[1511] See Chapter V, "Disregarding CIO Risk Metrics."

[1512] See 4/19/2012 email from Peter Weiland, CIO, to James Hohl, OCC, "Info on VaR, CSBPV, and stress status and limits," OCC-SPI-00022340 (discussing CSBPV breach of 1074% over 71 days).

[1513] See 12/8/2010 Supervisory Letter JPM-2010-80, OCC-SPI-00011201 [Sealed Exhibit]. The letter was copied to Jamie Dimon, Douglas Braunstein, Barry Zubrow, Stephen Cutler, and others. For more information about this letter, see Chapter VI.

[1514] See 3/30/2012 email from William McManus, JPMorgan Chase, to Douglas Braunstein, JPMorgan Chase, and others, "Audit Report: EMEA CIO Credit- Market Risk and Valuation Practices (Rating Needs Improvement)," JPM-CIO-PSI 0009289. Mr. Braunstein told the Subcommittee that he did not recall reading the report at that time. Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012). He also noted that the CIO wasn't given the lowest rating that it could have been given on the Internal Audit's rating spectrum. Id.

[1515] 4/11/2012 email from John Hogan, JPMorgan Chase, to Jes Staley, IB, Douglas Braunstein, JPMorgan Chase, and others, "Credit risk limits," JPM CIO PSI 0001086.

In the April 13 8-K filing and earnings call, Mr. Braunstein made no mention of the CIO or SCP risk deficiencies or the many risk limit breaches triggered by the SCP during the first quarter of 2012, even though investors likely would have wanted to know that the whale trades had breached all of the relevant risk limits during the first quarter, and some of those breaches were ongoing. That information would have certainly weighed against the false impression that Mr. Braunstein imparted: that the whale trades were known to and had been approved by the bank's risk managers.

A month later, in the May 10 10-Q business update call, Mr. Dimon admitted serious risk management failings in connection with the SCP.[1516] That those risk management deficiencies were of interest to investors and analysts was shown, not only by the questions asked during the May 10 call, but also in later communications with the bank. JPMorgan Chase emails show that, after the May 10 call, analysts specifically asked about the bank's risk management efforts.[1517] For example, hours after the May 10 call, one analyst asked the bank's head of investor relations, "who was watching the CIO? Doesn't internal audit monitor this?"[1518] Another analyst commented: "Pretty big confidence blow for best risk manager; very puzzling."[1519]

Ultimately, the bankwide risk management function did take over the management of the Synthetic Credit Portfolio, but that did not occur not until April 27, two weeks after Mr. Braunstein's statement. On April 27, Chief Risk Officer John Hogan sent his deputy, Ashley Bacon, with Mr. O'Rahilly from the Investment Bank, to the CIO London trading office to analyze the portfolio's transactions.[1520]

The bank and CEO Jamie Dimon have long touted its best-in-business approach to risk management which it claims contributes to its "fortress balance sheet."[1521] By telling investors that its credit

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[1516] See 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 4, http://i.mktw.net/_newsimages/pdf/ jpm-conference-call.pdf.

[1517] See, e.g., 5/10/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10Q call – Buyside and sellside comments (1)," JPM-CIO-PSI 0014783; 5/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10Q call – Buyside and sellside comments (3)," JPM-CIO-PSI 0017712 ("all, here are a few comments/themes regarding today's calls ... questions around broader risk management issues ...."); 5/10/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10Q call – Buyside and sellside comments (2)," JPM-CIO-PSI 0017754 ("Is this something that we should be concerned about in terms of the culture or risk management across the firm?").

[1518] Id.

[1519] Id.

[1520] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss); Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) (describing how Mr. Bacon's role with respect to the whale trades became "all consuming" on April 27).

[1521] See, e.g., "America's Traditional Strengths Will Win Out," Fortune, Jamie Dimon (4/9/2009, last updated 4/22/2009) http://money.cnn.com/2009/04/19/news/companies/dimon.fortune/index.htm ("Ultimately, however, it is up to us to manage our own companies wisely. That is why we have what I call a derivatives trades had been run by the bank's respected firm risk management team, Mr. Braunstein likely sought to instill investor confidence in the trades as ones where firm-level risk experts had evaluated the positions on the basis of potential risk and signed off on them. The problem with this representation, however, is that it was not true.

(2) Mischaracterizing SCP as "Fully Transparent to the Regulators"

On the April 13, 2012 earnings call, Mr. Braunstein also said the following with respect to the CIO's Synthetic Credit Portfolio:

> "And I would add that all those positions are fully transparent to the regulators. They review them, have access to them at any point in time, get the information on those positions on a regular and recurring basis as part of our normalized reporting."[1522]

This statement by Mr. Braunstein had no basis in fact. The bank never provided the OCC with "a regular and recurring" report on the Synthetic Credit Portfolio trading positions. In fact, it was not until a month later, on May 17, 2012, that in response to an OCC special request, the bank provided the agency for the first time with specific SCP position level data.[1523]

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fortress balance sheet. What that means is a significant amount of capital; high quality of capital; strong liquidity; honest, transparent reporting; and excellent risk measurement and management. ... We have to balance risk taking with doing what's right for our customers and shareholders. I always say my grandma could have made those crazy profits by taking more risk. But are you building a better business?"); testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., First Public Hearing before the Financial Crisis Inquiry Commission, at 1-2 (January 13, 2010) http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0113-Dimon.pdf ("As a result of our steadfast focus on risk management and prudent lending, and our disciplined approach to capital and liquidity management, we were able to avoid the worst outcomes experienced by others in the industry. ... We have always ... been acutely focused on maintaining a fortress balance sheet."); JPMorgan Chase, "Our Business Principles," at 5, http://www.jpmorganchase.com/corporate/About-JPMC/document/business_principles.pdf ("Create and maintain a fortress balance sheet.").

[1522] 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 7, JPM-CIO-PSI 0001151 (stated by Douglas Braunstein). In his statement, Mr. Braunstein used the word, "fully," to describe the bank's SCP disclosures to regulators, even though that word had been deliberately removed from the bank's initial talking points about the whale trades, as discussed above.

[1523] See 5/17/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, OCC, and others, "History of Trades," OCC-00004035; Subcommittee interview of Elwyn Wong, OCC (8/20/2012); Subcommittee interview of Michael Sullivan, OCC (8/30/2012); 5/18/2012 email from Michael Kirk, OCC, to Elwyn Wong, OCC, "CIO Call With Mike Brosnan," OCC-SPI-00021628 at 630 (quoting 5/17/2012 email chain from Fred Crumlish: "I told Mike B [Brosnan] that the Joe Sabatini emails with selected position information were sent by the bank after initial OCC and FRB enquiries. We concluded this information was pretty much useless, as it did not tell us what was happening risk wise.") (referencing the "Joe Sabatini emails:" 4/10/2012 email from Joseph Sabatini, JPMorgan Chase, to Fred Crumlish, OCC, and others, "Background and Supporting Data for CIO Discussion of April 9, 2012," OCC-SPI-00004312).

Contrary to Mr. Braunstein's representation, the bank was not "fully transparent" with its regulators regarding the SCP. As detailed in Chapter VI, although the SCP was established in 2006, the bank did not include the name of the Synthetic Credit Portfolio in any document given to the OCC until January 2012.[1524] At the end of January 2012, CIO executives told OCC examiners that the Synthetic Credit Portfolio was being reduced in size,[1525] leading the OCC to believe that the bank was planning to phase it out entirely within a year or two, when in truth the bank was already engaged in a strategy to increase the portfolio's size. At the same time the SCP was growing, the bank had ceased sending several regular CIO reports to the OCC during the first quarter of 2012.[1526] As SCP losses mounted in March and April, the bank did not update the OCC about what was happening. Instead, the bank gave notice to the agency of the SCP's problems in early May, only days before it disclosed such losses publicly as part of its 10-Q filing.[1527]

By telling investors that the Synthetic Credit Portfolio positions were "fully transparent" to regulators, the bank likely sought to reassure investors about the risky whale trades that the media had characterized as large enough to "driv[e] prices in the $10 trillion market."[1528] It would be reasonable for investors to want to know if such large positions were known to the bank's regulators. Investors might have reasoned that such trades, if known to regulators, could not have been overly risky; but if hidden, investors might have worried they were high risk transactions that regulators might otherwise have challenged.

[1524] 10/26/2012 OCC Confidential Supervisory Report, PSI-OCC-13-000025 [Sealed Exhibit] ("The firmwide VaR report for this date [January 27, 2012] is the first one that identifies SCP as a distinct risk taking unit in CIO and it accounts for over 90% of the CIO VaR.").

[1525] See discussion in Chapter VI, citing, e.g., 1/31/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, "CIO Quarterly Meeting," OCC-SPI-00004695.

[1526] See discussion in Chapter VI, citing to 4/19/2012 email from James Hohl, OCC, to Geralynn Batista, OCC, "CIO portfolio," OCC-SPI-00021700 (regarding missing Executive Management Reports); 4/13/2012 email from John Bellando, JPMorgan Chase, to James Hohl, OCC, "CIO January 2012 valuation memo and metri[c]s," OCC-00004735 (regarding missing CIO Valuation Control Group reports); Subcommittee interview of James Hohl, OCC (9/5/2012) (regarding missing CIO Executive Management Reports and missing CIO Valuation Control Group reports).

[1527] See discussion in Chapter VI, citing, e.g., 5/4/2012 email from Scott Waterhouse, OCC, to Fred Crumlish, OCC, CIO Synthetic Position, OCC-SPI-00013763 ("Doug Braunstein and John Hogan called to provide an update on the CIO position. . . . Current losses are approximately $1.6 billion.").

[1528] "JPMorgan Trader's Positions Said to Distort Credit Indexes," Bloomberg, Stephanie Ruhle, Bradley Keoun & Mary Childs (4/6/2012), http://www.bloomberg.com/news/2012-04-05/jpmorgan-trader-iksil-s-heft-is-said-to-distort-credit-indexes.html ("A JPMorgan Chase & Co. (JPM) trader of derivatives linked to the financial health of corporations has amassed positions so large that he's driving price moves in the $10 trillion market, traders outside the firm said.").

(3) Mischaracterizing SCP Decisions as "Made on a Very Long-Term Basis"

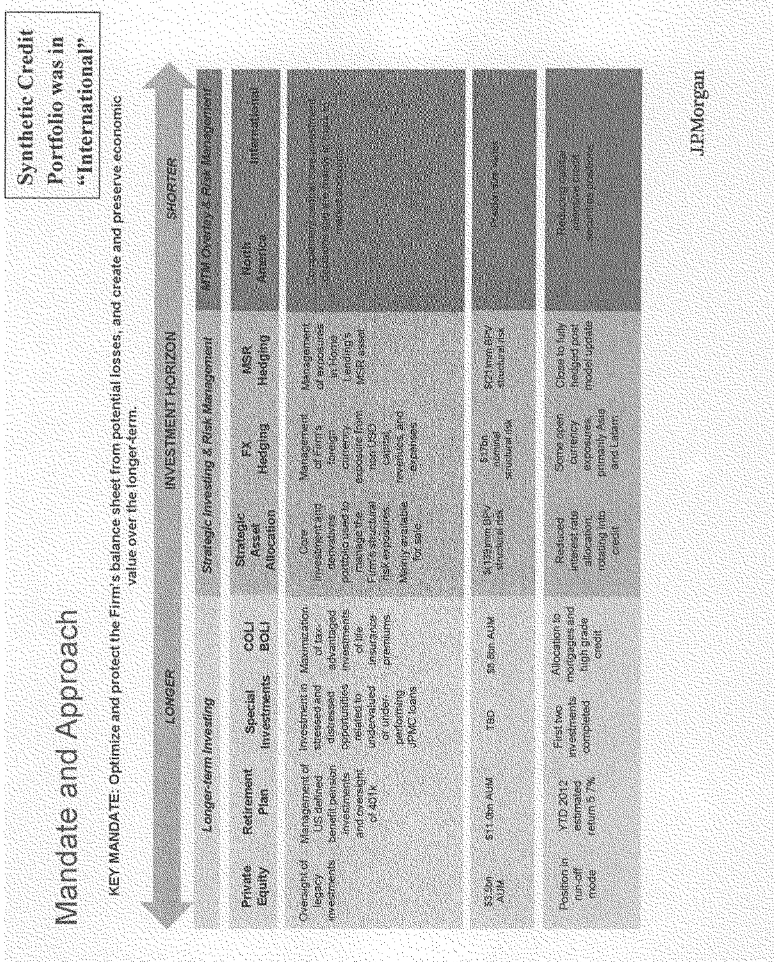
On the April 13, 2012 earnings call, Mr. Braunstein indicated that the SCP book provided stress loss protection against credit risk and that with regard to "managing" the stress loss positions, "[a]ll of those decisions are made on a very long-term basis."[1529] His statement suggested that the SCP had no short-term trading strategies or tactics to guide the portfolio. In fact, however, many of the SCP trading strategies and tactics employed a short time horizon, changing on a monthly or even day-to-day basis. Mr. Braunstein's statement was inconsistent with both the overall short-term posture of the portfolio, as well as the portfolio's decisionmaking since at least 2011. It was contrary to the facts.

In general, the Synthetic Credit Portfolio did not have a "long-term" investment horizon. To the contrary, since at least 2010, CIO head Ina Drew's presentations to her colleagues at the bank, including Mr. Braunstein, showed that the Synthetic Credit Portfolio, which was part of the larger Tactical Asset Allocation portfolio, had the shortest investment horizon of all of the portfolios in the CIO.[1530] One of those presentations by Ms. Drew, reprinted below, took place in March 2012, just a month before the earnings call.[1531]

[1529] 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 7, JPM-CIO-PSI 0001151.

[1530] See, e.g., 3/2012 "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," presentation prepared by Ina Drew and Irvin Goldman, CIO, JPM-CIO-PSI 0015015; 2/28/2012 email from John Wilmot, CIO, to Jamie Dimon, Douglas Braunstein, JPMorgan Chase, and others, "CIO Business Review Materials," JPM-CIO-PSI 0001940, at 949; 9/2010 "Chief Investment Office Presentation to the Directors Risk Policy Committee," presentation prepared by Ina Drew, CIO, OCC-SPI-000032575, at 576 (showing an earlier version of the same page regarding short-to-long term investment horizon, with "Tactical Investing," which included the Synthetic Credit Portfolio, as the portfolio in CIO with the shortest investment horizon).

[1531] See 3/2012 "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," presentation prepared by Ina Drew and Irvin Goldman, at CIO, JPM-CIO-PSI 0015016.



Source: 3/2012 "Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges," presentation prepared by Ina Drew and Irvin Goldman, CIO, JPM-CIO-PSI 0015016.

Secondly, Mr. Braunstein's "long-term" characterization is belied by the sheer volume of short-term trading in the SCP. For example, on January 27, 2012, the CIO traders engaged in 139 trades involving the SCP book.[1532] On that date, the traders repeatedly bought and sold positions in the IG9 10-year credit index at a range of prices; the number of those transactions alone exceeded 26.[1533] Buying and selling the same credit positions on the same day at a variety of prices is not consistent with making investment decisions on a long-term basis. Altogether in

[1532] Undated spreadsheet of trades from 10/3/2011 to 5/14/2012 produced by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037501.
[1533] Id.

the first quarter of 2012, traders executed over 4,300 trades.[1534] In addition, in 2011, the CIO traders engaged in a massive trading strategy that was designed to last only a few months near the end of the year; as part of that strategy, the CIO traders increased the exposure of the Synthetic Credit Portfolio by 10,000% to the HY credit index over the span of a single month, from October to November 2011.[1535] Overall, in the first three months of 2012, the CIO tripled the size of the SCP book, taking it from $51 billion to $157 billion, in a buying spree that was not motivated by decisionmaking on a "very long-term basis." When asked about these types of trades, JPMorgan Chase conceded to the Subcommittee that the SCP book was "actively" traded.[1536]

Moreover, as discussed earlier, in the first quarter of 2012, the SCP book was being managed to meet a number of short-term trading objectives. One was to produce short-term "carry" to offset some of the losses associated with its high yield credit protection, the value of which was deteriorating because of the market rally.[1537] Another was to enter into trades that would substantially lower the SCP's Risk Weighted Assets.[1538] In January 2012, CIO trader Bruno Iksil noted in an internal presentation that the "trades that made sense" included "turn[ing] the position[s] over to monetize volatility."[1539] Turning over a position to "monetize" volatility meant that the trading strategy was to flip the position, that is, buy low, and sell high.[1540] Each of these trading strategies is inconsistent with long-term decisionmaking.

Whether or not Mr. Braunstein was aware of that level of detail in the CIO trading operations, on the day before the April 13 earnings call, Ina Drew briefed him that the SCP book had increased in size since January and had changed from a net short to a net long posture,[1541] signaling short-term changes in the portfolio's size and strategy. In addition, Achilles Macris, who oversaw the SCP trading, emailed Mr.

1534 Undated spreadsheet of trades from 10/3/2011 to 5/14/2012 produced by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037501.

1535 See data analysis by OCC, using DTCC data for the bank. "JPMC-CIO timeline of Significant Events and OCC Discovery," OCC-SPI-00038895, at 6. See also 10/26/2012 OCC Confidential Supervisory Report, Appendix 11-B, "Caveman Trade," PSI-OCC-13-000121. For more information on this 2011 trading strategy, see Chapter III.

1536 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Jeanette Boot); Subcommittee interview of Peter Weiland, CIO (8/29/2012).

1537 See Chapter III, "SCP Trading" on the strategy implemented by CIO traders.

1538 See 1/19/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario clarification," JPM-CIO-PSI 0000152. Ms. Drew told the CIO traders to reduce RWA while still maintaining profit levels, that is, "review the unwind plan to maximize p l [profit-loss]." See 1/10/2012 email from Ina Drew, CIO, to Javier Martin-Artajo, CIO, and others, "International Credit Consolidated P&L 09-Jan-2012," JPM-CIO-PSI 0000075.

1539 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, "credit book last version," conveying "Core Credit Book Highlights," (January 2012), prepared by Mr. Iksil, at JPM-CIO-PSI 0000161.

1540 See Subcommittee interview of Michael Sullivan, OCC (8/30/2012).

1541 See 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, Douglas Braunstein, JPMorgan Chase, and others, "Synthetic Credit Materials," at JPM-CIO-PSI 0001103 (see table comparing "main exposures" of the book in January and Current).

Braunstein on April 8, 2012 that: "the most rewarding, short-term catalyst for CIO would be an MBIA related default event[.]"[1542] His email did not discuss any "very long-term" decisionmaking measures regarding the SCP.

Telling investors that "all of the decisions" in the SCP were made on a "very long-term basis" appears to have been an attempt to signal that the portfolio was handled in a conservative manner without the risks associated with short-term trading activities. It was also a description at odds with the facts, given that the SCP had tripled in size in just three months and had acquired billions of dollars in new credit derivative holdings in March alone which shifted the portfolio from a net short to a net long posture. Investors were not told that from 2011 to 2012, there were major strategic changes in the portfolio's goals, tactical changes about how to accomplish those goals, and daily position transactions, sometimes of substantial volume, followed by escalating losses. They also weren't told that, on March 23, 2012, Ms. Drew ordered SCP trading halted altogether so that the bank could analyze and gain control of the portfolio. By April 13, 2012, it was a portfolio in disarray, not one whose every decision had been made on a "very long term basis."

(4) Mischaracterizing SCP Whale Trades As Hedges

In early April 2012, as the bank was responding to media inquiries about the whale trades, it made multiple statements that the purpose of the CIO's Synthetic Credit Portfolio was to hedge the bank's risks. For example, one article reported the following:

> "Joe Evangelisti, a spokesman for J.P. Morgan, declined to comment on specific trades, or Mr. Iksil, except to say that recent trades were made to hedge the firm's overall risk. The group 'aims to hedge the bank's global structural risks and the unit's investments are directly related to managing those risks,' he said. The bank views its recent selling in the context of a range of related positions and feels its risk is now effectively balanced, added Mr. Evangelisti."[1543]

Two days later, during the bank's April 13 earnings call, Mr. Braunstein explained:

> "[W]e also need to manage the stress loss associated with that portfolio and – so we have put on positions to manage for a significant stress event in credit. We've had that position on for many years, and the activities that have been reported in the paper are basically part of managing that stress loss position, which we moderate and change over time,

[1542] 4/8/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, and others, "Synthetic Credit Summary," JPM-CIO-PSI 0001588 [underline in original].
[1543] "Making Waves Against 'Whale,'" Wall Street Journal, Katy Burne (4/11/2012).

depending upon our views as to what the risks are for our stress loss from credit. All of those decisions are made on a very long-term basis. They're done to keep the company effectively balanced from a risk standpoint. We are very comfortable with our positions as they are held today."[1544]

When Mr. Dimon was asked about the Synthetic Credit Portfolio on April 13, he said that it "offset" other bank exposures:

"It's a complete tempest in a teapot. Every bank has a major portfolio. In those portfolios, you make investments that you think are wise, that offset your exposures. Obviously, it's a big portfolio. ... But at the end of the day, that's our job, is to invest that portfolio wisely and intelligently to – over a long period of time to earn income and to offset other exposures we have."[1545]

A month later, during the May 10 business update call, Mr. Dimon three times described the Synthetic Credit Portfolio as a hedge:

"[T]he synthetic credit portfolio was a strategy to hedge the Firm's overall credit exposure, which is our largest risk overall .... We're reducing that hedge. ... The portfolio has proven to be riskier, more volatile and less effective [an] economic hedge than we thought."[1546]

While their language varied, these communications all made the same point, which is that the SCP was a counterbalance to potential losses in other parts of the bank. Given the briefing materials executives had, however, it was inaccurate for the bank to describe the SCP as a hedge, because it did not reflect the true nature of the portfolio and its potential for losses at that time.

No Clear Offsets. As described in Chapter III, the purpose of the SCP was undocumented, unclear, and changed over time.[1547] The assets that the SCP was purportedly hedging were not identified or defined in writing, and calculating the size and nature of the hedge was treated as a "guesstimate."[1548] Days before the April 13 earnings call, Mr. Dimon asked his colleagues, including Mr. Braunstein, for the correlation between the SCP and the portfolio the SCP was meant to hedge.[1549] Mr.

[1544] 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 7, JPM-CIO-PSI 0001151.
[1545] Id., at 10.
[1546] 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 2, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf. In addition, Mr. Dimon characterized the portfolio as a hedge five more times when responding to questions on the May 10 call.
[1547] See Chapter III, section entitled "Purpose of the Synthetic Credit Portfolio: Undocumented, Unclear, and Subject to Change."
[1548] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[1549] See 4/11/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "updated," JPM-CIO-PSI 0001077 ("[w]e are working on Jamie's request for [c]orrelation of the credit book against the portfolio").

Dimon told the Subcommittee that he did not recall if he received a response.[1550] Ms. Drew, who had told her colleagues she was "working on Jamie's request for correlation,"[1551] told the Subcommittee that so many events were unfolding at the time, that she did not recall if the correlation analysis was sent to him.[1552] The Subcommittee found no evidence that it was. Mr. Hogan also requested a correlation analysis to respond to regulators' questions about the SCP, and included Mr. Braunstein on his email,[1553] but JPMorgan Chase never produced it.[1554]

Net Long Posture. Mr. Braunstein explained to the Subcommittee that JPMorgan Chase, by its very nature as a bank which loans money, was "long" credit, because when credit deteriorated, the bank lost money.[1555] In contrast, a portfolio that held a "short" credit position generally gained money when credit deteriorated. On April 5, 2012, in anticipation of the press articles due to be published the following day,[1556] Ms. Drew sent Mr. Dimon, Mr. Braunstein, and other members of the JPMorgan Chase Operating Committee an email on April 5 stating:

> "The book has been extremely profitable for the company .... Going into the [financial] crisis we used the book to hedge ... credit widening .... Post December as the macros scenario was upgraded and our investment activities turned pro risk, the book was moved into a long position."[1557]

[1550] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
[1551] See 4/11/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "updated," JPM-CIO-PSI 0001077 ("[w]e are working on Jamie's request for [c]orrelation of the credit book against the portfolio").
[1552] Subcommittee interview of Ina Drew, CIO (12/11/2012).
[1553] 4/10/2012 email from John Hogan, JPMorgan Chase, to John Wilmot, CIO, Douglas Braunstein, JPMorgan Chase, Jamie Dimon, JPMorgan Chase, and others, "Materials for FED/OCC Questions," JPM-CIO-PSI 0001021.
[1554] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). See also Subcommittee interview of Michael Kirk, OCC (8/22/1012); 4/10/2012 email from Michael Kirk, OCC, to Fred Crumlish, OCC, and others, "CIO info on elephant trade," OCC-00004730 (Mr. Kirk: "What would be helpful would be to see the stress scenarios without these assets, and with these assets so one can understand the impact. ... It would also be helpful if the CIO could provide some indication of a present target level they are trying to achieve, and hence the change of activity that resulted in the same (in other words results prior to and after recent trades.)." Mr. Crumlish: "In my response on JPM email .... I also said it would be useful if they provided analytics or a summary that recapped the hedge strategy, such as the expected impact of the hedge on the projected stress loss identified. I asked for this on the call as well."); see 4/10/2012 email from Fred Crumlish, OCC to Scott Waterhouse, OCC, and others, JPM CIO trades, OCC-00004087 ("We asked the bank for a number of items yesterday that reflect details on the trades and support the stress loss hedge rationale associated with this particular strategy.").
[1555] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[1556] 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "CIO," JPM-CIO-PSI 0000539 ("I want to update the operating committee on what is going on with the credit derivatives book in CIO especially given a wsj article which will come out tomorrow.")
[1557] Id.

Mr. Braunstein told the Subcommittee that he was sure he read the email, though he was not aware of this particular sentence.[1558]

The Subcommittee staff asked JPMorgan Chase's officials to reconcile how the SCP could simultaneously be both "long," and serve as a hedge in 2012, when the bank itself was "long." If the SCP had the same overall long exposure as the bank overall, the SCP would lose money when the bank lost money, instead of offseting the bank's losses. The Chief Risk Officer for the firm, John Hogan, and his deputy, Ashley Bacon, conceded that they could not reconcile the SCP holding a long position and also functioning as a hedge for the bank.[1559] Similarly, John Wilmot, the Chief Financial Officer of the CIO, was unable to do so.[1560] Joseph Bonocore, the former Chief Financial Officer for the CIO and the former Treasurer for JPMorgan Chase, stated that he did not believe the book could both be long and maintain a hedge against losses in a credit crisis.[1561] Mr. Iksil told an internal bank investigation that he believed the book needed to be long in order to be stable, but recognized that having the book be long was inconsistent with its mission.[1562]

In contrast, Mr. Braunstein told the Subcommittee that the SCP book could both be long and provide a "fat tail hedge."[1563] Mr. Dimon concurred.[1564] However, Mr. Dimon conceded that the email from Ms. Drew described the SCP book as long and did not indicate that it nevertheless provided a fat tail hedge.[1565] When Mr. Braunstein was asked how he knew the book provided a fat tail hedge, he said there may have been discussions about it and, in any event, how the book was characterized on the earnings call on April 13 was how "we" thought the book was at the time.[1566]

Other JPMorgan Chase personnel told the Subcommittee that the SCP book had stopped functioning as a hedge well before April 13. Irvin Goldman, former Chief Risk Officer for the CIO, explained that the book had stopped being a "macro hedge" in December 2011, when they decided the capital costs of synthetic derivatives exceeded their economic value.[1567] Javier Martin-Artajo, head of CIO equity and credit trading, told an internal bank investigation that when a question arose as to whether the book would be unwound in January 2012, his supervisor, Achilles Macris, told him that the book no longer needed to hedge tail

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[1558] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[1559] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
[1560] Subcommittee interview of John Wilmot, CIO (9/11/2012).
[1561] Subcommittee interview of Joseph Bonocore, CIO (9/11/2012).
[1562] JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
[1563] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[1564] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
[1565] Id.
[1566] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[1567] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).

risk and that it did not need to provide a "payout."[1568] CIO head Ina Drew – who characterized the book as "long" on April 5 – told the Subcommittee that when the SCP was a "pure" high yield short, it qualified as a hedge under the Volcker Rule, but that the SCP had "morphed" and was no longer a pure high yield short; at that point, it should not qualify as, and was not, a hedge.[1569] Mr. Dimon expressed a similar sentiment when asked about the Synthetic Credit Portfolio at a Senate hearing in June 2012; he testified that, over time, the "portfolio morphed into something that rather than protect the firm, created new and potentially larger risks."[1570] Even Mr. Braunstein admitted that "there is a point where [the portfolio] ceased to perform in a manner to protect credit positions" of the firm.[1571]

The bank's regulators, the OCC, also expressed skepticism about the SCP functioning as a hedge. In a May 2012 internal email, one OCC examiner referred to the SCP as a "make believe voodoo magic 'composite hedge.'"[1572]

Scenario Analysis Showed SCP Was Not a Hedge. The statements by Mr. Braunstein and Mr. Dimon were also contradicted by an internal bank analysis that both received two days before the earnings call. That analysis clearly depicted the SCP as in a long posture and likely to lose money in a negative credit environment – which meant it was not operating as a hedge to offset the bank's other credit risks.

On April 11, 2012, an internal CIO presentation prepared for senior management, including Messrs. Dimon and Braunstein, reinforced Ms. Drew's April 5 characterization of the book as long.[1573] The presentation was prepared by the CIO traders with input from the head of JPMorgan Chase's Model Risk and Development Group, as well as his deputy, who had previously been a credit trader in the Investment Bank.[1574] On page 3 of that presentation, entitled "Synthetic Credit Summary: Risk & P&L Scenarios," reprinted below, a table showed that in multiple credit spread widening environments – i.e., situations in

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1568 JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
1569 Subcommittee interview of Ina Drew, CIO (9/7/2012).
1570 Testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S.Hrg. 112-715 (June 13, 2012), http://www.cq.com/doc/congressionaltranscripts-4105471.
1571 Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
1572 5/18/2012 email from Elwyn Wong, OCC, to Michael Kirk, OCC, "CIO call with Mike Brosnan," OCC-SPI-00021602.
1573 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701.
1574 2/4/2013 letter from Douglas Braunstein, JPMorgan Chase, to the Subcommittee, PSI-JPMC-35-000001 (explaining that the presentation was prepared "with input from C.S. Venkatakrishnan and Olivier Vigneron").

which credit deteriorated and the risk of default increased – the SCP would lose money.[1575]

Synthetic Credit Summary: Risk & P/L Scenarios

- Total Synthetic Credit VaR 59.2mm
- **10% Credit Spread Widening**
  - The position, beta-adjusted has net directionality of -$163MM in 10% parallel move in spreacs
  - **This is equivalent of $34.5bio of long risk in 5y IG equivalents**
- **Relative value Risk Exposures**
- IG vs. HY $27mm/bps of risk if IG underperforms HY by 1bps
- IG9 5/10s curve position $46MM/bps of risk if curve steepens 1bps
- XO vs. ITX $34mm/bps of risk if ITX underperforms XOVER by 1bps
- ITX9 5/10s curve position $19MM/bps if curve steepens 1bps

Index	Spr01	Spr+10%	Up50%
CDX HY	8,510,886	478,399,558	2,285,664,595
CDX LCDX	90,747	1,399,630	6,726,105
CDX IG	-35,121,718	-453,123,526	-2,144,460,027
ITRAXX MN	-22,056,110	-344,040,211	-1,771,890,467
ITRAXX XO	3,060,724	178,197,413	819,366,090
ITRAXX FINSUB	-560,652	-23,044,526	-107,358,386
ITRAXX FINSEN	[illegible]	[illegible]	[illegible]
SOVX WE	-19,909	-437,311	[illegible]
Synthetic Total	-48,127,273	-163,377,289	-917,573,542

Index	CS01	Beta Adj CS01	Compress01	Steepen01
CDX HY	8,510,886	42,554,432		
CDX LCDX	90,747	453,735		
CDX IG	-35,121,719	-35,121,719	-27,235,271	-45,080,715
US REGION	[illegible]	[illegible]	[illegible]	[illegible]
ITRAXX MN	-22,056,110	-22,056,110	-34,256,803	-19,071,244
ITRAXX XO	3,060,724	12,242,896		
ITRAXX FINSUB	-560,652	-2,242,609		
ITRAXX FINSEN	-31,240	-124,961		
SOVX WE	-19,909	-19,909		
EUROPE	[illegible]	[illegible]	[illegible]	[illegible]
Total Synthetic Credit	-48,127,273	-4,314,245	-61,492,074	-64,151,959

J.P.Morgan

Source: 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, Douglas Braunstein, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701, at 704 [emphasis added with arrows and circle].

Specifically, the presentation showed that, if credit spreads widened by one basis point, the book would lose $46 million. This result is shown in the first table on the left, reprinted above, in the first column captioned "Spr01," in the row captioned, "Synthetic Total." The table also showed that if credit spreads widened by 10%, the book would

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[1575] 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, Douglas Braunstein, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701, at 704.

lose $163 million. This result is shown in the next column, captioned "Spr+10%," in the bottom-most entry. Finally, the table showed in the last column that, if credit spreads widened by 50%, the book would lose $918 million – nearly $1 billion.

The SCP book was not always projected to lose money in a negative credit environment. As recently as February 2012, in another internal CIO presentation reprinted below, when the SCP book was characterized as hedging "tail risk," if credit spreads widened by 50%, the book was expected to *generate* $100 million in gains, and it was expected to roughly break even if credit spreads widened by 10%.[1576] Mr. Braunstein, who received this presentation, told the Subcommittee he did not focus on this page.[1577]

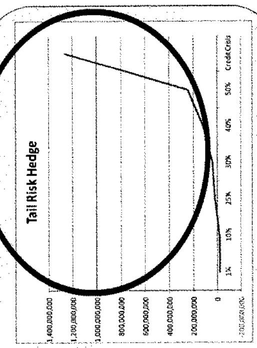
As the February chart below indicates, the SCP book was projected to lose a small amount of money until spreads widened more than 10%, and then when spreads widened by 50%, the book's profits were projected to increase dramatically. But by April 11, as shown in the earlier presentation, the SCP book's assets had changed, the book's net position had shifted from net short to net long, and it no longer was projected to generate money when spreads widened. To the contrary, by April 11, the SCP was projected to lose money not only when spreads widened by 10%, but also when they widened by 50%.

[1576] 2/2012 "CIO February 2012 Business Review," JPM-CIO-PSI 0001940, at 963.
[1577] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).

CIO International Core Credit: Tail Risk Book

Currently the Core Credit Book is:

1. **An option** with positive convexity, positive carry and upside on large spread widening and default waves (similar to 2008-2009)
2. **Current Position:**
   - I. **US** mortgage-related issuers (Radian, MGIC, ILFC, RESCAP, ALLY) may file as the US Government and banks are looking for a settlement on past underwriting practices
   - II. **Europe** countries including Greece and Portugal may opt to restructure some national champions like banks or telecom operators. These events could generate US$200mm-500mm P&L gains



Capital

- This is a Tail Risk Book that had under Basel I an RWA cost of US$5bln and from 2007-2011 has generated US$2.4bln total return
- Under Basel 2.5, Risk Weighted Assets are estimated to increase 5-8x (methodology still in development); this would increase the RWA of the core credit book to US$36bln however, CIO is currently working to reduce this to US$20bln for year end 2012
- Despite effectiveness of the Tail Risk Book hedging credit portfolio, the change in regulatory capital regime is likely to force a re-size / run-off of synthetic portfolio in order to maintain RWA targets for the Firm
- CIO continues to coordinate with IB Risk to improve the applicable RWA and capital levels

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Source: 2/2012 "CIO February 2012 Business Review," JPM-CIO-PSI 0001940, at 963 [emphasis added with circle around line graph].

When asked to explain how he could have believed that the book continued to provide stress loss protection given the information on page 3 of the April 11 presentation, Mr. Braunstein told the Subcommittee that he had not relied on that part of the presentation, but rather on three other scenarios on a subsequent page.[1578] He referred the Subcommittee staff to page 7 of the April 11 presentation, reprinted below, and stated

[1578] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).

that he relied on the three scenarios that, collectively, were projected to have an "80% likelihood" of occurring.[1579]

Synthetic Credit Summary: Risk & P/L Scenarios

Scenarios for Q2	Realised P&L in Q1	Current Spread	1 IG Steepening	2 Dramatic event on Europe	3 Sluggish stale growth	4 New Financial Crisis	5 Status Quo	6 Central scenario	7 Optimistic scenario	8 Currency crisis	9 End of QE	10 Many defaults
Carry	150		150	250	220	250	200	170	160	400	100	350
IG9 Projections	Initial curve											
IG9 0.75yr	132	88	26	112	74	96	68	48	44	249	[illegible]	201
IG9 2.75yr	141	90	33	131	96	117	90	72	[illegible]	[illegible]	[illegible]	[illegible]
IG9 5.75yr	150	111	79	150	122	139	111	95	80	222	[illegible]	194
Slope												
0.75yr / 5.75yr	18	43	53	38	48	43	43	47	[illegible]	[illegible]	[illegible]	[illegible]
Curve slope change (bps)	25	0	10	-5	5	0	0	4	[illegible]	[illegible]	[illegible]	[illegible]
Implied CSW	-35%	0%	-35%	35%	10%	25%	0	-15%	20%	100%	-50%	75%
P&L	-580		-650	-375	-355	-250	-150	350	702	[illegible]	1126	1725
			10% EXTREME			80% LIKELIHOOD			10% OPTIMISTIC			

Note regarding P&L Estimate of 10 April 2012

Today's P&L estimate of -$395MM represents a move 6.5x current VaR95 of $60MM.

Off the run IG.9 curves bear steepened avg +7bps (30% of YTD move), and spreads widened avg +10bps

- **Realised P&L in Q1**
  - Q1 Realised P&L -$580, driven by losses in short risk HY (-670MM), vs. +128MM in CDX.IG, and -30MM in iTraxx
  - The IG component has been the main P&L driver of underperformance in Q1, as IG.9 forward long risk positions did not deliver anticipated profits given steepening of the curve. Current book is overall risk balanced, given the cross-market long/short and has positive carry of $2MM/day, while retaining upside on defaults
- **Q2 P&L Estimates - these scenarios do not include 10 April P&L, which would accrete back into each scenario +$400MM, if re-calibrated for today's market moves**
  - -$250MM (New Financial Crisis) implies an average spread widening of +25%, driven by banks/financials undergoing stress. In this case, the portfolio P&L is driven by:
    - +250MM carry
    - -100MM given relative underperformance of IG vs. HY (compression, led by banks/financials widening)
    - -$300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - -$100MM due to spread widening, not offset in this case by curve flattening (we assume here that curves remain 43bps steep in IG equivalents)
  - -$150MM (Status Quo) in this case we assume that market levels and curves 'freeze' at current levels; in this scenario CIO would delta hedge around volatility throughout the quarter
    - +200MM carry
    - -$300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - -$50MM due to long-dated tranche underperformance as observed in Q1
  - +$350MM (Central Scenario) in this case bull steepening of IG curves (+4bps), more than offset by outperformance of IG.9 curve vs. on the run
    - +170MM carry
    - -$280MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - +$110MM due to rally in credit spreads -15%
    - +$200MM due to relative outperformance of IG 9 curve vs. on the run IG curves (while counter-intuitive, the "compression" effect of IG.9 vs. on the run IG complex is driver of performance)
    - +$150MM due to long-dated equity tranche outperformance
  - In the section "10% Optimistic" the convexity of the portfolio in a highly positive or a highly negative market outcome is demonstrated
    - +$702MM in the event of -20% tightening of spreads, decompression of HY vs. IG credit, and IG.9 forward outperformance (rolling down the curve)
    - $1,126 "End of QE" refers to a scenario of strong growth led by U.S., spreads avg. -50% tighter
    - +1,725MM in "Many Defaults" means wave of defaults among widest spread names (incl. MBIA, Radian, iStar) curve flattening, and +75% spread widening, driven by performance of HY shorts, IG flatteners and long protection positions in the portfolio
  - In the section "10% Extreme" it is estimated that the book would range -$355MM to -$650MM.
    - -$355MM in the event of bear steepening of curves, spreads wider by avg +10%
    - -$650MM in the event of bull steepening of curves, spreads tighter by avg -25%, driven by underperformance of IG.9 (forwards do not roll down curve in rally)

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Source: 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701, at 708 [emphasis added with circle and box around existing text].

[1579] Id. (referring to 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701, at 708).

The three scenarios he referenced, numbered 4, 5, and 6, above, considered what would happen in the event of a "New Financial Crisis," if the "Status Quo" continued, or if a "Central Scenario" took place. But contrary to Mr. Braunstein's statement, all three scenarios indicated that the SCP book had stopped providing stress loss protection and would likely lose money.

Scenario 4, labeled "New Financial Crisis," considered what would happen if credit spreads widened by 25%, and projected that, in that scenario, the SCP would lose $250 million. Several JPMorgan Chase officials had told the Subcommittee that a financial crisis continued to be the "tail event" that the book was meant to hedge.[1580] Mr. Dimon explained that it was the original purpose of the hedge,[1581] and that the SCP had made money for JPMorgan Chase during the 2008 financial crisis as a hedge against credit widening.[1582] Yet by April 11, 2012, the bank projected that the SCP would lose money in just such a scenario, a projection inconsistent with a book intended to provide protection against stress loss from credit risk.

Scenario 5 considered what would happen under the "Status Quo." In this scenario, as the name indicated, credit spreads did not tighten or widen, yet the SCP was projected to lose $150 million. In fact, the narrative below the chart indicated that, under this scenario, the SCP would lose $300 million, but those losses would be partially offset by the book's positive carry – that is, the premiums the book would take in from having sold long credit protection to short parties.[1583]

Scenario 6 considered what would happen under the so-called "Central Scenario." In this scenario, credit spreads tightened by 15%, and the SCP book was projected to make a profit of $350 million. In other words, the SCP book would make money during a bull market when the credit environment improved. That is the opposite of what Ms. Drew had described as the purpose of the book – that when it was a

[1580] Subcommittee briefing by JPMorgan Chase (8/15/2012) (stated by Gregg Gunselman).

[1581] Testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S.Hrg. 112-715 (June 13, 2012), http://www.cq.com/doc/congressionaltranscripts-4105471 ("[W]hat I'm told is they thought what they were doing is a more cost-efficient way to reduce the exposure and maintain some of hedge against back-tail events.").

[1582] As Ina Drew herself pointed out to Mr. Braunstein and other members of the operating committee a week before the earnings call: "Going into the [financial] crisis we used the book to hedge ... credit widening." See 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon and others, JPMorgan Chase, "CIO," JPM-CIO-PSI 0000539.

[1583] See 4/11/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "updated," JPM-CIO-PSI 0001077, with chart entitled "Synthetic Credit Summary," at 078 ("-300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches").

hedge, the book provided protection against credit spread *widening* events.[1584]

These three scenarios in the April 11 presentation indicated that when the credit environment improved, the SCP would make money, and that when credit deteriorated (or stayed the same), the SCP would lose money. Far from indicating that the SCP provided stress loss protection associated with credit risk, the April 11 presentation showed that the SCP book held the same long position as the bank and did not support Mr. Braunstein or Mr. Dimon's descriptions of the SCP as an offset of the bank's other credit exposures or as stress loss protection.

During his interview, the Subcommittee asked Mr. Dimon to reconcile Mr. Braunstein's public statements with the fact that none of the scenarios that Mr. Braunstein himself said he relied on indicated that the book functioned as a hedge. First, Mr. Dimon contended that the bank's investors – the target audience of the earnings call – would not have cared if the book was a hedge, implying that Mr. Braunstein would have had no reason to discuss, on an earnings call, whether or not the book functioned as a hedge.[1585] The bank knew, however, that it did matter to investors if the SCP was a hedge, as the head of investor relations emailed to Mr. Dimon after the May 10 call: "Need to manage this in DC because the hit there is going to be a lot bigger than the hit on earnings."[1586] Secondly, Mr. Dimon noted that he himself had been told it was a hedge, and "[n]obody said [to Mr. Braunstein] 'Why don't you go out there and lie.'"[1587] At that point, JPMorgan Chase's General Counsel intervened and denied that Mr. Braunstein had, on the earnings call, said that the book functioned as a hedge.[1588]

Mr. Braunstein subsequently sent a letter to the Subcommittee seeking to "clarify" whether he had, in fact, told the Subcommittee that he had relied on the three specific scenarios on page 7 of the April 11 presentation in developing his view of the hedging status of the SCP.[1589] The letter stated that it sought to "clarify one aspect of my interview

[1584] 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, "CIO," JPM-CIO-PSI 0000539.
[1585] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
[1586] 5/10/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10-Q call – Buyside and sellside comments (2)," JPM-CIO-PSI 0017754, at 756 (summarizing questions from analysts after the call about hedging, e.g., 'Have a lot of contacts in Washington who said this is going to be a big deal for Volcker; need to manage this in DC because the hit there is going to be a lot bigger than the hit on earnings."). See also, e.g., 5/11/2012 email from Sarah Youngwood to Jamie Dimon, JPMorgan Chase, and others, "10-Q call 0 Buyside and sellside comments (5)," JPM-CIO-PSI 0014833 ("What did the CIO-related loss stem from? A hedge position or a prop trade?").
[1587] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
[1588] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012) (intervention by Stephen Cutler, JPMorgan Chase).
[1589] 2/4/2013 letter from Douglas Braunstein, JPMorgan Chase, to the Subcommittee, PSI-JPMC-35-000001 (clarifying statements made about the Synthetic Credit Portfolio during the 9/12/2012 interview with the Subcommittee).

with you and others on September 12, 2012, as to which I understand from discussions with my counsel that there may be some misunderstanding."[1590] The letter offered two additional explanations for Mr. Braunstein's comments on the earnings call, which are described below.

SCP's History. As noted above, during the interview with Mr. Dimon, JPMorgan Chase's General Counsel denied that Mr. Braunstein had characterized the SCP book as a hedge during the April earnings call.[1591] In the letter, Mr. Braunstein did not repeat that denial. Rather, he explained that his "statements on April 13 regarding those hedging characteristics were references to the portfolio's design and historical performance as a hedge."[1592]

Mr. Braunstein's comments on April 13 did not indicate, however, that he was speaking about the portfolio's "design and historical performance as a hedge." Mr. Braunstein's comments were in the present tense, referred to recent press articles, and conveyed a description of the SCP as it stood on that day, not at some historical date. As Mr. Braunstein said on the call: "We ... need to manage the stress loss associated with that portfolio .... We have put on positions to manage for a significant stress event in credit .... the activities that have been reported in the paper are basically part of managing that stress loss position[.]"[1593] He also stated: "They're done to keep the company effectively balanced from a risk standpoint. We are very comfortable with our positions as they are held today." Use of the word, "today," indicates that Mr. Braunstein was not presenting a historical view. Moreover, if he had not been speaking about the SCP's current function as a hedge, it is unclear why he then said that the SCP trading "is consistent with what we believe the ultimate outcome will be related to Volcker."[1594]

In addition, while Mr. Braunstein's letter discussed only his own statements, other statements made by Mr. Dimon and Joseph Evangelisti, the bank's senior spokesperson, were also framed in the present tense.[1595] In fact, even one month later, on May 10, Mr. Dimon continued to mischaracterize the SCP as a "hedge."[1596]

[1590] Id.
[1591] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
[1592] 2/4/2013 letter from Douglas Braunstein, JPMorgan Chase, to the Subcommittee, PSI-JPMC-35-000001 (clarifying statements made about the Synthetic Credit Portfolio during the 9/12/2012 interview with the Subcommittee).
[1593] 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 7, JPM-CIO-PSI 0001151.
[1594] Id.
[1595] See, e.g., "Making Waves Against 'Whale,'" Wall Street Journal, Katy Burne (4/11/2012) ("The bank views its recent selling in the context of a range of related positions and feels its risk is now effectively balanced, added Mr. Evangelisti."); 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 10, JPM-CIO-PSI 0001151 (Mr. Dimon:

No "Fat Tail Hedge." In addition to contending that he was discussing the SCP's function as a hedge in a historical sense, Mr. Braunstein's letter to the Subcommittee also explained that he had described the SCP as a hedge after "receiv[ing] information from a number of sources regarding the CIO/London Whale issue" including "numerous conversations with Ina Drew, J.P. Morgan's Chief Investment Officer, and members of her London-based team, including the CIO's Chief Risk Officer and Chief Financial Officer, as well as John Hogan, J.P. Morgan's Chief Risk Officer." He also "specifically recalled" the April 11 presentation, described above.[1597] These sources do not provide a reasonable basis, however, for Mr. Braunstein's characterization of the SCP as a hedge.

On April 5, Ina Drew emailed Mr. Braunstein and other executives, including Jamie Dimon, to explain the CIO's derivatives activity. She wrote: "Post December [2011] as the macro scenario was upgraded and our investment activities turned pro risk, the book was moved into a long position."[1598] As detailed in Chapter III, holding a net "long position" is not consistent with the SCP being a hedge.

Achilles Macris, the head of the "London-based team" from which Mr. Braunstein said he gathered information, provided a more detailed update in the following email:

> "The synthetic credit book, as a dedicated hedge to our credit longs, continues to be short HY. In Q4 [2011], we decided to **neutralize the risk profile** of this book for two reasons: a) the large realized gains around the AMR [American Airlines bankruptcy] events, and b) given our large investment program in cash credit securities and related view."[1599]

In other words, while the SCP book continued to have some short, high yield positions, the addition of over $100 billion in investment grade longs "neutralized" the SCP book, and resulted in the portfolio's becoming, as Ina Drew indicated in her April 5 email, net long.[1600]

"But at the end of the day, that's our job, is to invest that portfolio wisely and intelligently to -- over a long period of time to earn income and to offset other exposures we have."). Neither statement referred to historical performance, but to the current status of the portfolio.

[1596] 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 2, 10, 12, and 18, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf.

[1597] 2/4/2013 letter from Douglas Braunstein, JPMorgan Chase, to the Subcommittee, PSI-JPMC-35-000001 (referring to 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701, at 708).

[1598] 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon and others, JPMorgan Chase, "CIO," JPM-CIO-PSI 0000539.

[1599] 4/8/2012 email from Achilles Macris, CIO, to Ina Drew, CIO and others, JPMorgan Chase, "Synthetic Credit Summary," JPM-CIO-PSI 0001588 [emphasis added].

[1600] 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon and others, JPMorgan Chase, "CIO," JPM-CIO-PSI 0000539.

Those longs were also purchased by the SCP to produce "carry" from the short parties in order to finance the purchase of additional positions and help offset the losses being incurred by the portfolio. Mr. Wilmot, the CIO CFO, another person from whom Mr. Braunstein said that he gathered information, explained to Mr. Braunstein that the long positions were purchased for carry, that is, profit.[1601] Mr. Hogan, the bank's Chief Risk Officer, emailed a similar explanation to Mr. Dimon: "I would say they just wanted to improve the carry on the book by selling protection [i.e. long positions] and taking in some premium."[1602] Ms. Drew also informed both Mr. Braunstein and Mr. Dimon that the "Investment Grade strategies" were to provide "some carry."[1603] Nowhere, however, in the bank's press statements, earnings call commentary, or SEC filings did the bank disclose this trading strategy to investors – that the SCP was purchasing long credit derivatives in part to produce carry and use that carry to finance other trades and offset short term losses from its high yield short positions.

Finally, the rest of the April 11 presentation does not support Mr. Braunstein's claim that the SCP was a hedge. The presentation examined the SCP's holdings relating to individual corporations, but did not identify or assess any offsetting exposures at the bank that were being counterbalanced.[1604] If the presentation were analyzing a hedging

[1601] On the day before the earnings call, in response to a question by Mr. Braunstein as to why the CIO had not simply reduced its high yield positions instead of adding the IG9 long positions, the CIO's Chief Financial Officer John Wilmot answered that the book sought to produce "carry (ie associated p&l)." 4/9/2012 email from John Wilmot, CIO, to Ina Drew, CIO and others, "Deliverables for meeting tomorrow," JPM-CIO-PSI 0001646. In other words, the CIO bought the $100 billion in long positions in part to generate "carry" or premiums from the short parties which the CIO could then use to offset some of the losses being incurred by the book's other positions.

[1602] 4/13/2012 email from John Hogan, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, "CIO," JPM-CIO-PSI 0001753.

[1603] See 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, Douglas Braunstein, JPMorgan Chase, and others, "Synthetic Credit Materials," JPM-CIO-PSI 0001100, at 101 ("The way that we at CIO have book-run the Core book to balance the negative carry cost of the High yield Book overtime has been using Investment Grade strategies that gave us some carry or buying optionality (or both) ...."). In other words, Ms. Drew's email indicated that the SCP book was purchasing IG9 tranches, not to hedge a bank credit risk, but to produce "carry" or premiums to finance the purchase of some of the short positions in the High Yield credit indices. Mr. Braunstein told the Subcommittee that he was familiar with that paragraph of her email. Mr. Braunstein conceded in his interview that the investment grade long positions "helped pay for the carry for the high yield positions" and that they may also have been used to "cover" the high yield short positions. He also said that the purpose "may have both and it depends when." Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).

[1604] Pages five and six are entitled, "Single Name Risk & Forward Jump to Default Risk." JPM-CIO-PSI 0001706-707. These pages estimated the revenues that the CIO would earn in the event certain individual corporations defaulted on their loans or declared bankruptcy, as well as the CIO's likely exposure to losses upon expiration in December 2012, of certain credit protection that it once held. Id. Nowhere are the defaults by individual corporations correlated to the portfolios that the SCP was purportedly hedging – either the available-for-sale portfolio in the CIO nor to any other portfolio held by the bank more generally. The OCC Examiner-in-Chief told the Subcommittee that the CIO's available-for-sale portfolio did not have any exposure to defaults by individual corporations and so would not have needed that type of hedge in any event. Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). The former Chief Risk portfolio, the bank analysis should have identified the assets or portfolios being hedged and evaluated the SCP's positions in that light. No such analysis was provided in the April 11 presentation. Mr. Braunstein told the Subcommittee that the presentation was prepared "with input from C.S. Venkatakrishnan,"[1605] however, Mr. Venkatakrishnan told the Subcommittee that he did not know what, if anything, the SCP was hedging.[1606]

The bottom line is that the SCP, *as a whole*, was not a hedge. It was net long and was projected to lose money when the credit markets worsened. In the April 11 presentation, information on pages 3, 5, and 7 predicted gain or loss figures for the *entire* synthetic credit portfolio, and showed that the bank itself predicted that the SCP would lose money in credit stress scenarios, thereby amplifying the bank's losses, rather than hedging, offsetting, or providing stress loss protection against them. Mr. Braunstein and Mr. Dimon reviewed that information two days before the earnings call, yet they told investors on April 13 that the SCP was a hedge. Mr. Dimon repeated that description on May 10, even though by then he knew even more details of the SCP and knew, as he later put it, the SCP had "morphed" into something else.

(5) Asserting SCP Trades Were Consistent With the Volcker Rule

The final point made in the April 13 earnings call by Mr. Braunstein involved the Volcker Rule. Mr. Braunstein stated:

> "The last comment that I would make is that based on, we believe, the spirit of the legislation as well as our reading of the legislation, and consistent with this long-term investment philosophy we have in CIO we believe all of this is consistent with what we believe the ultimate outcome will be related to Volcker."[1607]

The Volcker Rule, codified at Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is intended to reduce bank risk by prohibiting high-risk proprietary trading activities by federally insured banks, their affiliates, and subsidiaries. At the same time, the Volcker Rule is intended to allow certain bank trading activities to continue, including "risk-mitigating hedging activities," meaning

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Officer for the CIO also confirmed that for the Subcommittee. Subcommittee interview of Irvin Goldman, CIO (9/15/2012).

[1605] 2/4/2013 letter from Douglas Braunstein, JPMorgan Chase, to the Subcommittee, PSI-JPMC-35-000001 (referring to 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "synthetic credit information," JPM-CIO-PSI 0001701, at 708).

[1606] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

[1607] 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," at 7, JPM-CIO-PSI 0001151.

hedging activities that reduce, rather than increase, a bank's risk of losses.

The basis for Mr. Braunstein's prediction that the SCP's trading activities would be found to be "consistent with" the Volcker Rule is unclear. When the Subcommittee asked JPMorgan Chase if it had any legal opinion examining how the Volcker Rule would affect the bank's business, including the SCP, it responded that no such analysis had been performed.[1608] At the time Mr. Braunstein made his statement on April 13, the Volcker Rule's implementing regulation was still in draft form. Earlier in the year, on February 2, 2012, representatives of the bank had met with the OCC to voice the bank's views on the draft regulation.[1609] According to both the bank and the OCC, at no point did the discussion turn to the Synthetic Credit Portfolio, so the regulators could not have given the bank any guidance on the effect of the Volcker Rule on the SCP during that meeting.[1610] On February 13, 2012, the bank submitted an official comment letter to the OCC and other bank regulators criticizing the draft regulation implementing the Volcker Rule and offering recommendations for changes.[1611] Among other criticisms, JPMorgan Chase's comment letter expressed concern that the Volcker Rule's proposed regulation might not permit the CIO to continue to manage the Synthetic Credit Portfolio. The comment letter stated: "Under the proposed rule, this activity [i.e., credit derivatives] could have been deemed prohibited proprietary trading."[1612] This analysis directly contradicts Mr. Braunstein's statement during the earnings call that the bank had concluded that the SCP would be found to be "consistent with" the Volcker Rule.

In addition, when Ina Drew provided briefing materials to Mr. Braunstein the day before the earnings call, she provided no support for the notion that the synthetic credit trades would be permitted under the Volcker Rule. She sent him a "Questions and Answers" document, and with respect to the Volcker rule, wrote:

> **"[Question:] In your view, could this trading fall afoul of Volcker under a narrow definition (or even a broad one)?**

[1608] See Subcommittee briefing by JPMorgan Chase (8/23/2012) (Neila Radin and Greg Baer).
[1609] "Chronology of JPMC Regulator Meetings," table provided by JPMorgan Chase at Subcommittee briefing by JPMorgan Chase (8/23/2012) (attended by Greg Baer, Ina Drew, Irvin Goldman, Neila Radin, John Wilmot and Barry Zubrow).
[1610] Subcommittee interview of Michael Sullivan, OCC (8/30/2012) (stating that there was no mention of the synthetic credit portfolio).
[1611] 2/13/2012 letter from JPMorgan Chase, to Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and Office of the Comptroller of the Currency, "Comment Letter on the Notice of Proposed Rulemaking Implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," JPM-CIO-PSI 0013270.
[1612] Id., at JPM-CIO-PSI 0013326 (indicating that "the use of credit derivatives," that is, the Synthetic Credit Portfolio, was among the bank's "ALM activities that were crucial during the financial crisis [that] would have been endangered by the proposed rule.").

[Answer:] As Barry Zubrow pointed out in our comments to the Regulators in February, the language in Volcker is unclear as it pertains to anticipatory hedging needs on the ALM side. The condition for the hedging exception appears to have been drafted with trading desks in mind, where both sides of a hedge are marked to market. It is a poor fit with A[sset] L[iability] M[anagement]."[1613]

Ms. Drew's analysis, which describes the Volcker Rule's language as "unclear" and a "poor fit" for the SCP, is also contrary to the positive assessment provided by Mr. Braunstein during the earnings call.

Ms. Drew's suggested "answer" to a Volcker Rule question references the bank's official comment letter, which was signed by Barry Zubrow. Mr. Zubrow also sent an email to Mr. Braunstein on the day before the earnings call, but suggested a more positive response to a Volcker Rule question than did Ms. Drew. Mr. Zubrow wrote:

"If asked about London / CIO and Volcker[,] I suggest you add the following thoughts:

1.)Activity was NOT short term trading
2.)Was part of LONG TERM hedging of the bank[']s portfolio
3.)We do not believe that our activity in any way goes against the law as passed by Congress, nor the spirit or proposed rule as written."[1614]

Mr. Zubrow did not disclose or explain in the email why his view differed from the bank's official comment letter, which he had signed and which stated that the proposed Volcker Rule "could have [] deemed" the CIO's credit derivatives trading as prohibited. He nevertheless recommended a positive response, and Mr. Braunstein appears to have followed his advice. Apart from Mr. Zubrow's email, the Subcommittee was unable to uncover any other evidence to support Mr. Braunstein's statement.

A key, ongoing issue related to the SCP is whether it should be viewed as a risk-reducing hedge or as a high-risk proprietary bet that the Volcker Rule is meant to stop. Investors would likely consider, as one piece of information important in the overall mix, whether the CIO would be permitted under the law to continue operating the SCP as before or whether the SCP would have to be shut down, and a reasonable investor might have been reassured by Mr. Braunstein's

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[1613] 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "Synthetic Credit Materials," JPM-CIO-PSI 0001100, at 104 [emphasis in original].

[1614] 4/12/2012 email from Barry Zubrow, JPMorgan Chase, to Douglas Braunstein, JPMorgan Chase, Jamie Dimon, JPMorgan Chase, and others, "If asked about London / CIO and Volcker," JPM-CIO-PSI-H 0002418.

confident statement on this issue. Mr. Braunstein should have known, however, that he could not rely on Mr. Zubrow's brief, three-point email which directly contradicted the bank's 68-page official comment letter that had been vetted by the bank's counsel and other senior officials. Mr. Zubrow's email apparently had no other support in any bank legal analysis or regulatory communication. Mr. Braunstein's optimistic assessment during the April 13 earnings call may have reassured investors, but that is no justification for misinforming the public about the bank's official position that the Volcker Rule might prohibit the SCP as an example of high-risk proprietary trading.

(6) Omitting VaR Model Change

A final issue involves, as noted above in Chapter V, one of the key metrics used within JPMorgan Chase to monitor risk, called "Value-at-Risk" or "VaR." OCC regulations require national banks to use VaR risk metrics. JPMorgan Chase uses a number of different VaR models to test different types of risk with different confidence levels, including a historical VaR model with a 99% confidence level (VaR-99) whose results are used in its RWA model to determine the bank's capital requirements; a stress VaR model that focuses on risk results in stressed economic conditions; and a historical VaR model with a 95% confidence level (VaR-95) which the bank uses to track and set a limit on the amount of money that can be lost by the relevant business unit over the course of a day in ordinary economic conditions.[1615] JPMorgan Chase uses the VaR-95 model to report its VaR results in its public filings with the SEC.

From a regulatory standpoint, VaR is important for satisfying safety and soundness requirements, as a basis for OCC oversight, and to ensure adequate disclosure to investors. VaR models are reviewed, approved, and monitored by OCC examiners. VaR is also one option, among several alternatives, for banks to fulfill their disclosure obligations under SEC rules, which "require comprehensive disclosure about the risks faced by a public company,"[1616] including disclosure when banks change a VaR "model characteristics, assumptions, and parameters."[1617] In June

[1615] JPMorgan Chase used a 95% confidence level in the VaR results it reported publicly in its SEC filings. It used a slightly different formula, with a 99% confidence level, when incorporating VaR results into its RWA calculations. Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

[1616] Testimony of Mary Schapiro, "Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss," before the U.S. House of Representatives Committee on Financial Services, Serial No. 112-136 (June 19, 2012). In addition, OCC rules require disclosure of VaR. See 12 C.F.R. Part 3, Appendix b, Section 12.

[1617] SEC Regulation S-K, Quantitative and qualitative disclosures about market risk, 17 C.F.R. § 229.305. See also prepared statement of Mary Schapiro, "Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss," before the U.S. House of Representatives Committee on Financial Services, Serial No. 112-136 (June 19, 2012) (describing Regulation S-K, Section 305: "If a company chooses to use the VaR disclosure alternative to comply with this market risk exposure requirement, it must disclose changes to key model characteristics, assumptions and parameters used in providing the quantitative information

2012, then Chairman of the SEC, Mary Schapiro, testified before Congress that the SEC had an ongoing investigation into the extent of JPMorgan Chase's VaR disclosure.[1618]

JPMorgan Chase's Form 10-K explains that the bank "maintains different levels of limits. Corporate-level limits include VaR and stress limits. Similarly, line-of-business limits include VaR and stress limits[.]"[1619] The report also explained the VaRs for the different lines of business, including the CIO: "CIO VaR includes positions, primarily in debt securities and credit products, used to manage structural and other risks including interest rate, credit and mortgage risks arising from the Firm's ongoing business activities."[1620] In addition, JPMorgan Chase's Form 10-K provided a table, reprinted below, of VaR-95 totals for key lines of business, including the Investment Bank (IB) and the CIO.

The 2011 table showed that the CIO reported an average VaR-95 total of $61 million in 2010, and $57 million in 2011, meaning those were the total amount of losses that the CIO was projected to be at risk of losing in a single day in those years, with a 95% confidence level. The CIO's VaR totals were less than those shown for the Investment Bank (IB) which reported VaR totals of $87 million in 2010 and $76 million in 2011. The narrative in the report explained that the CIO VaR had decreased in 2011 due to "a decline in market volatility ... as well as position changes."[1621]

about market risk, including the reasons for the changes."); 6/28/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, OCC, and others, "2nd WilmerHale Call," OCC-SPI-00071386 (generally describing bank obligations with respect to VaR disclosure under SEC rules).

[1618] Testimony of Mary Schapiro, "Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss," before the U.S. House of Representatives Committee on Financial Services, Serial No. 112-136 (June 19, 2012) ("Our rules do require that changes to the value-at-risk model, the assumptions of parameters, have to be disclosed. So part of what we're investigating is the extent of that disclosure, whether it was adequate, among other things.").

[1619] 2/29/2012, JPMorgan Chase & Co., Form 10-K, at 162, http://files.shareholder.com/downloads/ONE/ 2275559219x0xS19617-12-163/19617/filing.pdf.

[1620] Id., at 159.

[1621] Id., at 160.

The table below shows the results of the Firm's VaR measure using a 95% confidence level.

Total IB trading VaR by risk type, Credit portfolio VaR and other VaR

As of or for the year ended December 31,	2011			2010			At December 31,	
(in millions)	Avg.	Min	Max	Avg.	Min	Max	2011	2010
IB VaR by risk type								
Fixed income	$ 50	$ 31	$ 68	$ 65	$ 33	$ 95	$ 49	$ 52
Foreign exchange	11	6	19	11	6	20	19	16
Equities	23	15	42	22	10	52	19	30
Commodities and other	16	8	24	16	11	32	22	13
Diversification benefit to IB trading VaR	(42) [a]	NM [b]	NM [b]	(43) [a]	NM [b]	NM [b]	(55) [a]	(34) [a]
IB trading VaR	58	34	80	71	40	107	54	77
Credit portfolio VaR	33	19	55	26	15	40	42	27
Diversification benefit to IB trading and credit portfolio VaR	(15) [a]	NM [b]	NM [b]	(10) [a]	NM [b]	NM [b]	(20) [a]	(5) [a]
Total IB trading and credit portfolio VaR	76	42	102	87	50	128	76	99
Other VaR								
[illegible]	[illegible]	6	98	[illegible]	8	47	16	9
Chief Investment Office ("CIO") VaR	57	30	80	61	44	80	77	56
Diversification benefit to total other VaR	(17) [a]	NM [b]	NM [b]	(13) [a]	NM [b]	NM [b]	(10) [a]	(10) [a]
Total other VaR	70	46	110	71	48	100	83	55
Diversification benefit to total IB and other VaR	(45) [a]	NM [b]	NM [b]	(59) [a]	NM [b]	NM [b]	(46) [a]	(65) [a]
Total IB and other VaR	$ 101	$ 67	$ 147	$ 99	$ 66	$ 142	$ 113	$ 89

(a) Average VaR and period-end VaR were less than the sum of the VaR of the components described above, which is due to portfolio diversification. The diversification effect reflects the fact that the risks were not perfectly correlated. The risk of a portfolio of positions is therefore usually less than the sum of the risks of the positions themselves.

(b) Designated as not meaningful ("NM"), because the minimum and maximum may occur on different days for different risk components, and hence it is not meaningful to compute a portfolio-diversification effect.

Source: 2/29/2012, JPMorgan Chase & Co., Form 10-K, at 159 [emphasis added with text box and circles to denote CIO VaR].

In January 2012, JPMorgan Chase allowed the CIO to change its VaR-95 model, but did not announce this change until May 10. As discussed in Chapter V, JPMorgan Chase implemented the new CIO VaR methodology at the end of January 2012,[1622] to end a four-day breach of the bankwide VaR limit that was caused by the CIO. The new

[1622] See 1/30/2012 email from Ashish Dev, JPMorgan Chase, to Peter Weiland, CIO, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM-CIO-PSI 0000187.

model immediately recast the CIO's VaR-95 total, dropping it by 50% on the day it was put into place.[1623] Neither the VaR model change nor its effect on the CIO's VaR total was publicly disclosed at the time.

Several months later, on April 6, 2012, media reports disclosed for the first time that the CIO was engaged in large credit derivative trades.[1624] On April 11, 2012, when asked about the CIO's credit holdings, a JPMorgan Chase official, Sarah Youngwood, head of investor relations, pointed an analyst to the CIO's VaR:

> Question: "Kush Goel – Neuberger (Buyside) . . . What was the specific credit position discussed in the article; where are these derivatives disclosed? . . .
>
> Answer: "CIO VaR is disclosed in the Market Risk section of the 10K with a brief description of the activities . . . ."[1625]

In other words, to assuage the analyst's concern about the CIO's large credit positions, JPMorgan Chase directed him to the bank's public disclosures regarding the CIO's VaR results in its 2011 Annual Report. Those results showed that the 2011 VaR total had actually decreased from the prior year and indicated that the most the CIO had at risk was $57 million, a relatively small sum in comparison to the bank's total holdings.

Two days later, on April 13, 2012, JPMorgan Chase filed its Form 8-K with the SEC and held its earnings call.[1626] In its 8-K filing, JPMorgan Chase included another chart, reprinted below, reporting the VaR results for the CIO and Investment Bank.[1627]

[1623] Levin Office briefing by JPMorgan Chase (7/19/2012); "CIO 10QVaR," JPMC-Senate/Levin 000155 (decrease of 50% from $132 million to $66 million on January 27, 2012).
[1624] See "JPMorgan Trader's Positions Said to Distort Credit Indexes," Bloomberg, Stephanie Ruhle, Bradley Keoun & Mary Childs (4/6/2012), http://www.bloomberg.com/news/2012-04-05/jpmorgan-trader-iksil-s-heft-is-said-to-distort-credit-indexes.html; "'London Whale' Rattles Debt Market," Wall Street Journal, Gregory Zuckerman and Katy Burne (4/6/2012).
[1625] 4/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon and others, JPMorgan Chase, "CIO articles – Calls (9)," JPM-CIO-PSI 0001093.
[1626] 4/13/2012 JPMorgan Chase & Co., Form 8-K, http://files.shareholder.com/downloads/ONE/2063348229x0xS1193125-12-161533/19617/filing.pdf.
[1627] Id., at 42.

JPMORGAN CHASE & CO.
MARKET RISK-RELATED INFORMATION
(in millions)

JPMORGAN CHASE & CO.

	QUARTERLY TRENDS					1Q12 Change	
95% CONFIDENCE LEVEL- AVERAGE IB TRADING VAR, CREDIT PORTFOLIO VAR AND OTHER VAR	1Q12	4Q11	3Q11	2Q11	1Q11	4Q11	1Q11
IB VaR by risk type:							
Fixed income	$ 60	$ 56	$ 48	$ 45	$ 49	7%	22%
Foreign exchange	11	12	10	9	11	(8)	—
Equities	17	19	19	25	29	(11)	(41)
Commodities and other	21	20	15	16	13	5	62
Diversification benefit to IB trading VaR (a)	(46)	(50)	(39)	(37)	(38)	8	(21)
IB trading VaR (b)	63	57	53	58	64	11	(2)
Credit portfolio VaR (c)	32	39	38	27	26	(18)	23
Diversification benefit to IB trading and credit portfolio VaR (a)	(14)	(21)	(21)	(8)	(7)	33	(100)
Total IB trading and credit portfolio VaR	81	75	70	77	83	8	(2)
Other VaR:							
[illegible] (d)	[illegible]	[illegible]	40	20	16	[illegible]	(31)
Chief Investment Office VaR (e)	67	69	48	51	60	(3)	12
[illegible]	[illegible]	[illegible]	(15)	(10)	(14)	[illegible]	57
Total other VaR	72	83	73	61	62	(13)	16
Diversification benefit to total IB and other VaR (a)	(37)	(45)	(35)	(44)	(57)	18	35
Total IB and other VaR (f)	$ 116	$ 113	$ 108	$ 94	$ 88	3	32

(a) Average VaR was less than the sum of the VaR of the components described above, due to portfolio diversification. The diversification effect reflects the fact that the risks were not perfectly correlated. The risk of a portfolio of positions is therefore usually less than the sum of the risks of the positions themselves.

(b) For further information on IB trading VaR, see footnote (b) on page 12.

(c) For further information on Credit portfolio VaR see footnote (c) on page 12.

(d) Mortgage Production and Servicing VaR includes the Firm's mortgage pipeline and warehouse loans, MSR, and all related hedges.

(e) CIO VaR includes positions, primarily in debt securities and credit products, used to manage structural risk and other risks, including interest rate, credit and mortgage risks arising from the Firm's ongoing business activities.

(f) Total IB, Credit portfolio and other VaR does not include the retained Credit portfolio, which is not reported at fair value; however, it does include hedges of those positions. It also does not include DVA on derivative and structured liabilities to reflect the credit quality of the Firm; principal investments (mezzanine financing, tax-oriented investments, etc.); and certain securities and investments held by Corporate/Private Equity, including private equity investments, capital management positions and longer-term investments managed by CIO.

Source: 4/13/2012 JPMorgan Chase & Co., Form 8-K, at 42 [emphasis added to denote CIO VaR].

This chart indicated that the CIO's average VaR for the first quarter of 2012 was $67 million, which represented a decline of $3 million from the previous quarter at the end of 2011.[1628] Again, by comparison, the Investment Bank's VaR was larger at $81 million.[1629]

[1628] Id.
[1629] Id.

An investor viewing the 8-K chart might have reasonably concluded that, since the 2011 fourth quarter VaR and the 2012 first quarter VaR were so similar, at $67 million and $69 million respectively, that the risk had not changed at the CIO or in its underlying portfolios. In fact, the risk had changed, and the SCP book was radically different. The 2012 portfolio was three times larger, with $157 billion in credit derivative notional value compared to $51 billion in 2011. In addition, the SCP held a new, complex mix of derivatives which had dramatically increased the portfolio's risk since the end of 2011. The fact that the CIO had replaced its VaR model with a new version that artificially lowered its VaR total overnight by 50% was nowhere mentioned in the 8-K filing. By omitting any mention of the model change and its significant impact on the CIO's VaR results, the information about the CIO VaR that was provided by the bank on April 11, by Sarah Youngwood to investors and analysts, and in the April 13 form 8-K and accompanying earnings call to the public, provided an incomplete and erroneous picture of the risks then facing the CIO.

The failure to disclose the change in methodology on April 13, either in the 8-K filing or during the earnings call, occurred even though the evidence indicates that both Mr. Braunstein and Mr. Dimon had been informed of the change at the time it was made in January 2012. Each had received multiple email communications about the expected reduction to be provided by CIO's new VaR model. They had received the emails in the context of the CIO's four-day breach of the bankwide VaR limit in January 2012 and were assured that the new CIO VaR model, which fed into the bankwide VaR, would produce a lower VaR result and so end the bankwide VaR breach.[1630] Under JPMorgan Chase policy, Mr. Dimon had to personally respond to breaches of the

[1630] 1/23/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI 0001337-38; 1/20/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% 10Q – VaR – Limit Excession Notification (COB 1/19/12)," JPM-CIO-PSI 0001890; 1/20/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "JPMC Firmwide VaR – Daily Update – cob 01/19/2012," JPM-CIO-PSI 0002457; 1/27/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "JPMC Firmwide VaR- Daily Update – COB 01/26/2012," JPM-CIO-PSI-H 0001675 ("The new VaR model for CIO was approved by MRG and is expected to be implemented prior to month-end."); 1/28/2012 email from John Hogan, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, "JPMC Firmwide VaR – Daily Update – COB 01/26/2012," JPM-CIO-PSI-H 0001675 ("This should be the last day of firmwide VaR breach. A CIO model change is planned to go in this week-end. New VaR methodology approved (and now the same methodology as IB) reduces standalone Credit VaR by approx. $30 mio."); 1/30/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "JPMC Firmwide VaR – Daily Update – COB 1/27/2012," JPM-CIO-PSI 0001339 ("The Firm's 95% 10Q VaR as of cob 01/27/2012 is $108mm of the $125mm limit, a decrease of $53mm from the prior day's revised VaR, driven by CIO (implementation of newly approved VaR model for synthetic credit)."); 2/2012 "CIO February 2012 Business Review," JPM-CIO-PSI 0001940, at 942 ("Today's Attendees, Operating Committee, Jamie Dimon, Doug Braunstein," and others.).

bankwide VaR limit and, in this case, approve a temporary VaR limit increase to end the CIO's breach. When the request was made of Mr. Dimon to temporarily increase the VaR limit, and he responded, "I approve" in an email, the rationale provided to him for raising the limit and ending the breach was that the CIO was going to soon have a new model that would reduce its VaR by 44%.[1631] Despite having received multiple emails and having approved a temporary VaR limit increase, Mr. Dimon told the Subcommittee that he did not recall the CIO's change to its VaR model and that he became aware of the issue only after "things blew up."[1632] He told the Subcommittee that he had relied on his risk management staff to inform him about VaR model issues and provide additional details if there were a problem.[1633] Mr. Braunstein told the Subcommittee that he, too, despite receiving the emails, was not sure if he was aware in January that a new CIO VaR model had been adopted that month.[1634]

In February 2012, the CIO's VaR model change was again addressed during a CIO February Business Review meeting attended by both Mr. Braunstein and Mr. Dimon.[1635] Prior to the meeting, Mr. Braunstein and Mr. Dimon each received a presentation, reprinted below, which included a section entitled, "VaR Highlights," describing the CIO's new VaR model.

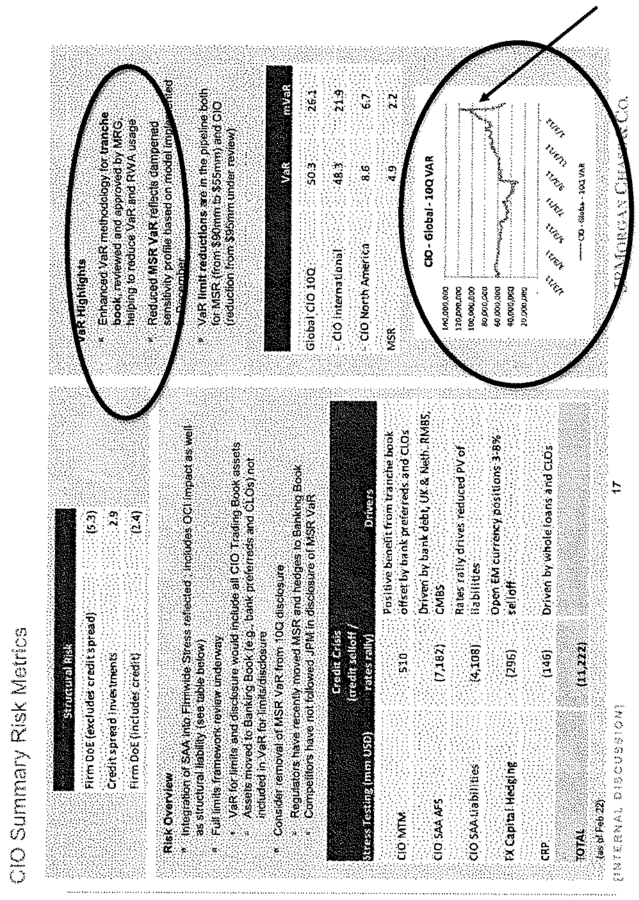
[1631] See 1/20/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC Firmwide VaR – Daily Update – COB 01/19/2012," JPM-CIO-PSI 0002457 (noting that the CIO's "improved VaR model" will reduce the CIO's VaR "by 44%"); 1/20/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% 10Q VaR – Limit Excession Notification (COB 1/19/12)," JPM-CIO-PSI 0001890 (noting that the CIO's "improved VaR model" will reduce the CIO's VaR "by 44%"); 1/20/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% 10Q – VaR – Limit Excession Notification (COB 1/19/12)," JPM-CIO-PSI 0001890 (noting that the CIO's "improved VaR model" will reduce the CIO's VaR "by 44%"); 1/23/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI 0004660 (noting that the CIO's "improved VaR model" will reduce the CIO's VaR "by 44%"); 1/23/2012 email from Jamie Dimon, JPMorgan Chase, to John Hogan, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI 0001337 (Dimon expressing "I approve" to an email requesting an increase in the CIO's VaR limit); 1/24/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "JPMC Firmwide VaR – Daily Update – COB 01/20/2012," JPM-CIO-PSI 0003346 (noting that the CIO's "improved VaR model" will reduce the CIO's VaR "by 44%"); 1/24/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, "JPMC Firmwide VaR – Daily Update – COB 01/23/2012," JPM-CIO-PSI 0003715 (noting that the CIO's "improved VaR model" will reduce the CIO's VaR "by 44%").

[1632] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

[1633] Id.

[1634] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).

[1635] 2/2012 "CIO February 2012 Business Review," JPM-CIO-PSI 0001940, at 942 ("Today's Attendees, Operating Committee, Jamie Dimon, Doug Braunstein," and others.).



Source: 2/2012 presentation slide prepared by the CIO, "CIO Summary Risk Metrics," which was part of a larger CIO presentation "CIO February 2012 Business Review," at 17, JPM-CIO-PSI 0001940 [emphasis added with circles and arrow to denote changes in CIO VaR results].

The "VaR Highlights" section explained that an "[e]nhanced VaR methodology ... [is] helping to reduce VaR and RWA usage" at the CIO.[1636] It also provided a line graph showing the trend in the CIO's "Global" VaR totals, as reported in its 10-Q filings going back to January 2011. The line graph showed the VaR total peaking in January 2012 at $120 million, followed by a precipitous decline.[1637] That decline was the result of the new VaR model which had reduced the CIO's risk rating by 50%.

Mr. Dimon told the Subcommittee that he did not specifically recall the February meeting, but stipulated that he saw the presentation.[1638] Mr. Braunstein told the Subcommittee that he attended the February Business Review, but that attendees usually did not go over every page of the presentation at the meeting and he did not recall the VaR highlights section.[1639] However, Irvin Goldman, then Chief Risk Officer for the CIO, told the Subcommittee that he specifically remembered going over the implementation of the new VaR methodology at the February meeting, and that there were no questions on it.[1640]

No public disclosure of the January 27 change in CIO VaR methodology was made until May 10, 2012, the day that JPMorgan Chase also disclosed that the SCP had lost nearly $2 billion and was expected to lose more. On that date, Mr. Dimon described the change in the VaR models during a business update call.[1641] On that same day, JPMorgan Chase filed its 10-Q quarterly report, finalizing its first quarter financial results. The 10-Q report included a chart, reprinted below, with revised VaR results for the CIO during the first quarter, but unlike the business update call, did not publicly disclose and explain the CIO VaR model changes.

[1636] Id.
[1637] Id.
[1638] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012) (describing the "CIO February 2012 Business Review," JPM-CIO-PSI 0001940).
[1639] Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
[1640] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
[1641] 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 2-3, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf (Mr. Dimon: "We are also amending a disclosure in the first quarter press release about CIO's VAR, Value-at-Risk. We'd shown average VAR at 67. It will now be 129. In the first quarter, we implemented a new VAR model, which we now deemed inadequate. And we went back to the old one, which had been used for the prior several years, which we deemed to be more adequate.").

(in millions)	2012 Avg.	2012 Min	2012 Max	2011 Avg.	2011 Min	2011 Max	At March 31, 2012	At March 31, 2011
IB VaR by risk type								
Fixed income	$ 60					56	$ 69	$ 55
Foreign exchange	11					17	14	11
Equities	17					42	17	22
Commodities and other	21					20	16	10
Diversification benefit to IB trading VaR	(46)					NM (b)	(62) (a)	(37) (a)
IB trading VaR	63					80	54	61
Credit portfolio VaR	32					33	30	28
Diversification benefit to IB trading and credit portfolio VaR	(14) (a)		NM (b)	(7) (a)	NM (b)	NM (b)	(13) (a)	(7) (a)
Total IB trading and credit portfolio VaR	81		99	83	53	102	71	82
Other VaR								
Mortgage Production and Servicing VaR	11	8	16	16	10	32	11	18
Chief Investment Office ("CIO") VaR(c)	129	85	187	60	55	64	186	55
Diversification benefit to total other VaR	(4) (a)	NM (b)	NM (b)	(14) (a)	NM (b)	NM (b)	(6) (a)	(13) (a)
Total other VaR(c)	136	89	197	62	55	69	191	60
Diversification benefit to total IB and other VaR	(47) (a)	NM (b)	NM (b)	(57) (a)	NM (b)	NM (b)	(61) (a)	(56) (a)
Total IB and other VaR(c)	$ 170	$ 111	$ 232	$ 88	$ 67	$ 104	$ 201	$ 86

The May 10 10-Q reported that average 1st Quarter CIO VaR was $129 million, double the average 2011 VaR of $60 million.

(a) Average VaR and period-end VaR were less than the sum of the VaR of the components described above, which is due to portfolio diversification. The diversification effect reflects the fact that the risks were not perfectly correlated. The risk of a portfolio of positions is therefore usually less than the sum of the risks of the positions themselves.

(b) Designated as not meaningful ("NM"), because the minimum and maximum may occur on different days for different risk components, and hence it is not meaningful to compute a portfolio diversification effect.

(c) CIO VaR presented above for the period ended March 31, 2012 supersedes the Firm's VaR disclosures included in its Form 8-K filed on April 13, 2012 and was calculated using a methodology consistent with the methodology used to calculate CIO's VaR in 2011, including the first quarter of 2011 reflected above.

Source: 5/10/2012 JPMorgan Chase & Co., Form 10-Q, at 73 [emphasis added with text box and outline of footnote to denote CIO VaR information].

In the chart, JPMorgan Chase disclosed a revised first quarter CIO VaR of $129 million, stating in a footnote that "CIO VaR presented above ... supersedes the Firm's VaR disclosures included in its Form 8-K filed on April 13, 2012."[1642] The revised first quarter CIO VaR in the 10-Q was nearly double in size from what had been reported in the April 8-K filing, which had reported CIO VaR totals of $69 million in the first quarter of 2012, and $67 million in the fourth quarter of 2011.[1643]

[1642] 5/10/2012 JPMorgan Chase & Co., Form 10-Q, at 73, http://investor.shareholder.com/jpmorganchase/secfiling.cfm?filingID=19617-12-213.
[1643] 4/13/2012 JPMorgan Chase & Co., Form 8-K, at 42, http://files.shareholder.com/downloads/ONE/2063348229x0xS1193125-12-161533/19617/filing.pdf. See also 2/29/2012, JPMorgan Chase & Co., Form 10-K, at 160, http://files.shareholder.com/downloads/ONE/2275559219x0xS19617-12-163/19617/filing.pdf (disclosing CIO average VaR in 2011 to be $57 million, and in 2010, $61 million).

The 10-Q filing contained only a limited explanation for the revised CIO VaR results. A footnote provided an opaque statement that the new total was "calculated using a methodology consistent with the methodology used to calculate CIO's VaR in 2011." In addition, using language that did not appear in prior quarterly reports, the 10-Q filing stated: "The Firm's VaR models are continuously evaluated and enhanced in response to changes in the composition of the Firm's portfolios, changes in market conditions and dynamics, improvements in the Firm's modeling techniques, systems capabilities, and other factors."[1644]

Together, the 10-Q statements do not plainly disclose that the CIO had replaced its old VaR model with a new one in January 2012, used that new model to calculate a much lower VaR for the CIO in the bank's April 8-K filing, and then decided to stop using the new model and reinstate the prior model to calculate the CIO's VaR total for the May 10-Q filing. In addition, the bank omitted disclosing in its 10-Q filing that the bank had determined the original first quarter VaR was inaccurate and had understated the SCP risk by a significant amount. The bank also omitted any mention of the operational problems it had discovered in connection with the discarded VaR model. CIO management had discovered those problems only a few days after the April 8-K was filed, but waited nearly a month to publicly correct the CIO's VaR results.[1645]

On May 10, 2012, the day the 10-Q report was filed, JPMorgan Chase also held a "business update call" with analysts, investors, the media, and others. At the outset of the call, Mr. Dimon explained orally what wasn't explained in the 10-Q filing: "In the first quarter, we implemented a new VAR model, which we now deemed inadequate. And we went back to the old one, which had been used for the prior several years, which we deemed to be more adequate." In addition, when asked why the bank had made the VaR model change "in the first place," Mr. Dimon responded: "There are constant changes and updates to models, always trying to get them better than they were before. That is an ongoing procedure."[1646] In both explanations, Mr. Dimon omitted any mention of the fact that the CIO VaR model adopted in January 2012 was not just "inadequate," but had been determined by the bank to

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[1644] 5/10/2012 JPMorgan Chase & Co., Form 10-Q, at 74, http://investor.shareholder.com/jpmorganchase/secfiling.cfm?filingID=19617-12-213.

[1645] See 4/18/2012 email from Keith Stephan, CIO, to Achilles Macris, CIO, and others, "CIO VaR," JPM-CIO-PSI 0001205 ("FYI-we discovered an issue related to the VAR market data used in the calculation .... This means our reported standalone var for the five business days in the period 10-16th April was understated by apprx $10 [million]."). For more information, see Chapter V.

[1646] 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 14, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf (in response to this question by an analyst: "And what caused you to change the VaR model in the first place? I mean you had something that was working and you changed it.").

have understated the risk of loss by the SCP. The January VaR model had indicated, for example, that the most money the CIO could lose in a day was $67 million, yet on March 30, 2012, the SCP reported internally a daily loss of $319 million, four times greater than the VaR had predicted. On April 10, 2012, the SCP reported internally a daily loss of $415 million, a nonpublic figure five times larger than the original VaR. The developer of the new CIO VaR model told the Subcommittee that the loss of $415 million meant that the CIO VaR "model [wa]s wrong."[1647]

Mr. Dimon stated during the May 10 call: "You should assume that we try to keep our readers update[d] about what we know and when we know it and it's just a constant practice of the company."[1648] When making this statement, Mr. Dimon did not disclose that bank management had been aware of the significant impact of CIO's VaR model change in January, but did not tell investors about the change. That information could and should have been, but was not, included in the bank's April 8-K report, which was issued after word first broke about the whale trades.

Ultimately, both Mr. Braunstein and Mr. Dimon claimed to the Subcommittee to have been personally unaware of the CIO's VaR model change in January 2012, even though both executives received multiple email communications about the proposed new CIO VaR model, and the 44% reduction it would have on the CIO's VaR, later received a CIO presentation on how the model change had dramatically lowered the CIO's VaR results, and, in at least one case, had the model change explained to them in person by the CIO's Chief Risk Officer, Irvin Goldman, in February 2012. In the case of Mr. Dimon, he was informed about the new VaR model as part of his responsibility as CEO to approve breaches of Level 1 risk limits as well as a temporary increase in the bank's VaR limit, a responsibility that the bank created as part of its risk management system and informed investors was in place.

Earlier information on the timing and dollar impact of the new VaR model would have helped investors evaluate the risks and possible dollar losses associated with the CIO's enlarged credit derivative holdings. The size of the change in the CIO's VaR was sufficiently large that it likely would have attracted notice and prompted questions from investors as soon as it was disclosed. On April 13, a week after media reports exposed vulnerable SCP positions, which only the bank knew had wiped out the SCP's 2011 profits, investors were likely interested in accurately estimating the amount of money that could be lost by the CIO. The 8-K filing indicated that the maximum value-at-

[1647] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
[1648] 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 4, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf.

risk was $67 million, despite the fact that three days earlier, on April 10, the SCP had reported internally a daily loss of $415 million.

When the change in CIO VaR was disclosed on May 10, along with the dramatically higher VaR results, it attracted questions from the marketplace.[1649] The bank's head of investor relations received many questions about both CIO VaR models from different analysts, including: "When did you change VaR model?,"[1650] "What would have happened if we [the bank] had not changed the VaR model?,"[1651] "How long was the 2012 model data tested?,"[1652] and, "As an analyst, you displayed a VaR under a model and didn't disclose the new model and would have loved to know what the difference was in the VaR using the two different models."[1653] Had the same VaR information been disclosed in April, it would likely have been of interest then, as well.

In explaining the VaR to the Subcommittee, Mr. Dimon downplayed its importance to investors as a risk measure, characterizing it as "deceptive," but he also admitted that a VaR of $150 million would have caused investors to possibly "ask about it."[1654] The OCC Examiner-In-Charge at JPMorgan Chase, Scott Waterhouse, also thought that a big VaR change would have triggered questions. As Mr. Waterhouse explained, a change in VaR from $69 million to $67 million is not important, but a change from $69 million to $129 million would have led him to "ask questions: Why did it go up? Did the model change? Did they buy something?"[1655] JPMorgan Chase's April 13 VaR disclosure – coming on the heels of the media reports about the whale trades – masked the risk increase in the CIO in a way that likely fended off potential questions from investors.

[1649] See, e.g., 5/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10-Q call - Buyside and sellside comments (6)," JPM-CIO-PSI 0014803 (summarizing questions from analysts); 5/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10-Q call - Buyside and sellside comments (2)," JPM-CIO-PSI 0017754 ("What was the sequence of the events? When did you back to the old model?"); Id., at 755 ("Did you restate the 12/31 VaR? Did Jamie say that the old model was inadequate?" and "Restated VaR. On what?"); 5/14/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10-Q call - Buyside and sellside comments (10)," JPM-CIO-PSI 0018241 ("When you put out your 2011 10K, did you use the 2011 model for VaR? In April did you disclose that you changed models? ... Is the increase in VaR all from the CIO office? Is it all related to the articles of the London Whale?"); 5/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10-Q call - Buyside and sellside comments (4)," JPM-CIO-PSI 0017987 ("Regarding the escalation of the issue, if you were using the old VaR model, do you think this would have hit the dashboard earlier?").

[1650] 5/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10-Q call - Buyside and sellside comments (6)," JPM-CIO-PSI 0014803.

[1651] Id.

[1652] 5/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10-Q call - Buyside and sellside comments (4)," JPM-CIO-PSI 0017987.

[1653] 5/14/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "10-Q call - Buyside and sellside comments (10)," JPM-CIO-PSI 0018241.

[1654] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

[1655] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

D. Analysis

As 2012 unfolded, the losses associated with the Synthetic Credit Portfolio continued to mount. When asked why its April statements were so positive in light of the ongoing, serious problems with the SCP, multiple senior JPMorgan Chase executives told the Subcommittee that the bank, like the traders, initially believed the SCP positions would "mean revert," that is, return to their prior profitability.[1656] Bank representatives explained that the credit derivative markets were not behaving in line with historic norms, and it was likely that the norms would return, and with them, the SCP gains.[1657] The markets, however, were not behaving in line with historic norms, in large part because the CIO traders had distorted them by engaging in massive trades and accumulating massive positions of synthetic instruments in markets with few participants.[1658] When the CIO traders finally stopped buying and started to exit their positions, changes in the value of the very indices that the CIO had overwhelmed made it even more difficult to exit them without incurring huge losses.[1659]

When the SCP's massive trades were made public on April 6, 2012, the bank initially responded by volunteering an inaccurate description of the SCP. The extensive problems surrounding the SCP as discussed throughout this Report – the tripling of the portfolio's size, its concentrated positions that required weeks or months to exit, its escalating losses that were being underreported, its ongoing risk limit breaches, and the risk models that masked the SCP's true risk profile – were concealed behind expansive statements that the bank was comfortable with its positions and that the concerns raised in the media were a tempest in a teapot. The evidence suggests that the bank initially mischaracterized or omitted mention of the SCP problems, not just

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[1656] See, e.g., Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012); 2013 JPMorgan Chase Task Force Report, at 5, 65 n.79, 68, 71, & 89. Some bank representatives also explained that the bank was sensitive to providing position information that could be used against it in the marketplace, but that reasoning offers no defense to volunteering misleading information to investors. "Rule 10b-5(b) do[es] not create an affirmative duty to disclose any and all material information. Disclosure is required under th[is] provision only when necessary 'to make ...statements made, in light of the circumstances under which they were made, not misleading .... Even with respect to information that a reasonable investor might consider material, companies can control what they have to disclose under these provisions by controlling what they say to the market." Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309, 1321-21 (2011).

[1657] Subcommittee interviews of Douglas Braunstein, JPMorgan Chase (9/12/2012) and Michael Cavanagh, JPMorgan Chase (12/12/2012).

[1658] See discussion in Chapter III. For example, an April 2012 analysis stated that, at the end of March, the SCP held an $82 billion long position in the IG9 index alone, which comprised nearly half the market in that index. See DTCC presentation to Subcommittee (9/27/2012) at 2, PSI-DTCC-01-000001 (showing total CDX IG9 untranched trading to total approximately $150 billion).

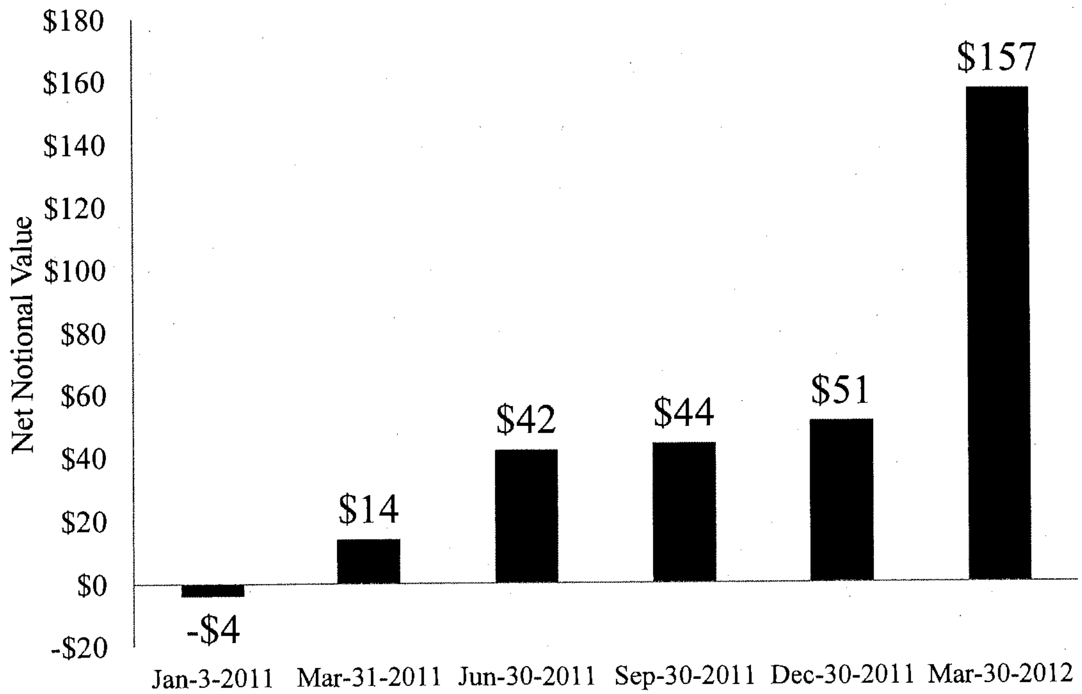
[1659] A chart prepared by the bank shows a general decline in credit spreads for the IG9 credit index from January 2012 until March 23, 2012, the day Ina Drew told the traders to stop trading, after which the prices began to rebound. See, e.g., undated chart entitled, "Credit Spreads on IG9 Index," prepared by JPMorgan Chase, JPM-CIO-PSI 0002062, reprinted in Chapter III.

because it believed the SCP would recover, but also because JPMorgan Chase likely understood the market would move against it even more if those facts were known. And once those facts were known, that is exactly how the market reacted, dropping the value of the bank's stock by 25% in the weeks following the SCP disclosures in the bank's May 10-Q filing. The bank's initial claims that its risk managers and regulators were fully informed and engaged, and that the SCP was invested in long-term, risk-reducing hedges allowed by the Volcker Rule, were fictions irreconcilable with the bank's obligation to provide material information to its investors in an accurate manner.

# # #

Growth of Synthetic Credit Portfolio

(In Billions)



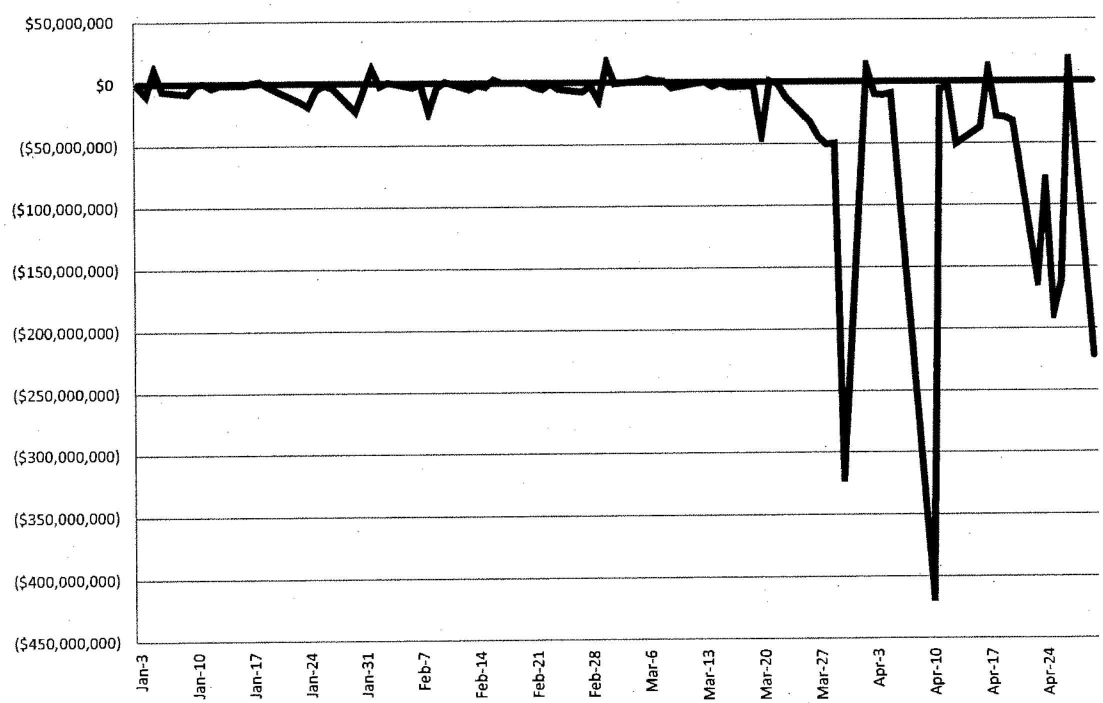
Source: Subcommittee chart created from data provided by JPMorgan Chase, JPM-CIO-PSI 0037609.

Permanent Subcommittee on Investigations

EXHIBIT #1a

Synthetic Credit Portfolio Daily Profits and Losses

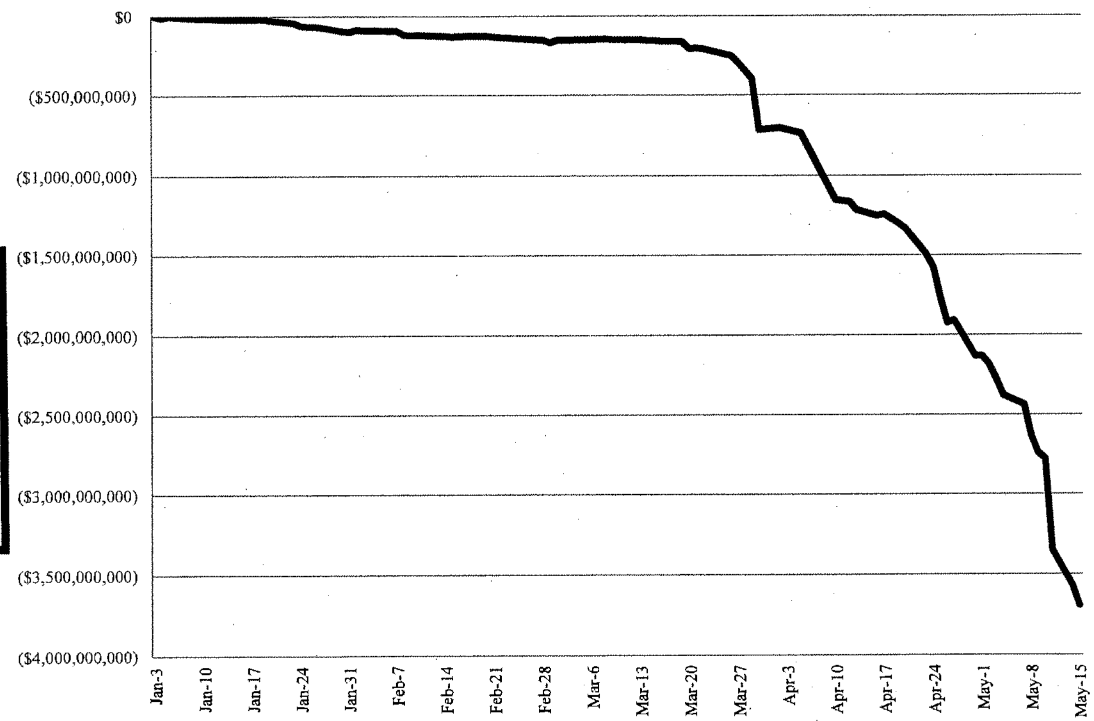
Permanent Subcommittee on Investigations
EXHIBIT #1b



512

Source: Subcommittee chart created from data provided by OCC spreadsheet, OCC-SPI-00000298; "Position Limit and Loss Advisory Summary

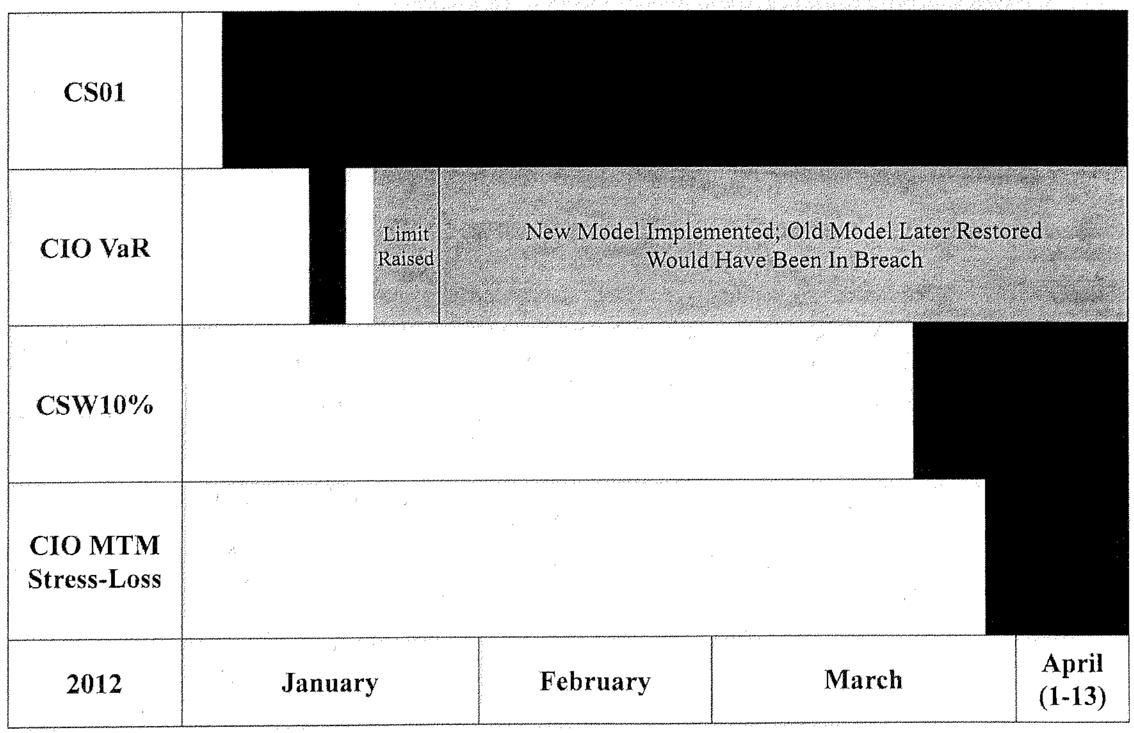
Synthetic Credit Portfolio Aggregate Profits and Losses



Source: Subcommittee chart created from data provided by OCC spreadsheet, OCC-SPI-00000298. Numbers do not reflect restated P&L figures.

Permanent Subcommittee on Investigations
EXHIBIT #1c

Synthetic Credit Portfolio Risk Limit Breaches

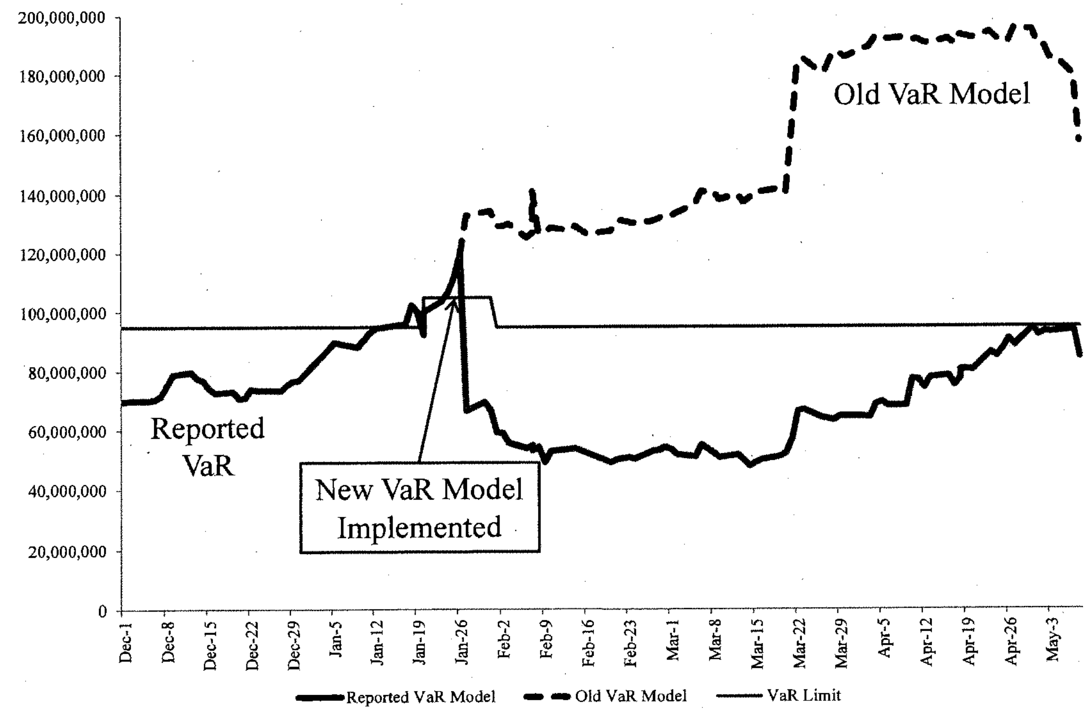


* Tested Weekly. See 5/13/2012 "Discussion Materials," OCC-SPI-00000023, at 030.

Source: Subcommittee chart created from data provided by JPMorgan Chase, JPM-CIO-PSI 0000628.

Permanent Subcommittee on Investigations
EXHIBIT #1d

Value-at-Risk for the CIO (10Q VaR)



Source: Subcommittee chart created from data provided by JPMorgan Chase, JPMC-Senate/Levin 000155-6.

Permanent Subcommittee on Investigations
EXHIBIT #1e

Permanent Subcommittee on Investigations
EXHIBIT #1f

Inaccurate Public Statements on April 13, 2012

- **Risk Managers:** "All of those positions are put on pursuant to the risk management at the firm-wide level."

- **Regulators:** "[A]ll those positions are fully transparent to the regulators."

- **Long-Term Decisions:** "All of those decisions are made on a very long-term basis."

- **Hedging:** "[W]e also need to manage the stress loss associated with that portfolio … so we have put on positions to manage for a significant stress event in Credit. We have had that position on for many years ...."

- **Volcker Rule:** "[W]e believe all of this is consistent with what we believe the ultimate outcome will be related to Volcker."

Source: 4/13/2012 "Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call," JPM-CIO-PSI 0001151.

Permanent Subcommittee on Investigations
EXHIBIT #1g

Synthetic Credit Portfolio
Internal Profits and Loss Reports
January – May 2012

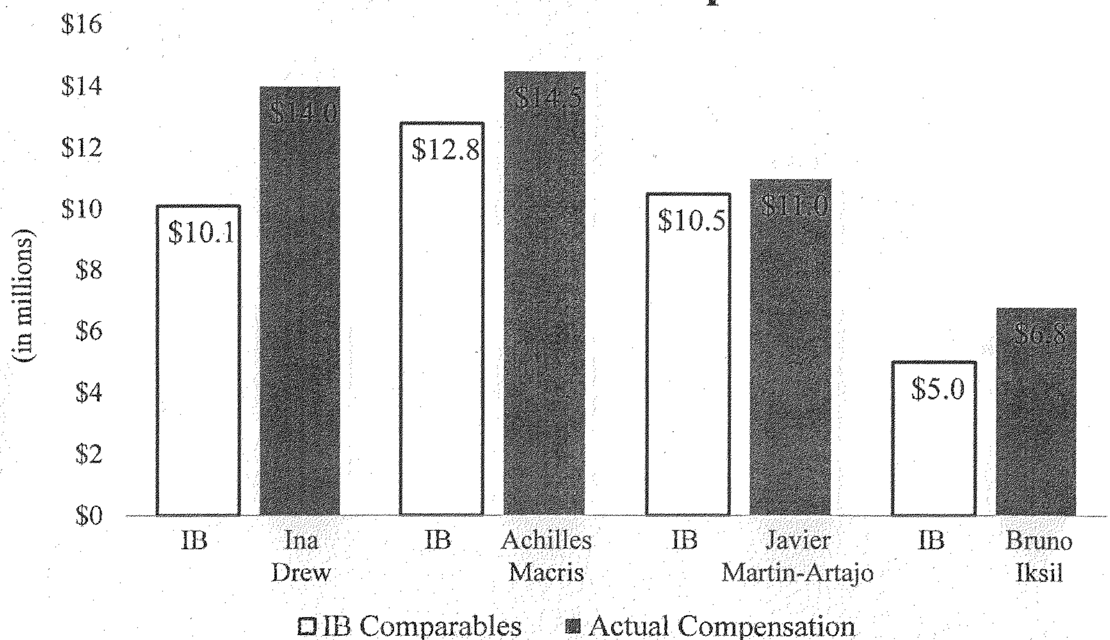
Synthetic Credit Portfolio - Daily and YTD Profit and Loss
January 1, 2012 through May 15, 2012

Trading Date	Daily P&L	YTD P&L	Trading Date	Daily P&L	YTD P&L	Trading Date	Daily P&L	YTD P&L	Trading Date	Daily P&L	YTD P&L	Trading Date	Daily P&L	YTD P&L
3-Jan	-$2,331,403	-$2,331,403	1-Feb	$11,899,066	-$88,468,701	1-Mar	$15,808,609	-$153,233,146	2-Apr	$11,615,112	-$707,057,081	1-May	-$794,944	-$2,132,563,367
4-Jan	-$9,405,151	-$11,736,554	2-Feb	-$2,476,245	-$90,944,946	2-Mar	-$878,902	-$154,112,048	3-Apr	-$10,407,844	-$717,464,925	2-May	-$52,404,248	-$2,184,967,615
5-Jan	$11,489,045	-$247,509	3-Feb	$800,677	-$90,144,269	5-Mar	$1,171,999	-$152,940,049	4-Apr	-$11,100,155	-$728,565,080	3-May	-$91,590,554	-$2,276,558,169
6-Jan	-$6,118,207	-$6,365,716	6-Feb	-$3,633,327	-$93,777,596	6-Mar	$3,161,395	-$149,778,654	5-Apr	-$9,517,665	-$738,082,745	4-May	-$103,250,854	-$2,379,809,023
9-Jan	-$8,161,497	-$14,527,213	7-Feb	-$749,985	-$94,527,581	7-Mar	$1,264,716	-$148,513,938	10-Apr	-$415,342,049	-$1,153,424,794	7-May	-$58,065,892	-$2,437,874,915
10-Jan	-$1,147,064	-$15,674,277	8-Feb	-$23,773,934	-$118,301,515	8-Mar	$1,154,204	-$147,359,734	11-Apr	-$6,301,198	-$1,159,725,992	8-May	-$195,248,051	-$2,633,122,966
11-Jan	$223,462	-$15,450,815	9-Feb	-$4,114,971	-$122,416,486	9-Mar	-$4,565,697	-$151,925,431	12-Apr	-$4,809,755	-$1,164,535,747	9-May	-$108,126,095	-$2,741,249,061
12-Jan	-$3,552,588	-$19,003,403	10-Feb	$1,044,270	-$121,372,216	12-Mar	-$838,406	-$152,763,837	13-Apr	-$50,629,714	-$1,215,165,461	10-May	-$36,461,805	-$2,777,710,866
13-Jan	-$1,328,679	-$20,332,082	13-Feb	-$5,029,818	-$126,402,034	13-Mar	-$55,325	-$152,819,162	16-Apr	-$37,415,502	-$1,252,580,963	11-May	-$570,159,849	-$3,347,870,715
16-Jan	-$1,474,654	-$21,806,736	14-Feb	-$1,756,535	-$128,158,569	14-Mar	-$3,654,838	-$156,474,000	17-Apr	$9,948,665	-$1,242,632,298	14-May	-$227,592,775	-$3,575,463,490
17-Jan	$538,245	-$21,268,491	15-Feb	-$3,310,361	-$131,468,930	15-Mar	-$730,181	-$157,204,181	18-Apr	-$28,338,553	-$1,270,970,851	15-May	-$119,236,467	-$3,694,699,957
18-Jan	$1,531,279	-$19,737,212	16-Feb	$2,787,722	-$128,681,208	16-Mar	-$3,864,759	-$161,068,940	19-Apr	-$29,239,630	-$1,300,210,481			
19-Jan	-$2,497,903	-$22,235,115	17-Feb	$151,612	-$128,529,596	19-Mar	-$3,368,891	-$164,437,831	20-Apr	-$32,236,022	-$1,332,446,503			
20-Jan	-$5,824,024	-$28,059,139	20-Feb	$1,402	-$128,528,194	20-Mar	-$43,553,294	-$207,991,125	23-Apr	-$161,148,061	-$1,493,594,564			
23-Jan	-$14,937,654	-$42,996,793	21-Feb	-$3,647,248	-$132,175,442	21-Mar	$701,825	-$207,289,300	24-Apr	-$81,602,918	-$1,575,197,482			
24-Jan	-$18,663,381	-$61,660,174	22-Feb	-$5,258,735	-$137,434,177	22-Mar	-$1,786,282	-$209,075,582	25-Apr	-$187,629,766	-$1,762,827,248			
25-Jan	-$5,349,602	-$67,009,776	23-Feb	-$1,144,086	-$138,578,263	23-Mar	-$12,555,383	-$221,630,965	26-Apr	-$162,235,258	-$1,925,062,506			
26-Jan	-$1,609,067	-$68,618,843	24-Feb	-$5,248,999	-$143,827,262	26-Mar	-$32,426,419	-$254,057,384	27-Apr	$15,364,325	-$1,909,698,181			
27-Jan	-$3,637,880	-$72,256,723	27-Feb	-$7,575,866	-$151,403,128	27-Mar	-$44,740,604	-$298,797,988	30-Apr	-$222,070,242	-$2,131,768,423			
30-Jan	-$22,790,129	-$95,046,852	28-Feb	-$2,894,309	-$154,297,437	28-Mar	-$50,685,464	-$349,483,452						
31-Jan	-$5,320,915	-$100,367,767	29-Feb	-$14,744,318	-$169,041,755	29-Mar	-$49,996,238	-$399,479,690						
						30-Mar	-$319,192,503	-$718,672,193						

Source: Subcommittee chart created from data provided by OCC spreadsheet, OCC-SPI-00000298. Numbers do not reflect restated P&L figures.

Permanent Subcommittee on Investigations
EXHIBIT #1h

2011 CIO Compensation vs. Investment Bank Comparables



Source: Subcommittee chart created from data provided by JPMorgan Chase, 6/21/2012 CIO Compensation Presentation, JPM-CIO-PSI-H 0002746, at 754.

Timeline: Key Events in JPMorgan Chase Whale Trades

Nov. 2006	Bank authorizes Chief Investment Office (CIO) to trade credit derivatives.
2008	Synthetic Credit Portfolio (SCP) acquires its name.
2009	As financial crisis eases, SCP earns $1 billion.
2010	OCC examines CIO investment portfolios; SCP is not explicitly mentioned. OCC requires documentation of investment decisions; Ina Drew criticizes OCC intrusiveness.
2011	Over 2011, SCP's notional size increases tenfold from $4 billion to $51 billion.
Nov. 2011	SCP makes $1 billion credit derivatives bet for gain of $400 million.
Dec. 2011	Bank & CIO managers decide improving economy lessens need for credit protection. Jamie Dimon instructs Ina Drew to reduce the CIO's Risk Weighted Assets (RWA).
Dec. 22, 2011	CIO traders propose reducing RWA, in part, by manipulating models. CIO quantitative head Pat Hagan develops CIO models that artificially lower SCP risk results.
Jan. 6, 2012	SCP trading breaches CS01 risk limit; breach continues and increases until CIO risk metrics are overhauled in May.
Jan. 16-20, 2012	SCP trading causes four-day breach in bankwide VaR; breach reported to Jamie Dimon.
Jan. 23, 2012	Dimon and Chief Risk Officer John Hogan approve a temporary bankwide VaR limit increase to end the breach; told a new CIO VaR model will reduce CIO's VaR by 44%.
Jan. 27, 2012	CIO names SCP for the first time in a routine VaR report to OCC. New VaR model approval is rushed through and drops CIO's VaR overnight by 50%.
Late Jan. 2012	SCP losses escalate. CIO traders begin mismarking SCP values to minimize losses.
Late Jan. 2012	CIO trader Bruno Iksil gives presentation showing SCP lost $100 million in January and could lose $300 million more; proposes "trades that make sense" -- buying more longs to offset losses and reduce RWA. OCC holds standard quarterly meeting with CIO; told SCP would be reduced.
Feb. 2012	Over February, SCP loses another $69 million.
Mar. 2, 2012	Comprehensive Risk Measure (CRM) used to calculate RWA indicates SCP could lose up to $6.3 billion in 2012, in worst case scenario. CIO risk manager calls result "garbage."
Mid-Mar. 2012	Julien Grout, SCP trader, keeps 5-day spreadsheet showing reported SCP values deviated from midpoint prices by over $400 million. Trader Bruno Iksil calls SCP's booked values "idiotic" and calls SCP book "more and more monstrous." Over two weeks, CIO traders acquire $40 billion more in multiple long credit derivatives, in what OCC called "doubling down" on an already losing trading strategy.
Mar. 20, 2012	Traders Iksil and Grout report internally $40 million loss, largest SCP loss to date, and a $600-800 million "lag" in SCP book, but Ina Drew says she did not read the email.

Permanent Subcommittee on Investigations
EXHIBIT #1i

Timeline: Key Events in JPMorgan Chase Whale Trades

Mar. 23, 2012	Ms. Drew orders "phones down" and stops SCP trading. SCP trading breaches CSW10% limit; it continues until risk metrics overhauled in May.
Mar. 29, 2012	SCP trading breaches CIO Stress Loss limit, which is tested weekly, through April.
Mar. 31, 2012	At quarter end, SCP's notional size triples from $51 billion to $157 billion, and SCP flips from net short to net long. Total quarterly losses reported internally as nearly $719 million. CIO London office head Achilles Macris says he's "lost confidence" in his team, SCP has moved into "crisis mode."
Apr. 5, 2012	After media inquiries, bank prepares talking points that SCP is a "hedge" and regulators were "fully" informed of trades, but then drops both words from talking points.
Apr. 6, 2012	Bloomberg and Wall Street Journal report whale trades by JPM CIO office in London.
Apr. 9, 2012	Senate confirms new Comptroller of the Currency, Thomas Curry. Regulators have first meeting with JPM on whale trades; bank downplays any problem.
Apr. 10, 2012	CIO traders report internal SCP daily loss of $6 million, then 90 minutes later, different credit derivative values leading to a loss of $400 million.
Apr. 11, 2012	--Bank's chief spokesman, Joe Evangelisti, quoted saying whale trades were a "hedge" of bank's overall risk." --To prepare for earnings call, bank executives receive SCP presentation showing, in a financial crisis, SCP would not offset bank losses, but lose $250 million. SCP also lost money in 3 negative credit scenarios, showing it wasn't hedging bank's credit risks.
Apr. 13, 2012	Bank executives learn SCP positions are huge & hard to exit; SCP reports $1.2 billion loss. Bank files 8-K form previewing first quarter earnings and holds earnings call. --Bank CEO Jamie Dimon calls whale trade stories "a complete tempest in a teapot." --With respect to SCP, Chief Financial Officer Doug Braunstein says: --"All of those positions are put on pursuant to risk management at the firm-wide level." --"[A]ll those positions are fully transparent to the regulators" who get "information on those positions on a regular and recurring basis as part of our normalized reporting." -- "All of those decisions are made on a very long-term basis." --"[W]e also need to manage the stress loss associated with that portfolio ... so we have put on positions to manage for a significant stress event in Credit." --"[W]e believe all of this is consistent with what we believe the ultimate outcome will be related to Volcker." 8-K filing discloses CIO's VaR results, but not the January change in CIO's VaR model.
Apr. 19, 2012	OCC inquires for first time about CIO breaches, including CS01 breach of over 1,000% for 71 days. CIO Chief Market Risk Officer, Peter Weiland, tells OCC that risk limit will be replaced with something more "sensible" in the future.

Timeline: Key Events in JPMorgan Chase Whale Trades

Apr. 27, 2012	Bank's Chief Risk Officer John Hogan dispatches Ashley Bacon, his deputy, to London CIO office to analyze SCP.
May 4, 2012	Bank calls OCC Examiner-in-Charge Scott Waterhouse to disclose SCP loss of $1.6 billion; internally, losses were reported to be $2.3 billion.
May 9, 2012	Bank meets with OCC; Chief Risk Officer John Hogan denies SCP books were mismarked, despite collateral valuation disputes.
May 10, 2012	Bank's Controller validates SCP marks, even though the marks were $512 million off the midpoints, were "aggressive," consistently favored the bank, and minimized SCP losses. Bank files 10-Q form finalizing first quarter earnings and holds business update call. Mr. Dimon discloses: --SCP in much worse shape than disclosed a month earlier. --SCP lost $2 billion in second quarter. (Internally, losses reported as $2.8 billion.) --"[T]he synthetic credit portfolio was a strategy to hedge the Firm's overall credit exposure.... We're reducing that hedge." Calls SCP a hedge 8 times during call. --"In the first quarter, we implemented a new VAR model, which we now deemed inadequate. And we went back to the old one, which had been used for the prior several years, which we deemed to be more adequate." 10-Q filing does not clearly disclose that same information.
May 11, 2012	Internally, bank reports SCP daily loss of $570 million, its largest; no public disclosure.
May 14, 2012	Bank fires London CIO personnel: Achilles Macris, Javier Martin-Artajo, Bruno Iksil. Ina Drew, CIO head, retires from JPMorgan Chase.
June 2012	Bank discloses SCP has lost $4.4 billion.
July 13, 2012	Bank restates first quarter profits, disclosing additional SCP losses of $660 million.
Fourth quarter	OCC issues six Supervisory Letters with 20 Matters Requiring Attention involving CIO.
Dec. 2012	SCP losses for the year total $6.2 billion. SCP has been dismantled, with most credit derivatives transferred to JPMorgan Investment Bank.
Jan. 2013	Bank releases management task force report on whale trades. OCC issues Cease and Desist Order requiring JPMorgan Chase to take corrective actions.

Prepared by U.S. Senate Permanent Subcommittee on Investigations, March 2012.

EXCERPT

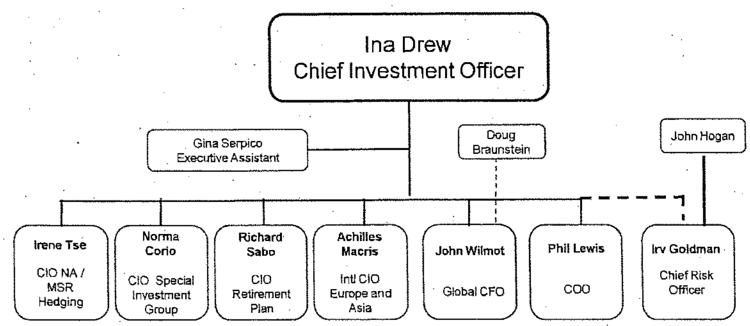
CHIEF INVESTMENT OFFICE - ORGANIZATION

April 2012

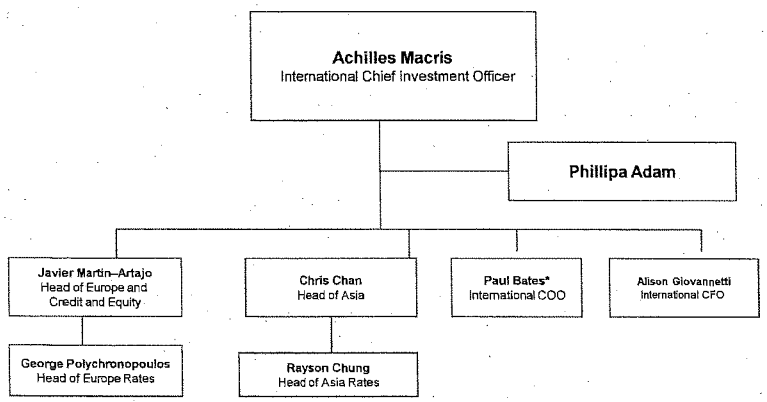
CHIEF INVESTMENT OFFICE

Permanent Subcommittee on Investigations
EXHIBIT #2

Chief Investment Office – Direct Reports



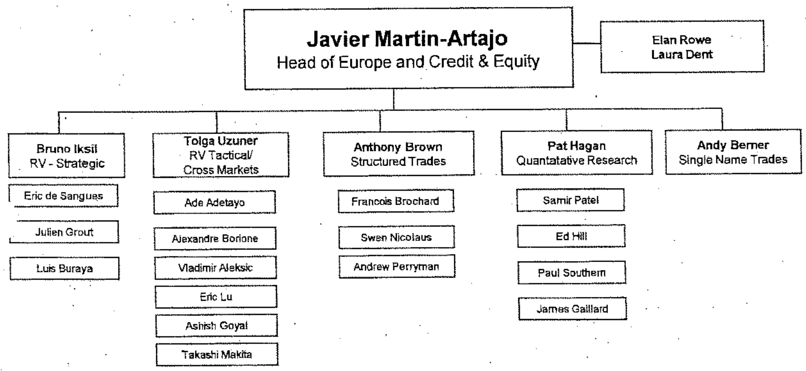
International CIO



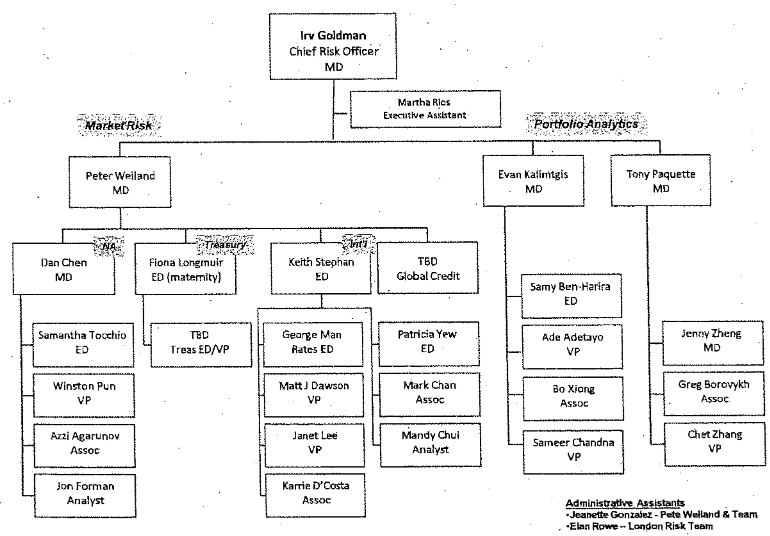
*Reports to Phil Lewis – CIO Global COO
**Reports to John Wilmot – CIO Global CFO

International Chief Investment Office

Equity and Credit



CIO RISK MANAGEMENT TEAM



Testimony of Jamie Dimon

Chairman & CEO, JPMorgan Chase & Co.

Before the U.S. Senate Committee on Banking, Housing and Urban Affairs

Washington, D.C.

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 non-profits. These include deposit accounts, loans, credit cards, mortgages, capital markets advice, mutual funds and other investments.

<u>What does the Chief Investment Office do?</u>

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.

<u>What Happened?</u>

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

Permanent Subcommittee on Investigations
EXHIBIT #3

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%; our estimated Basel III Tier 1 common ratio is at 8.2% – 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% 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% year on year. In the first quarter, we provided over $4 billion of credit to small businesses, up 35% 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 two years, in

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

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 three 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.

From:	McInerney, James A
To:	Dianne.Dobbeck@ny.frb.org; Waterhouse, Scott; Waterhouse (Regulator), Scott X; Sullivan, Michael; Crumlish, Fred; cneedham@FDIC.gov; Oarya@FDIC.gov; Arya(Regulator), Om; jyao@fdic.gov
CC:	Genova, Diane M.; Gunselman, Gregg B; Hill, Erin
Sent:	7/24/2012 8:08:37 PM
Subject:	CIO: Response to Regulator Requests on NBIA, Risk Tolerance and Follow-up VaR model questions
Attachments:	CIO Risk Appetite 2010 FINAL.PDF; CDS amendment CDS Residential MBS-doc.zip; Credit & Equity-pdf.zip; NBIA Amendment_ITRAXX_CMBX-doc.zip; NBIA_am_Sov_CDS -doc.zip

CONFIDENTIAL

As requested, please see our response to your questions on NBIA, Risk Tolerance and the VaR Model:

1) NBIA: Attached is the NBIA for the CIO relating to Credit and Equity Capability in NA and EMEA. The approval document lists the Initiative Sponsors, the Key Contacts and the Working Group members. There are emails attached to the document evidencing the individual approvals. Also attached are the approvals for additional activities within CIO: Sovereign CDS Trading, Credit Default Swaps referencing Residential Mortgage Backed Securities and Credit Default Swaps referencing Markit CMBX index.

2) Risk Tolerance: Attached is the presentation made to the Risk Working Group on September 16, 2010.

3) Follow up to VaR model questions: Patrick Hagan will attend a meeting with you tomorrow and is prepared to give oral answers to your questions relating the VaR model.

Kind regards,

Jim McInerney
Vice President & Assistant General Counsel
JPMorgan Chase Bank, N.A.
Mortgage Banking Legal Department
237 Park Avenue
New York, New York 10017
Direct: (212) 622-0560
james.a.mcinerney@jpmchase.com

Permanent Subcommittee on Investigations
EXHIBIT #4

05/22/2008 15:32 2128346552 **EXCERPT** PAGE 01/30

Chief Investment Office
New Business Initiative Approval
Executive Summary

Name of Initiative	Credit and Equity Capability
Portfolio(s)/Region(s)	NA/ EMEA
Initiative Sponsor	Achilles Macris, Andy Panzures
Initiative Approver	
Brief Initiative Description	CIO needs broad product capability/expertise to dynamically allocate capital and invest across asset classes, as well as to effectively manage residual exposures created by the Firm's operating businesses. The key areas where CIO needs to initially build out its product capability are in Credit & Equities.
Economic Rational for Proceeding	Credit: ■ The Firm has large cyclical exposure to credit, which is the single largest risk concentration from the operating businesses. ■ Credit exposure and capital are increasingly fungible (Basel II). ■ CIO to add credit capabilities to manage macro overlay programs similar to interest rates, mortgages, and foreign exchange. Equity: Provides CIO with capability to opportunistically allocate capital to equities to: ■ Refine and target existing macro views. ■ Complement CIO's existing product capability in constructing macro hedges over the economic cycle.
Key Changes From Current Activity	Credit: CIO currently has very limited credit capability, mainly being confined to yield enhancement strategies. This initiative will provide the platform to build CIO's capability in order to allow CIO to manage corporate credit exposures and diversify its asset classes. Equity: **Redacted by the Permanent Subcommittee on Investigations**
Changes to Operational Processes	CIO will rely on the Equity Derivatives Group (EDG) support model. This

	will be determined and governed by a Service Level Agreement. CIO will retain ownership of balance sheet substantiation.
Key Risk Issues	CIO will be reliant upon the EDG middle office processing and confirmation activity. This will be addressed via SLA between CIO and EDG support.
Risk Rating (1, 2 or 3)	**2 - Medium** New products and systems to CIO, but not to the Firm
Priority Rating (A, B or C)	**A - High**
Other Significant Information	
Target Launch Date	
Date Authorized to Proceed with Development	

<u>**Guidance:**</u>
Initiative Approver: authorizes initiative development, agrees the initiative launch and prioritizes initiatives for development. The initiative approver should be a direct report of the CIO.
Initiative Sponsor: the Sponsor should typically be a Portfolio Manager.

Risk Rating is based on incremental risk and materiality of risk change:
1 – High Risk – *significant incremental risk* - new business for the area, significant residual risk after risk management, manually intensive environment, considerable legal exposure, cross border issues, significant effort for Regulator approval, infrastructure under stress, major investment of capital, significant balance sheet implication
2 – Medium Risk – *moderate incremental risk* - multiple risk control areas are affected requiring cross discussion about the risks and operational considerations.
3 – Low Risk – *little incremental risk* - implementation of a vanilla initiative requiring the involvement of several risk control areas where only minor concerns are anticipated.

JPMorganChase

Chief Investment Office
New Business Initiative Approval Proposal

Credit & Equity Capability

Initiative Sponsor	Achilles Macris, Andy Panzures
Key Contact	Roger Kibble-White, Alison Giovannetti, , Brandon Konigsberg, Bonnie Kindler, Jason Hughes
Date Authorization to Develop Received	
Target Launch Date	

Table of Contents

1. Proposal Summary

Name of Initiative	Credit and Equity Capability
Portfolio(s)/Regions(s)	NA/ EMEA
Initiative Sponsor	Achilles Macris, Andy Panzures
Initiative Approver	
Brief Initiative Description	CIO needs broad product capability/expertise to dynamically allocate capital and invest across asset classes, as well as to effectively manage residual exposures created by the Firm's operating businesses. The key areas where CIO needs to build out its product capability are in Credit & Equities.
Economic rationale for proceeding	Credit: ■ The Firm has large cyclical exposure to credit, which is the single largest risk concentration from the operating businesses. ■ Credit exposure and capital are increasingly fungible (Basel II). ■ CIO to add credit capabilities to manage macro overlay programs similar to interest rates, mortgages, and foreign exchange. Equity: Provides CIO with capability to opportunistically allocate capital to equities to: ■ Refine and target existing macro views. ■ Complement CIO's existing product capability in constructing macro hedges over the economic cycle.
Key changes from current activity	Credit: CIO currently has very limited credit capability, mainly being confined to yield enhancement strategies. This initiative will provide the platform to build CIO's capability in order to allow CIO to manage corporate properties and diversify its asset classes. Equity: **Redacted by the Permanent Subcommittee on Investigations**
Key Risk issues	CIO will be reliant upon the EDG middle office processing and confirmation activity. This will be addressed via SLA between CIO and

	EDG support
Risk Rating (1, 2 or 3)	**2 - Medium** New products and systems to CIO, but not to the Firm
Priority Rating (A, B or C)	**A - High**
Processing Location	
Main systems impacted	STS, PYRAMID
Other LOB's or Legal Entities Impacted	Bank and Whitefriars Inc.
Operational impact (include anticipated volumes and key capacity metrics)	Anticipated Monthy Vols Credit Indices: iTraxx, CDX etc. 80 Credit default swaps 40 **Redacted By** **Permanent Subcommittee on Investigations**
Other significant information	
Regulatory approvals required	No
Balance Sheet usage	
Other Policies impacted	
Additional Headcount Required	4 traders – 2 in EMEA , 2 in New York 2 FTE cost allocation from Equity Derivatives group 2 CIO Middle Office FTE , 1 in EMEA , 1 in New York
Date authorized to proceed with development	
Target Launch Date	Late April
Key Contact for questions	Roger Kibble-White, Alison Giovannetti, Brandon Konigsberg, Bonnie Kindler, Jason Hughes
Person responsible for Post Implementation Review	

2. Working Group and Approvers

Stakeholder Area	Working Group Member(s)	Signature	Agreed Completion Date	Date Approved
Business Sponsorship				
Global Head	Ina Drew			
Global CFO	Joe Bonocore			
Portfolio Manager (Initiative Sponsor)	Achilles Macris, Andy Panzures			
Regional CFO	Brandon Konigsberg, Roger Kibble-White, Colvis Lee			
T&O Manager	Alison Giovannetti, Phil Lewis			
Risk Control Areas				
Market Risk, Credit Risk & VCG	Bob Rupp, Fiona Longmuir			
Finance – Accounting	Mark Allen, Allister Jeffrey, David Alexander			
Regulatory Capital	Keith Enfield/Mark Weber			
Finance – Controls	Elliot Honeyfield, Nancy Dennery			
T&O – Technology	Joe Colman, Nick Wood			
T&O - Operations	Alison Giovannetti, Bonnie Kindler, Tom Mauro			
Tax	Mark Prodiani			
Legal	Carolyn Monroe-Koatz			
Compliance	Colin Harrison, Bob Cole			
Funding	Frederic Mouchel			
Audit	Bill McManus, Sally Russell			
Other as appropriate				
Senior Country Officer				
Legal Entity CFO/SFO	Allister Jeffrey			

*Sign-Offs are contained in a separate file distributed with this document

3. Initiative Overview

i. Initiative description, economic justification, strategic fit, growth forecast, expected volume, capacity limits
ii. Business Rationale including market opportunities and risks

Please see Executive Summary.

Proposed initial product list:

Credit:

- Credit Indices: iTraxx, CDX etc. – see below for indices
- Credit default swaps (not on corporate names) – see below for indices
- Options on Credit Indices– see below for indices.
  For EMEA, Options on Credit indices are dependent upon the build out of credit products within Pyramid Equities, scheduled for May/June 2006, and should not be traded until this implementation is complete.

Indices:

Europe: Itraxx, USA: CDX, Japan: Itraxx

Components:

- Xover 5 yr
- Hivol 5 yr
- Main IG 5 yr
- Main IG 10yr
- Financial Sub Index 5 yr
- Financial Sub Index 10 yr

Options on:

- Xover 5 yr
- Hivol 5 yr
- Main IG 5 yr

Equity:

–

Redacted by the
Permanent Subcommittee on Investigations

Redacted by the
Permanent Subcommittee on Investigations

4. **Trade & Legal Entity Flow**

i. Include an end to end product flow diagram including external resources utilized

Pyramid → STS → General Ledger

- Client facing trade captured in Pyramid
- Trade settled through STS
- Confirmation generated through XDG a subset of STS
- Pyramid auto generates a back to back trade between the Bank and JP Morgan Whitefriars Inc.
- Pyramid auto feeds JPMCB and JP Morgan Whitefriars Inc General Ledger
- Client risk recorded in JMPCB
- Trade risk recorded in JP Morgan Whitefriars Inc

ii. List legal entities impacted

Street → Bank → Whitefriars Inc

- London Branch (trades back-to-back through the branch)
- NY Branch (trades back-to-back through the branch)
- JP Morgan Whitefriars Inc. (ultimate repository of the risk)

5. **Market Risk/Valuation Control/Credit Risk**

Market Risk

The initial product slate is:

Credit ($5mm VaR limit):

- Credit Indicies
- Credit default swaps
- Options on credit indices

Equity ($10mm VaR limit):

Redacted by the Permanent Subcommittee on Investigations

The Business has, to date, operated under a regional limits infrastructure therefore it may be necessary to realign the hierarchy to be more reflective of a global risk framework by asset class. This will require developmental work from the VARS MO and the risk reporting teams.

Equities trading:

Redacted by the Permanent Subcommittee on Investigations

Credit trading:
Credit trading is essentially a new business and therefore requires a new limits infrastructure comprising both VaR and non-statistical measures such as 10% credit spread widening, csbpv or default exposure.

Ideally CIO should clone the Credit Hybrids version of Pyramid and utilize the "Trevor" database to ensure:
(i) index exposures are fed on a decomposed name-by-name basis for more accurate VaR computation and to feed the Single Name Position Risk monitoring process.
(ii) options can be appropriately handled (the Equities version does not support credit options)
CIO will also need to clone the separate PCM feed from Trevor for regulatory capital purposes.

It is understood that owing to systems constraints the Credit Hybrids functionality within Pyramid will not be available for use by CIO until May/June 2006. **CIO should therefore refrain from undertaking credit options trading until this time.** Since the Equities version of Pyramid is the only platform available then there will be a number of short-comings, namely:
a) no decomposed index feed
b) no SNPR feed
c) reliance on the Pyramid model for computing VaR (in which credit data is understood to be dubious)
CIO will need to additionally clone the PCM feed for regulatory capital purposes and should ensure that the relevant credit products are set up accordingly.

Given the deficiencies of the Pyramid Equities version for the credit trading activity, MVAR would insist that in the event the required systems development does not occur by end of H1'06 new activities must stop and the CIO Risk Committee must evaluate how to proceed.

Valuation Control

CIO is not a market maker and uses the Investment Bank's risk and valuation systems to transact its products. As such CIO is a price taker using prices and valuation inputs controlled and determined by the market making businesses of the bank. CIO's Valuation Control Group coordinator will ensure that where pricing adjustments are identified from the month end price test process for market making groups in the Investment Bank, that where CIO hold the same positions the adjustments are also discussed with/applied to CIO.

Credit trading:

The only candidates for reserves are credit spread options which may qualify for Unobservable Parameter Reserves depending on the size and type of positions held. Index CDSs tend not to incur reserves, however, if the business were to venture into single name space theses positions would qualify for Price Discovery, Recovery Rate and/or Concentration reserves.

6. Finance - Accounting

i. Describe accounting treatment to be utilized

The instruments in the initial product slate are derivatives and as such must be marked-to-market. These items will be treated as trading instruments. ETF's will also be treated as trading instruments.

ii. Consider Accounting Policy review and regulatory reporting implications

Regulatory considerations are considered in Section 8 below.

iii. Will the accounting for the new products be performed manually or will it be automated?

The accounting will be automated using the ACE accounting engine to generate entries.

7. Finance - Regulatory Capital

JP Morgan Whitefriars Inc. has no standalone regulatory capital requirements. Positions in JP Morgan Whitefriars Inc. will be subject to the Firm's regulatory capital requirements:

i. *Has this product been reviewed by regulatory reporting (US and non-US) to ensure that it will be reported in accordance with regulatory reporting requirements. List any regulatory reporting requirements (US and non-US) in relation to the new product and provide a description of any requirements that differ from GAAP.*

This product been reviewed by regulatory reporting (US and non-US) to ensure that it will be reported in accordance with regulatory reporting requirements.

ii. *For Risk-based capital purposes, will this product be booked under trading or banking book rules and has legal and regulatory reporting reviewed the proposed treatment.*

For Risk-based capital purposes, this product will be booked under trading book rules and legal and regulatory reporting reviewed the proposed treatment.

iii. *Will this product feed into appropriate market, counterparty credit and specific risk systems (if so, please describe the feed names, internal model, risk and booking systems, and appropriate contacts in technology and middle office)? If not, have procedures and controls been put in place to report it manually and who will be the contact person for manual reporting?*

The following approaches will be used to feed the Firm's specific risk systems:

- Credit: CIO will leverage the Equity Derivatives Group's PYRAMID infrastructure. CIO will use the infrastructure to feed the Firm's PCM model which will be used to calculate specific risk on the credit products with the exception of Credit Options which will be calculated using the following rule:-

  For option positions, long or short, the risk weighted amount is the market value of the effective notional amount of the underlying instrument or index multiplied by the option's delta. These are required to be reported on a manual template. For credit options which are NOT price based, we may not be able use a option delta approach (we may need to use a notional x 8% approach).

  Equity:

**Redacted by the
Permanent Subcommittee on Investigations**

iv. *Describe the nature of any collateral held in relation to this product*

No specific collateral will be held against the proposed products, however derivative MTM collateralisation will be subject to normal Firm collateral group process.

v. *Does this product impact deposits and, if so, has this been communicated to regulatory reporting for purposes of calculating appropriate reserves.*

This product does not impact deposits.

vi. *Has any impact to risk weighted assets been identified, evaluated and communicated to regulatory reporting. Are the appropriate risk weighted asset limits in place and been reviewed by the applicable CFO?*

Given the use of approved models as detailed above, the impact to risk weighted assets is not deemed to be material and can be accommodated within CIO's existing limits.

vii. *Has the methodology for calculating risk weighted assets for VAR and specific risk been communicated and approved by regulatory reporting & Market Risk Management? Is any regulatory approval or specific risk model development required for this product?*

The methodology for calculating risk weighted assets for VAR and specific risk been communicated and approved by regulatory reporting. The models have been approved by the regulators and hence no specific regulatory approval or specific risk model development is required for this product.

viii. *If this product requires risk (including general, specific and counterparty) has the product been submitted to regulatory reporting to update the risk inventory list?*

The product slate is part of the bank's existing approved products.

8. Finance - Controls

i. Consider changes to the control environment including process, control procedures and review
ii. Sarbanes Oxley implications: ownership of new process templates, testing

The Credit and Equity business will ultimately reside in JP Morgan Whitefriars Inc. A new operational controls template will be created for SOX purposes specific to the Credit & Equity business and will address all key controls. Also, additional control steps will be added to the "CIO CFO" SOX template covering this new activity.

Discreet cost centers, SPN's and books are being established for CIO Europe and New York to support and segregate the activity.

9. T&O - Technology

CIO New Business Initiative Approval Policy

Post-Implementation Review

Section 1 - to be completed at the time of approval

Name of Initiative:	
Line of Business:	
Post Implementation Key Contact:	
Launch Approval Date:	
First Transaction Date:	

Brief description of the approved initiative:

(copy from initiative summary)

List any conditions associated with the approval, comment on open items and the timeframe for completion.

Risk Review Group	Conditions raised during sign off	Comments

Section 2 - to be completed within 6 months of the activity going live

Address the following:
Is the initiative as described in the proposal when it was approved?
Is the initiative within the volumes and limits agreed when approval was granted?
Have there been any operational errors as a result of introducing this initiative?
What economic value has been received and how does that value compare to the initial projections?
Have there been material operational changes that were or should be documented?
Other points of note

Post implementation review completed by	(Insert name)
Date	(Insert date completed)

Send completed copy to LOB ORM, Regional Expeditor and Audit

Redacted by the Permanent Subcommittee on Investigations

Credit

10% Credit Spread Widening	$2mm (Total) $2mm (By Sub-Index e.g. itraxx main, itraxx hivol)
CSBPV	$2mm (Total) $2mm (By Sub-Index)
Vega	tba (Total – expressed in 0.1 bp b/e terms)

Credit & Equity NBIA Sign-off.txt

CIO & GFLM
Alison C Giovannetti
20/04/2006 12:44

To: Jason LDN Hughes/JPMCHASE@JPMCHASE, Roger X Kibble-White/JPMCHASE@JPMCHASE
cc:
Subject: Re: Credit & Equity NBIA - sign off
This document contains a file attachment with a file size of 198.2 KB.

Signed off

Regards,
Alison

Alison Giovannetti
GDP : 8 325 8025
External : (020) [redacted]

▬ = Redacted by the Permanent Subcommittee on Investigations

Corporate Reporting Business Advisory - Tel 212-834-9425 Cell [redacted]
Keith Enfield
20/04/2006 14:51

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE@JPMCHASE
Subject: Re: Credit & Equity NBIA

I approve but I think you should make a note that non-vanilla equity products (if you ever have any) and credit swaptions (which you are planning on trading and are not currently approved for PCM) will need to be reported via the manual template.

Phil Lewis
21/04/2006 13:57

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Alison C Giovannetti/JPMCHASE@JPMCHASE, thomas.j.mauro@jpmorgan.com@JPMCHASE
Subject: Re: Credit & Equity NBIA
This document contains a file attachment with a file size of 198.2 KB.

Jason - ok to sign-off.

As stated in the document, next step is to finalise the SLAs and SOPs

regards
Phil

David M Alexander
25/04/2006 14:11

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE
Subject: Re: Credit & Equity NBIA

Credit & Equity NBIA Sign-off.txt

Jason -

You have my approval. I traded vms with Roger - all of these positions will be mtm in a trading book. Please revert back to me if any other types of positions are held beyond what is included in the NBIA that might warrant different acctg, I.e. Loans or non-marketable equity securities.

Thanks.

Nancy E. Dennery Chief Investment Office - Tel (212) 834 - 9485
Nancy E Dennery
25/04/2006 13:09

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE@JPMCHASE
Subject: Re: Fw: Credit & Equity NBIA
This document contains a file attachment with a file size of 198.2 KB.

Yes, I have reviewed and sign off for the controls section.

Treasury - Tel +44 20 7777 0034
Frederic Mouchel
03/05/2006 09:56

To: Jason.LDN.Hughes@jpmorgan.com@JPMCHASE
cc:
Subject: Re: Credit & Equity NBIA
This document contains a file attachment with a file size of 198.2 KB.

Fine with me.

Rgds
F

Investment Bank - Technology
Nicholas JS Wood
03/05/2006 17:50

To: Jason LDN Hughes/JPMCHASE
cc: joseph g coleman
Subject: Re: Credit & Equity NBIA
This document contains a file attachment with a file size of 199.4 KB.

Jason - this looks fine from my point of view. Off the top of my head the areas that we need to include in the plan are:
my review of any tools that Joe may be developing (you allude to these but don't specify what they do or how big they will be - bottom of P13)
create appropriate id admin workflows for the existing apps (Pyramid, STS, etc) for the CIO staff - unless we will use thre same approvers as for EDG and E&H
update the BC plans for CIO as these new systems will need to be included.

regards,

Nick Wood

Robert J. Cole Compliance - Tel 212/270-1554 Fax 212/270-3450
Robert J Cole

Credit & Equity NBIA Sign-off.txt

05/05/2006 20:19

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE@JPMCHASE, Brandon Konigsberg/JPMCHASE@JPMCHASE, Carolyn Monroe-Koatz/JPMCHASE@JPMCHASE, Colin R Harrison/JPMCHASE@JPMCHASE
Subject: Re: NBIA - Compliance Section

Jason- See my comments below (in red and strikethrough), which includes new language regarding compliance approval required before trading in credit/equity indices with less than 20 names as we discussed. With these changes, we are ok from US Compliance perspective

Feel free to call me with any questions.

- Tel (201) 595-5696 Fax (201) 595-6776
Arthur Kirshenbaum
04/05/2006 15:48

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE@JPMCHASE
Subject: Re: Fw: Credit & Equity NBIA

Jason,
I have no further comments or questions and approve.
Is this e-mail sufficient or do you have a more formal process?
Arthur

Mark Frediani
27/04/2006 15:25

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE@JPMCHASE
Subject: Re: Fw: Credit & Equity NBIA
This document contains a file attachment with a file size of 778.5 KB.

Jason,

I don't have any issues. Please accept this e-mail as my sign-off.

Regards,
Mark

Robert R Rupp
28/04/2006 20:49

To: Achilles O Macris/JPMCHASE@JPMCHASE, Andrew Panzures/JPMCHASE@JPMCHASE
cc: Ina Drew/JPMCHASE@JPMCHASE, Enrico Dalla Vecchia/JPMCHASE@JPMCHASE, Joseph S. Bonocore/JPMCHASE@JPMCHASE, Roger X Kibble-White/JPMCHASE@JPMCHASE, Brandon Konigsberg/JPMCHASE@JPMCHASE, Jason LDN Hughes/JPMCHASE@JPMCHASE, Fiona J. Longmuir/JPMCHASE@JPMCHASE
Subject:

Enrico, Fiona and I met to review the credit and equity NBIA and we agreed to sign-off, for purposes of the new product approval process.

Fiona prepared a summary of our discussion which includes a list of follow-up issues (see the bottom of the attachment). More detailed information is included in the NBIA document. Most of the issues are

Credit & Equity NBIA Sign-off.txt

related to feeds and reports that Roger/Fiona/Jason and others have been working on. In addition to those issues, there are two items I want to note here:

1. We assembled an approach to limits that parallels the method used in the IB for these products. While we are set on VAR limits, we need to work with you to fill out the other proposed limits (eg delta, vega, credit events) outlined in the attachment.

2. Pls note the systems issues around credit options which need to be resolved before proceeding with that product.

Any questions/issues, lets discuss early next week. thanks

Bob

CIO / GFLM Technology - Tel 212-622-6136
Joseph G Coleman
25/04/2006 13:03

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Alison C Giovannetti/JPMCHASE@JPMCHASE
Subject: Re: Credit & Equity NBIA

Confirmed - I sign off

Elliot M Honeyfield
20/04/2006 10:39

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE@JPMCHASE
Subject: Re: Credit & Equity NBIA
This document contains a file attachment with a file size of 198.2 KB.

Happy to sign off, just noticed a few grammar errors that I will advise of

regards

Elliot

LONDON BRANCH LEA LEGAL ENTITY CONTROLLERS - Tel 44 207 777 2275 Fax 44 207 777 2010
Mark S. Allen
09/05/2006 18:50

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Andrew Marcovitch/JPMCHASE@JPMCHASE, Arthur Kirshenbaum/JPMCHASE@JPMCHASE, Dermot M Walsh/JPMCHASE@JPMCHASE, Rachel E Leigh/JPMCHASE@JPMCHASE, Madhura Shah/JPMCHASE@JPMCHASE
Subject: Re: Fw: Credit & Equity NBIA
This document contains a file attachment with a file size of 778.5 KB.

Jason,

My sign-off is obviously dependant on Rachel Leigh's approval to use the Equities infrastructure. Otherwise no further questions.

Regards,

Credit & Equity NBIA Sign-off.txt

Mark

Roger X Kibble-White
10/05/2006 12:10

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc:
Subject: Fw: Credit & Equity NBIA
This document contains a file attachment with a file size of 198.2 KB.

Jason

Signed-off.

Thanks

Roger

Chief Investment Office Finance and Business Management - Tel (852)2800-7091 or GDP280-7091 Fax (852)2810-6709
Colvis Lee
10/05/2006 14:52

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Charles K.C. Mong/JPMCHASE@JPMCHASE, Roger X Kibble-White/JPMCHASE@JPMCHASE
Subject: Re: equity and credit initiatives

Hi Jason,

There is no issue from Asia CIO CFO perspective. The market risk limits granted are on a global basis. We are in the process of coordinating a separate NBI sign-off for Asia and will refer to the global limits in our assessment. Pls take this as my signoff.

Thanks,

Colvis

Chief Investment Office CFO/COO
Joseph S. Bonocore
10/05/2006 16:09

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE@JPMCHASE, Ina Drew/JPMCHASE@JPMCHASE
Subject: Credit/Equities NBIA

Approved.
Joe

Chief Investment Office
Ina Drew
10/05/2006 16:19

Credit & Equity NBIA Sign-off.txt

To: Jason LDN Hughes/JPMCHASE@JPMCHASE
cc: Roger X Kibble-White/JPMCHASE@JPMCHASE, Joseph S. Bonocore/JPMCHASE@JPMCHASE
Subject: Fw: Credit/Equities NBIA

Approved,
Ina Drew

Carolyn L. Monroe-Koatz Managing Director & Assoc. General Counsel
Carolyn Monroe-Koatz
15/05/2006 14:59
To: Roger X Kibble-White/JPMCHASE@JPMCHASE
cc:
Subject: Credit and Equity Capability NBIA

Roger - can't find the mail asking me to sign off. I am signed off, but I am going to send you later today a revised NBIA. My assistant is inputting more material into the Legal section right now. CMK

JPMorgan Chase & Co.

Audit Department Report

CIO Global Credit Trading

Report Number:	G-07/005
Audit Rating:	Satisfactory
Report Date:	November 29, 2007
Audit Type:	Audit

No Prior Report Explanation: First Time Review of New Business, Product or Service

Business Overview and Context
Chief Investment Office (CIO) credit trading activities commenced in 2006 and are proprietary position strategies executed on credit and asset backed indices. Trades are executed in London and New York. CIO has its own dedicated Middle Office, Market Risk and Valuation Control Groups (VCG), but utilizes the IB Equities Pyramid/STS suite of applications and IB Operations groups to process, confirm and settle the trades.

Audit Scope
Audit reviewed the following global risk and control processes operating in London and New York:

- Trade capture processes & controls (including cancel, amends & late trades)
- Daily P&L and market risk calculation, sign off & reporting processes and controls
- Monthly VCG valuation & reserves
- Middle Office reconciliation break item clearance & oversight

Key Findings
Based on the results of our evaluation and sample testing, the control environment is rated "Satisfactory". However, addressing the following matters will further enhance the effectiveness of control procedures:

- We noted an aged item of $500,000 (debit balance) in a suspense account. While this was identified by Middle Office, month-end reconciliations did not highlight the item on a timely basis. Management is currently determining proper disposition of the item and is strenghtening reconciliation procedures.

- While not material to the overall year-to-date CIO P&L, we noted some calculation errors in the VCG price testing for September month-end. We identified 6 errors, resulting in net under-reserving of $386,000. Management is currently in the process of adjusting the entries and implementing additional controls over the review of calculation results.

Status
Management has agreed with the audit findings and is implementing corrective actions. No further response is necessary.

Business Details

Level 1:	Chief Investment Office
Business Executive:	Ina Drew
Level 2:	CIO
Business Executive:	Achilles O Macris, Joseph S. Bonocore

Permanent Subcommittee on Investigations
EXHIBIT #5

Location: New York, New York, US
Business Executive: Javier X Martin-Artajo, Phil Lewis, Roger X Kibble-White

Audit Details
Management Team Member: Hatzopoulos, Alexander X
Audit Manager: William K McManus
Auditor In Charge: Sally Russell

Detailed Findings and Management Action Plans

Issue: Suspense Item
The September month end balance on a reserve account (with a debit balance of $24.9 million) included a $ 500k debit which appears to have been outstanding since April 2007. This had been identified at August month end by CIO and is under investigation by Finance and Middle Office to determine disposition, including write-off if necessary. This item arose when an unrelated brokerage adjustment item posted in May was erroneously matched as a reversal of the April month end P&L adjustment for late trades executed after end of day. The month end reconciliation process had failed to identify the error.

Management should continue their investigation and strengthen their reconciliation procedures over this account.

Action Plan
CIO agrees with the point raised and the accompanying recommendation. As stated, CIO was aware of the issue and we have already acted to strengthen our processes around this reconciliation. Specifically, pricing adjustments and trade related adjustments (for example late trades) are now recorded in separate PYRAMID books and reconciled discretely. Pricing reserves are also specifically substantiated against Pricing Testing results.

Target Date: 12/31/07
Issue Owner: Roger X Kibble-White

Issue: VCG Calculation Errors
While not material to the overall year-to-date CIO P&L, we noted some calculation errors in the VCG price testing calculation for September month end. We identified 6 errors, resulting in net under-reserving of $386k. Details have been provided to Management. While controls over reviewing more material differences are operating effectively, VCG should enhance their current procedures for validating final price testing calculations.

Action Plan
By nature VCG process for Credit Price testing is a manual operation pulling together large amounts of information from multiple sources. Whie the errors recorded were small the size of positions in certain strategies multiplies the effect. To avoid similar mistakes going forward CIO has instigated extra controls, including separately recording all prices received in "soft copy" from brokers, dealers etc, a review of the calculations and prices used by other members of the group and CIO has moved to running the process weekly to provide on-going feedback and identify potential issues prior to month end.

CIO has also identified new sources of prices for a number of strategies where there had previously been difficulty in sourcing information.

Target Date: 12/31/2007
Issue Owner: Phil Lewis

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-- End Report --

Summary of Positions by Type

Notional USD Factored	Date						
Type	2011-01-03	2011-03-31	2011-06-30	2011-09-30	2011-12-30	2012-03-30	2012-06-29
CDS_INDEX	-14,212,090,532	18,981,099,123	44,978,685,306	17,869,281,012	17,803,320,690	99,809,214,335	-15,922,982,448
CDS_SINGLE_NAME					-	-	835,252,534
CDS_TRANCHE	10,212,156,745	-4,820,952,252	-3,021,344,404	26,371,449,362	33,283,389,737	57,269,099,390	54,604,244,782
Grand Total	-3,999,933,787	14,160,148,870	41,957,340,902	44,240,730,376	51,086,710,428	157,078,313,725	39,516,514,867

Summary of Positions by Type and Series

Notional USD Factored		Date						
Type	Product Series	2011-01-03	2011-03-31	2011-06-30	2011-09-30	2011-12-30	2012-03-30	2012-06-29
CDS_INDEX	CDX.NA.HY	-15,872,894,000	-1,014,951,500	11,932,828,500	3,114,116,500	-4,246,185,000	-22,047,733,000	-29,913,674,000
	CDX.NA.IG	-17,589,506,395	-12,051,602,395	-14,121,147,995	-29,177,517,995	-9,947,825,995	62,123,218,005	14,160,226,005
	CDX.NA.IG.HVOL	-0	-0	-	-	-	-	
	CDX.NA.XO	-	-	-	-	-	-	
	ITRAXX.EUR.FINSEN	-0	-70,952,480	-155,864,191	26,866,987	0	73,240,757	-0
	ITRAXX.EUR.FINSUB	-613,097,189	-1,197,677,867	-1,861,670,893	-1,486,431,075	-2,328,273,666	-2,114,660,403	-3,102,705,254
	ITRAXX.EUR.HIVOL	0	0	-	-	-	-	-
	ITRAXX.EUR.MAIN	24,385,425,805	37,478,656,786	51,872,466,296	48,309,323,652	40,740,245,026	71,774,454,424	10,428,139,571
	ITRAXX.EUR.SOVXWE	-	-	-	-	-	40,665,000	-
	ITRAXX.EUR.XOVER	-19,905,753	73,790,579	-1,421,626,410	-1,682,545,056	-5,215,875,674	-8,680,974,446	-5,338,972,770
	LCDX.NA	-4,502,113,000	-4,236,164,000	-1,266,300,000	-1,232,532,000	-1,198,764,000	-1,164,996,000	-1,164,996,000
CDS_INDEX Total		-14,212,090,532	18,981,099,123	44,978,685,306	17,869,281,012	17,803,320,690	99,809,214,335	-15,922,982,448
CDS_SINGLE_NAME						-	-	835,252,534
CDS_SINGLE_NAME Total						-	-	835,252,534
CDS_TRANCHE	CDX.NA.HY	9,367,799,720	8,118,656,644	10,394,268,290	13,177,165,794	12,369,757,169	14,308,175,567	15,204,533,082
	CDX.NA.IG	-10,810,447,157	-19,648,039,614	-13,545,590,864	-5,911,554,006	-5,360,701,943	-7,356,130,485	-9,000,333,231
	ITRAXX.EUR.MAIN	8,354,776,253	3,325,954,275	-3,111,768,697	15,957,364,778	23,239,155,826	47,355,169,732	45,438,160,356
	LCDX.NA	3,300,027,930	3,382,476,443	3,241,766,867	3,148,472,796	3,055,178,686	2,961,884,575	2,961,884,575
CDS_TRANCHE Total		10,212,156,745	-4,820,952,252	-3,021,344,404	26,371,449,362	33,283,389,737	57,269,099,390	54,604,244,782
Grand Total		-3,999,933,787	14,160,146,870	41,957,340,902	44,240,730,375	51,086,710,428	157,078,313,725	39,516,514,867

Permanent Subcommittee on Investigations
EXHIBIT #6

From: Drew, Ina <Ina.Drew@jpmorgan.com>
Sent: Tue, 10 Jan 2012 17:05:41 GMT
To: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
CC: Macris, Achilles O <achilles.o.macris@jpmorgan.com>
Subject: Re: International Credit Consolidated P&L 09-Jan-2012

Let's review the unwind plan to maximize p l. We may have a tad more room on rwa. Pls schedule asap.

From: Martin-Artajo, Javier X
To: Drew, Ina
Cc: Macris, Achilles O
Sent: Tue Jan 10 12:01:01 2012
Subject: RE: International Credit Consolidated P&L 09-Jan-2012

Total reserve is 30 MM . I do not think that we will have a release for sometime unless we get an opportunity . Bruno has been unwiding some of these postions opportunisticly . The other side of the P/L is that it has been somewhat costly to unwind too so net net we have actually lost a little bit of money to unwind .

From: Drew, Ina
Sent: 10 January 2012 16:17
To: Martin-Artajo, Javier X
Cc: Macris, Achilles O
Subject: RE: International Credit Consolidated P&L 09-Jan-2012

OK, thanks. Can you forward the schedule for releases, ie: what is the release planned given the budgeted reduction.

From: Martin-Artajo, Javier X
Sent: Tuesday, January 10, 2012 11:05 AM
To: Drew, Ina
Cc: Macris, Achilles O
Subject: RE: International Credit Consolidated P&L 09-Jan-2012

Management line is the release of P/L that comes from unwinding off the run positions . This is an adjustment that was made in 2009 for iliquidity of the credit derivatives book . In a way it is a reserve release for iliquid indexes .

From: Drew, Ina
Sent: 09 January 2012 21:25
To: Martin-Artajo, Javier X
Cc: Macris, Achilles O
Subject: FW: International Credit Consolidated P&L 09-Jan-2012

The management line is?? Thanks.

From: Munjayi, Tendai

Permanent Subcommittee on Investigations
EXHIBIT #7

Sent: Monday, January 09, 2012 3:58 PM
To: EOD Credit estimate
Cc: CIO P&L Team
Subject: International Credit Consolidated P&L 09-Jan-2012

	MTM Credit P&L as at	09/01/2012	
			USD 000's
		Daily Est.	MTD
Strategic	Redacted By Permanent Subcommittee on Investigations		
Tactical	Core Tactical	-1,824	-3,306
	Tactical 2	0	31
	Credit Single Names	35	161
Total Core		-4,329	-30,811
Investments	Redacted By Permanent Subcommittee on Investigations		
Total Investments			
Management			
Total International Credit:		-4,068	-7,740

	TRR Credit P&L as at	09/01/2012	
			USD 000's
		Daily Est.	MTD
Strategic	Redacted By Permanent Subcommittee on Investigations		

Redacted By
Permanent Subcommittee on Investigations

Tactical	Tactical 1	-1,824	-3,306
	Tactical 2	0	31
	Credit Single Names	35	161
Total Core		-4,329	-30,811
Investments			

Redacted By
Permanent Subcommittee on Investigations

Total Investments			
Management		0	20,772
Total International Credit:		-4,068	-7,740

CREDIT MARKET COMMENTARY

Synthetic Credit

Another day with very little realized volatility, and a bit more weakness, coming from European bank equities (Italian banks such as Unicredito), pushing single names, then FINSEN then iTraxx.Main index wider. Overall levels of spreads remain very high, relatively to the recent move in convexity instruments - credit volatility was once more very much for sale, especially in Europe (-3pt in iTraxx. Main ATM March), and longer date mezzanine tranches are decently tighter too. US credit was wider - consolidating a bit after the recent outperformance given the good numbers for the US economy. Our iTraxx positions are getting hurt mostly due to the long overlay, and the compression between iTraxx.Main and iTraxx.Xover. In CDX.IG super senior tranches are catching a bid - causing mezzanine tranches to tighten, hurting our positioning in this complex. In CDX.HY short dated off the run index are decently outperforming today, causing HY curves to steepen - we are also benefiting from higher mezzanine tranches across the board.

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Permanent Subcommittee on Investigations

Many Thanks and Kind Regards

Tendai,

Tendai Munjayi
Chief Investment Office
JP Morgan Chase & Co.
100 Wood St, London EC2V 7AN
Tel ☎ +44 (0) 207 777 9424
Email ✉ tendai.munjayi@jpmorgan.com

From: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>
Sent: Wed, 18 Jan 2012 15:58:26 GMT
: Grout, Julien G <julien.g.grout@jpmchase.com>
Subject: FW: Meeting materials for 11am meeting
Importance: High

From: Perryman, Andrew X
Sent: 18 January 2012 15:57
To: Serpico, Gina
Cc: Iksil, Bruno M; Martin-Artajo, Javier X; Macris, Achilles O; Hagan, Patrick S
Subject: Meeting materials for 11am meeting
Importance: High

Hi Gina,
Please find attached a copy of the meeting materials for Ina's 3pm meeting with Javier, Achilles and Bruno. Any questions please do not hesitate to give me a call.

Kind regards,
Andy

Andrew Perryman | JPMorgan | Chief Investment Office | 100 Wood Street, 6th Floor, London, EC2V 7AN | ☎ Direct: +44 20 7777 1070 | Blackberry: [redacted] | ✉ andrew.perryman@jpmorgan.com

▬ = Redacted by the Permanent Subcommittee on Investigations

EXCERPT

CORE CREDIT BOOK HIGHLIGHTS

Bruno Iksil

January 2012

J.P.Morgan

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Core Credit Book – Current RWA Summary

- The table below is the CIO International desk model's Core Credit Book RWA summary (Strategic + Tactical)
- As of COB 16th January 2012 the CIO calculated Core Credit Book RWA was USD20.9bln
- This compares to average USD40.3bln RWA for December 2011 provided by QR

Core Credit	CIO Calc 99Var	CIO Calc Capital	CIO Calc RWA	QR Reported RWA (December Average)
HistVar	86,566,113	273,746,085	3,421,826,066	5,431,270,000
StressVar	189,476,958	599,178,751	7,489,734,393	17,557,570,000
CRM	802,991,095	802,991,095	10,037,388,685	18,274,000,000*
Total		1,675,915,931	**20,948,949,143**	41,262,840,000

*Average CRM for Q4 provided

Core Credit	CIO Calc 95Var
HistVar	69,252,890
StressVar	166,360,769

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Credit book highlights

3 blocks of forward spread exposure

- **Main ITraxx S9:** 20% book RWA – gross notional: USD90bln - estimated carry: USD100mm
- **CDX IG9:** 35% book RWA – gross notional: USD278bln - estimated carry: USD200mm
- **CDX HY10 and 11:** 45% book RWA – gross notional: USD115bln - estimated carry: USD10mm

Main P&L components

- 35% reduction cost USD590mm (not a worst case but based on today's market depth)
  - -USD130mm Main
  - -USD250mm CDX IG
  - -USD210mm CDX HY
- Expected carry over the year with regular reduction : USD300mm – 500mm
- Remaining optionality: USD200-300mm on defaults
- Potential drawdown: USD100-200mm in US HY

Expiration schedule :

- **Main ITraxx S9:** June 2013 (50% position)
- **CDX IG9:** Dec 2012 (40% position)
- **CDX HY10 and 11:** Jun 2012 and Dec 2012: (30% position)

From: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
Sent: Thu, 19 Jan 2012 14:01:52 GMT
To: Drew, Ina <Ina.Drew@jpmorgan.com>; Wilmot, John <JOHN.WILMOT@jpmorgan.com>
CC: Macris, Achilles O <achilles.o.macris@jpmorgan.com>; Weiland, Peter <peter.weiland@jpmchase.com>
Subject: Credit book Decision Table - Scenario clarification

Ina ,

as a follow up from yesterdays conversation regarding the tranche book I would like to further clarify the different scenarios and assumptions for each of them .

The first scenario is the one discussed when you were in London an is a scenario that we reduce our book to the agreed target at year end 2012 of 20.5 Bln but the current model used by QR remains . This would need the path of reduction to be to reduce the RWA using a strategy that postions the book for maximum carry and would have high trading costs and a higher risk profile so that we could have also a large drawdown .

The second scenario or Central Scenario discussed with you and John Wilmot is a scenario that we meet the year end target by opportunistically reducing the necessary legs and optimization is used following the current QR model guidelines and assumes that we get a reduction on the cost of capital using the new VAR .

The third scenario is posible if we get the new model but we do not get diversification and we would reconsider .

The fourth scenario is our Target scenario and the one we are hoping to implement again by midyear .

Let me know if you want to further discuss .

Best regards

Javier

Permanent Subcommittee on Investigations
EXHIBIT #9

Credit book Decision Table in "no diversification" assumption

Model	QR model prevails	QR model prevails	CIO model prevails	CIO model prevails
Scenarios and perceived feasibility as of today	REDUCTION (as discussed at 7th December 2011 meeting London and follow up on Xmas)	[illegible]	Possible if approved by QR	TARGET SCENARIO (to be confirmed once approved by QR)
Model applied and diversification	QR Model no diversification	[illegible]	CIO Model no diversification	CIO Model no diversification
Data?	No detailed data	[illegible]	Data available	Data available
Reduction in RWA	RWA reduced from USD 43 Bln to USD 20 Bln	[illegible]	RWA reduced from USD 21 Bln to USD 15 Bln	RWA reduced from USD 21Bln to USD 20 Bln
RWA target EOY (undiversified)	USD 20 Bln	[illegible]	USD 15 Bln	USD 20 Bln
Estimated Diversified RWA	USD 20 Bln	[illegible]	USD 15 Bln	USD 7.5 Bln
Risk management	Systematic reduction of the largest legs across the book Unwind of existing trades across the board	[illegible]	Active risk reduction of the critical legs with regards to RWA marginals Buying protection on IG9 10yr, MAIN S9, HY10 7yr	Opportunistic risk reduction and optimization towards upside in stress Roll the protection on short term tenors expiring
Trading cost	USD 590mm	[illegible]	USD 100mm	USD 100mm
Carry	USD 400-500mm	[illegible]	USD 200mm	USD 50mm
Optionality	USD 0-50mm	[illegible]	USD 0-50mm	USD 0-300mm
P&L range	USD -150mm to USD -50mm	[illegible]	USD 50mm to USD 150mm	USD -50mm to USD -250mm
Drawdown needed	USD 300mm	[illegible]	USD 150mm	USD 100mm

From: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>
Sent: Thu, 26 Jan 2012 09:11:17 GMT
: Grout, Julien G <julien.g.grout@jpmchase.com>
Subject: FW: credit book last version

From: Iksil, Bruno M
Sent: 26 January 2012 08:31
To: Perryman, Andrew X
Subject: credit book last version

latest version for ismg.. for ur record

EXCERPT

CORE CREDIT BOOK HIGHLIGHTS

Bruno Iksil

January 2012

J.P.Morgan

Credit book executive summary

1-The credit book has a YTD P&L -100MUSD and conveys a further 300M USD drawdown

- **Where the YTD loss coming from?**
  - **Short risk HY exposure (-50M USD) + off the run vs on the run basis (-200MUSD)**
- **What would generate the drawdown ?**
  - Further distorsion on forward spreads : -200M USD
  - Rally in US HY and defaults at the same time (as Eastman Kodak this year) : -200M USD
- **Which trades were done so far this year ? :** sold protection in Itraxx main-xover and CDX IG (no US HY)
- Offsetting gains to the loss : new trades (+110MUSD) and carry (+40MUSD)

2- the trades that make sense

- The trade that makes sense : sell the forward spread and buy protection on the tightening move
  - Use indices and add to existing position
  - Go long risk on some belly tranches especially where defaults may realize
  - Buy protection on HY and Xover in rallies and turn the position over to monetize volatility
- Start with a long risk bias and use the equity tranches on tighter spreads to optimize upside on stress.

3- Profile of the book and main scenario considered :

- The book is long vega short gamma (like tactical but 15-20 time larger) : daily carry +2M
- Main scenario is spread tightening : we add gamma via flatteners and sell protection
- The plan : buy protection on the way to tighter spreads

Credit book Risk Profile

1-The credit book conveys upside on defaults in IG and a decompression trade HY vs IG

- **We are both long risk on forward spreads and carry Jump to default upside in itraxx Main S9 and CDX IG9**
- **The long risk overlay in series 9 is mostly hedging short risk in US HY and itraxx Xover**
- **We also carry a "spread basis" risk between series 9 in IG versus on the runs IG indices**

2- The main P&L drivers

- The forward spreads in series 9 IG, in particular in Equity tranches :
  - 10M$ per Bp in Main itraxx S9
  - 20M$ per Bp in CDX IG9
- The Hy10-HY11 2yr into 2yr forward spread (via equity tranche) versus the HY14 5yr (3yr) : 1-2M$ per Bp
- A compression trade : US HY vs US IG (3.5M$ per BP), itraxx Xover vs itraxx Main (1.25M$ per BP)

3- The current strategy :

- We receive forward spreads in IG series 9 and HY series 10-11 versus on the run spreads
- We hedge the downside in HY defaults with an overlay short risk in HY on the runs
- We position for cheap upside on Jump to default in high grade space within a RWA reduction plan

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Credit book P&L story Q4 2011 till today

1-Where does the loss and potential drawdown come from?

- The book started the year short risk long vega : spreads tightened 20% across the board (IG-25Bp HY-125Bps)
  - Estimated loss on pure spread tightening & HY to IG compression = 50M USD*
  - S9/IG9 forward spread vs on the run = 100M* USD (5bp)*
  - HY off the run lagging on the runs (EK) = 100M USD* (65bps)*
- Which is current loss , which is further drawdown
  - Current loss shows the spread rally mitigated by new trades : -100M USD
  - Most of the drawdown will come from basis risk from Off the runs series where we have longs versus on the run series where we have shorts

2- What triggered this loss : position unwinds and book rebalancing ?

- In Q4 2011 : we sold out some of the biggest exposure to reduce RWA
  - Sold HY8 to Hy11 indices to reduce longs : 10 bln (60% of the long)
  - Bought back 0-3 5x10 in ig9 and s9 : total 400m (10-15% of the position)
  - Sold protection on super-senior IG and sold risk in HY on the runs to cover hy11 3yr expiry
- Markets were in high stress level and we had to keep P&L in check, thus stay short risk long vega

3- What was done this year so far? :

- Sold protection across the board : 10Bln main, 10bln IG versus short risk 7Bln US HY
- Added flatteners : 5bln S9, 10bln ig9 to maintain the upside on defaults.

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Credit book trades that makes sense...

1-Sell protection across the IG board – buy protection in HY

- Stress levels in Europe should recede similarly to Q3-Q4 2008 between Bear stearns and Lehman
  - The LTRO plus potential coming collateral criteria changes will help stabilization
  - Unicredit "successful" recap provides a temporary "floor" to bank tangible equity
  - Market players were deeply shaken and started the year very defensively
- IG credit spreads have been plagued by financial stress
  - the memory of 2008 has triggered a deep rooted sell off in financials
  - Yet US banks and some european banks have made genuine efforts to clean their exposure

2- add flatteners in IG and HY on a large credit rally

- The deleveraging process will not stop :
  - Rates are very low but credit spreads are explosive
  - Banks will tier out the weak lenders in a low potential growth environment
  - HY and Xover names are the most vulnerable if growth does not pick up while rates stay low
- The long risk exposure and the flatteners should provide a low level of RWA versus the upside on credit events

3- Use belly tranches on wide spreads and equity tranches on tight spreads

- Go long risk belly tranches when spreads are wide and about to collapse
- Go long risk equity tranches when spreads are tight, stable and about to become volatile

Credit book profile change proposed and main scenario...

1-The credit book has still a long vega, short gamma profile

- **Current carry is +2M, VAR, 60-70MUSD dly, net short risk of +200MUSD in 50% spread widening**
- **Central scenario :**
  - Spreads tighten another 50%, curve barely moves
  - The book started the year long vega, short risk and suffered as risk aversion receded fast.
- **What the plan is short term:** sell more protection especially in Xover and HY to maintain RWA under check and neutralize the +/- 50% Credit spread moves scenarios

2- The target risk profile

- The book will step into positive gamma- long risk profile
  - The upside on default will be reduced due to the long risk but remains elevated thanks to the flatteners
  - The carry will be maintained on a constant spread basis but will diminish with spreads tightening
  - Larger shorts will remain in Xover and HY names

3- Adverse scenarios and possible drawdowns

- Defaults show in series where we are long risk (HY10-HY11) and not in others : this can cost 200m upfront
- The curves steepen and spreads do not tighten : this can cost another 300M.

Credit book profile P&L summary table

Compression effect		Relative Compression	Bp Value
CDX HY S17 05Y	-134	-27	3.5M USD
CDX IG S17 05Y	-22		BP value
ITRAXX XO S16 05Y	-130	6	1.25M USD
ITRAXX MN S16 05Y	-25		

Fwd Evolution (Idx)		Relative performance of fwd vs OTR	
CDX IG S17 05Y	-22		
CDX IG S15 05Y	-28		
CDX IG S14 05Y	-31		
CDX IG S14+S15 05Y	-30		BP Value
CDX IG S09 5X5	-23	6	20M USD
ITRAXX MN S16 05Y	-25		
ITRAXX MN S15 05Y	-28		BP Value
ITRAXX MN S09 5X5	-27	1	10M USD
CDX HY S17 05Y	-134		BP Value
CDX HY S10 5X7	-70	64	1M USD

RV

Fwd Evolution (iTranches)			
ITRAXX MN S09 05Y 00-03	-0.44		
ITRAXX MN S09 10Y 00-03	1.26	1.70	
CDX IG S09 05Y 00-03	-1.16		
CDX IG S09 10Y 00-03	0.07	1.23	
CDX HY S08 05Y 10-15	-5.36		EASTMAN KODAK
CDX HY S09 05Y 10-15	-7.12		EASTMAN KODAK
CDX HY S08+S09 05Y 10-15	-6.24		EASTMAN KODAK
CDX HY S10 07Y 10-15	-6.46	-0.22	EASTMAN KODAK

SKEW 5YR (as of 25/01 close)	
ITRAXX.IG	-7.0
ITRAXX.XO	-14.7
ITRAXX.HV	-11.2
ITRAXX.FIN5NR	-5.9
ITRAXX.FIN5UB	-17.2
ITRAXX.SOVX.WE	-11.1
CDX.IG	-8.1
CDX.HY	1.6

Skew as of Dec30,11 CLOSE	
ITRAXX.IG	-9.3
ITRAXX.XO	-5.3
ITRAXX.HV	-7.2
ITRAXX.FINSNR	-11.0
ITRAXX.FINSUB	-21.6
ITRAXX.SOVX.WE	-3.2
CDX.IG	-9.8
CDX.HY	0.2

	iTraxx	CDX.IG	CDX.HY
Carry	10.0	20.0	10.0
New Trades PnL	70.3	110.4	-46.1
Directionality	-13.5		26.8
Compression	7.6	-93.6	
Forward Underperformance	-13.9	-125.4	-64.0
	Europe	USA	
Total	60.5	-161.8	

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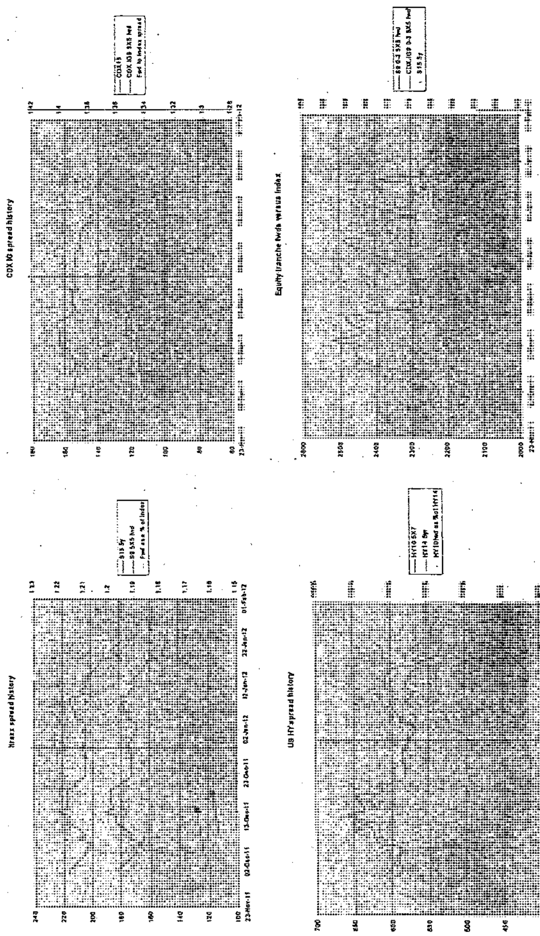
Credit book profile P&L Charts



CORE CREDIT BOOK HIGHLIGHTS

7

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Core Credit Book – Current RWA Summary

- The table below is the CIO International desk model's Core Credit Book RWA summary (Strategic + Tactical)
- As of COB 16th January 2012 the CIO calculated Core Credit Book RWA was USD20.9bln
- This compares to average USD43bln RWA for December 2011 provided by QR

Core Credit	CIO Calc 99Var	CIO Calc Capital	CIO Calc RWA	QR Reported RWA (December Average)
HistVar	86,566,113	273,746,085	3,421,826,066	5,431,270,000
StressVar	189,476,958	599,178,751	7,489,734,393	17,557,570,000
CRM	802,991,095	802,991,095	10,037,388,685	18,274,000,000*
Total		1,675,915,931	**20,948,949,143**	41,262,840,000

*Average CRM for Q4 provided

Core Credit	CIO Calc 95Var
HistVar	69,252,890
StressVar	166,360,769

Decision Table

Model	QR model prevails	QR model prevails	CIO model prevails	CIO model prevails
Scenarios and perceived feasibility as of today	REDUCTION (as discussed at 7th December 2011 meeting London and follow up on Xmas)	CENTRAL SCENARIO (possible with data from QR as discussed with John Wilmot)	Possible if approved by QR	TARGET SCENARIO (to be confirmed once approved by QR)
Model applied and diversification	QR Model no diversification	QR Model no diversification	CIO Model no diversification	CIO Model no diversification
Data?	No detailed data	Data updates through the year	Data available	Data available
Reduction in RWA	RWA reduced from USD 43 Bln to USD 20 Bln	RWA reduced from USD 43 Bln to USD 20 Bln	RWA reduced from USD 21 Bln to USD 15 Bln	RWA reduced from USD 21Bln to USD 20 Bln
RWA target EOY (undiversified)	USD 20 Bln	USD 20 Bln	USD 15 Bln	USD 20 Bln
Estimated Diversified RWA	USD 20 Bln	USD 20 Bln	USD 15 Bln	USD 7.6 Bln
Risk management	Systematic reduction of the largest legs across the book Unwind of existing trades across the board	Opportunistic reduction of the critical legs identified from marginals Buying protection on IG9 10yrs, MAIN S9, HY10 7yr	Active risk reduction of the critical legs with regards to RWA marginals Buying protection on IG9 10yr, MAIN S9, HY10 7yr	Opportunistic risk reduction and optimization towards upside in stress Roll the protection on short term tenors expiring
Trading cost	USD 590mm	USD 250mm	USD 100mm	USD 100mm
Carry	USD 400-500mm	USD 200mm	USD 200mm	USD 50mm
Optionality	USD 0-50mm	USD 50-150mm	USD 0-50mm	USD 0-300mm
P&L range	USD -150mm to USD -50mm	USD -50mm to 100mm	USD 50mm to USD 150mm	USD -50mm to USD 250mm
Drawdown needed	USD 300mm	USD 200mm	USD 150mm	USD 100mm

Credit book highlights

3 blocks of forward spread exposure

- **Main ITraxx S9:** 20% book RWA – gross notional: USD90bln - estimated carry: USD100mm
- **CDX IG9:** 35% book RWA – gross notional: USD278bln - estimated carry: USD200mm
- **CDX HY10 and 11:** 45% book RWA – gross notional: USD115bln - estimated carry: USD10mm

Main P&L components

- 35% crude reduction cost USD590mm (in case we get no detail from QR computation)
  - -USD130mm Main
  - -USD250mm CDX IG
  - -USD210mm CDX HY
- Expected carry over the year with regular reduction : USD300mm – 500mm
- Remaining optionality: USD200-300mm on defaults
- Potential drawdown: USD100-200mm in US HY

Expiration schedule :

- **Main ITraxx S9:** June 2013 (50% position)
- **CDX IG9:** Dec 2012 (40% position)
- **CDX HY10 and 11:** Jun 2012 and Dec 2012: (30% position)

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Credit book possible paths

QR method prevails : target RWA 20Bln

- **Path 1 : QR provides regular and detailed data about CRM-stress var and var scenarios:**
  - Active and opportunistic reduction necessary : trading cost estimated to be 250M USD
  - Estimated carry accrued over the year 200MUSD
  - Potential gains from remaining convexity : 50-150M USD
  - **P&L range : -50MUSD to +100M USD**
- **Path2 : QR does not update (2011 scenario) : <u>Central scenario so far</u>**
  - **Systematic reduction necessary : estimated reduction cost 590M USD**
  - **Estimated carry accrued over the year 400-500M USD**
  - **Potential gains from remaining convexity : 50M USD**
  - **P&L range : -150MUSD to -50M USD**
- **Path 3 : QR grants diversification in VAR-STRESS VAR_ CRM**
  - P&L range to be defined
  - NO DATA or any Hint for now
  - Optimisation possible
    - Trading costs 100-200M USD depending on scale target
    - Carry flat
    - Optionality 200-300M USD

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Credit book possible paths 2

CIO method prevails : target RWA 20Bln

- **Path 1 : 15 Bln RWA target no optionality targeted: the books expires naturally**
  - Risk management and trading costs : 100M USD
  - Estimated carry accrued over the year 200MUSD
  - Potential gains from remaining convexity : 0-50M USD
  - P&L range : 100M-150M USD
- **Path2 : 20 Bln RWA Jump optionality : the book is actively managed**
  - Risk management and trading cost 100M USD
  - Estimated carry accrued over the year 50M USD
  - Potential gains from convexity : 0-250M USD
  - P&L range : -50MUSD to 200MUSD
- **Path 3 : Diversification granted**
  - P&L range to be defined
  - NO DATA or any Hint for now
  - Optimisation possible
    - Trading costs 100-200M USD depending on scale target
    - Carry flat
    - Optionality 300-500M USD

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Credit book possible paths 3

Possible risk management options as the book options for upside on Jump-to-default expire :

- **Path 1 : the risks are neutralized and the book accrues the remaining carry**
  - We buy protection on long term tenors where we have long risk exposures
  - Ideal scenario if forward credit spreads compress
  - The cost will be very low on a bull market.
  - Target positions IG9 10yr, Main Itraxx 10yr, HY10 7yr, HY11 7yr
- **Path2 : The upside on jump to default events is maintained the book is not reduced**
  - We roll over the jump upside by adding flatteners on low spreads
  - We lock a good positive carry by selling the forward credit spreads on wide spreads
  - The cost can be limited but this requires some increase in notionals
  - Target trades : flatteners on mezzanine tranches, flatteners on indices, directional trading on on-the-run indices
- **Path 3 : Diversification granted**
  - With data : the book can be scaled according to stress scenarios
  - NO DATA or any Hint for now
  - Optimisation possible
    - Trading costs 100-200M USD depending on scale target
    - Carry flat
    - Optionality 300-500M USD or more..

From: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>
Sent: Mon, 30 Jan 2012 18:07:48 GMT
To: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
Subject: RE: update on core credit book

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yes. Are you available now?

From: Martin-Artajo, Javier X
Sent: 30 January 2012 18:05
To: Iksil, Bruno M
Subject: Re: update on core credit book

Let's discuss when you have a second . Can you call me on my mobile ?

From: Iksil, Bruno M
Sent: Monday, January 30, 2012 04:41 PM
To: Martin-Artajo, Javier X
Cc: Grout, Julien G
Subject: update on core credit book

We have to report a loss in the widening today, much less because the book has a long risk bias.
Comes month end and we cannot really prevent the forward spreads from moving up.
We get closer but each day the dealers report unreliable runs, wider bid-ask quotes and this cost us.
To trade them is costly and leads to increase in notionals.
We have some evidence that our counterparties need to frame the prices to our disadvantage but here the book is really balanced, ie there is this foward spread exposure that has nice features but this is not a profile where we can control the P&L unless we just let it roll off.

We need to discuss at this stage I guess :
the book is now set to carry positively and get some extra gains depending on where defaults show up. A no default scenario is now also a good outcome. Yet, the final result is unknown. All I see is that liquidity is so poor that we just add notionals with the street. So that improves the outright final P&L number but this increases the issues with the risks and the size, as well as our sensitivity to price moves and trading costs.

Because the views in the book are much more benign than in the past, the mean reverting pattern of the P&L is stronger (ie we face an ever lower risk to be wronged). Yet, to avoid this accumulation we need to let go on one way : the only one I see is to stay as we are and let the book simply die. That we should take some hits because the markets might create noise in the P&L is a certain reality. Yet, the control of the drawdown now is generating issues that make the book only bigger in notionals.

As a paradoxical result, I have to take directional views on the market direction, in order to pre-empt the moves that the dealers will do against us. And I see that the trading I run is closer and close to dealers' with a directional bias. This is a problem we had many times but only when we had views going counter to consensus. At the current stage, we still have the long risk in forwaed spreads but the notionals become scary and upside is limited unless we have really unexpected scenarios. In the meantime, we face larger and larger drawdown pressure versus the risk due to notional increases.

Please let me know the course of action I should take here.

From: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>
Sent: Mon, 30 Jan 2012 17:28:21 GMT
To: Buraya, Luis C <luis.c.buraya@jpmorgan.com>; De Sangues, Eric <eric.de.sangues@jpmorgan.com>
Subject: FW: update on core credit book

From: Iksil, Bruno M
Sent: 30 January 2012 16:42
To: Martin-Artajo, Javier X
Cc: Grout, Julien G
Subject: update on core credit book

We have to report a loss in the widening today, much less because the book has a long risk bias.
Comes month end and we cannot really prevent the forward spreads from moving up.
We get closer but each day the dealers report unreliable runs, wider bid-ask quotes and this cost us.
To trade them is costly and leads to increase in notionals.
We have some evidence that our counterparties need to frame the prices to our disadvantage but here the book is really balanced, ie there is this foward spread exposure that has nice features but this is not a profile where we can control the P&L unless we just let it roll off.

We need to discuss at this stage I guess :
the book is now set to carry positively and get some extra gains depending on where defaults show up. A no default scenario is now also a good outcome. Yet, the final result is unknown. All I see is that liquidity is so poor that we just add notionals with the street. So that improves the outright final P&L number but this increases the issues with the risks and the size, as well as our sensitivity to price moves and trading costs.

Because the views in the book are much more benign than in the past, the mean reverting pattern of the P&L is stronger (ie we face an ever lower risk to be wronged). Yet, to avoid this accumulation we need to let go on one way : the only one I see is to stay as we are and let the book simply die. That we should take some hits because the markets might create noise in the P&L is a certain reality. Yet, the control of the drawdown now is generating issues that make the book only bigger in notionals.

As a paradoxical result, I have to take directional views on the market direction, in order to pre-empt the moves that the dealers will do against us. And I see that the trading I run is closer and close to dealers' with a directional bias. This is a problem we had many times but only when we had views going counter to consensus. At the current stage, we still have the long risk in forwaed spreads but the notionals become scary and upside is limited unless we have really unexpected scenarios. In the meantime, we face larger and larger drawdown pressure versus the risk due to notional increases.

Please let me know the course of action I should take here.

Best regards

Bruno IKSIL

From: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>
Sent: Tue, 31 Jan 2012 12:36:28 GMT
To: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
Subject: hello, quick update in core credit...

---

ok they keep playing games in itraxx now. I will show up for small in the hope we can limit the pain.

as to IG9, things look much better. not that we are imune but we can show that we are not at mids but on realistic level.

I wait for Hy and will keep you in the loop when I have a final number.

I went I to ISMG and advised that we set the book for long risk carry the time for us to see whether we really need to fight in mars.

It will be time then : I just reminded the episode of 09 when I feared the drawdown and I ended up with the right position but not the right timing.

I hope I did right.

Let me know your thoughts.

Regards

Bruno

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From: Macris, Achilles O <achilles.o.macris@jpmorgan.com>
Sent: Tue, 31 Jan 2012 13:42:51 GMT
To: Drew, Ina <Ina.Drew@jpmorgan.com>
Subject: Core book p&l drawdown and main exposures

FYI -- further to our discussion, please see my comments to Javier below:

-----Original Message-----
From: Martin-Artajo, Javier X
Sent: 31 January 2012 12:44
To: macris@[redacted] Macris, Achilles O
Subject: Re: Core book p&l drawdown and main exposures

Achilles,
The meetings so far are positive with respect to VAR, good for Stress Var and not clear for CRM. Been working on the presentation for today this morning. I am in a meeting with Risk now and with QR in 45 minutes. Then Ina and Hogan briefly. The process here in NY is complicated because Market Risk needs to coordinate with the guys that talk to the regulators on a very regular basis.

So we are going to see a further reduction of the Var of at least 15%in the next 3-4 weeks. Now I am working on the CRM with QR. Then to see Adam Gilbert on the regulatory side.

[redacted] = Redacted by the Permanent Subcommittee on Investigations

----- Original Message -----
From: macris@[redacted]
Sent: Tuesday, January 31, 2012 07:58 AM
To: Martin-Artajo, Javier X
Cc: Iksil, Bruno M; Stephan, Keith; Kalimtgis, Evan
Subject: FW: Core book p&l drawdown and main exposures

Hi Javier,

How is it going in NY?
Are you dialling into ISMG?
We need to discuss the synthetic book.

The current strategy doesn't seem to work-out.
The intention was to be more bullish, but the book doesn't behave as intended.

Taking into account the conservative year-end marks and the January positive carry, the financial
Performance is worrisome.
I think that we need to urgently revaluate the core position in bearish steepeners and the associated maximum drawdown's.
The "timing" issues on the older series are somewhat predictable, and the

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second order p&l discrepancies should be viewed differently from the core position.

Thanks,
A

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----- Original Message -----
From: Iksil Bruno [mailto:[redacted]
Sent: Tuesday, January 31, 2012 06:28 AM
To: Iksil, Bruno M
Subject: Core book p&l drawdown and main exposures

The book currently conveys a short risk exposure in us hy and a long risk exposure in ig indices series 9 (both CDx and itraxx). This exposure balances the jump to default risk of the book : we would lose money now on a default in us hy and make money if the default occurs in ig world. One can summarize the net exposure as : the book has a bullish flatteners in ig and a bearish steepeners in us hy.

Since the start of the year, the book loses money on the short in hy and makes money overall in ig as expected. Now, the loss in hy is higher than expected because of equity tranches moves (linked to Kodak default). The gain in ig is lower than expected due to the lag in series forward spreads.

The drawdown in p&l is large because the notionals are large and the trade on forward spreads involve many legs all of which incurs a loss. The drawdown is sudden because the spreads have squeezed but capital has not come back to the markets yet. The skews and the basis remain large while the spreads have tightened 20% ytd.

Why does it impact the book ?
The book used the forward spreads (a net long risk exposure) to buy protection on defaults short term and buy some upside on large spread widening. This worked very well last year.
Now January is very bullish and the street owns the protection we sold on the forwards. Towards month end the spread on series 9 remains sticky and tends to widen more than the rest especially the on-the-run indices where the book still has short risk overlay. So the book is squeezed on both ends and we saw this pattern from the first days of the year. It did not really correct since then. This explains why the ig part of the book does not perform as expected.

The book is also hurt on the hy leg and this is linked to the unwinds from last year : I sold out some longs in hy8-9-10-11 series. The street was caught long risk in the on the run indices ie hy14-15-16-17 when AMR filed : they entered flatteners by selling what I was selling in order to limit the losses. In this rally, with Kodak filing for chapter 11, they have sponsored their own position at the expense of the book. No one can tell what will happen after Kodak is removed rom the indices because the recovery is quite low already (73%). The on the runs indices have rallied a lot since December catching up with the equity market. The book has lagged the rally on its longs via equity tranches but would catch up if there isn't any default in us hy over the next 3-6 months (in hy10-11 series).

Yesterday and today most likely, no matter what the market will do, the series 9 forwards will underperform and for hy I expect some framing too. Yet here this is broad based. I tried to fight it in the last sessions and it was unsuccessful.

If you have time I will send you a memo that describes the technicals of the market positioning in ig world. Let me know if you care to read it.

Best regards

Bruno Iksil

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From: Achilles Macris <macris@[redacted]
Sent: Thu, 01 Mar 2012 11:10:42 GMT
To: 'Martin-Artajo, Javier X' <javier.x.martin-artajo@jpmorgan.com>
Subject: priorities

Hey Javier,

Here are some thoughts:

- Focus on the metrics and P+L of the synthetic book. I am worried that the $20b RWA committed be year-end, is too aggressive. If we need to

Actually reduce the book, we will not be able to defend our positions.... We need to win on the methodology and then the diversification. Hogan, doesn't not understand the book and it should be explained through Ashley etc. Let's meet Ashley soonest.

As this would be driving all things important to us, it would be important to focus on the P+L and the post methodology RWA, should be what it takes to achive the P+L.....

We need to find a low RWA spread trade for size. Something between George and Tolga. Maybe Austria or EU, and buy $15b spread with low RWA.....

OR, step-in and buy the RMBS at new tights if you think that would generate issuance....

In Credit, to focus on some MtM low hanging fruit...... to assist the B/E for Bruno etc

Thanks,
Achilles

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From: Grout, Julien G <julien.g.grout@jpmchase.com>
Sent: Tue, 20 Mar 2012 19:52:02 GMT
To: CIO ESTIMATED P&L <CIO_CREDIT_P&L@jpmchase.com>
CC: CIO P&L Team <CIO_P&L_Team@jpmchase.com>
Subject: CIO Core Credit P&L Predict [20 Mar]: -$39,686k (dly) -$275,424k (ytd)

Daily P&L: -$39,685,995
YTD P&L: -$275,424,307

Daily P&L($) YTD P&L($)

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Europe High Grade -21,802,054 32,664,651

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US High Grade -20,314,624 458,833,337

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US HY & LCDX 11,562,342 -404,083,807

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US ABX / TABX -155 -20,081

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New Investments -10,802,807 -392,038,020

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Dead Books (Core) -85 1,377

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Washbook/Costs 0 0

[redacted]

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Explanatory P&L (in $1000s):
Name Total Dirctnl Tranche Carry IR N/T Adjust FX

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Close COD

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SOVX 0
CDX IG 83.5 -1.5
CDX HY 100 -0.063
LCDX 102

The roll period creates distortions in prices that impact us. The hit comes mostly from the rally in credit market where the series 9 both Itraxx.Main and CDX.IG lag. The book does not have enough CS01 to balance this lag : as the breakdown shows the book loses a lot of money on directional ($105M) while it is long risk in CDX.IG credit and short risk in CDX.HY and iTraxx.Xover credit. Yet, we estimate the gain on decompression as $30M in Europe and $30M in the US while the series 9 lag versus the market is of 1-2bps or $100M. The net result is a loss of $40M and we must expect more to come until investors opt to profit from the ongoing lag in those series 9.

As of today, reconstructing the CDX.IG9 10yr performance from the on the run indices and the 4 widest names in CDX.IG9 (Radian, MBIA, Istar, Sprint), the underperformance of the CDX.IG9 curves is between 6bps to 13 bps, which amount approximately to $450-500M for the sole CDX.IG9 series. iTraxx.Main S9 is also lagging by 3-4 bps or another $60-80M. Added to this the CDX.HY loss of $100M for Kodak and Rescap, plus the lag of the CDX.HY10-CDX.HY11 series versus the on-the-runs that is also $100-200M, the lag in P&L is material ($600-800M). As to the potential outperformance, it is much more a function of whether some names default and which one will default. We estimate the carry daily to be $1M while it may not show as it is stored in the ability of the forward spreads to "roll down" the curve. So far they did but at a much lower pace than the on the run indices rally : both in CDX.IG, iTraxx.Main and CDX.HY curves : in IG space, the long term forward rolled down slower than the market (i.e. short term spreads outperformed) while in CDX.HY, it is the opposite, i.e. long term spreads outperform short term spreads. This can be explained by the recovery in CDX.IG space while RESCAP and KODAK failed in CDX.HY space.

The CDX.HY bucket is now protected against any default and the cost of buying the protection is covered with selling protection in CDX.IG on the run indices. We sold more protection today in CDX.IG and iTraxx.Main in order to improve the carry and the recovery of the book looking forward.

Again, a lot of prices are still being framed and we are providing our best estimate.

From: Oaikhiena, Isi <isi.oaikhiena@jpmchase.com>
Sent: Tue, 20 Mar 2012 20:40:57 GMT
To: EOD Credit estimate <EOD_Credit_estimate@jpmchase.com>
CC: CIO P&L Team <CIO_P&L_Team@jpmchase.com>
Subject: International Credit Consolidated P&L 20-Mar-2012

MTM Credit P&L as at 20/03/2012

		USD 000's			
		Daily Est.	MTD	QTD	YTD
Strategic	Europe High Grade	Redacted By Permanent Subcommittee on Investigations			
	US High Grade				
	US High Yield				
	US ABX and TABX				
	Europe Sub Fin				
	IR Hedges				
	New Investments				
	Total Strategic	-39,686	-41,621	-275,425	-275,425
Tactical	Core Tactical	Redacted By Permanent Subcommittee on Investigations			
	Tactical 2				
	Credit Single Names				
Total Core		-41,814	-35,852	-222,885	-222,885
Investments	MTM CLO	Redacted By Permanent Subcommittee on Investigations			
	MTM ABS				
	Investment Equity				
	ABS CDS				

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		Daily Est.	MTD	QTD	YTD
Total Investments		Redacted By Permanent Subcommittee on Investigations			
Management					
Total International Credit:		-41,595	-21,584	-86,205	-86,205

TRR Credit P&L as at 20/03/2012

		USD 000's			
		Daily Est.	MTD	QTD	YTD
Strategic	Europe High Grade	Redacted By Permanent Subcommittee on Investigations			
	US High Grade				
	US High Yield				
	US ABX and TABX				
	Europe Sub Fin				
	IR Hedges				
	New Investments				
	Total Strategic	-39,686	-41,621	-275,425	-275,425
Tactical	Tactical 1	Redacted By Permanent Subcommittee on Investigations			
	Tactical 2				
	Credit Single Names				
Total Core		-41,814	-35,852	-222,885	-222,885
Investments	MTM CLO	Redacted By Permanent Subcommittee on Investigations			
	MTM ABS				
	Investment Equity				
	ABS CDS				
	AFS ABS (TRR)				
	AFS CLO (TRR)				

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Total Investments				
Management				
Total International Credit:	-41,595	-21,584	-86,205	-86,205

CREDIT MARKET COMMENTARY

Synthetic Credit

The roll period creates distortions in prices that impact us. The hit comes mostly from the rally in credit market where the series 9 both Itraxx.Main and CDX.IG lag. The book does not have enough CS01 to balance this lag : as the breakdown shows the book loses a lot of money on directional ($105M) while it is long risk in CDX.IG credit and short risk in CDX.HY and iTraxx.Xover credit. Yet, we estimate the gain on decompression as $30M in Europe and $30M in the US while the series 9 lag versus the market is of 1-2bps or $100M. The net result is a loss of $40M and we must expect more to come until investors opt to profit from the ongoing lag in those series 9.

As of today, reconstructing the CDX.IG9 10yr performance from the on the run indices and the 4 widest names in CDX.IG9 (Radian, MBIA, Istar, Sprint), the underperformance of the CDX.IG9 curves is between 6bps to 13 bps, which amount approximately to $450-500M for the sole CDX.IG9 series. iTraxx.Main S9 is also lagging by 3-4 bps or another $60-80M. Added to this the CDX.HY loss of $100M for Kodak and Rescap, plus the lag of the CDX.HY10-CDX.HY11 series versus the on-the-runs that is also $100-200M, the lag in P&L is material ($600-800M). As to the potential outperformance, it is much more a function of whether some names default and which one will default. We estimate the carry daily to be $1M while it may not show as it is stored in the ability of the forward spreads to "roll down" the curve. So far they did but at a much lower pace than the on the run indices rally : both in CDX.IG, iTraxx.Main and CDX.HY curves : in IG space, the long term forward rolled down slower than the market (i.e. short term spreads outperformed) while in CDX.HY, it is the opposite, i.e. long term spreads outperform short term spreads. This can be explained by the recovery in CDX.IG space while RESCAP and KODAK failed in CDX.HY space.

The CDX.HY bucket is now protected against any default and the cost of buying the protection is covered with selling protection in CDX.IG on the run indices. We sold more protection today in CDX.IG and iTraxx.Main in order to improve the carry and the recovery of the book looking forward.

Again, a lot of prices are still being framed and we are providing our best estimate.

Secured Credit

The market continues to trade well with mezzanine paper closing in on their peak levels from mid-2011 and a continued shortage of senior vanilla ABS/MBS continuing to put pressure on spreads. We continue to receive healthy amortisations across the asset classes.

March 20, 2012

~~DRAFT~~ Transcript of Call # ~~5601530708350332369~~ JPM-CIO-A 00000055

Date: March 20, 2012

Time: 16:09:36 – 16:31:56

Participants: Martin-Artajo and Iksil

Iksil	Hello.
Martin-Artajo	Hi Bruno.
Iksil	Yea. Hi Javier.
Martin-Artajo	Hello man.
Iksil	Yea so, yea we sent an estimate down 40 million today.
Martin-Artajo	Yea. Why did you do that?
Iksil	Because you know, it was, we actually did not recover what we're gaining on decompression we are making like 50, 60 million on decompression and we were losing [inaudible] in this lag and--
Martin-Artajo	Okay, okay, I just don't want you to do this, I don't know why you've done it anyway you've done it, so that's it. I don't know why, anyway, you should have told me this because it doesn't help us for the conversation for tomorrow
Iksil	Yea but I thought that because you have discussed already, you know, I thought we should actually you know, not do like minus, minus 5 every day but just say okay boom you know there is, there is something happening, it's the roll date (overlapping voices) --
Martin-Artajo	Okay, okay listen you've done it. You think that this is right. This is not what I would have done but you've done it so I'm okay with this. I've already said what the problem is, so okay they know they're not going to be surprised we have a meeting tomorrow it's just that um--
Iksil	I know it's embarrassing but--

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Permanent Subcommittee on Investigations
EXHIBIT #17

March 20, 2012

Martin-Artajo	Yea I don't understand your logic mate, I just don't understand. I told Achilles, he told me that he didn't want to show the loss until we know what we're going to do tomorrow. But it doesn't matter I know that you have a problem you want to be at peace with yourself, okay its okay Bruno. I've, it's alright I know that you're in a hard position here, because, you know
Iksil	I can tell you how I got there. You know, I work with Julien that's why we are still there and, you know, what we've tried to do is to say okay you know for month's end, we want to fight, where are we you know, so and you know really, really, if we want to just be realistic as to what we can expect to do, I wanted to show like upfront, precisely before ~~what~~ we discuss, you know, what it's going to look like that you know if we expect potentially to lose 100, 200 million it's because from where we are today, right, we will fail to bring back one basis point here, a crossover point in high yield there. It's just that, you see, just
Martin-Artajo	No, no, no, it's okay, it's everywhere I know. I've sent you, I've sent you a report there to illustrate what the problem is. I don't know if you've read it, but it just highlights the whole conversation we've had. Okay --
Iksil	Yea, okay.
Martin-Artajo	Um, it basically says the following, it basically says that we've reduced enormously the volatility of the book, the VaR and the stress VaR and the CRM, okay? Now the problem that we have is that we've increased thi~~s~~e IRC because of the extra long lets say okay
Iksil	Yes, yes [inaudible], right?
Martin-Artajo	Yes.
Iksil	Yes, I saw it yes.
Martin-Artajo	So the problem that we have ~~from~~ with this, ok, is that, the problem that we have from this is that really it just shows the problem, this spreadsheet just shows the problem. It shows that, it shows that -we have a book that has been reduced in risk terms a lot. It shows that these guys have been doing something with the model that is stupid okay because the CRM now, they just don't know how to explain what we do okay? They're just stupid quants really okay? The only guy that has been able to understand a little bit is the new guy, this Venkat guy. He understands what the problem is okay. He knows that this book, we need to keep doing what

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we're doing. It's just that we need to get rid of the CRM by externalizing the trade which is what the investment bank needs to do and then at some point we need to time the extra long, okay, which means that, you know, we can keep the long until it gets very, very tight or, or you do what the investment bank does is that you short IG and you go long high yield and then you get the benefit of that because happens to be the problem that the CRM has, okay. It happens to be capital for free. And that's what the, that's what the investment bank has done if you think about it okay. The investment bank has the short as the overlay okay, let's put it the hedges, right? So our hedges are kind of a long according to the model that these guys use okay. You follow me?

Iksil: No, no. I know, I know you see but that's why I tried sending this P&L I sent also the comments it came from Julien but I wrote it, where I said okay you know we take this loss, we are ~~mountaining~~ maintaining long risk where we have to be, the rally is on IG but guess what you know it's lagging so much that actually we have to show loss, and I explained that this is a lag that keeps going, that amounts to a potential of 800 bucks, right, that, that --

Martin-Artajo: What are you saying Bruno? What are you talking about? What is, y~~Y~~ou're losing your mind here, man, why did, you're sending an email that you would get, what is this 800 bucks?

Iksil: It's just the lag that we have in IG, ~~HY~~ in high yield, in main that is all over the book that makes that this book is just bleeding ~~in~~ the money but it's just the lag, that's just the lag.

Martin-Artajo: Okay but this is ~~just~~ what we need to explain tomorrow you don't need to explain in the email man.

Iksil: Yea but I had to put the comment on this big move, I thought, I thought that was, that was a way to, to, to show what's happening on a day like --

Martin-Artajo: Yea but why do you do it today when we are going to explain it tomorrow. Anyway, listen you've done it okay I don't know man, I've been, I don't know why you didn't tell me when I was there I don't know why, why.

Iksil: Because, because, because that's, that's what we saw today, you know we've tried everything, we've run though all the runs, all the prices, all the way we should--

Martin-Artajo: I know Bruno but listen mate, listen the problem that, okay it's fine you've done it I cannot really tell you, you know, not to do this, you've done it because you feel

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March 20, 2012

you have to do it, that's okay. What I don't understand at all is why are you explaining this, this way on the email? Why don't you explain it tomorrow when Ina is there and we have, because this only, this only creates, it just creates more tension you understand? It's not going to help me here as much, right? Because then tomorrow I'm going to say look you know this is. What happens if she tells me that we cannot keep going long? I just don't, anyway, no it's not a big deal, okay 40 million, to be honest is not a big deal, it's not a big problem, okay so don't, don't, okay, I don't know, I'm just, I'm just tired, man, I just, I don't know what to. You know we are really getting into something that the ~~IB~~ investment bank hates, okay, and you know they just do. They just have it because they have the opposite position here because they have optimized their model, right? ~~-~~So they've optimized this model and now we're going to have to challenge them not only in the market but on the model side, because otherwise, you know, otherwise, we're going to have to trade at some point you know, and that's what I, that's what I--

Iksil: ~~It's~~ That's what you fear.

Martin-Artajo: Sorry?

Iksil: That's ~~It's~~ what you fear, right? That at some stage we are in a corner because no one wants to go on with this challenge with the IB, yes?

Martin-Artajo: No, I don't know Bruno, you're logic sometimes, let's talk tomorrow because we have all morning to prepare for this okay? I, listen man, I, I don't know, I know that you're doing your job, you're trying your best, okay, so, you know, I don't think you mean, you know, I just sometimes don't connect with you, I don't know, I just don't know how to explain this.

Iksil: Yea it's difficult because you know the thing is we're on the desk and we're really looking at it you know and everything and I said you know it's like there were 4 basis points missing on IG 9 or 4 basis points missing on ~~[inaudible]~~ S9 so we try to you know--

Martin-Artajo: Okay, okay, o~~O~~kay man, this is, this is okay, I wish I had, sorry about I didn't get your call. I um-

Iksil: No, I tried, I waited, I waited. I sent you an SMS because I thought you would you know receive it on you blackberry before everything, but you know and we kept looking for it, and I tried and tried, and I'm not fooled by that you know it's just that, I have to, I don't know I thought, I thought that was, that was not realistic

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know what we were doing, and um, and I said probably I was wrong you know, I thought that it was this estimate before tomorrow, you know, was the way to, because I know Ina is going to read the comments, so maybe it will leave some time, and she will have different questions, or I don't know, because usually when we discuss you know we're really short and squeezed and I wanted to say these things before we actually, I actually have to explain the whole thing, but in summary that's what we, we discussed today right, that it's just a mark to market noise, that's um. So that, I don't know, probably I ~~Olivier~~ made the mistake right, but that, it's one mistake for~~from~~ another here, because if I don't --

Martin-Artajo No, no, no, man, no man.

Iksil I think I do a worst one, you know so. It's sort of my logic is strange but ~~it's like~~in fact I have to choose between one bad thing and one thing that I think was wors~~e~~t.

Martin-Artajo Yea no I, listen I'm not going to, I'm not going to sugar coat things, you know. I don't know if you're thinking that you, you know I'm just trying to do this the best possible way, man, okay so, I'm trying to get all the facts in front of Achilles and Ina, the fact that we show a loss here it's okay it's not, it is a problem, you know I've already told her that there's a problem, so, you know, I've already told her, so you know we're going to sit down tomorrow and talk about the CRM and we're going to talk about the problems. You know I've sent you an email on what she wants to discuss tomorrow she wants to see the changes in the book okay so you need to make sure Julien does that.

Iksil It, I was working on it.

Martin-Artajo Okay. Thank you for that man, I am, I know, I've been, I'm working on this other deal that I need to get done for the ~~book~~ for the book, for the secured credit book. It's just that I um, shit, I wish, I don't know, just explained this a little bit better because what happens is that you know, I think that, it's nor here nor there, it just highlights that there are problems in the book. You know in that sense I understand what you're saying. The problem ~~that~~ I have is that I wish that um, because I also think that what~~'s~~ happens ~~here~~, what's happening here it'ss just the investment bank that we have in front of us is doing things I mean, this, the call that I had today you know when Anil Pinto [sic] called I know that they have a problem here okay. So the more we recognize that we have a problem okay. ~~So t~~The more ~~we~~ you recognize ~~that we have a problem okay, it's, the more you recognize~~ the harder it is to settle with the IB at a better price if that what's going to happen. You understand what I'm saying?

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Iksil	Yea, yea because we settle the P&L at a level where we acknowledge more and more and more, which means that it's more and more acceptable, and therefore it's more and more [~~inaudible~~] ~~issues~~difficult to refuse. That's the way I understand that, yes.
Martin-Artajo	Yes, so in a way, what happens is that, imagine if tomorrow, imagine if tomorrow they say we need to settle with the IB, okay. If there is a chance, I'm saying I think it's a, I don't know, a 15 percent, 25 percent chance because we are over the capital here, okay. Listen to me tomorrow we'll go through this, but I don't know you probably are tired now. But 25 percent chance, why? Because we are over the capital right and we have a loss here that is, it's not a dramatic loss, okay. It's a loss that you know that we can take and ~~we can~~ get out because the books are so big now in terms of P&L that you know, you know if I take the other side of this, and say, if you are Achilles, if Achilles is going to decide on this okay, he would say okay let's get out of the trade and settle with the IB and whatever it is right? You follow me?
Iksil	Yes, yes.
Martin-Artajo	So, so, you know there is a chance that this happens and they say okay stop this, we're going to stop this, they call the investment bank and they settle this okay, they settle the delta difference that we need and the CRM that we need to externalize okay. There is a chance that this happen, I'm not saying it's~~this is~~ going to happen Bruno I'm just telling you that this could happen. So let's sit down tomorrow to discuss because I want to see all the, all the scenarios that we need to discuss, the other scenario that we need to discuss is how, what is the trade that puts us back inside the capital right, inside the 36 billion. Well, it's very easy to do now because all you need to do is reduce the, reduce the extra delta that Pat has in his book by a third, right? A little bit more than a third, a little bit more than a third. You follow me?
Iksil	Yes.
Martin-Artajo	You understand what I'm saying?
Iksil	Yes, yes, yes, yes.
Martin-Artajo	Okay so, you know it could be that they say okay well let's reduce the extra delta, i.e. the long in ~~IG~~ investment grade by a third, which means that we need to reduce the extra delta that we have by, I don't know, the number could be, I don't know 6

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billion, okay? 6 billion, okay? And then we're inside the capital ~~nowand~~ we, you and I, don't want that, because, because we don't because we've decided that's not what we want to do. But I'm just giving you all the, we need to discuss this tomorrow, it's not the right time, okay you've sent the email Ina's going to see it, she's not going to be surprised by the loss because I've discussed it with her. She will send me an email, and Achilles tonight, so ~~we'll~~ I will have to answer this email you see. So, so anyway, you've just created something I need to return, respond that's all. That's why I'm telling you. I just want you to know that this is what's going to happen so you know, it's a consequence that maybe I could have avoided but it's unavoidable tomorrow, because we need to, we need to explain what are the options that we have, and when we explain the options we're going to say okay, what are the options here? The options are settle with the ~~IB~~investment bank, not settle with the ~~IB~~ investment bank but then we have to time the exit of the book so, you know, and that's, so they give us extra capital for let's say a quarter or two, right? And then, you know, you know, then other things happen. I think that, I think that, I think, you know, I think we have to be honest with what we do here, that's going to be our issue. It's not going to amount to $40 million I agree with you so I don't think this is an issue, but I wish I could have discussed it with you. So thank you for um, thank you for um, for the work. I don't know man. I know that you're late in the office and you should go and rest, and we'll talk tomorrow.

Iksil Okay, okay.

Martin-Artajo Everything else, everything else okay? You tired, you okay, man, you tired, are you sleeping well?

Iksil No it's, no it's relatively okay because you know again, I, the discussion with Achilles you know I (he?) tried again the question I have, do I miss something? Did I miss something? And I did feel, you know, unsettled by his questions, you know, and I just think that, I agree with you it's really a question of ~~perfection~~perception, and yea probably I should not have done that it's just that you know that, that's the situation still I thought that that would be you know a way to start ~~stop~~ the discussion--

Martin-Artajo Okay, it's not here nor there, okay I'm just saying it's, I don't know. I wish I could discuss it with you, because um, I didn't, I didn't want to show the P&L and Achilles told me yesterday not to do it. So, okay, so we're just going to have to explain that this is getting worse, that's it. Okay, alright man -- Sorry?

Iksil No I said sorry for that, it's just that, yea, I in any case I ~~(inaudible) or~~ feel bad. If I

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do that I know I'm not making your life any easier, and if --

Martin-Artajo: No, no, no, you know I think that you're an honest guy, you know, it's just that, I did not want you to do this way, but you know you feel that the bid offer spreads are giving you a headache, and you want to release it this way, which is your own way of doing it, and it's fair, it's fair, it's fair. I don't want you to-- Sorry?

Iksil: The thing is you know today, I said I told Julien you know okay let's try to frame this you know, this P&L estimate whatever it's going to be, right, so that with tomorrow, whatever the decision made, right, whether we settle or we decide to fight, you know like we go long and then we are going to defend the position on IG, on 9, on ~~HY~~ high yield you know, try to do the minimum size everywhere you know so that the book grows~~goes~~ a little bit but not too much, so that we are, you know, we maintain knowledge the level where we are, and [inaudible] we aren't too far off. I thought ~~saw~~ that tomorrow, at one stage, after, before at one stage later, I would show you, you know what the plan can be, where, how many basis points here and there we are chasing and what size we can expect to do, right? And I realized we were, we were, we had to get closer to where the market is even if the market is wrong, you see? Because, because that's where we start, you know, it's also, I want to avoid you know a second stage where I say something and you know, I don't, I cannot deliver because then you know there will be a lot of questions and doubts, and I didn't see you know we are close enough to where the market is it may move you know, I'm aware of that, so we didn't want to show something, like. The number I search, you know, is the result of where I thought, you know, we could take a reference. So that whatever ---

Martin-Artajo: Okay Bruno, no, no, no, it's fine, okay, I see what you're going through, okay I think you're going through your own logic here to explain it, and there is, there is, you know, I think you have a reasonable way of explaining this, I um, you know, it would have been okay. I wish I discussed it with you, but that's, that's done, okay. You've done it, it's ~~that's~~ fine, and this is what you believe and I'm sure you have, you know, we'll sit down tomorrow and we'll look at the spreadsheet. I'm sure you've done some numbers that make sense and you that think this is a part of something that you can't recover ~~and there for~~therefore you've released, and you know, I know what you're doing and you're signaling here that there is a problem. I've already said it, Achilles knows it, and Ina knows it, and you're saying it now so, okay. I truly don't have a lot to say now because we have so much to speak tomorrow, I mean we have a long day tomorrow. So I, I hope, you know. Let's go and relax a little bit if you can, and let's start tomorrow, and we'll start again, because this is not going to be, you know, there's not a lot we can do on the phone

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	now and you know I want you to be fresh tomorrow too. So I, I, thank you for at least letting me know and calling me, and I'll see you tomorrow, okay?
Iksil	Okay, okay.
Martin-Artajo	Okay man. Bye.
Iksil	Bye.

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From: Grout, Julien G <julien.g.grout@jpmchase.com>
Sent: Thu, 22 Mar 2012 17:46:07 GMT
To: CIO ESTIMATED P&L <CIO_CREDIT_P&L@jpmchase.com>
CC: CIO P&L Team <CIO_P&L_Team@jpmchase.com>
Subject: CIO Core Credit P&L Predict [22 Mar]: +$82k (dly) -$276,990k (ytd)

Daily P&L: $82,141
YTD P&L: -$276,990,321

Daily P&L($) YTD P&L($)

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Europe High Grade 25,839,314 124,436,937

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US High Grade -82,388,848 409,065,325

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US HY & LCDX 94,962,354 -347,851,042

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US ABX / TABX -155 -21,008

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New Investments -20,633,978 -461,330,052

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Dead Books (Core) -13 2,017

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Washbook/Costs 0 0

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Explanatory P&L (in $1000s):
Name Total Dirctnl Tranche Carry IR N/T Adjust FX

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Another day of weakness triggered by negative news from China overnight, a very poor set of PMI in Europe. The market feels shaky here, with European financials, iTraxx.Xover and CDX.IG underperforming. Volatilities are higher by about +4pt across the board, but there was no flattening of index curves - some market players were actually marking curves a tad steeper, on the off the run series (S9, IG9). No obvious theme in tranches today - equity tranches were steeper again, in CDX.IG, but slightly flatter in iTraxx.
The behaviour of the book was close to what happened yesterday - the book is making money thanks to the decompression trades in Europe and in the US (our shorts in CDX.HY, S14,15,16,17 widened), with gains estimated to $80M. Again, the book is getting hurt with losses in index forward spreads in S9 and IG9, and in tranches (weaker CDX.HY equity and mezzanine tranches, steeper IG9 equity tranches).

Today we sold protection in the following index: iTraxx.Main (5.65B), iTraxx.Xover (300M), CDX.IG (3.95B) and FINSUB (100M). Beside providing carry, these trades should reduce the VaR, but increase the IRC. We are pausing in our sale of protection, to see what the overall impact on capital numbers is going to be.

Again, a lot of prices are still being framed and we are providing our best estimate.

From: Goldman, Irvin J
Sent: Thu, 22 Mar 2012 19:53:19 GMT
To: Weiland, Peter <peter.weiland@jpmchase.com>
Subject: RE: I would like to understand the increase in positions in credit

---

Ina is freaking - really! Call me

-----Original Message-----
From: Weiland, Peter
Sent: Thursday, March 22, 2012 03:26 PM Eastern Standard Time
To: Goldman, Irvin J
Subject: FW: I would like to understand the increase in positions in credit

Here is my best estimate.

Delta-adjusted on-the-run equivalent position increased from $91B to $122B, up 34%, same pct as cs01. CSW 10% and 50% only went up 11-13%. So my estimate would be somewhere in between but on the high side. I would say IRC increases from $18.75B to about $26B, which would take total RWA to $52B.

Starting with the $45B we discussed the other day:

Assuming that the CRM didn't change because most of the activity has NOT been in tranches, I got index position changes from George:

21-Mar-12	Notional	Delta Adj OTR Eqv Pos	Spr01	Spr+10%	Up50%
CDX IG	52,127,750,005	86,961,565,781	-39,871,740	-431,420,257	-2,114,101,859
ITRAXX MN	45,669,025,000	35,013,568,593	-20,469,654	-231,638,821	-1,139,079,866
Combined Total	97,796,775,005	121,975,134,375	-60,341,394	-663,059,078	-3,253,181,725

Diff	Notional	Delta Adj OTR Eqv Pos	Spr01	Spr+10%	Up50%
CDX IG	27,683,000,000	22,670,658,318	-10,374,650	-55,572,802	-280,773,456

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ITRAXX MN	6,757,250,000	7,875,193,276	-4,862,885	-14,376,964	-75,079,284
Combined Total	34,440,250,000	30,645,861,594	-15,237,535	-69,949,765	-355,852,740

07-Mar-12	Notional	Delta Adj OTR Eqv Pos	Spr01	Spr+10%	Up50%
CDX IG	24,444,750,005	64,290,907,463	-29,497,090	-375,847,456	-1,833,328,404
ITRAXX MN	38,911,775,000	27,038,375,317	-15,606,769	-217,261,857	-1,064,000,582
Combined Total	63,356,525,005	91,329,282,780	-45,103,858	-593,109,313	-2,897,328,985

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Peter Weiland
Tel: +1 212 834 5549
Mob: +1 914 [redacted]

From: Drew, Ina
Sent: Thursday, March 22, 2012 2:00 PM
To: Weiland, Peter; Goldman, Irvin J
Subject: I would like to understand the increase in positions in credit

Since our meeting yesterday and what the RWA implications are.

			pre-split	post-split
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
CRM	*Actual*	*Actual*	*Estimate*	*Estimate*
CRM standalone	26,395	31,100	78,763	15,600
CRM div. factor	31%	29%	29%	5%
CRM diversification	-8,122	-9,093	-22,841	-780
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

— = Redacted by the Permanent Subcommittee on Investigations

From: ADE ADETAYO <AADETAYO1@[redacted]
Sent: Fri, 23 Mar 2012 16:35:37 GMT
To: ADE ADETAYO <AADETAYO1@[redacted]; ADE ADETAYO <ADEBOWALE.O.ADETAYO@JPMORGAN.COM>; BRUNO IKSIL <BIKSIL2@[redacted] BRUNO IKSIL <bruno.m.iksil@jpmorgan.com>
Subject:

03/23/2012 05:17:22 ADE ADETAYO, MORGAN (J.P.) has joined the room
03/23/2012 05:17:22 ADE ADETAYO, MORGAN (J.P.) says:
*** MORGAN (J.P.) (20833) Disclaimer: THIS IS FOR INFORMATION ONLY AND NOT THE PRODUCT OF JPMORGAN `S RESEARCH DEPT.IT IS INTENDED FOR THE RECIPIENT ONLY.IT IS NOT AN OFFER OR SOLICITATION FOR PURCHASE OR SALE OF ANY FINANCIAL PRODUCT AND NOT SUITABLE FOR PRIVATE CUSTOMERS.PRICES ARE INDICATIVE ONLY.WE MAY HOLD A Ã¨POSITION OR ACT AS MARKET MAKER IN ANY FINANCIAL PRODUCT DISCUSSED ABOVE. CLIENTS SHOULD CONSULT THEIR ADVISORS ON TAX,ACCOUNTING,LEGAL OR OTHER ISSUES ARISING AND EXECUTE TRADES THROUGH A JPM ENTITY IN THEIR HOME JURISDICTION UNLESS GOVERNING LAW PERMITS OTHERWISE. FOR Ã¨INFORMATION ABOUT JPM UK ENTITIES REFER TO Ã¨www.jpmorgan.com/pages/disclosures 2009 JPMORGAN CHASE & CO. JPMSL IS AUTHORISED AND REGULATED BY THE FSA.

03/23/2012 05:17:30 ADE ADETAYO, MORGAN (J.P.) says:
hi bruno

03/23/2012 05:17:30 BRUNO IKSIL, JPMORGAN CHASE BANK, has joined the room
03/23/2012 05:17:30 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
*** JPMORGAN CHASE BANK, (748320) Disclaimer: THIS IS FOR INFORMATION ONLY, NOT AN OFFER OR SOLICITATION FOR THE PURCHASE OR SALE OF ANY FINANCIAL INSTRUMENT, NOR AN OFFICIAL CONFIRMATION OF TERMS. THE INFORMATION IS BELIEVED TO BE RELIABLE, BUT WE DO NOT WARRANT ITS COMPLETENESS OR ACCURACY. PRICES AND AVAILABILITY ARE INDICATIVE ONLY AND ARE SUBJECT TO CHANGE WITHOUT NOTICE. WE MAY HOLD A POSITION OR ACT AS A MARKET MAKER IN ANY FINANCIAL INSTRUMENT DISCUSSED HEREIN. CLIENTS SHOULD CONSULT THEIR OWN ADVISORS REGARDING ANY TAX, ACCOUNTING OR LEGAL ASPECTS OF THIS INFORMATION AND EXECUTE TRANSACTIONS THROUGH A J.P. MORGAN ENTITY IN THEIR HOME JURISDICTION UNLESS GOVERNING LAW PERMITS OTHERWISE.

03/23/2012 05:17:34 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
hello

03/23/2012 05:17:45 ADE ADETAYO, MORGAN (J.P.) says:
can I call you

03/23/2012 05:18:10 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
sure

03/23/2012 05:18:14 ADE ADETAYO, MORGAN (J.P.) says:
if you are free,\

03/23/2012 05:18:25 ADE ADETAYO, MORGAN (J.P.) says:
thanks, whats your number...

03/23/2012 05:18:39 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
0044 [redacted]

03/23/2012 05:50:23 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
javier mobile is [redacted]

Permanent Subcommittee on Investigations
EXHIBIT #20

03/23/2012 06:16:13 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
did you get Javier on the phone

03/23/2012 06:16:15 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
?

03/23/2012 06:16:23 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
btw we take a big hit today

03/23/2012 06:16:36 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
across the board

03/23/2012 06:16:44 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
right where we have a position

03/23/2012 06:17:17 ADE ADETAYO, MORGAN (J.P.) says:
yes I called spoke to him quickly

03/23/2012 06:17:24 ADE ADETAYO, MORGAN (J.P.) says:
he said will call me back

03/23/2012 06:17:28 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok

03/23/2012 06:17:30 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
cool

03/23/2012 06:17:35 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
thx for that

03/23/2012 06:18:34 ADE ADETAYO, MORGAN (J.P.) says:
seems people in the mkt know the position

03/23/2012 06:18:41 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
yes

03/23/2012 06:18:42 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
they do

03/23/2012 06:18:56 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
and they have a chief commander

03/23/2012 06:19:30 ADE ADETAYO, MORGAN (J.P.) says:
no good

03/23/2012 06:19:42 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
no

03/23/2012 06:19:45 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
u see

03/23/2012 06:19:55 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
u will feel less alone very soon

03/23/2012 06:20:06 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
but like u

03/23/2012 06:20:09 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i did not fail

03/23/2012 06:20:16 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
this is not what i will be told

03/23/2012 06:20:25 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
unlike you

03/23/2012 06:20:25 ADE ADETAYO, MORGAN (J.P.) says:
damn

03/23/2012 06:20:29 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i picked the trades

03/23/2012 06:20:36 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
so us ee

03/23/2012 06:20:55 ADE ADETAYO, MORGAN (J.P.) says:
hope it turns out well for you

03/23/2012 06:21:03 ADE ADETAYO, MORGAN (J.P.) says:
I really hope so

03/23/2012 06:21:10 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
no well it is not the end of the world

03/23/2012 06:21:19 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
but the end of what i have done so far

03/23/2012 06:21:20 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
for sure

03/23/2012 06:21:26 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i cannot fight

03/23/2012 06:21:29 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i cannot wait

03/23/2012 06:21:32 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i cannot argue

03/23/2012 06:22:51 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i may not come back on Monday

03/23/2012 06:23:00 ADE ADETAYO, MORGAN (J.P.) says:
really?

03/23/2012 06:23:03 ADE ADETAYO, MORGAN (J.P.) says:
oh no

03/23/2012 06:23:04 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
well

03/23/2012 06:23:10 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i will know this afternoon

03/23/2012 06:23:15 ADE ADETAYO, MORGAN (J.P.) says:
damn

03/23/2012 06:23:25 ADE ADETAYO, MORGAN (J.P.) says:
hope goes okay

03/23/2012 06:23:30 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
this is a big setup i think

03/23/2012 06:23:35 ADE ADETAYO, MORGAN (J.P.) says:
I relly hope so

03/23/2012 06:23:40 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
but i comes from the top

03/23/2012 06:23:56 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
and there is little i can do

03/23/2012 06:24:19 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
if they let the book roll that will be a gain in the end

03/23/2012 06:24:26 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
but the drawdown is huge

03/23/2012 06:24:39 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
a bit like the guys blowing on the super seniors

03/23/2012 06:25:38 ADE ADETAYO, MORGAN (J.P.) says:
damn, so sorry to hear this

03/23/2012 06:26:23 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ah it could be worse

03/23/2012 06:26:30 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
I could have doe a bad trade

03/23/2012 06:26:37 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
u know some real big mistake

03/23/2012 06:26:40 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i did not

03/23/2012 06:26:45 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
but u know how it is

03/23/2012 06:26:49 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
once the loss is there

03/23/2012 06:26:58 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
good trades look like very abd trades

03/23/2012 06:27:07 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
and this is where all this stops

03/23/2012 06:27:19 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i am not so much at loss

03/23/2012 06:27:21 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
net net

03/23/2012 06:27:28 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
if they just freeze the book

03/23/2012 06:27:32 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
that will be a gain

03/23/2012 06:27:44 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
but the damage to me is irreversible

03/23/2012 06:27:52 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
and that was the aim i think

03/23/2012 06:28:10 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
it is flattering to see all these guys devoting so much energy to that aim

03/23/2012 06:28:33 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
the pain for me is sam as for you

03/23/2012 06:28:48 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
to distance myself from wat ketp alive for so many years

03/23/2012 06:29:06 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
and to keep a positive memory of all this

03/23/2012 06:29:18 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ie not giving too much importance to today's events

03/23/2012 06:30:41 ADE ADETAYO, MORGAN (J.P.) says:
wow

03/23/2012 06:30:52 ADE ADETAYO, MORGAN (J.P.) says:
so sad this is happening

03/23/2012 06:30:59 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
it had to happe

03/23/2012 06:31:08 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
it started back in 2008 you see

03/23/2012 06:31:15 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i survived pretty well

03/23/2012 06:31:23 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
until i was alone

03/23/2012 06:31:29 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
to be the target

03/23/2012 06:31:39 ADE ADETAYO, MORGAN (J.P.) says:
u alone now?

03/23/2012 06:31:53 ADE ADETAYO, MORGAN (J.P.) says:
you have the backing of londin right?

03/23/2012 06:31:58 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
yes i mean the guys know my position because i am too big for the market

03/23/2012 06:31:59 ADE ADETAYO, MORGAN (J.P.) says:
london

03/23/2012 06:32:02 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
yes

03/23/2012 06:32:04 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i did

03/23/2012 06:32:11 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
because i made a lot of money

03/23/2012 06:32:17 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
there was no other reason

03/23/2012 06:32:21 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
this year

03/23/2012 06:32:47 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
for the first time, achilles started thinking i could be of use other than to make money

03/23/2012 06:32:56 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
just to protect the whole group

03/23/2012 06:33:02 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
but here is the loss

03/23/2012 06:33:10 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
and it becomes too large

03/23/2012 06:33:13 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
and this is it

03/23/2012 06:33:28 ADE ADETAYO, MORGAN (J.P.) says:
will he bck you?

03/23/2012 06:33:28 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
we realize that i am too visible

03/23/2012 06:33:37 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
up to a point yes

03/23/2012 06:33:44 ADE ADETAYO, MORGAN (J.P.) says:
good

03/23/2012 06:33:47 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
but here this is too big an issue

03/23/2012 06:33:56 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
it is out of my hands already

03/23/2012 06:35:19 ADE ADETAYO, MORGAN (J.P.) says:
so what happens now?

03/23/2012 06:35:37 ADE ADETAYO, MORGAN (J.P.) says:
you having a meeting with Javier and Achilles

03/23/2012 06:35:39 ADE ADETAYO, MORGAN (J.P.) says:
?

03/23/2012 10:20:58 ADE ADETAYO, MORGAN (J.P.) has left the room
03/23/2012 11:30:22 ADE ADETAYO, MORGAN (J.P.) has joined the room
03/23/2012 11:30:22 ADE ADETAYO, MORGAN (J.P.) says:
*** MORGAN (J.P.) (20833) Disclaimer: THIS IS FOR INFORMATION ONLY AND NOT THE PRODUCT OF JPMORGAN `S RESEARCH DEPT.IT IS INTENDED FOR THE RECIPIENT ONLY.IT IS NOT AN OFFER OR SOLICITATION FOR PURCHASE OR SALE OF ANY FINANCIAL PRODUCT AND NOT SUITABLE FOR PRIVATE CUSTOMERS.PRICES ARE INDICATIVE ONLY.WE MAY HOLD A Ã¨POSITION OR ACT AS MARKET MAKER IN ANY FINANCIAL PRODUCT DISCUSSED ABOVE. CLIENTS SHOULD CONSULT THEIR ADVISORS ON TAX,ACCOUNTING,LEGAL OR OTHER ISSUES ARISING AND EXECUTE TRADES THROUGH A JPM ENTITY IN THEIR HOME JURISDICTION UNLESS GOVERNING LAW PERMITS OTHERWISE. FOR Ã¨INFORMATION ABOUT JPM UK ENTITIES REFER TO Ã¨www.jpmorgan.com/pages/disclosures 2009 JPMORGAN CHASE & CO. JPMSL IS AUTHORISED AND REGULATED BY THE FSA.

03/23/2012 12:35:37 ADE ADETAYO, MORGAN (J.P.) has left the room

▬ = Redacted by the Permanent Subcommittee on Investigations

From: JULIEN GROUT <JGROUT3@[redacted]
Sent: Fri, 23 Mar 2012 18:37:47 GMT
To: JULIEN GROUT <JGROUT3@[redacted]>; JULIEN GROUT <julien.g.grout@jpmchase.com>; BRUNO IKSIL <BIKSIL2@[redacted]BRUNO IKSIL <bruno.m.iksil@jpmorgan.com>
Subject:

03/23/2012 05:45:49 JULIEN GROUT, JPMORGAN CHASE BANK, has joined the room
03/23/2012 05:45:50 JULIEN GROUT, JPMORGAN CHASE BANK, says:
*** JPMORGAN CHASE BANK, (741671) Disclaimer: THIS IS FOR INFORMATION ONLY, NOT AN OFFER OR SOLICITATION FOR THE PURCHASE OR SALE OF ANY FINANCIAL INSTRUMENT, NOR AN OFFICIAL CONFIRMATION OF TERMS. THE INFORMATION IS BELIEVED TO BE RELIABLE, BUT WE DO NOT WARRANT ITS COMPLETENESS OR ACCURACY. PRICES AND AVAILABILITY ARE INDICATIVE ONLY AND ARE SUBJECT TO CHANGE WITHOUT NOTICE. WE MAY HOLD A POSITION OR ACT AS A MARKET MAKER IN ANY FINANCIAL INSTRUMENT DISCUSSED HEREIN. CLIENTS SHOULD CONSULT THEIR OWN ADVISORS REGARDING ANY TAX, ACCOUNTING OR LEGAL ASPECTS OF THIS INFORMATION AND EXECUTE TRANSACTIONS THROUGH A J.P. MORGAN ENTITY IN THEIR HOME JURISDICTION UNLESS GOVERNING LAW PERMITS OTHERWISE.

03/23/2012 05:45:54 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bruno

03/23/2012 05:45:54 BRUNO IKSIL, JPMORGAN CHASE BANK, has joined the room
03/23/2012 05:45:54 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
*** JPMORGAN CHASE BANK, (748320) Disclaimer: THIS IS FOR INFORMATION ONLY, NOT AN OFFER OR SOLICITATION FOR THE PURCHASE OR SALE OF ANY FINANCIAL INSTRUMENT, NOR AN OFFICIAL CONFIRMATION OF TERMS. THE INFORMATION IS BELIEVED TO BE RELIABLE, BUT WE DO NOT WARRANT ITS COMPLETENESS OR ACCURACY. PRICES AND AVAILABILITY ARE INDICATIVE ONLY AND ARE SUBJECT TO CHANGE WITHOUT NOTICE. WE MAY HOLD A POSITION OR ACT AS A MARKET MAKER IN ANY FINANCIAL INSTRUMENT DISCUSSED HEREIN. CLIENTS SHOULD CONSULT THEIR OWN ADVISORS REGARDING ANY TAX, ACCOUNTING OR LEGAL ASPECTS OF THIS INFORMATION AND EXECUTE TRANSACTIONS THROUGH A J.P. MORGAN ENTITY IN THEIR HOME JURISDICTION UNLESS GOVERNING LAW PERMITS OTHERWISE.

03/23/2012 05:45:59 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
salut

03/23/2012 05:46:01 JULIEN GROUT, JPMORGAN CHASE BANK, says:
salut

03/23/2012 05:46:03 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c mort la

03/23/2012 05:46:28 JULIEN GROUT, JPMORGAN CHASE BANK, says:
david de CS appoelle au sujet des skew trades. je lui demande un prix ferme sur indice vs single names?

03/23/2012 05:46:32 JULIEN GROUT, JPMORGAN CHASE BANK, says:
coupons matched etc

03/23/2012 05:46:33 JULIEN GROUT, JPMORGAN CHASE BANK, says:
?

03/23/2012 05:46:42 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui

E-MAIL TRANSLATION

[redacted] = Redacted by the Permanent Subcommittee on Investigations

From: JULTEN GROUT <JGROUT3@[redacted]
Sent: Fri, 23 Mar 2012 18:37 :47 GMT
To: JULTEN GROUT <JGROUT3@[redacted]; JULIEN GROUT
<j ulien .g.grout@jpmchase.com>; BRUNO IKSIL <BIKSIL2@[redacted] BRUNO
IKSIL <bruno.m.iksil@jpmorgan.com>
Subject:

03/23 /20]205:45:49 JULIEN GROUT, JPMORGAN CHASE BANK, has joined the room
03 /23/201205:45:50 JULIEN GROUT, JPMORGAN CHASE BANK, says:
*** JPMORGAN CHASE BANK, (741671) Disclaimer: THIS IS FOR INFORMATION ONLY, NOT AN OFFER OR SOLICITATION FOR THE PURCHASE OR SALE OF ANY FINANCIAL INSTRUMENT, NOR AN OFFICIAL CONFIRMATION OF TERMS. THE INFORMATION IS BELIEVED TO BE RELIABLE, BUT WE DO NOT WARRANT ITS COMPLETENESS OR ACCURACY PRICES AND AVAILABILITY ARE INDICATIVE ONLY AND ARE SUBJECT TO CHANGE WITHOUT NOTICE. WE MA Y HOLD A POSITION OR ACT AS A MARKET MAKER IN ANY FINANCIAL INSTRUMENT DISCUSSED HEREIN. CLIENTS SHOULD CONSULT THEIR OWN ADVISORS REGARDING ANY TAX, ACCOUNTING OR LEGAL ASPECTS OF THIS INFORMATION AND EXECUTE TRANSACTIONS THROUGH A IP. MORGAN ENTITY IN THEIR HOME JURISDICTION UNLESS GOVERNING LAW PERMITS OTHERWISE.

03/23/20]205:45 :54 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bruno

03/23/20 1205:4554 BRUNO IKSIL, JPMORGAN CHASE BANK, has joined the room
03/23120 12 05 :4554 BRUNO IKSIL, JPMORGAN CHASE BANK, says
*** JPMORGAN CHASE BANK, (748320) Disclaimer: THIS IS FOR INFORMATION ONLY, NOT AN OFFER OR SOLICITATION FOR THE PURCHASE OR SALE OF ANY FINANCIAL INSTRUMENT, NOR AN OFFICIAL CONFIRMATION OF TERMS. THE INFORMATION IS BELIEVED TO BE RELIABLE, BUT WE DO NOT WARRANT ITS COMPLETENESS OR ACCURACY. PRICES AND AVAILABILITY ARE INDICATIVE ONLY AND ARE SUBJECT TO CHANGE WITHOUT NOTICE. WE MAY HOLD A POSITION OR ACT AS A MARKET MAKER IN ANY FINANCIAL INSTRUMENT DISCUSSED HEREIN. CLIENTS SHOULD CONSULT THEIR OWN ADVISORS REGARDING ANY TAX, ACCOUNTING OR LEGAL ASPECTS OF THIS INFORMATION AND EXECUTE TRANSACTIONS THROUGH A IP. MORGAN ENTITY IN THEIR HOME JURISDICTION UNLESS GOVERNING LAW PERMITS OTHERWISE.

03/23/201205:45:59 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
salut
hi
031231201205:46:01 JULTEN GROUT, JPMORGAN CHASE BANK, says:
salut
hi
03/23/20 1205:4603 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c mort la
it is over/it is hopeless now
03/23 /20 1205:46:28 JULIEN GROUT, JPMORGAN CHASE BANK, says:
david de CS appoelle au sujet des skew trades. je lui demande un prix ferme sur indice vs single names?
David from CS calls about skew trades. I ask him a firm price on index vs single names?
03/23/201205:46:32 JULIEN GROUT, JPMORGAN CHASE BANK, says:

coupons matched etc
coupons matched etc
03/23/2012054633 JULIEN GROUT, JPMORGAN CHASE BANK, says:
?
?
03 /23/201205:46:42 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui
yes
03/23/20 1205:46:46 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c un full upfront
it is a full upfront
03/23/20 1205:46:54 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok understood
ok understood
03 /23/201205:48: 11 JULIEN GROUT, JPMORGAN CHASE BANK, says:
pour revenir a ton premier point
to get back to our first point
03 /23 /20 1205:48: 14 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
continue a vendre la ss
keep on selling the ss
03/23/201205:48 :25 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
leve la 0-3 10yr
levy/raise/exercise the 0-3 10yr
03/23/20 1205 :48 :28 JULIEN GROUT, JPMORGAN CHASE BANK, says
on en discutera lundi si tu veux bien,
we will talk about that on Monday if it is fine with you
03 /23 /20 1205:48 :32 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok ok je continue ca
ok ok I continue that
03123/20 1205:48 :38 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui
yes
03 /23 /201205:48:48 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je te dis
I tell you
03/23/201 205:48:52 BRUNO TKSIL, JPMORGAN CHASE BANK, says
ils vont nous defoncer
they are going to trash/destroy us
03/23/20 12 05:48 :56 JULIEN GROUT, JPMORGAN CHASE BANK, says :
y a bcp a dire, mais je ne veux pas charger ta charette qui est deja bien remplie
there is a lot to say, but I don't want to burden you more than you already are
03/23 /20 12 055228 BRUNO IKSIL, JPMORGAN CHASE BANK, says
c soir tu as au moins 600m
tonight you'll have at least 600m
03123/201 2055236 BRUNO IKSIL, JPMORGAN CHASE BANK, says
BID ASK
BID ASK
03/23 /20 120552:40 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
MID
MID

03123120 1205 :52 :51 BRUNO TKSIL, JPMORGAN CHASE BANK, says:
BID ASK TU AS 300M AU MOINS
BID ASK YOU HAVE 300M AT LEAST
03/23/2012 05:54:46 JULIEN GROUT, JPMORGAN CHASE BANK, says:
tu as vu le run de jospehine.. attack full force.
You have seen Josephine's run.. attack full force.
03/23/2012 05:57 :56 BRUNO IKSTL, JPMORGAN CHASE BANK, says:
oui
yes
03 /23 /20120557:59 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c partout
it is everywhere/all over the place
03/23/20 12 0558:04 BRUNO IKSTL, JPMORGAN CHASE BANK, says:
on est mort je te dis
we are dead I tell you
03/23 /2012 05:58 :19 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
mais bon c hors de mon controel maintenant
but then it is out of my hands now
03/23/2012 05:58:27 BRUNO TKSIL, JPMORGAN CHASE BANK, says:
j'ai fait ce qu'il fallait
I did what I had to do
03 /23 /2012 06:04:04 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
*03/23/2012 06:*18:11 JULIEN GROUT, JPMORGAN CHASE BANK, says
oula bnp ...
wow bnp...
03/23/2012 07:2702 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bruno/
bruno/
03/23/2012 07:30:46 BRUNO IKSTL, JPMORGAN CHASE BANK, says:
oui
yes
*03/23/2012 07:31:*38 JULIEN GROUT, JPMORGAN CHASE BANK, says:
l'arret du trading c nous 3 ou juste moi?
The stop of the trading, is it the 3 of us or only me ?
03123/2012 07:31:49 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
toi
you
03123/2012 07:31 :52 BRUNO IKSTL, JPMORGAN CHASE BANK, says:
sur core
on core
03/23/2012 07:31 :52 JULIE GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03 /23/2012 07:32:05 JULIEN GROUT, JPMORGAN CHASE BANK, says
eric/luis ils peuvent continuer, sur leur tactical
eric/luis can go on, on their tactical
03/23/2012 07:32:06 BRUNO IKSIL, JPMORGAN CHASE BANK, says:

continue sur la ss les 0-3 1 A yr
go on with the ss the 0-3 1 A yr
03/23/2012 07:32:07 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok?
Ok?
03/23/2012 07:32:11 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui
yes
03 /23 /20 1207:32:27 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
continue sur les 25-35 HY
go on with the 25-35 HY
03123 /20 120732:32 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
pas les 15-25
not the 15-25
03/23/201207:32:53 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03/23/201207:33 :02 JULIEN GROUT, JPMORGAN CHASE BANK, says:
tu pourras me donner la couleur stp? s'il y en a.
will you give me the color please ? if there is some.
03/23120 1207:33: 17 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
rien poour le moment
nothing for now
03 /23/201207:33 :20 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03/23 /20 120733 :28 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ca va se negocier avec l'IB
it will be negotiated with the IB
03/23/20 1207:33:34 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
tout en haut
at the top
03123120 1207:33:41 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
et je vais en prendre pour mon grade
and I am going to be hauled over the coals
03 /23 /20 1207:33:44 JULIEN GROUT, JPMORGAN CHASE BANK, says
today?
today?
03/23/20 120733:49 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
mais bon on a du carry
but we have some carry
03123/20 1207:33 :51 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ah? cela t'a ete confirme/
ah ? it was confirmed to you ?
03 /23 /20 1207:34:03 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c pas necessaire
it is not necessary
03/231201207:34:20 BRUNO IKSIL, JPMORGAN CHASE BANK, says
tu ne perds pas 500M sans conseuqences
you don't lose 500M without consequences

03/23/20 12 07:34:30 BRUNO TKSIL, JPMORGAN CHASE BANK, says
garde le pour toi
keep it for you
03123/201207:34:39 JULIEN GROUT, JPMORGAN CHASE BANK, says:
oh oui
oh yes
03/23 /20 120734:52 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c le bon sens qui me dit ca
good sense tells me so
03/23120 120746:55 JULIEN GROUT, JPMORGAN CHASE BANK, says:
tua as parle a august? sinon, je lui dis de nous montrer le skew trade (sous le bon format)?
Did you talk to august ? otherwise, I tell him to show us the skew trade (under the good format)?
03 /2312012074729 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui
yes
03/23 /20 12074735 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03/23/20 120747:38 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
essaie de collecter des prix fermes
try to collect firm prices
03/23 /20 1207 4 745 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je n'ai rien vu de ferme pour le moment
I haven't seen anything firm for now
03/23 /20 1207481 5 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03123/2012 07:56:47 JULIEN GROUT, JPMORGAN CHASE BANK, says
Bruno? tu as besoin de qqcho/
Bruno ? do you need anything ?
03/23/20 12 08:13:16 JULIEN GROUT, JPMORGAN CHASE BANK, says
bon bruno
well bruno
03/23 /20 1208:13 :26 JULIEN GROUT, JPMORGAN CHASE BANK, says:
javier est reparti dans un conf call avec A
javier is back again in a phone call with A
03 /23/2012081332 JULIEN GROUT, JPMORGAN CHASE BANK, says:
je n'ai pas pu lui parler
I couldn't talk to him
03/23 /201208 14 :05 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok
ok
03 /23/201208:14:24 JULIEN GROUT, JPMORGAN CHASE BANK, says:
mais bon il n'avait pas l'ai conceme par des slidse .. plutot autre chose
but anyway he did not seem concerned by the slides.. rather something else
03/23 /2012 08:14:35 JULIEN GROUT, JPMORGAN CHASE BANK, says
je vais chercher le dej et je reviens
I am going to get lunch and I come back
03 /23/2012 08:26: 17 BRUNO IKSIL, JPMORGAN CHASE BANK, says
tu es la?
Are you here?

03/23 /2012 08:31:42 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
urgent
urgent
03 /23/20 12 08:3349 JULIEN GROUT, JPMORGAN CHASE BANK, say s:
oui
yes
03/23/2012 085930 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
regarde ton email
look at your email
03 /23/20 1209:0002 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
essaye de retrouver les run de roman shukhman sur ig9 pour montrer qu'ils sont plus steep et mettent le ig9 10yr plus que le marche
try to find roman shukhman's runs on ig9 in order to show that they are "more steep"/steeper and that they put the ig9 10 yr more than the market
03123/20 1209:01 :36 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bruno
bruno
03 /23/20 120902:07 BRUNO IKSIL, JPMORGAN CHASE BANK, says
essaie de retrouver les chat sur les chat de jp ou ils nou sniffent
try to find the chats about the jp's chat where they sniff us
03123 /2012090213 JULIEN GROUT, JPMORGAN CHASE BANK, says:
tu te rappelles l'histoire de debut d'annee avec Sylvain sur le roll s9 5y?
do you remember the story from the beginning of the year with Sylvain on the s9 5y roll ?
03/23 /20120902:20 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
non
no
03 /23/20 1209:02:26 BRUNO IKSIL, JPMORGAN CHASE BANK, says
c'etait koi deja?
What was it again?
03123 /20120902:41 JULIEN GROUT, JPMORGAN CHASE BANK, says
j'avais checke sylvain, et fait une gross taille de roll s9 5y
I had checked with Sylvain and done a big size of roll s9 5y
03 /231201209:0251 JULIEN GROUT, JPMORGAN CHASE BANK, says:
peux de temps apres il me dit que jpm le lift dessus
shortly after he tells me that jpm lifts him from it
03/231201209:0256 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ah oui
oh yes
03 /23 /20 1209:03:04 BRUNO TKSIL, JPMORGAN CHASE BANK, says:
il faut le retrouver celui la
we need to find this one
03 /23 /20 1209:03 :13 JULIEN GROUT, JPMORGAN CHASE BANK, says
je 'ai, en francais malheureusement
I have it, in French unfortunately
03 /23/20120903 :21 BRUNO IKSIL, JPMORGAN CHASE BANK, says
c pas grave envoie
it does not matter, send it
03123 /20 120903:3 1 JULIEN GROUT, JPMORGAN CHASE BANK, says
en rrecanche peux tu me rappeler ce que tu avais trade/booke?
However could you remind me what you traded/booked ?
03123120 120903 :33 BRUNO IKSIL, JPMORGAN CHASE BANK, says:

achilles comprend tres bien le francais
achilles understands French very well
03 /23 /20 1209:03:42 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
cad?
Which means?
03 /23 /201209:03:48 JULIEN GROUT, JPMORGAN CHASE BANK, says:
je veux le timing exact
I want the exact timing
03/23/20 1209:03:56 BRUNO IKSIL, JPMORGAN CHASE BANK, says
de quoi?
of what ?
03/23/20 1209:04:03 JULIEN GROUT, JPMORGAN CHASE BANK, says
ben des evenements
well, of the events
03/23/2012090416 JULIEN GROUT, JPMORGAN CHASE BANK, says
parce que si tu as deja traite du roll avant moi la dessus
because if you have already treated some roll before me on that
03123/2012090420 JULIEN GROUT, JPMORGAN CHASE BANK, says
ca sera encore plus limpide
it will be even clearer
03 /23 /20 120904:23 JULIEN GROUT, JPMORGAN CHASE BANK, says:
tu vois?
Do you see ?
03123 /20 1209:04:32 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je ne me souviens plus
I don't remember
03/23/201209:04:39 JULIEN GROUT, JPMORGAN CHASE BANK, says
ok je regarde le blotter
ok I look at the blotter
03/23/201209:04:41 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c quel jour?
What day is it ?
03/23 /20 1209:05:27 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ah ui ! tu as traite 250m de roll s9 avec db a 7h55 !!
oh yes! You dealt with 250m of roll s9 with db at 7h55!!
03 /23 /20 12 0905 :29 JULIEN GROUT, JPMORGAN CHASE BANK, says
le 4-jan
on 4th Jan
03 /23/20 120906:11 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok
ok
03 /23 /20 1209:0618 BRUNO IKSIL, JPMORGAN CHASE BANK, says
tu as le chat?
Do you have the chat?
03/23/20 120906:22 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ajoute le
add it
03/23 /20 1209:06 :29 JULIEN GROUT, JPMORGAN CHASE BANK, says:
avec sylvain? oui

with Sylvain ? yes
03/23/20120906:31 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je ne vois rien chez moi
I can't see anything on mine
03 /23 /20 1209:06:37 BRUNO IKSTL, JPMORGAN CHASE BANK, says:
mais je me rappelle
but I remember
03/23 /201209: 14:32 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok apparemment tu as booke le trade vers 8h20 ce jour la, moi j'ai trade a 9h.
ok apparently you booked the trade around 8h20 this day, and I traded at 9h.
03 /23/20 12 09: 14 :52 BRUNO IKSIL, JPMORGAN CHASE BANK, says
cool
cool
03 /23 /20 1209:5007 JULIEN GROUT, JPMORGAN CHASE BANK, says:
pour l'instant je n'ai que 5 'pieces' au dossier
for now I have only 5 documents in the file
03 /23/201209:53:45 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
regarde ton email
look at your email
03 /23/20 1209:53:49 JULIEN GROUT, JPMORGAN CHASE BANK, says:
vu
seen
03/23120 1209:53:50 JULIEN GROUT, JPMORGAN CHASE BANK, says:
un de plus
one more
03/23/201209:54:03 BRUNO IKSIL, JPMORGAN CHASE BANK, says
ben oui on ne va pas bosser comme si on etait parano tout le temps aussi
well yes, we are not going to work as if we were paranoid all the time!
03/23120 1209:54:25 JULIEN GROUT, JPMORGAN CHASE BANK, says:
6 pieces
6 documents
03/23120120956:24 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
regarde tes chats a toi avec JP guys
look at your own chats with the JP guys
03/23 /2012 10:05 :37 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je fais Mark Shirfan
I look at Mark Shirfan
03 /23/20 12 10:2250 JULIEN GROUT, JPMORGAN CHASE BANK, says:
vois les emails stp
look at the emails please
03/23 /20 12 1023 14 BRUNO IKSIL, JPMORGAN CHASE BANK, says
je vois
I see
03/23 /20 12 10:23:21 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
la var explose
the var explodes
0312312012 10:2328 JULIEN GROUT, JPMORGAN CHASE BANK, says:
oui
yes

03/23/20 12 10:23 :35 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c foutu
it is over
03/23 /20 12 10:23 :37 JULIEN GROUT, JPMORGAN CHASE BANK, says:
le sule moyen c le book a zero
the only way is the book at zero
03123 /20 12 10:25 :04 JULIEN GROUT, JPMORGAN CHASE BANK, says:
tu peux me dire ce que t'a dit ade ce matin?
Can you tell me what ade told you this morning?
03/23/201210:2550 BRUNO TKSIL, JPMORGAN CHASE BANK, says
3 gars de l'ib sont venus lui demander ma taille sur ig9
3 IB guys came to ask him my size on ig9
03 /23 /2012 1026:08 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je ne veux pas savoir qui c
I don't want to know who it is
03/23/2012 1026: 19 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je suis sur le call
I am on the call
03/23/2012 10:28:01 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
as tu eu des updates sur les marginal?
Did you get the updates about the marginal?
03/23/201210:28:06 JULIEN GROUT, JPMORGAN CHASE BANK, says:
no
no
03/23/201210:28:10 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
rwa
rwa
03/23/2012 10:28:22 JULIEN GROUT, JPMORGAN CHASE BANK, says:
48.7
48.7
03 /23 /2012 10:2848 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
les marginals sur le rwa
the marginals on the rwa
03 /23120 12 10:29: 15 JULIEN GROUT, JPMORGAN CHASE BANK, says:
non rien .. en cours
no, nothing.. in progress
03/23 /2012 10:29:33 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
j'en ai besoin
I need them
03/23/2012 10:2939 JULIEN GROUT, JPMORGAN CHASE BANK, says
je sais
I know
03/23/20J 2 10:2944 JULIEN GROUT, JPMORGAN CHASE BANK, says:
je viens de relancer pat
I just asked Pat again
03 /23 /2012 10:29:59 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
merci
thanks
03 /23 /2012 10:31: 18 JULIEN GROUT, JPMORGAN CHASE BANK, says
tu peux me faire les transcripts de david gldenberg a CS stp?

Can you please do/check david gldenberg's transcripts to CS ?
03 /2312012 10:31 :38 BRUNO IKSIL, JPMORGAN CHASE BANK, say s:
je suis sur le call
I am on the call
03/23/2012 10:3145 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03/23/2012 10:3148 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
tout est sur le chat de cs
everything in on cs's chat
03/23 /2012 10:31 58 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
peux tu le faire
can you do it?
03/23/20 12 10:3203 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03 /2312012 10 57: 13 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
appelle moi qd tu peux
call me when you can
03 /23/20 12 11 :36: 16 JULIEN GROUT, JPMORGAN CHASE BANK, says:
tjs en ligne?
Still online ?
03123/20 12 11 :3842 JULIEN GROUT, JPMORGAN CHASE BANK, says:
dis moi quand tu as pu retrouver les chats de David Goldenberg
tell me when you can find David Goldenberg's chats
03 /23 /20 12 11 :3843 JULIEN GROUT, JPMORGAN CHASE BANK, says:
stp
please
03 /23 /20 12 1200:09 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
c sur le chat de cs sur la fin de mois
It is on cs's chat at the end of the month
03/23/20 12 1200 16 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
et il ya celui de citi
and there is the citi one
03/23/20 12 1200:28 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
il faut montrer les deux en parallel
you need to show both in parallel
03/23/20 12 12 00 3 4 JULIEN GROUT, JPMORGAN CHASE BANK, says
peux tu me les envoyer stp?
Can you send them to me please?
03/23/20 12 12:0106 BRUNO IKSIL, JPMORGAN CHASE BANK, says
ok je fqis citi
ok I do citi
03/23/20 12 12:01 :12 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
tu peux fqire cs?
Can you do cs please ?
03 /23/2012 12:0339 JULIEN GROUT, JPMORGAN CHASE BANK, says:
C'ETAIT SUR QUOI DEJA ? LES 6B?
About what was it again? The 6B?

03 /23/20 12 12:0440 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok laisse tomber
ok give it up
03/23/20 12 12:0441 BRUNO IKSIL, JPMORGAN CHASE BANK, says
je e fais
I do it
03123/20 12 1204:54 JULIEN GROUT, JPMORGAN CHASE BANK, says:
desole y avait javier j 'ai perdu le fil
sorry javier was here and I lost track
03 /23/2012 12:04:59 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
pas de pb
no pb
0312312012 12:05:06 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
regarde tes email
look at your emails
03/23/2012 1205:16 BRUNO TKSn.., JPMORGAN CHASE BANK, says:
je faire janvier et fevrier sur credit suisse
I am going to do January and February on credit suisse
03/23 /2012 12:05:44 JULIEN GROUT, JPMORGAN CHASE BANK, says:
peux tu te rappeler des chats ou les traders te disaient que l'IB poussait sur ig9?
Can you remember chats where the traders told you that the IB insisted on ig9?
03 /2312012 12:07:45 BRUNO TKSIL, JPMORGAN CHASE BANK, says:
non
no
03/23 /201212:07:47 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
aucun
none
03/23 /2012 12: 19:23 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bruno
bruno
03 /23/20 12 12: 19:39 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui
yes
03/23 /2012 12: 19:46 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ignore le dernier email pour csfb*
disregard the last email for csfb
03 /23 /2012 12 19:49 BRUNO TKSIL, JPMORGAN CHASE BANK, says:
c un dupe
it is a trick
03 /23 /2012 12: 1952 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bon j'ai les marginals old fashion
well, I have the old fashion marginals
03/23 /2012 12 1956 BRUNO IKSIL, JPMORGAN CHASE BANK, says
ah demande a Javier
ah ask Javier
03 /23 /2012122001 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
quel pnl on print today
what pnl we print today
03 /23 /2012 12:20:08 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je ne sais plus la

I don't know anymore
03 /23 /20121220:22 JULIEN GROUT, JPMORGAN CHASE BANK, says:
j'ai aussi les marginals pour un split IRC/optimal tranches book, ca t'interesse?
I also have the marginals for a split IRC/optimal tranches book, are you interested ?
03/23/20 12 12:20:29 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui
yes
03 /23/2012 12:20:33 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
stp va voir javier
please, go see javier
03/23/2012 12:20:40 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je ne sais pas quel pnl envoyer la
I don't know which pnl I should send
03 /2312012 12:20:42 JULIEN GROUT, JPMORGAN CHASE BANK, says
ok je vais aller lui demander. il pense que les pieces que j'ai amassees ne sont pas assez
ok I am going to ask him, he thinks that the documents that I collected are not enough
03/23/20 121 2:20:44 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03 /23120 12 12:20:49 JULIEN GROUT, JPMORGAN CHASE BANK, says:
je vais aller lui envoyer
I am going to send them to him
03 /23/201212:22:32 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
dis moi qd core delta est updated
tell me when core delta is updated
03/23/2012 12:24:27 JULIEN GROUT, JPMORGAN CHASE BANK, says
done
done
03 /2312012 12:24:51 JULIEN GROUT, JPMORGAN CHASE BANK, says:
si on doit faire bcp plus de ig9 vs ig18 il faut faire une simulation sur le rwa via Pat
if we must do much more ig9 vs ig18, we need to do a simulation on the rwa via Pat
03/23/2012 12:27: 17 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bon je fais le pnl la
well, I do the pnl now
03/23/2012 1227: 18 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok?
ok?
0312312012 12:29:55 BRUNO IKSIL, JPMORGAN CHASE BANK, says
ah non on ne fera jamais ca !
oh no, we will never do that !
03/23/20 12 12:2959 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
yen a marre a la fin
enough is enough
03/23/20 12 12:30 13 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
tu as parle a Javier?
Did you talk to Javier?
03/23/20 12 12:37: 12 JULIEN GROUT, JPMORGAN CHASE BANK, says:
tu noteras qu'il veut faire les simuls de capital AVANT de traiter
you'll notice that he wants to do the capital simulations BEFORE dealing

03123/20 12 12:51 :30 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bon ca va douiller sur la compression la
it is going to be spent/expensive on the compression now
03/23/20 12 12:52:46 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui
yes
03/23120 12 12:53:00 JULIEN GROUT, JPMORGAN CHASE BANK, says
as tu parle a Javier?
Did you talk to javier ?
03/23/2012 125606 JULIEN GROUT, JPMORGAN CHASE BANK, says
b?
b?
03123 /20 12 12:56:35 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
oui
yes
03 /23/201212:56:39 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ok
ok
03/23 /2012 12:57: 19 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
we show -3 until month end on this one
we show -3 until month end on this one
03/23 /20 12 12:57:21 BRUNO IKSIL, JPMORGAN CHASE BANK, says
anyway
anyway
03/23/20121303 :35 JULIEN GROUT, JPMORGAN CHASE BANK, says:
je peux appeler?
Can I call?
03/23/20 121303:47 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
si tu veux
if you want
03 /23/20 1213:0752 JULIEN GROUT, JPMORGAN CHASE BANK, says:
le bo ne va rien faire, parce quele pb aujourd'hui c'est la compression
the bo is not going to do anything, because today's problem is compression
03123 /20 12 13 08:07 BRUNO IKSIL, JPMORGAN CHASE BANK, says
arrete
stop that
03123/201213 :08 :19 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
tu ne perds pas 200m en compression
you do not loose 200m with compression
03/23/20 121308:55 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bon
well
03123/20 12 13:09:28 JULIEN GROUT, JPMORGAN CHASE BANK, says:
on a 34m de cs0l en ig. hy unc'd today (par rapport a nos marques) et ig+3.25. ca fait 110m
we have 34m of cs01 in ig. Hy unc'd today (in comparison with our marks) and ig+3.25. it makes 110m
03/23/2012 1309:35 JULIEN GROUT, JPMORGAN CHASE BANK, says
ok?
Ok?

03/23/2012 1309:44 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ecoute je n'ai pas le temps
listen, I don't have time
03123/20 1213:09:49 JULIEN GROUT, JPMORGAN CHASE BANK, says:
pok
why?
03/23/20 121309:51 JULIEN GROUT, JPMORGAN CHASE BANK, says
ok
ok
03/23/20 12130953 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
je suis avec pat pour voir les trades
I am with pat to see for the trades
03/23/20 1213 :10:04 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
tout ce que je te demande c de dire a Javier ce que tu vois
all that I am asking you is to tell Javier what you see
03123/20 12 13: 10: 14 BRUNO IKSTL, JPMORGAN CHASE BANK, says:
c tout et ils decide ce qu'on montre
that's it and he decides what we show
03/23/20 12 13: 1 0:20 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
parce que la moi je ne sais plus
because me, I don't know anymore
03/23/20 12 13 1026 BRUNO IKSIL, JPMORGAN CHASE BANK, says
je regarde la reduction du rwa
I look at the reduction in the rwa

03/23/20 12 14 :37 :47 JULIEN GROUT, JPMORGAN CHASE BANK, has left the room

From: Goldman, Irvin J <irvin.j.goldman@jpmchase.com>
Sent: Mon, 26 Mar 2012 22:23:58 GMT
To: Macris, Achilles O <achilles.o.macris@jpmorgan.com>; Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
CC: Drew, Ina <Ina.Drew@jpmorgan.com>; Wilmot, John <JOHN.WILMOT@jpmorgan.com>; Weiland, Peter <peter.weiland@jpmchase.com>; Stephan, Keith <keith.stephan@jpmorgan.com>
Subject: Tranche Plan

All,

Now that we have the new RWA increase, Ina would like to discuss the forward plan for reduction. She does not want any trades executed until we all discuss it. We will have a call first thing in the morning.

Irv

Irvin Goldman | J.P.Morgan | Chief Investment Office | 270 Park Ave. | ☎ Tel: +1 212 834 2331 | ✉ irvin.j.goldman@jpmchase.com

From: Macris, Achilles O <achilles.o.macris@jpmorgan.com>
Sent: Fri, 30 Mar 2012 14:15:25 GMT
To: Bacon, Ashley <Ashley.Bacon@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>
Subject: synthetic credit -- crisis action plan

FYI

From: Macris, Achilles O
Sent: 30 March 2012 15:13
To: Hogan, John J.
Cc: Drew, Ina
Subject: FW: synthetic credit -- crisis action plan

Hi John,

I have asked Ashley for help with the synthetic credit book.

In the first quarter, my team failed in targeting RWA and we need your urgent help to do a better job in Q2.
Ashley, Javier and myself think that the most experienced person at the firm is Olivier. Olivier is both familiar with the correlation product as well as the capital attributes of correlation.

I would be grateful if you could approve dedicating Olivier to CIO priorities for Q2.

Background: following years of exceptional performance in this book utilizing 5b RWA, we have decided to risk neutralize the book post the large gains on the AA events around thanksgiving. While we remained short in HY, we have bought IG to achieve a risk neural stance. Since then, and while both IG rallied and the RV between HY and IG worked in our favour, the proxing of IG long via IG 9 forwards, did not work and resulted in almost total loss of hedging effectiveness. Additionally, the RWA increased beyond my targets and I have lost confidence in my team's ability to achieve the targeted RWA and their understanding of the synthetic levers to achieve the RWA objectives.
Due to the size of the book, our market manoeuvrability is limited. I am further worried that the "best" course of action from a risk and economic point of view, may be conflicting with the appropriate capital utilization.

Many thanks,
Achilles

From: Bacon, Ashley
Sent: 30 March 2012 14:14
To: Macris, Achilles O
Subject: RE: synthetic credit -- crisis action plan

Achilles, John asked that you send him a note (cc Ina) just summarising that you want Olivier, what the ask is, and that this has some urgency. Then I think we move ahead.

Thanks

From: Macris, Achilles O

Sent: 30 March 2012 13:50
To: Goldman, Irvin J
Cc: Drew, Ina; Martin-Artajo, Javier X; Tse, Irene Y
`ubject: RE: synthetic credit -- crisis action plan

Hi Irv,

I just spoke with Ashley regarding the issue and he has agreed to dedicate Olivier to help us with RWA targeting for Q2.

Ashley immediately understood the issue and agreed with the approach to get the firm's best talent involved early in the process.
Without any doubt, Olivier is very familiar with the correlation product as well as the management of the capital attributes of correlation.

Following our call, Ashley spoke with Venkat who also agreed with our proposal to dedicate Olivier to our priorities for Q2.
We have jointly agreed to have Olivier based in our office for Q2. Ashley will being informing John Hogan.
Both Ashley and Venkat are displaying very strong support and partnership on this. I am indebted to both.

best,
Achilles

▬ = Redacted by the Permanent Subcommittee on Investigations

From: macris@[redacted]
Sent: 30 March 2012 10:38
~o: Martin-Artajo, Javier X; Stephan, Keith
.c: Brown, Anthony M; Polychronopoulos, George H; Uzuner, Tolga I; Enfield, Keith; 'Chris'; Weiland, Peter
Subject: synthetic credit -- crisis action plan

Hi guys,

On Tuesday we will be presenting the final action plan for the book for Q2.

As we already had several meetings on this, we must get it right this time, otherwise we could lose our collective credibility.

Due to the size of the book, we only have "one move" to achieve our dual objective of stabilizing the risk and P+L of the book, while achieving our
targeted RWA objectives for the end of Q2.
We must insure that we don't overtrade, or alter the risk profile to an uncertain RWA result.
Therefore, the objective is to determine what is the best course of action to insure that the book is and remains balanced in risk and P+L terms.
Additionally, we must "price" the best economic solution in terms of average and final Q2 RWA.

Regarding RWA targeting, I will be asking Ashley for help. Hopefully, Olivier will be made available to exclusively focus on the CIO RWA targeting for Q2.

Clearly, we are in a crisis mode on this. The crisis team is to have short daily meetings and your daily update and progress report needs to be commercial and forward looking to mark to implementation of the stated objectives.

We will be discussing the suspension of our investment programs as well as potential OCI crystallizations at the ISMG.

Thanks,
Achilles

THE WALL STREET JOURNAL.
WSJ.com

April 6, 2012, 1:19 p.m. ET

'London Whale' Rattles Debt Market

By GREGORY ZUCKERMAN And KATY BURNE

In recent weeks, hedge funds and other investors have been puzzled by unusual movements in some credit markets, and have been buzzing about the identity of a deep-pocketed trader dubbed "the London whale."

That trader, according to people familiar with the matter, is a low-profile, French-born J.P. Morgan Chase & Co. employee named Bruno Michel Iksil.

Mr. Iksil has taken large positions for the bank in insurance-like products called credit-default swaps. Lately, partly in reaction to market movements possibly resulting from Mr. Iksil's trades, some hedge funds and others have made heavy opposing bets, according to people close to the matter.

Those investors have been buying default protection on a basket of companies' bonds using an index of the credit-default swaps, or CDS. Mr. Iksil has been selling the protection, placing his own bet that the companies won't default.

Mr. Iksil, who works primarily out of London, has earned around $100 million a year for the bank's Chief Investment Office, or CIO, in recent years, according to people familiar with the matter.

There is no suggestion the bank or the trader acted improperly.

Mr. Iksil didn't respond to calls and emails seeking comment.

J.P. Morgan said the CIO unit is "focused on managing the long-term structural assets and liabilities of the firm and is not focused on short-term profits."

The bank added, "Our CIO activities hedge structural risks and invest to bring the company's asset and liabilities into better alignment."

Kavi Gupta, a trader at Bank of America Merrill Lynch, wrote a message to investors Thursday about the mystery trader, saying hedge funds are accelerating wagers against "the large long," or bullish investor. "Fast money has smelt blood," he wrote. Bank of America declined to comment.

The hedge funds are wagering that the cost of default protection using the index will increase, potentially putting Mr. Iksil in a money-losing position and forcing him to reduce some of his holdings.

Buying protection on the index is currently cheaper than what it costs to protect the index's component companies individually.

Any reduction in Mr. Iksil's position could result in profits for the hedge funds and losses for the bank, according to a person familiar with the matter. There is no indication that any such reduction is planned.

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J.P. Morgan Chase has emerged from the financial crisis as one of the strongest global banks, and Chief Executive James Dimon often boasts of the company's "fortress balance sheet."

Mr. Iksil's trades are partially hedged, or protected by some offsetting trades, according to people close to the matter. Mr. Dimon is regularly briefed on details of some of the group's positions, these people added.

One person familiar with the matter said the bank has run tests that show Mr. Iksil's positions likely will be profitable in any economic or market downturn.

Some analysts who follow J.P. Morgan Chase, the biggest U.S. bank by assets, said they weren't aware of the group's trading. "They've talked about their investment strategies and procedures and risk controls but haven't highlighted this division," said Gerard Cassidy, a banking analyst at RBC Capital Market.

J.P. Morgan said the CIO unit's "results are disclosed in our quarterly earnings reports and are fully transparent to our regulators."

Mr. Iksil, who has worked at J.P. Morgan since January 2007, commutes to London each week from his home in Paris, and works from home most Fridays. He sometimes wears black jeans in the office and rarely a tie, according to someone who worked with him.

Mr. Iksil works with two junior traders and focuses on complex trades in credit markets, developing most of his investment ideas and then getting approval from senior bank executives, according to someone close to the matter.

In the past, he often has been bearish on markets and placed trades to express that downbeat perspective, sometimes criticizing colleagues as too optimistic on markets. Some of his best performances have come during market downturns, though he has also made trading mistakes in volatile times.

However, Mr. Iksil has turned more upbeat recently. He has been selling protection on an index of 125 companies in the form of credit-default swaps. That essentially means he is betting on the improving credit of those companies, which he does through the index—CDX IG 9—tracking these companies.

Mr. Iksil has done so much bullish trading that he has helped move the index, traders say. Now, even as Mr. Iksil is selling credit protection on the company index, a number of hedge funds and other investors are buying protection on it.

Some investors say they are betting that Mr. Iksil could have to exit some of his bullish trades, perhaps because the pending Volcker rule limiting bank risk-taking would push up the cost of credit protection. J.P. Morgan has said the Volcker rule doesn't prohibit its CIO unit from investing or hedging activities.

A sign of how hot the trade is: The net "notional" volume in the index ballooned to $144.6 billion on March 30 from $92.6 billion at the start of the year, according to Depository Trust & Clearing Corp. data.

Write to Gregory Zuckerman at gregory.zuckerman@wsj.com and Katy Burne at katy.burne@dowjones.com

Bloomberg

PrintBack to story

JPMorgan Trader's Positions Said to Distort Credit Indexes

By Stephanie Ruhle, Bradley Keoun and Mary Childs - Apr 6, 2012

A JPMorgan Chase & Co. (JPM) trader of derivatives linked to the financial health of corporations has amassed positions so large that he's driving price moves in the $10 trillion market, traders outside the firm said.

The trader is London-based Bruno Iksil, according to five counterparts at hedge funds and rival banks who requested anonymity because they're not authorized to discuss the transactions. He specializes in credit-derivative indexes, a market that during the past decade has overtaken corporate bonds to become the biggest forum for investors betting on the likelihood of company defaults.

Investors complain that Iksil's trades may be distorting prices, affecting bondholders who use the instruments to hedge hundreds of billions of dollars of fixed-income holdings. Analysts and economists also use the indexes to help gauge perceptions of risk in credit markets.

Though Iksil reveals little to other traders about his own positions, they say they've taken the opposite side of transactions and that his orders are the biggest they've encountered. Two hedge-fund traders said they have seen unusually large price swings when they were told by dealers that Iksil was in the market. At least some traders refer to Iksil as"the London whale," according to one person in the business.

Joe Evangelisti, a spokesman for New York-based JPMorgan, declined to comment on Iksil's specific transactions. Iksil didn't respond to phone messages and e-mails seeking comment.

Most-Active Index

The credit indexes are linked to the default risk on a group of at least 100 companies. The newest and most-active index of investment-grade credit rose the most in almost four months yesterday and climbed again today.

The Markit CDX North America Investment Grade Index of credit-default swaps Series 18 (IBOXUMAE) rose 3.3 basis points to 100.2 basis points as of 10:18 a.m. in New York, after jumping 4.4 basis points yesterday, according to Markit Group Ltd. The price of the index is quoted in yield spreads, which rise along with the perceived likelihood of increased corporate defaults.

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EXHIBIT #24b

A credit-default swap is a financial instrument that investors use to hedge against losses on corporate debt or to speculate on a company's creditworthiness.

Iksil may have "broken" some credit indexes -- Wall Street lingo for creating a disparity between the price of the index and the average price of credit-default swaps on the individual companies, the people said. The persistence of the price differential has frustrated some hedge funds that had bet the gap would close, the people said.

Close Supervision

Some traders have added positions in a bet that Iksil eventually will liquidate some holdings, moving prices in their favor, the people said.

Iksil, unlike JPMorgan traders who buy and sell securities on behalf of customers, works in the chief investment office. The unit is affiliated with the bank's treasury, helping to control market risks and investing excess funds, according to the lender's annual report.

"The chief investment office is responsible for managing and hedging the firm's foreign-exchange, interest-rate and other structural risks," Evangelisti said. It's "focused on managing the long-term structural assets and liabilities of the firm and is not focused on short-term profits."

Iksil probably traded under close supervision at JPMorgan, said Paul Miller, an analyst at FBR Capital Markets in Arlington, Virginia.

"The issue is how much capital they're putting at risk,"said Miller, a former examiner for the Federal Reserve Bank of Philadelphia.

Volcker Rule

A U.S. curb on proprietary trading at banks, meant to reduce the odds they'll make risky investments with their own capital, is supposed to take effect in July. Regulators are still determining how the so-called Volcker rule will make exceptions for instances where firms are hedging to curtail risk in their lending and trading businesses.

Wall Street banks including JPMorgan, Goldman Sachs Group Inc. and Morgan Stanley have submitted comment letters and met with regulators to discuss their complaints about the rule.

"Several agencies claiming jurisdiction over the Volcker rule have proposed regulations of mind-numbing complexity,"JPMorgan Chief Executive Officer Jamie Dimon said in his annualletter to shareholders released this week. "Even senior regulators now recognize that the current proposed rules are unworkable and will be impossible to implement."

Combined Revenue

JPMorgan had $4.14 billion of combined revenue last year from the chief investment office, treasury and private-equity investments, according to the annual report. The treasury and chief investment office held a combined $355.6 billion of investment securities as of December 2011, up 14 percent from a year earlier, according to a year-end earnings statement.

Chief Investment Officer Ina Drew, who runs the unit, was among JPMorgan's highest-paid executives in 2011, earning $14 million, a 6.8 percent pay cut from 2010, the bank said in a regulatory filing this week. Drew referred a request for comment to Evangelisti.

Iksil has earned about $100 million a year for the chief investment office in recent years, the Wall Street Journal said in an article following Bloomberg News's initial report, citing people familiar with the matter.

Iksil joined JPMorgan in 2005, according to his career-history record with the U.K. Financial Services Authority. He worked at the French investment bank Natixis (KN) from 1999 to 2003, according to data compiled by Bloomberg.

Trader's Position

The French-born trader commutes to London each week from Paris and works from home most Fridays, the Journal article said, citing a person who worked with him.

The trader may have built a $100 billion position in contracts on Series 9 (IBOXUG09) of the Markit CDX North America Investment Grade Index, according to the people, who said they based their estimates on the trades and price movements they witnessed as well as their understanding of the size and structure of the markets.

The positions, by the bank's calculations, amount to tens of billions of dollars and were built with the knowledge of Iksil's superiors, a person familiar with the firm's view said.

To contact the reporters on this story: Stephanie Ruhle in New York at sruhle2@bloomberg.net; Bradley Keoun in New York at bkeoun@bloomberg.net; Mary Childs in New York at mchilds5@bloomberg.net

To contact the editors responsible for this story: David Scheer at dscheer@bloomberg.net; Shannon D. Harrington at sharrington6@bloomberg.net

From: Hogan, John J. <John.J.Hogan@jpmorgan.com>
Sent: Tue, 10 Apr 2012 23:17:16 GMT
To: Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>
Subject: Re: Credit

Lovely

From: Braunstein, Douglas
Sent: Tuesday, April 10, 2012 07:14 PM
To: Hogan, John J.
Subject: Fw: Credit

A bit more than we thought

From: Drew, Ina
Sent: Tuesday, April 10, 2012 07:08 PM
To: Dimon, Jamie; Braunstein, Douglas; Wilmot, John; Zubrow, Barry L; Staley, Jes
Subject: Credit

The mtm loss is 412 mil today, an 8 standard deviation event mostly from the steeping of the 1g9 curve. SPECIFIC to our position. No other high grade or high yield index moved much clearly anticipating our liquidation.

I am in the office further reviewing the p l scenario with London and will send it on shortly.

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EXHIBIT #25

From: Wilmot, John <JOHN.WILMOT@jpmorgan.com>
Sent: Tue, 10 Apr 2012 22:50:48 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>; Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Drew, Ina <Ina.Drew@jpmorgan.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>
CC: Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Stephan, Keith <keith.stephan@jpmorgan.com>; Weiland, Peter <peter.weiland@jpmchase.com>
Subject: Net positions vs average trading volumes

CIO Net Positions in Selected Indices vs. 1m daily trading volume:

The below table shows that CDX.IG.9 net position for CIO is $82.2bio, which is approximately 10-15 days of 100% of trading volume based on the 1m avg volume published by JPMorgan Research. ITX.9 net position for CIO is $35bio, which is approximately 8-12 days of 100% trading volume based on the 1m avg volume. For on the run positions the numbers are much smaller, ranging from 0.25 days to 2 days volume in IG and HY, respectively.

cid:image008.png@01CD1696.F4E58380

John C. Wilmot | Chief Investment Office | john.wilmot@jpmorgan.com | Work: (212) 834-5452 | Cell: [redacted]

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	30 Mar 2012	1 Week ago	1m avg	LTM avg	[illegible]	[illegible]
ITRAXX EUROPE SERIES 17	23.9	28.2	25.1	25.1	6.013	0.24
CDX.NA.IG.18	23.6	37.5	30.6	30.6	15.791	0.52
CDX.NA.IG.17	8.3	35.8	17.7	18.9	11.4925	0.65
CDX.NA.IG.9	7	8.6	8.1	10.6	82.284	10.16
ITRAXX EUROPE CROSSOVER SERIES 17	6.9	8.4	7.6	7.6	0.09	0.01
ITRAXX EUROPE SERIES 16	6.8	28.7	16	18.8	12.6035	0.60
CDX.NA.HY.17	6.6	3.8	4.3	3.5	6.0705	1.68
CDX.NA.HY.18	6.3	0	6.3	6.3	0	-
ITRAXX EUROPE SENIOR FINANCIALS SERIES 17	6.1	6.3	6.2	6.2	0	-
ITRAXX EUROPE SERIES 9	5	5.1	4.3	5.5	35.818725	6.33

Source: JPMorgan Credit Derivative Indices Daily Trading Volumes 30 Mar 2012

From: Wong, Elwyn
To: Kirk, Mike
Sent: 5/18/2012 3:20:16 AM
Subject: RE: CIO call with Mike Brosnan

This is just a strategy and not an explanation. And this is Ina Drew speak before she was fired.

They took up a strategy to reduce their make believe voodoo magic "Composite Hedge" linearly to change in 5ryr - 10 yr fwd CDS spread.

I give them first prize for "consistency". But so what? Why were they right and as hindsight would have it, they were wrong.

From: Kirk, Mike
Sent: Thursday, May 17, 2012 6:20 PM
To: Wong, Elwyn
Subject: RE: CIO call with Mike Brosnan

That's the point!

The relationship obviously didn't hold, and I would be if we plotted the graph today the locations would be far from the diagonal…and I be if we had access to the data that the red portion is moving up and farther to the right with each passing day in April

From: Wong, Elwyn
Sent: Thursday, May 17, 2012 5:58 PM
To: Kirk, Mike; Crumlish, Fred; Hohl, James
Cc: Waterhouse, Scott
Subject: RE: CIO call with Mike Brosnan

I was not at the April 16 meeting. But let me venture to guess what it is trying to say.

[cid:image001.png@01CD3459.B17C27D0]

The y-axis is rolling 10 yr cds - rolling 5 yr cds. They had a few Bloomberg graphs showing how this rolled spread from being NEGATIVE in 2008 and 2009 (just like Greece and Italy) towards more normalization when it eventually returned to being positively sloped.

The x-axis is the Hedge Index Composite. I venture to guess this is the aggregate hedge that think they need to put on, related to the aggregate number on the extreme lower right hand side, the $158 .498 mil. They have a whole matrix of longs and shorts and that's the composite. As fear resided and rolling 10 yr minus rolling 5 yr returned to positive, they can reduce their total hedge. As Mike said, the REDS are which they are at now --- so their hedge is not that unreasonable, IF THE HEDGE AMOUNT DID HAVE THIS RELATIONSHIP TO THE SLOPE of 5yr to 10yr CDS

The sentence which is somewhat perplexing is "the relationship is bounded by the off-the-run HY shorts and the on-the-run IG shorts. Meaning that this is their core hedge?

[cid:image002.png@01CD3459.B17C27D0]

The whole scenario thing about convexity is talking their book/advertizing - in a panic situation, people will run to put protection in the short end and not the long end. So the curve FLATTENS again like in 2007. In other words, their hedge has analytical underpinning. Not only are they reducing their short risk hedge prudently according to the slope of the 5yr -10yr, as plotted on Bloomberg, the flattener would have been a safe bet because in case they were reducing their hedge too fast and the economy tanked against, the built in flattener would be there to help.

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From: Kirk, Mike
Sent: Thursday, May 17, 2012 4:51 PM
To: Crumlish, Fred; Hohl, James; Wong, Elwyn
Cc: Waterhouse, Scott
Subject: RE: CIO call with Mike Brosnan

Fred,

Happy to join you in your calls with Mike B.

In respect to your questions, in the order asked:

· The graph on page 7 shows the slippage of their portfolio compared to the hedge. The closer to the diagonal the more closely the hedge tracks the portfolio. The red highlighted area is recent period they were discussing where hedges were breaking down, and markets were not moving according to their modeled projections based upon historical correlations.

· To make the chart you would need two items. A targeted portfolio and a hedge portfolio. We could ask for this chart of the strategy prior to re working the hedge position to remove part of the hedge (why we were told they decided to sell IG with fallen angels). This request may be instructive and could settle the issue of whether the original portfolio was an effective hedge. P&L for previous 4 years, however, was fairly reasonable, so that would tend to support the banks statement that the hedge worked well for years. It went astray when they reduced the hedge.

· I think Matt Zames would likely have a different view of the choice of strategy with hindsight being a benefit. Position really went bad as shown in March/April, question is did the London desk continue selling in IG in April with the curve steepening and spreads widening and basis (to theoretical) trading rich. This is something we do not at this time know.

· You can give Mike B my cell phone number.

Please note Elwyn and James will likely have quality information to add so you may want to wait to hear from them before passing along.

Regards,
Mike

From: Crumlish, Fred
Sent: Thursday, May 17, 2012 4:22 PM
To: Kirk, Mike; Hohl, James; Wong, Elwyn
Cc: Waterhouse, Scott
Subject: CIO call with Mike Brosnan

Scott and I spoke to Mike Brosnan today about what we were doing now and going forward on the CIO book. We will likely have a call with him frequently, and, particularly with respect to the intricacies of the position, will need to include you.

A couple of things specific to the pre-April 16 interactions and some of the emails that are circulating:

- I told Mike B that the Joe Sabatini emails with selected position information were sent by the bank after initial OCC and FRB enquiries. We concluded that this information was pretty much useless, as it did not tell us what was happening risk wise. We also talked about a couple of those other emails, but I emphasized that the culmination was getting a meeting with Ina Drew and company on April 16.

- With respect to the April meeting, Mike B. is going through the "synthetic credit deck" and he had a few technical questions, not all of which I was able to fully answer since I didn't recall or had been focusing on other issues and didn't think of those questions. With respect to this presentation:

o Mikeand James: Please have a look at your notes for page 7 as I wasn't fully able to explain the graph on the bottom. Also if you have details on the scenario description on page 11, we should pass that along.

o It would be nice at some point if we could get a chart such as that on page 5 *before* the position was put on. Maybe we will request it, maybe not. Let's see if we need it after going through new reporting

o More to the point, I told Mike that the bank would likely not stand behind (aside from a statement that it was the best they knew at the time) this analysis at this point, as the position turned out to be far more problematic than presented and so the description of risk was missing.

o Mike Kirk - as usual, don't be surprised if Mike just calls you sometime.

- I told Mike that next Monday we will be going over current risk reporting and positions in more detail, as the reporting is evolving. He might want to speak with us shortly after. I'd expect to have Mike and Elwyn to help speak to technical details etc.

So, keep your notes current. All emails get circulated widely, and of course generate questions.

- apc

*** If you have received this message in error, please delete the original and all copies, and notify the sender immediately. Federal law prohibits the disclosure or other use of this information. ***

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EXHIBIT #28

Date	Distance	iTraxx	CDX.IG	CDX.HY	iTraxx.Main S9 10y	CDX.IG9 10y	CDX.HY
12-Mar-12	(202,543,647)	(59,050,049)	(90,077,977)	(53,415,621)	3.0	2.0	0.17
13-Mar-12	(206,639,426)	(61,372,979)	(89,698,506)	(54,687,653)	3.8	2.0	0.18
14-Mar-12	(268,984,074)	(82,396,799)	(130,202,780)	(58,279,879)	4.0	3.0	0.18
15-Mar-12	(292,470,549)	(83,045,952)	(181,254,945)	(37,635,855)	4.0	4.0	0.12
16-Mar-12	(498,717,231)	(100,525,860)	(158,706,386)	(107,356,237)	5.0	3.0	0.34
16-Mar-12	(432,348,435)	(130,119,511)	(143,345,094)	(107,356,237)	5.0	3.0	0.34

Distance YTD	iTraxx.Main S9 10y	CDX.IG9 10y
(426,488,692)	8.6	5.7
(430,584,471)	10.0	5.7
(492,929,119)	9.0	6.8
(516,415,593)	7.8	7.8
(722,662,276)	13.9	8.4
(656,293,479)	12.0	7.2

From: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>
Sent: Fri, 16 Mar 2012 18:12:42 GMT
o: Grout, Julien G <julien.g.grout@jpmchase.com>
Subject: FW: update on Core PNL

From: Iksil, Bruno M
Sent: 16 March 2012 17:34
To: Martin-Artajo, Javier X
Subject: update on Core PNL

The divergence has increased to 300 now ; the rescap news is pushing the tranches and HY indices against us.

I worked on the IG9 ans main S9 a bit today. There is some size. Not large. But if I trade 2 bps tighter, I reckon there will be size.

Tactical starts being impacted despite the trading gains. Small though. But the hits show anywhere but the spots I tried to correct.

It has been like this since the start of the year and the drift keeps going. I reckon we get to 400 difference very soon.

:uno

From: Drew, Ina <Ina.Drew@jpmorgan.com>
Sent: Fri, 23 Mar 2012 11:13:55 GMT
To: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
CC: Macris, Achilles O <achilles.o.macris@jpmorgan.com>
Subject: Re: Synthetic Book - URGENT

You guys need to get irv and call hogan and explain. I can give him a heads up. Smart to involve ashley. More later

---

From: Martin-Artajo, Javier X
Sent: Friday, March 23, 2012 06:48 AM
To: Drew, Ina
Cc: Macris, Achilles O
Subject: Synthetic Book - URGENT

Ina ,

during the last week we have been trying to work on our best path for the Synthetic Book trying both to reduce our overall RWAs and get the book in a balanced way . The problem with this has been that we have engaged in a dialogue with Risk Management(Ashley Bacon) , QR (Venkat) and the IB (Guy America and Daniel Pinto) and this has resulted in a hightened alert about our positions in the IB and is really hurting us in various ways .

While we have been reducing the VAR and SVAR we have increased our overall RWAs because of the increase of the IRC (New to CIO given the problems that we highlighted with QR) and also we have worse marks against our current book .

We are left here with two options :

Option A : We do not settle with the IB : we do not change the current book and exceed the RWA that is going to be in the region of 44-47 Bln (this has to be confirmed by QR next week) . This option will have a bad month end mark P/L impact 0 to -150-200 MM . This is our favoured choice that gives us time to correct mistakes with QR , positive carry and upside on defaults . We would still need to reduce RWA by reducing our IRC or joining the IB with reducing the CRM outside . So this will be a mark to market P/L problem and we are left with a book that has positive carry and upside on defaults .

Option B :we settle with the IB : we close the extra long position with the IB and we will have a book that is not as well balanced will have a short bias , will reduce RWA by 10-15 Bln and have an impact on P/L that could be as large as - 350 MM . This loss will be permanent and would leave the book with a small negative carry and option on defaluts but a permanent loss for the book .

In any case it is very important that we need to let the IB know that we need to talk to them to stop this negative espiral that we are seeing in the market because we have disclosed too much information to them and we are severily affected by this . Specifically on the long IG 9 position that is getting the attention of the market .

I need to discuss this as soon as posible

regards

Permanent Subcommittee on Investigations
EXHIBIT #30

From: ACHILLES <macris@[redacted]

▬▬ = Redacted by the Permanent Subcommittee on Investigations

Sent: Fri, 06 Apr 2012 20:29:53 GMT
To: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
CC: InaDrew <ina.drew@jpmorgan.com>
Subject: Re: Update

The issue remains; what is "fair value" for the IG9, as this will drive the marks.

As the IG9 is not "pure play" IG due to the risky HY names included, the regular IG participants are not likely to be supporting it. Therefore, relatively small selling (against single names etc) could drive the marks further.

In our case, we are ultimately secure on those risky names (as they are included in our HY short), however we must project what the possible negative marks may be resulting in P+L terms and what would be the exact market mechanism to stabilise the series absent an event.

From: Martin-Artajo, Javier X
Sent: Friday, April 06, 2012 07:59 PM
To: Drew, Ina
Subject: Update

Ina ,
I just had a conversation with Achilles and I would like to update you on two topics : one relates to compliance and another one relates to work I am doing on the book to estimate the worst case P/L for Q2 .

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Permanent Subcommittee on Investigations

In terms of the worse case scenario for us for Q2 I am redoing the work once again to make sure that if we exclude very adverse marks to our book the potential loss due to market moves or any economic scenario including defaults would not exceed a number higher than - 200 MM USD at the end of Q2 with the current book as it is . I will have all the numbers ready on Sunday afternoon NY time and send it to you as soon as I have them .

I will send this information and an update from compliance too on Sunday .

Best regards

Javier
This email is confidential and subject to important disclaimers and conditions including on offers for the purchase or sale of

March 16, 2012

Call #5601530708350439469,

Julien: Bruno? It's Julien. I'm at minus 4 with a lot of effort, plus 2 points. I can do better but...

Bruno: No, don't waste your time, it won't help. Check the new trades because I don't think.there are as many winning trades. I did some "coquilles" in the booking.

J. There's 500mln de F9 10Y. I think that's BNP

B. No, 500 mln, I applied at 143 I think.

J. At what level on the 5Y?

B. 93.

J. Oh yes, OK, that's much tighter, you have 9, 9.50, you lose a lot. [discussion] It's logical.

B. Yes, yes.

J. Do you know what you did with nealia?

B. I went ahead at 30.

J. In fact it's flat, with the Delta, it's flat.

B. Yes.

J. 250 mln of 5Y, what level?

B. 121 and something.

J. 121?

B. 100,000, yes, there's about a million there.

J. Yes. The big items, 450 of...

B. yes, you mark 5/8, right?

J. No, I was obliged to mark at 3/8.

B. So that makes...that will [...] a lot.

J. you projected at what level?

B. 3/4

J. Yes, that makes 1.7 mln, 1.6 mln.

B. This makes no sense. Is [ ] still there?

J. Yes, he's locked away. But he seems relaxed, I don't know what you told him just now. He said not to worry, not to worry.

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B. But there is no hope, these are contracts of "debils" (idiots). I'm in the middle of analysing something – at the end of the afternoon we did the book and it's much smaller than it is today, and if they had applied the RWA methodology that we are going to use, in fact this makes a huge difference.

J. Wait a second, can we send 2.1 on "tactico?"

B. Yes. [unintelligble – but I think he is saying something of the family of...I will take it up the as$]. 300 minimum, minimum.

J. Days like this are hard when you look at the basis that is narrowing...

B. No, there is no way, look at a class, we take 300 mln of new PnL

J. You did this today?

B. No, these are not real new trades, just exercise of options, there's a freakout, no one is able to explain what happened.

J. Did you speak to [...]

B. Yes, yes. He says nothing, I find that ridiculous. I'll send you the thing I sent.

J. You sent something to propose doing that?

B. Yes, that's what I sent when you said it was at 300. I can't keep this going, we do a one-off at the end of the month to remain calm. I think what he's expecting is a remarking at the end of the month, you can't do it unless it's monthend. It's clear that I'm the [ ]. He can't imagine a bank, a dealer, a hedge fund [unintelligible]. I don't know where he wants to stop, but it's getting idiotic. OK, go ahead with the commentary.

J. Yes, I agree. I think what he's expecting is some hope on the rolls.

B. No, but it's exactly that that he doesn't understand, he doesn't understand, there is no roll, there isn't, you see, that's all. And Monday we'll start with a $100 gap and end the week with a $300 gap. The market has done nothing, it's rallied.

J. And instead there has been movement on the [CLM] that could have justified some things.

B. No, I looked at that, it's not that clear. It's off by 50.

J. Where do you see the 50?

B. 30, 32.

J. That's before the marking.

B. Yesterday it was at 30 mid, today it's at 30 and a half mid, on the same quoter. Today it's almost normal. Once we get the feedback we need to ask what was the RWA now with your way of looking at the book at the beginning of the year, beginning of 2011 because in my opinion there is a huge mistake. The more I think about it, the more emotional I am, looking at

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the book in 2010, there was no reason to do work on the RWA at the time. When I see the DRE on the PnL, we had DRE on the PnL, there were aggressive movements on the book of the same type, but it was 3 times, maybe 4 times smaller. There's no use, it's ridiculous, it's ridiculous. I tried to call him but he didn't answer, I don't want to ruin his long weekend. Did you tell him that the difference was so high or not?

J. No, because it was before I did the estimates.

[unintelligible – difficult to understand]

B...Yes, but a marginal difference means we should have recouped ...now it's worse than before, I don't want to overstate it but it's worse than before, there's nothing that can be done. This is the first time I've ever seen this, there's nothing that can be done, absolutely nothing that can be done, there's no hope. There is no solution, the book continues to grow, more and more monstruous. Can you send me the prices of where you are? Send me the positions in advance so I can make my comments because I don't want to ruin my weekend on that. At this point we need to be lucid with the solutions. Someone is calling me...it's [ralia], ciao.

J.

03/16/2012 12:19:32 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok

03/16/2012 12:19:43 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i have the loss

03/16/2012 12:19:45 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
right?

03/16/2012 12:19:55 LUIS BURAYA, JPMORGAN CHASE BANK, says:
the new trade pnl is f*ck up because the prices are stupid, have a look into new trade tab

03/16/2012 12:20:01 LUIS BURAYA, JPMORGAN CHASE BANK, says:
th call 1300

03/16/2012 12:20:29 LUIS BURAYA, JPMORGAN CHASE BANK, says:
the FV should be 105.11, that it is where it is closed. I don't understand why they are still pricing it at 998.29

03/16/2012 12:21:06 LUIS BURAYA, JPMORGAN CHASE BANK, says:
same with the call 1350 and with the call 1160

03/16/2012 12:21:13 LUIS BURAYA, JPMORGAN CHASE BANK, says:
and 1320

03/16/2012 12:21:21 LUIS BURAYA, JPMORGAN CHASE BANK, says:
the FV should equal the price

03/16/2012 12:21:26 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
how and when does this clear?

03/16/2012 12:21:29 LUIS BURAYA, JPMORGAN CHASE BANK, says:
the ESDP is 1405.11

03/16/2012 12:21:39 LUIS BURAYA, JPMORGAN CHASE BANK, says:
the reported pnl is correct

03/16/2012 12:21:43 LUIS BURAYA, JPMORGAN CHASE BANK, says:
or should be

03/16/2012 12:23:26 LUIS BURAYA, JPMORGAN CHASE BANK, says:
do you follow me?

03/16/2012 12:35:25 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
SX5E vol going very bid into the close, very squeezy, outperforming the rest of europe by 30bps across the curve.

03/16/2012 12:36:46 LUIS BURAYA, JPMORGAN CHASE BANK, has left the room
03/16/2012 12:39:18 LUIS BURAYA, JPMORGAN CHASE BANK, has joined the room
03/16/2012 12:50:55 LUIS BURAYA, JPMORGAN CHASE BANK, has left the room
03/16/2012 12:54:30 LUIS BURAYA, JPMORGAN CHASE BANK, has joined the room
03/16/2012 12:57:46 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
Bruno : Tactical pnl 1st draft -7.3M USD

03/16/2012 12:58:07 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
block 4 -8.4M divs +1.8M

03/16/2012 12:59:37 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
block 4 detail : 71 eur +3.5M / 71 USD - 5M / 75 USD -7M / 74 + 76 +0.6M (atlas is +1.3M)

03/16/2012 12:59:49 LUIS BURAYA, JPMORGAN CHASE BANK, says:
Recovering from yesterday

03/16/2012 13:01:05 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
what do you want us to do Bruno ?

03/16/2012 13:06:48 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok

03/16/2012 13:06:59 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
is the atals pnl correct?

03/16/2012 13:07:22 LUIS BURAYA, JPMORGAN CHASE BANK, says:
Reported pnl should be correct

03/16/2012 13:07:26 LUIS BURAYA, JPMORGAN CHASE BANK, says:
However

03/16/2012 13:07:27 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
with the option expiry I cannot guarantee that

03/16/2012 13:07:34 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
so new trade is correct

03/16/2012 13:07:36 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
?

03/16/2012 13:07:43 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
my reported pnl is wrong in the strats where I have expiring options

03/16/2012 13:08:24 LUIS BURAYA, JPMORGAN CHASE BANK, says:
The options are misprice in atlas, I don;t know the situation in Scala.

03/16/2012 13:08:50 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
can you send me the positions eric?

03/16/2012 13:09:08 LUIS BURAYA, JPMORGAN CHASE BANK, says:
If there's pnl coming we will check if it is from those instruments

03/16/2012 13:09:46 LUIS BURAYA, JPMORGAN CHASE BANK, says:
The cash is supposed to correctly reflect the pnl

03/16/2012 13:09:54 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
positions and predict in your mailbox bruno

03/16/2012 13:10:07 LUIS BURAYA, JPMORGAN CHASE BANK, says:
The problem is as usual, the fair value concept

03/16/2012 13:11:45 LUIS BURAYA, JPMORGAN CHASE BANK, says:
Eric, what is the pnl in equities only? In the option rewport

03/16/2012 13:12:26 LUIS BURAYA, JPMORGAN CHASE BANK, says:
In MT

03/16/2012 13:12:27 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
thx eric

03/16/2012 13:12:30 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
let me see

03/16/2012 13:12:42 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
where is core pnl here?

03/16/2012 13:14:17 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
julien?

03/16/2012 13:16:23 JULIEN GROUT, JPMORGAN CHASE BANK, says:
yes

03/16/2012 13:16:32 JULIEN GROUT, JPMORGAN CHASE BANK, says:
306

03/16/2012 13:16:45 JULIEN GROUT, JPMORGAN CHASE BANK, says:
hy taking a beating today actually, esp in tranches

03/16/2012 13:16:49 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok

03/16/2012 13:17:20 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
so the pnl in tactical is doen wiht thos eprices that brings up 306 in core right?

03/16/2012 13:17:34 JULIEN GROUT, JPMORGAN CHASE BANK, says:
correct

03/16/2012 13:17:41 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok

03/16/2012 13:17:55 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i think u should set ig9 levels as follows

03/16/2012 13:18:03 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
5 yr at 72

03/16/2012 13:18:08 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
7yr at 88

03/16/2012 13:18:24 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
10 yr at 110

03/16/2012 13:18:53 JULIEN GROUT, JPMORGAN CHASE BANK, says:
well rite now i am 70.25 86.25 109.75

03/16/2012 13:19:00 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ref 88.75

03/16/2012 13:19:17 JULIEN GROUT, JPMORGAN CHASE BANK, says:
i will use your levels

03/16/2012 13:19:27 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i see ur levels

03/16/2012 13:19:34 JULIEN GROUT, JPMORGAN CHASE BANK, says:
ah ok

03/16/2012 13:19:37 JULIEN GROUT, JPMORGAN CHASE BANK, says:
one sec

03/16/2012 13:19:53 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
or u do the corrections ur self

03/16/2012 13:20:00 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i do not mmind

03/16/2012 13:20:04 LUIS BURAYA, JPMORGAN CHASE BANK, says:
Be back in 15mins

03/16/2012 13:34:10 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
sent an Email to javier anouncing this is more 300 now

03/16/2012 13:34:19 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
that was 100 Monday

03/16/2012 13:34:22 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
it is 300 now

03/16/2012 13:34:30 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
1000 for month end?

03/16/2012 13:35:08 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
ouch

03/16/2012 13:35:23 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
well that is the pace

03/16/2012 13:45:03 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
any update JUlien?

03/16/2012 13:47:57 JULIEN GROUT, JPMORGAN CHASE BANK, says:
still working on this, sorry it's taking time

03/16/2012 13:48:05 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
i am sorry too

03/16/2012 13:48:11 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
this is the end

03/16/2012 13:48:18 JULIEN GROUT, JPMORGAN CHASE BANK, says:
?

03/16/2012 13:48:18 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
hey hey

03/16/2012 13:48:24 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
no talk like that

03/16/2012 13:48:29 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
cheer up

03/16/2012 13:48:39 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
yes JP
will not lose a cent on this

03/16/2012 13:48:59 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
we'll see

03/16/2012 13:49:10 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
one day after the other

03/16/2012 13:49:20 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
like in 09

03/16/2012 13:49:42 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
no

03/16/2012 13:52:00 BRUNO IKSIL, JPMORGAN CHASE BANK, says:
ok call me when u have something ready

03/16/2012 13:53:34 JULIEN GROUT, JPMORGAN CHASE BANK, says:
will do

03/16/2012 13:53:40 JULIEN GROUT, JPMORGAN CHASE BANK, says:
sorry it's taking so long again.

03/16/2012 14:04:03 JULIEN GROUT, JPMORGAN CHASE BANK, says:
bruno 9m de new trade?

03/16/2012 14:04:38 JULIEN GROUT, JPMORGAN CHASE BANK, says:
currently -4m

03/16/2012 14:04:42 JULIEN GROUT, JPMORGAN CHASE BANK, says:
core

03/16/2012 14:06:21 ERIC DE SANGUES, JPMORGAN CHASE BANK, says:
tactical now +2.1M

03/16/2012 14:13:21 ERIC DE SANGUES, JPMORGAN CHASE BANK, has left the room
03/16/2012 14:55:50 LUIS BURAYA, JPMORGAN CHASE BANK, has left the room
03/16/2012 14:58:47 LUIS BURAYA, JPMORGAN CHASE BANK, has joined the room
03/16/2012 15:00:36 JULIEN GROUT, JPMORGAN CHASE BANK, has left the room
03/16/2012 15:17:02 JULIEN GROUT, JPMORGAN CHASE BANK, has joined the room

TRANSCRIPT OF AUDIO RECORDING PRODUCED TO THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Date: Undated (likely late April 2012) Telephone Call
Parties: Javier Martin-Artajo, Ina Drew, Gina Serpico
Identifier: JPMC Box 10\20120827_Audio Documents\20120827_PSI-A_WH\NATIVES\JPM-CIO-PSI-A 0000076.wav

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Mr. Martin-Artajo: JP Morgan.

Ms. Serpico: Yes, may I please speak to Javier?

Mr. Martin-Artajo: Yeah, it's me.

Ms. Serpico: Oh, hi! I don't recognize your voice. It's Gina. Can you hold for Ina,please?

Mr. Martin-Artajo: Sure.

Ms. Serpico: Thank you. [Speaking to Ina] It's Jav-

Ms. Drew: Hi.

Mr. Martin-Artajo: Hi, Ina.

Ms. Drew: Excuse me. Just so you know, I tried to call Achilles. You might want to let him know.

Mr. Martin-Artajo: Yeah.

Ms. Drew: I saw Hogan. I delivered the message on what we can and cannot deliver on limits this week or next. That we are doing an appropriate review, that there is a divergence between the single name system that's [Indecipherable.] the number and the index system, and he needs to take the pressure off in terms of penciling in a number quickly.

Mr. Martin-Artajo: Ok.

Ms. Drew: I think he's fine with that. And what we can pencil in, we will, but we don't have to do everything. And then I just wanted to get a really brief update on, you know, what the P&L might look like. It looked like the curve, the forward curve was flattening a little.

Mr. Martin-Artajo: Yes. We are going to be showing a slight positive today. I just want to confirm that with Bruno. I think we are going to be up like somewhere around $20 million today, ok? So this is the first, this is a big event for us, because we are starting to get money back. The guys are a little bit unsure, because we are not trading in the

Permanent Subcommittee on Investigations
EXHIBIT #32c

market. Maybe, maybe, maybe there's a little bit more money in the trade. I, I want them to just show me what they think is for sure, ok? So I think we are going to be up probably somewhere in the $20 million, ok? Somewhere around that.

Ms. Drew: That, that's on the curve?

Mr. Martin-Artajo: That's on the curve. It's a little bit on the curve. And, you know, if we mark the full, the full, I think, I think, to be honest with you Ina, we don't know where the market is trading, so really –

Ms. Drew: I understand.

Mr. Martin-Artajo: Because the bid/offer spread is a little bit wide, it's getting better every day so we are within the bid offer spread. Now, that means that probably the real P&L is probably like $50, but I'm going to show about half of that, ok? I just want to make sure that we don't, because I, I, I really want to make sure what we put in the P&L what we know for sure. And, so we are, but it is very important, because this is the first day that we are – If you forget about the idiosyncratic thing that happened yesterday in Rescap, I mean – this is a, this is a market that actually is starting to trade a little bit better for our position. It is slightly better. I'm not saying that this is going to be a fast process, but it, it is important that we start getting positive numbers now, right?

Ms. Drew: The curve that I put on, Manish put on the screen for me with Julien's help, that it was starting to, point upwards slightly.

Mr. Martin-Artajo: Yeah. Yeah, it is starting to get a little better. The only thing is I don't know how much it's trading and I don't want to, I, I, I don't want to show the P&L until these guys confirm. I mean we are normally quite conservative in that. And, and I, you know, you know, if, if, if the price gets outside the, the bid-offer spread, then we mark that, ok? So, so 3 bps as you know is 150 bucks.

Ms. Drew: Yeah.

Mr. Martin-Artajo: So the instruction to you that we have here is probably around $100 million, ok? So I don't want them to show $100 million today if they are not sure, ok? So, so just for you to know that, you know, it's about, you know, you know, if this is, you know, we need to have a real, sort of 3bps move to, to, to recognize that. I hope it happens and, if it happens between now and the end of the day or, or, whenever it happens, I'll show you. I'll let you know, ok? I'll send you an email when, if, if things are improving.

Ms. Drew: Here's my guidance. It's absolutely fine to stay conservative, but it would be helpful, if appropriate, to get, to start getting a little bit of that mark back.

Mr. Martin-Artajo: Exactly, I know.

Ms. Drew: If appropriate, so you know, an extra basis point you can tweak at whatever it is I'm trying to show, you know, with demonstrable data and if not, then the description is, you know, we have a conservative mark but the curve is starting to trend [Indecipherable.] –

Mr. Martin-Artajo: Ok, I will write that. I will write that. It's just that I don't want to do it until I'm sure, ok? Because I, I, I know that we need this. I know that we need the reversal, and it does help our case enormously, right? It starts to give us a little bit of credibility that I've lost by, by explaining this in, in, in such a bad way, really.

Ms. Drew: Ok. But are you ok?

Mr. Martin-Artajo: I'm ok. I'm ok. Thank you very much for - I thought that today's meeting was very good, Ina. I, I really felt that, that we had a good meeting, today. I think that –

Ms. Drew: Get our arms around everything, and we will, you know, go forward, but sometimes you gotta, like, look back to go forward.

Mr. Martin-Artajo: Yeah. Yeah, I mean we've shown a lot of our mistakes today. I think that, I think that, you know, I think this post mortem is, is actually a, a realistic one. I, I, I, you know, I think that we've, we've made quite a lot of mistakes. I think that we communicated poorly internally. You know, I think we also forgotten how, how, how difficult it was, you know the positions that we've made given everything, right? Given, given, you know, year end. Given how fast things have happened in Europe. How, how, you know, I, I, I, I'd like to go to New York after, you know, in a week or two or three to, to, to just, you know, maybe, maybe we can sit down. Because I feel, you know, we have cathartic things here that maybe heal some of the things that maybe were not as good in the past. And, and, you know, things like this, it's like the twin towers falling down and suddenly we get, you know, we remember, how privileged this thing is and –

Ms. Drew: Ok, I've got it. I'm just reaching out to mostly tell you about the limits and get the P&L, and I'm going to L&C and I will look, look out for the email later.

Mr. Martin-Artajo: Thank you, Ina. Thank you.

Ms. Drew: Call if you need me. Bye.

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May 8, 2012

Javier Martin-Artajo and Alistair Webster Conversation

Javier: Hi Alistair

Alistair: Hey how are you?

Javier: I'm good man, tell me

Alistair: I have a very quick question for you. Apologies for pestering you on this.

Javier: Yeah, no no that's absolutely fine. Tell me..

Alistair: So I have, we've obviously been through a lot of detail on sort of pricing moves and how we got to where we got to at each position level.

Javier: Yeah.

Alistair: But there's just one sort of trend that I'm being asked for a sort of sense of how we think it happened from a trend perspective.

Javier: Right

Alistair: And that is if we look at the 18. You remember our famous population of 18?

Javier: The 18? What is the 18?

Alistair: The 18 positions that we reviewed with Doug.

Javier: Yeah.

Alistair: So if I look at those back in January, the front office marks were all either mid or somewhere close to mid.

Javier: Right.

Alistair: That..

Javier: In terms of conservative and aggressive. That's what you're asking?

Alistair: Well, it's subtly different, subtly different.

Javier: Okay.

Draft Likel

Permanent Subcommittee on Investigations
EXHIBIT #32d

May 8, 2012

Alistair: But they were, none of them were actually at the boundaries of the bid or offer.

Javier: Right.

A: So then when, if we roll forward to March, if the front office marks had migrated, not all of them, to the aggressive side, most of them, not all of them, to the aggressive side, but they've also migrated from either mid to somewhere close to being at the, you know, the bounds of the bid or offer.

J: Yeah, but I think that's because we were trading there. I think that's because we were trading them, quite heavily.

A: Um hmm. In March..?

J: Yeah, in March we were not trading as, I mean, we traded as I mean, to be honest with you, we traded a lot in March and we traded a lot in January. We didn't trade as much in February right? I mean, that that's kind of how it went for us. We traded a lot in January and we traded a lot in the middle of...towards the, I think, the peak of the trading was like the 20-23rd of March. That's when we traded a lot. So we were on one side of the market obviously because that's what we were doing.

A: But would that be, if you were trading would you, you would be on the conservative side of the market as opposed to the the aggressive side, right?

J: If you're trading, I don't understand your question.

A: I think that..

J: I mean are you saying that we had a trend at the end of the month to mark a little bit towards more one side of bid offer as opposed to the trend that we had at the beginning of the year. That's what you're saying right?

A: Yeah, cause before the beginning of the year you guys...

J: Okay two things. One is that at the end of March we really traded a lot and second, that, I don't think the traders have that bias to be honest with you. I don't think so. I mean, listen, you can have any interpretation you want, but,...

A: Agreed.

J: I don't think so. I do not think that they were, let's not forget that we stopped trading at the 28th of March, cause Ina just wanted us to stop trading, so maybe the last three days, I mean, if you're asking about the last three days we traded less. I don't think they changed the way they mark their books to be honest with you. I don't think that's what I would say happened.

A: Um hmm.

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J: What I would say happened is that the most surprising thing to me that, and I told you before and I will tell you again Redacted Attorney Client Privilege

A: Um hmm.

J: The thing that I experienced that was incredibly strange to us, right, is not only that you're telling us about about mid offer spread, but we were actually finding very surprising is a move between the actual marks that we mark the book at the end of the month okay...

A: Um hmm.

J: and what we got from Markit and Totem three days later, okay.

A: Um hmm.

J: That is an incredibly surprising thing to me and to the traders. How much that difference was. So what my conspiracy theory is telling me is that there's information between when we close our books at the end of March and where they agreed where the market was three days later.

A: Um hmm.

J: That is very very difficult for me to explain and, to be honest with you, I still don't know, I mean I still don't know why that happened. I'm still looking into it and I will never give up until I find out what happened there. My guess is that they were already, Bloomberg and Wall Street Journal were already writing their story so so their story was ready then. I think they were ready to publish it. I think they only needed to confirm a few things and they just delayed it for one week. So I think that information was already in the dealers and the hedge funds to be honest with you. that is a big move for me, and when we look at the actual move of that and we look at how the difference of our book marks at the end of the month, and when I look at the IB marks at the end of the month that they gave us, and I look at Totem marks, what surprised me incredibly was the same amount that the IB would have priced our book at was actually the price that at which Totem would have marked it. Now, I think that is very very very interesting to look at that and compare to the quotes that we had from JPMorgan at the end of of March.

A: Um hmm.

J: and that is an amazingly, interesting thing for you as an auditor and as an accountant. I'd love you to help me with that once this is a little bit less critical, because...

A: Okay

J: I do not know, I don't understand how can it be that the quotes we get form our own IB and from the market that we trade on on the end of the month and during the day of the end of the month, which, you see the history of that ...

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A: Um hmm.

J: You..then, you see what happened when the Totem numbers were published.

A: Um hmm.

J: This is an amazing thing for me and not only that, what is amazing to me is that the actual IB marks agree with Totem marks which is even more surprising to me, so this is what I would say is more than where the traders mark their book which I would like to, you know, I don't think they have a bias. I still don't think they have a bias now. I do think that on April 30th, I think you're going to see the same thing. I think, I mean Ashley was saying the same thing as your're telling me.

A: In April it would revert back to the norm in the sense that there's some mid, some, somewhere between bid and offer, and that there's two...

J: I know you're saying that, but let me tell you what Ashley told me. He says that we are not. He told me that I should be even more conservative than that, so, there's lots of opinions on this.

A: Oh no, I have to agree with that...

J: This is an OTC market. We trade in the markets. We have an interpretation. We are changing it into what you guys are guiding us that we should do and we're going to do it. I mean I will do what the Firm wants me to do. I just, you're asking me if I think that the traders had a change in the way they marked their books. I don't think so. To be honest with you, we traded less at the end of March, the very last three days of March, but, we were very alert on what the close would be because it was very material for us since we had been losing a lot of money that week. And the books experienced a very large drawdown that week. So obviously these guys were looking at the markets, you know, even more attention than ever. On Friday as you can see, the market was very volatile and also that explains quite a lot of things if you look at the spreadsheet I sent you.

A: Um hmm.

J: But I wouldn't say that we were aggressive or particularly aggressive in March. I wouldn't say that. I would say that it it was very difficult to mark books even though we didn't trade as much then and I don't think that. I don't feel that, I was aggressive to be honest with you. Doug's asked me that three times already.

A: Um hmm.

J: You're asking me twice, umm.

A: No no I'm not, I'm not.

J: And Ashley is already asking me. Ashley is asking me the same thing. Look, first of all, I wasn't aware that this was going to be an issue because I wasn't, I mean I don't, I don't, you know, mark books. You know we have a lot of valuation processes that you know very well.

May 8, 2012
A: Um hmm.

J: and you know, we contribute to the marking of the books. As you know, we do the estimates and the best estimates that we can. Today we still have issues because today, I was just before this meeting, trying to explain, you know again, you know, how we did it for last week. So it's not exactly like we are yet with a firm way to explain this. Unfortunately, it's difficult to to get to the right methodology. We differ from the IB--we trade at different times we have different different markets and, I know that the firm wants us to have one standard but you know that I think it's difficult to agree with that because you know I was still I'm still doing this in parallel to see what it means for our book, and I think we're going to get a lot of volatility if we do that so I think it's better if we actually get some tolerance which is lower and we try to price everything in ICE or Markit everyday. And then the tranches do what the guys are doing, which is give the best estimate based on the quote, so at least we align the indexes with ICE and or Markit. And I'd like to do that-- more than aligning that to the IB quotes. I really think that having the IB quotes is a problem and I don't want to be, you know, dealing with that. I think that the IB has a different business model and they are buyers on certain things and they don't trade quite a lot of the things that we own, so I think Markit or ICE is the reference we should use, or close to that, and then, you know, without interpretation of the traders, so no interpretation on that and then we do what we can on the tranches. I think this would remove some of the bias I think that you are referring to.

A: Um hmm, the possible bias, the possible bias.

J: I don't think there was a bias to be honest.

A: Understood.

J: Is that what you wanted from this call?

A: No, I mean, to be honest with you, I mean you you can interpret it any which way you want to and I'm not here to accuse you or anything like that. It was more, just a sort of, someone will ask that, you know, cause obviously we've documented everything you've done and you know we've been through the process, position by position, and well, they say, well they did this on that one and what they did with this on that one. I was just trying to catch if there was some sort of general trend you know and essentially what you articulate is look, you know, less trading at the end of the month, you know potentially the information is already out there so the banks are starting to move against us and there's volatility in the market.

J: That is basically what I am saying.

A: So that was very helpful.

J: Ok, you're welcome.

A: As always, Javier, I'm not certainly not trying to, you know, be an accuser. I'm just trying to get to a grip with everything. I'm just a simple guy.

May 8, 2012

J: Ok.

A: But I do certainly appreciate all the time and effort that you've put into helping me and you know...

J: I have to say the same Alistair. I, you have to understand, that I get probably, I'm getting between 100 and 150 calls a day. I don't know how many does Jamie Dimon get, but I am sure I get more, but, I'm the only one here, ok, thank you, man.

A: That's why I say I'm grateful...

J: Alrighty.

A: for the time. Thanks a lot.

J: Cheers.

From: Grout, Julien G <julien.g.grout@jpmchase.com>
Sent: Tue, 10 Apr 2012 19:02:01 GMT
o: CIO ESTIMATED P&L <CIO_CREDIT_P&L@jpmchase.com>
CC: CIO P&L Team <CIO_P&L_Team@jpmchase.com>
Subject: CIO Core Credit P&L Predict [10 Apr]: -$5,711k (dly) -$626,834k (ytd)

Daily P&L: -$5,710,991
YTD P&L: -$626,833,772

	Daily P&L($)	YTD P&L($)
Europe Financials	-15,447,416	-70,109,112

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Europe High Grade	-72,418,493	-83,026,416

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US High Grade	-310,657,048	-178,547,277

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US HY & LCDX	410,592,536	281,987,487

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US ABX / TABX	-774	-26,312

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Permanent Subcommittee on Investigations

New Investments	6,522,635	-529,210,342

Redacted by the
Permanent Subcommittee on Investigations

Dead Books (Core)	-337	1,790

Redacted by the
Permanent Subcommittee on Investigations

Washbook/Costs	0	0
		0

Redacted by the
Permanent Subcommittee on Investigations

Redacted by the Permanent Subcommittee on Investigations

Big moves in credit index today. US credit had already taken a hit following Friday's poor NFP report. Today's sell off was amplified by further concerns in the European complex, with Spain (+21bp at 488bp) and Italy (+20bp at 438bp) leading the way wider. This is pushing financials and iTraxx.Main too, and credit is actually compressing in Europe, thus despite the worsening of the economic situation there. This compression is causing a 70M loss today. The loss however is partially compensated by decompression in US credit, with the CDX.HY complex underperforming.

Today saw a significant bear steepening in off the run CDX.IG9 and iTraxx.Main S9 index curves: for instance iTraxx.Main S9 jun18 is underperforming the on the run benchmark index by +3bp while the front end iTraxx.Main S9 Jun13 is outperforming by -2bp . It is difficult to find a catalyst for these moves - one would have expected some flattening in those; despite the substantial move in spreads (and in credit volatility in general) and some flattening seen in single name curves, the front end of these curves is still outperforming. Note that the moves happened in small volumes - if any, in iTraxx.Main S9.

No trade today.

	10-Apr-12	04-Apr-12	03-Apr-12	02-Apr-12	02-Apr-12	30-Mar-12
raxx.Main S17 Jun17						
iTraxx.Main S9 Jun18						
5/10 S9						
5y S9						
iTraxx.Xover S17						
OTE 5y CDS						
PORTEL 5y CDS						
BESPL 5y CDS						
DXNS 5y CDS						
CDX.IG18 Jun17						
CDX.IG9 Dec17						
IG9 5/10						
5y IG9						
RDN 5y CDS						
MBI 5y CDS						
FON 5y CDS						
SFI 5y CDS						
HY10						
HY11						
HY14						
HY15						
HY16						
HY18						
ESCAP 5y CDS						

Redacted By Permanent Subcommittee on Investigations

Again, a lot of prices are still being framed and we are providing our best estimate

From: Grout, Julien G <julien.g.grout@jpmchase.com>
Sent: Tue, 10 Apr 2012 20:30:42 GMT
To: CIO ESTIMATED P&L <CIO_CREDIT_P&L@jpmchase.com>
CC: CIO P&L Team <CIO_P&L_Team@jpmchase.com>
Subject: CIO Core Credit P&L Predict [10 Apr]: -$394,735k (dly) -$1,015,858k (ytd)

Daily P&L: -$394,735,120
YTD P&L: -$1,015,857,902

	Daily P&L($)	YTD P&L($)
Europe Financials	-15,444,894	-70,106,589

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Europe High Grade	-189,451,352	-200,059,275

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US High Grade	-449,375,200	-317,265,429

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US HY & LCDX	346,055,097	217,450,048

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US ABX / TABX	-774	-26,312

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New Investments	-62,215,559	-597,948,537

Redacted By

Permanent Subcommittee on Investigations

Dead Books (Core)	-343	1,784

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Washbook/Costs	0	0

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Big moves in credit index over the long week end. US credit had already taken a hit following Friday's poor NFP report. Today's sell off was amplified by further concerns in the European complex, with Spain (+21bp at 488bp) and Italy (+20bp at 438bp) leading the way wider. This is pushing financials and iTraxx.Main too, and credit is actually compressing in Europe (iTraxx.Xover outperforming by -9bp), thus despite the worsening of the economic situation there. This compression, along the directional moves in the index, is causing a 80M loss today. In the US the compression is less obvious, although CDX.HY has been outperforming equities.

Today saw a significant bear steepening in off the run CDX.IG9 and iTraxx.Main S9 index curves: for instance iTraxx.Main S9 Jun18 is +15.75bp wider while the on the run benchmark index S17 is +12bp and the front end iTraxx.Main S9 Jun13 is only +7.25bp, thus a steepening +8.5bp; similarly CDX.IG9 Jun17 is marked +12bp wider while the on the run CDX.IG18 is +9bp and the front end CDX.IG9 Dec12 is only +6bp, thus a +6bp steepening. It is difficult to find a catalyst for these moves - one would have expected some flattening in these curves; despite the substantial move in spreads (and in credit volatility in general) and some flattening seen in single name curves, the front end of these curves is still outperforming. Note that the moves happened in small volumes - if any, in iTraxx.Main S9. These moves are causing a loss of 160M in CDX.IG and 140M in iTraxx.Main.

-) trade today.

	10-Apr-12	04-Apr-12	03-Apr-12	02-Apr-12	02-Apr-12	30-Mar-12
iTraxx.Main S17 Jun17						
iTraxx.Main S9 Jun18						
5/10 S9						
5y S9						
iTraxx.Xover S17						
OTE 5y CDS						
PORTEL 5y CDS						
BESPL 5y CDS						
DXNS 5y CDS						
CDX.IG18 Jun17						
CDX.IG9 Dec17						
IG9 5/10						
5y IG9						
RDN 5y CDS						
MBI 5y CDS						
FON 5y CDS						
SFI 5y CDS						
HY10						
HY11						
HY14						
HY15						
HY16						
HY18						

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Permanent Subcommittee on Investigations

RESCAP 5y CDS

ain, a lot of prices are still being framed and we are providing our best estimate

From: Hughes, Jason LDN <Jason.LDN.Hughes@jpmorgan.com>
Sent: Fri, 20 Apr 2012 19:07:35 GMT
To: Kastl, Edward R <kastl_edward@jpmorgan.com>
Subject: RE: Credit Index and Tranche Book

Exactly. Marked within bid offer except for the positions where you see an adjustment

Instrument	Tolerance
ITRAXX MN S09 10Y 22-100	5 bps
CDX HY S10 05Y 15-25	0.5 price points
CDX HY S11 05Y 15-25	0.5 price points
CDX IG S09 10Y 00-03	1.5bps
CDX HY S08 05Y 10-15	1 price points
CDX IG S09 05Y 00-03	1bps
ITRAXX MN S09 07Y 22-100	0.75 bps
ITRAXX MN S09 07Y	6bps
CDX HY S10 07Y 10-15	1.5 price points
ITRAXX MN S09 10Y 00-03	0.75 bps
CDX IG S09 10Y 30-100	0.5 bps
CDX HY S11 05Y 10-15	2 price points
CDX IG S09 07Y 30-100	0bps.75
ITRAXX MN S16 05Y	2bps
ITRAXX MN S09 05Y 00-03	0.5 bps
CDX LCDX S10 05Y 12-15	1 price points
CDX HY S11 07Y	0.5 price points
CDX LCDX S10 05Y 15-100	0.5 price points
CDX HY S08 07Y 15-25	2 price points

Regards,

Jason Hughes
CIO Europe
020 7777 3301

From: Kastl, Edward R
Sent: 20 April 2012 19:52
To: Hughes, Jason LDN
Cc: Wilmot, John
Subject: RE: Credit Index and Tranche Book

When you say "most advantageous" you mean within Bid/Offer tolerances, correct? Only the $17mm at the bottom would be outside of tolerance and that is where we posted an adjustment.

Generally speaking, what are the tolerances for these 19 positions?

Ed

From: Hughes, Jason LDN

Permanent Subcommittee on Investigations
EXHIBIT #34a

Sent: Friday, April 20, 2012 2:41 PM
To: Kastl, Edward R
Subject: Credit Index and Tranche Book

Ed, At March month end the CIO FO marked their book at the most advantageous levels based on the positions they held in specific indices and tranches. CIO VCG price tested the positions initially mid versus mid and that resulted in the following adjustments

Global	Differences (Ccy)	Differences ($)
S4 FIN SUB	-18,443,604	-24,560,425
S6_EU	-4,268,031	-5,683,523
S12_EU	0	0
S14_EU	-27,536,181	-36,668,556
S6_US	3,466,609	3,466,609
S18_US	-80,183,976	-80,183,976
S11B_US	2,223,732	2,223,732
S11C_US	5,371,007	5,371,007
S15B	26,090,038	26,090,038
S15C	9,122,647	9,122,647
S15D	-37,088,552	-37,088,552
S9_US	0	0
S27A_US	5,178,854	5,178,854
S27B_EU	-2,285,717	-3,043,776
S27C_US	-61,254,250	-61,254,250
S27D_US	5,492,713	5,492,713
Core Credit Total	**-174,114,711**	**-191,537,457**
Tactical 14_EU	0	0
Tactical 32_EU	-89,449	-119,115
Tactical 70_EU	-19,890	-26,487
Tactical 70_USD	-7,689	-7,689
Tactical 71_EU	-1,067,544	-1,421,595
Tactical 71_USD	0	0
Tactical 75_USD	0	0
Tactical Total	**-1,184,572**	**-1,574,886**
Credit Total	**-175,299,284**	**-193,112,343**

However, based on our normal practice we then applied market derived thresholds to each of the individual positions. If a position was within tolerance then no adjustment was required and if a position was outside tolerance an adjustment was passed to bring it back within tolerance. After applying these tolerances the adjustment became

Global	Differences (Ccy)	Differences ($)
S4 FIN SUB	-2,757,552	-3,672,094
S6_EU	-987,157	-1,314,547
S12_EU	0	0
S14_EU	-2,920,748	-3,889,415
S6_US	2,218,438	2,218,438
S18_US	0	0
S11B_US	0	0
S11C_US	0	0
S15B	0	0

S15C	0	0
S15D	0	0
S9_US	0	0
S27A_US	0	0
S27B_EU	-6,028,625	-8,028,018
S27C_US	0	0
S27D_US	0	0
Core Credit Total	**-10,475,644**	**-14,685,636**
Tactical 14_EU	0	0
Tactical 32_EU	-89,449	-119,115
Tactical 70_EU	-505,906	-673,690
Tactical 70_USD	-7,689	-7,689
Tactical 71_EU	-1,067,544	-1,421,595
Tactical 71_USD	0	0
Tactical 75_USD	0	0
Tactical Total	**-1,670,588**	**-2,222,089**
Credit Total	**-12,146,232**	**-16,907,725**

The difference between the 2 numbers highlights the size of the positions CIO hold and the difference that can result from marking within a normal market bid/offer spread.

Liquidity Reserve

Our policy has been to exclude Series 9 of the ITAXX and CDX IG based on the liquidity of these series as they are still very liquid for the correlation markets. The following table shows the changes we have been able to make to our positions in these indices and tranches during 2012 (Positions are in local currency)

	Dec-31	Jan-31	Feb-29	Mar-31
ITRAXX MN S09 05Y	25,376,375,000	19,682,625,000	13,748,375,000	17,304,875,000
ITRAXX MN S09 05Y 00-03	-2,480,000,000	-2,595,000,000	-2,615,000,000	-2,950,000,000
ITRAXX MN S09 05Y 03-06	35,000,000	-5,000,000	-300,000,000	-360,000,000
ITRAXX MN S09 05Y 06-09	-15,000,000	280,000,000	340,000,000	340,000,000
ITRAXX MN S09 05Y 09-12	25,000,000	165,000,000	280,000,000	280,000,000
ITRAXX MN S09 05Y 12-22	-1,075,000,000	-375,000,000	-175,000,000	-125,000,000
ITRAXX MN S09 05Y 22-100	7,300,000,000	11,300,000,000	7,500,000,000	7,100,000,000
ITRAXX MN S09 07Y	3,855,000,000	3,837,000,000	4,353,250,000	5,016,250,000
ITRAXX MN S09 07Y 00-03	-480,000,000	-480,000,000	-490,000,000	-590,000,000
ITRAXX MN S09 07Y 03-06	-10,000,000	-10,000,000	-140,000,000	-160,000,000
ITRAXX MN S09 07Y 06-09	10,000,000	-25,000,000	-25,000,000	-25,000,000
ITRAXX MN S09 07Y 09-12	230,000,000	180,000,000	180,000,000	180,000,000
ITRAXX MN S09 07Y 12-22	-950,000,000	-750,000,000	-450,000,000	-450,000,000
ITRAXX MN S09 07Y 22-100	6,575,000,000	6,675,000,000	9,975,000,000	10,950,000,000
ITRAXX MN S09 10Y	7,892,750,000	10,573,750,000	10,339,750,000	12,957,600,000
ITRAXX MN S09 10Y 00-03	1,425,000,000	1,415,000,000	1,445,000,000	1,270,000,000
ITRAXX MN S09 10Y 03-06	-220,000,000	-100,000,000	-140,000,000	5,000,000
ITRAXX MN S09 10Y 06-09	160,000,000	270,000,000	270,000,000	380,000,000
ITRAXX MN S09 10Y 09-12	-30,000,000	235,000,000	235,000,000	235,000,000
ITRAXX MN S09 10Y 12-22	-1,015,000,000	-495,000,000	180,000,000	155,000,000
ITRAXX MN S09 10Y 22-100	5,100,000,000	7,775,000,000	12,070,000,000	15,810,000,000
CDX IG S09 05Y	-30,569,500,000	-40,103,500,000	-49,563,000,000	-32,722,500,000
CDX IG S09 05Y 00-03	-2,580,000,000	-2,725,000,000	-2,995,000,000	-3,570,000,000

CDX IG S09 05Y 03-07	-1,090,000,000	-1,355,000,000	-1,395,000,000	-1,395,000,000
CDX IG S09 05Y 07-10	-1,435,000,000	-2,045,000,000	-2,045,000,000	-2,045,000,000
CDX IG S09 05Y 10-15	-2,905,000,000	-2,905,000,000	-2,905,000,000	-2,905,000,000
CDX IG S09 05Y 15-30	-12,215,000,000	-12,215,000,000	-12,215,000,000	-12,215,000,000
CDX IG S09 05Y 30-100	-270,000,000	-270,000,000	-270,000,000	-270,000,000
CDX IG S09 07Y	30,253,500,005	28,885,000,005	33,546,000,005	33,847,000,005
CDX IG S09 07Y 00-03	-705,000,000	-555,000,000	-370,000,000	-405,000,000
CDX IG S09 07Y 03-07	165,000,000	165,000,000	-190,000,000	-215,000,000
CDX IG S09 07Y 07-10	-345,000,000	-345,000,000	-410,000,000	-365,000,000
CDX IG S09 07Y 10-15	-925,000,000	-1,195,000,000	-1,820,000,000	-1,970,000,000
CDX IG S09 07Y 15-30	-4,940,000,000	-5,340,000,000	-6,290,000,000	-6,965,000,000
CDX IG S09 07Y 30-100	10,380,000,000	10,980,000,000	10,780,000,000	11,430,000,000
CDX IG S09 10Y	37,219,500,000	54,764,500,000	67,790,500,000	80,343,500,000
CDX IG S09 10Y 00-03	3,300,000,000	3,290,000,000	3,370,000,000	2,805,000,000
CDX IG S09 10Y 03-07	-20,000,000	60,000,000	-120,000,000	60,000,000
CDX IG S09 10Y 07-10	155,000,000	345,000,000	265,000,000	775,000,000
CDX IG S09 10Y 10-15	-785,000,000	-1,730,000,000	-1,900,000,000	-1,980,000,000
CDX IG S09 10Y 15-30	-1,345,000,000	-2,075,000,000	-2,750,000,000	-3,800,000,000
CDX IG S09 10Y 30-100	11,975,000,000	16,625,000,000	15,875,000,000	16,725,000,000

These moves only show the changes month on month and do not show the significant volumes we have been able to trade intr-month.

Regards,

Jason Hughes
CIO Europe
020 7777 3301

From: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>
Sent: Fri, 20 Apr 2012 10:27:58 GMT
'o: Bates, Paul T <paul.t.bates@jpmchase.com>
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

---

thx Paul. We can address that partly because it is possible here that BofA and MS are not in line with other market participants.

From: Bates, Paul T
Sent: 20 April 2012 11:23
To: Iksil, Bruno M
Cc: Grout, Julien G; Martin-Artajo, Javier X; O'neill, Rory H; Hughes, Jason LDN
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

Hi Bruno,

The file we were sent only had the top 15 trade breaks with either BOA or MS in it. They were not complete trade lists therefore I do not know the complete valuation difference with each of these Cp's.

Here are the two summary pivots based on the trades we were given:

BOA:

MS:

As you can see the bigger differences are on the Itraxx S9 22% - 100%.

have attached the files with these pivots so you can drill down to look at the underlying .rades.

If you need more details please let me know.

`anks

Paul

-----Original Message-----
From: Iksil, Bruno M
Sent: 20 April 2012 11:00
To: Bates, Paul T
Cc: Grout, Julien G; Martin-Artajo, Javier X
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

thx Paul. Could you help us "decipher" in plain words what we should look at and come back to you on the issues raised here?

-----Original Message-----
From: Bates, Paul T
Sent: 20 April 2012 10:58
To: Grout, Julien G; Iksil, Bruno M
Cc: O'neill, Rory H; Coombes, Hema S; Hughes, Jason LDN
Subject: FW: URGENT ::: Huge Difference for iTraxx & CDX trades

Here are the detailed files we were sent from the collateral guys.

---Original Message-----
From: Hughes, Jason LDN
Sent: 20 April 2012 10:31
To: O'neill, Rory H
Cc: Enfield, Keith; Bates, Paul T; Coombes, Hema S
Subject: FW: URGENT ::: Huge Difference for iTraxx & CDX trades

Rory, Can you liase with Julien on this

Regards,

Jason Hughes
CIO Europe
020 7777 3301

-----Original Message-----
From: Iksil, Bruno M
Sent: 20 April 2012 10:30
To: Hughes, Jason LDN
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

I would like to know the detail of the instruments and the counterparties claiming this. Please `form Julien and Javier about this.

-----Original Message-----
From: Hughes, Jason LDN

Sent: 20 April 2012 10:13
To: Iksil, Bruno M; Grout, Julien G
bject: FW: URGENT ::: Huge Difference for iTraxx & CDX trades

Bruno/Julien, We've had some queries from the collateral group around some of our tranche marks. Major query seems to be on Itraxx Series 9 10year 22-100 tranche. I've had a quick look at some data and my thoughts are shown in the mail below and just wondered if there was anything else you wanted to add (or if I got anything wrong) of if you had any further evidence for the prices.

I'm working from home today but happy to speak on phone if required

Regards,

Jason Hughes
CIO Europe
020 7777 3301

-----Original Message-----
From: Hughes, Jason LDN
Sent: 20 April 2012 09:51
To: O'neill, Rory H; Bates, Paul T; Green, James E; CIO EMEA MO; CIO P&L Team
Cc: Coombes, Hema S; Enfield, Keith
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

I've quickly looked into ITRAXX Series 9 10year 22-100 tranche which seems to form the majority of e issues in both files.

AS of 30th March 2012 for this tranche CIO were marked at 33 versus an independent price of 34.75. Considering that the bid offer seen in the market is anything between 3 and 6 bps we considered the position to be marked within tolerance and therefore at fair value. For the same date Dataquery (JPM data but independent of CIO) shows a level of 35.

For 18th April, the date that these files refer to, CIO is marked at 45.75 Dataquery has a price of 48. Even using the tolerances we applied at last month end (which are now probably too tight) we would still fall within tolerance and so from my perspective we still look to be well marked.

It is probably worth confirming with Bruno/Julian but I'm sure with all the sensitivity around the book they are going to be very sure of all their marks.

Any questions let me know

Regards,

Jason Hughes
CIO Europe
020 7777 3301

-----Original Message-----
om: O'neill, Rory H
ent: 20 April 2012 09:23
To: O'neill, Rory H; Hughes, Jason LDN; Bates, Paul T; Green, James E; CIO EMEA MO; CIO P&L Team
Cc: Coombes, Hema S; Enfield, Keith

Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

'oth files attached)

-----Original Message-----
From: O'neill, Rory H
Sent: 20 April 2012 09:14
To: Hughes, Jason LDN; Bates, Paul T; Green, James E; CIO EMEA MO; CIO P&L Team
Cc: Coombes, Hema S; Enfield, Keith
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

-----Original Message-----
From: Hughes, Jason LDN
Sent: 20 April 2012 08:59
To: Bates, Paul T; O'neill, Rory H; Green, James E; CIO EMEA MO; CIO P&L Team
Cc: Coombes, Hema S; Enfield, Keith
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

Paul, Valuations were OK as of March month end. I can't do an intra-month valuation as we don't get sufficient market data especially around tranche positions

Regards,

'son Hughes
_IO Europe
020 7777 3301

-----Original Message-----
From: Bates, Paul T
Sent: 20 April 2012 08:46
To: Hughes, Jason LDN; O'neill, Rory H; Green, James E; CIO EMEA MO; CIO P&L Team
Cc: Coombes, Hema S; Enfield, Keith
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

Rory, Can you and James check all the trades are ok and they are getting the correct MTM fed down. Have they sent us the full population? Do we know the size of the difference?

Jason, Can you look in detail at these valuation differences and check that you are happy with our current marks on these instruments.

Thanks

Paul

-----Original Message-----
From: Hughes, Jason LDN
nt: 20 April 2012 08:27
.o: O'neill, Rory H; Green, James E; CIO EMEA MO; CIO P&L Team
Cc: Bates, Paul T; Coombes, Hema S
Subject: RE: URGENT ::: Huge Difference for iTraxx & CDX trades

Rory, Assuming you meant end of March and not April. There were differences between the desk and ׳e independent marks at month end. The desk marked the book at the boundary of the bid/offer ˏpread depending on whether the position was long or short. We then applied a tolerance to make sure the prices were within tolerance and the majority of positions were. We had a small number of positions where they fell outside these tolerances and hence the adjustment that was passed. With the volatility seen around month end and the size of our positions even small price differences would be expected.

Regards,

Jason Hughes
CIO Europe
020 7777 3301

-----Original Message-----
From: O'neill, Rory H
Sent: 20 April 2012 06:22
To: Green, James E; CIO EMEA MO; CIO P&L Team; Hughes, Jason LDN
Cc: Bates, Paul T; Coombes, Hema S
Subject: Re: URGENT ::: Huge Difference for iTraxx & CDX trades

Jason,

Can you confirm the 30Apr VCG result on these instruments? Do we have any known discrepancies with the mkt?

ıanks,
Rory
------Original Message------
From: Vaz, Daniel X
To: Green, James E
To: CIO EMEA MO
To: CIO P&L Team
Cc: IBOD Collateral Project Team
Cc: Miller, Charles R
Cc: Demo, Mark
Cc: Daryanani, Nilam I
Subject: URGENT ::: Huge Difference for iTraxx & CDX trades
Sent: 20 Apr 2012 01:43

Hi James, CIO,

Can you please validate the marks for the CDS trades booked with ref entity as iTraxx Europe s9 22%-100% or CDX.NA.IG.8 30%-100%? We are seeing huge differences in these trades when we compare our marks with CP marks. I took a sample of 15 trades from MSCS & BOA portfolio with greater MTM differences. Can you please investigate & advice why we would have such huge differences at a trade level which is impacting our margin calls?

CP
tal portfolio diff
ɜmple trade count
Comments
Internal Collateral tracking number

MSCS
USD 36.2 MM
15
All trades are booked with ref entity as iTraxx Europe s9 22%-100% cart=351950 BOA USD 46 MM
15
Trades are booked with ref entity as iTraxx Europe s9 22%-100% or
CDX.NA.IG.8 30%-100%
·t=351952

Daniel Vaz | Team Leader | Collateral & Derivatives Confirms | Investment Bank | J.P. Morgan | T: +912261260408 | daniel.x.vaz@jpmorgan.com | jpmorgan.com | JPMC Internal use only

From: Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>
Sent: Fri, 20 Apr 2012 15:31:33 GMT
To: Hogan, John J. <John.J.Hogan@jpmorgan.com>
Subject: Re: Collateral Disputes

Is this the first time this has happened

From: Hogan, John J.
Sent: Friday, April 20, 2012 11:24 AM
To: Braunstein, Douglas
Subject: Fw: Collateral Disputes

This isn't a good sign on our valuation process on the Tranche book in CIO. I'm going to dig further.

From: Goldman, Irvin J
Sent: Friday, April 20, 2012 11:21 AM
To: Hogan, John J.
Subject: FW: Collateral Disputes

-----Original Message-----
From: Lewis, Phil
Sent: Friday, April 20, 2012 11:20 AM Eastern Standard Time
To: Goldman, Irvin J; Weiland, Peter
Cc: Kastl, Edward R; Bates, Paul T
Subject: RE: Collateral Disputes

Yes we are – we have collateral disputes from a number of counterparties (obviously on positions that aren't novated to ICE, so the tranches and ICE ineligible indices). Biggest are with MS and GS. First we heard of these was this morning (collateral process is done at a Legal entity level – when differences become big enough they reach out to MO & VCG). MO are checking all bookings and flows, with the desk and VCG (Jason Hughes/Ed Kastl) are checking marks. We are also trying to get some granularity by product

I'll forward you a note from the collateral guys.

This table shows differences by cpty and the Gross Absolute PV across all outstanding trades with each cpty

CP	Sum of ABS (Local)	Sum of MTM_DIFF	%
BBVASA	856,948	-141,471	-17%
BNPP	1,427,575,108	17,698,254	1%
BOA	3,135,860,802	72,455,626	2%
BPLC	1,078,123,886	-427,385	0%
CA	28,737,306	2,032,294	7%
CGML	49,019,323	-667,742	-1%
CITI	4,417,744,863	60,630,170	1%
CSI	421,675,999	27,289,077	6%
CSX	474,311,803	15,227,896	3%
DBKAG	3,080,139,893	56,005,118	2%
GSI	4,701,978,454	89,576,979	2%

HSBCEU	100,908,403	121,569	0%
HSBCUS	35,801,766	6,027,808	17%
MLI	6,244,692	-156,884	-3%
MSCS	4,124,528,028	114,910,670	3%
MSIL	222,395,628	1,724,699	1%
NOMURAIP	258,811,944	-2,974,037	-1%
RBSPLC	81,168,415	-2,667,779	-3%
SGCIB	3,004,157,922	16,658,449	1%
UBSAG	2,576,649,497	46,660,667	2%
Grand Total	29,226,690,681	519,983,977	2%

From: Goldman, Irvin J
Sent: Friday, April 20, 2012 11:00 AM
To: Lewis, Phil
Subject: FW: Collateral Disputes

Please let me know.

-----Original Message-----
From: Hogan, John J.
Sent: Friday, April 20, 2012 10:22 AM Eastern Standard Time
To: Goldman, Irvin J; Weiland, Peter
Subject: Collateral Disputes

Are you having any in the tranche (or index) positions?

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Attorney Client Work Product
May 10, 2012

Table of Contents

This memo summarizes the Firm's review of the valuation of its CIO EMEA credit portfolio in light of the current market conditions and dislocation that occurred in April 2012.

I. Background

The CIO EMEA credit portfolio is made up of Investment and Core Credit portfolios[1]. The Investment portfolio consists of available-for-sale investment securities, while the Core Credit Portfolio primarily consists of synthetic credit positions -- credit derivative positions on various credit indices and tranches of those indices (the index and tranche credit derivatives portfolio). These synthetic positions were entered into to manage the market value deterioration in a potential stress scenario associated with investment securities held in the available-for-sale portfolio; the positions have changed over time depending on the Firm's view of credit risk.

CIO has a substantial presence in the financial markets, and the breadth and depth of its activity has generally given CIO a good sense of the market, with strong market contacts and market intelligence. In particular in these credit products, CIO executed a significant volume in the market and therefore had deep access to market pricing and color.

During January, February and through the first few weeks of March, CIO was buying, to add to existing positions, the risk of (i.e. selling credit protection) the following indices and tranches to reduce the short high yield credit risk position in the portfolio:

- CDX Investment Grade North America Series 9, 10 year and 7 year.
- ITraxx Main Series 9, 10 year and 7 year.

In addition, on April 6, the business press began reporting on certain of these positions, providing other market participants with some level of information regarding the Firm's positions and activity.

[1] CIO also has a North America credit portfolio, but that portfolio does not include synthetic credit positions and therefore is not subject to this review.

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May 10, 2012

In April[1], market activity and market prices for these credit derivatives changed significantly and a number of unusual trends were observed, including:

- The difference between cost of protection on investment grade indices and high yield indices in Europe and North America reduced significantly.
- The difference between cost of protection on short dated risk and long dated risk in a number of indices increased significantly. For a number of indices the cost of protection on the index moved inconsistently with the prices of protection on various tranches of the index. For example, for the iTRaxx Main Series 9 10 year during April:
  - Spread moves for the index itself implied some increase in losses due to increased correlation within the index.
  - Price moves in the super senior tranche implied losses due to very much larger increases in correlation within the index.
  - Price moves in the more junior tranches implied limited increases in correlation.

[1]These trends began to emerge in late March, but developed and became much more significant in April.

These changes have been unusual compared to the historical relationship between investment grade and high yield indices, as well as the relationship between index and tranche exposures. Due to the complexity and the size of the Firm's positions, the effect of these changes, in conjunction with other market factors, on the estimated fair value of the Firm's positions has been significantly negative during April. As noted throughout this memo, relatively small variations in price can have a relatively large impact on the estimated fair value of the entire portfolio, given the size of the Firm's positions.

Size of Position Data

The following table provides the absolute notional amounts (in USD) of these positions at various dates.

Table 1: Notional amount of CIO positions

Notional ($)	31-Dec-11	21-Jan-12	28-Feb-12	30-Mar-12	19-Apr-12
ITRAXX MN	63,877,901,370	76,235,846,930	97,848,010,020	118,982,003,490	118,505,911,681
CDX IG	(15,328,527,939)	(8,446,686,524)	6,220,451,026	54,767,087,520	56,054,146,920
CDX HY	8,123,572,169	4,810,808,419	(1,016,924,933)	(7,739,557,433)	(7,557,874,933)
ITRAXX XO	(5,207,601,000)	(4,371,339,000)	(7,017,111,000)	(8,869,960,500)	(8,736,465,500)
ITRAXX FINSUB	(2,324,580,000)	(2,191,630,000)	(3,079,320,000)	(2,112,040,000)	(2,080,280,000)
CDX LCDX	1,856,414,686	1,626,651,611	1,796,888,575	1,796,888,575	1,796,888,575
ITRAXX FINSEN		(79,910,000)	(140,700,000)	73,150,000	100,706,250
SOVX WE				46,665,000	46,665,000
Total	50,997,179,286	67,783,741,435	94,611,293,688	156,944,227,652	158,129,707,994

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Table 2: CIO's share of market volume

The following table compares the absolute notional amount of CIO's transactions in selected indices and to the absolute notional of street-wide transactions, in order to provide a sense of the relative size of CIO's activity in the market for the first four months of 2012. This data, as well as similar data from 2011, demonstrates two key points: 1) prior to late March 2012, CIO was a substantial participant in these credit markets, and 2) even without CIO's involvement (throughout these periods and in April after CIO substantially reduced its activity), the remaining street volume was substantial.

ITRAXX SERIES 9 7Y

Month	CIO Notional Traded	Street Volume	CIO %
Jan-12	$ 993,000,000	$ 6,181,250,000	16%
Feb-12	4,751,750,000	9,754,250,000	49%
Mar-12	775,000,000	8,325,375,000	9%
Apr-12	487,500,000	5,004,150,000	10%
Total	$ 7,007,250,000	$ 29,265,025,000	

ITRAXX EUROPE SERIES 9 10Y

Month	CIO Notional Traded	Street Volume	CIO %
Jan-12	$ 11,769,250,000	$ 26,758,710,300	44%
Feb-12	7,244,900,000	15,205,250,000	48%
Mar-12	6,601,250,000	13,806,250,000	48%
Apr-12	338,750,000	5,570,925,000	6%
Total	$ 25,954,150,000	$ 61,341,135,300	

ITRAXX EUROPE SERIES 16 5Y

Month	CIO Notional Traded	Street Volume	CIO %
Jan-12	$ 26,440,500,000	$ 206,771,511,713	13%
Feb-12	36,359,500,000	216,991,196,801	17%
Mar-12	26,075,000,000	199,058,170,509	13%
Apr-12	25,000,000	13,785,754,578	0%
Total	$ 88,900,000,000	$ 636,606,633,601	

CDX.NA.IG.9 7Y

Month	CIO Notional Traded	Street Volume	CIO %
Jan-12	$ 7,091,500,000	$ 55,936,345,841	13%
Feb-12	8,387,000,000	48,791,460,000	17%
Mar-12	2,017,000,000	41,738,540,328	5%
Apr-12	256,000,000	23,310,200,000	1%
Total	$ 17,751,500,000	$ 169,776,546,169	

CDX.NA.IG.9 10Y

Month	CIO Notional Traded	Street Volume	CIO %
Jan-12	$ 28,528,000,000	$ 83,065,700,000	34%
Feb-12	20,032,000,000	48,049,133,456	42%
Mar-12	9,819,500,000	72,016,977,456	14%
Apr-12	677,000,000	31,722,783,000	2%
Total	$ 59,056,500,000	$ 234,854,573,912	

Note: April data extends to April 26, 2012.

Given the size of the Firm's portfolio and the nature of the positions, the portfolio is sensitive to small changes in credit spreads. At March 31, 2012, the sensitivity to a 1 basis point move in credit spreads across the investment grade and high yield spectrum was approximately ($84) million, including ($134) million from long risk positions, offset by $50 million from short risk positions.

II. JPMorgan Chase Fair Value Measurement Policy

General

Fair value is the price to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability (an exit price). The sale or transfer assumes an orderly transaction between market participants.

Data Sources and Adjustments

Valuation techniques used to measure the fair value of an asset or liability maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources. Valuations consider current market conditions and available market information and will, therefore, represent a market-based, not firm-specific, measurement.

Where available, quoted market prices are the principal reference point for establishing fair value. Market quotations may come from a variety of sources, but emphasis is given to executable quotes and actual market transactions (over indicative or similar non-binding price quotes). In certain circumstances valuation adjustments (such as liquidity adjustments) may be necessary to ensure that financial instruments are recorded at fair value.

Bid – offer spread and position size

As further described in US GAAP Accounting Standards Codification Topic 820 Fair Value Measurement ("ASC 820"'), the objective of a fair value measurement is to arrive at an appropriate exit price within the bid – offer spread, and ASC 820 notes that mid-market pricing may (but is not required to) be used as a practical expedient.

> 820-10-35-36C "If an asset or a liability measured at fair value has a bid price and an ask price (for example, an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorized within the fair value hierarchy (that is, Level 1, 2, or 3). The use of bid prices for asset positions and ask prices for liability positions is permitted but is not required."
>
> 820-10-35-36D "This Topic does not preclude the use of mid-market pricing or

other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread."

Effective Q1 2012, size-based adjustments are explicitly not allowed for cash instruments held by a firm. However, US GAAP continues to permit size-based adjustments for derivatives portfolios if an election is made to do so. Under its current business and risk management strategy, the Firm has not made such a portfolio election for this CIO portfolio, and so evaluates the value of its positions without specific consideration of their overall size.

Cut-off and Timing

US GAAP is not prescriptive regarding market close and timing of valuation. As an operational matter, the Firm allows desks in different regions to mark their books as of the close in that region, and requires that these cut-off practices be applied consistently.

III. CIO Valuation Process

Background

CIO's valuation process reflects how and to whom CIO would exit positions by typically seeking price quotes from the dealers with whom CIO would most frequently transact and with whom CIO would seek to exit positions, rather than looking for more broad based consensus pricing from a wide variety of dealers not active in these credit markets. In that regard, CIO's valuation process is consistent with that of a non-dealer investor/manager.

CIO necessarily uses judgment to identify the point within the bid-offer spread that best represents the level at which CIO reasonably believes it could exit its positions, considering available broker quotes, market liquidity, recent price volatility and other factors.

As noted below, CIO's evaluation of valuation adjustments has been based on market liquidity for the positions, rather than on the absolute size of CIO's positions. In the normal course of business, CIO will continue to review its valuation practices in light of its current risk management and exit strategies to ensure its valuation practices continue to represent CIO's estimate of exit price.

Front Office Mark Process

The main source of information for pricing comes from the Bloomberg messages (pricing runs distributed by the dealers). Where available the desk collects them for all indices and tranches.

Then depending on the product and availability of information the following processes are followed:

- For index products:
  - "On the run" indices (i.e. most recent series, 5y point): as these are the most liquid instruments, the front office typically uses the dealer runs.
  - "Off the run" indices: Front office looks at bid-offer spreads, volumes, recent price changes and recent transaction data, and the front office mark is established at an appropriate price within the bid-offer.
- For tranche products:
  - For liquid tranches: front office computes the best-bid/best-ask using the dealers' runs - the tranche is then marked using the mid of this 'best' market.
  - For illiquid tranches: front office looks at bid-offer spreads, volumes, recent price changes, relevant index prices, and recent transaction data, and the front office mark is established at an appropriate price within the bid-offer.

Timing of Valuation

CIO's valuation policy, consistent with the Firm's policy, is to value its positions as of the close of business in the relevant region. Although the broker quotes CIO receives are generally consistent with that timing, other data sources may provide data using different timing, as follows:

Source	Timing
Broker quotes	As received
Markit/Totem – NA indices and tranches	New York close
Markit/Totem – EMEA indices and tranches	London close
ICE – NA indices	30 minutes before New York close
ICE – EMEA indices	30 minutes before London close

VCG Independent Process

VCG independently price tests the front office marks at each month end and determines necessary adjustments to arrive at fair value for the purposes of the US GAAP books and records. The remainder of this section describes this process.

A. Pricing data sources
   CIO VCG obtains prices from third parties as follows:
   - Markit/Totem[2] – an independent service that provides prices for a wide range of products derived from the inputs provided by a number of financial institutions.

[2] Markit and Totem are within the same group. Markit provides data the credit derivative indices, while Totem provides data for the tranche risk of those indices.

- Dealer Quotes – Prices from major broker dealers for specific indices and tranches of those indices.
- VCG must approve the sources for all market prices and other parameters as being reliable and applicable.

CIO VCG also looks to actual prices at which CIO has executed recent transactions as an additional source of market information.

The following is a list of the dealers CIO VCG obtains quotes from on a regular basis for indices and tranches in which they have a reasonable level of activity:

- Citi
- Deutsche Bank
- Credit Suisse
- HSBC
- Goldman Sachs
- JPMorgan (IB)
- Royal Bank of Scotland
- Barclays
- Morgan Stanley
- BNP Paribas
- Nomura
- BofA/Merrill Lynch

These dealer quotations are received from a standing solicitation for price estimates for index and tranche positions. The number of dealer quotes received in any particular month generally ranges from 1-4, and is based primarily on which dealers choose to provide quotes that period.

B. Deriving the best estimate of mid-market price (VCG mid-market price) for price testing purposes

Indices:

- For the more liquid indices, typically the on the run indices, VCG utilizes Markit as its primary source for the CIO VCG mid-market price. VCG will also look to broker quotes, but generally finds there to be limited differences to Markit data.
- For the less liquid indices, CIO VCG again uses Markit data as the primary source of independent data. However, given the reduced liquidity of these indices dealer quotes sourced by the front office are also used. Differences between the Markit data and the broker quotes are investigated, for example by reviewing actual levels of trading activity. The CIO VCG mid-market price is determined using the combination of the Markit data, broker quotes and actual trades executed by CIO.

Tranches:

- CIO VCG uses broker quotes as the primary source of data for determining the CIO VCG mid market prices for the tranches positions. CIO VCG also obtains consensus prices from Totem from the Investment Bank[3] (JPM IB). However, CIO VCG uses the

[3] The Investment Bank obtains these as it contributes as a dealer to the Totem consensus prices.

broker quotes, with less reliance on TOTEM data, due to the Firm's experience that the tranches tend to be less liquid than the indices and for any given position, only 2-3 dealers tend to be active in that tranche. Therefore, CIO VCG believes that the broker quote process is appropriately focused on the more active dealers for those tranches. This emphasis on broker quotes also reflects CIO's likely exit strategy, which is more likely to be with specific dealers active in these tranches. Where there are significant differences between broker quotes and TOTEM, CIO VCG will investigate the reasons for such differences, for example, by looking at the levels at which CIO has actually executed transactions, to validate the integrity of the broker quotes received.

C. Estimating the range of fair value utilizing price testing thresholds
- Price testing thresholds are commonly used in valuation to account for reasonable degrees of variance between valuation data obtained from different sources.
- These thresholds are generally established to represent normal bid-offer spreads for each product, with the goal of ensuring that the final mark used by the Firm is within the range of bid-offer spread after applying these thresholds.
- Price testing thresholds may be determined on a variety of bases (e.g., volatility of parameter, market depth and liquidity and pricing service spreads).
- CIO VCG is responsible for establishing the price testing thresholds used. The tolerance thresholds were consistent from 12/31/11 to 3/31/12.

D. Determining a book price
- The CIO VCG mid-market price plus/minus the price testing threshold set by CIO VCG per instrument (the VCG valuation range) is compared to the front office mark. If the front office mark is outside the VCG valuation range, the position mark is adjusted to the outer boundary of the range. Within the VCG valuation range front office marks may be used without adjustment.
- Irrespective of threshold levels, any difference between front office mark and the mid-market price may be adjusted, at CIO VCG's discretion.
- CIO VCG has not historically adjusted front office marks directly to Markit/Totem spreads/prices for the less liquid indices and tranches because:
    - Given its level of activity in the market, CIO has large amounts of specific transaction data that should be considered in determining fair value.
    - CIO has observed that broker quotes are indicative prices that are relevant to the valuation process, in addition to the consensus prices provided by Markit/Totem.
        - Based on CIO experience, CIO believes that the broker quotes received better reflect executable prices, and therefore represent

important market data that should be given priority where available.
- CIO's experience is that not all dealers participating in the Totem process are active in the relevant products and that obtaining direct dealer quotes from the more active dealers for a particular product may better reflect executable prices.

- Markit/Totem prices are based on quotes by market makers acting in that capacity. CIO, like other non-dealer investors/managers, is not a market-maker and it does not contribute to the Markit/Totem service. Furthermore, in the case of Totem the resulting data is accessible only to market makers who contribute to that service.
- CIO has observed that the business valuation cut-off time may differ from the data provided by Markit/Totem. The combination of intra-day price moves on the last day of the month and the difference between the time when Markit/Totem fixes and the time when CIO closes its books can result in pricing differences that while small from a price perspective, could be significant for such a large portfolio.

- As additional analysis, CIO estimated that as of March 31, 2012, the sum total of the differences between the front office marks and the CIO VCG mid market estimates was $512 million before adjustment to the boundary of the VCG valuation range (considering price testing thresholds) and $495 million after adjustment.

E. Apply necessary valuation adjustments

- CIO applies valuation adjustments as appropriate for positions deemed to be less liquid. Generally, any on the run index (typically, the four most recent series) and associated tranches have been viewed to be liquid based on market activity, and appropriate front office and CIO VCG judgment. In addition, other indices and tranches continued to have sufficient market activity to be deemed liquid as of March 31, 2012 (for example, ITRAXX Main Series 9 indices and the CDX IG Series 9 indices).
- As of March 31, CIO recorded liquidity valuation adjustments of $188 million for the following:
  - High yield - series 11 and prior indices and tranches.
  - Investment grade - series 12 and prior, excluding series 9 index.
    - CIO believes that the investment grade Series 9 index has generally traded similar to on the run positions because it is viewed as a market benchmark by investors.
- The liquidity adjustments for the series 9 tranches (both high yield and investment grade) were recorded as of March 31, 2012 to reflect the decline in market liquidity

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by the end of the first quarter. The incremental liquidity reserve of $155 million for series 9 investment grade tranches was applied for the first time at March 31 as a result of this decline in market activity.

- The liquidity reserve was calculated using CIO's standard liquidity reserve methodology and using spread volatility provided by JPM IB. This volatility varies by position in the capital structure, and is highest for equity tranches and lowest for super senior tranches: = [CS01] x square root [holding period] x [spread volatility
  - CS01 is the credit spread sensitivity to a 1 bps change in market spreads relative to position size
  - Holding period – JPM IB suggested max 120 days was used
  - Spread volatility – provided by JPM IB; varies by position in the capital structure, and is highest for equity tranches and lowest for super senior tranches.
- As of March 31 a liquidity valuation adjustment was not recorded for the CDX North America Investment Grade and Itraxx Main Series 9 indices as each was viewed to be liquid. As noted in Table 2 above, trading volume in the Series 9 index continued to be relatively robust, including through April, without CIO activity in the market, and the volume of market activity excluding CIO has been substantial.
- Details of all adjustments taken to arrive at the fair value for US GAAP books and records are included in Appendix A.

F. Comparison to Industry Practice

The Firm believes that its valuation practices in CIO are consistent with industry practices for other non-dealer investors/managers. CIO, like other non-dealer investors/managers, relies more heavily on transaction-level data available through its own market activity, and its valuation process reflects its exit market and the participants in that market. In the normal course, the Firm evaluates its own business and risk management practices, and makes appropriate refinements to reflect its best estimates of fair value.

G. Review of CIO Q1 pricing information

- CIO analyzed its pricing data as compared to other available market sources and the results are included in Appendix B.
- As of the January, February and March month ends CIO compared its front office marks and final US GAAP book price for reasonableness to a combination of the Markit/Totem data, broker quotes and actual transaction data around the month end date.
- There was evidence that actual transactions and broker quotes diverged from Markit/Totem prices in some cases.
- CIO book marks on individual positions were generally within the bid offer spread.

- As additional analysis, CIO estimated the aggregate difference in the front office marks and the CIO VCG mid-market estimates. This difference ($512 million), less the price testing threshold adjustment of $17mm and less the liquidity reserve of $188mm, was approximately $307 million as of March 31, 2012, compared to the gross value of derivative receivables and payables of approximately $8 billion.

IV. Conclusions

- CIO believes that its marks as of March 31, 2012 represents CIO's estimate of its exit price as of that date.
- In the context of its gross marks (approximately $8 billion of derivative receivables and $8 billion of derivative payables across CIO's portfolio), intra-day price volatility, and CIO's transaction data, CIO believes that it has made reasonable judgments regarding the prices within in the bid-offer spread that best represent CIO's exit price.
- The CIO valuation process is documented and consistently followed period to period.
- Market-based information and actual traded prices serve as the basis for the determination of fair value.
- CIO's book value, including the valuation adjustments, at March 31 2012 for the index and tranche credit derivatives portfolio is within the range of reasonable fair values for such instruments.

We have shared this memo with PricewaterhouseCoopers; they concur with the conclusions reached herein.

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Appendix A – March 31, 2012 Position Marks

The following table provides the notional amount and fair values of the Firm's positions as of March 31, 2012, including the following: $17 mm tolerance level adjustments, $33 mm liquidity adjustment, and $155 incremental liquidity adjustment.

(Note: subsequent CIO analysis noted that the required tolerance adjustment should have been $12 million, but the following schedule provides detail of the original $17 million estimate.)

					VCG Adjustments			
	Instrument	Sum of Abs Notl	Sum of Factored Notional	Sum of MTM USD	Threshold	Liquidity	Incremental Liquidity	Total
	ABX HE 6.1 A	184,655,854	0	(0)				(0)
	ABX HE 6.1 AAA	64,627,195	0	0				0
	ABX HE 6.2 AAA	28,036,361	0	(0)				(0)
	ABX HE 6.2 BBB	6,075,000	200,000	184,727				184,727
	ABX HE 6.2 BBB-	39,325,000	(11,975,000)	(11,047,091)				(11,047,091)
	ABX HE 7.1 A	47,742,773	(0)	0				0
	ABX HE 7.1 AAA	334,760,632	0	(0)				(0)
	ABX HE 7.1 BBB 35-100	6,346,154	6,346,154	6,120,712				6,120,712
	ABX HE 7.1 BBB- 40-100	43,958,337	43,125,003	41,691,525				41,691,525
	CDX HY S07 07Y	294,000,000	0	(952)				(952)
	CDX HY S07 07Y 15-25	620,000,000	0	25,494,831				25,494,831
	CDX HY S07 07Y 25-35	140,000,000	0	610,410				610,410
	CDX HY S07 07Y 35-100	754,123,080	0	6,280,655				6,280,655
	CDX HY S08 05Y	24,279,864,000	(15,509,624,000)	61,182,958		(1,392,677)		59,790,281
1	CDX HY S08 05Y 10-15	895,275,000	812,235,000	83,829,224		(73,307)		83,755,917
	CDX HY S08 05Y 15-25	4,660,000,000	1,410,000,000	(11,351,307)		(134,009)		(11,485,316)
	CDX HY S08 05Y 25-35	2,853,000,000	(653,900,000)	10,182,581		(57,879)		10,124,702
	CDX HY S08 05Y 35-100	13,159,563,876	94,469,231	9,154,335		(8,254)		9,146,081
	CDX HY S08 07Y	5,796,420,000	179,760,000	(151,048)		(153,457)		(304,505)
	CDX HY S08 07Y 10-15	326,970,000	(45,710,000)	(26,672,697)		(28,053)		(26,700,750)
	CDX HY S08 07Y 15-25	1,666,000,000	(225,000,000)	37,211,343		(192,407)		37,018,936
	CDX HY S08 07Y 25-35	902,000,000	(202,000,000)	37,704,466		(247,147)		37,457,319
	CDX HY S08 07Y 35-100	1,242,270,368	(106,859,819)	10,626,032		(86,917)		10,539,115
	CDX HY S09 05Y	12,701,875,000	(8,566,500,000)	66,922,108		(1,638,258)		65,283,850
	CDX HY S09 05Y 10-15	772,800,000	70,840,000	41,445,079		(14,406)		41,430,673
	CDX HY S09 05Y 15-25	3,225,000,000	1,065,000,000	9,796,578		(316,253)		9,480,325
	CDX HY S09 05Y 25-35	1,215,000,000	(675,000,000)	33,600,243		(244,862)		33,355,381
	CDX HY S09 05Y 35-100	3,239,503,082	(3,050,610,774)	117,453,529		(865,668)		116,587,861
	CDX HY S10 05Y	21,259,096,000	9,234,882,000	(276,711,735)		(4,429,212)		(281,140,947)
	CDX HY S10 05Y 10-15	604,750,000	(232,125,000)	(156,232,601)		(66,922)		(156,299,523)
3	CDX HY S10 05Y 15-25	3,663,000,000	(2,093,000,000)	(43,805,732)		(1,825,216)		(45,630,949)
	CDX HY S10 05Y 25-35	1,845,000,000	(555,000,000)	44,425,075		(320,873)		44,104,202
5	CDX HY S10 05Y 35-100	14,352,199,827	(3,808,161,157)	272,290,710		(1,788,826)		270,501,884
	CDX HY S10 07Y	16,436,590,000	2,046,550,000	(85,934,727)		(2,401,844)		(88,336,571)
2	CDX HY S10 07Y 10-15	1,359,626,250	(1,359,039,250)	(1,167,383,862)		(718,385)		(1,168,102,247)
	CDX HY S10 07Y 15-25	1,605,000,000	(185,000,000)	(47,125,229)		(414,753)		(47,539,982)
	CDX HY S10 07Y 25-35	1,015,000,000	(299,000,000)	37,819,202		(340,667)		37,478,535
	CDX HY S10 07Y 35-100	5,266,226,561	(1,452,477,157)	161,846,470		(1,722,255)		160,124,215
6	CDX HY S11 05Y	5,606,560,000	(994,140,000)	33,242,883		(659,517)		32,583,366
	CDX HY S11 05Y 10-15	432,402,500	(405,402,500)	(319,897,099)		(130,937)		(320,028,036)
4	CDX HY S11 05Y 15-25	1,125,000,000	(1,016,000,000)	(141,956,686)		(660,044)		(142,616,730)
	CDX HY S11 05Y 25-35	790,000,000	(250,000,000)	22,357,928		(171,061)		22,186,867
	CDX HY S11 05Y 35-100	987,492,693	(558,127,308)	40,578,565		(316,036)		40,262,529
	CDX HY S11 07Y	3,931,200,000	(3,102,720,000)	77,531,118		(4,948,903)		72,582,215
	CDX HY S11 07Y 10-15	16,825,000	(16,825,000)	(14,510,265)		(5,820)		(14,516,085)
	CDX HY S11 07Y 15-25	30,000,000	30,000,000	10,632,380		(34,976)		10,597,404
	CDX HY S11 07Y 35-100	95,873,077	(35,873,077)	11,500,379		(128,292)		11,372,087
	CDX HY S14 03Y	72,760,000	72,760,000	(1,746,247)				(1,746,247)
7	CDX HY S14 05Y	12,558,590,000	12,073,590,000	(192,510,741)				(192,510,741)
8	CDX HY S15 05Y	9,962,270,000	9,520,560,000	(62,200,356)				(62,200,356)
	CDX HY S16 05Y	8,308,060,000	6,707,560,000	14,917,661				14,917,661
	CDX HY S16 10Y	48,500,000	0	0				0
	CDX HY S17 05Y	9,270,775,000	8,022,385,000	153,219,436				153,219,436
	CDX IG HVOL S08 05Y	100,000,000	0	0				0
	CDX IG S07 07Y	1,464,560,000	703,720,000	5,665,292	414,812	(423,021)		5,657,083
	CDX IG S07 07Y 07-10	250,000,000	(110,000,000)	2,073,890		(75,851)		1,998,039
	CDX IG S07 07Y 15-30	1,050,000,000	0	(5,019,497)				(5,019,497)
	CDX IG S07 07Y 30-100	3,857,595,440	0	23,291,618				23,291,618
	CDX IG S08 05Y	968,000,000	0	(0)				(0)
	CDX IG S08 07Y	858,615,000	(473,654,000)	(8,543,315)	1,803,627	(352,428)		(7,092,116)
	CDX IG S08 07Y 03-07	60,000,000	0	(410,957)				(410,957)
	CDX IG S08 07Y 07-10	1,290,000,000	0	(7,908,074)				(7,908,074)

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	Instrument	Sum of Abs Notl	Sum of Factored Notional	Sum of MTM USD	VCG Adjustments Threshold	VCG Adjustments Liquidity	VCG Adjustments Incremental Liquidity	Total
	CDX IG S08 07Y 10-15	200,000,000	0	3,752,951				3,752,951
	CDX IG S08 07Y 15-30	525,000,000	375,000,000	(1,029,087)		(322,953)		(1,352,039)
	CDX IG S08 07Y 30-100	3,375,746,010	0	13,842,410				13,842,410
	CDX IG S08 05Y	116,298,890,477	31,676,380,000	26,177,866				26,177,866
9	CDX IG S09 05Y 00-03	6,809,760,374	2,718,245,188	497,344,882			(739,081)	496,605,800
	CDX IG S09 05Y 03-07	6,715,000,000	1,395,000,000	(19,251,820)			(406,787)	(19,658,607)
	CDX IG S09 05Y 07-10	10,597,000,000	2,045,000,000	(11,807,222)			(546,683)	(12,353,905)
	CDX IG S09 05Y 10-15	5,675,000,000	2,905,000,000	(15,597,521)			(818,770)	(16,426,290)
	CDX IG S09 05Y 15-30	30,245,000,000	12,215,000,000	(85,032,953)			(3,442,778)	(88,475,711)
	CDX IG S09 05Y 30-100	36,342,317,046	260,414,862	17,001,964			(73,210)	16,928,753
11	CDX IG S09 07Y	51,472,432,005	(32,753,095,000)	(151,132,031)				(151,132,031)
	CDX IG S09 07Y 00-03	3,469,513,118	308,465,789	142,230,554			(337,065)	141,893,489
	CDX IG S09 07Y 03-07	2,045,000,000	215,000,000	50,233,428			(231,404)	50,002,024
	CDX IG S09 07Y 07-10	6,325,000,000	365,000,000	119,476,524			(390,332)	119,086,192
	CDX IG S09 07Y 10-15	2,790,000,000	1,970,000,000	(8,791,310)			(1,887,017)	(10,678,327)
	CDX IG S09 07Y 15-30	13,845,000,000	6,965,000,000	(124,254,073)			(7,311,359)	(131,565,432)
	CDX IG S09 07Y 30-100	36,827,620,445	(11,024,221,870)	306,212,849			(11,468,335)	294,744,514
12	CDX IG S09 10Y	92,607,692,000	(77,772,509,000)	(1,252,580,587)				(1,252,580,587)
10	CDX IG S09 10Y 00-03	4,147,420,182	(2,136,549,781)	(1,341,270,978)			(2,594,116)	(1,343,865,094)
	CDX IG S09 10Y 03-07	2,590,000,000	(90,000,000)	(6,249,420)			(116,202)	(6,365,622)
	CDX IG S09 10Y 07-10	3,495,000,000	(775,000,000)	24,782,107			(1,585,840)	23,196,267
	CDX IG S09 10Y 10-15	3,610,000,000	1,980,000,000	117,037,861			(4,098,728)	112,939,133
	CDX IG S09 10Y 15-30	5,400,000,000	3,800,000,000	(30,828,404)			(7,781,059)	(38,609,463)
	CDX IG S09 10Y 30-100	20,423,263,361	(16,131,213,494)	773,069,596			(33,970,414)	739,099,182
	CDX IG S10 05Y	9,916,663,474	0	(4,327)				(4,327)
	CDX IG S10 05Y 00-03	517,951,464	0	(0)				(0)
	CDX IG S10 05Y 03-07	250,000,000	0	(1,960,364)				(1,960,364)
	CDX IG S10 05Y 07-10	80,000,000	0	2,044,489				2,044,489
	CDX IG S10 07Y	265,232,000	0	0				0
	CDX IG S10 10Y	1,548,800,000	0	11,639				11,639
	CDX IG S12 05Y	5,560,068,409	0	98,999				98,999
	CDX IG S13 05Y	4,882,784,000	0	(46,845)				(46,845)
	CDX IG S14 05Y	8,899,000,000	7,857,000,000	(78,705,095)				(78,705,095)
	CDX IG S14 10Y	1,243,000,000	(257,000,000)	(857,420)				(857,420)
	CDX IG S15 03Y	604,000,000	0	(0)				(0)
	CDX IG S15 03Y 00-03	40,000,000	0	0				0
	CDX IG S15 05Y	23,298,500,000	17,520,500,000	(154,951,364)				(154,951,364)
	CDX IG S15 05Y 00-03	235,000,000	195,000,000	54,924,827	(7,689)			54,917,138
	CDX IG S15 05Y 03-07	20,000,000	(20,000,000)	(1,070,389)				(1,070,389)
	CDX IG S15 05Y 15-100	100,000,000	(10,000,000)	6,539				6,539
	CDX IG S15 10Y	254,000,000	54,000,000	377,531				377,531
	CDX IG S16 05Y	24,206,250,000	18,478,750,000	(138,026,195)				(138,026,195)
	CDX IG S16 10Y	1,398,000,000	(302,000,000)	(3,131,595)				(3,131,595)
	CDX IG S17 05Y	27,717,200,000	(11,402,500,000)	77,306,796				77,306,796
	CDX IG S18 05Y	15,191,000,000	(15,191,000,000)	65,505,418				65,505,418
	CDX LCDX S10 05Y	5,750,874,000	1,184,986,000	(28,981,012)		(538,320)		(29,519,332)
	CDX LCDX S10 05Y 05-08	5,750,000	0	0				0
	CDX LCDX S10 05Y 12-15	1,050,000,000	(110,000,000)	23,965,359		(53,544)		23,911,815
	CDX LCDX S10 05Y 15-100	4,002,706,111	(2,551,594,675)	221,670,056		(1,339,504)		220,330,552
	CDX XO S08 05Y	47,143,000	0	(1)				(1)
	ITRAXX FINSEN S10 05Y	87,888,897	0	(784)				(784)
	ITRAXX FINSEN S12 05Y	106,531,996	0	6,348				6,348
	ITRAXX FINSEN S13 05Y	119,648,486	0	(575)				(575)
	ITRAXX FINSEN S14 05Y	1,302,353,651	0	(1,464)				(1,464)
	ITRAXX FINSEN S15 05Y	2,604,041,478	0	(10,754)				(10,754)
	ITRAXX FINSEN S16 05Y	2,893,675,342	(0)	24,823				24,823
	ITRAXX FINSEN S17 05Y	673,941,129	(73,240,747)	(2,073,489)				(2,073,489)
	ITRAXX FINSUB S06 10Y	66,582,488	0	2,474				2,474
	ITRAXX FINSUB S07 05Y	177,109,443	123,843,445	1,176,365	(842,303)	(11,123)		322,939
	ITRAXX FINSUB S07 10Y	266,329,980	0	(11,083)				(11,083)
	ITRAXX FINSUB S08 05Y	1,674,010,241	703,111,174	11,666,696		(201,846)		11,464,850
	ITRAXX FINSUB S08 10Y	133,184,985	0	(40,029)				(40,029)
	ITRAXX FINSUB S09 05Y	3,385,054,174	2,253,151,716	8,276,439	(2,260,482)	(1,075,287)		4,940,670
	ITRAXX FINSUB S09 10Y	199,747,493	0	(20,922)				(20,922)
	ITRAXX FINSUB S10 05Y	2,587,395,863	1,471,473,195	26,048,211	(457,879)	(977,048)		24,613,284
	ITRAXX FINSUB S10 10Y	332,912,488	0	(1,316)				(1,316)
	ITRAXX FINSUB S11 05Y	303,326,872	0	5,736				5,736
	ITRAXX FINSUB S12 05Y	2,010,983,182	1,033,360,361	62,100,561		(1,055,500)		61,045,061
	ITRAXX FINSUB S13 05Y	5,086,902,610	(0)	334,752				334,752
	ITRAXX FINSUB S14 05Y	4,973,712,564	(1,737,303,185)	(143,450,332)	(1,065,850)			(144,516,182)
	ITRAXX FINSUB S15 05Y	3,495,581,119	606,600,727	57,695,601	654,421			58,350,022
	ITRAXX FINSUB S16 05Y	5,254,690,704	(1,392,905,949)	82,140,503				82,140,503
	ITRAXX FINSUB S17 05Y	986,420,963	(946,171,465)	64,496,190				64,496,190
	ITRAXX HV S07 05Y	128,730,801	0	0				0
	ITRAXX MN S06 10Y	6,960,378,798	(105,000,000)	(5,129,020)	(1,314,547)	(178,833)		(6,622,400)
	ITRAXX MN S06 10Y 00-03	712,432,723	163,130,744	93,141,398		(145,331)		92,995,060
	ITRAXX MN S06 10Y 03-06	692,205,467	(190,747,486)	(74,490,371)		(308,172)		(74,798,543)
	ITRAXX MN S06 10Y 06-09	3,142,663,883	(28,812,898)	101,848,841		(45,839)		101,803,002
	ITRAXX MN S06 10Y 09-12	606,026,061	0	5,240,180		0		5,240,180
	ITRAXX MN S06 10Y 12-22	2,396,969,910	0	47,943,520		0		47,943,520

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	Instrument	Sum of Abs Notl	Sum of Factored Notional	Sum of MTM USD	VCG Adjustments: Threshold	VCG Adjustments: Liquidity	VCG Adjustments: Incremental Liquidity	Total
	ITRAXX MN S06 10Y 22-100	2,635,984,005	0	25,776,827		0		25,776,827
	ITRAXX MN S07 05Y	3,521,777,337	0	0				0
	ITRAXX MN S07 10Y	2,870,074,158	0	7,468				7,468
	ITRAXX MN S07 10Y 00-03	48,045,930	0	7,147				7,147
	ITRAXX MN S07 10Y 06-09	479,393,982	(0)	4,036,422		0		4,036,422
	ITRAXX MN S07 10Y 09-12	239,696,991	0	3,036,633		0		3,036,633
	ITRAXX MN S07 10Y 12-22	1,065,319,960	0	653,326		0		653,326
	ITRAXX MN S07 10Y 22-100	6,879,658,746	0	(4,593,298)		0		(4,603,298)
	ITRAXX MN S08 05Y	4,263,277,316	0	146				146
	ITRAXX MN S08 05Y 00-03	346,228,987	0	(1,934)				(1,934)
	ITRAXX MN S08 05Y 03-06	959,441,164	(0)	2,956,675		0		2,956,675
	ITRAXX MN S08 05Y 06-09	372,861,986	0	237,708		0		237,708
	ITRAXX MN S08 05Y 09-12	159,797,994	0	770,086		0		770,086
	ITRAXX MN S08 05Y 12-22	1,131,902,468	0	1,386,232		0		1,386,232
	ITRAXX MN S08 10Y	5,124,189,007	(1)	(2,274)				(2,274)
	ITRAXX MN S08 10Y 00-03	625,875,477	(0)	226,681				226,681
	ITRAXX MN S08 10Y 03-06	905,621,966	0	2,278,173		0		2,278,173
	ITRAXX MN S08 10Y 06-09	1,025,370,482	(0)	9,125,128		0		9,125,128
	ITRAXX MN S08 10Y 09-12	439,444,484	(0)	16,046,944		0		16,046,944
	ITRAXX MN S08 10Y 12-22	4,037,662,849	(0)	22,835,178		0		22,835,178
	ITRAXX MN S08 10Y 22-100	12,384,344,537	0	70,810,712		0		70,810,712
	ITRAXX MN S09 05Y	125,284,750,038	(23,344,036,633)	207,439,231				207,439,231
	ITRAXX MN S09 05Y 00-03	11,180,676,800	3,826,367,353	1,024,601,825			(1,672,955)	1,022,928,870
	ITRAXX MN S09 05Y 03-06	6,842,166,670	479,393,982	50,970,087			(247,449)	50,727,638
	ITRAXX MN S09 05Y 06-09	8,429,344,185	(462,790,093)	96,588,364			(221,205)	96,367,159
	ITRAXX MN S09 05Y 09-12	6,431,669,260	(372,861,986)	13,441,538			(174,860)	13,266,678
	ITRAXX MN S09 05Y 12-22	13,056,627,762	166,455,244	(21,856,971)	(37,163)		(74,609)	(21,968,763)
	ITRAXX MN S09 05Y 22-100	67,381,487,482	(9,454,714,847)	(12,568,331)			(4,448,790)	(17,018,121)
16	ITRAXX MN S09 07Y	35,764,430,375	(8,579,568,563)	108,869,714	(8,204,788)			100,664,926
	ITRAXX MN S09 07Y 00-03	2,250,488,418	785,673,471	399,622,086			(668,236)	398,953,850
	ITRAXX MN S09 07Y 03-06	692,457,974	213,063,982	22,980,196			(256,151)	22,724,044
	ITRAXX MN S09 07Y 06-09	3,868,695,813	33,291,249	83,295,546			(42,354)	83,253,192
	ITRAXX MN S09 07Y 09-12	652,255,968	(239,998,591)	(9,472,546)			(298,646)	(9,771,791)
	ITRAXX MN S09 07Y 12-22	2,996,212,388	698,242,478	(1,134,458)			(728,128)	(1,862,586)
14	ITRAXX MN S09 07Y 22-100	14,581,566,956	(14,331,566,955)	73,844,633			(17,686,367)	56,158,266
17	ITRAXX MN S09 10Y	66,222,478,490	(17,254,997,395)	303,088,246	(2,111,576)			300,976,670
13	ITRAXX MN S09 10Y 00-03	6,469,688,118	(1,591,199,437)	(1,163,058,151)			(2,003,272)	(1,165,061,356)
	ITRAXX MN S09 10Y 03-06	3,335,783,125	(6,958,260)	1,445,627			(12,725)	1,432,802
	ITRAXX MN S09 10Y 06-09	3,275,658,878	(608,826,881)	(41,486,591)			(1,092,573)	(42,579,164)
	ITRAXX MN S09 10Y 09-12	3,628,493,607	(212,837,739)	(35,784,228)			(685,826)	(36,469,854)
	ITRAXX MN S09 10Y 12-22	10,200,438,619	(205,436,742)	(39,184,119)			(458,506)	(39,642,624)
15	ITRAXX MN S09 10Y 22-100	59,578,018,774	(21,553,389,713)	(126,609,454)			(46,933,988)	(173,543,442)
	ITRAXX MN S10 05Y	15,608,571,098	0	(91)				(91)
	ITRAXX MN S11 05Y	4,335,698,507	0	9,088				9,088
	ITRAXX MN S12 05Y	5,122,181,534	0	(118)				(118)
	ITRAXX MN S13 05Y	10,941,501,818	0	1,692				1,692
	ITRAXX MN S14 05Y	19,772,338,461	(35,932,893)	(266,932)				(266,932)
	ITRAXX MN S15 03Y	5,272,002,153	3,740,604,716	(6,307,017)				(6,307,017)
	ITRAXX MN S15 03Y 00-03	93,215,497	93,215,497	32,188,065				32,188,065
	ITRAXX MN S15 03Y 03-06	13,316,500	(13,316,500)	(200,216)				(200,216)
	ITRAXX MN S15 03Y 22-100	1,930,892,428	(359,434,035)	1,822,606				1,822,606
	ITRAXX MN S15 05Y	23,173,705,347	(4,940,754,329)	(42,415,291)				(42,415,291)
	ITRAXX MN S15 05Y 00-03	332,912,488	332,912,488	175,486,448				175,486,448
	ITRAXX MN S15 05Y 22-100	2,596,717,403	(2,596,717,403)	13,829,469				13,829,469
	ITRAXX MN S15 07Y	2,390,311,681	(1,178,510,238)	(25,935,517)				(25,935,517)
	ITRAXX MN S15 07Y 00-03	392,836,735	392,836,735	235,003,815				235,003,815
	ITRAXX MN S15 07Y 03-06	259,671,740	259,671,740	63,563,224				63,563,224
	ITRAXX MN S15 07Y 22-100	2,663,299,900	(2,663,299,900)	(9,789,912)	(1,421,395)			(11,210,307)
	ITRAXX MN S15 10Y	3,619,158,235	2,173,519,049	82,791,564				82,791,564
18	ITRAXX MN S16 05Y	62,106,822,829	(19,220,350,557)	(179,280,526)				(179,280,526)
	ITRAXX MN S16 10Y	2,390,311,681	1,764,436,164	61,800,127				61,800,127
	ITRAXX MN S17 05Y	7,921,985,554	(7,906,473,888)	(93,917,625)	(2,137,575)			(96,055,200)
	ITRAXX SOVXWE S03 05Y	24,265,800	0	3,103				3,103
	ITRAXX SOVXWE S08 05Y	46,665,000	(46,805,000)	(2,425,375)				(2,425,375)
	ITRAXX XO S07 05Y	147,014,155	0	(107)				(107)
	ITRAXX XO S08 05Y	59,924,248	(0)	(51)				(51)
	ITRAXX XO S09 05Y	239,696,991	0	(584)				(584)
	ITRAXX XO S10 05Y	198,469,109	0	(0)				(0)
	ITRAXX XO S11 05Y	155,248,012	0	4,046				4,046
	ITRAXX XO S12 05Y	469,806,102	0	579				579
	ITRAXX XO S13 05Y	39,150,509	0	140				140
	ITRAXX XO S14 05Y	1,483,804,274	6,625,085	(30,728)	(119,115)			(149,843)
	ITRAXX XO S15 05Y	2,346,034,300	1,740,133,572	12,315,943				12,315,943
	ITRAXX XO S16 05Y	9,971,394,827	6,953,875,040	177,863,391				177,863,391
	ITRAXX XO S17 05Y	1,651,245,938	119,848,498	6,043,322				6,043,322
	Grand Total	1,553,488,019,329	(157,392,843,786)	(45,820,055)	(15,907,722)	(32,878,725)	(155,262,771)	(249,869,273)
	Assets		(82,959,580,014)	7,987,328,315	(11,615,484)	(20,966,293)	(73,771,713)	7,879,974,825
	Liabilities		(74,433,263,772)	(8,033,148,370)	(4,292,238)	(11,912,431)	(81,491,058)	(8,129,844,098)
	Net		(157,392,843,786)	(45,820,055)	(15,907,722)	(32,878,725)	(155,262,771)	(249,869,273)

Appendix B - CIO Price Testing Data

The following tables set out valuation estimates of various sources, as well as the final CIO price recorded books and records for the most significant positions within the portfolio. The table also includes notionals for the positions and whether CIO is long or short the risk of the index/tranche (i.e. whether it has sold or purchased credit protection respectively).

The following observations were noted:

- For all selected positions the front office marks were within the bid offer spread indicated by the broker quotes except for the iTraxx Main IDX S09 07Y.
    - This was a result of a front office data input error that was identified and adjusted by VCG to the outer boundary, in accordance with the VCG price testing protocol. (The value difference between the original front office mark and the intended mark was approximately $20 million, and the difference between the CIO book value and the intended mark was less than $15 million).
- CIO VCG spreads/prices correspond to Markit/Totem data for the liquid indices and reflect the broker mids for illiquid indices and tranches.
- There are a number of instances where the broker-mid spreads/prices diverge from the Markit/Totem data.
- There are a number of instances where the CIO transaction data in appendix C show that actual traded spreads/prices diverge from Markit/Totem data in similar time periods. For example: iTraxx Main IDX Series 16 5 year at February month end, and CDX High Yield Series 10 7 year 10-15% tranche at January month-end.
- Average traded prices in the few days surrounding month-end are directionally consistent with the point in the bid offer spread in which the positions have been marked by CIO, as shown by Appendix C. In general, the front office marks, subject to liquidity adjustments, used for CIO books and records reflect information derived from numerous data sources available to CIO front office, rather than relying solely on any one single factor. For example:
    - Recent transaction data (same-day and recent day actual trades) may in some cases be viewed to provide more relevant and reliable information regarding current exit prices (see additional observations below).
    - In some cases, differences between CIO book values and other market information such as Totem/Markit are created because of timing differences between the close of CIO's books and the close of the Totem/Markit data (see additional observations below).
- In certain cases, CIO executed trades on the last day of the month at a price that is different than Totem (and in several cases, was between the Totem value and the CIO book price). See table below for information as of March 31, 2012 (including average traded prices on March 30, 2012):

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	Totem	CIO Books	Avg. Traded
CDX.NA.HY 15-25% S10 05Y	92.607	93.326	93.125
CDX.NA.HY 15-25% S11 05Y	83.108	83.685	83.375
CDX.NA.HY IDX S11 07Y	101.250	101.866	101.750
CDX.NA.IG 0-3% S09 10Y	63.219	62.869	63.250
iTraxx.Main 0-3% S09 10Y	66.202	65.993	66.313
iTraxx.Main IDX S09 07Y	129.000	122.657	129.000 *
iTraxx.Main IDX S09 10Y	149.000	144.250	149.000 *

* executed tranche reference trades, not stand-alone traded prices

- The difference between the various data points (FO, Broker prices, and Totem) are relatively insignificant on a price basis, when evaluated in context of:
  - Daily price volatility - the following table shows that for most of the tested positions, the price difference between the Totem price and the CIO book price is less than the average daily price change during recent months.

	March price difference Totem - CIO	Average daily price change			
		Jan	Feb	Mar	Apr
CDX.IG Main Series 9 (7Yr)	2.00	2.85	2.00	1.98	2.06
CDX.IG Main Series 9 (10Yr)	2.25	2.87	1.73	2.00	2.26
CDX.HY 100 Series 11 (7Yr)	0.62	0.35	0.31	0.29	0.29
CDX.HY 100 Series 14 (5Yr)	0.25	0.30	0.30	0.28	0.28
CDX.HY 100 Series 15 (5Yr)	0.25	0.30	0.33	0.32	0.33
iTraxx.Main IDX S16 5Y	1.88	3.74	3.22	3.08	4.05
iTraxx.Main IDX S09 07Y	6.34	4.42	3.29	3.22	4.31
iTraxx.Main IDX S09 10Y	4.75	4.24	3.17	3.54	4.24

  - Intraday price volatility – the following table shows three representative series and the maximum, minimum and mean prices during the day on March 31, 2012.

	max	min	mean	variation	% of mean
CDX.IG Series 18 5 Y	93.000	90.750	91.910	2.250	2.4%
CDX.HY Series 18 5Y	97.188	96.750	96.950	0.438	0.5%
iTraxx.Main Series 17 5Y	127.625	122.750	125.115	4.875	3.9%

  - Potential timing differences – CIO EMEA closes its books at the close of business in London, while some of the comparative market data is as of the close of business in New York. This timing difference may result in differences in reported prices.
    - For example, the market price on March 31, 2012 at 4 pm London time for the CDX IG Series 18 5 year was 92.88, and the market price at 9 pm (NY close) was 91.25, a 1.75% difference from the London close.

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	APRIL	TOTEM	ICE	FO	Broker Bid	Broker Mid	Broker Offer	VCG Price	CIO Books (GAAP)	Notional (- Long Risk + Short Risk)	Risk	Basis	Benefit
1	CDX.NA.HY 10-15% S08 05Y			95.375	95.000	95.375	95.750	95.563	95.394	1585	short	Price	lower price
2	CDX.NA.HY 10-15% S10 07Y	9.765		10.625	8.125	9.825	11.125	9.585	10.872	-4041	long	Price	higher price
3	CDX.NA.HY 15-25% S10 05Y	95.710		96.000	95.625	95.875	96.125	95.708	95.951	-2083	long	Price	higher price
4	CDX.NA.HY 15-25% S11 05Y	85.350		85.500	84.750	85.500	86.250	85.375	85.435	-1015	long	Price	higher price
5	CDX.NA.HY 35-100% S10 05Y	105.572		105.688	105.375	105.563	105.750	105.542	105.640	-3905	long	Price	higher price
6	CDX.NA.HY IDX S11 07Y	101.506		101.500	101.063	101.313	101.563	101.505	101.370	-4408	long	Price	higher price
7	CDX.NA.HY IDX S14 05Y	102.039	102.125	101.500	101.500	101.688	101.875	102.039	101.539	12447	short	Price	lower price
8	CDX.NA.HY IDX S15 05Y	101.080	101.093	100.625	100.563	100.750	100.938	101.060	100.625	9915	short	Price	lower price
9	CDX.NA.IG 0-3% S09 05Y	14.846		14.813	14.625	14.813	15.000	14.733	14.785	3570	short	Upfront	higher price
10	CDX.NA.IG 0-3% S09 10Y	62.842		62.875	62.375	62.625	62.875	62.797	63.001	-2650	long	Upfront	lower price
11	CDX.NA.IG IDX S09 07Y	91.958	91.750	91.000	90.500	92.000	93.500	91.968	94.650	-34193	long	Spread	lower spread
12	CDX.NA.IG IDX S09 10Y	118.839	119.250	119.000	118.750	119.500	120.250	118.839	122.650	-60669	long	Spread	lower spread
13	iTraxx.Main 0-3% S09 10Y	67.302		67.375	67.125	67.375	67.625	67.406	67.509	-1485	long	Upfront	lower price
14	iTraxx.Main 22-100% S09 07Y	19.292		18.250	17.500	18.500	19.500	18.750	22.098	-14982	long	Spread	lower spread
15	iTraxx.Main 22-100% S09 10Y	46.083		46.000	44.000	46.000	48.000	46.375	48.849	-21841	long	Spread	lower spread
16	iTraxx.Main IDX S09 07Y	148.682		146.000	143.000	145.000	147.000	148.682	149.528	-7078	long	Spread	lower spread
17	iTraxx.Main IDX S09 10Y	171.893		170.000	166.000	168.000	170.000	171.893	174.331	-17177	long	Spread	lower spread
18	iTraxx.Main IDX S16 05Y	139.539	139.400	139.000	137.750	138.500	139.250	139.539	139.000	-18724	long	Spread	lower spread

	MARCH	TOTEM	ICE	FO	Broker Bid	Broker Mid	Broker Offer	VCG Price	CIO BOOKS (GAAP)	Notional (- Long Risk + Short Risk)	Risk	Basis	Benefit
1	CDX.NA.HY 10-15% S08 05Y	92.309		91.500	91.500	92.000	92.500	92.000	91.509	1565	short	Price	lower price
2	CDX.NA.HY 10-15% S10 07Y	11.337		13.125	10.625	11.875	13.125	11.875	13.072	-4041	long	Price	higher price
3	CDX.NA.HY 15-25% S10 05Y	92.607		93.375	92.875	93.125	93.375	93.125	93.326	-2083	long	Price	higher price
4	CDX.NA.HY 15-25% S11 05Y	83.106		83.750	82.875	83.313	83.750	83.313	83.885	-1015	long	Price	higher price
5	CDX.NA.HY 35-100% S10 05Y	105.626		106.000	105.625	105.813	106.000	105.813	105.853	-3970	long	Price	higher price
6	CDX.NA.HY IDX S11 07Y	101.250		102.000	101.250	101.625	102.000	101.511	101.868	-4408	long	Price	higher price
7	CDX.NA.HY IDX S14 05Y	101.639	101.688	101.438	101.438	101.688	101.813	101.639	101.438	12447	short	Price	lower price
8	CDX.NA.HY IDX S15 05Y	100.750		100.500	100.500	100.688	100.875	100.723	100.600	9815	short	Price	lower price
9	CDX.NA.IG 0-3% S09 05Y	17.714		18.375	17.750	18.063	18.375	18.063	18.348	3570	short	Upfront	higher price
10	CDX.NA.IG 0-3% S09 10Y	63.219		62.750	62.750	63.125	63.500	63.125	62.869	-2605	long	Upfront	lower price
11	CDX.NA.IG IDX S09 07Y	90.000	89.880	88.000	88.000	89.500	91.000	89.671	88.000	-33847	long	Spread	lower spread
12	CDX.NA.IG IDX S09 10Y	113.000	112.380	110.750	110.750	112.250	113.750	112.243	110.750	-60344	long	Spread	lower spread
13	iTraxx.Main 0-3% S09 10Y	66.202		65.875	65.750	66.250	66.625	66.250	65.993	-1591	long	Upfront	lower price
14	iTraxx.Main 22-100% S09 07Y			12.000	12.000	13.300	14.500	13.333	15.646	-14509	long	Spread	lower spread
15	iTraxx.Main 22-100% S09 10Y			33.000	33.000	34.700	36.750	34.706	36.849	-20948	long	Spread	lower spread
16	iTraxx.Main IDX S09 07Y	129.000		119.750	123.250	127.250	131.250	130.657	122.657	-6680	long	Spread	lower spread
17	iTraxx.Main IDX S09 10Y	149.000	150.500	144.250	144.250	147.750	151.250	150.659	144.250	-17265	long	Spread	lower spread
18	iTraxx.Main IDX S16 05Y	123.435	123.830	121.750	121.250	121.750	122.250	123.435	121.750	-18814	long	Spread	lower spread

	FEBRUARY	TOTEM	ICE	FO	Broker Bid	Broker Mid	Broker Offer	VCG Price	CIO BOOKS (GAAP)	Notional (- Long Risk + Short Risk)	Risk	Basis	Benefit
1	CDX.NA.HY 10-15% S08 05Y	89.632		89.750	89.500	90.000	90.500	89.750	89.750	1450	short	Price	lower price
2	CDX.NA.HY 10-15% S10 07Y	15.875		17.000	15.160	16.245	17.330	40.750	17.000	-4041	long	Price	higher price
3	CDX.NA.HY 15-25% S10 05Y	95.076		95.375	94.660	95.120	95.580	96.292	95.375	-1833	long	Price	higher price
4	CDX.NA.HY 15-25% S11 05Y	86.208		86.250	85.660	86.330	87.000	86.333	86.250	-815	long	Price	higher price
5	CDX.NA.HY 35-100% S10 05Y	-		106.188	106.000	106.145	106.290	107.792	106.188	-3905	long	Price	higher price
6	CDX.NA.HY IDX S11 07Y	101.495		102.000	101.063	101.563	102.063	101.495	102.000	-4308	long	Price	higher price
7	CDX.NA.HY IDX S14 05Y	101.427	101.594	101.375	101.250	101.500	101.750	101.427	101.375	12457	short	Price	lower price
8	CDX.NA.HY IDX S15 05Y	100.500		100.563	100.313	100.500	100.688	100.503	100.563	8215	short	Price	lower price
9	CDX.NA.IG 0-3% S09 05Y	24.034		24.188	23.830	24.060	24.290	24.063	24.188	2995	short	Upfront	higher price
10	CDX.NA.IG 0-3% S09 10Y	59.871		59.875	59.625	59.853	60.080	59.864	59.875	-3370	long	Upfront	lower price
11	CDX.NA.IG IDX S09 07Y	94.756	95.810	92.000	89.813	91.613	93.813	93.756	92.000	-33546	long	Spread	lower spread
12	CDX.NA.IG IDX S09 10Y	114.987	115.750	112.500	111.063	113.313	115.563	113.987	112.500	-67791	long	Spread	lower spread
13	iTraxx.Main 0-3% S09 10Y	65.918		66.125	65.875	66.138	66.400	65.869	66.125	-1445	long	Upfront	lower price
14	iTraxx.Main 22-100% S09 07Y	-		15.500	15.250	16.125	17.000	15.750	15.500	-9975	long	Spread	lower spread
15	iTraxx.Main 22-100% S09 10Y	-		34.500	34.400	35.115	35.830	34.936	34.500	-12070	long	Spread	lower spread
16	iTraxx.Main IDX S09 07Y	135.476		131.750	130.750	132.750	134.750	135.476	131.750	-4353	long	Spread	lower spread
17	iTraxx.Main IDX S09 10Y	150.333	150.750	146.750	144.250	146.250	148.250	150.033	146.750	-10340	long	Spread	lower spread
18	iTraxx.Main IDX S16 05Y	128.870	128.940	128.250	128.000	128.250	128.500	128.875	128.250	-9230	long	Spread	lower spread

	JANUARY	TOTEM	ICE	FO	Broker Bid	Broker Mid	Broker Offer	VCG Price	CIO BOOKS (GAAP)	Notional (- Long Risk + Short Risk)	Risk	Basis	Benefit
1	CDX.NA.HY 10-15% S08 05Y	70.716		70.000	69.625	70.313	71.000	70.000	70.000	1140	short	Price	lower price
2	CDX.NA.HY 10-15% S10 07Y	19.911		20.750	19.700	20.538	21.375	20.542	20.750	-4031	long	Price	higher price
3	CDX.NA.HY 15-25% S10 05Y	93.168		93.375	92.875	93.313	93.750	103.792	93.375	-1668	long	Price	higher price
4	CDX.NA.HY 15-25% S11 05Y	86.592		86.250	85.438	86.063	86.688	86.063	86.250	-530	long	Price	higher price
5	CDX.NA.HY 35-100% S10 05Y	106.245		106.313	106.170	106.315	106.460	106.300	106.313	-3705	long	Price	higher price
6	CDX.NA.HY IDX S11 07Y	101.125		101.000	100.688	101.000	101.313	101.125	101.000	-3633	long	Price	higher price
7	CDX.NA.HY IDX S14 05Y	100.761	100.890	100.625	100.375	100.625	100.875	100.761	100.625	11857	short	Price	lower price
8	CDX.NA.HY IDX S15 05Y	100.030		100.125	99.938	100.125	100.313	100.031	100.125	6215	short	Price	lower price
9	CDX.NA.IG 0-3% S09 05Y	26.579		26.813	25.400	25.680	26.900	26.687	26.813	2725	short	Price	lower price
10	CDX.NA.IG 0-3% S09 10Y	60.901		60.750	60.563	60.813	61.063	60.792	60.750	-3290	long	Price	higher price
11	CDX.NA.IG IDX S09 07Y	103.614	104.580	102.000	101.500	103.500	105.500	103.614	102.000	-26665	long	Spread	lower spread
12	CDX.NA.IG IDX S09 10Y	120.944	121.250	119.560	118.000	120.750	122.500	120.944	119.560	-64765	long	Spread	lower spread
13	iTraxx.Main 0-3% S09 10Y	66.573		66.563	66.290	66.620	66.950	66.625	66.563	-1415	long	Price	higher price
14	iTraxx.Main 22-100% S09 07Y	-		19.750	18.180	19.495	20.830	19.500	19.750	-6675	long	Spread	lower spread
15	iTraxx.Main 22-100% S09 10Y	-		40.000	39.400	40.600	41.800	40.500	40.000	-7775	long	Spread	lower spread
16	iTraxx.Main IDX S09 07Y	150.764		148.500	146.750	148.750	150.750	150.764	148.500	-3637	long	Spread	lower spread
17	iTraxx.Main IDX S09 10Y	160.840	162.000	158.000	156.500	158.500	160.500	158.250	158.000	-10574	long	Spread	lower spread
18	iTraxx.Main IDX S16 05Y	143.750	143.890	143.000	142.500	143.000	143.500	143.703	143.000	1387	long	Spread	lower spread

Data sourced from CIO; validated by CIO VCG - New York and London

Privileged and Confidential
Attorney Client Work Product
May 10, 2012

Appendix C - CIO Transaction Data

The following tables set out the following:

- 'SIZE (week ending)' - The average traded volume for the relevant week.
- 'AVG PRICE (week ending)' – The average price at which CIO executed its transactions during the relevant week.

For relevant observations, please refer to appendix B.

	SIZE (week ending)	6-Jan-12	13-Jan-12	20-Jan-12	27-Jan-12	3-Feb-12	10-Feb-12	17-Feb-12	24-Feb-12	2-Mar-12	9-Mar-12	16-Mar-12	23-Mar-12	30-Mar-12	Avg
1	CDXNAHY 10-15% S08 05Y	20	60	20	-	30	200	-	-	45	30	120	-	-	40
2	CDXNAHY 10-15% S10 07Y	280	-	130	300	10	-	-	-	-	-	-	-	-	55
3	CDXNAHY 15-25% S10 05Y	10	80	25	30	70	15	20	-	140	10	20	50	30	38
4	CDXNAHY 15-25% S11 05Y	70	110	-	20	85	25	175	-	20	20	130	10	20	53
5	CDXNAHY 35-100% S10 05Y	-	-	-	-	-	200	-	-	-	-	-	-	-	15
6	CDXNAHY IDX S11 07Y	100	-	-	1,350	300	-	-	-	-	-	-	-	100	142
7	CDXNAHY IDX S14 05Y	250	300	725	175	-	150	225	-	85	-	-	-	25	149
8	CDXNAHY IDX S15 05Y	350	200	450	150	-	300	625	325	550	-	900	-	200	312
9	CDXNAIG 0-3% S09 05Y	30	105	-	55	10	120	75	-	90	60	280	-	145	75
10	CDXNAIG 0-3% S09 10Y	60	-	-	110	30	-	-	-	-	-	200	235	130	59
11	CDXNAIG IDX S09 07Y	596	2,120	-	3,584	828	374	3,799	2,421	1,965	-	1,431	405	10	1,349
12	CDXNAIG IDX S09 10Y	5,988	10,226	958	10,031	2,228	2,399	1,041	4,833	11,880	721	3,859	3,995	841	4,508
13	iTraxx Main 0-3% S09 10Y	30	-	20	20	10	10	-	-	-	-	-	20	155	20
14	iTraxx Main 22-100% S09 07Y	-	100	-	-	-	500	1,925	500	975	-	-	250	125	337
15	iTraxx Main 22-100% S09 10Y	-	1,675	50	-	-	2,645	250	1,275	215	1,000	1,525	1,000	125	747
16	iTraxx Main IDX S09 07Y	-	88	135	831	-	1,980	1,094	590	887	-	-	153	363	455
17	iTraxx Main IDX S09 10Y	1,673	5,412	1,662	3,027	520	3,288	1,024	1,798	2,185	988	3,678	1,151	484	2,067
18	iTraxx Main IDX S16 05Y	6,339	4,928	7,292	9,384	6,521	10,905	10,575	6,583	10,383	1,043	5,900	8,800	-	6,819

	AVERAGE PRICE (week ending)	6-Jan-12	13-Jan-12	20-Jan-12	27-Jan-12	3-Feb-12	10-Feb-12	17-Feb-12	24-Feb-12	2-Mar-12	9-Mar-12	16-Mar-12	23-Mar-12	30-Mar-12	SD1H12 TOTEM Prices
1	CDXNAHY 10-15% S08 05Y	83.25	62.75	60.38	-	71.08	87.14	-	-	89.75	90.38	88.55	-	-	92.38
2	CDXNAHY 10-15% S10 07Y	18.75	-	15.38	18.93	20.75	-	-	-	-	-	-	-	-	11.31
3	CDXNAHY 15-25% S10 05Y	75.00	82.31	85.63	89.25	92.88	90.25	93.00	-	95.13	92.50	93.00	93.50	92.58	92.88
4	CDXNAHY 15-25% S11 05Y	69.88	74.28	-	82.50	85.92	83.50	85.25	-	86.25	82.50	83.67	83.83	83.38	83.25
5	CDXNAHY 35-100% S10 05Y	-	-	-	-	-	106.25	-	-	-	-	-	-	-	-
6	CDXNAHY IDX S11 07Y	97.31	-	-	100.39	101.00	-	-	-	-	-	-	-	101.75	101.51
7	CDXNAHY IDX S14 05Y	97.63	97.58	98.85	100.88	-	101.19	100.63	-	101.47	-	-	-	101.88	101.83
8	CDXNAHY IDX S15 05Y	97.04	96.89	98.33	99.82	-	100.88	99.94	100.23	100.80	-	100.57	-	100.94	100.72
9	CDXNAIG 0-3% S09 05Y	38.00	32.87	-	27.56	28.88	28.30	28.30	-	29.84	24.33	22.11	-	17.18	17.88
10	CDXNAIG 0-3% S09 10Y	70.00	-	-	62.80	61.25	-	-	-	-	-	62.31	60.74	62.53	63.31
11	CDXNAIG IDX S09 07Y	130.60	124.05	-	110.16	106.44	102.00	106.80	103.88	96.51	-	91.23	84.42	90.00	89.67
12	CDXNAIG IDX S09 10Y	145.87	138.25	133.75	125.44	120.92	122.12	123.60	120.45	115.89	119.33	115.33	106.70	111.20	112.24
13	iTraxx Main 0-3% S09 10Y	69.96	-	68.63	67.13	66.63	65.50	-	-	-	-	-	63.13	65.29	66.75
14	iTraxx Main 22-100% S09 07Y	-	36.75	-	-	-	17.50	20.18	17.83	17.85	-	-	15.00	12.75	-
15	iTraxx Main 22-100% S09 10Y	-	59.88	58.00	-	-	36.48	40.50	37.93	37.88	33.25	34.13	31.45	33.63	-
16	iTraxx Main IDX S09 07Y	-	189.50	179.83	183.14	-	136.18	145.31	138.80	137.13	-	-	113.00	125.00	130.68
17	iTraxx Main IDX S09 10Y	194.37	195.71	181.42	168.27	158.79	150.28	157.84	154.07	149.69	152.57	147.18	138.30	144.88	150.66
18	iTraxx Main IDX S16 05Y	175.22	175.04	164.98	147.32	140.44	131.11	139.27	132.24	129.82	136.75	126.59	113.06	-	123.44

Data sourced from CIO; validated by CIO middle office

MARKET RISK LIMITS

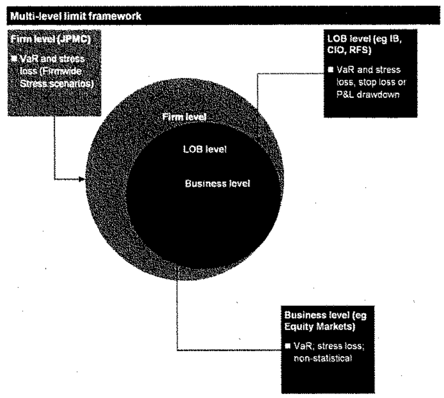
March 2012

STRICTLY PRIVATE AND CONFIDENTIAL

J.P.Morgan

Permanent Subcommittee on Investigations
EXHIBIT #37

A: Market Risk Limits Overview



Limit structure

- Limits aligned with management risk appetite
- Limits are reviewed on an ongoing basis
- Non-statistical limits are business-specific

Limit excession resolution process

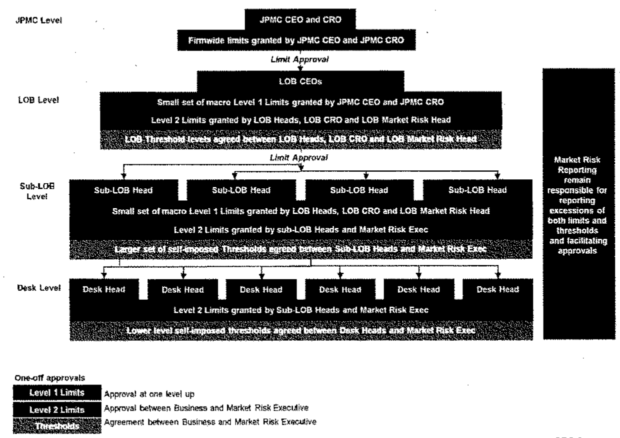
- Daily monitoring of position vs. limit
- Daily excess and loss reporting to head of relevant business level, depending on excess
- Business in excession must
  - Reduce risk within limit, or
  - Agree to follow-up action plan, or
  - One-off approvals may be granted to accommodate large client transactions or market conditions

APPENDIX

11

J.P.Morgan

A: Market Risk Limits Control Structure



APPENDIX

12

J.P.Morgan

A: Market Risk Governance of Level 1 and 2 Limits and Thresholds

	Level 1 limits	Level 2 limits	Thresholds
Levels	■ Firm, LOB, Sub-LOB	■ LOB, Sub-LOB, Desk	■ LOB, Sub-LOB, Desk
Initial Limit Approval	■ Limit requestor and corresponding Market Risk Executives, plus one level up in organization approve; approval documented	■ Limit requestor and corresponding Market Risk Executives approve; approval documented	■ Limit requestor and corresponding Market Risk Executives agree; no documented approval required
Excession actions	■ Business Unit must take immediate steps toward reducing its exposure to be within the limit, unless a One-off Approval is granted by all Grantors and Grantees of limits	■ Business Unit must take immediate steps toward reducing its exposure to be within the limit, unless a One-off Approval is granted by all Grantors and Grantees of limits	■ Not required to take action to bring utilization within Threshold, no documented one-off approvals required
Excession notification	■ Reported in Friday Risk pack and Limit/Threshold excession report, and to all approvers via email	■ Reported in Friday Risk pack and Limit/Threshold excession report, and to all approvers via email	■ Reported in Limit/Threshold excession report
Number in place	■ Approximately 100	■ Approximately 270	■ Over 4,200

APPENDIX

21/12/2011 13h23

Ina requests a exercise whereby we try to reduce further the RWA by the end of Q1 2012

To Javier

Hello
Just talked to julien
It is holiday time in london yet not in ny may be. Thus, noone in the london office today.
So best I can say is that the execution cost for unwinding the book are proportionnal to what julien computed ie 400m if I remember well.

Adjusted for the expiry t
And the duration shortening this gives 200-300m depending on the speed.

Julien should drop you a quick em

12/1/2012

The short risk is covered and official Var blows up

From: Martin-Artajo, Javier X
Sent: 12 January 2012 10:36
To: Iksil, Bruno M; Hagan, Patrick S
Subject: VAR high compared to IB . Need to discuss.

Need to get the new VAR model asap Pat .

Interesting how much we diversify the IB !!!!! on VAR terms . How can it not be the case for CRM will remain one of the great mysteries until we get deeper into the results of t

18/1/2012
Var increases a lot : I keep selling protection in main, buying protection in xover and US HY

I think I will need to have this number daily.. so that I am not be made responsible for this in the future. I reckon the group var will increase subsequently to my own var reduction.

Please let me know your thoughts on the matter.

Permanent Subcommittee on Investigations
EXHIBIT #38

Bruno

From: Martin-Artajo, Javier X
Sent: 18 January 2012 15:31
To: Iksil, Bruno M; Hagan, Patrick S
Subject: FW: VaR limit breach

18/1/2012
meeting with Ina on RWA reduction plan

From: Perryman, Andrew X
Sent: 18 January 2012 15:57
To: Serpico, Gina
Cc: Iksil, Bruno M; Martin-Artajo, Javier X; Macris, Achilles O; Hagan, Patrick S
Subject: Meeting materials for 11am meeting
Importance: High

Hi Gina,

Please find attached a copy of the meeting materials for Ina's 3pm meeting with Javier, Achilles and Bruno. Any questions please do not hesitate to g

Post the conf call with Ina, a big issue is raised around the cost of trading the book down in RWA and the potential carry.

I prepared a new presentation with the different options.....

20/1/2012
The Var keeps increasing as I add the decompression trade in order to flatten the HY exposure and I add to the xover-main trade

Where is this coming from ?

I have the qualitative explanation.. not the numbers in detail

From: Martin-Artajo, Javier X
Sent: 20 January 2012 11:00
To: Hagan, Patrick S; Iksil, Bruno M
Subject: FW: Breach of firm var

Can we please write about this a quick note . Fast please .

From: Goldman, Irvin J
Sent: 20 January 2012 03:08
To: Stephan, Keith; Weiland, Pe

From: Martin-Artajo, Javier X
Sent: 20 January 2012 11:00
To: Hagan, Patrick S; Iksil, Bruno M
Subject: FW: Breach of firm var

Can we please write about this a quick note . Fast please .

From: Goldman, Irvin J
Sent: 20 January 2012 03:08
To: Stephan, Keith; Weiland, Peter
Cc: Macris, Achilles O; Martin-Artajo, Javier X; Kalimtgis, Evan
Subject: Breach of firm

23/1/2012
The Var keeps explodes and shows up at the top of the firm....

We will sort this out in the coming days starting today. This is embarrassing I know. To say the least..
I need the marginals in cases like this. The marginals are the effect that a marginal change on one instrument has on the whole risk number. It is different from the contribution of one line or one position to the total. Because the measure is non linear. We did not have the marginals last wee

From: Martin-Artajo, Javier X
Sent: 23 January 2012 15:25
To: Iksil, Bruno M
Cc: Buraya, Luis C
Subject: FW: Aggregate Credit VaR

Bruno ,

please read . You need to reduce the VAR for tactical too until the new VAR model is operational . Want to discuss your limits until we sort the problem we currently *have .*

rgds

From: Lee, Janet X
Sen

I move the Var down on Tactical

the var in tactical is back below 10m

I will see if I can do more.. Not sure at all about the impact on total Var though

From: Chandna, Sameer X
Sent: 24 January 2012 16:30
To: Iksil, Bruno M; De Sangues, Eric; Buraya, Luis C; Grout, Julien G
Cc: Stephan, Keith; Lee, Janet X
Subject: Core Tactical var 23rd Jan

Bruno,

Total Tactical Var is $8.6mm as of 23rd. Reducti

24/1/2012
The books starts to lose money in an uncontrollable way....I prepare slides for the ISMG meeting

I sent slides for review to Andrew Perryman and Javier

I will have some slides for the meeting in the morning.. not the one for the afternoon.

From: Perryman, Andrew X
Sent: 24 January 2012 09:14
To: Iksil, Bruno M; Brown, Anthony M; Uzuner, Tolga I; Polychronopoulos, George H; berner, andy X

Cc: Martin-Artajo, Javier X; Kalimtgis, Evan
Subject: Weekly SAA Topics 26th January 2012

Please can you let me know if you have any discuss

Here is the message

From: Enfield, Keith
Sent: 26 January 2012 08:00
To: Macris, Achilles O; Martin-Artajo, Javier X; Polychronopoulos, George H; Kalimtgis, Evan; Chan, Chris S.; Chung, Rayson KK; Stephan, Keith; Douglas, Jamie P; Iksil, Bruno M; Uzuner, Tolga I; Bradley, John C.; Brown, Anthony M; berner, andy x; Fleming, Lorraine M
Cc: Bates, Paul T; Lee,

Attachments:
120126 Credit Highlights Presentation-ppt.zip (671 KB)

26/1/2012

ISMG meeting, I explain the loss coming in the book mostly from Series (underperformance vs the market rally

The new Var model is is the process of being approved but I cannot use it officially yet

From: Martin-Artajo, Javier X
Sent: 26 January 2012 10:57
To: Iksil, Bruno M; Hagan, Patrick S
Subject: FW: New methodology for Var jump - IMPORTANT

FYI

From: Martin-Artajo, Javier X
Sent: 26 January 2012 10:56
To: Goldman, Irvin J; Drew, Ina
Cc: Macris, Achilles O; Weiland, Peter
Subject: New methodology for Var jump

Irv/Ina ,

the New Var Met

Attachments:
VAR CIO review DRAFT-doc.zip (251 KB)
JanVarFinalModel.xls (21 KB)

I ask Keith when I can use this new Var model

Thx keith.

Please let me know as soon as possible whether I have to take action on the old methodology var number. So far I understand I should wait and favour the new methodology as far as the core book is concerned..
All I do is I make sure that the var for the tactical book remains within the limit, which it does although I had no confirmation of today's result.

I tested today the margl

27/1/2012

I request to Javier an increase in the CS01 because, after Kodak filing statement, I need to cover some default risks and thus I need to sell more protection on IG and Main to balance the directionality of the book. I here hit the limit in CS01

To Javier I write at 9h09

I will need an increase in the CS01 limit in order to reduce further the notionals and set the book for a smoother P&L path.

I am currently contrained by this limit of 10M CS01 that prevents me from having a decent convexity if spreads tighten mostly.

This is due to the current exposure we have now on defaults in US HY (we may lose money on defaults now because i cannot add flatte

Keith finds out that we allow the IB to benefit of an RWA that is below their regulatory floor. I suspect this is why my own RWA is so high

yes quite convenient to sit on the floor... I can tell ...being stuck to the roof

From: Martin-Artajo, Javier X
Sent: 27 January 2012 13:04
To: Hagan, Patrick S; Iksil, Bruno M
Subject: FW: Revised Floor calc with y/e data

interesting split

From: Stephan, Keith
Sent: 27 January 2012 13:01
To: Martin-Artajo, Javier X
Subject: FW: Revised Floor calc with y/e data

30/01/2012

I increase the CS01 and this causes worries although the x%CS01 is very bening

To Javier at 11h57...

the CS01 has reached 13.5M USD while the book is only marginally up in 10% CS01 tighetning

in the meantime the book still provide 1bln protection in the worst case for the group on a spread widening.

I just wanted to tell you how it looks like. I reckon this is close to where the book should be to be neutral with markets.

Bruno

30/01/2012 : Month end and I have to report a loss : I highlight my inability to neatly prevent the series 9 forwards to drift against us

To Javier at 16h42

We have to report a loss in the widening today, much less because the book has a long risk bias, *Comes month end and we cannot really prevent the forward spreads from moving up.*

We get closer but each day the dealers report unreliable runs, wider bid-ask quotes and this cost us.

To trade them is costly and leads to increase in notionals.

We have some evidence that our counterparties ne

Message to Evan where I highlight the material drawdown 17h52..

I know this.

Now I see the reply from Tolga and I see how different and alien this book is in the current setup. Not that I "discover" that, and I see that you try to remove the ambiguities here.

I just provide my thoughts on this matter, all the more so as the book has a material drawdown which in my view should only be cured in a run-off mode. I guess I have a responsibility here and

Attachments:
image001.png (27 KB)

Again to Javier for Month end 18h24

so the whole street here is framing and I tried.... same story all over the book parts.

To Javier soon after....18h30

are you available for a call?

From: Martin-Artajo, Javier X
Sent: 30 January 2012 18:29
To: Iksil, Bruno M
Subject: Re: so the whole street here is framing and I tried.... same story all over the book parts.

Let's keep trying tomorrow and wed then , Patience is going to be needed once again .

From: Iksil, Bruno M

Sent: Monday, January 30, 2012 06:23 PM
To: Martin-Ar

Late in the day 30/01/2012 21h02

To Javier

there is more loss coming in core credit book

I reckon we have another 50M coming from CDX IG9 exposure. The guys have a huge skew trade on and they will defend it as much as we do. I think I should take the pain fast over to next month. I have tried but it will ot move : they have moved some of those trades out at BOA but BNP, CSFB and BARCLAYS go for the fight. It is pointless in my view to go for a fight. We will roll down and recover the

21h13

ok they really push against our positions here everywhere. there is more pain to come in HY too : a lot of capital comes back into basis and skew trades. I can see a bad scenario here where spreads widen and guys do not go long risk but make basis arbs with a bearish view on weak names. Here we should stop adding and take full pain : I see 50m coming in IG9 as I mentionned and another 50m in HY,

21h48 I explain a bit more what I see and understand

They use the differential between single names and indices : usually, single names trades wider than indices in bullish mode.

This is even more the case on the forward spread we have a long risk exposure simply because we have sold protection all the way since last year.

Take the case of IG9 curve :

in IG9, because of RADIAN and MBIA presence that have both high upfront single nam

23h18... a different subject .. apparently

Henry KIM is running the HY index trading here in JP IB New York and he would like to know whether there is some opportunity for him here at CIO be it New York or London.

I thought may be he could try to meet with you while you are in New York even informally.

He is very young and very talented.

Let me know if you can find some spare time for him and he will get in contac

31/01/2012 : official month end,,, the pain is showing up and I try to explain to Javier and Achilles what is going on

Fw: Core book p&l drawdown and main exposures

I sent this memo to achilles ahead of the ismg meeting. I am travelling back to london today.

----- Original Message -----
From: Iksil, Bruno M
Sent: Tuesday, January 31, 2012 06:30 AM
To: Macris, Achilles O; 'macris@[redacted]
Subject: Fw: Core book p&l drawdown and main exposures

----- Original Message -----
From: Iksil Bruno [mailto:biksil2@[redacted]

▬ = Redacted by the Permanent Subcommittee on Investigations

The book currently conveys a short risk exposure in us hy and a long risk exposure in ig indices series 9 (both CDx and itraxx). This exposure balances the jump to default risk of the book : we would lose money now on a default in us hy and make money if the default occurs in ig world. One can summarize the net exposure as : the book has a bullish flatteners in ig and a bearish steepeners in us h

31/01/2012.. update.. things get worse again

ok they keep playing games in itraxx now. I will show up for small in the hope we can limit the pain.

as to IG9, things look much better, not that we are imune but we can show that we are not at mids but on realistic level.

I wait for Hy and will keep you in the loop when I have a final number.

I went I to ISMG and advised that we set the book for long risk carry the time

1/2/2012 ... we work out the PNL breakdown and start investigating what we can do

To Javier ...22h08...

1- P&L breakdown

We broke down the P&L per block and item (carry, new trade, directionality, compression, forwards, fin sub and rates)

The loss in directionality comes from the rally in HY. The improvement in new trades is due to the fight and some additional long risk in main.

You will notice the loss in fin sub, where we also have a forward trade funding a good upside in

2/2/2012 : I send to Javier and updated Pres where I highlight to potential further loss of 300M from a current loss of 100M

TO Javier 12h50

here is the latest version of the presentation

This message has been archived.

Attachments:
3feb2012 Credit Highlights Presentation-ppt.zip (2.4 MB)

3/2/2012 : conf call with Ina.. the text slides are removed and the focus is put on the risk management and the trade attractiveness at Javier's request

you will see that the number of slide is a bit higher than expected. I thought the presentation should have some annex still. I comment on the skew on the last 2 slides. difficult to summarize.

Attachments:
3feb2012 Credit Ina conf call-ppt.zip (688 KB)

10/2/2012.. the new rwa figures are out for month end and there is an increase.. I try to explain that the decompression trade HY Xover versus IG adds notionals and therefore capital consumption.. That most of this is due to RESCAP and KODAK defaults

To Pat Hagan and Javier 10h12

hello Pat

Here is what is happening here, happy to have quantitative data on it :

since Rescap event, we had a new drawdown... here is what I did since then with Julien :

I sold risk in HY on the runs (HY17 and HY16) and bought risk in IG17 and itraxx main 16, maintaining our 10%CS01 and 50% CS01 almost flat to slightly flat. PLease notice that the crude CS01 (that assumes all

13/2/2012.. rescap officially files, we take a hit again in our longs while the market rallies overall in HY and we take another hit from that...

To the whole ISMG committee and INA Drew12h50

From: Iksil, Bruno M
Sent: 13 February 2012 12:49
To: Drew, Ina
Subject: Core credit book P&L drivers over the last week.

Rescap : last Wednesday, ALLY announced they were preparing a pre-packaged banruptcy for Rescap. The 5yr CDS moved up from 40pts to 58 pts and the market bull flattened, ie we lost on our short risk positions (HY14 to hy17) and we lost on our long risk

To Javier 17h49...the problems worsen

we report a loss today due to compression of hy and xover spreads versus IG spreads (europe mostly bu US too).

We are converging towards a balanced P&L I think but we may wobble until *month end downward.*

The carry starts having an effect but it is too small (the basic daily carry is 1-2m while the compression move hit us 50m today just in itraxx)

Now the wilde tightening

14/2/2012.. the drift against our positions continue

we keep acknowledging losses without fighting. Today this is the us hy equity tranche group marked down 1 pots out of any specific news or single name move.

Also someone is pushing the index spreads wider into the London close, especially financial spreads.

The curves tended to flatten but the series 9 rolls changes made sure the forwards did not tighten while the whole market wi

15/2/2012.. same issue.. different face 17h56

very interesting session... again we record a loss but this is really due to another market weird move : the ote cds went up to 42 pts upfront (up 12pts on the day), and is in the xover index. UBS issued a coco bond that was oversubscribed and barely sold off in the widening. As a summary, fins widened a lot due to greece headline and xover outperformed despite the greece headline and OTE.

16/2/2012.. I try to reduce RWA and Var as much as I can in a bleeding book

to Javier 8h56

I am working now on var stress var and crm, ie on rwa marginals based on pat's model. This is the first set of numbers I can use.

I am making progress in the sense that I can use now Pat's work to figure out *whether we have good balance.*

As of now I just have to buy protection to reduce rwa, not big sizes but across the board.

I use tranches to improve the whole risk profile

Reply from Javier

From: Martin-Artajo, Javier X
Sent: 16 February 2012 08:58
To: Iksil, Bruno M
Subject: Re: core credit book PnL comment for the 15th Feb 2012

Let's review on monday with Pat too then to see what gets reported on the actuals .

From: Iksil, Bruno M
Sent: Thursday, February 16, 2012 08:55 AM
To: Martin-Artajo, Javier X
Subject: RE: core credit book PnL comment for th

20/2/2012 : I plan to update the ISMG meeting about the core book as PNL drift keeps sinking

To Andrew Perrymwn 11h27

RE: SAA Weekly Topics: Thursday 23rd February 2012

yes I have some update from ina's presentation to the ismg

but I need to gather some updates ...

From: Perryman, Andrew X
Sent: 20 February 2012 11:17
To: Brown, Anthony M; Iksil, Bruno M; berner, andy x; Uzuner, Tolga I; Polychronopoulos, George H
Cc: Martin-Artajo, Javier X; Kalimtgis, Evan
Subject: SAA Weekly Topics: Thursday 23rd February 2012

Please can you let me know

21/2/2012 : new presentation .. I stress upon the potential that I see coming and some features of the book to dimension all these events..like the book is huge but the market move is not huge while the hit is very large

to Javier and Andy...21h50

here is the updated presentation for next ISMG

I tried to make 3 new points from last pres for Ina :

1- the P&L drift in February is focussed on forwards and show up in the "investment" block of the book

2- the loss for February is spread across the book by clips of 40-50m with only slight drifts overall in a stable market

3- I highlighted the default profile and the carry profile of the book in detail

22/2/2012 : latest version... I highlight the potential path followed into quarter end

To Javier, Andy Berner, Andrew Perryman 12h15

core credit latest version

This message has been archived.

Attachments:
[120222 Core Credit Book PNL Review Bruno Update-ppt.zip](1.9 MB)

27/2/2012 : I added some summary slides that show the equivalent main positions of the book in simple indice form

to Javier, 15h24

latest slides for core credit

This message has been archived.

I added slides 4 and 5 that help "view" what the book is in BP sensitivity and strategic positioning..

Attachments:
[120223 Core Credit Book PNL Review Bruno Update-ppt.zip](2.7 MB)

28/2/2012.. month end .. more bleeding.. I completed the position by addin approx 6-7 Bln ig9 10yr where I thought he pb was...still think so btw

Keith needs to explain what happens wrt the larger PNL loss...13h58.. to Javier too

bullet points on core credit book

This message has been archived.

what the Core credit book is :

1- AN OPTION with positive convexity, positive carry on large and wild spread widening AND upside on default waves (similar to 2008-2009)

2- the VIEW is always based on Macro analysis (not targeting any specific name) : currently, we have a decompression trade on to pre-empt either an equity sell-off or a further rally in IG space.

3- the FORECAST i

14h14 To Andrew Perryman... we have to provide some update on the book

FW: Synthetic Credit Slide (text draft) --

This message has been archived.

From: Martin-Artajo, Javier X
Sent: 28 February 2012 13:42
To: Stephan, Keith
Cc: Iksil, Bruno M
Subject: RE: Synthetic Credit Slide (text draft) --

Very similar to what I just told Bruno to share with you . Lets get Andy Perryman/Bruno to put on a slide and lets then review .

tks

From: Stephan, Keith

Sent: 28 February 2012 13:40
To: Martin-Artajo, Ja

29/2/2012.. Month end shenanigans...

To Javier .. I highlight the trades I had to do to keep the PNL hit under control 22h28

This message has been archived.

I have sold important amounts of protection in ig9 10yr (close to 7bln all day or 3.5m cs01) and this will push the cs01 beyond the 25m limit. This is related to month end price moves that were all adverse although we could limit the damage.

I reckon the cs01 will jump to 28m (I bough protection for approx 500k in hy and xover) from 25m this morning. I went back inside the 25m limit this morn

1/3/2012...the day after the hit

The Risk guys are aware of it .. to Keith Stefan 5h44

This message has been archived.

----- Original Message -----
From: Iksil, Bruno M
Sent: Wednesday, February 29, 2012 10:27 PM
To: Martin-Artajo, Javier X
Subject: Core credit book update

I have sold important amounts of protection in ig9 10yr (close to 7bln all day or 3.5m cs01) and this will push the cs01 beyond the 25m limit. This is related to month end price moves that were all adverse although we could limit the d

this trading blows up the CS01 limit and I have to come back into it as I do not have yet the extension...

to Keith and Javier 13h02

This message has been archived.

I reduced 1.75M USd on itraxx this morning.

This is half of what is need to get back into the 25m limit.

I will work on it now...

18h07 ...to keith and Javier.. I came back in line...not quite under 25m cs01

This message has been archived.

The cs01 has been reduced by 2.5m usd today. So that puts the cs01 back to 25.5m.

I bought protection on main (2.7bln) and xover (750m). I bought some ig 17 (300m) and us hy (650m).

I bought in the spread tightening. Now that it has stopped tightening I do not chase unless you advise me to do so. I will finish tonight I hope with ig and hy mostly if the rally resumes.

Otherwise I will fi

6/3/2012 : Ashley Bacon comes in the loop now to collapse the risks between CIo and the IB.. he comes from the IB as most of the other guys do...

I reply to Javier 15h29

Re: Need to talk to you about a presentation of the Book to Ashley Bacon

This message has been archived.

Ok will do

From: Martin-Artajo, Javier X
Sent: Tuesday, March 06, 2012 02:42 PM
To: Iksil, Bruno M
Subject: Need to talk to you about a presentation of the Book to Ashley Bacon

Bruno ,

If you can call me around 4.30 PM today (5.30 PM your time) that would suit me well . Need around 15 mins from you .

regards

I called Julien (because I was on Holiday) so that he prepares this meeting....18h51

This message has been archived.

I asked him to work on 3 things
1- for thursday : update the pnl breakdown (forwds, directional, new trades, defaults etc..) And the pnl history chart
2- for monday : look at all the presentations we did with andy to compile a new set of slides describing the risks of the book. Andy and Julien should send you a draft version in order to get your feedback (what is good, not good, missing)
3- t

8/3/2012 17h55... important that I attend the meeting.. Achilles was in

To Javier

This message has been archived.

Yes I think I may have 30m late at the most.

----- Original Message -----
From: Martin-Artajo, Javier X
Sent: Thursday, March 08, 2012 05:32 PM
To: Iksil, Bruno M
Subject: RE: Monday meeting.

Bruno ,

Try to make the meeting as early as posible , It is important . I will start but you need to be part of the discussion . It will be a long meeting around 2 Hours . It will be only about R.

12/3/2012 : new presentation that provides a compact and synthetic view of the book and its issues.. to mention that so far the decompression as worked but not a lot yet...the roll will trigger the decompression and additional losses on the book...I start losing sleep..

to Javier and Andy..2h37

hello, following our last phone call, last week, please have a second look to this presentation I prepared with Andy for the ISMG meeting of the 23rd Feb 2012

This message has been archived.

I think the 5 first slides describe very well the book. The slide 4 in particular display the notionals and gives a clue of the scale of the moves. This shows quickly how the book can actually lose 200M and possibly another 200M while being range bound. The connection with last year gain is really a coincidence : the AMR move was really exceptional and the spread moves this year have also been exc

Attachments:
120223 Core Credit Book PNL Review Bruno Update-ppt.zip (2.7 MB)

15/3/2012 . the roll approaches and we start getting more losses...

To Javier 18h45

The divergence increases between crude mid prices and our estimate. Julien will send a small spreasheet recording the breadown of the divergence per blocks.

The ig9 10yrs lags another bp today. The hy market struggles to keep the rally pace with the sp500. Rescap curve is now flat at 65pts upfront. The equity tranches are fully impacted now. Yet the hy indices keep performing well.

Since month end, despite rescap event and greece, xover in itraxx and hy in cdx have maintained their ratio versus ig rally. That is 4bps tighter for ig17, 5 bps for main s16, 21 bps for xover and 20-25 bps for hy (if one adds the loss in rescap that is prices as certain now ie 75cts in price). In that regard, we keep the ig9 10 as performing like the market beta adjusted.

The whole ig9 curve should have outperformed actually if we look at the performance of radian and mbia or sfi. This is reflected in the ig9 5yr that has tightened 10bps, but not in ig9 10yr that has tightened less than 1 bps by the quotes we receive. What is really puzzling here is that the skew quotes have not changed! The cds outperformance and index underperformance should have tightened the skew.

We look at what we could do the reduce the difference while not growing the positions especially in ig9. The solutions are very limited : some main s9 trades could help, some hy trades too but the principal lag is where we do not want to add.

What I do right now is buying 0-3 7yr and 10yr in order to smooth the extinction of the book. This will be may be the solution : let the book run off. So I prepare it for this outcome. So far I did not show up in the index market. Just testing waters. I may not find size but the trading cost is high, not only the bid ask but the almost infinite ability of the dealers to twist their runs.

Best regards

Bruno

16/3/2012 ..I try to help designing a "sleep" mode for the book as I doubt we can expect any improvement in the short term ....

To Javier 6h42

I thought this night that we should consider putting some skew trades on both in ig9 10yr and itraxx mains9 10yr :
we could lock 60cts over good size I think.
This would maintain the upside on default, improve the carry and basically offset the loss we have now.

As I mentionned yesterday, despite the rally in Radian, MBIA and SFI, despite the lag in the IG9 10yr index, the skew has barely changed.
It shows to me a puzzling obstination on dealer side to keep it like that. Because this cannot be the result of a HF holding the market on its own alone.

This trade is not perfect of course but if the book goes in run-off mode as far as tranches are concerned, that is an interesting option. This money is obtained from a downgrade in the liquidity of the portfolio. Yet, it looks a much better option than collapsing or unwinding the trades with the street or any dealer or counterparty in block trades.

The trades could be booked on a standalone basis from one cash quote, so this would be easy to mark (with an increased issue here I agree).
The liquidity injection we would operate might also be favorable for us to reduce some tranche lines, especially the 0-3 10yr in that regard.

As a summary :
Negatives
- added dependency on dealers quotes
- downgraded profile if the book remains a tail risk book in credit derivatives
- slight overload in operations due to the single name booking
- we may have to increase RWA in the process first hand

positives
- we lock a PNL in form of carry forward that offsets the current unrealized loss
- does not alter the tail profile in terms of defaults upside
- likely helps us reduce some remaining large positions once we have traded sizes on skew
- once booked, very simply to mark and maintain.
- allows us to pay the trading costs to set the book for run off mode

The real choice to make is whether the book should be on run-off mode, ie we lightly manage it with a long risk bias ; we would allow for P&L swings and we would just prepare for default risk looking forward. To be sure, this is the case already but the book is not in run off mode. If the book steps in run-off, the skew trade would make sense because we would not plan to unwind agressively as we did last year.

Let me know

Bruno

To Javier 15h37

I explain the book structure as it is

we have 3 blocks : itraxx, IG and HY

IG is the largest one and the most difficult one :

trade ideas....
- swap index IG9 10yr for single names with full upfront skew trades
- buy protection in 0-3, sell protection in 7-10 in both 7yr and 10yr
- buy outright protection in 7yr vs sell protection in on the run IG

Main is the least difficult one
- we should do the same kind of trades as the problem is the same

US HY is the trickiest one
trade ideas....
- buy the HY 10 hy11 15-25 and 25-35 tranches to roll down and shelter from the first defaults
- leave the equity tranches as they are almost deleted
- add some flatteners in HY14 HY15 HY16 and HY17 as time passes by

IG trades will improve the carry, reduce liquidity a bit but allow for a smooth roll down. The target is to be buyer of protection on all equity tranches : thus the delat increasing over time, the long position will switch to neutral fast without us trading more. Now the best profile is to keep the long risk bias to start.

Itraxx is the same theme as IG with a size much smaller.

HY : the problem is the upside on default. Some names are still a bit problematic (TXU and realogy). I think the number of defaults is limited in these series(HY11 and HY10) where we have the downside on defaults. The flatteners will need to be funded over time. Hence the long risk in IG and Main blocks.

All this would not change materially the profile of the book. Over the rest of its life, we would simply stick to these trades and do nothing more. We have to define the optimal exposure in long risk terms to ensure we have a decent carry.

Bruno

From March 21st till April 16th 2012-04-16

I sold 2-3 billion more in IG and Main to finish the book balance : the P&L explanation showed a shortage of carry dues to maturity extension. Now the book looks balanced till the end of the year, losing "only " 175m at worse

The first 2 weeks of April were devastating due to the press articles that showed the line of blood. May be that was a mistake to let the book in run off right at this moment. It should have been done earlier but it would have implied no forced reduction in RWA, increased Var, less diversification in stress and more P&L potential drawdowns.

Now all the issue is about the availability of liquidity to keep the book with upside on P&L when credit events occur. The book is put to sleep.

Iksil, Bruno M

From: Iksil, Bruno M
Sent: 12 March 2012 02:37
To: Martin-Artajo, Javier X; Perryman, Andrew X; Grout, Julien G
Subject: hello, following our last phone call, last week, please have a second look to this presentation I prepared with Andy for the ISMG meeting of the 23rd Feb 2012
Attachments: 120223 Core Credit Book PNL Review Bruno Update-ppt.zip

I think the 5 first slides describe very well the book. The slide 4 in particular display the notionals and gives a clue of the scale of the moves. This shows quickly how the book can actually lose 200M and possibly another 200M while being range bound. The connection with last year gain is really a coincidence : the AMR move was really exceptional and the spread moves this year have also been exceptional but in very different moves.

In addition I would like to add another slide to describe how the IG9 trade requires possibly capital spot to allow for a quicker and smoother capital reduction: the focus would be on radian where there is a risk that , should radian file for chapt 11, it may only be in 2013 or later.
In that case we should right now buy protection on IG9 0-3 7yr and 10yr, and sell protection on 7-10 7yr and 10yr tranches. This might increase the RWA first hand, not sure about Var and stress var. As time passes by, the delta would increase and reduce smotthly the net long exposure.

This would be the best trade we could do as of today : this will not impact the carry at first (instead we would sell the implied long temr spread volatility) but will reduce the positive convexity of the book. Yet this will make the profile of core closer to tactical. Now tactical is approx 10 to 20 times smaller than core and has a "natural" P&L noise of 2-3M daily. So, we should expect a higher daily P&L noise in core of up to 20-40M while totday it is much smaller out of market moves described in the past.

In order to highlight different order of magnitudes, I think I should add two other slides :
1-how really the market prices defaults of their way to appearance (what is prices in vs what is not yet). This will help understand the slide 3 that details the default exposure breakdown
2-how IG9 has moved versus a regression modelled spread coming from, IG15, HY17, and Radian 5yr CDS : this would help explain how and why the IG move is so peculiar.

Let me know Your thoughts

Best regards

Bruno IKSIL

2

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Iksil, Bruno M

From: Iksil, Bruno M
Sent: 15 March 2012 18:45
To: Martin-Artajo, Javier X
Subject: Update on core

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Iksil, Bruno M

From: Iksil, Bruno M
Sent: 16 March 2012 06:42
To: Martin-Artajo, Javier X
Cc: Grout, Julien G; Hagan, Patrick S
Subject: trade ideas on core

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- added dependency on dealers quotes
- downgraded profile if the book remains a tail risk book in credit derivatives
- slight overload in operations due to the single name booking

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- we may have to increase RWA in the process first hand.

positives :

- we lock a PNL in form of carry forward that offsets the current unrealized loss.
- does not alter the tail profile in terms of defaults upside
- likely helps us reduce some remaining large positions once we have traded sizes on skew
- once booked, very simply to mark and maintain.
- allows us to pay the trading costs to set the book for run-off mode

The real choice to make is whether the book should be on run-off mode, ie we lightly manage it with a long risk bias : we would allow for P&L swings and we would just prepare for default risk looking forward. To be sure, this is the case already but the book is not in run off mode. If the book steps in run-off, the skew trade would make sense because we would not plan to unwind agressively as we did last year.

Let me know

Bruno

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Let me know

mo

Iksil, Bruno M

From: Iksil, Bruno M
Sent: 16 March 2012 15:37
To: Martin-Artajo, Javier X; Grout, Julien G
Subject: strategy for core

we have 3 blocks : Itraxx, IG and HY

IG is the largest one and the most difficult one :
trade ideas.....
- swap index IG9 10yr for single names with full upfront skew trades
- buy protection in 0-3, sell protection in 7-10 in both 7yr and 10yr
- buy outright protection in 7yr vs sell protection in on the run IG

Main is the least difficult one
- we should do the same kind of trades as the problem is the same

US HY is the trickiest one
trade ideas....
- buy the HY 10 hy11 15-25 and 25-35 tranches to roll down and shelter from the first defaults
- leave the equity tranches as they are almost deleted
- add some flatteners in HY14 HY15 HY16 and HY17 as time passes by

IG trades will improve the carry, reduce liquidity a bit but allow for a smooth roll down. The target is to be buyer of protection on all equity tranches : thus the delat increasing over time, the long position will switch to neutral fast without us trading more. Now the best profile is to keep the long risk bias to start.

Itraxx is the same theme as IG with a size much smaller.

HY : the problem is the upside on default. Some names are still a bit problematic (TXU and realogy). I think the number of defaults is limited in these series(HY11 and HY10) where we have the downside on defaults. The

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flatteners will need to be funded over time. Hence the long risk in IG and Main blocks.

All this would not change materially the profile of the book. Over the rest of its life, we would simply stick to these trades and do nothing more. We have to define the optimal exposure in long risk terms to ensure we have a decent carry.

Bruno

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Bruno

Iksil, Bruno M

From: Iksil, Bruno M
Sent: 16 March 2012 17:34
To: Martin-Artajo, Javier X
Subject: update on Core PNL

The divergence has increased to 300 now ; the rescap news is pushing the tranches and HY indices against us.

I worked on the IG9 ans main S9 a bit today. There is some size. Not large. But if I trade 2 bps tighter, I reckon there will be size.

Tactical starts being impacted despite the trading gains. Small though. But the hits show anywhere but the spots I tried to correct.

It has been like this since the start of the year and the drift keeps going. I reckon we get to 400 difference very soon.

Bruno

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Iksil, Bruno M

From: Iksil, Bruno M
Sent: 19 March 2012 11:45
To: Martin-Artajo, Javier X
Cc: Grout, Julien G
Subject: Core Book analysis and proposed strategy

Book position

- The book has positive carry, P&L upside on defaults and positive convexity if spreads gap wider. It is relatively neutral directionally overall at current market spread levels>

- To obtain this profile, the book receives the forward credit spreads. When markets are caught in squeeze like this one, the P&L volatility can become very large : this is what is happening since the beginning of this year in CDX IG9 and Main ITRAXX S9 series. The hit amounts to 5-10 Bps lag in those forwards versus the 50-60Bps rally.

- The book incurred a loss of 100m usd IN us hy from KODAK default and RESCAP almost certain default : this weakness have been corrected now and offers decent upside in any new default in HY indices

Market behaviour

- The CDX IG9 and ITRAXX Main S9 are the series where index tranches still trade. This is where the street owns some protection especially in the longer tenors for capital relief reason and uncertainty about the timing of defaults.

- some large Hedge funds have some "skew trades" where they buy protection on the series 9 10yr indices versus the single names

-In the rally, those series (where the book is long risk and the street is short risk) have lagged consistently : by trading and trying to correct the lag, we could retrieve 1-2bps but then we met strong resistance either with size or bid-ask widening.

- this year the tranche market depth has vanished : we can trade but small size each time with an appetite from dealers to load protection on the longest tenors.

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-in US HY, in addition to the 2 defaults, we face a flattening trend advertized by dealers saying that either we have defaults or we rally : either ways, the curve flattens and we have a steepener on.

- as a summary, the book is a very visible player and holds a trade that the street wants to have now : ie a protection against unpredictable defaults. At the same time, they still own their "no default" trades from last year. So the street systematically steepens the series 9 curves and maintain the longest tenors wider than anything else.

Proposed strategy : **let the P&L fluctuate while not defending, just maintaining the upside on defaults over time**

-CDX IG and ITRAXX MAIN : over the next 18 months

- buy back the protection in 0-3 10yr to reverse the profile (3Bln in main, 6bln in IG)

- buy some 0-3 in 7yr tenors (1bln main-2 bln in IG)

- sell protection over time on widenings to maintain the carry (5-10 Bln Main and IG)

- CDX US HY : over the next 18 months

- put flatteners on in HY14-hy15-hy16-hy17 series while we own the protection on the 5yr now

- let the longs in HY10-hy11 series live as they have lost already 18 names out of 100 and look safer than hy 14 to hy17 series

P&L possible range : the loss is likely to range between 100m to 300m

- main reason is the CDX IG9 lag (2-3bps or 100-150m)

- second next is CDX HY : the hit is another 100m spread within the tranche and index bid-ask. Typical here, you cannot really trade but the mid does not change.

- third is Main itraxx : the curve in S9 steepened by 5bps pushing the forward back up while the other curves steepened 1 bp in the rally. The hit here is 80-100m.

- the estimated bid-ask on the book grossly amounts to 500m all-in (200m for IG, 100m for itraxx main, 200m for CDX HY).

Conclusion

- the book has very useful features and should be maintained with its upside on defaults as much as possible.

2

- the market is very small now and we are too visible with likely some of our trades creating a concern among dealers : this affects us both in the bid-ask cost and the Mark_To_market because the street owns the long term protection to cover their legacy, ie "no default" trades mostly held in form of steepeners and long risk in short term equity tranches.

- there is a trap that is building : if we limit the Mark-To_Market we risk increasing the notionals further and weaken our position versus the rest of the market. One solution would be to let the book be really long risk, yet this would not be in a liquid market and may increase the P&L noise especially in corrections.

- the solution proposed amounts to be longer risk and let the book expire carrying the upside on default ; I think we own here a very good position for a size that is also significant. This would involve some mechanical trading, ie buy protection on 10yr equity tranches, put flatteners in HY 14-17 and SELL protection on spread wdidening.

The PNL breakdwon and bid-ask analysis will come soon after. Julien is on it.

Bruno

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Bruno

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From: Goldman, Irvin J
Sent: Fri, 04 May 2012 18:14:15 GMT
To: Weiland, Peter <peter.weiland@jpmchase.com>; Tocchio, Samantha X <samantha.x.tocchio@jpmorgan.com>; Lee, Elizabeth M <elizabeth.m.lee@jpmorgan.com>
Subject: FW: Information needed
Importance: High

-----Original Message-----
From: Nase, Angjela X
Sent: Thursday, May 03, 2012 11:54 AM
To: Goldman, Irvin J
Cc: Surtani, Lavine; Lynch, Matthew A; Chen, Ted C; Doyle, Robin A.
Subject: RE: Information needed
Importance: High

Hi Irv,

Per your request to Matt, please find the CIO excessions attached. Please let us know if you need anything else.

Regards,
Angjela

-----Original Message-----
From: Lynch, Matthew A
Sent: Wednesday, May 02, 2012 9:56 PM
To: MRM External Reporting
Cc: Surtani, Lavine
Subject: Fw: Information needed

Fyi please see this high priority request from Irv. I committed to getting something to him by mid day tomorrow. Given that we have sent several such emails over the last few months with excession summaries we should be able to pull this together.

----- Original Message -----
From: Goldman, Irvin J
Sent: Wednesday, May 02, 2012 06:44 PM
To: Lynch, Matthew A
Cc: Doyle, Robin A.
Subject: Information needed

Matt,
I need a summary for a specific workstream john hogan requested of all CIO excessions, breach's reported by mrm from 9/30/2011 to today. This is high priority. Please let me know estimated delivery of request.
Thanks
Irv

Permanent Subcommittee on Investigations
EXHIBIT #39

40098	CIO - Int l - Global Equities - Aggr - Top Tier Vega	10/26/2011	Level 2 Limit	2,000,000	7,848,459	5,848,459	292
32403	CIO - Global Equities - Int'l - Aggr - Total Gross Equity Vega	10/27/2011	Other Threshold	6,000,000	17,660,153	11,660,153	194
40098	CIO - Int l - Global Equities - Aggr - Top Tier Vega	10/27/2011	Level 2 Limit	2,000,000	7,864,020	5,864,020	293
32404	CIO - Global Equities - Int'l - Aggr - Total Net Equity Vega	10/27/2011	Level 2 Limit	4,500,000	10,715,067	6,215,067	138
32403	CIO - Global Equities - Int'l - Aggr - Total Gross Equity Vega	10/28/2011	Other Threshold	6,000,000	17,344,231	11,344,231	189
40098	CIO - Int l - Global Equities - Aggr - Top Tier Vega	10/28/2011	Level 2 Limit	2,000,000	7,328,548	5,328,548	266
32404	CIO - Global Equities - Int'l - Aggr - Total Net Equity Vega	10/28/2011	Level 2 Limit	4,500,000	9,864,208	5,364,208	119
32404	CIO - Global Equities - Int'l - Aggr - Total Net Equity Vega	10/31/2011	Level 2 Limit	4,500,000	8,701,231	4,201,231	93
40098	CIO - Int l - Global Equities - Aggr - Top Tier Vega	10/31/2011	Level 2 Limit	2,000,000	6,155,446	4,155,446	208
32403	CIO - Global Equities - Int'l - Aggr - Total Gross Equity Vega	10/31/2011	Other Threshold	6,000,000	16,034,376	10,034,376	167
38588	CIO - Global - Aggregate - Combined CIO & MSR VAR	11/14/2011	Level 1 Limit	145,000,000	145,931,456	931,456	1
38588	CIO - Global - Aggregate - Combined CIO & MSR VAR	11/15/2011	Level 1 Limit	145,000,000	148,316,192	3,316,192	2
38599	CIO - Int'l - Aggregate - Equity VAR	11/30/2011	Level 2 Limit	12,000,000	13,208,411	1,208,411	10
38602	CIO - Int'l - 10Q - Equity VAR	11/30/2011	Level 2 Limit	12,000,000	13,208,411	1,208,411	10
38599	CIO - Int'l - Aggregate - Equity VAR	12/1/2011	Level 2 Limit	12,000,000	12,877,700	877,700	7
38602	CIO - Int'l - 10Q - Equity VAR	12/1/2011	Level 2 Limit	12,000,000	12,877,700	877,700	7
38602	CIO - Int'l - 10Q - Equity VAR	12/2/2011	Level 2 Limit	12,000,000	13,429,773	1,429,773	12
38599	CIO - Int'l - Aggregate - Equity VAR	12/2/2011	Level 2 Limit	12,000,000	13,429,773	1,429,773	12
38599	CIO - Int'l - Aggregate - Equity VAR	12/5/2011	Level 2 Limit	12,000,000	13,251,517	1,251,517	10
38602	CIO - Int'l - 10Q - Equity VAR	12/5/2011	Level 2 Limit	12,000,000	13,251,517	1,251,517	10
38588	CIO - Global - Aggregate - Combined CIO & MSR VAR	12/7/2011	Level 1 Limit	165,000,000	170,095,104	5,095,104	3
38588	CIO - Global - Aggregate - Combined CIO & MSR VAR	12/8/2011	Level 1 Limit	165,000,000	174,545,920	9,545,920	6
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/6/2012	Level 2 Limit	5,000,000	-5,767,816	767,816	15
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/9/2012	Level 2 Limit	5,000,000	-6,540,464	1,540,464	31
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/10/2012	Level 2 Limit	5,000,000	-7,173,676	2,173,676	43
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/11/2012	Level 2 Limit	5,000,000	-6,705,051	1,705,051	34
38603	CIO - Int'l - 10Q - Credit VAR	1/12/2012	Level 2 Limit	95,000,000	96,814,688	1,814,688	2
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/12/2012	Level 2 Limit	5,000,000	-7,073,191	2,073,191	41
38591	CIO - International - 10Q - Total VAR	1/16/2012	Level 1 Limit	95,000,000	95,692,064	692,064	1
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/16/2012	Level 2 Limit	5,000,000	-6,789,050	1,789,050	36
38589	CIO - Global - 10Q VAR	1/16/2012	Level 1 Limit	95,000,000	95,681,928	681,928	1
38603	CIO - Int'l - 10Q - Credit VAR	1/16/2012	Level 2 Limit	95,000,000	96,494,152	1,494,152	2
38589	CIO - Global - 10Q VAR	1/17/2012	Level 1 Limit	95,000,000	95,699,848	699,848	1
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/17/2012	Level 2 Limit	5,000,000	-8,623,171	3,623,171	72
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/18/2012	Level 2 Limit	5,000,000	-10,501,915	5,501,915	110
38591	CIO - International - 10Q - Total VAR	1/18/2012	Level 1 Limit	95,000,000	100,778,448	5,778,448	6
38603	CIO - Int'l - 10Q - Credit VAR	1/18/2012	Level 2 Limit	95,000,000	98,016,888	3,016,888	3
38589	CIO - Global - 10Q VAR	1/18/2012	Level 1 Limit	95,000,000	102,385,400	7,385,400	8
38585	CIO - Intl - International - Aggregate - Total VaR	1/18/2012	Level 1 Limit	100,000,000	104,252,784	4,252,784	4
38600	CIO - Int'l - Aggregate - Credit VAR	1/18/2012	Level 2 Limit	100,000,000	100,427,112	427,112	0
38019	CIO - Global Credit - Credit Spread BPV - Total	1/18/2012	Level 2 Limit	12,000,000	-12,476,463	476,463	4
38600	CIO - Int'l - Aggregate - Credit VAR	1/19/2012	Level 2 Limit	100,000,000	100,137,712	137,712	0
38589	CIO - Global - 10Q VAR	1/19/2012	Level 1 Limit	95,000,000	99,936,344	4,936,344	5
38603	CIO - Int'l - 10Q - Credit VAR	1/19/2012	Level 2 Limit	95,000,000	99,976,192	4,976,192	5
38585	CIO - Intl - International - Aggregate - Total VaR	1/19/2012	Level 1 Limit	100,000,000	100,226,928	226,928	0
38591	CIO - International - 10Q - Total VAR	1/19/2012	Level 1 Limit	95,000,000	99,576,968	4,576,968	5
38019	CIO - Global Credit - Credit Spread BPV - Total	1/19/2012	Level 2 Limit	12,000,000	-12,242,682	242,682	2
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/19/2012	Level 2 Limit	5,000,000	-9,038,065	4,038,065	81
38585	CIO - Intl - International - Aggregate - Total VaR	1/20/2012	Level 1 Limit	100,000,000	100,349,216	349,216	0
38600	CIO - Int'l - Aggregate - Credit VAR	1/20/2012	Level 2 Limit	100,000,000	100,691,064	691,064	1
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/20/2012	Level 2 Limit	5,000,000	-9,244,498	4,244,498	85
38603	CIO - Int'l - 10Q - Credit VAR	1/20/2012	Level 2 Limit	95,000,000	100,207,568	5,207,568	5
38591	CIO - International - 10Q - Total VAR	1/20/2012	Level 1 Limit	95,000,000	99,800,376	4,800,376	5
38591	CIO - International - 10Q - Total VAR	1/23/2012	Level 1 Limit	95,000,000	101,827,328	6,827,328	7
38600	CIO - Int'l - Aggregate - Credit VAR	1/23/2012	Level 2 Limit	100,000,000	102,249,600	2,249,600	2
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/23/2012	Level 2 Limit	5,000,000	-9,183,831	4,183,831	84
38585	CIO - Intl - International - Aggregate - Total VaR	1/23/2012	Level 1 Limit	100,000,000	102,966,032	2,966,032	3
38603	CIO - Int'l - 10Q - Credit VAR	1/23/2012	Level 2 Limit	95,000,000	101,721,928	6,721,928	7
38589	CIO - Global - 10Q VAR	1/24/2012	Level 1 Limit	105,000,000	106,610,296	1,610,296	2
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/24/2012	Level 2 Limit	5,000,000	-9,865,676	4,865,676	97
38600	CIO - Int'l - Aggregate - Credit VAR	1/25/2012	Level 2 Limit	110,000,000	110,314,224	314,224	0
38580	CIO - Global - Aggregate - Global VAR	1/25/2012	Level 1 Limit	110,000,000	115,473,248	5,473,248	5
38019	CIO - Global Credit - Credit Spread BPV - Total	1/25/2012	Level 2 Limit	12,000,000	-12,795,898	795,898	7

[illegible]

38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/9/2012	Level 2 Limit	200,000,000	-269,885,938	69,885,938	35
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/10/2012	Level 2 Limit	200,000,000	-321,873,773	121,873,773	61
38019	CIO - Global Credit - Credit Spread BPV - Total	4/10/2012	Level 2 Limit	12,000,000	-56,034,550	44,034,550	367
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/10/2012	Level 2 Limit	5,000,000	-53,929,565	48,929,565	979
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/10/2012	Level 2 Limit	300,000,000	-342,342,685	42,342,685	14
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/11/2012	Level 2 Limit	300,000,000	-376,853,345	76,853,345	26
38019	CIO - Global Credit - Credit Spread BPV - Total	4/11/2012	Level 2 Limit	12,000,000	-59,238,806	47,238,806	394
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/11/2012	Level 2 Limit	200,000,000	-356,390,044	156,390,044	78
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/11/2012	Level 2 Limit	5,000,000	-57,135,483	52,135,483	1043
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/12/2012	Level 2 Limit	300,000,000	-374,478,448	74,478,448	25
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/12/2012	Level 2 Limit	5,000,000	-57,470,586	52,470,586	1049
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/12/2012	Level 2 Limit	200,000,000	-353,037,662	153,037,662	77
38019	CIO - Global Credit - Credit Spread BPV - Total	4/12/2012	Level 2 Limit	12,000,000	-59,652,844	47,652,844	397
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/13/2012	Level 2 Limit	200,000,000	-368,813,527	168,813,527	84
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/13/2012	Level 2 Limit	300,000,000	-390,547,052	90,547,052	30
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/13/2012	Level 2 Limit	5,000,000	-57,927,242	52,927,242	1059
38019	CIO - Global Credit - Credit Spread BPV - Total	4/13/2012	Level 2 Limit	12,000,000	-60,121,678	48,121,678	401
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/16/2012	Level 2 Limit	5,000,000	-57,985,157	52,985,157	1060
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/16/2012	Level 2 Limit	200,000,000	-371,895,266	171,895,266	86
38019	CIO - Global Credit - Credit Spread BPV - Total	4/16/2012	Level 2 Limit	12,000,000	-60,167,490	48,167,490	401
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/16/2012	Level 2 Limit	300,000,000	-393,676,447	93,676,447	31
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/17/2012	Level 2 Limit	200,000,000	-362,795,153	162,795,153	81
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/17/2012	Level 2 Limit	5,000,000	-57,676,484	52,676,484	1054
38019	CIO - Global Credit - Credit Spread BPV - Total	4/17/2012	Level 2 Limit	12,000,000	-59,885,623	47,885,623	399
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/17/2012	Level 2 Limit	300,000,000	-384,661,930	84,661,930	28
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/18/2012	Level 2 Limit	5,000,000	-58,521,238	53,521,238	1070
38019	CIO - Global Credit - Credit Spread BPV - Total	4/18/2012	Level 2 Limit	12,000,000	-60,742,826	48,742,826	406
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/18/2012	Level 2 Limit	300,000,000	-393,902,861	93,902,861	31
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/18/2012	Level 2 Limit	200,000,000	-372,061,660	172,061,660	86
38019	CIO - Global Credit - Credit Spread BPV - Total	4/19/2012	Level 2 Limit	12,000,000	-61,189,331	49,189,331	410
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/19/2012	Level 2 Limit	200,000,000	-380,193,919	180,193,919	90
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/19/2012	Level 2 Limit	300,000,000	-401,836,188	101,836,188	34
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/19/2012	Level 2 Limit	5,000,000	-58,982,269	53,982,269	1080
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/20/2012	Level 2 Limit	5,000,000	-59,676,571	54,676,571	1094
38019	CIO - Global Credit - Credit Spread BPV - Total	4/20/2012	Level 2 Limit	12,000,000	-61,876,597	49,876,597	416
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/20/2012	Level 2 Limit	300,000,000	-406,171,289	106,171,289	35
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/20/2012	Level 2 Limit	200,000,000	-384,647,536	184,647,536	92
38019	CIO - Global Credit - Credit Spread BPV - Total	4/23/2012	Level 2 Limit	12,000,000	-61,469,257	49,469,257	412
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/23/2012	Level 2 Limit	200,000,000	-400,815,797	200,815,797	100
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/23/2012	Level 2 Limit	300,000,000	-422,470,672	122,470,672	41
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/23/2012	Level 2 Limit	5,000,000	-59,272,161	54,272,161	1085
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/24/2012	Level 2 Limit	300,000,000	-411,332,289	111,332,289	37
38019	CIO - Global Credit - Credit Spread BPV - Total	4/24/2012	Level 2 Limit	12,000,000	-60,906,979	48,906,979	408
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/24/2012	Level 2 Limit	5,000,000	-58,721,289	53,721,289	1074
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/24/2012	Level 2 Limit	200,000,000	-389,658,389	189,658,389	95
38019	CIO - Global Credit - Credit Spread BPV - Total	4/25/2012	Level 2 Limit	12,000,000	-59,661,613	47,661,613	397
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/25/2012	Level 2 Limit	5,000,000	-58,737,497	53,737,497	1075
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/25/2012	Level 2 Limit	200,000,000	-403,685,619	203,685,619	102
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/25/2012	Level 2 Limit	300,000,000	-415,971,207	115,971,207	39
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/26/2012	Level 2 Limit	5,000,000	-59,556,629	54,556,629	1091
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/26/2012	Level 2 Limit	300,000,000	-443,150,935	143,150,935	48
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/26/2012	Level 2 Limit	200,000,000	-421,552,962	221,552,962	111
38019	CIO - Global Credit - Credit Spread BPV - Total	4/26/2012	Level 2 Limit	12,000,000	-61,718,741	49,718,741	414
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/27/2012	Level 2 Limit	5,000,000	-59,695,101	54,695,101	1094
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/27/2012	Level 2 Limit	300,000,000	-429,093,269	129,093,269	43
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/27/2012	Level 2 Limit	200,000,000	-407,310,286	207,310,286	104
38019	CIO - Global Credit - Credit Spread BPV - Total	4/27/2012	Level 2 Limit	12,000,000	-61,854,212	49,854,212	415
38016	CIO - Global Credit - 10% CSW - MTM - Total (long/short)	4/30/2012	Level 2 Limit	200,000,000	-428,187,762	228,187,762	114
38019	CIO - Global Credit - Credit Spread BPV - Total	4/30/2012	Level 2 Limit	12,000,000	-61,781,744	49,781,744	415
37991	CIO - Global Credit - 10% CSW - Total (long/short)	4/30/2012	Level 2 Limit	300,000,000	-447,715,780	147,715,780	49
38020	CIO - Global Credit - Credit Spread BPV - MTM - Total	4/30/2012	Level 2 Limit	5,000,000	-58,874,882	54,874,882	1097

Id	Description	Cob	Type	Value	Utilization	Excession	%
32091	CIO - Global - Max Stress Loss - FSI - Aggregate	4/3/2012	Level 1 Limit	800,000,000	-1,180,071,389	380,071,389	48
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/3/2012	Level 1 Limit	500,000,000	-858,842,646	358,842,646	72
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/4/2012	Level 1 Limit	500,000,000	-858,842,646	358,842,646	72
32091	CIO - Global - Max Stress Loss - FSI - Aggregate	4/4/2012	Level 1 Limit	800,000,000	-1,180,071,389	380,071,389	48
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/10/2012	Level 1 Limit	1,000,000,000	-1,526,602,110	526,602,110	53
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/11/2012	Level 1 Limit	1,000,000,000	-1,526,602,110	526,602,110	53
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/12/2012	Level 1 Limit	1,000,000,000	-1,526,602,110	526,602,110	53
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/13/2012	Level 1 Limit	1,000,000,000	-1,526,602,110	526,602,110	53
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/16/2012	Level 1 Limit	1,000,000,000	-1,526,602,110	526,602,110	53
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/17/2012	Level 1 Limit	1,000,000,000	-1,430,087,769	430,087,769	43
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/18/2012	Level 1 Limit	1,000,000,000	-1,430,087,769	430,087,769	43
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/19/2012	Level 1 Limit	1,000,000,000	-1,430,087,769	430,087,769	43
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/20/2012	Level 1 Limit	1,000,000,000	-1,430,087,769	430,087,769	43
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/23/2012	Level 1 Limit	1,000,000,000	-1,430,087,769	430,087,769	43
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/23/2012	Level 1 Limit	1,000,000,000	-1,430,087,769	430,087,769	43
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/24/2012	Level 1 Limit	1,000,000,000	-1,650,033,139	650,033,139	65
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/25/2012	Level 1 Limit	1,000,000,000	-1,650,033,139	650,033,139	65
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/26/2012	Level 1 Limit	1,000,000,000	-1,650,033,139	650,033,139	65
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/27/2012	Level 1 Limit	1,000,000,000	-1,650,033,139	650,033,139	65
32092	CIO - Global - Max Stress Loss - FSI - MTM	4/30/2012	Level 1 Limit	1,000,000,000	-1,650,033,139	650,033,139	65
32092	CIO - Global - Max Stress Loss - FSI - MTM	5/1/2012	Level 1 Limit	1,000,000,000	-1,650,033,139	650,033,139	65

Stop Loss Advisories

Id	Description	Cob	Type	Value	Utilization	Excession	%
32139	CIO - NA - MTM - Twenty Day Stop Loss Adv	10/3/2011	Level 1 Limit	25,000,000	-39,340,873	14,340,873	57
32139	CIO - NA - MTM - Twenty Day Stop Loss Adv	10/4/2011	Level 1 Limit	25,000,000	-29,132,856	4,132,856	17
32114	CIO - Global - MTM - Five Day Stop Loss Adv	3/26/2012	Other Threshold	60,000,000	-79,656,111	19,656,111	33
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	3/26/2012	Other Threshold	70,000,000	-73,518,000	3,518,000	5
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	3/26/2012	Other Threshold	70,000,000	-70,009,000	9,000	0
32114	CIO - Global - MTM - Five Day Stop Loss Adv	3/27/2012	Other Threshold	60,000,000	-82,935,270	22,935,270	38
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	3/27/2012	Other Threshold	70,000,000	-72,765,000	2,765,000	4
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	3/27/2012	Other Threshold	70,000,000	-73,465,000	3,465,000	5
32114	CIO - Global - MTM - Five Day Stop Loss Adv	3/28/2012	Other Threshold	60,000,000	-130,310,910	70,310,910	117
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	3/28/2012	Other Threshold	70,000,000	-126,298,000	56,298,000	80
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	3/28/2012	Other Threshold	70,000,000	-128,945,000	58,945,000	84
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	3/29/2012	Other Threshold	70,000,000	-182,659,000	112,659,000	161
32111	CIO - Global - Aggregate - Five Day Stop Loss Adv	3/29/2012	Other Threshold	150,000,000	-191,256,804	41,256,804	28
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	3/29/2012	Other Threshold	70,000,000	-183,268,000	113,268,000	162
32114	CIO - Global - MTM - Five Day Stop Loss Adv	3/29/2012	Other Threshold	60,000,000	-188,976,233	128,976,233	215
32114	CIO - Global - MTM - Five Day Stop Loss Adv	3/30/2012	Other Threshold	60,000,000	-185,398,055	125,398,055	209
32998	CIO - Int'l - MTM - One Day Stop Loss Adv	3/30/2012	Other Threshold	70,000,000	-141,958,000	71,958,000	103
32153	CIO - Int'l - Aggregate - One Day Stop Loss Adv	3/30/2012	Other Threshold	70,000,000	-136,310,000	66,310,000	95
32113	CIO - Global - MTM - One Day Stop Loss Adv	3/30/2012	Other Threshold	60,000,000	-135,774,116	75,774,116	126
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	3/30/2012	Other Threshold	70,000,000	-180,703,000	110,703,000	158
32110	CIO - Global - Aggregate - One Day Stop Loss Adv	3/30/2012	Other Threshold	100,000,000	-129,070,618	29,070,618	29
32111	CIO - Global - Aggregate - Five Day Stop Loss Adv	3/30/2012	Other Threshold	150,000,000	-185,092,463	35,092,463	23
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	3/30/2012	Other Threshold	70,000,000	-180,266,000	110,266,000	158
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	4/2/2012	Other Threshold	70,000,000	-146,352,000	76,352,000	109
32111	CIO - Global - Aggregate - Five Day Stop Loss Adv	4/2/2012	Other Threshold	150,000,000	-150,547,365	547,365	0
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/2/2012	Other Threshold	60,000,000	-152,919,669	92,919,669	155
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	4/2/2012	Other Threshold	70,000,000	-144,745,000	74,745,000	107
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	4/3/2012	Other Threshold	70,000,000	-117,393,000	47,393,000	68
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	4/3/2012	Other Threshold	70,000,000	-114,849,000	44,849,000	64
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/3/2012	Other Threshold	60,000,000	-109,897,507	49,897,507	83

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J.P. MORGAN CHASE & CO.

33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	4/4/2012	Other Threshold	70,000,000	-71,397,000	1,397,000	2
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/4/2012	Other Threshold	60,000,000	-68,395,399	8,395,399	14
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/9/2012	Other Threshold	60,000,000	-61,273,253	1,273,253	2
32113	CIO - Global - MTM - One Day Stop Loss Adv	4/10/2012	Other Threshold	60,000,000	-420,458,051	360,458,051	601
32998	CIO - Int'l - MTM - One Day Stop Loss Adv	4/10/2012	Other Threshold	70,000,000	-417,252,000	347,252,000	496
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/10/2012	Other Threshold	60,000,000	-61,783,416	1,783,416	3
32153	CIO - Int'l - Aggregate - One Day Stop Loss Adv	4/10/2012	Other Threshold	70,000,000	-402,588,000	332,588,000	475
32138	CIO - NA - MTM - Five Day Stop Loss Adv	4/10/2012	Other Threshold	25,000,000	-33,978,467	8,978,467	36
32110	CIO - Global - Aggregate - One Day Stop Loss Adv	4/10/2012	Other Threshold	100,000,000	-405,792,051	305,792,051	306
32138	CIO - NA - MTM - Five Day Stop Loss Adv	4/11/2012	Other Threshold	25,000,000	-28,621,415	3,621,415	14
32155	CIO - Int'l - Aggregate - Twenty Day Stop Loss Adv	4/13/2012	Other Threshold	70,000,000	-77,768,000	7,768,000	11
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/13/2012	Other Threshold	60,000,000	-68,761,162	8,761,162	15
33003	CIO - Int'l - MTM - Twenty Day Stop Loss Adv	4/13/2012	Other Threshold	70,000,000	-86,322,000	16,322,000	23
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/16/2012	Other Threshold	60,000,000	-98,721,319	38,721,319	65
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	4/16/2012	Other Threshold	70,000,000	-93,978,000	23,978,000	34
32112	CIO - Global - Aggregate - Twenty Day Stop Loss Adv	4/16/2012	Other Threshold	150,000,000	-178,238,289	28,238,289	19
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	4/16/2012	Other Threshold	70,000,000	-98,354,000	28,354,000	41
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/17/2012	Other Threshold	60,000,000	-84,257,692	24,257,692	40
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	4/17/2012	Other Threshold	70,000,000	-82,658,000	12,658,000	18
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	4/17/2012	Other Threshold	70,000,000	-85,152,000	15,152,000	22
32112	CIO - Global - Aggregate - Twenty Day Stop Loss Adv	4/18/2012	Other Threshold	150,000,000	-155,591,346	5,591,346	4
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	4/18/2012	Other Threshold	70,000,000	-104,012,000	34,012,000	49
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	4/18/2012	Other Threshold	70,000,000	-100,470,000	30,470,000	44
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/18/2012	Other Threshold	60,000,000	-108,609,097	48,609,097	78
32112	CIO - Global - Aggregate - Twenty Day Stop Loss Adv	4/19/2012	Other Threshold	150,000,000	-204,594,780	54,594,780	36
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/19/2012	Other Threshold	60,000,000	-130,987,139	70,987,139	118
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	4/19/2012	Other Threshold	70,000,000	-126,811,000	56,811,000	81
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	4/19/2012	Other Threshold	70,000,000	-138,440,000	68,440,000	98
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/20/2012	Other Threshold	60,000,000	-110,806,346	50,806,346	85
32112	CIO - Global - Aggregate - Twenty Day Stop Loss Adv	4/20/2012	Other Threshold	150,000,000	-232,212,264	82,212,264	55
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	4/20/2012	Other Threshold	70,000,000	-125,400,000	55,400,000	79
33002	CIO - Int'l - MTM - Five Day Stop Loss Adv	4/20/2012	Other Threshold	70,000,000	-109,715,000	39,715,000	57
32114	CIO - Global - MTM - Five Day Stop Loss Adv	4/23/2012	Other Threshold	60,000,000	-69,570,691	9,570,691	16
32113	CIO - Global - MTM - One Day Stop Loss Adv	4/23/2012	Other Threshold	60,000,000	-160,191,902	100,191,902	167
32110	CIO - Global - Aggregate - One Day Stop Loss Adv	4/23/2012	Other Threshold	100,000,000	-156,582,902	56,582,902	57
32154	CIO - Int'l - Aggregate - Five Day Stop Loss Adv	4/23/2012	Other Threshold	70,000,000	-88,389,000	18,389,000	26
32112	CIO - Global - Aggregate - Twenty Day Stop Loss Adv	4/23/2012	Other Threshold	150,000,000	-232,212,264	82,212,264	55

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Limit Excess	Limit Description	Excession Dates	Limit Amount	Average Utilization
Level 1	CIO - Global - 10Q VAR	1/16 - 1/19	95,000,000	98,425,880
Level 1	CIO - Global - 10Q VAR	1/24 - 1/26	105,000,000	112,685,029
Level 1	CIO - Global - Aggregate - Combined CIO & MSR VAR	11/14 - 11/15	145,000,000	147,123,824
Level 1	CIO - Global - Aggregate - Combined CIO & MSR VAR	12/7 - 12/8	165,000,000	172,320,512
Level 1	CIO - Global - Aggregate - Global VAR	1/25 - 1/26	110,000,000	119,667,216
Level 1	CIO - International - Aggregate - Total VaR	1/18 1/23	100,000,000	101,948,740
Level 1	CIO - International - Aggregate - Total VaR	1/25 - 1/28	110,000,000	117,412,628
Level 1	CIO - International - 10Q - Total VAR	1/16 - 1/23,	95,000,000	99,535,037
Level 1	CIO - International - 10Q - Total VAR	1/25 - 1/26	110,000,000	114,039,648
Level 1	CIO - Global - Max Stress Loss - MTM	3/29	500,000,000	(856,842,646)
Level 1	CIO - Global - Max Stress Loss - MTM	4/5 , 4/12 , 4/19	1,000,000,000	(1,535,574,339)
Level 1	CIO - Global - Max Stress Loss - Aggregate	3/29	800,000,000	(1,180,071,389)

Limit Excess	Limit Description	Excession Dates	Limit Amount	Average Utilization
Level 2	CIO - Int'l - Aggregate - Credit VAR	1/18 - 1/23	100,000,000	100,876,372
Level 2	CIO - Int'l - Aggregate - Credit VAR	1/25 - 1/26	110,000,000	113,073,812
Level 2	CIO - Int'l - 10Q - Credit VAR	1/12 - 1/23	95,000,000	98,671,903
Level 2	CIO - Int'l - 10Q - Credit VAR	1/26	110,000,000	112,791,400
Level 2	CIO - Int'l - 10Q - Equity VAR	11/30 - 12/5	12,000,000	13,191,850
Level 2	CIO - Global Credit - 10% CSW - MTM	3/22 - 4/30	200,000,000	(326,052,282)
Level 2	CIO - Global Credit - 10% CSW - Total	4/10 - 4/30	300,000,000	(402,280,226)
Level 2	CIO - Global Credit - Credit Spread BPV - MTM - Total	1/6 - 4/30	5,000,000	(33,055,377)
Level 2	CIO - Global Credit - Credit Spread BPV - Total	1/18 - 1/19 , 1/25 - 4/30	12,000,000	(39,058,125)
Level 2	CIO - Global Equities - Int'l - Aggr - Total Gross Equity Vega	10/3 - 10/31	6,000,000	14,764,863
Level 2	CIO - Global Equities - Int'l - Aggr - Total Net Equity Vega	10/3 - 10/31	4,500,000	9,745,687
Level 2	CIO - Global Equities- Int'l - Aggr - Top Tier Delta	10/4 , 10/10 - 10/14 ,10/19 - 10/26	250,000,000	317,832,266
Level 2	CIO - Global Equities - Int'l- Aggr - Top Tier Vega	10/3 - 10/31	2,000,000	6,824,777

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From: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
Sent: Thu, 12 Jan 2012 15:42:54 GMT
To: Weiland, Peter <peter.weiland@jpmchase.com>
CC: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>; Hagan, Patrick S <patrick.s.hagan@jpmorgan.com>
Subject: RE: JPMC Firmwide VaR - Daily Update - COB 01/09/2012

No , in terms of VAR . Will come back to you with a better explanation .From our point of view we did not have any P/L vol to increase the overall VAR so much . Pat's model is in line with the 70 VAR and has a much better explanation for these changes . Hopefully we get this approved as we speak .

in terms of book positioning as I explained the book is long risk now but has increased the short in HY and rebalanced on the rest . This should not have had a great increase in the VAR of our postions .

From: Weiland, Peter
Sent: 12 January 2012 14:45
To: Martin-Artajo, Javier X
Subject: Fw: JPMC Firmwide VaR - Daily Update - COB 01/09/2012

Is this not correct?
Peter Weiland
JPMorgan
o: +1 212 834 5549
m: +1 [redacted]

▬ = Redacted by the Permanent Subcommittee on Investigations

From: Stephan, Keith
Sent: Wednesday, January 11, 2012 07:29 AM
To: Weiland, Peter
Subject: RE: JPMC Firmwide VaR - Daily Update - COB 01/09/2012

This is what I sent to Javier and bruno yest

From: Stephan, Keith
Sent: 10 January 2012 17:17
To: Iksil, Bruno M; Grout, Julien G
Cc: Chandna, Sameer X; D'costa, Karolyn K; Lee, Janet X; Kalimtgis, Evan; Martin-Artajo, Javier X
Subject: FW: Core Credit Var Summary 06 January

Below are the major drivers in the increase in VAR since mid December for Credit Tranche portfolios – **since 21 December, the book var has moved from $76mm to 93mm**, nearly +25% increase driven by position changes and through the inclusion of mkt data in the last week of 2001 with rally in OTR HY indices.

The big drivers, are increases in notional of HY OTR short risk in indices +2.6bio not'l, +14MM VAR. At the same time the increase in index short risk (and long HY10 7Y reduction) has driven and increase in the positive benefit in the credit crisis stress loss scenario from 1.1bio to +$1.5bio.

Permanent Subcommittee on Investigations
EXHIBIT #40

In Marginal terms, the $17mm move since Dec 21 is driven by:

1) Stg 15D $14mm (increased short risk positions across HY14-HY17 by $2.65bn)

2) Stg 18US $1mm

3) Stg 27D $2mm (reduced Long risk pos in HY10 7Y + Price changes**see details below)

4) Note: 14EU does have a net increase in XO16 pos by $260mm but increase in MN16 long risk pos by $2.0bn more than offsets the var moves from XO.

Details:

Main days of big moves in Var:

Dec19 Var of $70.0mm
Dec21 Var of $75.8mm
Dec22 Var of $78.4mm
Dec30 Var of $82.7mm
Jan06 Var of $92.9mm

1)Changes from Dec19 to Dec21 of $5.8mm mainly driven by Stg15D. Increased Short Risk position by $1bn across HY14-HY17 indices.

2)Changes from Dec21 to Dec22 of $2.6mm mainly driven by Stg15D: Increased Short Risk position by $600mm in HY15 and HY17 indices.

3)Changes from Dec30 to Jan06 of $10.7mm mainly driven by

Stg 14 EU +1.8mm - XO16 5Y - increased short risk position by 150mm. Spread tightening of 16bps.

Stg 15B +1.2mm - Price widening of +0.875pts in HY10 7Y - short risk index position of $4.4B and short risk position SSnr Trn 35-100 of $3.7B

Stg 27D +2.7mm - shorter risk by $950mm across HY9 and HY10 7Y

Stg 15D +3.3mm - shorter risk by $438mm across HY16 and HY17 - Price improvement across most HY indices (HY15 +0.875pt, HY16 +1pt, HY17 +1.125pt)

From: Weiland, Peter
Sent: 11 January 2012 12:26
To: Stephan, Keith
Subject: FW: JPMC Firmwide VaR - Daily Update - COB 01/09/2012

fyi

Peter Weiland
Tel: +1 212 834 5549
Mob: +1 [redacted]

= **Redacted by the Permanent Subcommittee on Investigations**

From: Weiland, Peter
Sent: Tuesday, January 10, 2012 9:38 PM
To: Drew, Ina
Cc: Wilmot, John
Subject: Re: JPMC Firmwide VaR - Daily Update - COB 01/09/2012

Yes, I have details and can give you tomorrow. Short story is that the increase in VaR corresponds to increased credit protection on HY, in particular trades executed between Dec. 19 and Jan. 6.

This has been obviously a significant increase and I sent Javier an email today to highlight the RWA implications.

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Pete
Peter Weiland
JPMorgan
o: +1 212 834 5549
m: +1[redacted]

From: Drew, Ina
Sent: Tuesday, January 10, 2012 07:36 PM
To: Weiland, Peter
Cc: Wilmot, John
Subject: Fw: JPMC Firmwide VaR - Daily Update - COB 01/09/2012

This says cio var still 88? can u give me breakdown tomorrow

From: Market Risk Management - Reporting
To: Market Risk Management - Reporting; Dimon, Jamie; Zubrow, Barry L; Staley, Jes; Drew, Ina; Rauchenberger, Louis; Lake, Marianne; Hogan, John J.; Weiland, Peter; Weisbrod, David A.; Bacon, Ashley; Beck, David J; Braunstein, Douglas; Morzaria, Tushar R; Wilmot, John; Dellosso, Donna; Bisignano, Frank J
Cc: Doyle, Robin A.; Waring, Mick; Market Risk Reporting; Sreckovic, Steven; McCaffrey, Lauren A; Tocchio, Samantha X; Chiavenato, Ricardo S.; Chen, Dan
Sent: Tue Jan 10 19:32:44 2012
Subject: JPMC Firmwide VaR - Daily Update - COB 01/09/2012

Firmwide 95% 10Q VaR

- The Firm's 95% 10Q VaR as of cob 01/09/2012 is $123mm or 98% of the $125mm limit, an increase of $5mm from the prior day's revised VaR.
- The increase in the Firm's VaR is primarily driven by IB [redacted]
- Each LOB's contribution to the Firm's $123mm VaR (as shown by marginal VaR) are: IB [redacted] CIO ($67mm mVaR, primarily driven by CIO International credit tranche book), RFS [redacted], Private Equity [redacted] and TSS [redacted]
- The stand alone VaR for each LOB are as follows: IB is [redacted] CIO is $88mm (vs. $95mm limit), RFS [redacted] TSS is [redacted] Private Equity [redacted] and AM is [redacted]

10Q Externally Disclosed VaR
The below table shows the 95% 10Q VaR for the current quarter compared with the prior quarter and the corresponding quarter of prior year.

cid:image001.png@01CCCFCD.54D062D0

Please contact the MRM External Reporting team with any questions.

95% 10Q VaR ($mm)	1Q12 Spot	1Q12 Avg	4Q11 Spot	4Q11 Avg	1Q11 Spot	1Q11 Avg
IB VaR by risk type:						
Fixed income	49	49	49	56	55	49
Foreign exchange	15	15	19	12	11	11
Equities	24	19	19	19	22	29
Commodities & other	23	23	22	20	10	13
Diversification benefit to IB trading VaR	(57)	(52)	(55)	(50)	(37)	(38)
IB Trading VaR	54	54	54	57	61	64
CPG	35	39	42	39	28	26
Diversification benefit to IB trading & CPG VaR	(16)	(17)	(20)	(21)	(7)	(7)
Total IB trading & CPG VaR	73	76	76	75	82	83
Mortgage Production and Servicing VaR	15	15	16	74	18	16
Chief Investment Office (CIO) VaR	88	88	77	69	55	60
Diversification benefit to total other VaR	(7)	(9)	(10)	(30)	(13)	(14)
Total other VaR	96	93	83	113	60	62
Diversification benefit to total IB and other VaR	(46)	(53)	(46)	(39)	(56)	(57)
Total IB and other VaR	123	116	113	149	86	88

From: Goldman, Irvin J <irvin.j.goldman@jpmchase.com>
Sent: Fri, 20 Jan 2012 13:08:35 GMT
To: Wilmot, John <JOHN.WILMOT@jpmorgan.com>
Subject: FW: Breach of firm var

FYI

-----Original Message-----
From: Stephan, Keith
Sent: Friday, January 20, 2012 07:01 AM Eastern Standard Time
To: Goldman, Irvin J; Weiland, Peter
Cc: Martin-Artajo, Javier X; Macris, Achilles O; Kalimtgis, Evan
Subject: FW: Breach of firm var

Irv & Pete

Below please find details of the VaR limit breach. The VaR increase is driven by Core Credit (tranche) in EMEA. The VaR has increased steadily since the end of December as positions in CDX.HY on-the-run indices have been added to the portfolio to balance the book, which has been taken longer risk since the expiry of CDX.HY.11 3Y positions which matured 21 Dec 2011.

Key Points:

1. The increase in VaR is largely attributed to increased short risk positions in CDX.HY indices – which we have discussed w/ the desk and which were added specifically to reduce the outright long CS01 profile of the book (as we are additionally over the MtM CS01 limit and actively reducing this risk to move within the $5MM CS01 threshold)
2. We are reviewing the details of the current VaR number and actively working with the desk to reduce the current VaR based on current marginals, while continuing to address the CS01 as above; N.B. the action taken thus far has further contributed to the Positive Stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bio to +$1.6bio from 17-19 Jan.
3. We are in late stages of model approval for full revaluation which will have the effect reducing the standalone VaR for Core Credit from circa $96MM to approx $70MM – impact analysis on the marginal contribution to the Firm is ongoing and will be distributed later today.

I expect that we will resolve through active risk management the breach of VaR limit using current method over the next two trading sessions, depending on liquidity.

Furthermore, I believe that the process of model approval is nearing completion and that this will be implemented in the next 1-2wks in production.

My recommendation therefore is that we do not address, nor upsize the limit for CIO – but that we continue to work in partnership with the desk to manage to the current $95mm limit over the next two to three trading sessions – and that we discuss further with the model review group (MRG) today the schedule for completion of approval of the new model with a view toward implementation next week if possible. My team and I are disaggregating strategy level marginal VaR (reported daily) to the level of position / instrument level marginal VaR to provide the desk with precise list of actions that can be taken to most effectively reduce VaR while maintaining balance of other risk measures. This will be complete by mid-afternoon

London time today.

Evolution of Current VaR using production model:

cid:image001.png@01CCD767.766510C0

The details of the drivers of the VaR increases, using current model for measurement are as follows:

Jan18 to Jan19 (from $94.7mm to $98.6mm) - +$3.8mm move:

1) +4mm from Stg 15D – **Increased HY14 – HY16 short risk position by $1.075bn**

Jan17 to Jan18 (from $91.8mm to $94.7mm) +$3mm move:

1) +2mm from Stg 18US – Increased IG17 5Y short risk position by $2.25bn
2) +1mm from Stg 14EU – Increased Itraxx MN16 long risk position by $785mm

Jan16 to Jan17 (from $96mm to $91.8mm) – ($4mm) move:

1) -4mm from Stg 15D : **Reduced HY17 Index short risk position by $1.3bn**

Jan06 to Jan16 (from $93mm to $96mm) - +$3mm move:

1) +3mm from Stg 15D

Increase in HY Index short risk positions of $1.1bn (HY14$300mm, HY15 $250mm, HY16 $450mm, HY17 $50mm)

2) +2mm from Stg 18US

Increase in IG9 10Y Index long risk by $6.7bn

Increase in IG17 5Y short risk position by $3.0bn provides diversification

3) +1mm from Stg 14EU

Decrease in MN9 5Y Index long risk position by $7.25bn

Decrease in MN Outright Index short positions provide diversification (S15-S16 5/10Y – net decrease of $775mm

4) -3mm from worst day rolloffs (5th, 19th and 29th days)

Dec 21 to Jan06 (from $76mm to $93mm) - +$17mm move:

1) Stg 15D $14mm **(increased short risk positions across HY14-HY17 by $2.65bn)**
2) Stg 18US $1mm
3) Stg 27D $2mm (reduced Long risk pos in HY10 7Y + Price tightening in recent weeks meant that this position delivered positive offset on worst days
4) Note: 14EU does have a net increase in XO16 pos by $260mm but increase in MN16 long risk pos by $2.0bn more .

than offsets the var moves from XO.

From: Goldman, Irvin J
Sent: 20 January 2012 03:08
To: Stephan, Keith; Weiland, Peter
Cc: Macris, Achilles O; Martin-Artajo, Javier X; Kalimtgis, Evan
Subject: Breach of firm var

All,
This is the third consecutive breach notice (below) that has gone to Jamie and OC members. We need to get Ina specific answers to the cause of the breach, how it will be resolved and by when. She requested the answers today - Friday and would like Achilles and Javier to vett the international credit explanations.
Irv

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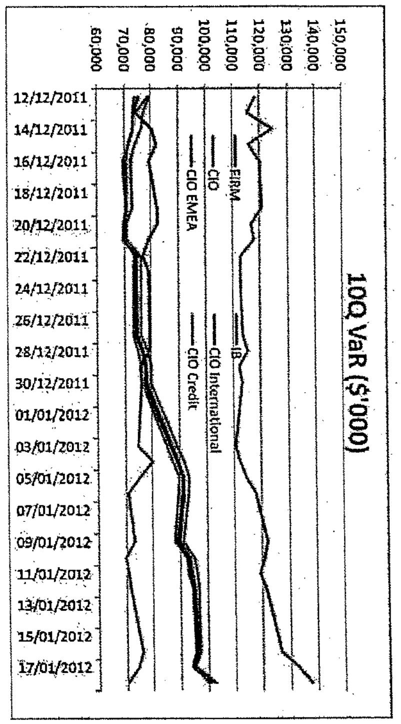
Firmwide 95% 10Q VaR

· The Firm's 95% 10Q VaR as of cob 01/18/2012 has increased by $5mm from the prior day's VaR to $138mm and has breached the $125mm Firm VaR limit for the third consecutive day.
· CIO's 95% 10Q VaR as of cob 01/18/2012 has increased by $7mm from the prior day's VaR to $102mm and has breached the $95mm CIO VaR limit for the third consecutive day.
· The increase in the Firm's VaR is primarily driven by an overall reduction in diversification benefit across the Firm and position changes in CIO and MSR.
· Each LOB's contribution to the Firm's $138mm VaR (as shown by marginal VaR) are: IB [redacted] CIO ($85mm mVaR, primarily driven by CIO International credit tranche book), RFS [redacted] Private Equity [redacted] and TSS [redacted]
· The stand alone VaR for each LOB are as follows: IB [redacted] is $102mm (vs. $95mm limit), RFS [redacted] TSS is [redacted] Private Equity is [redacted] and AM is [redacted]

10Q Externally Disclosed VaR
The below table shows the 95% 10Q VaR for the current quarter compared with the prior quarter and the corresponding quarter of prior year.

Please contact the MRM External Reporting team with any questions.


10Q VaR ($'000)
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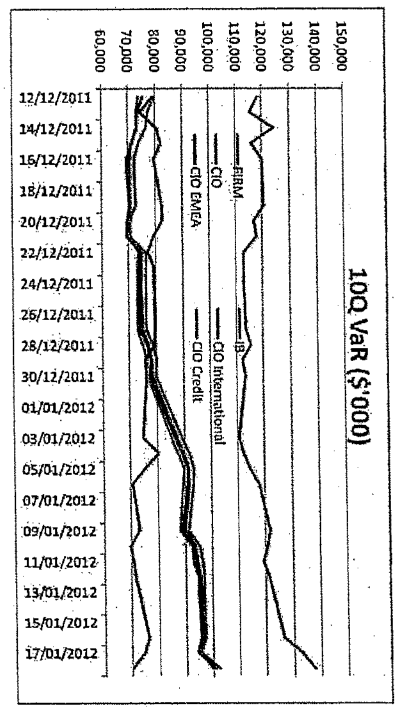
CIO International
CIO EMEA
CIO Credit


10Q VaR ($'000)
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CIO EMEA
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CIO International
CIO Credit
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01/01/2012
03/01/2012
05/01/2012
07/01/2012
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17/01/2012

From: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
Sent: Mon, 23 Jan 2012 09:58:33 GMT
To: Hagan, Patrick S <patrick.s.hagan@jpmorgan.com>
Subject: CIO VaR

FYI . Dual plan ..... as discussed keep the pressure on our friends in Model Validation and QR .

From: Hogan, John J.
Sent: 20 January 2012 23:15
To: Goldman, Irvin J
Cc: Drew, Ina; Macris, Achilles O
Subject: Re: CIO VaR

OK thx Irv. Good weekend!

From: Goldman, Irvin J
To: Hogan, John J.
Cc: Drew, Ina; Macris, Achilles O
Sent: Fri Jan 20 17:27:09 2012
Subject: CIO VaR

John,

Achilles and I have reviewed the CIO limit breach for the past four days. CIO has been managing a dual process of increasing overall credit spread protection while managing Basel III RWA targets. The action taken thus far has further contributed to the Positive Stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bio to +$1.6bio and created higher VaR resulting in the breach period.

Two important remedies are being taking to reduce VAR and have CIO get well within its limits while continuing to manage for Basel III RWA.

1. position offsets to reduce Var are happening daily.
2. Most importantly, a new improved Var model that CIO has been developing is in the near term process of getting approved by MRG and is expected to be implemented by the end of the January..

The estimated impact of the new VaR model based on Jan 18 data will be a CIO VAR reduction in the tranche book by 44% to 57mm, with CIO being well under its overall limits.

Irv

Irvin Goldman | J.P.Morgan | Chief Investment Office | 270 Park Ave. | ☎ Tel: +1 212 834 2331 | ✉ irvin.j.goldman@jpmchase.com

From: Hogan, John J. <John.J.Hogan@jpmorgan.com>
Sent: Sat, 28 Jan 2012 16:19:28 GMT
To: Bacon, Ashley <Ashley.Bacon@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>
Subject: Re: CIO VaR heads up and update

Thx and can you guys compare notes on any methodology difference btwn IB and CIO and let me know what you find? Thx, John

---

From: Bacon, Ashley
To: Hogan, John J.; Goldman, Irvin J
Sent: Sat Jan 28 11:15:12 2012
Subject: Re: CIO VaR heads up and update

If this change is what I think it is (full reval credit p&l calculation for the shocks derived from the VaR days, instead of sensitivities times shocks), then the IB is already on the new methodology so no change for us.

I will confirm, and let you know if not.

From: Hogan, John J.
Sent: Saturday, January 28, 2012 03:43 PM
To: Goldman, Irvin J; Bacon, Ashley
Subject: Re: CIO VaR heads up and update

Is this change in methodology applicable to IB's VaR as well. What was the primary change that we made? Thx, John

---

From: Goldman, Irvin J
To: Hogan, John J.; Drew, Ina
Sent: Fri Jan 27 13:35:40 2012
Subject: CIO VaR heads up and update

From: Stephan, Keith
Sent: Friday, January 27, 2012 1:30 PM
To: Goldman, Irvin J; Weiland, Peter
Cc: Kalimtgis, Evan; Martin-Artajo, Javier X; Macris, Achilles O; Lee, Janet X; Chandna, Sameer X
Subject: Update on *old/current methodology VaR* increase for COB 27 Jan
Importance: High

Below please find an update on the increase in VaR for Core Credit from 103.8mm to 107.6mm. Final VaR vectors globally have not been processed yet for COB 26 Jan, however CIO is over its temporary limit, and could cause the Firm to do the same. As such I wanted to communicate this to you to ensure we are all on the same page about what is happening.

The ***old methodology*** currently in production: VaR has increased by +$3mm, to $107.6mm driven by increase in CDX IG S9 10Y index long risk (+1.8bio notional). This is consistent w/ the VaR increases of the last several days, under the old methodology, wherein the VaR increases approx 1mm per billion of notional in IG9 10y. I estimate this will put CIO Global over its temporary $110mm limit and probably closer to $115mm—note: not all vectors globally are loaded yet for the 26 Jan cob – so I'm estimating here. This means that the formal notification of limit excess will be generated and distributed to you for approval.

Importantly, for the same COB 26 January, the ***new / full revaluation methodology*** shows VaR decreased ($1.3MM) from 70.8mm to 69.5mm. I estimate that this would make CIO global VAR closer to $76MM vs. the currently reported number >$115.

We anticipate final approval on Monday, and that the *new methodology *should* become the official firm submission from Monday, for 27 Jan COB – limit issues should therefore cease beginning from Monday.

We have completed all technology changes to support the daily production of the VaR under new methodology beginning from Monday.

Thanks and please let me know if you have any questions.

Keith

Keith Stephan
Chief Investment Office
JPMorgan Chase
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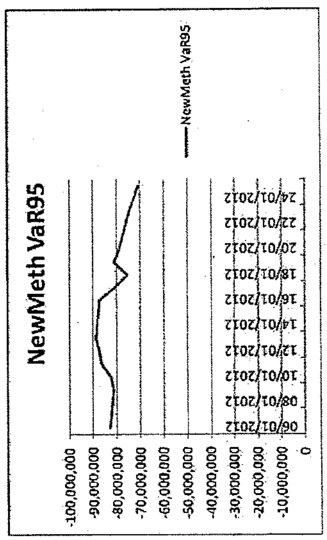
Tel ☎: +44(0)207 325 8812
Mob ☎: +44(0)759 592 1539
Email ✉: keith.stephan@jpmorgan.com


NewMeth VaR95
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08/01/2012
10/01/2012
12/01/2012
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16/01/2012
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20/01/2012
22/01/2012
24/01/2012

From: Dev, Ashish K <ashish.k.dev@jpmchase.com>
Sent: Mon, 30 Jan 2012 16:50:13 GMT
To: Weiland, Peter <peter.weiland@jpmchase.com>
CC: Rajesh, Govindan X <govindan.rajesh@jpmchase.com>
Subject: RE: draft of the MRG review of the HVAR methodology for the CIO core credit books

---

Pete – I talked to Rajesh and we agree that the new VaR is a clear improvement over the production version. Please go ahead with the implementation of the new HVaR methodology for the CIO credit books. Best regards! Ashish.

From: Weiland, Peter
Sent: Monday, January 30, 2012 11:40 AM
To: Dev, Ashish K
Cc: Rajesh, Govindan X; Stephan, Keith; Goldman, Irvin J; Lee, Janet X; Chandna, Sameer X
Subject: RE: draft of the MRG review of the HVAR methodology for the CIO core credit books

I just sat with Rajesh to discuss. Ashish we tried to call you but I guess you were away from your desk.

We are going to proceed with the new VaR vector. Rajesh will endeavor to distribute a new version of the approval document, but he has gotten some comfort from the data that he received from Pat this morning that Numerix and West End agree.

In any event the new VaR is a clear improvement over the production version, which helps to make us comfortable with the decision.

Best,

Pete

Peter Weiland
Tel: +1 212 834 5549
Mob: +1 [redacted]

— = Redacted by the Permanent Subcommittee on Investigations

From: Dev, Ashish K
Sent: Monday, January 30, 2012 10:43 AM
To: Weiland, Peter
Cc: Rajesh, Govindan X
Subject: RE: draft of the MRG review of the HVAR methodology for the CIO core credit books

Pete – I believe you have been looking for me. I am sorry I had a 8:30AM meeting outside the office which went on past the 10AM end. I did not get a chance to talk to Rajesh either. But my view is that if January tests look all right, we should go ahead and implement the new model even before the MRG review is completed. Regards! Ashish.

From: Weiland, Peter
Sent: Monday, January 30, 2012 7:40 AM
To: Dev, Ashish K
Subject: FW: draft of the MRG review of the HVAR methodology for the CIO core credit books

Hi Ashish –

Do you have any thoughts on this matter? I don't know how material the requested testing note is to the validity of the VaR, but if possible we would like to move forward with the new VaR, which is a significant improvement on the production version.

I have reminded Pat of the urgency of producing the testing note.

Please let me know if we can proceed with this important upgrade.

Thanks,

Pete

▬ = Redacted by the Permanent Subcommittee on Investigations

Peter Weiland
Tel: +1 212 834 5549
Mob: +1 [redacted]

From: Rajesh, Govindan X
Sent: Friday, January 27, 2012 10:59 AM
To: Weiland, Peter; Dev, Ashish K
Subject: RE: draft of the MRG review of the HVAR methodology for the CIO core credit books

Pete,
I guess this is a question for Ashish.

Ashish,
We've circulated a draft of the review, but it will take another couple of days to publish, since we are waiting for one additional testing note from Pat. Do you think it is OK for CIO to go live today?

Rajesh

From: Weiland, Peter
Sent: Friday, January 27, 2012 10:48 AM
To: Rajesh, Govindan X
Subject: Re: draft of the MRG review of the HVAR methodology for the CIO core credit books

Can we start using today?
Peter Weiland
JPMorgan
o: +1 212 834 5549
m: +1 [redacted]

▬ = Redacted by the Permanent Subcommittee on Investigations

From: Rajesh, Govindan X
Sent: Friday, January 27, 2012 09:39 AM
To: Stephan, Keith; Pirjol, Dan
Cc: Weiland, Peter; Hagan, Patrick S
Subject: RE: draft of the MRG review of the HVAR methodology for the CIO core credit books

PS: we're still waiting for the testing note showing that the pricer used for VaR matches the Numerix model. Of course, we'll update the review to make it clear that an in-depth review of that will be done separately.

Rajesh

From: Rajesh, Govindan X
Sent: Friday, January 27, 2012 9:38 AM
To: Stephan, Keith; Pirjol, Dan
Cc: Weiland, Peter; Hagan, Patrick S; Martin-Artajo, Javier X; Shen, Charles; Bangia, Anil K; Christory, Jean-Francois A; Scott, Brian GO
Subject: RE: draft of the MRG review of the HVAR methodology for the CIO core credit books

Thanks Keith. The last 3 were actually recommendations, not action plans, but it is good to have committed timelines on them.

Regarding the second AP, could you confirm that for illiquid series with material exposures, you will use the Credit Hybrids risk mapping tool to map them to the on-the-runs?

Thanks,
Rajesh

From: Stephan, Keith
Sent: Friday, January 27, 2012 9:29 AM
To: Pirjol, Dan; Rajesh, Govindan X
Cc: Weiland, Peter; Hagan, Patrick S; Martin-Artajo, Javier X; Shen, Charles; Bangia, Anil K; Christory, Jean-Francois A; Scott, Brian GO
Subject: FW: draft of the MRG review of the HVAR methodology for the CIO core credit books
Importance: High

Hi Dan and Rajesh

Please can you review the below action plan responses which I hope will satisfy final approval of the model? Importantly, I anticipate that point one (automation / industrialization) will be delivered by Monday a.m. as the team are well ahead of schedule – this work has been happening in the background through the testing phase. I've tried to put reasonable estimates around each of the points below – and given the priority of this initiative, I would suggest that each will be completed with dedicated focus, and I would envision that we will deliver more quickly than the (worst-case) timelines I've provided below.

Happy to discuss if you need further information.

Thanks
Keith

- *Operational risk.* The VaR computation is currently done off spreadsheets using a manual process. Thus it is error prone, and not easily scalable.
- ACTION PLAN: CIO should upgrade the infrastructure to enable the VaR calculation to be automated, and less subject to operational errors. **Item Owner: Patrick Hagan, Completion Date: TBD**
-

The MRM coverage team, technology and QR resources have identified an implementation plan, and will be working through the weekend of 29 Jan 2012 to complete automation required to run the VaR simulation daily, and to store results and vectors in a database. The MRM coverage team has agreed and SLA (service-level agreement) with the analytics team to produce the vector by 10h00 GMT daily, to provide time to analyse results and to ensure quality control before upload to MaRRS. Estimated completion: Tuesday 31 January 2012. (Owner: Samir Patel, Patrick Hagan)

- ACTION PLAN: CIO should establish a process to monitor the size of the positions with exposure to the illiquid time series, and if the exposures are material should risk map the positions to on-the-run time series. **Item Owner: Patrick Hagan, Completion Date: TBD**

The MRM coverage team, and QR resources have agreed an action plan to 1) define 'illiquid instruments' and 2) to monitor size of exposures to illiquid instruments on the basis of CS01 and Corr1% sensitivies. Where exposures to illiquid instruments exceed agreed thresholds, instruments will be mapped to 'on-the-run (correlation) series' instruments' time-series (currently ITX.MN S9, CDX.IG S9, and CDX.HY S9) consistent with market convention, and the IB Credit Hybrids business. Estimated completion: Friday 24 February 2012. (Owner: Julien Grout, Sameer Chanda)

- ACTION PLAN: CIO should re-examine the data quality and explore alternative data sources. For days with large discrepancies between dealer marks and IB marks, the integrity of the data used for HVAR calculation should be verified.

The MRM coverage team, and QR resources will compare market data time-series history vs. DataQuery, and dealer-marks. This process has been conducted previously, and will be re-visited to ensure the integrity of time-series. Given illiquidity of certain instrumentation, and especially in cases where CIO maintains positions in instruments where IB Credit Hybrids may not, we have found irregular patterns in DataQuery data, and amended our market data / time-series to reflect Dealer mid marks. An action plan to perform periodic review of time-series vs. DataQuery and dealer-marks has been agreed, to ensure on-going continuity of time-series history. The team will conduct a regular, 1x monthly review of time-series, attended by Front Office, MRM coverage, and QR resources to discuss discrepancies. Discrepancies which cannot be resolved will be escalated to the CIO Valuation Control Group for independent verification of prices / spreads. Further, in cases where time-series have been overridden by committee or by Valuation Control Group, the team will put forward an action plan to ensure adequate control, record-keeping and audit trail for time-series amendments which deviate from DataQuery. Estimated completion: Friday 24 February 2012. (Owner: Keith Stephan, Julien Grout)

- ACTION PLAN: For the purpose of capital calculation at firm-wide level, the CIO risk measures including VaR will have to aggregated with the risk metrics of the IB portfolio.For consistency the VaR methodologies used by the two groups must be reasonably similar. We recommend that CIO investigates using absolute daily changes for the base correlations, similar to the methodology adopted in IB.

The MRM coverage team, and QR resources will compare the current relative shifts in base correlation vs. the absolute shifts. This is a medium-term action plan target, and given estimated work-load may require a number weeks to complete. An action plan to review the results will be agreed between MRM coverage, QR resources and Front Office. The findings of that study will be published to Model Review Group, and will form the basis of further discussion, related to course of action, practicability, and resonableness of a move toward absolute base correlation shifts. If it is determined at the conclusion of the study, that a move to absolute correlation shifts is required, a further action plan will be established to commence the project to make this variation in computation and market data collection. Estimated completion: Friday 27 April 2012. (Owner: Patrick Hagan, Keith Stephan, Julien Grout)

From: Pirjol, Dan
Sent: 25 January 2012 19:33
To: Hagan, Patrick S; Weiland, Peter; Stephan, Keith; Bangia, Anil K; Bessin, Jean-Francois X
Cc: Rajesh, Govindan X; Shen, Charles; Scott, Brian GO
Subject: draft of the MRG review of the HVAR methodology for the CIO core credit books

All,

please find attached a first draft of the MRG review of the HVAR methodology for the CIO core credit books. Please send me your comments and suggestions by the end of the day Friday Jan.27.

Pat, please let me know if you agree with the formulation of the action plans, and what are your suggested completion dates.

Best regards,
Dan

From: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
Sent: Wed, 18 Apr 2012 21:51:26 GMT
To: Hagan, Patrick S <patrick.s.hagan@jpmorgan.com>
Subject: Fw: CIO VaR

What happened here ?

From: Stephan, Keith
Sent: Wednesday, April 18, 2012 08:03 PM
To: Macris, Achilles O; Martin-Artajo, Javier X
Cc: Weiland, Peter
Subject: FW: CIO VaR

FYI -we discovered an issue related to the VAR market data used in the calculation which we need to discuss. This means our reported standalone var for the five business days in the period 10-16th April was understated by apprx $10mm. This increases our marginal contribution to the Firm by $3.5mm. The unfortunate part is the firm is running close to its limit (CIO is within it's limit as it stands) and this will put the firm over. Which is something Pete is going to explain to Irv, Ashley, et al. as it will require approval / one-off limit extension / or permanent var limit increase for the Firm.

The market data used by Pat / Samir in the methodology for revaluation of the VAR was not inclusive of the major moves of 10 april that caused the realized pnl of -395mm. We have corrected this - and I'm investigating how / why this happened.

Standalone Synthetic Credit VaR	10/04/2012	11/04/2012	12/04/2012	13/04/2012	16/04/2012	17/04/2012
HVaR-95 Uploaded	55,840,398	55,058,312	55,180,605	58,812,234	59,120,859	64,146,238
H[illegible]95 Restated by QR	66,598,296	66,502,483	64,193,746	68,404,469	68,853,160	
Va[illegible] Diff	10,757,898	11,444,171	9,013,141	9,592,235	9,732,501	

Thanks

Keith

From: Stephan, Keith
Sent: 18 April 2012 18:02
To: Weiland, Peter
Cc: Man, George KB
Subject: FW: CIO VaR

Hi Pete - we have been going through the market data related to the realized pnl of 10 april (-$395mm) as this was not properly reflected in our market data environment for the VaR historical simulation. We have corrected the simulated pnl for the 10th April to be consistent with the mkt moves that drove the PnL on that date. The restated P&L vector for cob 10-Apr was included in today's cob 17-Apr VaR submission.

This loss increased Synthetic Credit / CIO Var by $5mm and marginal VaR contribution to Firm by $3.7mm assuming all VaR feeds are now in the latest snapshot.

[Picture (Device Independent Bitmap)]

▬ = Redacted by the Permanent Subcommittee on Investigations

From: Hagan, Patrick S
Sent: Thu, 22 Dec 2011 13:39:05 GMT
To: Grout, Julien G <julien.g.grout@jpmchase.com>
Subject: FW: RWA - Tranche Book

-----Original Message-----
From: Drew, Ina
Sent: Thursday, December 22, 2011 1:06 PM
To: Martin-Artajo, Javier X; Wilmot, John
Cc: Macris, Achilles O; macris@[redacted]Iksil, Bruno M; Hagan, Patrick S
Subject: RE: RWA - Tranche Book

Can you break out the cost again please of each
13 bil
1 bil hg
1 bil clo mtm

-----Original Message-----
From: Martin-Artajo, Javier X
Sent: Thursday, December 22, 2011 8:00 AM
To: Drew, Ina; Wilmot, John
Cc: Macris, Achilles O; macris@[redacted]; Iksil, Bruno M; Hagan, Patrick S
Subject: RE: RWA - Tranche Book

CLOs and Tranches MTM SAA . HG Mandate AFS SAA .

Will come back with total cost under normal trading and 90 days window .

-----Original Message-----
From: Drew, Ina
Sent: 22 December 2011 12:49
To: Martin-Artajo, Javier X; Wilmot, John
Cc: Macris, Achilles O; macris@[redacted]Iksil, Bruno M; Hagan, Patrick S
Subject: Re: RWA - Tranche Book

Total cost including hg and clo. (All in trading not saa, correct?)

----- Original Message -----
From: Martin-Artajo, Javier X
To: Drew, Ina; Wilmot, John
Cc: Macris, Achilles O; macris@[redacted]Iksil, Bruno M; Hagan, Patrick S
Sent: Thu Dec 22 07:46:36 2011
Subject: RWA - Tranche Book

Ina/John

We are in a position to reduce 15 Bln by end of Q1 by :

- Reducing Tranche Book 13 Bln
- Reducing CLO Book 1 Bln (as per the CLO conversation)
- Reducing HG Book 1 Bln (as per our HG Bank conversation)

Tranche Book

Under normal circumstances the Credit Derivatives Book will reduce three months of duration , expire the March rolls , improve both the Capital CRM and VAR/Stress numbers , and will require some further reductions and optimization in the actual position ratios .

The estimates of reductions will be :

Model reduction QR CRM (acknoledged already) 5 (Pat estimate)
Model reduction QR VAR 0.5 (Pat estimate)
Model Reduction QR Stress 1.5 (Pat estimate)
Reduction for duration shortening 1 Actual
Book Optimization 3 Estimate
Book Reduction 2 Trading reduction

TOTAL 13 Billion RWA end Q1 2012

The actual cost for these reductions will probably lower than 100 MM if the Book Reduction needed and is limited to reducing the Book after all the previous changes in three Strategies (See attachment if needed) .

This does not include the challenging but benefit of getting the actual diversification value that currently QR is not asigning to CIO and will be part of our effort to convince QR/Risk/CFO of the merits of this benefit . We will need to plan for a New York deep dive coordination with Risk Management , Finance and QR for end of January/Beginning of February .

Regards

Javier

-----Original Message-----
From: Drew, Ina
Sent: 22 December 2011 00:55
To: Martin-Artajo, Javier X; macris@[redacted]
Cc: Wilmot, John
Subject: Rwa

We are running an additional rwa reduction scenario. Can u send John and I a scenario whereby the tranche book and other trading assets are reduced by an incremental 15 bil in the first quarter? Not a stress scenario, so assuming normal (whatever that is now - not year end) liquidity. Pls list by trading strategy, ie: credit tranche, other trading positions, with cost estimate - (background: trying to work with ccar submission for firm that is acceptable for an increased buyback plan). Need in early ny morning -

From: Weiland, Peter <peter.weiland@jpmchase.com>
Sent: Fri, 02 Mar 2012 21:31:43 GMT
To: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
CC: Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Enfield, Keith <Keith.Enfield@jpmorgan.com>; Stephan, Keith <keith.stephan@jpmorgan.com>; Hagan, Patrick S <patrick.s.hagan@jpmorgan.com>; Wilmot, John <JOHN.WILMOT@jpmorgan.com>
Subject: Fw: CIO CRM results

Javier -
We got some CRM numbers and they look like garbage as far as I can tell, 2-3x what we saw before. They came from the technology guy running the process, so probably QR has not even reviewed the results.
Obviously a lot of work to be done here.
Pete
Peter Weiland
JPMorgan
o: +1 212 834 5549
m: +1 [redacted]

From: Weiland, Peter
Sent: Friday, March 02, 2012 03:50 PM
To: Krug, Kevin
Cc: Bangia, Anil K; Kabia, Amy A; Enfield, Keith
Subject: RE: CIO CRM results

Thanks Kevin. We will definitely need to look carefully into these numbers.

These results, if I understand them, suggest that there are scenarios where the CIO tranche book could lose $6B in one year. That would be very difficult for us to imagine given our own analysis of the portfolio.

Pete

Peter Weiland
Tel: +1 212 834 5549
Mob: +1 [redacted]

[redacted] = Redacted by the Permanent Subcommittee on Investigations

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From: Krug, Kevin
Sent: Friday, March 02, 2012 3:44 PM
To: Weiland, Peter
Cc: Bangia, Anil K; Kabia, Amy A; Enfield, Keith
Subject: CIO CRM results

Hi Pete,

Sorry for the late response, but I wanted to be able to provide some additional information with the numbers, which took some time to gather. As you can see your CRM numbers have increased significantly with the new hierarchy runs. It looks like there was already a trend upward that the new numbers are consistent with, although I'm sure that's not the right way to look at it. QR is investigating the drivers of the change and will provide further information as it becomes available. The tables below show the product counts for the 18th of Jan (last day of old hierarchy) and the 22nd of Feb (last completed run with the new hierarchy). There were also 4 positions rejected due to missing ccy's on 1/18 and 6 positions rejected on 2/22 due to missing spread curves. These positions can be seen by filtering on the last column of the attached file. You should at least make sure that we have all of your positions.

Regards,
Kevin

CIO CRM
($MM)

Date	Old Hierarchy	New Hierarchy
Jan 4th	1,966	
Jan 11th	2,344	
Jan 18th	3,154	
Jan 25th		N/A
Feb 1st		5,732
Feb 8th		Needs Re-run
Feb 15th		Needs Re-run
Feb 22nd		6,301

Count of PCM Product				
Jan 18, 2012	CDS	CDSINDEX	TRANCHE	Grand Total
XJCFADX/EUR INDX CRD	13	16833	8445	25291

Count of PCM Product				
Feb 22, 2012	CDS	CDSINDEX	TRANCHE	Grand Total
Synthetic Credit	9	19160	7758	26927

From: Vigneron, Olivier X <olivier.x.vigneron@jpmorgan.com>
Sent: Wed, 07 Mar 2012 17:08:15 GMT
To: Venkatakrishnan, CS <cs.venkatakrishnan@jpmorgan.com>
Subject: RE: New CRM numbers ...

---

great thanks

From: Venkatakrishnan, CS
Sent: 07 March 2012 16:57
To: Vigneron, Olivier X
Subject: RE: New CRM numbers ...

I will ask if you and I can see him on Friday. Venkat

From: Vigneron, Olivier X
Sent: 07 March 2012 16:56
To: Venkatakrishnan, CS; Christory, Jean-Francois A
Subject: RE: New CRM numbers ...

I know of him but have not yet met him...

From: Venkatakrishnan, CS
Sent: 07 March 2012 16:48
To: Vigneron, Olivier X; Christory, Jean-Francois A
Subject: RE: New CRM numbers ...

Ashley has invited Javier to my meeting with him. I will tell him that this is a priority and mention you, Olivier. Do you know Javier?

From: Vigneron, Olivier X
Sent: 07 March 2012 16:47
To: Venkatakrishnan, CS; Christory, Jean-Francois A
Subject: RE: New CRM numbers ...

meeting this guy is one of my top priority on CIO side. I need to sharpen my tools before hand but I am comfortable to face him...

From: Venkatakrishnan, CS
Sent: 07 March 2012 16:35
To: Christory, Jean-Francois A
Cc: Vigneron, Olivier X
Subject: FW: New CRM numbers ...

I am cc'ing the firepower ;-)

We obviously need to address his issues. Has the model been discussed with him? Has he raised this with us before? Or is that an example of "institutional inertia" also? ;-)

Permanent Subcommittee on Investigations
EXHIBIT #48

From: Christory, Jean-Francois A
Sent: 07 March 2012 16:19
To: Venkatakrishnan, CS
Subject: FW: New CRM numbers ...

FYI. Historically we have not replied to this type of e-mails and worked our way through Pete Weiland on the risk side to get comfortable with the positions. We can obviously decide to change the strategy now if we are going to have more firepower on the frontlines.
JF

From: Hagan, Patrick S
Sent: Wednesday, March 07, 2012 11:12 AM
To: Martin-Artajo, Javier X; Weiland, Peter; Iksil, Bruno M; Grout, Julien G
Cc: Bangia, Anil K; Christory, Jean-Francois A; Stephan, Keith; Broder, Bruce
Subject: New CRM numbers ...

The CRM represents the worst loss over a 12m horizon at the 99.9% confidence level. With their new model, QR is reporting that we have a stand alone CRM of roughly 6bn. This is radically higher than the worst loss we see at the same confidence level; the loss we see is far below 2bn.

The worst case scenario as identified by QR at the 1 in a 1000 level is
    CDX HY spreads widen by a factor of 2.02
    CDX IG spreads widen by a factor of 2.37
    Itraxx MN spreads widen by a factor of 3.46
There are also 3HY defaults, 2 IG defaults, and 4 Itraxx defaults

Using a top down, full repricing approach, we calculate the 12 month loss in this case as between 2.54bn and 2.78bn, depending on various assumptions about the full scenario. Note that QR does not construct the full 12m profit/loss under each scenario; instead QR "re-centers" the results. This neglects carry, a key feature of our books. Also, even though our book benefits from defaults, by subtracting the mean outcome from the P/L, their calculation gives us event risk to defaults. This is why we prefer our approach.

We see the bad scenarios generated by QR as being much much rarer than indicated in their model. For example, in our model, the probability of the spreads widening as in the QR scenario is much less than 1 part in 1000. Under our model, the QR scenario is at
    3.76 standard deviations (probability: 0.000084) if we do not include mean reversion in our model
    4.93 standard deviations (probability: 0.000000416) if we do include mean reversion in our model
Moreover, including the probabities of realizing the defaults indicated in the QR scenario would greatly lower these probabilities further.

Suppose we construct the scenario by going in the same direction as the QR scenario, but stopping at the 0.001 probability level. If we did not model mean reversion, this would yield the scenario
    CDX HY spreads widen by a factor of 1.79, and there are 3 HY defaults
    CDX IG spreads widen by a factor of 2.05, and there are 2 IG defaults
    Itraxx MN spreads widen by a factor of 2.79, and there are 4 Itraxx defaults
This scenario would result in a 12month loss of around 1.28bn.

Moreover, if we model mean reversion, then going in the same direction as the QR scenario, but stopping at the 0.001 probability level would yield the scenario
    CDX HY spreads widen by a factor of 1.57, and there are 3 HY defaults
    CDX IG spreads widen by a factor of 1.73, and there are 2 IG defaults
    Itraxx MN spreads widen by a factor of 2.20, and there are 4 Itraxx defaults

This is not a particularly bad scenario for us, with the damage caused by the Itraxx widening being offset by positive default payments and CDX widening. It yields a 12m loss of 0.14bn.

Examination of the path by path data provided by QR makes it appear that QR is using a Gaussian copula model, or some variant. This is distrubing. The Gaussian copula model, along with the popular variants, has been thoroughly discredited. Reasons cited are:

* it has no physical or economic basis or justification,
* it is mathematically inconsistent,
* it is not arbitrage free,
* it is a static model, neglecting the dominant risk of the credit markets,
* it has failed in practice, being commonly cited a one of the proximate causes of hundreds of billions USD losses in the industry.

Let us be clear here: Using the Gaussian copula model for hedging and trading purposes, requires fidelity between the model and the market place for relatively small market moves. The Gaussian copula model failed at this task. Hoping that the model is somehow valid for extrapolating down to the 0.001 level risks is madness. The only conceivable excuse for it is institutional inertia.

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From: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
Sent: Thu, 08 Mar 2012 12:10:08 GMT
To: Drew, Ina <Ina.Drew@jpmorgan.com>; Macris, Achilles O <achilles.o.macris@jpmorgan.com>
CC: Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Weiland, Peter <peter.weiland@jpmchase.com>
Subject: RE: CIO CRM results

Ina ,

I have a full presentation to explain the issues at SAA today .
The change in notional is not correct and the CRM is therefore too high . We need to understand better the way they are looking at the scenario that creates the CRM and we also disagree with them on this . More work in progress until we can understand how to improve the number but the if the result of an increase is due to an increase in the long index but not on the tranches this makes no sense since this is not part of the CRM measure and once we reconcile the portfolio this should be very clear of what we would do . First , go back to the results of end of year so that we go to a more neutral position before trying to do what we have done with the reduction of RWA due to VAR and StressVAR . (We are getting positive results here in line with expectations) .

regards

From: Drew, Ina
Sent: 08 March 2012 00:29
To: Macris, Achilles O; Martin-Artajo, Javier X
Cc: Goldman, Irvin J; Weiland, Peter
Subject: Fw: CIO CRM results

Not consistant with your take. Let's discuss thurs.

From: Venkatakrishnan, CS
To: Drew, Ina; Hogan, John J.; Bacon, Ashley; Goldman, Irvin J; Weiland, Peter
Sent: Wed Mar 07 19:12:25 2012
Subject: Fw: CIO CRM results

Ina,

There are two related issues. The first is the $3bn increase in CRM RWA between Jan and Feb, from $3.1bn to $6.3bn. The second is that your group believes that the absolute level of CRM RWA we calculate was high to begin with in Jan. The second question requires us to explain our models to the satisfaction of your team. I am in London and spoke with Javier today and we will make this an urgent matter.

Based on our models, though, we believe that the $3bn increase in RWA is entirely explained by a $33bn notional increase in short protection (long risk) in your portfolio between Jan and Feb. See table below.

Peter Weiland and your mid-office confirm this $33bn notional increase in long index risk. Further we both agree that this position change results in a change of about $150mm (a decrease) in 10%CSW. Per our models, a roughly 10% capital charge ($3bn) on this $33bn increase in risk is reasonable.

Also, to be clear, there has been no model change on our end; the change in RWA for tranches has hardly changed over the month.

I understand that we need to build your confidence in our models themselves but, given our models, we believe the increase in RWA is well explained by the build up in your risk positions.

I will call you tomorrow from London to follow up, but you can reach me at 917-[redacted]

Thanks,

Venkat

▬ = Redacted by the Permanent Subcommittee on Investigations

From: Bangia, Anil K
Sent: Wednesday, March 07, 2012 06:35 PM
To: Venkatakrishnan, CS
Subject: CIO CRM results

	Standalone CRM ($MM)		Net Notional($MM)			Position Count	
	Jan 18th	*Feb 22nd*	*Jan 18th*	*Feb 22nd*	*Position Increase*	*Jan 18th*	*Feb 22n*
All CIO Positions	3,154	6,301				25,291	26,92
Index CDS: All Positions	2,043	6,224				16,833	19,16
Index CDS: Common Positions	651	646				15817	1581
Index CDS: Rolloff Positions*	4,037		55,091			1,016	
Index CDS: New Positions		9,579		88,618	33,527		3,34
Index Tranche: All Positions	2,814	2,816				8,445	7,75
Index Tranche: Common Positions	1,972	2,174				7,334	7,33
Index Tranche: Rolloff Positions*	1,484					1,111	
Index Tranche: New Positions		1,416					42

* Includes 421 Dummy PCM Trades that were removed from PCM feed (4 CDS/227 Index CDS/190 Tranches)

From: Hagan, Patrick S <patrick.s.hagan@jpmorgan.com>
Sent: Wed, 21 Mar 2012 12:10:40 GMT
To: Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Stephan, Keith <keith.stephan@jpmorgan.com>; Venkatakrishnan, CS <cs.venkatakrishnan@jpmorgan.com>; Christory, Jean-Francois A <jean-francois.christory@jpmorgan.com>; Bangia, Anil K <anil.k.bangia@jpmorgan.com>; Broder, Bruce <bruce.broder@jpmorgan.com>; Enfield, Keith <Keith.Enfield@jpmorgan.com>
CC: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>; Weiland, Peter <peter.weiland@jpmchase.com>; Pat Hagan <pathagan1954@yahoo.com>
Subject: Optimizing regulatory capital

To optimize the firm-wide capital charge, I believe we should optimize the split between the tranche and index books. The bank as a whole may be leaving $6.3bn on the table, much of which may be recoverable.
Here is the situaton:

	total	IB	CIO
Alternative CRM floor:	$41.7bn	$28.3	$13.4
Model CRM:	$35.4bn	$18.3	$15.6
Effective CRM	$41.7bn	$28.3	$13.5
IRC			$18.75

Note that the effective CRM is currently controlled by the Alternative CRM floor. We should be able to move some directional trades out of the index book (to lower the IRC charge), and into the tranch book. This should increase the model CRM, but not the alternative CRM. Intuitively, the optimum split would have the Model CRM and Floor CRM nearly equal.

I think QR is in a unique position to perform this optimization. Here's what I think can be done.
a) the split between the index book (subject to IRC) and the tranch book (subject to CRM) should be a theoretical split, a matter of labeling for the capital calculations. If there is a natural split which helps us think about the positions, that's different, but for the purposes of the capital calculation, the books should be combined and split on the optimal basis;

b) If X our suggested index-only portfolio that is split off the combined book, then the theoretical split would be
New tranch + hedge book = Old combined book - aX,
New index book = aX,
where "a" would be 100% if we'd guessed the correct amount of directional hedges to remove from the combined book. But the idea would be for QR to find the value of "a" which results in the minimum post-diversification captial charge for the bank as a whole. With the capabilities shown to me by QR, I believe that they can accomplish this quite readily. The idea would be for them to do the optimization every week when they calculate the charges. (Who gets the savings is a different discussion.) QR may have the capacity to put this in place by quarter end.

c) Our book has four main axes. The eventual aim would be to provide QR with four index-only portfolios U, V, X, Y and create the theoretical portfolios:
New tranch + hedge book = Old combined book - aU - bV - cX - dY
New index book = aU + bV + cX + dY
Each week when QR calculates the firm's regulatory capital, they would have the additional task of determining the optimum coefficients a, b, c, and d which results in the minimum RWA for IRC + CRM. The other components of regulatory capital, historical Var and stress Var, aren't affected by the split, so this would be the optimal capital charge.

Permanent Subcommittee on Investigations
EXHIBIT #50

The new rules have too many arbitrary factors of three for the regulatory capital to rationally reflect our risks. I don't think we should treat this as regulatory arbitrage. Instead we should treat the regulatory capital calculation as an exercise of automatically finding the best results of an immensely arbitrary and complicated formula.

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Chief Investment Office,
J.P. Morgan
100 Wood Street
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patrick.s.hagan@jpmorgan.com

EXCERPTS FROM
TRANSCRIPT OF AUDIO RECORDING PRODUCED
TO THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Date: March 21, 2012 Telephone Call
Parties: Anil Bangia, Patrick Hagan
Bates Number: JPM-CIO-PSI-A 0000089

Mr. Bangia: I think, the, the email that you sent out, I think there is a, just FYI, there is a bit of sensitivity around this topic. So --

Mr. Hagan: There, there is a lot of sensitivity.

Mr. Bangia: Exactly, so I think what I would do is not put these things in email.

Mr. Hagan: That's exactly what I was told. Javier, Javier is the guy that asked me to send out the email this morning. And then he found out from, from Pete and – yeah, and he found out from some -- and Irv that this is …

Mr. Bangia: Yeah, yeah, I wouldn't put this you know in ….

Permanent Subcommittee on Investigations
EXHIBIT #51a

EXCERPTS FROM
TRANSCRIPT OF AUDIO RECORDING PRODUCED
TO THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Date: March 21, 2012 Telephone Call
Parties: Patrick Hagan, Anil Bangia
Bates Number: JPM-CIO-PSI-A 0000090

Mr. Hagan: Hi Anil, this is Pat.

Mr. Bangia: Hi Pat.

Mr. Hagan: Um, you know that email that I should not have sent?

Mr. Bangia: Um hum.

Mr. Hagan: Have you read it? Is that a feasible thing to do or is that impossible?

Mr. Bangia: Well it's, in some ways it's somewhat feasible, once we have a bit more of [indecipherable] development. So, a lot of the IRC tools that I was showing you are really based on a new model that is not in production yet. There is an old model that Bruce [Broder] has run, so that's the official model. So that has a very different offline manual process that complicates things.

Mr. Hagan: I see.

Mr. Bangia: And beyond that it's a matter of also, how much you guys should do it independently versus what, how much we can actually do on optimizing it, right, so, there's that side of that as well.

Mr. Hagan: Yeah, I mean, the feeling from the risk managers was that … treating the capital charge is this incredibly complicated mathematical function that we're, of course, going to optimize. And uh, they were less concerned about physically moving things from one physical book to another physical book.

Mr. Bangia: Yeah. Yeah. I think we should also make sure we don't oversell this in the sense that the stability of this, we have to see over time. So I, I would also not quote any numbers on how much we think we can save, right?

Mr. Hagan: Yeah, the thing is I was hoping we could save about half that and that's got to be split between the investment bank and us, so …

Mr. Bangia: Hmm.

Mr. Hagan: It's not clear, it's not clear.

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Mr. Bangia: Yeah, yeah, it's not clear.

EXCERPTS FROM
TRANSCRIPT OF AUDIO RECORDING PRODUCED
TO THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Date:	March 21, 2012 Telephone Call
Parties:	Peter Weiland, Patrick Hagan
Bates Number:	JPM-CIO-PSI-A 0000091

Mr. Weiland: I keep getting banged up .... I know you've had some emails back and forth with Venkat and Anil or whoever on the optimization of the IRC and CRM and everything else. Everyone is very, very – I told this to Javier the other day but maybe he didn't mention it to you – everyone is very, very sensitive about the idea – writing emails about the idea of optimizing –

Mr. Hagan: I got that sort of mentioned. I'd say it was mentioned to me [laughter].

Mr. Weiland: OK, so, I don't know, Irv just came by again and said, "Oh, Venkat was telling me he got another email from Pat you know –"

Mr. Hagan: From me?

Mr. Weiland: Maybe it's from a couple of days ago, I don't know, but .... if you're sensitive to it, that's all I wanted to know.

Mr. Hagan: Okay.

Mr. Weiland: So I think we can talk about, you know, allocation –

Mr. Hagan: Okay, so nothing about allocation, I understand –

Mr. Weiland: – Uh, you see, the work of the risk manager has very broad and unclear borders sometimes. Anyway –

Mr. Hagan: – Okay. I did write an email message. I didn't realize it was sensitive to that extent .... Ah, it's all mathematics.

Mr. Weiland: – Yeah, well that's, you know, the funniest thing is, the first time that someone mentioned it to me I said, you know, 'I'm sure that Pat just sees this as like a math problem, an interesting and a complicated math problem. And all this other crap that goes on about, like, the implications of regulatory arbitrage and stuff like that is like, completely boring' [laughter].

Mr. Hagan: – No it's not that. I just get annoyed when I see us creating risks when there were no risks —

Mr. Weiland: Yeah, I know.

Mr. Hagan: -- that's annoying. Ok, I understand the sensitivity. Tell Irv I'm sorry.

Permanent Subcommittee on Investigations
EXHIBIT #51c

From: Wilmot, John <JOHN.WILMOT@jpmorgan.com>
Sent: Tue, 03 Apr 2012 11:45:24 GMT
To: Drew, Ina <Ina.Drew@jpmorgan.com>
Subject: RE:

Here is my general reaction to this and to the document circulated last night:

1. I don't get the sense of clarity that we know what is driving the RWA (economic risk versus VaR, stress VaR, CRM and IRC) or the p&l - or more importantly that either will be manageable going forward
2. We are a significant player in a market that is less liquid, hence any attempt to manage p&l or capital away from an "as is" approach will either result in p&l dislocation or RWA constraints (a la 4Q11/1Q12)
3. We haven't made the case of how this book runs off and whether risk can be managed effectively within a fixed maturity, is that we can de-risk without creating continual tail risk further out past tranche maturities. This plane will never land.
4. We also haven't made the case of what it costs to significantly decrease the size of the book (in my mind the only certain way to reduce RWA)

I profess to probably being the least knowledgeable about this book amongst the senior team, so that leads me to be skeptical when we aren't directly answering questions. I think we have moved beyond the commercial utilization of this book in some jump-to-default capacity as it exhibits neither acceptable risk/return profiles nor market liquidity characteristics to justify capital.

John C. Wilmot | Chief Investment Office | john.wilmot@jpmorgan.com | Work: (212) 834-5452 | Cell: [redacted]

-----Original Message-----
From: Drew, Ina
Sent: Tuesday, April 03, 2012 6:52 AM
To: Wilmot, John
Subject: Fw:

▬▬ = Redacted by the Permanent Subcommittee on Investigations

Read before the meeting

----- Original Message -----
From: Macris, Achilles O
Sent: Tuesday, April 03, 2012 06:27 AM
To: Drew, Ina
Subject: RE:

OK -- maybe to follow-up the "background" that I send to John when we asked him for Olivier's help?

The situation is as follows:

- Javier and team believe that the book is currently balanced for risk and P+L.
- Clearly maintaining this "neutrality" will be resulting in higher RWA than we originally anticipated.
- Olivier is now in our office and he is 100% involved with the RWA projections of our book and ways to bringing it lower. Nevertheless, I don't believe that we will able to be precise in our RWA targeting as there are still several moving pieces in methodology etc. The best we can do for the next week(s) is to operate with RWA ranges as opposed to exact targets.
- Javier believes that retaining the existing book "as is" will generate no less than $750m in P+L until the end of the year and clearly much more if we experience defaults and the value reversal on IG forwards.
- Unfortunately, the above "as is" approach will likely result in a minimum of $45b RWA at the end of the year and likely in a $46-52b range.
- If we can't allocate these levels of RWA, and we must reduce it, then the pace of the reduction would be very relevant for the P+L. In order to maintain, risk neutrality in the book, we will need to be reducing the liquid on the run IG, parallel to reducing the short HY. The luck of liquidity

in HY, would likely delay the pace of IG liquidation and thus RWA reduction. Projecting a 50% reduction of the IG/HY by the end of the year, will be reducing RWA to the mid $30s. An orderly reduction will preserve over 60% of the P+L of the "as is" scenario above. Specifically, this approach would retain the jump to default but it will realize less curry than the over $2m daily, as of now.

My recommendation is the gradual reduction to a $35b RWA target by year-end. I realize that this is higher than what we have all hoped for. I am very concerned by over-acting in the market relative to our size and poor liquidity. We really need to minimize our market involvement and focus our activity to certain RWA reduction plans (pre-priced by Olivier) while utilizing liquidity in an orderly way.

Best,
Achilles

-----Original Message-----
From: Drew, Ina
Sent: 03 April 2012 00:39
To: Macris, Achilles O
Subject:

After we finish our review tomorrow, I will need you to prepare a short summary for hogan and jamie. We can talk about how to best present the gameplan.

From: Iksil, Bruno M <bruno.m.iksil@jpmchase.com>
Sent: Mon, 30 Jan 2012 21:02:17 GMT
To: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
Subject: there is more loss coming in core credit book

I reckon we have another 50M coming from CDX IG9 exposure. The guys have a huge skew trade on and they will defend it as much as we do. I think I should take the pain fast over to next month. I have tried but it will ot move : they have moved some of those trades out at BOA but BNP, CSFB and BARCLAYS go for the fight. It is pointless in my view to go for a fight. We will roll down and recover the loss. But i have to let it go . The day when either we have a panic or names like Radian, MBIA recover, the position will be at profit because the forwards will collapse. Now I just grow the exposure and the CS01 moves up.

From: Goldman, Irvin J
Sent: Tue, 14 Feb 2012 01:22:17 GMT
To: Drew, Ina <Ina.Drew@jpmorgan.com>
Subject: Re: Csbpv limit- please read

---

yes to all.

----- Original Message -----
From: Drew, Ina
To: Goldman, Irvin J
Sent: Mon Feb 13 20:21:04 2012
Subject: Re: Csbpv limit- please read

I have no memory of this limit. In any case it need to be recast with other limits. Its old and outdated

----- Original Message -----
From: Goldman, Irvin J
To: Drew, Ina
Sent: Mon Feb 13 20:18:38 2012
Subject: Csbpv limit- please read

Ina,
I will review thoroughly tomorrow as pete emailed me tonight. Not sure why it did not come up before. Wanted to give you heads up.

I copied below from his email:
We have a global credit csbpv limit. It was set up at the initiation of the credit book, Unfortunately we have been breaching for most of the year. Lavine's team is going to send out a notification (just within CIO) probably tomorrow.
the big portfolio changes they made in the tranche book in Dec/Jan. caused the increase.
We will need a one off limit increase .

From: Keith Stephan <keith.stephan@jpmorgan.com>
Sent: Fri, 17 Feb 2012 14:11:26 GMT
To: BRUNO IKSIL <BIKSIL2@[redacted] BRUNO IKSIL <bruno.m.iksil@jpmorgan.com>
Subject: FW: CIO Global Credit spread BPV limit breach- COB 02/09/2012

Bruno - can you read the below draft and let me know if you agree /w the points - think we need to get Javier on board w/ this before we send out formal limit request.

From: Stephan, Keith
Sent: 16 February 2012 17:09
To: Weiland, Peter
Cc: Lee, Janet X; Chandna, Sameer X
Subject: RE: CIO Global Credit spread BPV limit breach- COB 02/09/2012
Since mid-January CIO has been in breach of its global csbpv limits, driven primarily by position changes in the tranche book.

The csbpv methodology adds the csbpv sensitivities of all the credit products, unadjusted for correlations. As IG and HY positions have been added in January (with a hedge ratio of roughly 5x) the net csbpv prints a positive number even though on a beta-adjusted basis the book is relatively flat.

Market Risk is currently reviewing all limits and most likely will remove the csbpv limit to be replaced with a set of credit-spread-widening (CSW) limits to better reflect the risk of the portfolio in material market moves. Until the new limits are implemented we will propose a one-off to the csbpv, up to $20mm, as we find that the stress and csw measures are more appropriate indicators of the risk of the portfolio.

As you can see below - the CSBPV measure vs. 10% CSW shows that the book has been reasonably balanced despite the headline bpv looking much longer. This is not the case in the 50% CSW measure, as the parallel relative shifts of 50pc have the effect of steepening the already upward sloping credit curves, hence makes losses look higher when compared with the 10pc measure. This can be seen clearly in comparison of the 50% CSW measure vs. the Large Flattening Selloff / Credit Crisis scenario P&L, which simulates more realistic (i.e. flattening) curve dynamics in the large (circa 50%) selloff. The book, in this case, benefits, given that in CDX.IG, long forward risk is achieved via flattener positions, i.e. the stress loss for the IG strategies in the large flattening selloff is -100mm vs. -1bn in the 50% parallel move.

50% vs LFS:

ITX XO +0.5 vs +0.65 Diff $+0.15bn
ITX MN -1B vs -1.3B Diff $-0.3bn
CDX HY +1.4B vs +1.8B Diff $+0.4bn
CDX IG -1B vs -0.1B Diff $+1bn

[cid:image002.png@01CCECCD.B941A680]

50% parallel shock vs. Large Flattening Selloff:

Permanent Subcommittee on Investigations
EXHIBIT #55

[cid:image003.png@01CCECCD.B941A680]

50% vs LFS:

ITX XO +0.5 vs +0.65 Diff $+0.15bn
ITX MN -1B vs -1.3B Diff $-0.3bn
CDX HY +1.4B vs +1.8B Diff $+0.4bn
CDX IG -1B vs -0.1B Diff $+1bn

From: Weiland, Peter
Sent: 15 February 2012 23:39
To: Stephan, Keith
Cc: Lee, Janet X
Subject: FW: CIO Global Credit spread BPV limit breach- COB 02/09/2012

How about this? Maybe you can edit and add your graphs if you think it would help.

Since mid-January CIO has been in breach of its global csbpv limits, driven primarily by position changes in the tranche book.

The csbpv methodology adds the csbpv sensitivities of all the credit products, unadjusted for correlations. As IG and HY positions have been added in January (with a hedge ratio of roughly 5x) the net csbpv prints a positive number even though on a beta-adjusted basis the book is relatively flat.

Market Risk is currently reviewing all limits and most likely will remove the csbpv limit to be replaced with a set of credit-spread-widening (CSW) limits to better reflect the risk of the portfolio in material market moves. Until the new limits are implemented we will propose a one-off to the csbpv, as we find that the stress and csw measures are more appropriate indicators of the risk of the portfolio.

Pete

▬ = Redacted by the Permanent Subcommittee on Investigations

Peter Weiland
Tel: +1 212 834 5549
Mob: [redacted]

From: Hassan, Syed S
Sent: Wednesday, February 15, 2012 3:51 PM
To: Hassan, Syed S; Lee, Janet X; Stephan, Keith; D'costa, Karolyn K; Xiong, Bo
Cc: MRM CIO NA; MRM External Reporting; Weiland, Peter
Subject: RE: CIO Global Credit spread BPV limit breach- COB 02/09/2012

Hi Janet & Keith

Can you please advise on the below request? We'd like to get the notification out as the excession has been ongoing for a while now. Thanks.

Regards,

Hassan-

From: Hassan, Syed S
Sent: Monday, February 13, 2012 2:37 PM
To: Lee, Janet X; Stephan, Keith; D'costa, Karolyn K; Xiong, Bo
Cc: MRM CIO NA; MRM External Reporting
Subject: CIO Global Credit spread BPV limit breach- COB 02/09/2012

Hi Janet & Keith,

The following CIO Global Credit Spread BPV limits have been breaching since the aforementioned period.

Can you please examine and confirm the breaches as valid? If so, please also provide some commentary surrounding the breaches? Thanks.

[cid:image001.png@01CCECCC.BD81DDB0]

Regards,

Syed Hassan | Market Risk Management & Reporting | Chief Investment Office | J.P. Morgan | 2nd floor, 277 Park Avenue, NY | 212.270.2562| Syed.S.Hassan@JPMorgan.com.

Date of Breach	LOB	Limit Type	Limit ID	Current Limit	Limit Utilization	Excession
1/18/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	12,476,463.69	-476,463.694
1/19/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	12,242,682.67	-242,682.665
1/20/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	11,065,751.04	934,248.965
1/23/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	11,192,552.64	807,447.357
1/24/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	11,874,676.30	125,323.697
1/25/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	12,795,898.84	-795,898.842
1/26/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	13,579,489.16	-1,579,489.156
1/27/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	14,835,701.26	-2,835,701.261
1/30/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	16,507,706.96	-4,507,706.965
1/31/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	16,087,997.20	-4,087,997.197
2/1/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	14,328,947.64	-2,328,947.644
2/2/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	14,015,706.12	-2,015,706.120
2/3/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	15,491,436.60	-3,491,436.600
2/6/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	15,037,140.41	-3,037,140.408
2/7/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	16,790,494.73	-4,790,494.731
2/8/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	17,837,782.54	-5,837,782.536
2/9/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - Total	38019	12,000,000	20,551,039.63	-8,551,039.626
[redacted]						
[redacted]						
1/6/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	5,767,816.27	-767,816.268
1/9/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	6,540,464.31	-1,540,464.306
1/10/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	7,173,676.27	-2,173,676.270
1/11/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	6,705,051.65	-1,705,051.645
1/12/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	7,073,191.61	-2,073,191.607
1/16/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	6,789,050.32	-1,789,050.324
1/17/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	8,623,171.56	-3,623,171.558
1/18/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	10,501,915.86	-5,501,915.863
1/19/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	9,038,065.71	-4,038,065.712
1/20/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	9,244,498.81	-4,244,498.813
1/23/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	9,183,631.29	-4,183,631.287
1/24/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	9,865,676.28	-4,865,676.278
1/25/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	10,974,965.09	-5,974,965.090
1/26/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	11,845,290.09	-6,845,290.092
1/27/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	13,060,735.94	-8,060,735.943
1/30/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	14,669,691.76	-9,669,691.764
1/31/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	14,201,978.23	-9,201,978.226
2/1/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	12443275.5	-7,443,275.504
2/2/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	12096801.27	-7,096,801.272
2/3/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	13564638.64	-8,564,638.637
2/6/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	13124400.95	-8,124,400.945
2/7/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	14879848.15	-9,879,848.145
2/8/2012	CIO	Chief Investment Office CIO - Global Credit - Credit Spread BPV - MTM-Total	38020	5,000,000	15935564.9	-10,935,564.900
2/9/201[illegible]	CIO	Chief Investment Office CIO - Global Credit - Credit Sprea[illegible] MTM-Total	38020	5,000,000	18659019.36	[illegible]59,019.360

From: Venkatakrishnan, CS <cs.venkatakrishnan@jpmorgan.com>
Sent: Mon, 02 Apr 2012 21:53:53 GMT
To: Hogan, John J. <John.J.Hogan@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Bacon, Ashley <Ashley.Bacon@jpmorgan.com>
CC: Vigneron, Olivier X <olivier.x.vigneron@jpmorgan.com>
Subject: FW: CIO DAY 1

John/Ashley/Irv: Below is an update from Olivier. One source of model difference is that the capital models operate at the level of individual names but the CIO's desk models operate at the level of indices --- so the effect of name concentrations may be captured differently. We are pursuing the impact and further modeling of this. Venkat

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From: Vigneron, Olivier X
Sent: Monday, April 02, 2012 3:15 PM
To: Venkatakrishnan, CS
Subject: CIO DAY 1

Hi Venkat,

Main takeaways:

- Book comprises index trades only (tranches+ plain indices). All modelling done on the index spread, single names are assumed homogeneous and homogeneous pool model is then used to price tranches and generate index delta. Historical regression also gives them a beta adjusted delta for HY vs IG.
- Key takeaway 1: approximation around the dispersion of single names a key source of discrepancies when submitting portfolio to large single name shocks (as does IRC/CRM). More work to quantify impact of this approximation.
- Key takeaway 2: we need to load the book on a "bottom up" single name modelling approach that can give single name default exposures, as well as a CSW computation that is comparable to the Credit Trading desk for example.

Action points:

- To discuss modelling merits of CIO and its feedback on our IRC spread modelling with the model research group (will start with Matthias A. who has been involved by Anil).
- To model in Lynx (tool developed by credit trading team) the CIO portfolio. Preliminary dummy trades loaded. Tool is ring fenced (i.e. only I will have access). However I will check with Javier before loading the real notionals tomorrow that he is fine for me to go ahead with this.

Risk update:

On my CSW estimate sent yesterday for March 7th position, I missed the Xover trades, here is the updated estimate when including them:

Estimated All Tranches:	-45m CSW
Estimated CDX indices:	-350m CSW
Estimated ITRX indices:	-280m CSW
Estimated HY CDX:	+400m CSW
Estimated FinSub + Xover:	+150m CSW

Total: -125m CSW long (March 7th)

Face notional by maturity buckets and IG/HY split.

25bn short in 1Y IG
15bn short in 2Y HY,
17bn short 5Y HY
135bn long in 5Y IG

Olivier

From: Venkatakrishnan, CS
Sent: 30 March 2012 22:30
To: Vigneron, Olivier X
Subject: FW: CIO 10% CSW

Please see below and let's make sure we speak daily on this! Merci, Venkat

---

From: Hogan, John J.
Sent: Friday, March 30, 2012 5:28 PM
To: Venkatakrishnan, CS
Subject: RE: CIO 10% CSW

OK thanks Venkat—keep me posted please

From: Venkatakrishnan, CS
Sent: Friday, March 30, 2012 5:27 PM
To: Hogan, John J.
Subject: CIO 10% CSW

John: CIO's 10% CSW by my group's model estimate is long 245mm of risk; their own models (run by Weiland) quote $145mm. I don't understand the difference in the models and don't know how good a measure of risk 10%CSW is for their book. But I spoke to Ashley and we agree that 10%CSW has been trending up for CIO, by either their model or ours. Once Olivier spends time in the portfolio, we should get a better idea. I also sense from speaking with Javier that CIO are worried that they may now have to shed tranche risk in a tight market. I don't know how real this worry is but I wanted to make you aware. I will get a daily download from Olivier and keep you and Ashley posted (Ashley is out next week). I may myself go to London mid-week. Venkat

Please see the CSW10 results for original CIO portfolio and the split portfolio for March 21st.

Corp Portfolio						
COB	***10-Jan-12***	***18-Jan-12***	***25-Jan-12***	***31-Jan-12***	***28-Feb-12***	***21-Mar-12***
CSW10 (MM)	-7.2	73.7	80.6	62.2	150.1	245.2

21-Mar-12	Corp Portfolio	CIO Index Portfolio	Combined Portfolio
CSW10 (MM)	245.2	252.8	-7.6

This following is based on the latest split I received from Patrick Hagan this morning.

21-Mar-12	Corp Portfolio	CIO Index Portfolio	Combined Portfolio
CSW10 (MM)	245.2	213.5	31.7

From: Huang, Yuan X
Sent: Friday, March 30, 2012 10:02 AM
To: Venkatakrishnan, CS
Cc: Jia, Keith
Subject: FW: Mar-21 risk report for CIO and benchmark indices

We have the CSW10 results for a few days (see row 24 "Spread_10PcntUp"). If the date you are interested is not included (ex, Mar-7th), we can generate the results in about half an hour.

Regards,
Yuan

From: Jia, Keith
Sent: Thursday, March 29, 2012 11:46 AM
To: Huang, Yuan X
Cc: Bangia, Anil K
Subject: RE: Mar-21 risk report for CIO and benchmark indices

6-day risk report.

From: Huang, Yuan X
Sent: Wednesday, March 28, 2012 2:56 PM
To: Jia, Keith
Cc: Bangia, Anil K
Subject: Mar-21 risk report for CIO and benchmark indices

From: Weiland, Peter <peter.weiland@jpmchase.com>
Sent: Mon, 07 May 2012 15:32:57 GMT
To: Drew, Ina <Ina.Drew@jpmorgan.com>
CC: Goldman, Irvin J <irvin.j.goldman@jpmchase.com>
Subject: CSBPV History

Hi Ina –

Irv said you need some background on the CSBPV limit history. I created the attached slide for your reference (this has not gone to anyone else).

I also attach the limit memo from Brian Roseboro back in 2008 in case you need it.

I'm not sure what else you may need – I will be at the phone if there are other specific data that would help.

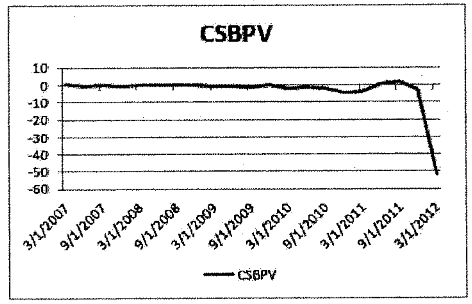
Pete

Peter Weiland | **J.P.Morgan** | Chief Investment Office | 270 Park Ave. | ☎ Tel: +1 212 834 5549 | ☎ Cell: +[redacted]
peter.weiland@jpmorgan.com

[redacted] = **Redacted by the Permanent Subcommittee on Investigations**

CIO Global Credit CSBPV Limits

CIO Global Credit CSBPV Limit has been in place since 2007
•Composed of both synthetic credit and cash credit (mostly collateralized securities)
•Net sum of CSBPVs for all credit underlyings
•Spot quarterly history of Global Credit CSBPV exposure at right



CSBPV in 2012

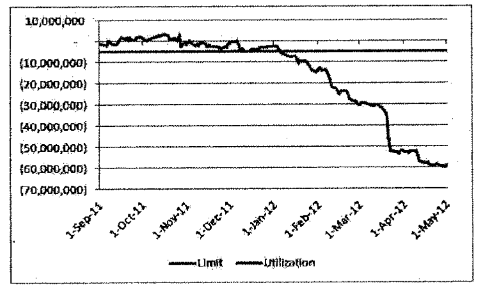
•Early in 2012 net CSBPV increased dramatically as IG positions were added and offset between HY and IG grew

•Given that a beta adjusted credit spread-neutral position including HY and IG requires 5-6x as much IG as HY, decision was taken at that time that the CSBPV limit should be changed to account better for the increased activity

•Written notification of limit breach from MRM Reporting included the following commentary: "Current measurement of raw CSBPV is not normalized for the level of spreads, nor does it capture convexity as represented in CSW10 (and Stress Loss) measures. Full limit review is underway for the CIO business, and a proposal is expected to address this issue."

•The limit usage was calculated correctly; the issue was simply that we decided that given the mix of underlyings it would be better to look at the sensitivities in a more granular way.

•New limits for Synthetic Credit were implemented according to underlying index as of May 1



From: Berg, Jaymin
To: <Crumlish, Fred>;<Fursa, Thomas>;<Kirk, Mike>;<Hohl, James>;<Wong, Elwyn>;<Kamath, Jairam>; <Monroe, Christopher>;<Tornese, Doug>;<McLaughlin, Doug>
Sent: 1/31/2012 6:17:33 PM
Subject: CIO Quarterly Meeting

Financial

- CIO finished 4th quarter with $785mm of revenues.

o MTM gains totaled $330mm of which $250mm of the gains originated from the credit tranche portfolio. The CIO was short credit, and a bankruptcy by AMR caused a large gain in CDSs.

- Securities losses totaled $14mm for the quarter primarily driven by losses on EMEA government guaranteed debt.

Investments

- Growth in the international SAA book is due to building out the team in EMEA and opportunistic purchases. It's expected to see more growth in the international portfolio going forward.

- CIO is investing less in rates products and focusing on more credit products due to low interest rates and MBS prepayment concerns from government programs (i.e. HARP 2).

- The rates products most attractive to the CIO are munis because of their longer duration.

- SAA had a negative DOE in 2011 but is expected to move to a positive DOE by the end of 2012.

- Management's view of investments is changing to a Structural Book and an MTM Book, although the Structural Book will include bank Pf and CDS that are MTM accounting.

- The MTM Book is decreasing in size in 2012. It's expected that RWA will decrease from $70B to $40B.

- The Structural Book RWA is expected to be flatish year over year.

MSR

- The 3Q and 4Q hedging volatility was attributed to anticipated changes to the MSR model. The MSR asset continued to have a longer average life than the old model could account for. The MSR model has now been updated and hedging returns normalized.

Jaymin T. Berg
U.S. Department of the Treasury
Office of the Comptroller of the Currency
Large Bank Supervision - Capital Markets
Tel: (212) 899-1395 | Fax: (301) 433-6183

BB: (202) [redacted]

— = **Redacted by the Permanent Subcommittee on Investigations**

Permanent Subcommittee on Investigations
EXHIBIT #58

From: Fursa, Thomas
To: <Hohl, James>
Sent: 4/13/2012 3:55:30 PM
Subject: Re: CIO deck

Thanks. I couldn't remember the guys name

----- Original Message -----
From: Hohl, James
Sent: Friday, April 13, 2012 11:53 AM
To: Fursa, Thomas
Subject: RE: CIO deck

Just e-mailed the guy who sent the report before getting this. If I don't hear back from him, I'll e-mail Ed.

-----Original Message-----
From: Fursa, Thomas
Sent: Friday, April 13, 2012 11:51 AM
To: Hohl, James
Subject: Re: CIO deck

If that's the last one - can you e-mail Ed Kastl for the latest?

----- Original Message -----
From: Hohl, James
Sent: Friday, April 13, 2012 11:31 AM
To: Fursa, Thomas
Subject: RE: CIO deck

The latest one that I got was January. I'll check WISDM.

-----Original Message-----
From: Fursa, Thomas
Sent: Friday, April 13, 2012 11:31 AM
To: Hohl, James
Subject: CIO deck

James - have you still been getting the CIO deck? I don't recall seeing it lately. Can you check WISDM to see what the last one is?

Thanks,
Tom

From: Sabatini, Joseph
To: Iacucci(Regulator), Anna; Crumlish (Regulator), Fred X; Dillon(Regulator), Donald
CC: Wilmot, John
Sent: 4/16/2012 2:54:36 PM
Subject: FW: materials for Fed/OCC/FDIC call at noon today
Attachments: synthetic credit book_Fed_OCC-pdf.zip

This time with the attachment !

From: Wilmot, John
Sent: Monday, April 16, 2012 10:44 AM
To: Sabatini, Joseph
Subject: materials for Fed/OCC/FDIC call at noon today

Joe – here are the materials for the noon call today on the Synthetic Credit Book. John

John C. Wilmot | Chief Investment Office | + john.wilmot@jpmorgan.com | (Work: (212) 834-5452 | (Cell: [redacted]

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Permanent Subcommittee on Investigations
EXHIBIT #60

Synthetic Credit Book Review

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Core Credit Book

- Objective since inception (2007) has been to manage a profile that would protect against a significant downturn in credit, offsetting natural credit exposures in CIO and the firm
- The strategy can be divided into four main components
  - Investment grade
    - US (CDX.IG)
    - Europe (iTraxx Main)
  - High Yield
    - US (CDX.HY)
    - Europe (iTraxx XO)
- On a very generalized basis, the combined strategies provide the following risk profile
  - Short HY risk (long protection) against long IG risk (long risk)
  - Short short-duration IG risk (long protection until YE12) against long long-duration IG risk (ie a credit curve flattener)
- The IG9 Series includes 5 fallen angel names included in the HY index
  - Radian
  - MBIA
  - Sprint
  - RR Donnelly
  - iStar Financial

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Rebalancing Activity

Market Back-drop

- Nov 29 AMR bankruptcy filing earlier than expected
- First European announcement of LTRO on December 8th 2011
- CDX High Yield series 11 matured December 20th 2011
- January 18 Kodak files for bankruptcy; rumored for weeks ahead

Risk Management Activity

- CIO decides to reduce the HY protection which was providing stress loss protection for both credit spread widening and systematic risk
- Post AMR default, HY index exhibits limited liquidity, exacerbated by expectations of Kodak event
- Difficult to hedge the book with HY indexes that matched the underlying risk of the protection
- Best available hedge was to use the IG 9 index that had the special feature of being both an instrument with liquidity of IG but with a HY component that allowed a hedge for a good part of the HY position
- After analyzing the economics of the hedge and the behavior of VaR and stress VaR, CIO increased the IG 9 long forward position

Synthetic Credit Summary: Notional Exposure

(all figures in billions USD)	Long	Short	Net
Gross external trades	836.1	-678.8	157.3
Notionals outstanding with JPM	210.8	-197.7	13.0
- index	162.2	-160.8	1.4
- tranche	48.6	-36.9	11.7
Notionals outstanding with ICE	250.1	-153.4	96.7
- index	250.1	-153.4	96.7
- tranche			
Notionals outstanding with external counterparties	375.2	-327.7	47.5
- index	122.1	-118.8	3.3
- tranche	253.1	-208.9	44.2

Detail of Positions				LONG	SHORT	Grand Total
Major Index Positions	CDX HY S08 05Y	external	ICE			
		internal	JPM-IB			
	CDX HY S08 05Y Total					
	CDX IG S09 05Y	external	Credit Agricole			
			ICE			
			Socgen			
		internal	JPM-IB			
	CDX IG S09 05Y Total					
	CDX IG S09 07Y	external	BofA			
			ICE			
			Socgen			
		internal	JPM-IB			
	CDX IG S09 07Y Total					
	CDX IG S09 10Y	external	BofA			
			ICE			
			Socgen			
			USS			
		internal	JPM-IB			
	CDX IG S09 10Y Total					
	ITRAXX MN S09 05Y	external	Citi			
			ICE			
			Socgen			
			UBS			
		internal	JPM-IB			
	ITRAXX MN S09 05Y Total					
	ITRAXX MN S09 10Y	external	BofA			
			Citi			
			ICE			
			Socgen			
		internal	JPM-IB			
	ITRAXX MN S09 10Y Total					
	ITRAXX MN S16 05Y	external	Citi			
			ICE			
			Socgen			
		internal	JPM-IB			
	ITRAXX MN S16 05Y Total					
	Subtotal of Major Index Positions			336,318,508,291	-184,906,954,786	153,409,553,505
	All Other Index Positions			198,134,045,686	-248,074,220,485	-51,940,174,599
	Total of Index Positions			534,452,564,177	-432,983,175,271	101,469,378,906
	Total of All Tranche Positions			301,660,076,879	-245,795,004,821	55,865,072,058

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- Gross external (to CIO, including IB) notional is $836bio long risk vs. $678bio short risk across all index and tranche products
- External index notional faces Intercontinental Exchange (ICE) is *net* $96.7bio, 97% of total net external index exposure
- Tranche products are not eligible for ICE clearing and are bilateral counterparty exposures

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Synthetic Credit Summary: Maturity Profile

Factored Notional $mm	Maturity																
Index	20-Jun-12	20-Dec-12	20-Jun-13	20-Dec-13	20-Jun-14	20-Dec-14	20-Jun-15	20-Dec-15	20-Jun-16	20-Dec-16	20-Jun-17	20-Dec-17	20-Jun-18	20-Jun-20	20-Dec-20	20-Jun-21	20-Dec-21	Grand Total
CDX HY	13,824	8,485	-2,455	3,197	517		-10,631	-5,735	-6,706	-7,828								-7,333
CDX LCDX			1,846															1,846
CDX IG		-53,965	0	-586	55	34,267	-7,657	-17,996	-18,479	11,493	15,791	91,564		257	-54	382		56,303
ITRAXX MN		7	28,276		-3,356		20,044	25	7,460	18,684	7,529	22	43,521			-2,132	-1,731	118,350
ITRAXX XO								-5	-1,767	-6,822	-118							-8,712
ITRAXX FINSUB	-121	-690	-2,210	-1,444		-1,014		1,705	-694	1,366	828							-2,074
ITRAXX FINSEN											72							72
SOVX WE										47								47
Grand Total	13,703	-45,262	26,467	1,167	-2,774	33,263	1,766	-21,606	-20,088	16,839	24,202	91,587	43,521	257	-54	-1,830	-1,731	156,498

10%CSW $mm	Maturity																
Index	20-Jun-12	20-Dec-12	20-Jun-13	20-Dec-13	20-Jun-14	20-Dec-14	20-Jun-15	20-Dec-15	20-Jun-16	20-Dec-16	20-Jun-17	20-Dec-17	20-Jun-18	20-Jun-20	23-Dec-20	20-Jun-21	20-Dec-21	Grand Total
CDX HY	4	2	-6	-39	-7		138	99	123	166								478
CDX LCDX			1															1
CDX IG		76	0	0	-1	-39	17	55	64	-46	-73	-504		-2	0	-3		-453
ITRAXX MN		-0	68		10		-6	-0	-21	-111	-47	-1	-282			24	20	-344
ITRAXX XO								0	33	143	3							178
ITRAXX FINSUB	0	2	9	8		9		-20	6	-22	-16							-23
ITRAXX FINSEN											-1							-1
SOVX WE										-0								-0
Grand Total	4	80	72	-31	2	-30	160	114	208	130	-134	-505	-282	-2	0	22	20	-163

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- Top table shows gross notionals across indices and tranches by underlying index family (simply adds notionals of indices and tranches)
- Bottom table shows the 10% credit spread widening (P/L $MMs) to 10% widening of credit spreads
- Largest short risk exposures in investment grade mature in Dec-12 for CDX.IG.9 and Jun-13for iTraxx S9
- Largest short risk exposures in high yield are concentrated in Dec-15 to Jun-16 for CDX.HY and Dec-16 for iTraxx Crossover
- One particular item to note is the iTraxx Main 20Jun13 which appears long given positive notional, but which is in fact short, as reflected in 10%csw, as a result of equity tranche protection which is a significant part of the position

Synthetic Credit Summary: Risk Summary

- **Total Synthetic Credit VaR 59.2mm**
- **10% Credit Spread Widening**
  - The position, beta-adjusted has net directionality of -$163MM in 10% parallel move in spreads
  - This is equivalent of $34.5bio of long risk in 5y IG equivalents
- **Relative value Risk Exposures**
  - IG9 5/10s curve position $46MM/bps of risk if curve steepens 1bps
  - ITX9 5/10s curve position $19MM/bps if curve steepens 1bps
  - IG vs. HY $27mm/bps of risk if IG underperforms HY by 1bps
  - XO vs. ITX $34mm/bps of risk if ITX underperforms XOVER by 1bps

Index	CS01	Beta-Adj. CS01	CSW 10%	HY vs. IG	Steepen01
CDX HY	8.51	42.55	478.40		
CDX LCDX	0.09	0.45	1.40		
CDX IG	-35.12	-35.12	-453.12	-27.24	-45.08
Total US	-26.52	7.09	26.68	-27.24	-45.08
iTraxx MN	-22.06	-22.06	-344.04	-34.26	-19.07
iTraxx XO	3.06	12.24	178.20		
iTraxx Finsub	-0.56	-2.24	-23.05		
iTraxx Finsen	-0.03	-0.13	-0.73		
SOVXWE	-0.02	-0.02	-0.44		
Total Europe	-19.61	-12.20	-190.05	-34.26	-19.07
Total Synthetic Credit	-46.13	-4.31	-163.38		

(mm USD)	Credit Crisis Stress	Synthetic VaR	Synthetic CSW10%	Synthetic CSBPV
Mar 2012	434	59	(163)	(46)
Feb 2012	1,552	50	(127)	(31)
Jan 2012	1,294	62	(144)	(15)
Dec 2011	1,446	80	91	(3)
Nov 2011	1,380	68	44	(1)
Oct 2011	1,165	65	27	(1)
Sep 2011	802	54	(29)	2
Aug 2011	392	51	(97)	(2)
Jul 2011	869	27	(69)	(2)
Jun 2011	795	31	(46)	1
May 2011	195	40	(128)	(4)
Apr 2011	278	55	(107)	(3)
Mar 2011	(39)	59	(115)	(4)
Feb 2011	148	63	(78)	(4)
Jan 2011	248	67	(100)	(6)

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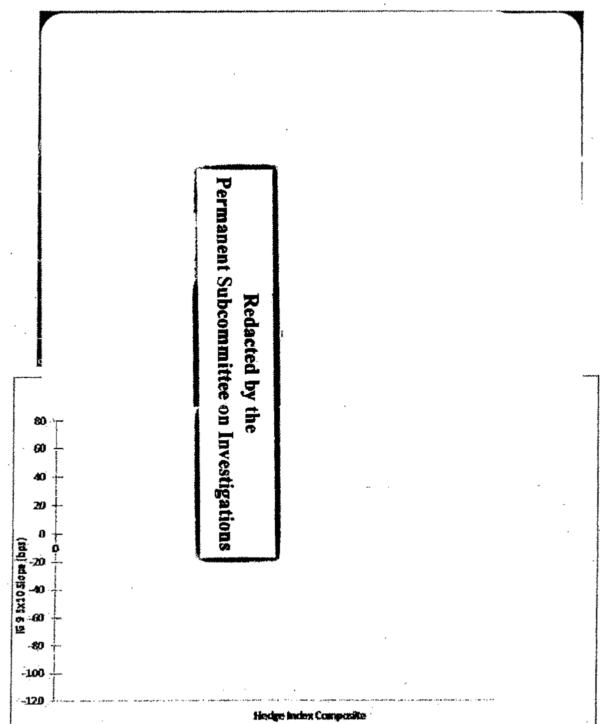
Synthetic Credit Summary: Exposure to CDX IG 9 Curve

- On a simple basis, curve could steepen by 20 bps more (on historical basis)
- Loss approx $1billion
- With hedges currently in place, we could steepen by 10bps approx
- Loss approx $550mm

- Bottom graph shows the behaviour of the slope of IG 9 1 yr versus IG 9 5 Yr that we have in our portfolio
- This shows the relationship between the slope of our position in the index versus the actual hedge that we have
- Bounding the relationship is the 5 Yr short that we have on the run five year IG and the short that we have in the HY OTR



Single Name Risk & Forward Jump to Default Risk

Table 1: default profile today and post December 2012

Portfolio	# of Names	# of names with default loss risk	Average P&L given Default ($mm)	Max P&L given Default ($mm)	# of names with default gain	Average Gain given Default ($mm)	Max Gain given Default ($mm)
Total portfolio today	588	62	-67	-205	526	133	600
Total portfolio post Dec 2012	585	228	-336	-716	357	133	600
IG9 only today	121	0	0	0	121	146	417
IG9 post Dec 2012	121	121	-572	-716	0	0	0

IG9 Hedge options	on-the-run IG18	covers 89 names out of 121
post Dec 2012	on-the-run HY18	covers 13 out of the remaining 32 names unhedged with IG18

- Today there is considerable default protection coming from IG9 tranches.
- Across the 121 names in IG9, the Jump-To-Default at Market Recovery goes from a current gain of +146m on average per name to a loss of -572m per name post December 2012.
- This is because of the roll-off of two forms of protection: on 20th Dec 2012
  - The first is the 32bn of short-dated Index protection.
  - Importantly, the second is the roll-off of nearly $4bn long protection on IG9 equity tranches. The equity tranche gives protection at an approximate ratio of 30 to 1, so the $4bn of equity tranche protection is equivalent to $120bn of index protection in terms of pure default risk.
- Post 20th December 2012, we would be able to partially hedge this exposure with the current on-the-run index but the overlap is 89 names out of the 121 in IG9.
- On the 32 remaining names we have a Jump-to-Default loss of $500mm on average per name that would need to be hedged by other means (HY on the run index, single name CDS, index tranches etc)

Single Name Risk – Default Protection in Current Portfolio

- Current portfolio provides Jump-To-Default protection on 526 names
- The Average gain given default is +$133MM, with the max +$600MM
- The Top 20 names positive Jump-To-Default at Market Recovery are shown in the table to the right; these are driven primarily by JTD protection afforded by iTraxx 0-3% equity tranches
- Across the 121 names in IG9, the Jump-To-Default at Market Recovery displays current gain of +146m

Potential Top Default Protection Exposures - Current Portfolio

COMPANY NAME	JTD
GAS NATURAL SDG, S.A.	
GDF SUEZ	
EDP - ENERGIAS DE PORTUGAL, S.A.	
PORTUGAL TELECOM INTERNATIONAL FINANCE B.V.	
PEUGEOT SA	
LAFARGE	
RENAULT	
THYSSENKRUPP AG	
DIXONS RETAIL PLC	
HELLENIC TELECOMMUNICATOINS	
CLARIANT AG	
DEUTSCHE POST AG	
ARCELORMITTAL	
FINMECCANICA S.P.A.	
BANCO ESPIRITO SANTO, S.A.	
DEUTSCHE LUFTHANSA AKTIENGELSELLSCHAFT	
GKN HOLDINGS PLC	
BANCA MONTE DEI PASCHI DI SIENA S.P.S.	
BANCO BILBAO VIZCAYA ARGENTARIA, SOCIEDAD ANONIMA	
BANCO SANTANDER, S.A.	

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Single Name Risk – Default Risk and Default Protection Post December 2012

- Post expiry of CDX.IG.9 0.75y instruments, across the 121 names in IG9, the Jump-To-Default at Market Recovery goes from a current gain of +146m on average per name to a loss of -572m per name post December 2012 as shown in the table
- Among other names, the portfolio retains its pro-default characteristics, as before

Potential Top Default Exposure Post December 2012

IG NAMES	JTD
BAXTER INTERNATIONAL INC	[redacted]
BRISTOL-MYERS SQUIBB COMPANY	
CAPITAL ONE BANK (USA) NA	
CENTEX CORPORATION	
COMCAST CABLE COMMUNICATIONS, LLC	
DUKE ENERGY CAROLINAS, LLC	
EMBARQ CORPORATION	
GOODRICH CORPORATION	
HONEYWELL INTERNATIONAL INC	
INGERSOLL-RAND COMPANY	
INTERNATIONAL BUSINESS MACHINES CORP	
INTERVAL ACQUISITION CORP	
MCDONALDS CORPORATION	
MCKESSON CORPORATION	
MEADWESTVACO CORPORATION	
RIO TINTO ALCAN INC	
ROHM AND HAAS COMPANY	
THE WALT DISNEY COMPANY	
WELLS FARGO & COMPANY	
WYETH LLC	

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Potential Top Default Protection Exposures - Current Portfolio

COMPANY NAME	JTD
GAS NATURAL SDG, S.A.	[redacted]
GDF SUEZ	
EDP - ENERGIAS DE PORTUGAL, S.A.	
PORTUGAL TELECOM INTERNATIONAL FINANCE B.V.	
PEUGEOT SA	
LAFARGE	
RENAULT	
THYSSENKRUPP AG	
DIXONS RETAIL PLC	
HELLENIC TELECOMMUNICATOINS	
CLARIANT AG	
DEUTSCHE POST AG	
ARCELORMITTAL	
FINMECCANICA S.P.A.	
BANCO ESPIRITO SANTO, S.A.	
DEUTSCHE LUFTHANSA AKTIENGELSELLSCHAFT	
GKN HOLDINGS PLC	
BANCA MONTE DEI PASCHI DI SIENA S.P.S.	
BANCO BILBAO VIZCAYA ARGENTARIA, SOCIEDAD ANONIMA	
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Synthetic Credit Summary: Portfolio Effects in Adverse Scenario

- **Stress Loss Protection**
  - In an environment of significant credit deterioration and the occurrence hard default events or perception of imminent defaults, the portfolio provides stress loss protection
  - This is due to the spread convexity of the portfolio to major market dislocation, during which curves may reprice significantly, flattening as hedgers rush to buy protection in short dated indices
  - In addition to the 'static' default profile shown in preceding slides, we simulate the portfolio behaviour (see scenario 10 below) by widening credit spreads by average 75%, and through flattening curves (for reference, above depicts -50bps curve flattening in IG.9 0.75y / 5.75y curve, a move which is extrapolated throughout the portfolio
  - In this case we envision the portfolio would produce substantial protection, circa $1,725MM driven by HY shorts and flattening of investment grade curves

			Scenario									
			1	2	3	4	5	6	7	8	9	10
Scenarios for Q2	Realised P&L in Q1	Current Spread	Extreme Curve Steepening	European Event	Sluggish Stale Growth	Financial Crisis	Status Quo	Central scenario	General Recovery	Currency Crisis	Strong Growth	Default Scenario
Carry	150		150	250	220	250	200	170	160	400	100	350
IG9 Projections	Initial curve											
IG9 0.75yr	132	68	26	112	74	96	68	48	44	249	[illegible]	[illegible]
IG9 2.75yr	141	90	63	131	98	117	90	72	67	236	[illegible]	198
IG9 5.75yr	150	111	79	150	122	139	[illegible]	95	90	222	[illegible]	[illegible]
Slope												
0.75yr / 5.75yr	18	43	53	38	48	43	43	47	46	27	[illegible]	[illegible]
Curve slope change (bps)	25	0	10	-5	5	[illegible]	[illegible]	24	[illegible]	[illegible]	15	50
Implied CSW	-35%	0%	-35%	35%	10%	25%	[illegible]	15%	20%	100%	50%	75%
P&L	-580		-650	-375	-355	250	150	350	702	900	1,125	1,725
			10% EXTREME			80% LIKELIHOOD			10% OPTIMISTIC			

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Synthetic Credit Summary: Risk & P/L Scenarios

			Scenario									
			1	2	3	4	5	6	7	8	9	10
Scenarios for Q2	Realised P&L in Q1	Current Spread	Extreme Curve Steepening	European Event	Sluggish State Growth	Financial Crisis	Status Quo	Central scenario	General Recovery	Currency Crisis	Strong Growth	Default Scenario
Carry	150		150	250	220	250	200	170	160	400	100	350
IG9 Projections	Initial curve											
IG9 0.75yr	132	68	26	112	74	96	68	48	44	249	[illegible]	201
IG9 2.75yr	141	90	53	131	98	117	90	72	61	236	80	198
IG9 5.75yr	150	111	79	150	122	139	111	95	90	222	59	194
Slope												
0.75yr / 5.75yr	18	43	53	38	48	43	43	47	46	27	58	[illegible]
Curve slope change (bps)	25	0	10	-5	5	0	[illegible]	[illegible]	[illegible]	[illegible]	15	[illegible]
Implied CSW	-35%	0%	-35%	35%	10%	25%	[illegible]	15%	20%	100%	-50%	76%
P&L	-580		-650	-375	-355	-250	-150	350	702	900	1125	1725
			10% EXTREME			80% LIKELIHOOD			10% OPTIMISTIC			

- **Realised P&L in Q1**
  - Q1 Realised P&L -$580, driven by losses in short risk HY (670MM), vs. +128MM in CDX.IG, and -30MM in iTraxx
  - The IG component has been the main P&L driver of underperformance in Q1, as IG.9 forward long risk positions did not deliver anticipated profits given steepening of the curve. Current book is overall risk balanced, given the cross-market long/short and has positive carry of $2MM/day, while retaining upside on defaults
- **Q2 P&L Estimates - these scenarios do not include 10 April P&L, which would accrete back into each scenario +$400MM, if re-calibrated for today's market moves**
  - -$250MM (New Financial Crisis) implies an average spread widening of +25%, driven by banks/financials undergoing stress. In this case, the portfolio P&L is driven by:
    - +250MM carry
    - -100MM given relative underperformance of IG vs. HY (compression, led by banks/financials widening)
    - -$300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - -$100MM due to spread widening, not offset in this case by curve flattening (we assume here that curves remain 43bps steep in IG equivalents)
  - -$150MM (Status Quo) in this case we assume that market levels and curves 'freeze' at current levels; in this scenario CIO would delta hedge around volatility throughout the quarter
    - +200MM carry
    - -$300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - -$50MM due to long-dated tranche underperformance as observed in Q1
  - +$350MM (Central Scenario) in this case bull steepening of IG curves (+4bps), more than offset by outperformance of IG.9 curve vs. on the run
    - +170MM carry
    - -$280MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - +$110MM due to rally in credit spreads -15%
    - +$200MM due to relative outperformance of IG 9 curve vs. on the run IG curves (while counter-intuitive, the "compression" effect of IG.9 vs. on the run IG complex is driver of performance)
    - +$150MM due to long-dated equity tranche outperformance
  - In the section "10% Optimistic" the convexity of the portfolio in a highly positive or a highly negative market outcome is demonstrated.
    - +$702MM in the event of -20% tightening of spreads, decompression of HY vs. IG credit, and IG.9 forward outperformance (rolling down the curve)
    - $1,126 "End of QE" refers to a scenario of strong growth led by U.S., spreads avg. -50% tighter
    - +1,725MM in "Many Defaults" means wave of defaults among widest spread names (incl. MBIA, Radian, iStar) curve flattening, and +75% spread widening, driven by performance of HY shorts, IG flatteners and long protection positions in the portfolio
  - In the section "10% Extreme" it is estimated that the book would range -$355MM to -$650MM.
    - -$355MM in the event of bear steepening of curves, spreads wider by avg +10%
    - -$650MM in the event of bull steepening of curves, spreads tighter by avg -25%, driven by underperformance of IG.9 (forwards do not roll down curve in rally)

JPMORGAN CHASE & CO.

From: Bellando, John W <john.w.bellando@jpmorgan.com>
To: <Hohl, James>
CC: <Fursa, Thomas>
Sent: 4/16/2012 3:26:41 PM
Subject: RE: CIO January 2012 valuation memo and metrics

Hi James –

I trust you are well. With regards to CSBPV you are correct.

Thanks,
John

From: james.hohl@occ.treas.gov
Sent: Monday, April 16, 2012 10:46 AM
To: Bellando, John W
Cc: thomas.fursa@occ.treas.gov
Subject: RE: CIO January 2012 valuation memo and metrics

Thanks very much. I do have one quick question. For the credit derivatives risk measure (CSBPV). I'd assume that stands for credit spread basis point value and that the exposure is to a 1 bpv widening of credit spreads. Please let me know whether that's correct or if it's something else. Thanks again, James

---

From: Bellando, John W [mailto:john.w.bellando@jpmorgan.com]
Sent: Friday, April 13, 2012 5.58 PM
To: Hohl, James
Subject: RE: CIO January 2012 valuation memo and metrics

Hi James –

Apologies for not distributing the February valuation work. I just sent the February and March reports.

Please let me know if you have any questions.

Thanks,
John

From: james.hohl@occ.treas.gov
Sent: Friday, April 13, 2012 11:49 AM
To: Bellando, John W
Subject: RE: CIO January 2012 valuation memo and metrics

Hi, I don't think that I received a report since this one, have they been distributed? Thanks, James

---

From: Bellando, John W [mailto:john.w.bellando@jpmorgan.com]
Sent: Monday, February 13, 2012 1.13 PM
To: Fursa, Thomas; Hohl, James; McManus, William K; Hawkins, Kimberly A
Cc: m.s.paul@us.pwc.com; 'kristen.brown@us.pwc.com'; 'philip.j.grealy@us.pwc.com'; 'philip.t.mijares@us.pwc.com'; Kastl, Edward R; Alexander, David M; Burke, Alethea X
Subject: FW: CIO January 2012 valuation memo and metrics

Pls find attached our January valuation summary memo and results.

Thanks,

Permanent Subcommittee on Investigations
EXHIBIT #61

John

From: Bellando, John W
Sent: Monday, February 13, 2012 1:07 PM
To: Wilmot, John; Alexander, David M; Weiner, Pamela; Giovannetti, Alison C; Lee, Colvis
Cc: Kastl, Edward R; Shuja, Amir; Bjarnason, David; Hughes, Jason LDN; Liu, Dorris X; Laskis, Adam; Burke, Alethea X
Subject: CIO January 2012 valuation memo and metrics

All –

Attached are two files for your review of the January 2012 CIO independent valuation results:

1) Global summary level VCG memo – January 2012 Valuation Summary

2) Global valuation summary with price testing results and coverage metrics - Global Valuation Summary Metrics January 2012

Please let me know if you have any questions.

Thanks,
John

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From: Wilmot, John
To: Hohl (Regulator), James X
Sent: 4/17/2012 12:24:59 PM
Subject: RE: Quick questions pp 4 and 5 of yesterday's presentation

Hi James,

Your notes and understanding are correct. Pages 4 and 5 reflect the entire synthetic credit portfolio, long (long credit risk) and short (short credit risk – ie long credit protection).

With respect to the grand total net position, the portfolio is measured as long credit risk under a 10% credit spread widening scenario. As you'll note on 6, this is equivalent to $34.5bn of long risk in 5y IG equivalents. Having said that, the portfolio as we describe it on page 2 has two general positions (short HY risk vs long IG risk and an IG curve flattener). These risk exposures are also outlined on page 6 and give you a sense of the sensitivity to relative spreads and curve. So while directionally (to a csw scenario) the portfolio positions are long risk there are 2nd and 3rd order sensitivities that need to be considered.

Having said all of that I believe there is a modest long credit risk sensitivity to the portfolio now.

Let me know if you have any further questions.

Regards,
John

John C. Wilmot | Chief Investment Office | + john.wilmot@jpmorgan.com | (Work: (212) 834-5452 | (Cell: [redacted]

From: Hohl (Regulator), James X
Sent: Tuesday, April 17, 2012 7:48 AM
To: Wilmot, John
Subject: Quick questions pp 4 and 5 of yesterday's presentation

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Hi John,

I wanted to check my understanding of the synthetic credit summaries on pp 4 & 5, and ask a follow-up question. I wrote down during the meeting that the tables reflect credit risk positions long or short, so that the CDS positions would be the opposite, e.g. looking at the top of p 4, the $836.1 long gross external trades results from CIO selling $836.1 notional CDSs and the $-678.8 short arises from CIO purchasing CDSs. I believe that the chart on p 5 is similarly constructed. I also wrote down that the chart on p 5 reflects the entire synthetic credit portfolio. Can you please let me know if I've misunderstood any of this.

My follow-up question is from the grand total net position on p 5 and my understanding of the tables outlined above. Does CIO management view the $-163 million as basically flat or is the synthetic credit portfolio going to be taking on additional credit risk?

Thanks, James

Permanent Subcommittee on Investigations
EXHIBIT #62

From:	Crumlish, Fred
To:	Brosnan, Mike; Belshaw, Sally; Pfinsgraff, Martin; Waterhouse, Scott
Cc:	Wilhelm, Kurt; Banks, George; Fursa, Thomas; Hohl, James; Kamath, Jairam; Kirk, Mike; Monroe, Christopher; Swank, Todd; Wong, Elwyn
Subject:	JPM CIO / IG9 "whale" trade
Date:	Tuesday, April 17, 2012 4:33:00 PM

On Monday 4/16 OCC and FRB examiners met with Ina Drew and several members of CIO staff and risk management to discuss the JPM synthetic credit book in view of recent press reporting. This message provides a summary of our discussion, followed by a more the detailed summary. It focuses specifically on recent changes to the synthetic credit book.

- JPM's CIO has been using a synthetic credit (credit derivative) portfolio since 2007. It was initially set up to provide income to mitigate other significant credit losses that would surface under a broad credit stress scenario. Since it wasn't possible to tailor a specific hedge to the JPM balance sheet as a whole, this portfolio was constructed. As the investment portfolio grew in 2007-2009, the synthetic credit portfolio was used to hedge stress and jump to default exposures in that portfolio as well.

- CIO's credit derivative position was managed to provide around $1 billion to $1.5 billion income in credit stress scenarios against firm wide losses of $5 billion to $8 billion.

- In late 2011, in view of a change in perception in the state of the economy, CIO managers decided to reduce high-yield (HY) credit protection; however, after the AMR bankruptcy and with Kodak expected to file for bankruptcy, the markets for CIO's HY indices weren't liquid enough to use them to unwind CIO's position.

- The IG 9 index, which is much more liquid than HY indices, includes five "fallen angels" that allowed it to be used to reduce a "good part" of CIO's HY position, so it was used to reduce the HY protection.

- The IG 9 market is not illiquid as it trades around $10 billion daily and spread changes for this index are in line with peer indices. The IG 9 curve has steepened in a move of around 6.5 standard deviations, and there has been strong buying of deferred contracts, implying that the buyers are certain that there will be no defaults in the next 9 months and nearly certain that there will be defaults next year. In view of events, however, JPM is conducting a "post mortem" of the IG 9 situation and its impact and share results with OCC and when completed.

The CIO began using credit derivatives around 2007 as part of its mandate to manage structural balance sheet positions. CIO only uses credit derivatives on indices, not specific names. Initially CIO bought protection (shorted risk) on mortgages, using ABX, and high yield indices to mitigate some of the firm's balance sheet credit exposure. At this time CIO investments were highly concentrated in Agency pass-through mortgage securities, and the structural credit risk was in the lines of business.

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EXHIBIT #63

Through the financial crisis deposit inflows combined with lower loan demand to leave the firm with significant excess funds. As part of its mandate to invest, when appropriate, in high credit quality, liquid investments, the CIO began purchasing low credit risk, top of the capital structure securities to use the excess funds. While high quality, these investment securities have more credit risk than the U.S. Agency pass-throughs that continued to be held, so that structural credit risk in the investment portfolio increased along with portfolio growth.

Throughout this the CIO continued using index credit default swaps (CDSs) to mitigate some of the structural credit risk in the investment portfolio and the lines of business other than the investment bank, which manages its own credit risk exposure. While there are liquid markets for many credit derivative indices, the markets are not deep enough to fully hedge a multi-trillion dollar balance sheet. CIO's credit derivative position was managed to provide around $1 billion to $1.5 billion income in credit stress scenarios against firmwide losses of $5 billion to $8 billion.

CIO managers decided to reduce the high yield credit derivative protection around Thanksgiving last year. After the AMR bankruptcy filing on November 29, 2011, the firm profited from its credit derivative positions as anticipated, but high yield index derivatives had limited liquidity as demand increased. CIO managers thought that it wouldn't be possible to reduce the high yield credit derivative position by using the indices that created it; the best available hedge product was the IG 9 index, which has good liquidity as an investment grade index and a high yield component as five of the index companies are "fallen angels" i.e., companies that have fallen below investment grade since the index originated. This was the reason that JPMCB began selling IG 9 CDSs; going long IG 9 credit risk (selling CDSs) would neutralize some of the short high yield credit risk position (long CDSs).

JPM provided the CIO notional CDS exposures as requested, along with a summary of the synthetic credit portfolio maturity profile and results of a 10% credit spread widening (CSW). The CIO CDS portfolio includes exposure to JPMC's IB along with third parties. The third-party counterparties are all major banks or broker/dealers. The stress results show that the CDS portfolio net exposure cannot be judged by looking at notional exposures alone. An example given is the iTraxx Main 20Jun13 position; the notional exposure is $28 billion long risk suggesting a loss if credit spreads widen, but the 10% CSW shows a profit of $68 million because of equity tranche protection that is part of the position.

The synthetic credit portfolio position now provides around $434 million income in the credit crisis stress scenario. Very generally, the portfolio risk profile is short high-yield risk against long investment grade risk and short short-duration (to yearend 2012) investment grade risk against long long-duration investment grade risk, i.e. a credit curve flattener. The portfolio VaR was $59.2 million on April 5th. The portfolio is reported in CIO positions and subject to all of the JPMC market risk management systems.

Through the indices used, the portfolio provides credit protection on 588 names. 121 of them are from the IG 9 index, which currently gives an average $146 million jump to default at market recovery gain per name. This position is stable until December 20, 2012 when $32 billion of short-dated protection rolls off along with $4 billion of protection on IG 9 equity tranches, and the average jump to default at market recovery becomes a loss of $572 million per name. Before that happens, CIO managers feel they have time to adjust the portfolio to compensate without roiling the IG 9 market.

In addition to inclusion in the firm-wide stress scenarios, CIO managers routinely run other stress scenarios to assess portfolio performance in a variety of circumstances. The synthetic credit portfolio is seen to provide stress loss protection in an environment of significant credit deterioration with defaults or perception of imminent defaults.

CIO managers have been surprised that the IG 9 market has been so willing to take on and sell so much protection, regardless of what JPMC did. The market is not illiquid as the IG 9 trades around $10 billion daily. The spread changes for this index are in line with peer indices. Many market participants have been strong buyers of deferred contracts, implying that they had complete certainty there would be no defaults in the next 9 months and near certainty that next year there will be defaults. The IG 9 curve has steepened in a move of several standard deviations. CIO managers said that the curve steepening move was around 6.5 standard deviations from the mean. A review of the IG 9 situation is being done, and it will be shared with the OCC and Fed when completed.

--

Attendees:

JPM: CIO attendees: Ina Drew Chief Investment Officer, John Wilmot CIO CFO, Achilles Macris CIO Managing Director EMEA (telephone), Javier Artajo CIO Managing Director EMEA (telephone), Irv Goldman Market Risk Management Managing Director, Pete Weiland Market Risk Management Managing Director, Keith Stephan Market Risk Management Executive Director EMEA (telephone), Greg Baer Managing Director Associate General Counsel, Joe Sabatini Managing Director Head Supervisory Relationship

OCC attendees: Fred Crumlish, James Hohl, Mike Kirk
Fed attendees: Anna Iacucci, two others

- apc

From: Wilmot, John
To: Regulator\), James X <Hohl \>
Sent: 4/19/2012 9:15:18 PM
Subject: RE: CIO EMR?

Yes, we still produce it but we don't include in the Treasury EMR. It is separate. I apologize for you guys being left off. I will get my team to rectify that and send you the monthlies ytd.

John C. Wilmot | Chief Investment Office | + john.wilmot@jpmorgan.com | (Work: (212) 834-5452 | (Cell: [redacted]

From: Hohl (Regulator), James X
Sent: Thursday, April 19, 2012 3:21 PM
To: Wilmot, John
Subject: CIO EMR?

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Hi John,

Does the CIO still produce an EMR? It wasn't included in the January Treasury EMR, which is where I used to see it. I'm looking for the balance sheet information that was in it. Thanks,

James

From: Weiland, Peter
To: Regulator\), James X <Hohl \>
CC: <Wilmot, John>;<Goldman, Irvin J>
Sent: 4/19/2012 10:24:01 PM
Subject: RE: Info on VaR, CSBPV, and stress status and limits

I talked to someone in reporting. The excessions email was incorrect.

We are in the midst of implementing stress limits that include SAA. The old limits were $500mm for MTM and $800mm for Aggregate excluding SAA. The numbers I gave you below are the new usages fully inclusive of SAA with the new limits as approved by Hogan et al. It may be that the official reports for April 5 still showed the old limits. Just to summarize, the new ones are:

CIO MTM usage $1.53B against limit of $1.0B
CIO Aggregate usage $12.67B against limit of $15.0B

Pete

Peter Weiland
Tel: +1 212 834 5549
Mob: +[redacted]

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From: Hohl (Regulator), James X
Sent: Thursday, April 19, 2012 2:51 PM
To: Weiland, Peter
Subject: RE: Info on VaR, CSBPV, and stress status and limits

Pete,

he attached 4/17 excession report was the source of the comment. It seems to show CIO aggregate stress of $ 18,454 million in the Level 1 tab to me also, unless we're not reading it correctly. I've also included the report that we have for 4/5 because the way I read it in the Level 1 tab, CIO exceeds both aggregate and MTM stress limits of $800 million and $500 million respectively. Please let me know whether we're reading the reports correctly.

Thanks, James

From: Weiland, Peter
Sent: Thursday, April 19, 2012 1:51 PM
To: Hohl (Regulator), James X
Cc: Wilmot, John; Goldman, Irvin J
Subject: RE: Info on VaR, CSBPV, and stress status and limits

Hi James –

Happy to help.

1. The Monday-Tuesday daily increase in the firm's VaR was due primarily to an increase in the CIO VaR. This was not due to any new trades, but rather to market data. In fact, in reviewing some of the market data from the last week we found that some of the volatility from April 10 was absent in the market data and we fixed it.
2. The aggregate stress comment is not correct. As of April 5, CIO is over its MTM stress limit, at $1.53B vs. limit of $1.0B. Aggregate stress usage is $12.67B vs. limit of $15B (within limit). With respect to CS01 limit, it is correct that we have been in excess for some time. This is a limit under review, as it currently aggregates CS01s from various underlyings (e.g., IG and HY) that should not be added. We have chosen not to adjust the limit until we implement the new methodology. We are working on a new set of limits for synthetic credit and the current CS01 will be replaced by something more sensible and granular.

Best,

Pete

■ Redacted by the Permanent Subcommittee on Investigations

Peter Weiland
Tel: +1 212 834 5549
Mob: +[redacted]

From: Hohl (Regulator), James X
Sent: Thursday, April 19, 2012 11:07 AM
To: Weiland, Peter
Subject: Info on VaR, CSBPV, and stress status and limits

Hi Pete,

Would you have any color around some observations about the CIO VaR, CSBPV and stress results? I received the following from another examiner this morning. Thanks, James

The increase in the Firm's VaR is primarily driven by CIO Synthetic Credit portfolio.

CIO aggregate stress loss is over 23% of its $15B limit. Also, MtM cs bpv limit is in excession by 1074% and has been in excession for 71 days.

From: Kamath, Jairam
To: Batista, Geralynn
Sent: 4/23/2012 5:51:25 PM
Subject: RE: Weekly Market Summary period ending 4/13

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Sorry, I missed your email last week. I also saw the final version Fred sent out. Looks good.

jairam.kamath@occ.treas.gov
Tel: 212-899-1386
BB: [redacted]
Fax: 301-433-6238

From: Batista, Geralynn
Sent: Thursday, April 19, 2012 1:15 PM
To: Kamath, Jairam
Cc: Swank, Todd; Fursa, Thomas
Subject: Weekly Market Summary period ending 4/13

Hi Jairam,

Do you mind taking a quick peek at this to confirm that it properly reflects the changes to the stress testing framework?

Thanks,

Geralynn

Stress losses increased attributable to additional portfolios added as a result of FSI (see details below) ; IB VaR unchanged; trailing 5-day trading revenue is moderate at $398mm.

STRESS RESULTS (COB 4/6/12)

Change Current

Current Loss/Gain

Prior week Loss/Gain

Limit

Scenario

Firm MTM Bad Case

[redacted]

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EXHIBIT #66

[redacted]

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irm Aggregate Bad Case

IB MTM Bad Case

CIO MTM

RFS MTM

-$667mm

-$1.5bn

-$860mm

-$1.0bn

Oil Crisis

[redacted]

The AFS portfolio has been added to the CIO Aggregate stress test, resulting in a dramatic rise in stress losses (see chart 1 below). However, the inclusion of the sizable AFS portfolio represents a discontinuity in the Aggregate Bad Case time series as previously displayed on the graphs. To adjust for this change, the CIO Aggregate loss estimate is subtracted from the series and shown on the "Adjusted" chart (see chart 2 below). 100% of CIO ˋggregate losses are assumed to come from the AFS portfolio for simplicity (note that prior week's CIO Aggregate ıoss contribution to Aggregate Bad Case losses was immaterial).

- Other portfolios, [redacted]
- [redacted]
  - [redacted]
  - [redacted]
  - The CIO MTM limit increased from $0.5bn to $1.0bn
  - The CIO Aggregate limit increased from $0.8bn to $15.0bn

Chart 1

<< OLE Object: Picture (Device Independent Bitmap) >>

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Chart 2

<< OLE Object: Picture (Device Independent Bitmap) >>

3 VAR (4/6 – 4/13)

[redacted]

MEETING MINUTES (4/18)

Follow-Up Items

- Review Fred's email (4/17) for to-do's while he is out
- Send Fred a list of impediments to having "strong" risk management in the areas of interest rate risk, price risk, and liquidity

Summary Bullets

General

- Sally visited to review the Supervisory Strategy over the past two days. She pointed out that regarding Heightened Expectations, the definition of "strong risk management" is to be considered at the dedicated risk management line, not the lines of business
- The Whale Trade issue is considered closed--email went out to Senior Management yesterday

Derivatives/Rates/Equities

[redacted]

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From: Batista, Geralynn
To: <Crumlish, Fred>;<Monroe, Christopher>;<Kirk, Mike>;<Swank, Todd>;<Hohl, James>;<Banks, George>;<Kamath, Jairam>;<Wong, Elwyn>;<Tornese, Doug>;<Fursa, Thomas>;<McLaughlin, Doug>;<Vourvoulias, Andrea>;<Glassman, Adam>;<Mark, Aaron>
CC: <Waterhouse, Scott>;<Jacobi, Gene>;<Atkins, Glenn>;<Batista, Geralynn>
Sent: 4/25/2012 8:10:07 PM
Subject: Weekly Market Summary period ending 4/20
Attachments: ATTACH000.eml

Stress losses increased marginally following last week's dramatic jump due to the inclusion of more portfolios into FSI (see last week's email attached below for more details); IB VaR is up from 85mm to 87mm; trailing 5-day trading revenue is moderate at $378mm.

STRESS RESULTS (COB 4/13/12)

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	Change Current	Current Loss/Gain	Prior week Loss/Gain	Limit	Scenario
Firm MTM Bad Case	[redacted]				
Firm Aggregate Bad Case					
IB MTM Bad Case					

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EXHIBIT #67

[redacted]

CIO MTM

$97mm

-$1.4bn

-$1.5bn

-$1.0bn

Oil Crisis

RFS MTM

[redacted]

- The increase in Firm Aggregate loss was driven by CIO's elevated utilization primarily due to a large sell off in equities
- For the second consecutive week, CIO is breaching its $1.0bn stress limit with a utilization of $1.43bn in the Oil Crisis scenario

[redacted]

Chart 1

<<...>>

Chart 2

<<...>>

AR (4/23)

Firm VaR is $144.9mm up from $134mm wow due to CIO VaR increase. After breaching the limit multiple times last week, the limit was raised to $145mm

[redacted]

[redacted]

[redacted]

MEETING MINUTES (4/25)

[redacted]

<<...>>

From: Crumlish, Fred
To: Hohl, James; Kamath, Jairam
Sent: 5/6/2012 9:03:05 PM
Subject: Re: CIO Synthetic Position

Just got back from chile and saw this. Also didn't see any emails or weekly summary comments since I went on leave..

-apc

OCC
202-439-3938

From: Waterhouse, Scott
Sent: Friday, May 04, 2012 12:03 PM
To: Crumlish, Fred; Hohl, James
Subject: CIO Synthetic Position

Doug Braunstein and John Hogan called to provide an update on the CIO position. They mentioned that if we have been watching the position reports and P&Ls, we would have seen that they have been taking some significant MTM losses over the past few weeks. These losses are on positions established some time ago. Current losses are approximately $1.6 billion. Doug said that over time, the bank has taken 'a couple billion' in gain as an offset to this position.

But at this point, the remaining position is too large and the bank is trying to reduce risk. John said that the long position is sensitive to a 10% widening in the amount of $900MM. This is hedged with a short position in high yields that has a 10% sensitivity of $650MM, giving a net risk to credit spread widening of $250MM. The bank is taking actions now to further reduce the exposure.

Doug said that the CIO will also close out some bond positions to take approximately $1 B in gains to offset this loss.

John said that Ashley Bacon, in his new role as global overseer of market risk, is introducing new risk measures and limits for the CIO.

The bank will publish its Q on Thursday, and Doug expects that they will make some comment in the document.

Doug wants to have a meeting on Wednesday to discuss the history of the position, its performance, and 'glide path' to further reduce the risk. He expects that the position will be down substantially by the time we get together. This meeting will be with the Fed. Fred -- you and James should be prepared to attend. Let's talk Monday about this.

Scott

Permanent Subcommittee on Investigations
EXHIBIT #68

From:	Crumlish, Fred
To:	Waterhouse, Scott
CC:	Kamath, Jairam; Kirk, Mike; Hohl, James
Sent:	5/7/2012 6:57:01 PM
Subject:	CIO information for Wednesday
Attachments:	FSI Limit Change FAQ.docx; R-700596-CIO_-_7-ppt.DRF

Scott - I have been catching up and going through email from the team, and am sending you a couple of background documents relevant to Wednesday. I believe you have the handout and notes from our meeting with Ina Drew, but I can resend them as well.

CIO went to the DRPC in March (see attached wisdm line), but there wasn't a lot of discussion of the synthetic book. JPM would acknowledge that what they do may be problematic from a Volker perspective, depending on the way the rules are written. (Note especially the wording of the mandate) However, they strongly believe that what they do should be exempt from Volker. I haven't found their pitch to DC or others particularly compelling however, since when before DC policy they tend to speak in generalities or use the word "hedge" too much when what they do is more accurately described as active risk mgmt.

Also attached is a JPM document summarizing some recent limit changes. (We have a monthly meeting with market risk reporting where changes to FSI and other matters related to limits reporting and approval are discussed). We have the email where Hogan approved the new firmwide stress limit.

FYI The follow up from our meeting with Ina Drew was to come back and provide us with the results of their "post mortem" on the "whale" issue and the changes that were going to be put in place. On the first call (the one that proceeded the larger meeting with Ina) Hogan also referred to this. I'd expect they would cover some of this during the meeting Wednesday

IMHO on balance closing the book down makes sense given that it was built in light of the crisis. So it's reason for existing isn't as compelling as it once was. Bank could use simpler ways of hedging OCI.

I asked the team to go into the FSI grids to get the main drivers of the stress loss numbers (ie, which factors contribute the most material share).

Also - given CIO's role, we haven't historically gotten daily P&L from them as we do the IB given the nature of its operations. However I asked James to first, put in a request for more granular daily P&L on the synthetic credit to help us prepare for Wednesday's meeting, and, more generally, put out the request that going forward we get daily P&L in a form such as they provide to (say) Ina Drew. Bank will likely object to this, but it will help us better to answer "Volker" related questions internally. James is also pursuing logic of limit changes with RM in CIO.

From: Kirk, Mike
To: <Crumlish, Fred>;<Hohl, James>
Sent: 5/10/2012 2:05:39 PM
Subject: RE: My opinion on yesterday's meeting.

Thanks Fred,

Wanted to get some ideas down on paper before I forget the details, and to serve as a roadmap in the future. Working on so many different things all of which will take place over long time periods...so wanted to write down the thoughts.

I'm certain James has more details and ideas.

Regards,

Mike

From: Crumlish, Fred
Sent: Thursday, May 10, 2012 9:58 AM
To: Kirk, Mike; Hohl, James
Subject: RE: My opinion on yesterday's meeting.

See bold.

- apc

From: Kirk, Mike
Sent: Thursday, May 10, 2012 9:22 AM
To: Crumlish, Fred; Hohl, James
Subject: My opinion on yesterday's meeting.

Fred,

James and I were chatting electronically about the recent CIO events, and I wanted to share my opinions as food for thought recognizing that these are only opinions as all the facts are not in, and I don't know for sure what has happened and what is the correct course of action.

It's not clear to me that the synthetic credit hedging strategy failed, as it worked quite well for some time (and perhaps until very recently), and then began to lose effectiveness and they didn't realize this until they tried to reduce part of it. I think it's possible bank processes failed, not the micro strategy of the synthetic credit hedge.

Agree – It wasn't the basic strategy; it was the specific trades done to adjust the position that failed; this seems to have eliminated all the benefit accrued so far. So the problem was the selection of the strategy to make the change

I admire Risk for standing up and taking blame for inadequate limits, but that's only part of the problem. No one will ever know prospectively how issues may arise; that's why there's multiple forms of controls. Issues sometimes manifest themselves thru risk, other times thru models and assumptions, others thru valuation, and others thru combinations of factors (likely in this case).

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Agree – Also CIO probably needs to focus more on the short term time horizon as well as the longer holding periods (Recall Ina's comments).

Many processes probably may need to be enhanced and management may want to rethink their strategy approval processes (note the MRA in 2010 attempts to get at this). I think all the senior managers, including Jaime Dimon, who approved this strategy shoulder the blame. I think Ina Drew considers herself to be a real money manager; she is not. She is a more like a ALM manager. The CIO function is in a bank. A real money manager produces returns monthly (sometimes more frequently) to investors who can withdraw at any time. This instills a certain amount of discipline in risk/return vs. liquidity. They know that any investment they make may need to be liquidated in short order, therefore they need to be conscious of their size, size of trades, and market ability to absorb their investments when they need to exit (I realize they have liquidity lines of credit to assist with this, but this provides for orderly liquidation, it does not provide for long term unwinds with large market risk exposure). Ina doesn't have that type of discipline forced upon her b/c bank liabilities are not correlated strongly to her return, and she doesn't have the risk that investors may withdraw funds if they are unhappy with her investment selections.

Agree – CIO needs a more balanced perspective

In reality Ina Drew is a hybrid, and should manager her function/business as a hybrid. Items that are marked to market probably should have the same processes as IB, as at the end of the day JPMC has limited appetite for P&L vol. Also, limits tend at JPMC to be set once there are material exposures. In this case, because of the size of JPMC's balance sheet, they would likely set the limits very large anyway. Moreover, there are so many permutations on how to reduce with derivs (Indices, tranches etc) that the limit system would have to have been extremely comprehensive, and it is unlikely they would have set it up that way (particularly if they didn't have the exposures yet) even if they did think of notional limits. So, I think that traders would have found other means to exit other than unwinding what they had. If reserves provided proper incentives to unwind vs. find less costly alternative the situation may have been better.

Once the bank finishes their investigations etc, we can also spend more time pulling this apart. CIO was on the schedule for October

More robust reserving for concentrations and liquidity may likely have resulted in traders rolling out of existing HY trades earlier before they became off the run indices, as there may have been an incentive to hold more actively and deeply traded indices rather than holding onto an older index as liquidity fell, and JPMC's concentration relative to market size increased. If the bank was not able to roll into another more liquid HY index that was a suitable hedge, this would have been an indication that the strategy may be breaking down, or that correlations have changed and holdings should be changed to match available credit hedges. It may not ever be known what happened, but somewhere in between initiating the position and the point where the bank decided to reduce the HY hedge the market's willingness/ability to absorb JPMC's size changed, and that should (I believe) be reflected in their P&L thru reserves (call it concentration or liquidity) and this would have provided the incentives to the bank to reduce exposures before it became a multibillion dollar issue. This is another way of saying that there was no process in place to reevaluate the strategy as long as it was in place in working in terms of <u>current P&L</u>, so they wouldn't know they were driving on a road where the bridge was out until they got there. The reserving process, sensitive to changes in concentrations and liquidity, are the road signs warning of danger ahead. Limit structures do not provide this warning until you get to the end of the road.

I wasn't satisfied with the comments made about valuation process and thresholds yesterday, and so we have some followup here. I am not sure they got the point, probably because of that "time horizon" comment. In addition to reserve, there were likely problems with the thresholds themselves. So this is another followup. (Valuation was one of the things Hogan said they are looking at)

In the case of this micro strategy, one can look at the market and make a case that the reason why they could not exit the HY CDS were not due to AMR, EK, LTRO, but due to a pronounced change in market perceptions of risk as one could one could sell IG instead. "What does that tell you"? (To quote a former trading mentor of mine.) I think that tells you (and with hindsight it's clear) that the market has changed materially, and no longer holds historical relationships true; therefore the JPMC traders use of historical relationships (correlations) was in error, because forward correlations were now materially different and likely to remain that way (as JPMC's later analysis agreed). Market's seemingly insatiable appetite to take the other side of JPMC's trades possibly indicated that the IMPLIED market price of this correlation has collapsed..something that eventually became realized in the losses at JPMC.

Agree and when evaluating strategy's perhaps traders should have looked at more scenarios. We will see what they did.

While having more granular limits would have certainly helped, the limits alone would not provide the proper incentive for traders to unwind the trades they have vs enter new ones and adding complexity. For as long as it is less costly to the traders P&L to enter new risks vs closing old ones, new risks will be added. This is a simple law of trading that will always hold true. With complex products traders can always find a way to reduce a type of exposure by adding a new one. The sue is when relationships assumed between the risks break down (correlations) the whole strategy implodes and multiple illiquid risks need to be unwound instead of one. And unwinding this is more complex that it seems because lifting one leg without the closing the other exposes new risks again, and it is extremely difficult to find the other side to multiple legged complex risks strategies; in other words it's unlikely that you will find someone who will want both legs of your complex hedge at a time when it's moving so much against you (or at any time for that matter because the other side of complex hedging strategies do not 'naturally exist").

Processes for new strategy should have included stresses to that strategy. But would they have stressed to extent market is currently dislocated? Probably not, b/c they would have based upon historical spreads and correlations which are now no longer relevant and the moves to current level would have been considered beyond extreme. I think this is a similar issue as the hybrids books...JPMC may not stress the complex risks enough. By putting the complex illiquid products thru the typical stress scenarios the bank is effectively ignoring the illiquidity because the standard scenarios assume an exit and rebalance which may not be feasible. The normal stress processes do not assume events happen multiple times, and do not go extremely deep into tails.

Agree I am curious to see what they did, though

I have no concerns generally with the overarching strategy of the CIO function and what they were attempting to do. I think, however, that processes may need to be strengthened. I understand the bank is looking at all processes right now; but, I think we should consider steering them towards changes in valuation policies and processes for mark to market items, initiating a new strategy review process that is documented and signed off by all control functions (sort of like a NBIA), and a review of stress processes for complex products and strategies (something I think the bank fell short of with respect to hybrids). Prospective strategies should be run thru the complex stress scenarios as part of the NBIA look a-like process.

Agree

Just thinking on paper, not saying that any of this is fact, or the solution.

Regards,

Mike

Mike Kirk

Capital Markets Examiner

Large Bank Supervision

Phone: 212 899-1383

Fax: 301 433-9209

From: Waterhouse, Scott
To: <Brosnan, Mike>;<Belshaw, Sally>
Sent: 5/11/2012 2:58:22 PM
Subject: RE: J.P.Morgan Chase

Just FYI – we did an examination of the CIO at the end of 2010 and have a follow-up planned soon. We had some concerns about overall governance and transparency of the activities. We received a lot of pushback from the bank, Ina Drew in particular, regarding our comments. In fact, Ina called Crumlish when he was in London and "sternly" discussed our conclusions with him for 45 minutes. Basically she said that investment decisions are made with the full understanding of executive management including Jamie Dimon. She said that everyone knows what is going on and there is little need for more limits, controls, or reports. At the conclusion of the exam, we issued the following MRA.

- Management should update and amend investment policies to clearly define the processes used to manage the investment portfolio as well as document current portfolio objectives and investment parameters.

The risk management framework for the investment portfolios (Strategic Asset Allocation and Tactical Asset Allocation) is not well documented. While overall risk controls and communication appear to be sound, the absence of a documented methodology with clear records of decisions and other approvals makes it difficult to determine whether portfolio risk management and control are governed according to senior management and DRPC expectations. Discussions with managers and a review of audit work enabled us to clarify how investment decisions are made and what parameters and limits exist around investment activities. Nevertheless, it is our expectation that the following minimums be formally documented:

- While trades, portfolio decisions and market analysis focus on maintaining an agreed upon duration of equity (DOE), there is no report that summarizes support for the agreed upon DOE. Senior ALCO receives only the DOE synopsis page, and documentation leading up to decisions and/or minutes of those discussions should be kept.
- Guidance articulating overall portfolio objectives or exposure targets and asset parameters is not used. While we recognize the need for maintaining flexibility in portfolio management, practices and decisions should be documented.
- Reporting and analysis on below-investment-grade and nonrated (NR) securities should be documented better to ensure ongoing compliance with *OCC Bulletin 2004-25.*

It just goes to show that it is difficult to always be smarter than the market. Humility is good.

From: Brosnan, Mike
Sent: Friday, May 11, 2012 10:35 AM
To: Belshaw, Sally; Waterhouse, Scott
Subject: Fw: J.P.Morgan Chase

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Permanent Subcommittee on Investigations
EXHIBIT #71

From: Regulator\), James X <Hohl \>
To: <Wilmot, John>
ent: 5/14/2012 11:24:14 AM
ubject: RE: CIO P&L reporting

Hi John, If there's a daily P&L distribution like those that we get from the IB, can you add either me or my boss Fred Crumlish to it as soon as possible. Thanks, James

---

From: Wilmot, John
Sent: Wednesday, May 09, 2012 6:20 PM
To: Hohl (Regulator), James X
Subject: RE: CIO P&L reporting

Jim – sorry for the delay. I am working on this request.

John C. Wilmot | Chief Investment Office | + john.wilmot@jpmorgan.com | (Work: (212) 834-5452 | (Cell: [redacted]

From: Hohl (Regulator), James X
Sent: Monday, May 07, 2012 11:58 AM
To: Wilmot, John
Subject: CIO P&L reporting

——— = Redacted by the Permanent Subcommittee on Investigations

Hi John,

We'd like to get the synthetic credit P&L for the past five weeks broken out on at least a weekly basis. If you've got regular reports that show this, just forwarding them would be best. Also, we are on the distribution for daily P&Ls from the IB. If CIO MTM positions are also distributed daily, we'd like to get the eporting on the same basis. I am on the distribution for the daily MSR P/L Estimate.

Thanks, James

Permanent Subcommittee on Investigations
EXHIBIT #72

From: Crumlish, Fred
To: <Waterhouse, Scott>
Sent: 5/15/2012 5:24:26 PM
Subject: FW:

Exactly. Let's see what the "lessons learned" says...

- apc

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From: Wong, Elwyn
Sent: Tuesday, May 15, 2012 1:17 PM
To: Kirk, Mike; Crumlish, Fred; Fursa, Thomas; Hohl, James
Subject: RE:

Good point. Does not add up. Collateral dispute of $700 mil versus a double digit reserves amount?

From: Kirk, Mike
Sent: Tuesday, May 15, 2012 1:14 PM
To: Wong, Elwyn
Subject: RE:

ust looked at it and can't find what I would think is the whole book...wondering are there items they weren't price testing?

Wondering how could they have a large collateral dispute and with these reports showing pricing this tight (16MM adjustment only)

Is the synthetic portfolio completely covered by this report? It's not clear to me.

From: Wong, Elwyn
Sent: Tuesday, May 15, 2012 11:18 AM
To: Kirk, Mike
Subject:

Talked to Tom. There is March CIO VCG report in WISDM under FVP/CIO. The Powerpoint mentioned increase by a small amount of reserves for CDS but we didn't find total amount in Spreadsheet. I will look more closely too.

CIO VCG reports to CIO Controller not to Jean Francois Bessin obviously.

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EXHIBIT #73

From: Regulator\), James X <Hohl \>
To: Regulator\), Fred X <Crumlish \>
Sent: 5/17/2012 7:36:43 PM
Subject: Not Getting CIO daily P&L after only one day

FYI - I got one CIO daily P&L distribution and then didn't yesterday. I inquired about it this morning, but haven't heard back.

From: Hohl (Regulator), James X
Sent: Thursday, May 17, 2012 8:09 AM
To: Rizaj, Admand X
Subject: RE: CIO Performance Summary - 05/15/2012

Hi, I received the daily report below on Tuesday, but didn't receive it on Wednesday. Was there a problem with the report last night? Thanks, James

---

From: Rizaj, Admand X
Sent: Tuesday, May 15, 2012 8:23 PM
To: CIO Daily Performance Summary
Subject: CIO Performance Summary - 05/15/2012

Admand Rizaj | JPMC CIO Finance | admand.x.rizaj@jpmorgan.com | (212) 834 - 9677

5-18-12

SBC Staff Briefing

Frame the briefing

JPMC transactions at issue involved an effort to hedge the bank's credit risk. Hedging credit risk is not uncommon, and if done properly, reflects sound risk management.

As has been reported, in late 2011, JPMC made a decision to lift or modify its original hedging position. Rather than terminating the position, the bank entered into a new position, in a different instrument; The combination was designed to effectively reduce the bank's exposure on the first position.

This has been described as a hedge on a hedge.

These transactions and the individual trades involved are quite complicated.

The OCC has very extensive expectations around national banks' derivatives activities, how hedging would be expected to be undertaken, and unwound, the process for risk identification in those activities, and communications with regulators about those activities.

We are in the process now of getting detailed information on ~~concerning~~ the activities that occurred, and comparing that information with the standards we apply, to identify just where breakdowns occurred.

[This will also inform whether there are changes we need to make in our expectations, or communications going forward.]

It would not be appropriate to discuss confidential bank-specific information, or details of the OCC examination work, but we can provide you with more general information on how we supervise this area and our expectations. [to Mike]

Permanent Subcommittee on Investigations
EXHIBIT #75

PSI-OCC-10-000001

From: Kirk, Mike
To: Wong, Elwyn
Sent: 5/18/2012 11:26:08 AM
Subject: RE: CIO call with Mike Brosnan
Attachments: image001.png; image002.png

Agreed too. That's the problem with using historical data and assuming mean reversion. It will work a lot of times, but one has to be mindful of paradigm shifts and the LTRO is a paradigm shift for the markets in the short run. Issue is JPM never stressed components of the trades beyond historical (I think). Had they looked at the components of the risks and stressed them to say 4-5-6 sds they would have the impacts of low probability events. Although my guess is they would have ignored that too! Arrogance drove this bus.

From: Wong, Elwyn
Sent: Thursday, May 17, 2012 7:56 PM
To: Kirk, Mike
Subject: Re: CIO call with Mike Brosnan

That's not worth the paper it is written on. You think they can convince my cleaning lady? A dollar on each cell of the mattrix is worth the same

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From: Kirk, Mike
Sent: Thursday, May 17, 2012 06:20 PM
To: Wong, Elwyn
Subject: RE: CIO call with Mike Brosnan

That's the point!

The relationship obviously didn't hold, and I would be if we plotted the graph today the locations would be far from the diagonal... and I be if we had access to the data that the red portion is moving up and farther to the right with each passing day in April

---

From: Wong, Elwyn
Sent: Thursday, May 17, 2012 5:58 PM
To: Kirk, Mike; Crumlish, Fred; Hohl, James
Cc: Waterhouse, Scott
Subject: RE: CIO call with Mike Brosnan

I was not at the April 16 meeting. But let me venture to guess what it is trying to say.

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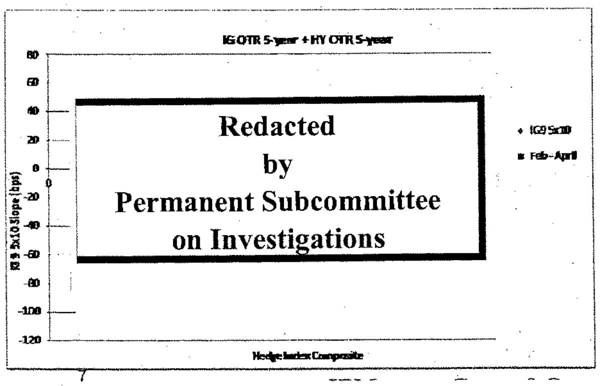

The y-axis is rolling 10 yr cds – rolling 5 yr cds. They had a few Bloomberg graphs showing how this rolled spread from being NEGATIVE in 2008 and 2009 (just like Greece and Italy) towards more normalization when it eventually returned to being positively sloped.

The x-axis is the Hedge Index Composite. I venture to guess this is the aggregate hedge that think they need to put on, related to the aggregate number on the extreme lower right hand side, the $158 .498 mil. They have a whole matrix of longs and shorts and that's the composite. As fear resided and rolling 10 yr minus rolling 5 yr returned to positive, they can reduce their total hedge. As Mike said, the REDS are which they are at now— so their hedge is not that unreasonable, IF THE HEDGE AMOUNT DID HAVE THIS RELATIONSHIP TO THE SLOPE of 5yr to 10yr CDS

The sentence which is somewhat perplexing is "the relationship is bounded by the off-the-run HY shorts and the on-the-run IG shorts. Meaning that this is their core hedge?

Factored Notional Sum	Maturity												
Index	20-Jun-12	20-Dec-12	20-Jun-13	20-Dec-13	20-Jun-14	20-Dec-14	20-Jun-15	20-Dec-15	20-Jun-16	20-Dec-16	20-Jun-17	20-Dec-17	20-Jun-
CDX HY	13,824	1,486	-2,465	3,167	617		-10,631	-6,736	-6,708	-7,828			
CDX LCDX			1,846										
CDX IG		-53,965	8	-586	85	34,267	-7,657	-67,536	-10,479	11,433	15,751	31,574	
ITRAXX MN		7	28,276		-3,356		28,044	25	7,453	38,684	7,528	22	43,[illegible]
ITRAXX XO								-5	-1,707	-8,822	-116		
ITRAXX FINSUB	-821	-690	-2,210	-1,444		-1,014		1,765	-634	1,366	828		
ITRAXX FINSEN											72		
SOVX WE										47			
Grand Total	13,703	-45,252	25,457	1,467	-2,774	33,253	1,756	-21,606	-10,088	16,939	24,202	91,587	43,[illegible]

The whole scenario thing about convexity is talking their book/advertizing – in a panic situation, people will run to put protection in the short end and not the long end. So the curve FLATTENS again like in 2007. In other words, their hedge has analytical underpinning. Not only are they reducing their short risk hedge prudently according to the slope of the 5yr -10yr, as plotted on Bloomberg, the flattener would have been a safe bet because in case they were reducing their hedge too fast and the economy tanked against, the built in flattener would be there to help.

From: Kirk, Mike
Sent: Thursday, May 17, 2012 4:51 PM
To: Crumlish, Fred; Hohl, James; Wong, Elwyn
Cc: Waterhouse, Scott
Subject: RE: CIO call with Mike Brosnan

Fred,

Happy to join you in your calls with Mike B.

In respect to your questions, in the order asked:

- The graph on page 7 shows the slippage of their portfolio compared to the hedge. The closer to the diagonal the more closely the hedge tracks the portfolio. The red highlighted area is recent period they were discussing where hedges were breaking down, and markets were not moving according to their modeled projections based upon historical correlations.
- To make the chart you would need two items. A targeted portfolio and a hedge portfolio. We could ask for this chart of the strategy prior to re working the hedge position to remove part of the hedge (why we were told they decided to sell IG with fallen angels). This request may be instructive and could settle the issue of whether the original portfolio was an effective hedge. P&L for previous 4 years, however, was fairly reasonable, so that would tend to support the banks statement that the hedge worked well for years. It went astray when they reduced the hedge.
- I think Matt Zames would likely have a different view of the choice of strategy with hindsight being a benefit. Position really went bad as shown in March/April, question is did the London desk continue selling in IG in April with the curve steepening and spreads widening and basis (to theoretical) trading rich. This is something we do not at this time know.
- You can give Mike B my cell phone number.

Please note Elwyn and James will likely have quality information to add so you may want to wait to hear from them before passing along.

Regards,
Mike

From: Crumlish, Fred
Sent: Thursday, May 17, 2012 4:22 PM
To: Kirk, Mike; Hohl, James; Wong, Elwyn
Cc: Waterhouse, Scott
Subject: CIO call with Mike Brosnan

Scott and I spoke to Mike Brosnan today about what we were doing now and going forward on the CIO book. We will likely have a call with him frequently, and, particularly with respect to the intricacies of the position, will need to include you.

A couple of things specific to the pre-April 16 interactions and some of the emails that are circulating:

- I told Mike B that the Joe Sabatini emails with selected position information were sent by the bank after initial OCC and FRB enquiries. We concluded that this information was pretty much useless, as it did not tell us what was happening risk wise. We also talked about a couple of those other emails, but I emphasized that the culmination was getting a meeting with Ina Drew and company on April 16.
- With respect to the April meeting, Mike B. is going through the "synthetic credit deck" and he had a few technical questions, not all of which I was able to fully answer since I didn't recall or had been focusing on other issues and didn't think of those questions. With respect to this presentation:
  - Mikeand James: Please have a look at your notes for page 7 as I wasn't fully able to explain the graph on the bottom. Also if you have details on the scenario description on page 11, we should pass that along.
  - It would be nice at some point if we could get a chart such as that on page 5 ***before*** the position was put on. Maybe we will request it, maybe not. Let's see if we need it after going through new reporting

- More to the point, I told Mike that the bank would likely not stand behind (aside from a statement that it was the best they knew at the time) this analysis at this point, as the position turned out to be far more problematic than presented and so the description of risk was missing.
- Mike Kirk – as usual, don't be surprised if Mike just calls you sometime.

- I told Mike that next Monday we will be going over current risk reporting and positions in more detail, as the reporting is evolving. He might want to speak with us shortly after. I'd expect to have Mike and Elwyn to help speak to technical details etc.

So, keep your notes current. All emails get circulated widely, and of course generate questions.

- apc

From: Kamath, Jairam
To: <Crumlish, Fred>;<Fursa, Thomas>;<Wong, Elwyn>
Sent: 5/21/2012 3:20:02 PM
Subject: RE: cio var change

Here are a few comments from the days preceding the synthetic credit VaR model change that became effective 1/27/12. Note the reduction of CIO VaR by 44% to $57mm.

COB 1/23/12
The stand alone VaR for each LOB are as follows: IB is $72mm (vs. $120mm limit), CIO is $103mm (vs. $105mm limit), RFS is $12mm (vs. $95mm limit), TSS is $9mm (vs. $25mm limit), Private Equity is $9mm (no limit set given immateriality), and AM is $0.2mm (no limit set given immateriality).

***CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.**

Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG to gain approval, which is expected to be implemented by the end of January.

The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm.

COB 1/24/12
CIO continues to manage the synthetic credit portfolio balancing credit protection and Basel III RWA. The new VaR model for CIO was approved today by MRG and is expected to be implemented prior to month-end.

jairam.kamath@occ.treas.gov
Tel: 212-899-1386
BB: [redacted]
Fax: 301-433-6238

▬ = Redacted by the Permanent Subcommittee on Investigations

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From: Crumlish, Fred
Sent: Monday, May 21, 2012 10:54 AM
To: Fursa, Thomas; Wong, Elwyn; Kamath, Jairam
Subject: cio var change

During the model control exam or elsewhere, did you specifically discuss the CIO VaR change. If so, let me know what and how. We can discuss. If it's a workpaper comment or meeting note, you can send me the link

- apc

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EXHIBIT #77

From: Waterhouse, Scott
To: Brosnan, Mike; Belshaw, Sally
Sent: 6/29/2012 8:07:30 PM
ubject: FW: 2nd Wilmer Hale Call

Interesting commentary. This is the SEC questioning of WilmerHale.

From: Kirk, Mike
Sent: Friday, June 29, 2012 9:06 AM
To: Wong, Elwyn; Waterhouse, Scott; Crumlish, Fred
Cc: Hohl, James; Patro, Dilip; Banks, George
Subject: RE: 2nd Wilmer Hale Call

Yes, a huge percentage at that point in history.

From: Wong, Elwyn
Sent: Friday, June 29, 2012 9:01 AM
To: Kirk, Mike; Waterhouse, Scott; Crumlish, Fred
Cc: Hohl, James; Patro, Dilip; Banks, George
Subject: Re: 2nd Wilmer Hale Call

That was my immediate reaction as well. Will be interesting to see what more they have to say in the 3rd call focusing on valuation. But more importantly, the few hundred million divergence was supposed to have been reflected in the PnL on the last day of March. Then in April there was another 700 mil collateral dispute? I mean, DISPUTE - that is a percentage of the mark to market!

-om: Kirk, Mike
ent: Friday, June 29, 2012 07:38 AM
To: Wong, Elwyn; Waterhouse, Scott; Crumlish, Fred
Cc: Hohl, James; Patro, Dilip; Banks, George
Subject: RE: 2nd Wilmer Hale Call

Section 1 on Traders is damaging to Hogan's reputation in respect to his interaction with regulators, in my opinion.

On the very first daily call, Hogan discussed that earlier there had been a large collateral dispute with their counterparties. I questioned him on how it was resolved and he said JPM eventually agreed to the counterparties marks and then paid out the near $400MM amount. I then followed with a question relating to what I described as mismarked books to which Hogan forcefully stated JPM books were not mismarked; leaving both Elwyn and me left puzzled over how a collateral dispute could be resolved by agreeing to the counterparties marks, without admitting your own marks were incorrect. The 4th bullet point below is consistent with a collateral dispute that is resolved by agreeing to counter parties levels, and more consistent with a common sense view of likely drivers of the same.

From: Wong, Elwyn
Sent: Thursday, June 28, 2012 6:17 PM
To: Waterhouse, Scott; Crumlish, Fred; Kirk, Mike
Cc: Hohl, James; Patro, Dilip; Banks, George
Subject: 2nd Wilmer Hale Call

Vilmer Hale made Part 2 of their presentation today in terms of their findings. They have yet to finish interviewing JPM employees in London. Materials were handed out to our DC

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people. Tom Dowd and Kevin Lee were 2 names I recognize.

There will be a third presentation specifically on trader marks and VCG. It is currently scheduled for next Tuesday but Wilmer Hale is asking for more time possibly until week after July 4th as they are still interviewing Lodon employees.

Today Wilmer Hale focused on who knew what and when they knew.

Traders:

- Perplexingly, traders seem to have formulated their RWA reduction strategy based on their own method of calculating RWA outside of that calculated by Risk Management/Finance (unsure how exactly the latter calculates it but it did to a large extent involve Westend and unsure why IG vs HY would reduce RWA at all). While there was not much disagreement between traders and Risk on the large reduction in VaR upon the implementation of Westend, there were lengthy debates on why RWA should increase upon the rollout of the Westend. The disagreement led to Venkat and Olivier's involvement in the first place (separate and distinct from Hogan parachuting them in by April 27th). Macris was unsuccessful in convincing Venkat that traders RWA methodology was correct and Risk Management's was wrong.

- Traders had debated splitting tranches and their delta hedges into one book to calculate Comprehensive Risk Measure (CRM) and the pure index positions into another book to calculate Incremental Risk Capital (IRC)

- Macris and Drew made no mentioning of increase in RWA (according to Risk Management's calculation) in February CIO ERM attended by Dimon and Braunstein

- Wilmer Hale has already begun using the term "hiding losses". A junior trader Julian Grout was responsible for FO daily marks. He kept a record of the difference between "crude-mids" (taking market prices without taking specific consideration of circumstances and size and who it was from) and CIO marks. It was $100mil in Jan 2012 and had grown to $300mil in Mar. That record was last dated 03/15/2012. Real market marks were trued by end of Mar and the large loss on 3/31/2012 was due to that one reason. For example, a realized loss was $12 mil on a day in March when the crude-mid divergence was $600 mil. On another day, it was $18 mil loss when the divergence was $300 mil.

- Bruno Iksil mused on divergence reaching $1 bil by the end of March but if CIO held out it would not lose a single penny. On a Friday, he said he didn't want to come back on Monday.

- Traders were intentionally doing larger notionals to drive the market their way. They talked about "taking the P/L pain" versus the risk of building larger positions.

- Traders gave much smaller loss estimates under different scenarios repeatedly during rehearsals for the earnings call and inquiries triggered by the Bloomberg London Whale article just prior to that. 80% chance of Q2 losses between $150 mil and $250 mil but possible large drawdown intra-quarter.

· A lot of emails between Bruno and Javier not less from them to Macris

· When Ina met with traders to further discuss why the results of Risk Management's RWA calculations were so different from the traders, they did not include positions put on from 3/7 to 3/20 (we now know they doubled down around this time)

· Other senior hires within CIO made incidental suggestions. Head of NA CIO trading suggested using IRS swap spread to hedge credit spread widening. John Wilmott suggested using OCI to fund some unwinds. Wilmott also suggested closing the book entirely

Dimon and Braunstein

· Nothing new on this front as I have written on this extensively in the last email. In a nutshell, they only began asking for details around the Bloomberg news break and during the run-up to the 4/13/2012 earnings call. Macris told Braunstein the majority of the positions were taken in Jan and Feb but we now know the doubling down in March. Dimon, Braunstein and Hogan believed Ina and Macris well into April for at least another week after 4/13/2012 earnings call. That was when more significant losses began to show.

Risk Reporting

· For the 4/13 earnings supplement, neither Levine Surtani and Matt Lynch from Risk Reporting nor Goldman/Weiland knew they should be disclosing VaR model change even though SEC guidelines said they should. They even consulted Ashley Bacon. After Goldman/Weiland sign-off, since only average VaR was reported, no one had picked up on the sudden decrease in VaR caused by the new model.

· Only when 10Q was about to be filed and more people were involved such as PCW and Controllers were they then made aware of the need for disclosure.

· The part on why they had to re-instate old model with a much large VaR is now familiar to us

From: Market Risk Management - Reporting <marketriskmanagement-reporting@jpmorgan.com>

Sent: Fri, 20 Jan 2012 23:10:24 GMT

To: Market Risk Management - Reporting <marketriskmanagement-reporting@jpmorgan.com>; Dimon, Jamie <jamie.dimon@jpmchase.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>; Staley, Jes <jes.staley@jpmorgan.com>; Drew, Ina <Ina.Drew@jpmorgan.com>; Rauchenberger, Louis <louis.rauchenberger@jpmorgan.com>; Lake, Marianne <Marianne.Lake@jpmorgan.com>; Weiland, Peter <peter.weiland@jpmchase.com>; Weisbrod, David A. <David.A.Weisbrod@jpmchase.com>; Bacon, Ashley <Ashley.Bacon@jpmorgan.com>; Beck, David J <david.j.beck@jpmchase.com>; Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Morzaria, Tushar R <tushar.r.morzaria@jpmorgan.com>; Wilmot, John <JOHN.WILMOT@jpmorgan.com>; Dellosso, Donna <Donna.Dellosso@jpmorgan.com>; Bisignano, Frank J <frank.j.bisignano@jpmchase.com>

CC: Doyle, Robin A. <Robin.A.Doyle@chase.com>; Waring, Mick <Mick.Waring@jpmorgan.com>; Market Risk Reporting <Market_Risk_Reporting@jpmchase.com>; Sreckovic, Steven <steven.sreckovic@jpmorgan.com>; McCaffrey, Lauren A <lauren.a.mccaffrey@jpmorgan.com>; Tocchio, Samantha X <samantha.x.tocchio@jpmorgan.com>; Chiavenato, Ricardo S. <ricardo.s.chiavenato@jpmorgan.com>; Chen, Dan <Dan.Chen@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>

Subject: JPMC Firmwide VaR - Daily Update - COB 01/19/2012

Firmwide 95% 10Q VaR

- The Firm's 95% 10Q VaR as of cob 01/19/2012 has decreased by $9mm from the prior day's VaR to $129mm and continues to breach the $125mm Firm VaR limit for the fourth consecutive day.
- CIO's 95% 10Q VaR* as of cob 01/19/2012 has decreased by $2.5mm from the prior day's VaR to $100mm and continues to breach the $95mm CIO VaR limit for the fourth consecutive day.
- The decrease in the Firm's VaR is primarily driven by an overall increase in diversification benefit across the Firm and position changes in CIO and MSR.
- Each LOB's contribution to the Firm's $129mm VaR (as shown by marginal VaR) are: IB [redacted] CIO ($78mm mVaR, primarily driven by CIO International credit tranche book), RFS [redacted] Private Equity [redacted] and TSS [redacted]
- The stand alone VaR for each LOB are as follows: IB is [redacted] CIO is $100mm (vs. $95mm limit), RFS is [redacted] TSS [redacted] Private Equity [redacted], and AM [redacted]

*CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.

Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG to gain approval, which is expected to be implemented by the end of January.

The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm.

10Q Externally Disclosed VaR

Permanent Subcommittee on Investigations
EXHIBIT #79a

From: MRM Reporting <mrm.reporting@jpmchase.com>
Sent: Fri, 20 Jan 2012 23:10:53 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>
CC: Staley, Jes <jes.staley@jpmorgan.com>; Drew, Ina <Ina.Drew@jpmorgan.com>; Doyle, Robin A. <Robin.A.Doyle@chase.com>; Weiland, Peter <peter.weiland@jpmchase.com>; Bacon, Ashley <Ashley.Bacon@jpmorgan.com>; Waring, Mick <Mick.Waring@jpmorgan.com>; Lochtefeld, Thomas A <thomas.a.lochtefeld@jpmorgan.com>; Surtani, Lavine <Lavine.Surtani@jpmchase.com>; Tocchio, Samantha X <samantha.x.tocchio@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Gondell, Sarah N <sarah.n.gondell@jpmorgan.com>; Sreckovic, Steven <steven.sreckovic@jpmorgan.com>; McCaffrey, Lauren A <lauren.a.mccaffrey@jpmorgan.com>; MRM Business Reporting <MRM_Business_Reporting@jpmchase.com>; MRM Reporting <mrm.reporting@jpmchase.com>; Intraspect - LIMITS <Intraspect_-_LIMITS@restricted.chase.com>
Subject: JPMC 95% 10Q VaR - Limit Excession Notification (COB 1/19/12)

The Firm's 95% 10Q VaR breached its $125mm limit for the fourth consecutive day on January 19th 2012, primarily driven by CIO.

CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.

Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG to gain approval, which is expected to be implemented by the end of January.

The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm.

Blackberry friendly:
$ mm
COB VaR Limit
1/19/2012 129.2 125.0
1/18/2012 138.0 125.0
1/17/2012 132.9 125.0
1/16/2012 126.5 125.0

Permanent Subcommittee on Investigations
EXHIBIT #79b

From: MRM Reporting <mrm.reporting@jpmchase.com>
Sent: Mon, 23 Jan 2012 20:30:50 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com> Drew, Ina <Ina.Drew@jpmorgan.com>; Staley, Jes <jes.staley@jpmorgan.com>; Weiland, Peter <peter.weiland@jpmchase.com>; Bacon, Ashley <Ashley.Bacon@jpmorgan.com>; Waring, Mick <Mick.Waring@jpmorgan.com>; Doyle, Robin A. <Robin.A.Doyle@chase.com>; Bisignano, Frank J <frank.j.bisignano@jpmchase.com>; Tocchio, Samantha X <samantha.x.tocchio@jpmorgan.com>; Lochtefeld, Thomas A
CC: <thomas.a.lochtefeld@jpmorgan.com>; GREEN, IAN <ian.green@jpmorgan.com>; Gondell, Sarah N <sarah.n.gondell@jpmorgan.com>; MRM Firmwide Reporting <MRM_Firmwide_Reporting@jpmorgan.com>; Intraspect - LIMITS <Intraspect_-_LIMITS@restricted.chase.com>
Subject: APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval

Importance: High

This email is to request your approval to implement the temporary increase of the Firm's 95% 10Q VaR limit from $125mm to $140mm, expiring on January 31st, 2012. There is a pending approval for a new model for the CIO Intl Credit Tranche book. If the new model is approved and implemented prior to January 31st, the Firm's 95% 10Q VaR limit will revert back to the original $125mm level.

CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.

Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG to gain approval, which is expected to be implemented by the end of January.

The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm.

Below are estimated VaR levels for COB 1/18/12 using the new Credit Tranche model.

COB 1/18/12	CURRENT FIRM	NEW MODEL FIRM	CURRENT CIO	NEW MODEL CIO
95% 10Q VaR	$137,961,471	$98,456,554	$102,385,406	$57,183,430

Proposed Change to the Firm's 95% 10Q VaR:

LOB	Limit Type: Level 1	Current Limit	Proposed Temporary Limit
JPMC	95% 10Q VaR	$125mm	$140mm

If more information is required, please let us know and we will arrange to provide further details.

Permanent Subcommittee on Investigations
EXHIBIT #79c

Blackberry friendly:

Temporary increase of the JPMC 95% 10Q VaR Limit from $125mm to $140mm.

Upon receipt of your approval, the above limit change will be entered into Market Risk Systems with a start date of **January 20, 2012.**

If you approve of the limit change, please reply to all with your approval.

Thank you.

From: Dimon, Jamie <jamie.dimon@jpmchase.com>
Sent: Mon, 23 Jan 2012 23:13:18 GMT
To: Hogan, John J. <John.J.Hogan@jpmorgan.com>; MRM Reporting <mrm.reporting@jpmchase.com>
CC: Drew, Ina <Ina.Drew@jpmorgan.com>; Staley, Jes <jes.staley@jpmorgan.com>; Weiland, Peter <peter.weiland@jpmchase.com>; Bacon, Ashley <Ashley.Bacon@jpmorgan.com>; Waring, Mick <Mick.Waring@jpmorgan.com>; Doyle, Robin A. <Robin.A.Doyle@chase.com>; Bisignano, Frank J <frank.j.bisignano@jpmchase.com>; Tocchio, Samantha X <samantha.x.tocchio@jpmorgan.com>; Lochtefeld, Thomas A <thomas.a.lochtefeld@jpmorgan.com>; GREEN, IAN <ian.green@jpmorgan.com>; Gondell, Sarah N <sarah.n.gondell@jpmorgan.com>; MRM Firmwide Reporting <MRM_Firmwide_Reporting@jpmorgan.com>; Intraspect - LIMITS <Intraspect_-_LIMITS@restricted.chase.com>
Subject: Re: APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval

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I approve.

From: Hogan, John J.
To: MRM Reporting; Dimon, Jamie
Cc: Drew, Ina; Staley, Jes; Weiland, Peter; Bacon, Ashley; Waring, Mick; Doyle, Robin A.; Bisignano, Frank J; Tocchio, Samantha X; Lochtefeld, Thomas A; GREEN, IAN; Gondell, Sarah N; MRM Firmwide Reporting; Intraspect - LIMITS
Sent: Mon Jan 23 17:44:41 2012
Subject: RE: APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval

I approve.

From: MRM Reporting
Sent: Monday, January 23, 2012 3:31 PM
To: Dimon, Jamie; Hogan, John J.
Cc: Drew, Ina; Staley, Jes; Weiland, Peter; Bacon, Ashley; Waring, Mick; Doyle, Robin A.; Bisignano, Frank J; Tocchio, Samantha X; Lochtefeld, Thomas A; GREEN, IAN; Gondell, Sarah N; MRM Firmwide Reporting; Intraspect - LIMITS
Subject: APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval
Importance: High

This email is to request your approval to implement the temporary increase of the Firm's 95% 10Q VaR limit from $125mm to $140mm, expiring on January 31st, 2012. There is a pending approval for a new model for the CIO Intl Credit Tranche book. If the new model is approved and implemented prior to January 31st, the Firm's 95% 10Q VaR limit will revert back to the original $125mm level.

CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.

Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG to gain approval, which is expected to be implemented by the end of January.

Permanent Subcommittee on Investigations
EXHIBIT #79d

The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm.

Below are estimated VaR levels for COB 1/18/12 using the new Credit Tranche model.

COB 1/18/12	CURRENT FIRM	NEW MODEL FIRM	CURRENT CIO	NEW MODEL CIO
95% 10Q VaR	$137,961,471	$98,456,554	$102,385,406	$57,183,430

Proposed Change to the Firm's 95% 10Q VaR:

LOB	Limit Type: Level 1	Current Limit	Proposed Temporary Limit
JPMC	95% 10Q VaR	$125mm	$140mm

If more information is required, please let us know and we will arrange to provide further details.

Blackberry friendly:

Temporary increase of the JPMC 95% 10Q VaR Limit from $125mm to $140mm.

Upon receipt of your approval, the above limit change will be entered into Market Risk Systems with a start date of **January 20, 2012.**

If you approve of the limit change, please reply to all with your approval.

Thank you.

From: Market Risk Management - Reporting <marketriskmanagement-reporting@jpmorgan.com>

Sent: Tue, 24 Jan 2012 00:05:59 GMT

To: Market Risk Management - Reporting <marketriskmanagement-reporting@jpmorgan.com>; Dimon, Jamie <jamie.dimon@jpmchase.com>; Hogan, John J. <JohnJ.Hogan@jpmorgan.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>; Staley, Jes <jes.staley@jpmorgan.com>; Drew, Ina <Ina.Drew@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Weiland, Peter <peter.weiland@jpmchase.com>; Weisbrod, David A. <David.A.Weisbrod@jpmchase.com>; Bacon, Ashley <Ashley.Bacon@jpmorgan.com>; Beck, David J <david.j.beck@jpmchase.com>; Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Morzaria, Tushar R <tushar.r.morzaria@jpmorgan.com>; Wilmot, John <JOHN.WILMOT@jpmorgan.com>; Dellosso, Donna <Donna.Dellosso@jpmorgan.com>; Bisignano, Frank J <frank.j.bisignano@jpmchase.com>; Rauchenberger, Louis <louis.rauchenberger@jpmorgan.com>; Lake, Marianne <Marianne.Lake@jpmorgan.com>

CC: Doyle, Robin A. <Robin.A.Doyle@chase.com>; Waring, Mick <Mick.Waring@jpmorgan.com>; Market Risk Reporting <Market_Risk_Reporting@jpmchase.com>; GREEN, IAN <ian.green@jpmorgan.com>; McCaffrey, Lauren A <lauren.a.mccaffrey@jpmorgan.com>; Tocchio, Samantha X <samantha.x.tocchio@jpmorgan.com>; Chiavenato, Ricardo S. <ricardo.s.chiavenato@jpmorgan.com>; Chen, Dan <Dan.Chen@jpmorgan.com>

Subject: JPMC Firmwide VaR - Daily Update - COB 01/20/2012

▬ = Redacted by the Permanent Subcommittee on Investigations

Firmwide 95% 10Q VaR

- The Firm's 95% 10Q VaR as of cob 01/20/2012 is $131mm of the $140mm limit, an increase of $3mm from the prior day's revised VaR.
- CIO's 95% 10Q VaR* as of cob 01/20/2012 is $100mm of the $105mm limit, materially unchanged from the prior day's VaR.
- Each LOB's contribution to the Firm's $131mm VaR (as shown by marginal VaR) are: IB ([redacted]IO ($80mm mVaR, primarily driven by CIO International credit tranche book), RFS [redacted] Private Equity ([redacted], and TSS [redacted]
- The stand alone VaR for each LOB are as follows: IB is [redacted] CIO is $100mm (vs. $105mm limit), RFS is [redacted] TSS is [redacted] Private Equity is [redacted]nd AM is [redacted]

*CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.

Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG to gain approval, which is expected to be implemented by the end of January.

The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm.

10Q Externally Disclosed VaR

The below table shows the 95% 10Q VaR for the current quarter compared with the prior quarter and the corresponding quarter of prior year.

Permanent Subcommittee on Investigations
EXHIBIT #79e

From: Market Risk Management - Reporting <marketriskmanagement-reporting@jpmorgan.com>
Sent: Tue, 24 Jan 2012 23:31:28 GMT
To: Market Risk Management - Reporting <marketriskmanagement-reporting@jpmorgan.com>; Dimon, Jamie <jamie.dimon@jpmchase.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>; Staley, Jes <jes.staley@jpmorgan.com>; Drew, Ina <Ina.Drew@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Weiland, Peter <peter.weiland@jpmchase.com>; Weisbrod, David A. <David.A.Weisbrod@jpmchase.com>; Bacon, Ashley <Ashley.Bacon@jpmorgan.com>; Beck, David J <david.j.beck@jpmchase.com>; Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Morzaria, Tushar R <tushar.r.morzaria@jpmorgan.com>; Wilmot, John <JOHN.WILMOT@jpmorgan.com>; Dellosso, Donna <Donna.Dellosso@jpmorgan.com>; Bisignano, Frank J <frank.j.bisignano@jpmchase.com>; Rauchenberger, Louis <louis.rauchenberger@jpmorgan.com>; Lake, Marianne <Marianne.Lake@jpmorgan.com>
CC: Doyle, Robin A. <Robin.A.Doyle@chase.com>; Waring, Mick <Mick.Waring@jpmorgan.com>; GREEN, IAN <ian.green@jpmorgan.com>; McCaffrey, Lauren A <lauren.a.mccaffrey@jpmorgan.com>; Tocchio, Samantha X <samantha.x.tocchio@jpmorgan.com>; Chiavenato, Ricardo S. <ricardo.s.chiavenato@jpmorgan.com>; Chen, Dan <Dan.Chen@jpmorgan.com>; Market Risk Reporting <Market_Risk_Reporting@jpmchase.com>
Subject: JPMC Firmwide VaR - Daily Update - COB 01/23/2012

— = **Redacted by the Permanent Subcommittee on Investigations**

<u>Firmwide 95% 10Q VaR</u>

- The Firm's 95% 10Q VaR as of cob 01/23/2012 is $134mm of the $140mm limit, an increase of $3mm from the prior day's VaR.
- CIO's 95% 10Q VaR* as of cob 01/23/2012 is $103mm of the $105mm limit, an increase of $3mm from the prior day's VaR.
- Each LOB's contribution to the Firm's $134mm VaR (as shown by marginal VaR) are: IB [redacted] CIO ($79mm mVaR, primarily driven by CIO International credit tranche book), RFS [redacted] Private Equity [redacted], and TSS [redacted]
- The stand alone VaR for each LOB are as follows: IB is [redacted] CIO is $103mm (vs. $105mm limit), RFS is [redacted] TSS is [redacted] Private Equity is [redacted], and AM is [redacted]

*CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.

Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG to gain approval, which is expected to be implemented by the end of January.

The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm.

<u>10Q Externally Disclosed VaR</u>
The below table shows the 95% 10Q VaR for the current quarter compared with the prior quarter and the corresponding quarter of prior year.

Permanent Subcommittee on Investigations
EXHIBIT #79f

From: Hogan, John J. <John.J.Hogan@jpmorgan.com>
Sent: Sat, 28 Jan 2012 16:18:23 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>
Subject: Fw: JPMC Firmwide VaR - Daily Update - COB 01/26/2012

This should be the last day of firmwide VaR breach. A CIO model change is planned to go in this week-end. New VaR methodology approved (and now the same methodology as IB) reduces standalone Credit VaR by approx $30 mio. John

---

From: Market Risk Management - Reporting
To: Market Risk Management - Reporting; Dimon, Jamie; Hogan, John J.; Zubrow, Barry L; Staley, Jes; Drew, Ina; Goldman, Irvin J; Weiland, Peter; Weisbrod, David A.; Bacon, Ashley; Beck, David J; Braunstein, Douglas; Morzaria, Tushar R; Wilmot, John; Dellosso, Donna; Bisignano, Frank J; Rauchenberger, Louis; Lake, Marianne
Cc: Doyle, Robin A.; Waring, Mick; Market Risk Reporting; GREEN, IAN; McCaffrey, Lauren A; Tocchio, Samantha X; Chiavenato, Ricardo S.; Chen, Dan
Sent: Fri Jan 27 18:16:35 2012
Subject: JPMC Firmwide VaR - Daily Update - COB 01/26/2012

[redacted] = **Redacted by the Permanent Subcommittee on Investigations**

Firmwide 95% 10Q VaR

- The Firm's 95% 10Q VaR as of cob 01/26/2012 has increased by $8mm from the prior day's VaR to $161mm and has breached the $140mm Firm VaR limit for the third consecutive day.
- CIO's 95% 10Q VaR* as of cob 01/26/2012 has increased by $8mm from the prior day's VaR to $120mm and has breached the $110mm CIO VaR limit for the third consecutive day.
- The increase in the Firm's VaR is primarily driven by an overall reduction in diversification benefit across the Firm and position changes in CIO.
- Each LOB's contribution to the Firm's $161mm VaR (as shown by marginal VaR) are: IB [redacted] CIO ($107mm mVaR, primarily driven by CIO International credit tranche book), RFS [redacted]), Private Equity [redacted] and TSS [redacted]
- The stand alone VaR for each LOB are as follows: IB is [redacted]), CIO is $120mm (vs. $105mm limit), RFS is [redacted] TSS is [redacted] Private Equity is [redacted] and AM is [redacted]

* CIO continues to manage the synthetic credit portfolio balancing credit protection and Basel III RWA. The new VaR model for CIO was approved by MRG and is expected to be implemented prior to month-end.

10Q Externally Disclosed VaR

The below table shows the 95% 10Q VaR for the current quarter compared with the prior quarter and the corresponding quarter of prior year.

Confidential Treatment Requested by JPMORGAN CHASE & CO.

Permanent Subcommittee on Investigations
EXHIBIT #79g

JPM-CIO 0002215

~~**From:** Goldman, Irvin J~~
Sent: Mon, 30 Jan 2012 23:53:05 GMT
To: Weiland, Peter <peter.weiland@jpmchase.com>
Subject: Re: JPMC Firmwide VaR - Daily Update - COB 01/27/2012

Just got it.

From: Weiland, Peter
To: Goldman, Irvin J
Sent: Mon Jan 30 18:52:30 2012
Subject: FW: JPMC Firmwide VaR - Daily Update - COB 01/27/2012

This is the email you want.

Peter Weiland
Tel: +1 212 834 5549
Mob: +1 [redacted]

[redacted] = **Redacted by the Permanent Subcommittee on Investigations**

From: Market Risk Management - Reporting
Sent: Monday, January 30, 2012 6:49 PM
To: Market Risk Management - Reporting; Dimon, Jamie; Hogan, John J.; Zubrow, Barry L; Staley, Jes; Drew, Ina; Goldman, Irvin J; Weiland, Peter; Weisbrod, David A.; Bacon, Ashley; Beck, David J; Braunstein, Douglas; Morzaria, Tushar R; Wilmot, John; Dellosso, Donna; Bisignano, Frank J; Rauchenberger, Louis; Lake, Marianne
Cc: Doyle, Robin A.; Waring, Mick; Market Risk Reporting; GREEN, IAN; McCaffrey, Lauren A; Tocchio, Samantha X; Chiavenato, Ricardo S.; Chen, Dan
Subject: JPMC Firmwide VaR - Daily Update - COB 01/27/2012

Firmwide 95% 10Q VaR

- The Firm's 95% 10Q VaR as of cob 01/27/2012 is $108mm of the $125mm limit, a decrease of $53mm from the prior day's revised VaR, driven by CIO (implementation of newly approved VaR model for synthetic credit).
- Each LOB's contribution to the Firm's $108mm VaR (as shown by marginal VaR) are: IB [redacted], CIO ($35mm mVaR, primarily driven by CIO Synthetic Credit), RFS [redacted] Private Equity [redacted] and TSS [redacted]
- The stand alone VaR for each LOB are as follows: IB is [redacted] CIO is $66mm (vs. $95mm limit), RFS is [redacted] TSS is [redacted], Private Equity is [redacted] and [redacted]

10Q Externally Disclosed VaR

The below table shows the 95% 10Q VaR for the current quarter compared with the prior quarter and the corresponding quarter of prior year.

Permanent Subcommittee on Investigations
EXHIBIT #79h

From: Wilmot, John <JOHN.WILMOT@jpmorgan.com>
Sent: Tue, 28 Feb 2012 23:48:50 GMT
To: Enfield, Keith <Keith.Enfield@jpmorgan.com>; Weiner, Pamela <pamela.weiner@jpmorgan.com>
Subject: FW: CIO Business Review Materials

FYI

John C. Wilmot | Chief Investment Office | john.wilmot@jpmorgan.com | Work: (212) 834-5452 | Cell: [redacted]

From: Wilmot, John
Sent: Tuesday, February 28, 2012 6:32 PM
To: Dimon, Jamie; Braunstein, Douglas; Zubrow, Barry L; Drew, Ina; Hogan, John J.; Macris, Achilles O; Tse, Irene Y; Goldman, Irvin J
Cc: Warren, Shannon S; Gunselman, Gregg B; Jain, Manish; Will, Kathleen; Alvelo, Alexandra X; Peterson, Ruth J; Serpico, Gina; Beamon-Fontenelle, Margaret; Adam, Phillipa C; Gonzalez, Jeanette; Rios, Martha I; O'Donnell, Julie
Subject: CIO Business Review Materials

Attached please find the CIO Business Review materials for our discussion tomorrow, February 29th at 2:00pm.

John

John C. Wilmot | Chief Investment Office | john.wilmot@jpmorgan.com | Work: (212) 834-5452 | Cell: [redacted]

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Permanent Subcommittee on Investigations
EXHIBIT #80

CIO February 2012 Business Review

Business Review agenda – CIO

Today's Attendees		
Operating Committee	**CIO**	
Jamie Dimon	Ina Drew	John Wilmot
Doug Braunstein	Irv Goldman	
Barry Zubrow	Achilles Macris	
John Hogan	Irene Tse	

February agenda (1 ½ hrs)

Discussion Topics	Presenter	Pages	Duration
1. Review of current agenda	Drew	1-4	[20 mins]
(i) Discussion points			
2. Financial Summary	Wilmot	5-7	[5 mins]
3. CIO Business Structure	Drew/Wilmot	8-10	[5 mins]
(i) Overview		8-9	
(ii) RWA Forecast		10	
4. SAA Portfolio Analytics	Goldman/Macris/Tse	11-16	[20 mins]
(i) Overview		11	
(ii) RWA Efficient Portfolio		12-13	
(iii) Alternative Portfolios		14	
(iv) Economic Impact Analysis		15	
(v) OCI and PV Sensitivity		16	
5. Risk	Goldman	17-18	[10 mins]
6. Reinvestment Activity	Macris/Tse	19-30	[20 mins]
(i) 3Q11 - 1Q12 Purchases		19-25	
(ii) What we are looking at buying		26-29	
7. FX Capital Hedging	Macris	30	[5 mins]
8. Other Corporate Activities	Drew/Wilmot	31-32	[5 mins]

Business Review scorecard

Business topics covered	Review required	Pages
Other Corporate Activities	✓	31-32
Control Environment	×	33
Material changes to Mission Critical	×	34
Appendix - SPAR Analytics	×	35-43

CIO Business Structure – Mandate and Approach

- Optimize and protect the Firm's balance sheet from potential losses, and create and preserve economic value over the longer-term

Longer-term investing			
[illegible]	Retirement Plan	Special Investments	[illegible]
[illegible] legacy investments	[illegible] of US defined benefit pension [illegible] investment and oversight	[illegible] stressed and distressed opportunities related to undervalued or [illegible] performing JPMC loans	[illegible] tax advantaged [illegible] insurance premiums
[illegible] AUM	[illegible] AUM	[illegible]	[illegible] AUM
[illegible] run-off mode	YTD 2012 estimated [illegible]	First two [illegible]	Allocation to [illegible] grade credit

CIO Business Structure (continued)

- Volcker Rule permits risk-mitigating hedging activity, so the prohibition on prop trading does not apply to the "purchase or sale of a covered financial position" by a banking entity that is made "in connection with and related to individual or aggregated" positions
- As proposed, however, the Rule may adversely affect certain ALM activities. CIO is selectively reducing certain MtM/Trading Account activities and calibrating "under-60 day" activities across the division
- Further alignment of activities within Volcker Rule framework has resulted in the consolidation of Strategic and Tactical Asset Allocation portfolios. CIO has completed transition from legacy "SAA & TAA" to consolidated financials, risk management and portfolio structure.
- [redacted] MtM Overlay is for non-AFS eligible transactions and for more dynamic hedging activities
- CIO is resizing the credit book as a hedge for fat-tail risk

North America

MSR Hedging
- Post model changes, activities are limited to hedging the mortgage servicing asset

Rates
- Duration management and dynamically hedging JPM corporate debt liabilities

Agency Mortgages
- Our core rates assets to match liabilities
- Generating income via dollar roll, specified pools and TBAs

Municipal Bonds
- Book generated significant income via spread and tax advantage
- It is also a tool for us to hedge our corporate debt issuance

Non-Agency & CMBS
- CMBS generated significant income and OCI with extremely low RWA usage
- Legacy positions in RMBS, and currently targeting opportunistic adds to RMBS portfolio with positions to benefit from 2012 NPR

Corporate Debt & Preferreds
- Focus on bank debt and preferreds given the recent widening between Banks and Corporates
- The book generated significant income via spread and DRD tax benefits

International

Rates & FX
- Duration management and spread income from global rates curves.
- All liabilities passed to Int'l have thus far been placed in tractors and closely matched.

Emerging Markets Credit
- Dynamically managed investment grade emerging market bonds where JPM has a capital presence.
- Makes use of duration, single name protection and macro index hedges to manage draw-downs.

Secured Credit
- Top of the capital structure RMBS and CLO investments.
- The book generates significant added value from its ability to source the most suitable funding assets in the primary markets.

Synthetic Credit
- Index and tranche credit stress and jump protection portfolio.
- The credit derivatives portfolio seeks to efficiently provide mark-to-market stress offset to the CIO Int'l credit investments activity.

Developed Markets Credit
- Dynamically managed senior bond spread portfolio focused on core national champion banks.
- Can utilize duration, single name hedging overlays and macro index hedges.

FX Hedging
- Management of the firm's embedded FX capital exposures through dynamic spot hedging and efficient NII generation and risk management through derivative overlay and local currency duration.

RWA Forecast

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- RWA trends reflect CIO structure
  - [redacted]
- 2012 trend will reflect continued reduction to MTM Overlay offset by continued rotation into higher RWA rates and credit within SAA
  - [redacted]

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CIO Summary Risk Metrics

[illegible]

Risk Overview

- Integration of SAA into Firmwide Stress reflected; includes OCI impact as well as structural liability (see table below)
- Full limits framework review underway
  - VaR for limits and disclosure would include all CIO Trading Book assets

[redacted]

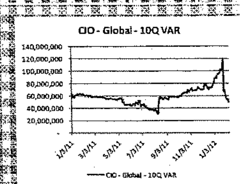
Stress Testing (mm USD)	Credit Crisis (credit selloff / rates rally)	Drivers
CIO MTM	510	Positive benefit from tranche book offset by bank preferreds and CLOs

[redacted]

VaR Highlights

- Enhanced VaR methodology for tranche book, reviewed and approved by MRG, helping to reduce VaR and RWA usage
- Reduced MSR VaR reflects dampened sensitivity profile based on model implemented in December
- VaR limit reductions are in the pipeline both for MSR (from $90mm to $55mm) and CIO (reduction from $95mm under review)

	VaR	mVaR
Global CIO 10Q	50.3	26.1
- CIO International	48.3	21.9
- CIO North America	8.6	6.7
MSR	4.9	2.2



CIO Market Risk Summary

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CIO Reinvestment Activity – 3Q11 through YTD12

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CIO Reinvestment Activity – 3Q11 through YTD12

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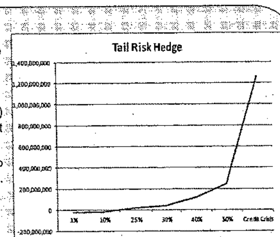
CIO International Core Credit: Tail Risk Book

Currently the Core Credit Book is:

1. **An option** with positive convexity, positive carry and upside on large spread widening and default waves (similar to 2008-2009)
2. **Current Position:**
   - I. **US** mortgage-related issuers (Radian, MGIC, ILFC, RESCAP, ALLY) may file as the US Government and banks are looking for a settlement on past underwriting practices
   - II. **Europe** countries including Greece and Portugal may opt to restructure some national champions like banks or telecom operators. These events could generate US$200mm-500mm P&L gains



Capital

- This is a Tail Risk Book that had under Basel I an RWA cost of US$5bln and from 2007-2011 has generated US$2.4bln total return
- Under Basel 2.5, Risk Weighted Assets are estimated to increase 5-8x (methodology still in development); this would increase the RWA of the core credit book to US$36bln however, CIO is currently working to reduce this to US$20bln for year end 2012
- Despite effectiveness of the Tail Risk Book hedging credit portfolio, the change in regulatory capital regime is likely to force a re-size / run-off of synthetic portfolio in order to maintain RWA targets for the Firm
- CIO continues to coordinate with IB Risk to improve the applicable RWA and capital levels

MARCH 2012

Directors Risk Policy Committee – CIO 2012 Opportunities and Challenges

Chief Investment Office

Ina Drew
Irv Goldman

Permanent Subcommittee on Investigations
EXHIBIT #81

STRICTLY PRIVATE A

J.P.Morgan

JPM-CIO-PSI 0015015

Mandate and Approach

KEY MANDATE: Optimize and protect the Firm's balance sheet from potential losses, and create and preserve economic value over the longer-term.

LONGER ← INVESTMENT HORIZON → *SHORTER*

Longer-term Investing				*Strategic Investing & Risk Management*			[redacted]
Private Equity	**Retirement Plan**	**Special Investments**	**COLI BOLI**	**Strategic Asset Allocation**	**FX Hedging**	**MSR Hedging**	[redacted]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[redacted]
$3.5bn AUM	$11.0bn AUM	TBD	$8.8bn AUM	$(139) mm BPV structural risk	$17bn nominal structural risk	$(21) mm BPV structural risk	[redacted]
Position in run-off mode	YTD 2012 estimated return 5.7%	First two investments completed	Allocation to mortgages and high grade credit	Reduced interest rate allocation, rotating into credit	Some open currency exposures, primarily Asia and Latam	Close to fully hedged post model update	[redacted]

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J.P.Morgan

JPM-CIO-PSI 0015016

Overview

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Business Structure

- Manage the portfolio with TRR mindset, delivering on
  - Financial returns vs budget
  - RWA limits
  - Risk adjusted returns (OCI and liability marked)
- Allocation of $153bn in RWA and $6.9bn in capital against AFS and MTM activities
  - AFS investment portfolio $110bn in RWA
  - MTM activities $43bn in RWA
  - Reallocation trend of RWA from MTM to AFS
- 430 people worldwide

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Governance Structure

- Expanded Management Committee
  - Operating issues
- Investment Committee
  - ALM and Investment portfolio review, analytics and asset allocation
- CIO Risk Committee
  - Management of aggregate market, credit, reputation and operational risks

CIO Risk Summary – COB March 6, 2012

DoE

Credit Crisis Stress

FX Capital Hedging

Country Risk

SAA Risk

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OEP FX Hedging Summary

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MTM Overlay

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MSR Hedging Program

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Synthetic Credit Summary

Portfolio	Spr01	Spr+10%	Up50%	Lg Fltn Selloff	Sml Fll Selloff	Var95	Contrib Var95
Core Strategic	(25.4)	8.9	(38.1)	1,428.1	80.1	48.6	48.3
Core Tactical	0.1	12.6	20.6	87.8	50.4	8.4	2.3
Synthetic Total	(25.3)	21.5	(17.5)	1,515.9	130.5	50.5	50.5

088

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Volcker

Proposed Volcker Rule	CIO View
Any trade subject to Market Risk Capital Rules is deemed de facto prop trading	A transaction that is legitimately risk hedging is not prop trading because of the application of accounting and capital rules
Trades held for less than 60 days duration are presumptively prop trading	MTM positions that are true risk mitigation transactions might benefit from short term price movements but are not prop trading
Hedge must be "reasonably correlated" to the risk being hedged, but the preamble to the Rule states the hedge is only permissible when it is "established slightly before" the banking entity becomes exposed to the underlying risk	Purpose of stress tests is to inform the banking entity about risks to which it may become exposed, and based upon that information it is prudent for the banking entity to take risk-mitigating actions. Use crisis as an example of anticipatory hedging

- ALM-Volcker comment letter was submitted to the Clearing House and SIFMA for industry submission
- Included as part of JPM comment letter on Volcker Rule specific examples of actions taken during the crisis that need clarification under the Rule as written
- Held meetings with Fed and OCC in late January. Scheduling meetings with the FDIC and CFTC

From: mcmanus_william@jpmorgan.com
Sent: Fri, 30 Mar 2012 22:12:22 GMT
To: JOHN.WILMOT@jpmorgan.com; peter.weiland@jpmchase.com
CC: Ina.Drew@jpmorgan.com; achilles.o.macris@jpmorgan.com; anthony.m.brown@jpmorgan.com; javier.x.martin-artajo@jpmorgan.com; bruno.m.iksil@jpmchase.com; phil.lewis@jpmorgan.com; irvin.j.goldman@jpmchase.com; david.bjarnason@chase.com; Ashley.Bacon@jpmorgan.com; steinar.zinke@jpmorgan.com; John.J.Hogan@jpmorgan.com; hema.s.coombes@jpmchase.com; alison.c.giovannetti@jpmorgan.com; kastl_edward@jpmorgan.com; paul.t.bates@jpmchase.com; Jason.LDN.Hughes@jpmorgan.com; keith.stephan@jpmorgan.com; Keith.Enfield@jpmorgan.com; rory.h.oneill@jpmchase.com; Douglas.Braunstein@jpmorgan.com; warren_shannon@jpmorgan.com; jean-francois.bessin@jpmorgan.com; Daniel.Pinto@jpmorgan.com; frank.j.pearn@jpmorgan.com; graham.j.meadows@jpmorgan.com; hatzopoulos_alexander@jpmorgan.com; mcmanus_william@jpmorgan.com; Paul.A.Ricci@chase.com; jorn.x.rose@jpmorgan.com; john.r.buttarazzi@jpmchase.com; andrew.c.challen@jpmchase.com; spencer.x.john@jpmorgan.com; avis.b.rodriguez@us.pwc.com; lauren.m.tyler@jpmorgan.com
Subject: Audit Report: EMEA CIO Credit - Market Risk and Valuation Practices (Rating: Needs Improvement)

Audit Department Report

EMEA CIO Credit - Market Risk and Valuation Practices

Report Number: G-12/003
Audit Rating: Needs Improvement
Report Date: March 30, 2012
Audit Type: Audit

Prior Report Number: G-10/003
Prior Report Date: February 26, 2010
Prior Report Rating: Satisfactory

Prior Audit Type: Audit

Business Overview and Context
The CIO EMEA credit portfolio is made up of 'Investment' and 'Core Credit' portfolios. The Investment portfolio consists of Asset Backed Securities (ABS), Collateralised Loan Obligations (CLOs), Mortgage Backed Securities (MBS) and Rates products (Corporate & Government Bonds) and had a total notional of approximately $157 billion as of 12/31/11, $140bn within the strategic asset allocation (SAA) book and $17bn in the tactical asset allocation (TAA) book. The Core Credit portfolio primarily consists of derivative positions such as the CDS indices and tranches and had a total notional value of approximately $50 billion as of 12/31/11.

The Market Risk team is an independent control function within the CIO whose primary responsibilities are identifying, defining and monitoring appropriate measurement techniques to control market risk, using information provided by the JPMorgan risk infrastructure. CIO Valuation Control Group (VCG) is also an independent control function within the CIO responsible for price testing and fair value adjustments.

Audit Scope
The audit scope focused on risk and controls specifically relating to:

- Market Risk including the risk limits and sensitivities, VAR methodology and stress testing;
- Monthly valuation and reserve processes including independent price testing and provisioning;
- The completeness of positions included in the market risk and financial valuation processes.

Key Findings
The controls supporting the EMEA CIO Credit market risk management and valuation practices are being rated 'Needs Improvement' due to the following:

CIO VCG Practices
CIO utilise a number of risk and valuation models which have not been subject to review by the Model Risk Group. While there may be instances where the use of unapproved models is acceptable for a predefined period of time, no reserves are currently taken to account for positive P/L on unapproved models used for valuation purposes (i.e. Swaptions - Unapproved Model - Positive P/L $18m).

In addition, Audit noted deficiencies in the EMEA CIO VCG practices including the absence of a formally applied price sourcing hierarchy, insufficient consideration of potentially applicable fair value adjustments (e.g. concentration reserves for significant credit indices positions) and the lack of formally documented/consistently applied price testing thresholds. There is also a lack of transparency and quantitative assessment of the considerable judgment used to price test the CLO book given the inherent valuation uncertainty with the positions.

Market Risk

- Stress Testing - There is no documented stress testing methodology to outline key testing components (e.g. computational method and shock factors used) or assess limitations such as off-line risk measurement, missing risk factors and curves. As a result, Audit was unable to fully assess the stress testing framework and related scenario outputs.
- Market Risk Management Practices - The SAA book ($140Bn Notional as at 12/31) does not currently feed the firm wide market risk limits and thresholds framework and relevant SAA stress testing results are not measured against corresponding limits. CIO also does not explicitly measure the portfolio sensitivity to certain potentially applicable risk measures.
- Market Risk Models - EMEA CIO is currently using unapproved models in the calculation of risk (including VaR) and associated risk measurement methodologies have not been appropriately documented and/or catalogued.

VaR Data Controls
While Audit found no specific examples of incomplete or inaccurate data, the control process around the offline VaR calculation needs to be enhanced to ensure completeness and accuracy of Credit trade data used in the offline calculation of VaR.

Root Cause
Root cause: Poorly documented CIO VCG practices and failure to comply with firmwide risk management standards.

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ianagement agrees with the reported issues and is implementing corrective actions.

Business Details
Level 1: Chief Investment Office
Business Executive: Ina Drew

Level 2: CIO
Business Executive: Achilles O Macris, John Wilmot, Phil Lewis, Irvin J Goldman

Location: United Kingdom, EMEA
Business Executive: Achilles O Macris

Audit Details
Management Team Member: Hatzopoulos, Alexander X
Audit Manager: John R Buttarazzi
Auditor In Charge: Andrew C Challen

—— = Redacted by the Permanent Subcommittee on Investigations

Detailed Findings and Management Action Plans

Issue: CIO VCG Practices
Audit testing identified several deficiencies and inconsistencies in EMEA CIO VCG practices and methodologies. Specifically:

- CIO is not currently deferring positive P&L generated from unapproved valuation models. Specifically, several unapproved models (Primus Sabre, AUB Option, Offline TDR, Prime Whole Loan, CMBX, Bond) are currently being used for valuation purposes without any corresponding reserves. Per VCG, associated 2011 P&L was predominantly limited to Swaptions totalling $18m.
- CIO VCG lacks a formally documented price sourcing hierarchy to govern the consistent use and appropriate application of independent prices for price testing purposes. Audit also noted that in price testing high grade corporate bonds, CIO VCG inappropriately utilises an indicative report sent by JPM Asset Management (JPMAM), basod on their incorrect understanding that such prices were validated by JPMAM's price testing function. Utilising Bloomberg prices, Audit estimated a price testing increase of $58m at 12/31/11. Separately, emerging market bonds are being price tested at mid levels, which is inconsistent with the front office marking at bid and resulted in an Audit estimated price testing decrease of $50m.
- There is no evidence of CIO VCG review to ensure the ongoing validity of thresholds applied to corporate, EM, government and government guaranteed bond price testing. Further, while the formally documented bond price testing threshold is +/- 1.5 price points (which would result in minimal required adjustments) different thresholds are actually applied by EMEA VCG without sufficient transparency or evidence. At year-end, Audit's independent bond price testing using dynamic thresholds resulted in an estimated $110m net increase. In addition, thresholds used to determine which price testing differences require adjustment are not clearly defined for Credit Indices.
- Concentration FVA was not calculated or applied for credit indices to account for the significant market positions. While the subsequently calculated potential concentration FVA of $13m would not have resulted in a required adjustment based on the CIO policy (which only requires taking the larger of the liquidity or concentration FVA), the policy's appropriateness should be reassessed.
- [redacted]

Root Cause: Insufficient assessment/formalisation of certain price testing methodologies and poorly documented CIO VCG prectices.

Action Plan
CIO will review current methodology to ensure consistency in application and appropriate practices are utilised. Specifically, CIO VCG will:

- Implement and evidence enhanced oversight of positive P&L being generated from unapproved and disapproved models, with reserves as necessary.
- Define and implement a price sourcing hierarchy to ensure a consistent and appropriate price sourcing and testing approach.
- Ensure price testing is performed consistently with front office marking policy.
- Document the rationale for current Bond price testing thresholds and reassess as necessary; clearly define price testing thresholds for ABS and CDS.
- Improve evidence of the monthly VCG ABS price testing process in order to enable re-performance.
- Reconsider the appropriateness of the existing credit indices price testing policy to ensure concentration is sufficiently incorporated.

Target Date: July 31, 2012
Issue Owner: Jason LDN Hughes

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Issue: Market Risk Management and Stress Testing Practices
Audit noted the following with regards to the market risk management framework, which is currently subject to a comprehensive reassessment by the CIO:

- There is no stress testing methodology documentation in place to outline key testing components (e.g. computational method and shock factors used for each asset class) or assess limitations such as offline risk measurement, missing risk factors and curves. Therefore Audit was unable to fully assess the validity of the stress testing framework and scenario outputs.
- The SAA book ($140bn Notional as at 12/31) does not currently feed the firm wide market risk limits and thresholds framework. While there is SAA portfolio stress testing and risk measurement of non statistical measures (e.g. CS01 and CSW), these exposures are not measured against corresponding limits. In the context of a large sell off scenario, the stress loss for AFS Credit is estimated to be $2.6bn.
- CIO does not explicitly measure the portfolio sensitivity to certain potentially applicable risk measures such as bond/CDS basis, index basis and prepayment risk to facilitate sufficient consideration of corresponding risk management and controls.
- The Single Name Position Risk (SNPR) issuer exposure is misstated for the trading portfolio as it does not incorporate a disaggregation of the credit index tranche exposure at issuer level.
- [redacted]

Root Cause: Market risk management practices have not been recently assessed or updated.

Action Plan

1. Comprehensive stress testing methodology documentation will be produced and specifically include shock factors (including FSI alignment) and an assessment of all risk factors. (Target Date: July 31, 2012)
2. CIO is currently undertaking a comprehensive review of the risk measurement and limits framework across all asset classes to assess potentially required enhancements including whether additional risk factors are required for inclusion. (Target Date: July 31, 2012)
3. CIO is in the process of implementing new functionality to enable the disaggregation of the credit index tranche for SNPR risk measurement purposes. (Target Date: September 30, 2012)
4. [redacted]

Target Date: July 31, 2012
Issue Owner: Keith Stephan

[redacted]

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Permanent Subcommittee on Investigations

Issue: Market Risk Models
CIO is currently using unapproved models in the calculation of risk (including VaR) and associated risk measurement methodologies have not been appropriately documented and/or catalogued. Specifically:

- CIO specific amendments to approved IB VaR methodologies have not been documented or submitted to MRG for review. Unapproved amendments pertain to the production of P&L vectors and the use of proxies.
- CIO generate non statistical risk measures used for risk management, stress and VaR measurement via the internally developed West End analytics model, which has not been submitted to MRG for review.
- Documentation for all product sensitivity inputs used in CIO VaR models was not maintained in the Global Model Database (GMD), as required.
- The CIO Quantitative Research (QR) model inventory is incomplete. For example, the application of VaR and sensitivity models to specific product types is not included.

Root Cause: Model documentation for VaR and non statistical models was not appropriately maintained and submitted to MRG for review.

Action Plan

1. CIO will document all amendments to the approved VaR model and submit to MRG for review.

2. CIO will document the West End Analytics engine and submit to MRG for review.
3. The QR model inventory and GMD will be updated as appropriate.

Target Date: June 30, 2012
Issue Owner: Keith Stephan

Issue: VaR Data Controls
While Audit found no specific examples of incomplete or inaccurate data, the control process around the offline VaR calculation needs to be enhanced to ensure completeness and accuracy of Credit trade data used in the offline calculation of VaR for the Credit Sectors. Specifically:

- For Synthetic Credit, controls require enhancement to ensure the completeness and accuracy of trade positions used in the market risk VaR model, which are sourced from Primus via a stored procedure.
- For Secured Credit, controls require enhancement to ensure the completeness and accuracy of the sensitivity data (CSO1) used in the market risk VaR model and sourced from the trader maintained blotter (which is used as the central source of position and risk information for VaR reporting).

In addition, no SOX testing was being performed on these manual processes, which require designation as key SOX controls.

Root Cause: A lack of clear handshakes for ensuring the completeness and accuracy of VaR feeds in the off-line process.

Action Plan
1. CIO MO will implement daily controls to ensure the completeness and accuracy of data used in the off-line calculation of VAR.
2. Following successful implementation of the above, Middle Office manager to deem control as a SOX key control and test as necessary going forward.

Target Date: May 31, 2012
Issue Owner: Hema S Coombes

Issue: VCG reporting
Audit noted the following with regards to VCG reporting to senior management:

- Pre- and post- price testing threshold results are not being reported.
- There is no historical analysis or trending of key valuation matrics with only the current month being reported.
- High grade bond price testing results that were reported to senior management varied from the underlying calculation files by $11m due to a manual reporting error. However, this issue did not result in a financial statement impact.

Root Cause: Insufficient focus on ensuring the appropriateness of VCG reporting to senior management.

Action Plan
VCG will enhance their reporting to senior management to provide transparency and analysis.

Target Date: June 30, 2012
Issue Owner: Jason LDN Hughes

Issue: Manual Errors within Price Testing and FVA Process
Controls over spreadsheets used for price testing purposes are not appropriately designed, resulting in several manual errors totalling $13m, $1.4m of which had a financial statement impact. The $1.4m error ($31m reported versus $32.4m actual) was primarily the result of several off-the-run credit indices being excluded. Other errors noted include VCG using an incorrect benchmark for 37 of the bonds tested and EUR/GBP high grade corporate bond positions not being converted into USD before aggregation for reporting purposes.

Root Cause: Controls over spreadsheets used for price testing purposes are not appropriately designed.

Action Plan
CIO VCG will implement sufficient spreadsheet control and governance processes in the VCG process to sufficiently minimise the risk of manual errors.

Target Date: July 31, 2012
Issue Owner: Jason LDN Hughes

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– End Report –

From: Drew, Ina <Ina.Drew@jpmorgan.com>
Sent: Thu, 05 Apr 2012 21:05:18 GMT
: macris@btinternet.com
CC: Wilmot, John <JOHN.WILMOT@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>
Subject: Fw: Jamie's fine with this.

From: Drew, Ina
Sent: Thursday, April 05, 2012 04:53 PM
To: Evangelisti, Joseph; Zubrow, Barry L
Subject: Re: Jamie's fine with this.

Point two. Assets and liabilities

We do not disclose cio earnings - part of corporate

From: Evangelisti, Joseph
Sent: Thursday, April 05, 2012 04:45 PM
To: Drew, Ina; Zubrow, Barry L
Subject: Jamie's fine with this.

---

m: Dimon, Jamie
Sent: Thursday, April 05, 2012 4:45 PM
To: Evangelisti, Joseph
Subject: Re: Revised: WSJ/Bloomberg CIO stories

Ok

From: Evangelisti, Joseph
Sent: Thursday, April 05, 2012 04:44 PM
To: Drew, Ina; Dimon, Jamie; Hogan, John J.; Scher, Peter L; Zubrow, Barry L; Staley, Jes; Cutler, Stephen M; Radin, Neila; Braunstein, Douglas; Wilmot, John
Subject: Revised: WSJ/Bloomberg CIO stories

Here are some revised points based on your comments. The WSJ's deadline is in 10 minutes. Thanks, Joe

- The Chief Investment Office is responsible for managing and hedging the firm's foreign exchange, interest rate and other structural risks.
- CIO is focused on managing the long-term structural liabilities of the firm and is not focused on short-term profits.
- Our CIO activities hedge structural risks and invest to bring the company's asset and liabilities into better alignment.
- Our CIO results are disclosed in our quarterly earnings reports.
- We cooperate closely with our regulators, who are aware of our hedging activities.

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- Background: Not correct to attribute gains to a single trader. Members of the CIO take long-term hedging positions in the context of our overall liquidity management structure.

- Background: $200 billion vastly overstated. $600 million in gains overstated.

- Won't comment on a specific people.

From: Evangelisti, Joseph
Sent: Thursday, April 05, 2012 4:06 PM
To: Drew, Ina; Braunstein, Douglas; Hogan, John J.; Staley, Jes; Scher, Peter L
Cc: Dimon, Jamie; Youngwood, Sarah M
Subject: WSJ/Bloomberg CIO stories

The Wall Street Journal and Bloomberg are working on prominent stories about Bruno Iksil, a managing director in our Chief Investment Office in London.

They are saying that Iksil currently has more than $200 billion in positions in credit trading products and has made JPM more than $600 million in profits over the past two years. They said his current CDS positions on the IG9 Index are roiling the market and that some of his positions may result in losses.

More generally, the WSJ and Bloomberg are saying that JPMorgan basically has a large proprietary trading shop hidden in its CIO, and that many analysts are unfamiliar with specifics around its activities. They also say that with increased capital rules the upcoming Volcker Rule, these activities could come under pressure.

I'd like us to hit hard the points that the CIO's activities are for hedging purposes and that the regulators are fully aware of our activities. I'd like to give them the following on the record:

- The Chief Investment Office is responsible for managing and hedging the firm's liquidity, foreign exchange, interest rate and other structural risks.

- Gains in the CIO offset and hedge losses in other parts of the firm.

    - The investments and positions undertaken by the CIO are to hedge positions and losses in other parts of the firm and are done in the context of our overall company risk management framework. Hedging gains reflected in our financial statements represent one side of a transaction that is hedging a loss in one of our main businesses.

- We cooperate closely with our regulators, and they are fully aware of our hedging activities.

- Background: Not correct to attribute gains to a single trader. Members of the CIO take long-term hedging positions in the context of our overall liquidity management structure.

- Background: $200 billion vastly overstated. $600 million in gains overstated.

- Won't comment on a specific people.

From: Drew, Ina <Ina.Drew@jpmorgan.com>
Sent: Thu, 05 Apr 2012 21:58:38 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>; Staley, Jes <jes.staley@jpmorgan.com>; Cutler, Stephen M <stephen.m.cutler@jpmorgan.com>; Maclin, Todd <TODD.MACLIN@chase.com>; Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Erdoes, Mary E <mary.erdoes@jpmorgan.com>; Smith, Gordon <gordon.smith@chase.com>; Petno, Douglas B. <Douglas.B.Petno@jpmorgan.com>; Bisignano, Frank J <frank.j.bisignano@jpmchase.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Cavanagh, Mike <mike.cavanagh@jpmchase.com>
Subject: CIO

I want to update the operating committee on what is going on with the credit derivatives book in CIO especially given a wsj article which will come out tomorrow.

One of the activities in cio is a credit derivatives book which was built under Achilles in London at the time of the merger. The book has been extremely profitable for the company (circa 2.5 billion) over the last several years. Going into the crisis, we used the instrumentation to hedge mortgage risk and credit widening. Recently, in December, the book outperformed as it was positionned in for "jump" risk or default risk throughout the summer as a relatively inexpensive hedge for fallout from weak markets during the european crisis. The fourth quarter 400 million gain was the result of the unexpected american airlines default.

Post December as the macro scenario was upgraded and our investment activities turned pro risk, the book was moved into a long position. The specific derivative index that was utilized has not performed for a number of reasons. In addition the position was not sized or managed very well Hedge funds that have the other side are actively and aggressively battling and are using the situation as a forum to attack us on the basis of violating the Volcker rule

Having said that, we made mistakes here which I am in the process of working through. The drawdown thus far has been 500 mil dollars but nets to 350 mil since there are other non derivative positions in the same credit book. The earnings of the company were not affected in the first quarter since we realized gains out of the 8.5 billion of value built up in the securities book.

John Hogan and his team have been very helpful. I wanted my partners to be aware of the situation and I will answer any specific questions at oc monday.

Have a good holiday.

From: Drew, Ina <Ina.Drew@jpmorgan.com>
Sent: Wed, 02 May 2012 13:34:09 GMT
To: Drew, Ina <Ina.Drew@jpmorgan.com>
Subject:

LEADING INTO THE CRISIS AND ECONOMIC DOWNTURN:

IN DISCUSSION WITH JD. CIO DECIDES TO BUY CREDIT PROTECTION . USING INSTRUMENTATION ON THE SYNTHETIC CREDIT DERIVIATIVES MARKET , PRINCIPALLY IN THE HIGH YIELD SPACE

WHICH LEFT US SHORT RISK OR LONG PROTECTION IN WHICH CASE THE POSITION WOULD PROFIT AS HIGH YIELD COMPANIES DEFAULTED. AS TIME PROGRESSED AND THE FILINGS OCCURRED, THIS POSITION WAS BALANCED TO A MODERATE EXTENT WITH INVESTMENT GRADE LONG RISK POSITIONS.

OVER THE LAST 5 YEARS, THE POSITIONS MADE APPROXIMATELY 2.3 BILLION DOLLARS, WERE REASONABLY STABLE WITH PREDICTABLE P L ALTHOUGH THERE WERE A COUPLE OF PERIODS OF DISTORTIONS MAINLY CENTERED AROUND SYSTEMATIC MARKET EVENTS INCLUDING LEHMAN AND AIG.

IN NOVEMBER OF 2011 THE POSITION WAS QUITE STABLE AND IN BOUNDS FROM ALL PERSPECTIVES.

WHAT HAPPENED?

FOUR THINGS HAPPENED AROUND THE MONTH OF DECEMBER TO CHANGE MY THINKING ON THE NEED FOR A PRO DEFAULT BIASED HEDGE .

1. THE COMPANY WAS STARTING TO DO THE MATH AROUND THE BASLE III RWA RULES. THE SAME BOOK THAT WAS DRAWING20 OF CAPITAL UNDER BASLE I (THE REGIME THAT WAS IN PLACE DURING THE ENTIRE TIME OF THE HEDGE CONSTRUCTION) WAS GOING TO NEED APPROXIMATELY 60 BIL OR THREE TIMES THE CAPITAL TO SUPPORT
2. WE HAD A BIG PAY DAY. AMERICAN AIRLINES FILED EARLY AND WE OWNED IN THE HIGH YIELD HEDGE, A SIGNIFICANT OPTION ON THAT OUTCOME. WE RECORDED $450 MILLION OF GAINS. ALTHOUGH THIS WAS A POSITIVE EVENT FOR THE BOOK, THE HIGH YIELD MARKETS WERE RIOLED AND DISLOCATED FOR THIS AND OTHER TECHNICAL REASONS.
3. THE LTRO IN EUROPE WAS ANNOUNCED ON DECEMBER 8^{TH} PROVIDING STRONG SUPPORT FOR THE CREDIT UNIVERSE.
4. THE ECONOMY, PARTICULARLY IN THE UNITED STATES WAS LOOKING MUCH BETTER FROM ALL MACROECONOMIC STATISTICS AND WAS FURTHER FUELED BY THE LARGE SCALE EUROPEAN LILQUIDITY INJECTION. WE HAVE A PRO RISK THEMATIC THROUGH THE INVESTMENT BOOKS.

BOTTOM LINE: FOR ALL OF THE REASONS CITED, WE MADE A DECISION TO REDUCE THE SIZE OF THE HIGH YIELD SHORT.

THE TRADERS WERE DETERMINING HOW BEST TO REDUCE THE SHORT IN THE HIGH YIELD MARKET GIVEN THE DESCRIBED LACK OF LIQLIUIDITY IN THE HIGH YIELD MARKET. A DIRECT REDUCTIONOF THE EXPLICIT POSITION WAS DEEMED NOT POSSIBLE AND ENORMOUSLY EXPENSIVE.

THE DESK THEN TURNED TO THE NEXT BEST PROXY WHICH IS CALLED THE IG9 INDEX. IT IS AN OLD INDEX FROM 2007. COMPOSED OF 125 EQUALLLY WEIGHTED NAMES. WHICH MADE SENSE GIVEN THAT THE INDEX HAD 5 NAMES INCLUDING RADIAN, MBIA, ISTAR AND SPRINT OR COMMONALITY IN SINGLE NAMES THAT WOULD DIRECTLY OFFSET THE HIGH YIELD POSITION. THIS CHOICE WAS VIEWED AS HAVING AMPLE LIQLUIDITY AND A GOOD PROXY TO REDUCE THE SHORT.

LIMIT

THE CONSTRAINING OPERATING LIMIT IN PLACE WAS VAR AND THE VAR HAD BEEN A GOOD PREDICTOR OF THE RISK. IN FACT, AS POSITIONS WERE ADDED THE VAR WAS COMING DOWN WHICH WAS ALSO A KEY DRIVER OF THE INTENDED CAPITAL REDUCTION.

THE DESK ADDED A VERY LARGE INVESTMENT GRADE POSITION TO TRY TO KEEP UP WITH THE REBALANCING THAT BELIEVED WAS NECESSARY AS THE HIGH YIELD MARKET WAS RISING IN PRICE.

WHAT WENT WRONG?

THIS IS WHERE AND HOW THE MAJOR PROBLEMS STARTED.

FIRST WE DID NOT HAVE LIMITS CONSTRAINING THE NOMINAL AMOUNTS OF POSITIONS THAT WOULD CLEARLY HAVE FLAGGED THE PURCHASES AS TOO LARGE AND CONCENTRATED FOR THE UNDERLYING LIQUIDITY OF THE MARKET DESPITE THE FACT THAT THE RISK EQUIVALENT OF THE PURCHASES WERE WITHIN LIMIT.

THE MODEL GOT IT WRONG. ALL THE THEORETICAL UNDERPINNINGS OF VALUATION HAVE BROKEN DOWN AND THE VOLATILITY HAS BROKEN ALL HISTORICAL AND WORSE CASE BANDS.

THERE WAS NO ELEVATION OF THE SIZE OF THE POSITION CHANGE OR A DISCUSSION AROUND THE MAGNITUDE OF NEW LONG RISK BEING ADDED TO EFFECTVELY CLOSE DOWN OR BALANCE THE SHORT HIGH YIELD POSITION.

THE RESULT

THE RESULT IS A VERY LARGE, CONCENTRATED POSITION WHICH RETAINS ITS PRO DEFAULT PROPERTIES UNTIL THE END OF THE YEAR, IE STILL SHORT THE HIGH YIELD MARKET.

HOWEVER THE OVERALL BOOK IS LONG AGGREGATE CREDIT PRINCIPALLY IN INVESTMENT GRADE IN EUROPE AND THE UNITED STATES.

THE STRESS LOSS HAS FLIPPED FROM A POSITIVE RESULT TO A NEGTIVE RESULT SHOULD THERE BE A SEVERE SHOCK OR DOWNTURN.

WHAT ARE WE DOING?

THE FIRM WITH SIGNIFICANT HELP FROM THE INVESTMENT BANK AND THE RISK MANAGEMENT ORGANIZATION IS FRAMING A RISK REDUCTION PLAN THAT IT HAS STARTED TO GENTLY IMPLEMENT. THIS WILL TAKE AT LEAST THREE MONTH. WE ARE UNABLE TO PREDICT THE SIGNIFICANT P L VOLATILITY THAT MAY ARISE AS A CONSEQUENCE.

I HAD STARTED REDUCING THE ALLOCATION TO INVESTMENT GRADE CREDIT IN THE INVESTMENT PORTOLIO IN THE FIRST QUARTER AND AM ACCELERATING THOSE SALES TO MONETIZE SOME OF THE 9 BIL OF GAINS WE HAVE HARVESTED FROM THOSE CASH INVESTMENTS. WE CONSIDER THOSE SALES TO BE BOTHI GOOD ECONOMIC SALES AND ALSO THE RIGHT THING TO DO TO BRING DOWN THE FIRMS EXPOSURE TO CREDIT, ALBEIT TOP OF THE CAPITAL STRUCTURE, WHILE THE RISK REDUCTION PLAN FOR THE EXCESS PSOTION IN THE CREDIT DERIVATIVES BOOK IS BEING UNWOUD.

WE ARE WORKING THROUGH THE 10Q DISCLOSURE AND DOUG AND JAMIE ARE WEIGHING THE RISK REWARD TO THE COMMUNICATION PLAN AROUND A PRESS RELEASE AND ANAYST MEETRING AND THE POTENTIAL IMPACT ON THE MARKET AND OUR ABILITY TO REDUCE THIS POSITION.

WHAT WENT WRONG:

From: Macris, Achilles O <achilles.o.macris@jpmorgan.com>
Sent: Sun, 08 Apr 2012 23:14:32 GMT
To: Drew, Ina <Ina.Drew@jpmorgan.com>
CC: Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Dimon, Jamie <jamie.dimon@jpmchase.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; macris@[redacted]
Subject: Synthetic Credit Summary

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Hi Ina,

Following up from our earlier call, here is a summary of our synthetic credit activity, results and outlook for Q2.

Year-to-date the synthetic book is -$525MM. Offsets in other credit positions limit the Q1 loss to -$350MM, while the Q1 CIO Int'l financial income was +$830MM including the synthetic book. The Q1 TRR (including OCI delta) is $3.2bio year to date.

The synthetic credit book, as a dedicated hedge to our credit longs, continues to be short HY. In Q4, we decided to neutralize the risk profile of this book for two reasons: a) the large realized gains around the AMR events, and b) given our large investment program in cash credit securities and related view.

Our attempt to neutralize the book has been unsuccessful. We ended up losing a predictable -575MM on HY shorts, however the IG hedge delivered only +50MM. Although investment grade performed very well in Q1 and the relationship between HY and IG also worked in our favour, two idiosyncratic factors rendered our hedge ineffective:

1. **Our longs, IG.9 and ITX.9 forwards, are in the off-the-run curves which steepened +24bps.** Excess liquidity and the pro-risk environment drove carry traders to the front-end.

2. **Our longs underperformed the on-the-run indices as they contain specific high-risk names** in the old series (CDX.IG.9 contains Radian, MBIA, Countrywide, ILFC, iStar Financial, RR Donnelly; iTraxx.S9 contains Hellenic Telecom, Banco Espirito Santo, Portugal Telecom, Dixons, Elec. de Portugal).

The reason, however that we have chosen these IG proxies is because these are the very names that we are short in HY instruments.

Therefore, although thus far unsuccessful, these IG proxies best neutralize and balance our synthetic books to event risk. This has been reflected in the VaR and Stress VaR. Overall, we still remain short these names with a pro-default jump risk profile.

The book is overall risk balanced, given the cross-market long/short and has positive carry of $2MM/day, while retaining upside on defaults (see graph below).

For final Q2 we estimate a P&L range of -150MM to +250MM. Intra-quarter P&L could exceed this range, but not significantly.

The above estimate does not include P&L on default events, which is significantly positive, as shown in graphs below.

It is my impression that the recent market attention to our IG.9 activities maybe due to the market's incorrect perception that we are outright long IG.9 index with a related default risk profile. We are not.

I think it would be much more likely that the significant market shorts in IG.9 10Y will need to be covered. Many dealers hold significant shorts in IG.9 against legacy CDO portfolios, and as hedges to illiquid single-name inventory.

Related to IG.9, the most rewarding, <u>short-term</u> catalyst for CIO would be an MBIA related default event and

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subsequent curve flattening. Alternatively, a settlement or positive case outcome for MBIA would be bullish and would support a rally in the forwards. Our P&L profile in this case would be in the above range of -150 to +250MM, and more carry dependent. Unfortunately this scenario would tie up augmented RWA further forward.

Best,
Achilles

From: Drew, Ina <Ina.Drew@jpmorgan.com>
Sent: Mon, 09 Apr 2012 22:39:52 GMT
To: Serpico, Gina <Gina.Serpico@jpmorgan.com>
Subject: Fw: Deliverables for meeting tomorrow

Print

From: Wilmot, John
Sent: Monday, April 09, 2012 06:38 PM
To: Drew, Ina; Macris, Achilles O; macris@[redacted]Martin-Artajo, Javier X
Cc: Goldman, Irvin J
Subject: RE: Deliverables for meeting tomorrow

A couple of follow-ups separately from a conversation I had with Doug late this afternoon:

- Profile of maturity of the Index and Tranche positions (driven by the discussion on the handout Appendix: Position CDX IG position changes since June 2011 allocated to IG9 forward trade)
- Doug had the question of why we just didn't reduce the HY position to reduce our risk rather than going long the IG 9 (we discussed carry (ie associated p&l) but he makes the relevant point that from an RWA perspective this might be less economic)
- Lastly, Doug wanted some history relative to current positions (longs and shorts) and what were the relative indicative credit spreads at entry against current spreads

My follow-up question from this morning's discussion:

- On the Appendix page referenced above: Can you explain to me the trend in risk trend highlighted in the far right column "Net CDx IG index position on "5yr" bucket""? It went from -14.4bn in Feb to -0.96bn in Mar to +12.1bn in April. Did the $8bn in IG5.75yr exposure add between Mar and Apr solely drive the $13bn addition to the Net CDx IG position?
- I think for reference purposes we also need to consider any statements around market volumes and days to liquidation carefully especially as it relates to p&l impact

John C. Wilmot | Chief Investment Office | john.wilmot@jpmorgan.com | Work: (212) 834-5452 | Cell: [redacted]

From: Drew, Ina
Sent: Monday, April 09, 2012 5:42 PM
To: Macris, Achilles O; macris@[redacted]Martin-Artajo, Javier X
Cc: Goldman, Irvin J; Wilmot, John
Subject: Deliverables for meeting tomorrow

[redacted] = Redacted by the Permanent Subcommittee on Investigations

-Index/Tranches – Gross Notionals, nets – itemized for central clearing or counterparty risk

Table with spreads and VIEWS on spread moves with p /l associated. This is for Jamie and Doug.
It is an extension of the table you provided that shows spread moves monthly.

Redacted - Non-Public Supervisory InformationRedacted - Non-Public Supervisory Information

'st of questions that we MAY or may not use for specific discussion with the GR (Hill)

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We can review all and start a process for follow up things we need to address for risk management etc.

John/Irv – anything to add.

lease make sure ALL e mails are distributed to me John and Irv. We will vet together with you tomorrow and then send out as appropriate.

ACHILLES – your other follow up was with Daniel on FSA**

From: Hogan, John J. <John.J.Hogan@jpmorgan.com>
ɲnt: Wed, 11 Apr 2012 11:18:29 GMT
- J: Staley, Jes <jes.staley@jpmorgan.com>; Zinke, Steinar X <steinar.zinke@jpmorgan.com>
CC: Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Dimon, Jamie <jamie.dimon@jpmchase.com>
Subject: Fw: Credit risk limits

This is the governance used in the IB to control what is currently going on in CIO. We (obviously) need to implement this in CIO as soon as possible. John

----- Original Message -----
From: GREEN, IAN
Sent: Wednesday, April 11, 2012 06:53 AM
To: Bacon, Ashley; Goldman, Irvin J
Cc: Hogan, John J.
Subject: RE: Credit risk limits

CH uses a small number of limits (attached) and a significant reliance on the Structural Risk Measure (SRM - also attached) as the principal business limits. Directional limits tend to be small as the book is managed to be broadly neutral to spreads & correlation. All tranches and index trades are decomposed into Single Name positions and managed against spread-based limits and thru SNPR. We also rely heavily on the Stress Testing framework running 20 spread scenarios and 6 basis scenarios daily. An example Stress page for CH is attached.

ere is a also a significant reliance placed on the risk MIS and periodic reviews of the gross portfolio risks forums like the IRBC..I can send additional commentary on these if required.

Thanks
Ian

-----Original Message-----
From: Bacon, Ashley
Sent: 11 April 2012 00:14
To: Goldman, Irvin J; GREEN, IAN
Cc: Hogan, John J.
Subject: Re: Credit risk limits

Ian, could you please send Irv the structure of CH limits and thresholds (and the SRM).

Thanks

----- Original Message -----
From: Goldman, Irvin J
Sent: Tuesday, April 10, 2012 05:57 PM
To: Bacon, Ashley
Cc: Hogan, John J.
Subject: Credit risk limits

hley,
.n you tell me what IB risk limits and measures we use for credit hybrids outside of var, stress + cs 10 widening.

From: Martin-Artajo, Javier X <javier.x.martin-artajo@jpmorgan.com>
'nt: Wed, 11 Apr 2012 14:59:13 GMT
.o: Drew, Ina <Ina.Drew@jpmorgan.com>
CC: Macris, Achilles O <achilles.o.macris@jpmorgan.com>
Subject: RE: Single names CDS basis relative to IG 9 CDS - URGENT update

---

Ina ,

the market is quiet today . To early to tell but so far about flat P/L . **The tension has stopped now** . The bank's communications yesterday are starting to work . I hope that it keeps this way tomorrow .

regards

From: Drew, Ina
Sent: 11 April 2012 15:53
To: Martin-Artajo, Javier X
Subject: RE: Single names CDS basis relative to IG 9 CDS - URGENT update

How is it going? Any market color today?

.om: Martin-Artajo, Javier X
Sent: Wednesday, April 11, 2012 10:52 AM
To: Staley, Jes
Cc: Drew, Ina; Braunstein, Douglas; Hogan, John J.; Macris, Achilles O
Subject: FW: Single names CDS basis relative to IG 9 CDS - URGENT update

Jes ,

further to your last question on the single names versus index I hope that this clarifies your question .

best regards

Javier

From: Martin-Artajo, Javier X
Sent: 11 April 2012 15:31
To: Drew, Ina
Cc: Macris, Achilles O
Subject: Single names CDS basis relative to IG 9 CDS - URGENT update

Ina ,

regarding the relationship of a CDS index versus its components that is not an exposure that we have in the book . But , it is likely to affect our book given that it is not driving the dynamics of our curve position . The demand for single names in the .st has not affected the index position if you look at the graph below . The basis to theoretical has been somewhere around - 20 bps at the beginning of the year (**Orange line**) and the CDX IG 9 10 Yr (5.75 maturity , ie our long in IG 9 5 Yr as we call

JPM-CIO-PSI-H 0002342

JPM-CIO 0002883

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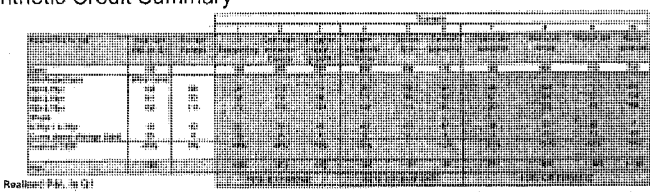
From: Drew, Ina <Ina.Drew@jpmorgan.com>
Sent: Wed, 11 Apr 2012 00:16:29 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>; Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>; Staley, Jes <jes.staley@jpmorgan.com>
CC: Goldman, Irvin J <irvin.j.goldman@jpmchase.com>; Wilmot, John <JOHN.WILMOT@jpmorgan.com>; Macris, Achilles O <achilles.o.macris@jpmorgan.com>
Subject: FW: updated

ALL: Please see attached 2nd quarter scenarios for the Credit Book with descriptions.
We can review all assumptions and answer questions on the 8:30am call. We are working on Jamie's request for
Correlation of the credit book against the portfolio and will also have those numbers at 8:30am.

Synthetic Credit Summary



> **Note regarding P&L Estimate of 10 April 2012**
>
> Today's P&L estimate of -$395MM represents a move 6.5x current VaR95 of $60MM.
>
> Off the run IG.9 curves bear steepened avg +7bps (30% of YTD move), and spreads widened avg +10bps

- **Realised P&L in Q1**
  - Q1 Realised P&L -$580, driven by losses in short risk HY (670MM), vs. +120MM in CDX.IG, and -30MM in ITraxx
  - The IG component has been the main P&L driver of underperformance in Q1, as IG.9 forward long risk positions did not deliver anticipated profits given steepening of the curve. Current book is overall risk balanced, given the cross-market long/short and has positive carry of $2MM/day, while retaining upside on defaults
- **Q2 P&L Estimates - these scenarios do not include 10 April P&L, which would accrete back into each scenario +$400MM, if re-calibrated for today's market moves**
  - -$250MM (New Financial Crisis) implies an average spread widening of +25%, driven by banks/financials undergoing stress. In this case, the portfolio P&L is driven by:
    - +250MM carry
    - -100MM given relative underperformance of IG vs. HY (compression, led by banks/financials widening)
    - -$300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - -$100MM due to spread widening, not offset in this case by curve flattening (we assume here that curves remain 43bps steep in IG equivalents)
  - -$150MM (Status Quo) in this case we assume that market levels and curves 'freeze' at current levels; in this scenario CIO would delta hedge around volatility throughout the quarter
    - +200MM carry
    - -$300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - -$50MM due to long-dated tranche underperformance as observed in Q1
  - +$350MM (Central Scenario) in this case bull steepening of IG curves (+4bps), more than offset by outperformance of IG.9 curve vs. on the run
    - +170MM carry
    - -$280MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - +$110MM due to rally in credit spreads -15%
    - +$200MM due to relative outperformance of IG 9 curve vs. on the run IG curves (while counter-intuitive, the "compression" effect of IG.9 vs. on the run IG complex is driver of performance)
    - +$150MM due to long-dated equity tranche outperformance
  - In the section "10% Optimistic" the convexity of the portfolio in a highly positive or a highly negative market outcome is demonstrated.
    - +$702MM in the event of -20% tightening of spreads, decompression of HY vs. IG credit, and IG.9 forward outperformance (rolling down the curve)
    - $1,126 "End of QE" refers to a scenario of strong growth led by U.S., spreads avg. -50% tighter
    - +1,725MM in "Many Defaults" means wave of defaults among widest spread names (incl. MBIA, Radian, iStar) curve flattening, and +75% spread widening, driven by performance of HY shorts, IG flatteners and long protection positions in the portfolio
  - In the section "10% Extreme" it is estimated that the book would range -$355MM to -$650MM.
    - -$355MM in the event of bear steepening of curves, spreads wider by avg +10%
    - -$650MM in the event of bull steepening of curves, spreads tighter by avg -25%, driven by underperformance of IG.9 (forwards do not roll down curve in rally)

J.P.Morgan

From: Wilmot, John <JOHN.WILMOT@jpmorgan.com>
Sent: Wed, 11 Apr 2012 18:59:00 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>
CC: Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>; Drew, Ina <Ina.Drew@jpmorgan.com>; Staley, Jes <jes.staley@jpmorgan.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>
Subject: synthetic credit information

Jamie,

Attached please find a presentation on the synthetic credit book that was reviewed this afternoon with Doug, Jes, Ina, Barry and John. It covers the relevant data requests from the past several days.

John

John C. Wilmot | Chief Investment Office | john.wilmot@jpmorgan.com | Work: (212) 834-5452 | Cell: [redacted]

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EXHIBIT #90

906

Synthetic Credit Summary: Notional Exposure

- Gross external (to CIO, including IB) notional is $836blo long risk vs. $678blo short risk across all index and tranche products
- External index notional faces Intercontinental Exchange (ICE) is *net* $96.7blo, 97% of total net external index exposure
- Tranche products are not eligible for ICE clearing and are bilateral counterparty exposures

(all figures in billions USD)	Long	Short	Net
Gross external trades	836.1	-678.8	157.3
Notionals outstanding with JPM	210.8	-197.7	13.0
- index	162.2	-160.8	1.4
- tranche	48.6	-36.9	11.7
Notionals outstanding with ICE	250.1	-153.4	96.7
- index	250.1	-153.4	96.7
- tranche			
Notionals outstanding with external counterparties	375.2	-327.7	47.5
- index	122.1	-118.8	3.3
- tranche	253.1	-208.9	44.2

- CDX.IG.9 net position for CIO is $82.2blo, which is approximately 10-15 days of 100% of trading volume
- ITX.9 net position for CIO is $35blo, which is approximately 8-12 days of 100% trading volume
- For on the run positions the numbers are much smaller, ranging from 0.25 days to 2 days volume in IG and HY, respectively.

Index Name	30 Mar 2012	1 Week ago	1m avg	LTM avg	CIO Net Position	No. Days Volume
ITRAXX EUROPE SERIES 17	23.9	26.2	25.1	25.1	6.0	0.24
CDX.NA.IG.18	23.6	37.5	30.6	30.6	15.8	0.52
CDX.NA.IG.17	8.3	35.8	17.7	18.9	11.5	0.65
CDX.NA.IG.9	7	8.6	8.1	10.6	82.3	10.16
ITRAXX EUROPE SERIES 16	6.8	28.7	16	18.8	12.8	0.80
CDX.NA.HY.17	6.6	3.8	4.3	3.5	8.1	1.88
CDX.NA.HY.18	6.3	0	6.3	6.3	0.0	-
ITRAXX EUROPE SERIES 9	5	5.1	4.3	5.5	35.8	8.33

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Synthetic Credit Summary: Maturity Profile

Factored Notional Sum Index	20-Jun-12	20-Dec-12	20-Jun-13	20-Dec-13	20-Jun-14	20-Dec-14	20-Jun-15	20-Dec-15	20-Jun-16	20-Dec-16	20-Jun-17	20-Dec-17	20-Jun-18	20-Jun-20	20-Dec-20	20-Jun-21	20-Dec-21	Grand Total
CDX HY	13,824	8,485	-2,455	3,197	517		-10,831	-5,736	-6,708	-7,828								-7,333
CDX LCDX			1,846															1,848
CDX IG		-63,085	8	-596	65	34,287	-7,857	-17,596	-16,478	11,493	15,791	91,584		257	-54	302		66,363
ITRAXX MN		7	70,278		-3,395		20,044	26	7,460	18,684	7,529	72	43,521			-2,132	-1,731	116,360
ITRAXX XO								-6	-1,767	-6,872	-118							-8,712
ITRAXX FINSUB	-121	-830	-2,210	-1,444		-1,014		1,705	-594	1,368	528							-2,874
ITRAXX FINSEN											72							72
SOVX WE										47								47
Grand Total	13,703	-45,202	26,467	1,167	-2,774	33,263	1,788	-21,006	-20,088	15,939	24,202	91,667	43,821	257	-54	-1,830	-1,731	166,496

10%CSW Sum Index	20-Jun-12	20-Dec-12	20-Jun-13	20-Dec-13	20-Jun-14	20-Dec-14	20-Jun-15	20-Dec-15	20-Jun-16	20-Dec-16	20-Jun-17	20-Dec-17	20-Jun-18	20-Jun-20	20-Dec-20	20-Jun-21	20-Dec-21	Grand Total
CDX HY	4	2	-8	-39	-7		130	89	123	166								478
CDX LCDX			1															1
CDX IG		70	6	8	-1	-39	17	55	64	-46	-73	-304		-2	0	-3		-453
ITRAXX MN		-4	68		10		-6	-9	-21	-111	-42	-1	-282			24	20	-344
ITRAXX XO								6	33	143	3							178
ITRAXX FINSUB	6	2	8	8		9		-70	6	-22	-16							-23
ITRAXX FINSEN											-1							-1
SOVX WE										-6								-6
Grand Total	4	80	72	-31	2	-30	160	134	208	130	-134	-305	-282	-2	0	22	20	-182

- Top table shows gross notionals across indices and tranches by underlying index family (can be confusing, adds notionals of indices and tranches)
- Bottom table shows the 10% credit spread widening per maturity bucket
- Largest short risk exposures in investment grade mature in Dec-12 for CDX.IG.9 and Jun-13for ITraxx S9
- Largest short risk exposures in high yield are concentrated in Dec-15 to Jun-16 for CDX.HY and Dec-16 for ITraxx Crossover

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Synthetic Credit Summary: Risk & P/L Scenarios

- Total Synthetic Credit VaR 59.2mm
- **10% Credit Spread Widening**
  - The position, beta-adjusted has net directionality of -$163MM in 10% parallel move in spreads
  - <u>This is equivalent of $34.5blo of long risk in 5y IG equivalents</u>
- **Relative value Risk Exposures**
- IG vs. HY $27mm/bps of risk if IG underperforms HY by 1bps
- IG9 5/10s curve position $46MM/bps of risk if curve steepens 1bps
- XO vs. ITX $34mm/bps of risk if ITX underperforms XOVER by 1bps
- ITX9 5/10s curve position $19MM/bps if curve steepens 1bps

Index	Spr01	Spr+10%	Up50%
CDX HY	8,510,886	478,399,558	2,285,664,595
CDX LCDX	90,747	1,399,630	6,726,105
CDX IG	-35,121,719	-453,123,526	-2,144,460,027
ITRAXX MN	-22,056,110	-344,040,211	-1,771,899,467
ITRAXX XO	3,060,724	178,197,413	819,366,090
ITRAXX FINSUB	-560,652	-23,044,526	-107,358,380
ITRAXX FINSEN	-31,240	-727,797	-3,496,997
SOVX WE	-19,909	-437,811	-2,115,454
Synthetic Total	-46,127,273	-163,377,269	-917,573,542

Index	CS01	Beta Adj CS01	Compress01	Steepen01
CDX HY	8,510,886	42,554,432		
CDX LCDX	90,747	453,735		
CDX IG	-35,121,719	-35,121,719	-27,235,271	-45,080,715
US REGION	-26,520,086	7,886,448	-27,235,271	-45,080,715
ITRAXX MN	-22,056,110	-22,056,110	-34,256,803	-19,071,244
ITRAXX XO	3,060,724	12,242,896		
ITRAXX FINSUB	-560,652	-2,242,608		
ITRAXX FINSEN	-31,240	-124,961		
SOVX WE	-19,909	-19,909		
EUROPE	-19,607,187	-12,200,693	-34,256,803	-19,071,244
Total Synthetic Credit	-46,127,273	-4,314,245	-61,492,074	-64,151,959

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Synthetic Credit Summary: Exposure to steepness

- On a simple basis, curve could steepen by 20 bps more (on historical basis)
- Loss approx $1billion
- With hedges currently in place, we could steepen by 10bps approx
- Loss approx $550mm

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- Bottom graph shows the behaviour of the slope of IG 9 1 yr versus IG 9 5 Yr that we have in our book . This shows the relationship between the slope of our position in the index versus the actual hedge that we have bouding the relationship that is the 5 Yr short that we have on the run five year IG and the short that we have in the HY OTR since Jan 2008 . This ratio is 85 % and 15% as per our book .

+ IG9 5x10
x Feb.-April

Single Name Risk & Forward Jump to Default Risk

Table 1: default profile today and post December 2012

Portfolio	# of Names	# of names with default loss risk	Average P&L given Default ($mm)	Max P&L given Default ($mm)	# of names with default gain	Average Gain given Default ($mm)	Max Gain given Default ($mm)
Total portfolio today	586	62	-67	-205	526	133	600
Total portfolio post Dec 2012	585	228	-336	-716	357	133	600
IG9 only today	121	0	0	0	121	146	417
IG9 post Dec 2012	121	121	-572	-716	0	0	0

IG9 Hedge options	on-the-run IG18	covers 89 names out of 121
post Dec 2012	on-the-run HY18	covers 13 out of the remaining 32 names unhedged with IG18

- Today there is considerable default protection coming from IG9 tranches.
- Across the 121 names in IG9, the Jump-To-Default at Market Recovery goes from a current gain of +146m on average per name to a loss of -572m per name post December 2012.
- This is because of the roll-off of two forms of protection:
  - The first is the 32bn of short-dated protection on 20th Dec 2012.
  - The second (and this is important) is the roll-off of nearly $4bn long protection on IG9 equity tranches. The equity tranche gives protection at an approximate ratio of 30 to 1, so the $4bn of equity tranche protection is equivalent to $120bn of index protection in terms of pure default risk.
- Post 20th December 2012, we would be able to partially hedge this exposure with the current on-the-run index but the overlap is 89 names out of the 121 in IG9.
- On the 32 remaining names we have a Jump-to-Default loss of $500mm on average per name that would need to be hedged by other means (HY on the run index, single name CDS, index tranches etc)

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Single Name Risk & Forward Jump to Default Risk

- Across the 121 names in IG9, the Jump-To-Default at Market Recovery goes from a current gain of +146m on average per name to a loss of -572m per name post December 2012 as shown in the table

Table 2: Top 20 names Default Exposure Post Dec 2012

Names IG9	JTD post dec
BAXTER INTERNATIONAL INC.	
BRISTOL-MYERS SQUIBB COMPANY	
CAPITAL ONE BANK (USA), NATIONAL ASSOCIATION	
CENTEX CORPORATION	
COMCAST CABLE COMMUNICATIONS, LLC	
DUKE ENERGY CAROLINAS, LLC	
EMBARQ CORPORATION	
GOODRICH CORPORATION	
HONEYWELL INTERNATIONAL INC.	
INGERSOLL-RAND COMPANY	
INTERNATIONAL BUSINESS MACHINES CORPORATION	
INTERVAL ACQUISITION CORP.	
MCDONALD'S CORPORATION	
MCKESSON CORPORATION	
MEADWESTVACO CORPORATION	
RIO TINTO ALCAN INC.	
ROHM AND HAAS COMPANY	
THE WALT DISNEY COMPANY	
WELLS FARGO & COMPANY	
WYETH LLC	

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Synthetic Credit Summary: Risk & P/L Scenarios

			Scenario									
			1	2	3	4	5	6	7	8	9	10
Scenarios for Q2	Realised P&L in Q1	Current Spread	IG Steepening	Dramatic event on Europe	Sluggish state growth	New Financial Crisis	Status Quo	Central scenario	Optimistic scenario	Currency crisis	End of QE	Many defaults
Carry	150		150	250	220	250	200	170	160	400	100	350
IG9 Projections	Initial curve											
IG9 0.75yr	132	68	26	112	74	96	68	48	44	249	1	201
IG9 2.75yr	141	90	53	131	98	117	90	72	67	236	30	196
IG9 5.75yr	150	111	79	150	122	139	111	95	90	222	66	194
Slope												
0.75yr / 5.75yr	18	43	53	38	48	43	43	47	46	27	65	[illegible]
Curve slope change (bps)	25	0	10	-5	5	0	0	4	4	-170	15	60
Implied CSW	-35%	0%	-36%	35%	10%	-25%	0	-15%	-20%	100%	-50%	75%
P&L	-580		-850	-375	-395	-250	-150	350	702	900	1,125	1,725
			10% EXTREME			80% LIKELIHOOD			10% OPTIMISTIC			

Note regarding P&L Estimate of 10 April 2012

Today's P&L estimate of -$395MM represents a move 6.5x current VaR95 of $60MM.

Off the run IG.9 curves bear steepened avg +7bps (30% of YTD move), and spreads widened avg +10bps

- **Realised P&L in Q1**
  - Q1 Realised P&L -$580, driven by losses in short risk HY (670MM), vs. +128MM in CDX.IG, and -30MM in iTraxx
  - The IG component has been the main P&L driver of underperformance in Q1, as IG.9 forward long risk positions did not deliver anticipated profits given steepening of the curve. Current book is overall risk balanced, given the cross-market long/short and has positive carry of $2MM/day, while retaining upside on defaults
- **Q2 P&L Estimates - these scenarios do not include 10 April P&L, which would accrete back into each scenario +$400MM, if re-calibrated for today's market moves**
  - -$250MM (New Financial Crisis) implies an average spread widening of +25%, driven by banks/financials undergoing stress. In this case, the portfolio P&L is driven by:
    - +250MM carry
    - -100MM given relative underperformance of IG vs. HY (compression, led by banks/financials widening)
    - -$300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - -$100MM due to spread widening, not offset in this case by curve flattening (we assume here that curves remain 43bps steep in IG equivalents)
  - -$150MM (Status Quo) in this case we assume that market levels and curves 'freeze' at current levels; in this scenario CIO would delta hedge around volatility throughout the quarter
    - +200MM carry
    - -$300MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - -$50MM due to long-dated tranche underperformance as observed in Q1
  - +$350MM (Central Scenario) in this case bull steepening of IG curves (+4bps), more than offset by outperformance of IG.9 curve vs. on the run
    - +170MM carry
    - -$280MM due to 'duration extension' as we project that the short-dated short risk duration in IG will contract as expiry approaches
    - +$110MM due to rally in credit spreads -15%
    - +$200MM due to relative outperformance of IG 9 curve vs. on the run IG curves (while counter-intuitive, the "compression" effect of IG.9 vs. on the run IG complex is driver of performance)
    - +$150MM due to long-dated equity tranche outperformance
  - In the section "10% Optimistic" the convexity of the portfolio in a highly positive or a highly negative market outcome is demonstrated.
    - +$702MM in the event of -20% tightening of spreads, decompression of HY vs. IG credit, and IG.9 forward outperformance (rolling down the curve)
    - $1,126 "End of QE" refers to a scenario of strong growth led by U.S., spreads avg. -50% tighter
    - +1,725MM in "Many Defaults" means wave of defaults among widest spread names (incl. MBIA, Radian, iStar) curve flattening, and +75% spread widening, driven by performance of HY shorts, IG flatteners and long protection positions in the portfolio
  - In the section "10% Extreme" it is estimated that the book would range -$355MM to -$650MM.
    - -$355MM in the event of bear steepening of curves, spreads wider by avg +10%
    - -$650MM in the event of bull steepening of curves, spreads tighter by avg -25%, driven by underperformance of IG.9 (forwards do not roll down curve in rally)

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Appendix: CDX.IG.9 Market Impact

- CIO increased the CDX.IG.9 5.75y exposure by $36blo during January and February
- Compared to on the run equivalent spread moves this does not appear to have distorted market prices
- "Skew" or index to theo basis has been mean reverting / moving less negative since start of year (organge line on DataQuery graph)

CDX.IG.9 Spreads

	IG9 0.75y	IG9 2.75y	IG9 5.75y	0.75y / 5.75y slope	IG 5Y OTR	HY 5Y OTR	IG 5Y OTR adj for IG.9 HY names (est)
Jun-11	56	90	131	75	85	462	103.85
Sep-11	145	157	167	22	125	811	159.3
Dec-11	131	140	147	16	120	680	148
Jan-12	90	102	119	29	102	567	125.25
Feb-12	83	92	113	30	93	546	115.6
Mar-12	70	88	111	41	91	571	115
Apr MTD	80	98	128	48	103	630	129.35
YTD Chg	-61	-52	-36	25	-29	-109	-33
MTD Chg	10	10	15	5	12	59	14.35

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From: Drew, Ina <Ina.Drew@jpmorgan.com>
Sent: Thu, 12 Apr 2012 15:19:17 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>; Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>; Hogan, John J. <John.J.Hogan@jpmorgan.com>; Zubrow, Barry L <barry.l.zubrow@jpmchase.com>; Staley, Jes <jes.staley@jpmorgan.com>
CC: Wilmot, John <JOHN.WILMOT@jpmorgan.com>; Youngwood, Sarah M <sarah.m.youngwood@jpmorgan.com>; Evangelisti, Joseph <joseph.evangelisti@jpmchase.com>; Goldman, Irvin J <irvin.j.goldman@jpmchase.com>
Subject: FW: Synthetic Credit Materials

Attached please find the three documents we discussed:

- Core Credit Executive Summary
- Synthetic Credit Q+A
- Market Structure Overview

Permanent Subcommittee on Investigations
EXHIBIT #91

Below is an explanation from a strategic point of view the construction, execution, risk profile and the extreme P/L outlook for the synthetic credit book or Core Credit Book .

The **construction** of the credit derivatives book : the Core Credit Book as we call it internally was designed since its inception to benefit from market downside risk with a profile that would offer the firm the best risk/reward for that downside protection .

At the beginning of 2007 we started a program that bought ABX and TABX protection on the subprime and since July 2008 we started a program that would benefit from large defaults on High Yield names as the Risk / Reward for having curve flatenners was a very good way to get this protection for the company. The book has kept its profile of pro-default risk for High Yield until the end of 2011 .

The **execution** of the **High Yield Book** from inception in 2007 was based on buying protection on the on-the-run series and tranches of this series and balancing the book with older series as the High Yield market tends to have wider names as times passes since it collects the most traded names and will include the large fallen angels too. So , this makes sense to do if we believe that we have a bad economy in front of us but has to be balanced to adjust for large spread moves and needs to offset with some positive carry to make the book with the smallest negative carry that we think is appropriate .

The way that we at CIO have **book-run** the **Core Book** to balance the negative carry cost of the High yield Book overtime has been using Investment Grade strategies that gave us some carry or buying optionality (or both) in the tranche market to offset the directionality of the High Yield Book if this was more efficient than using intra- High Yield hedging .

From an execution point of view the Book from the beginning of 2011 was a pivotal year since we started to realize that the Risk / Reward that this book offered started to have a Risk / Reward that was not as compeling as it had been in the past and started to reduce the book notionals and size until June 2011 when we increased the High Yield Book once again as the events of Europe and US started to gather momentum .

The **P/L Outlook** for the Core Book could be described as balanced in terms of directionality (without a short bias Beta adjusted) and with large default protection for all of 2012 of the top 12 High Yield riskiest names in HY and a positive carry of 2 MM/day .

In order to explain the P/L outlook for Q2/Q3/Q4 2012 I would like to describe the book in a more detail group of trades to better understand the risks that the book currently has.

The Core Credit Book has two main Books : the **Investment Grade Book** and the **High Yield Book**.

The Investment Grade Book (**IG Book**) has two strategies one for Europe **(iTraxx Block)** and one for the US **(IG CDX Block)**

The High Yield Book has just one strategy called **HY Block.**

The **IG CDX Block** would best be described as a long risk IG 9 CDX position and a short of equivalent size in IG On the run CDX (OTR) and an extra block of long risk OTR . The European iTraxx position would be described in the same way as long Series 9 and short the OTR. This position has positive carry of 4 MM USD /day. They way that we are positioned to go long risk in the IG 9 position is by going long risk the 3Yr and 5 Yr maturities and being short the 1 year maturity to be neutral default risk , positive carry and with a long beta risk to the 5 riskier names that are part of the short HY position that we have in the HY Book .

The **HY Book** would best be described as an on the run HY OTR short risk(that includes all the risky names (Rescap,TXU,Radian,MBIA,IStar) and a long risk HY10/HY 11 (Older series of CDX High Yield) that do not include these names . This is how we get protection for riskier names and has a negative carry of 2.7 MM/Day

These two books are also rebalanced relative to each other to reduce the overall VAR and sVAR of the whole book with what we would describe as an **Net extra delta IG/HY** on the run indexes only. This position would be best described as long IG OTR vs short HY OTR . This position is 0.5 MM USD carry/day.

The main exposures of these blocks are :

IG	Start Jan Book	Current Book
Forward vs OTR		
S9 Fwd	20,497,375,000	38,511,625,000
5yr IG OTR eq	-19,566,360,556	-36,799,997,222
Forward vs OTR		
IG9 fwd	54,651,951,114	94,540,640,003
IG OTR	-53,463,865,220	-92,485,408,699
HY OTR	**Start Jan Book**	**Current Book**
HY On the run	-8,555,429,927	-11,105,441,146
HY10-11	14,405,446,694	18,699,100,082
Net Extra Delta	**Start Jan Book**	**Current Book**
Net ITRAXX Main OTR	-4,116,619,444	11,496,447,222
Net CDX IG OTR	-21,886,277,212	3,249,309,790

The scenario that is most critical for CIO (large adverse scenario) happens to be the one that we experienced yesterday (10th April) which is a bear steepener of the IG Block both in the US and Europe and the rest of our positions remaining stable . This scenario is the one that caused us almost all of the loss since Feb 2012 . I do believe that this position will either mean revert because of the enhanced carry that has also increased from yesterdays move of the IG block or though a default or series of defaults in the most critical names MBIA , Radian , ISTAR , Sprint , and MGIC in the next year . The magnitude of the move over the weekend for this curve to steepen, i.e. our short in the front did not widen but the 5yr IG widened relative to our OTR by 7 bps . This is unprecedented for a day on a mark to market and it could still go wider on its own but the part of our book that should be protecting us from most of this widening is the HY short position OTR that contains these names too and should have mitigated around 70% of this move . It did not materialize . So this goes agains all economic sense , is due to the marks that we are experiencing on our large US IG Block that has caught the attention of the media . It could still go wider and we could face and additional loss if the same behaviour persists but at some point that we have already gone beyond the HY bucket should hedged our exposure . I believe that this mark to marked loss is going to mean revert for those reasons .

It might take some time but I am very confident that this outcome will be materialized in the coming months.

How do derivative instruments and the "synthetic credit" activity fit in with the overall CIO activity?
The Chief Investment Office has utilized the "synthetic credit portfolio," which is a portfolio of credit derivatives, to construct a hedge against other risks on JPMC's balance sheet. This activity has been part of the CIO portfolio construction and risk management since 2007. The related credit derivative instruments offer an efficient means to establish protection against adverse credit scenarios and "stress events".

This activity is among the key tools utilized by CIO to manage and hedge stress loss risks. The synthetic credit portfolio has benefited the Firm, especially in times of credit market dislocation, sudden spread widening and in the occurrence of defaults, which is typically a catalyst for credit spread widening scenarios.

In Q3 and Q4'11, CIO began to reduce the net stress loss risk profile of the hedges, as more positive macroeconomic data in the US and an improving situation in Europe post LTRO merited a reduction to the stress loss protection of the "synthetic credit portfolio." The book, as a dedicated hedge, continues to be balanced, and to protect our portfolio from stress events.

Have you met Bruno Iksil?
Yes – I've met Bruno in person. (Specifically on 29 March 2010 in a meeting at 100 Wood Street in Lonon). I am in regular contact with the team in CIO.

In your view, could this trading fall afoul of Volcker under a narrow definition (or even a broad one)?
As Barry Zubrow pointed out in our comments to the Regulators in February, the language in Volcker is unclear as it pertains to anticipatory hedging needs on the ALM side. The condition for the hedging exception appears to have been drafted with trading desks in mind, where both sides of a hedge are marked to market. It is a poor fit with ALM.

What is the P+L impact on JPM since this story was released?
The book is balanced, and the performance clearly is a function of market prices. The Chief Investment Office performance has been good, and that's reflected in our results.

How much have these positions made or lost for JPMC? What is the corresponding loss or gain in your book?
The "synthetic credit portfolio," since inception has positively benefited JPMorgan, in particular in times of dislocation and stress in credit markets globally, as was witnessed in 2008, 2009, and more recently in the high yield bond market in the US in late 2011.

Is most of the activity in the I9 index speculative bets by hedge funds?
Hedge funds are industry participants in CDX.NA.IG credit default swap indices. Other industry participants include banks, broker-dealers, insurance companies, pensions, sovereign wealth funds, and other investors who seek either to gain exposure to Investment Grade credit via credit default swap indices, or to hedge existing exposure to Investment Grade credit. Information related to hedge fund's relative size is difficult to estimate, however, can be thought of as proportional to the capital and funding available to the hedge fund manager employing CDX.IG.9 credit default swap indices in its portfolio.

Is most of the activity in the I9 index speculative bets by hedge funds?
Hedge funds are industry participants in CDX.NA.IG credit default swap indices. Other industry participants include banks, broker-dealers, insurance companies, pensions, sovereign wealth funds, and other investors who seek either to gain exposure to Investment Grade credit via credit default swap indices, or to hedge existing exposure to Investment Grade credit. Information related to hedge fund's relative size is difficult to estimate, however, can be thought of as proportional to the capital and funding available to the hedge fund manager employing CDX.IG.9 credit default swap indices in its portfolio.

What risk or type of risk at JPMC does the IG.9 position hedge?
JPMorgan utilizes "IG.9," among other hedging instruments to mitigate or reduce portfolio "stress loss," associated with credit risks on our balance sheet, particularly in the investments securities portfolio.

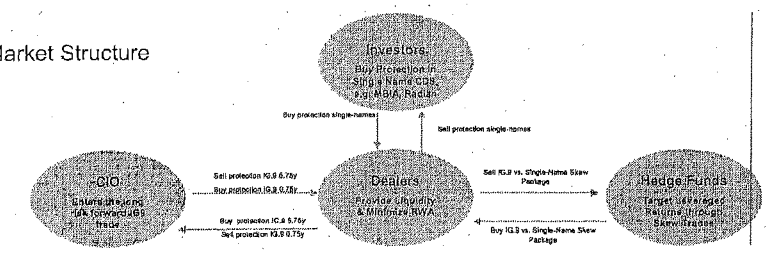
I understand that you're hedging you overall risk and the investments securities portfolio - can you give a sense of the relative size of hedging activity in the past – how big can the 'gross' get and what is the basis risk around this?
The size of hedging activity is a function of the size of the risks we manage, so it changes through time. If you look at the history, heading into the Crisis, the Firm's ALM team in CIO used credit derivatives to purchase protection on high yield credit default swap indices with short term maturities and to sell protection on high yield credit default swap indices with longer-term maturities—in effect, taking a high yield curve flattening position in the credit derivatives market. This strategy resulted in the Firm recognizing some gains as near-term default risks increased. The gains recognized on these derivatives strategies offset in part the losses that occurred on credit assets held by the Firm.

Are your examiners aware of this activity?
Yes, this activity is included in our regulatory reporting practices, in financial statements, and—as part of the Firm-wide Market Risk policy—this activity is captured in the Firm's risk measurement systems.

Do firms on the other side of these trades have an interest in forcing you out of them?
Clearly certain market participants have expressed an interest understanding what is the long-term nature of JPMorgan's hedging activity—particularly in CDX.IG.9. It would be speculative to assume participants on the "other side" of JPMorgan's activity want to "force us out," and we're in the business of risk management of our own positions, not theirs. JPMorgan's position in IG.9 is part of a portfolio balanced across a range of outcomes. It is conceivable that the opposite position may not be balanced, which could motivate those portfolio risk managers to seek to reduce those exposures.

Why would a bank need a synthetic credit portfolio?
A bank or investor may utilize a "synthetic credit portfolio," that is, a portfolio of credit derivatives, in particular to construct a hedge to other risks on it's balance sheet. It is an efficient means, given liquidity in the index market, to establish protection against adverse scenarios and "stress events." It is often more practical to buy protection on credit default swap indices than it is to establish a "short risk" position in a cash security.

Market Structure



- CIO is short risk / long protection in IG.9 0.75y
- CIO is long risk / short protection in IG.9 5.75y as part of a long forward risk position
- This position hedges HY shorts elsewhere in portfolio, provides "carry," yet retains convexity in spread widening (curve flattening), and upside on defaults

- In the context of market making activity dealers over time accumulate risk selling protection on single name CDS, beta-hedged through buying protection on the corresponding index (IG.9 contains MBIA, Radian)
- In this way, the protection sourced from CIO covers the dealer's requirement for index protection on IG.9 5.75yr
- The residual "matched book" gives rise to the so-called a "skew" trade, which measures the basis between single names and their index
- Dealers transfer this basis risk to hedge funds to reduce RWA. This is done for surprisingly low spreads (between 10-15bps for IG.9).

- Hedge Funds enter the "Skew trade" by selling protection on single names and buying protection on the index
- To fund this activity, HF's rely on Prime Brokers. HF's must provide capital to PB's upfront and to cover MTM overtime on both legs of the trade (i.e. they are not perfectly netted)
- HF's profit from this activity as the "skew" compresses (YTD has moved -16bps to -11bps)
- HF's are 'in the money,' and instead of holding to maturity to earn this as carry, given the PB capital requirements, they seek to exit & monetize

- Dealers look for CIO to buy protection on IG.9 5.75y, i.e. for CIO to unwind current position
- To allow the HF's to unwind and take profit, and to 'collapse' the trade, the Dealer needs to sell protection on the index to buy protection on single names, to maintain flat risk
- To exit the position and monetize carry as 'upfronts' to boost performance, HF's seek to buy protection on the single names and sell protection on the index

J.P.Morgan

From: Zubrow, Barry L <barry.l.zubrow@jpmchase.com>
ent: Thu, 12 Apr 2012 21:07:12 GMT
To: Braunstein, Douglas <Douglas.Braunstein@jpmorgan.com>
CC: Dimon, Jamie <jamie.dimon@jpmchase.com>; Youngwood, Sarah M <sarah.m.youngwood@jpmorgan.com>; Evangelisti, Joseph <joseph.evangelisti@jpmchase.com>; Drew, Ina <Ina.Drew@jpmorgan.com>
Subject: If asked about London / CIO and Volcker

I suggest you add the following thoughts:

1.). Activity was NOT short term trading

2.). Was part of LONG TERM hedging of the banks portfolio

3). We do not believe that our activity in any way goes against the law as passed by Congress, nor the spirit or proposed rule as written.

Barry

From: Hogan, John J. <John.J.Hogan@jpmorgan.com>
Sent: Fri, 13 Apr 2012 14:35:10 GMT
To: Dimon, Jamie <jamie.dimon@jpmchase.com>
Subject: RE: CIO

Doug and I asked that the first day. Answer was it most "efficient" way to do it. I would say they just wanted to improve the carry on the book by selling protection and taking in some premium. This is all part of the post mortem and we will fix it.

From: Dimon, Jamie
Sent: Friday, April 13, 2012 10:29 AM
To: Hogan, John J.
Subject: RE: CIO

Why didn't they just sell vs offset

From: Hogan, John J.
Sent: Friday, April 13, 2012 10:24 AM
To: Dimon, Jamie
Subject: CIO

Jamie-
Below confirms the net notional are truly net notionals with no basis. I spoke with Ashley this morning who is working with Achilles to implement a similar limit/governance structure on this book to the one we have in the IB—we will do this for all of CIO over coming weeks and I will keep you posted on that. Let me know if you need anything else.
John

From: Goldman, Irvin J
Sent: Friday, April 13, 2012 10:20 AM
To: Hogan, John J.
Subject: Re:

John,
Yes. To be perfectly clear there is no basis within each maturity.

From: Hogan, John J.
Sent: Friday, April 13, 2012 10:03 AM
To: Goldman, Irvin J
Subject: RE:

Irv,
Can you just confirm that the longs and the shorts from each maturity bucket net perfectly and that the net notional is truly the net amount that is shown below without any basis risk?
Thx,
John

From: Goldman, Irvin J
Sent: Thursday, April 12, 2012 7:05 PM
To: Dimon, Jamie; Hogan, John J.; Braunstein, Douglas
Cc: Drew, Ina
Subject:

All,
Enclosed please find IG 9 positions by maturity and related volume data and charts.
Irv

cid:image005.png@01CD18DD.D2B48F60

cid:image006.png@01CD18DD.D2B48F60

Irvin Goldman | J.P.Morgan | Chief Investment Office | 270 Park Ave. | ☎ Tel: +1 212 834 2331 | ✉ irvin.j.goldman@jpmchase.com

Redacted By The Permanent Subcommittee on Investigations

CIO Synthetic Credit
CDX.IG.9 Positioning Detail
IG.9 Life-to-date Trading Activity per instrument
(USD billions)

Instrument	Maturity	Gross longs	Gross shorts	Net Notional	Daily Avg Volume
CDX.IG.9 5Y	12/20/2012	43.5	-76.2	-32.7	3.6
CDX.IG.9 7Y	12/20/2014	43.7	-9.7	34.1	1.6
CDX.IG.9 10Y	12/20/2017	88.4	-7.5	80.9	1.5

EDITED TRANSCRIPT

JPM - Q1 2012 JPMorgan Chase & Co. Earnings Conference Call

EVENT DATE/TIME: APRIL 13, 2012 / 12:30PM GMT

OVERVIEW:

JPM reported 1Q12 revenues of $2[illegible]b, net income of $5.4b and EPS of $1.31.

THOMSON REUTERS

Permanent Subcommittee on Investigations
EXHIBIT #94

CORPORATE PARTICIPANTS

Doug Braunstein *JPMorgan Chase & Company - CFO*

Jamie Dimon *JPMorgan Chase & Company - Chairman & CEO*

CONFERENCE CALL PARTICIPANTS

Glenn Schorr *Nomura - Analyst*

Guy Moszkowski *BofA Merrill Lynch - Analyst*

John McDonald *Sanford Bernstein - Analyst*

Betsy Graseck *Morgan Stanley - Analyst*

Brennan Hawken *UBS - Analyst*

Mike Mayo *CLSA - Analyst*

Matthew O'Connor *Deutsche Bank - Analyst*

Ed Najarian *ISI Group - Analyst*

Chris Kotowski *Oppenheimer & Co. - Analyst*

Andrew Marquardt *Evercore Partners - Analyst*

Jim Mitchell *Buckingham Research - Analyst*

Paul Miller *FBR - Analyst*

Christopher Wheeler *Mediobanca - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to JPMorgan Chase's first-quarter 2012 earnings call. This call is being recorded.

Your line will be muted for the duration of the conference. We will now go live to the presentation. Please stand by.

At this time I would like to turn the call over to JPMorgan Chase's Chairman and CEO, Jamie Dimon, and Chief Financial Officer, Doug Braunstein. Mr. Braunstein, please go ahead.

Doug Braunstein - *JPMorgan Chase & Company - CFO*

Thanks, operator. I am going to be taking you through the earnings presentation, which as you know is available on our website. I would also ask everyone to refer to the disclaimer regarding forward-looking statements at the back of the presentation.

And with that, if you all turn to page one, for the quarter we generated net income of a $5.4 billion, $1.31 per share. That is on revenues of $27.4 billion, up 6% year on year, 24% quarter on quarter. Return on tangible common equity of the 16% for the quarter and our characterized solid performance across most of our businesses, particularly strong results in the Investment Bank and significant improvement year over year in mortgage banking.

There are a number of significant items that we are highlighting here on this page. We do that every quarter. It includes DBA, reserve releases, litigation billed in the WaMu settlement.

Every quarter we also have some modest pluses and minuses. We don't put these up front, but if you did total these significant items they had an aggregate negative impact of $0.09 a share on our reported numbers this quarter. I am going to discuss them in much more detail as we go through the financials.

Strong capital generation in the quarter. We ended with Tier 1 common of $128 dollars, that is up $5 billion-plus; strong Basel I and Basel III ratios of 10.4% and 8.4%, respectively. And I wanted just to highlight a couple of trends for the quarter and then we will go into the businesses.

First is, if you look across our businesses, we have continuing signs of underlying fundamental growth. So 23% loan growth across wholesale year on year. Record middle-market loans this quarter, up 19% year on year. $4 billion of credit provided to small businesses, that is up 35% year on year.

Record retail channel mortgage originations, up 11% this year. Deposits CBB up 8% year over year. Sales volume in Card up 12% year over year. And so the underlying fundamentals year on year look strong.

On the credit side, we continue to have stable and good credit results in our wholesale business and on the consumer side real, continuing improvement in Consumer. I would say in aggregate we are putting on better quality loans today from that loan growth, but just two quick statistics. In Mortgage net charge-offs are down 25% year on year; in Card net charge-offs are down 37% year on year.

So with that it's sort of an underlying theme. Let's turn to the Investment Bank on page three.

For the quarter you see circled net income of $1.7 billion. That is on revenues of $7.3 billion, reported ROE of 70%.

On page one we did highlight $900 million in DVA losses pretax for the IB this quarter. And as we have mentioned consistently in the past, we don't consider the DVA as a part of our core business results. In fact, after the changes from this quarter, if you remember the spread widening, we saw in the third quarter of 2011 where we booked a $1.9 billion gain on DVA.

In the last two quarters we have now reversed $1.5 billion of that, and obviously if spreads returned to the level they were last summer we would have gone round trip. So I am going to focus on the IB numbers excluding all DVA.

So in the first quarter revenues were $8.2 billion, $2.2 billion in net income, and we had a 23% return on equity. Those numbers are all very comparable to what was a very strong first quarter of 2011, but I do want to remind everyone that we tend to have a seasonally strong first quarter to start the year.

IB fees in the quarter of $1.4 billion. That is down 23% year on year, up 23% quarter on quarter, and if you look on appendix page nine you will see we continue to maintain our number one market-leading share in fees.

Markets revenues were relatively flat year on year. On a linked-quarter basis revenues were up significantly. Fixed income revenue was $5 billion and that reflected continued solid client revenues across the products, particular strength this quarter in our global rates business.

Equities revenue of $1.4 billion really approved results across cash and derivatives, and we continue to have improving performance from our prime services. We are seeing increased balances there, a little improved leverage in the markets, and a modest uptick in spreads.

Credit portfolio revenue was a little over $400 million, up from the fourth quarter, and then expenses in the quarter of $4.7 billion were down 6% year on year. The comp-to-revenue ratio, ex DVA, which is the way we manage it, was 35% for the quarter.

If you go directly to page five, Consumer & Business Banking, you will see circled net income of $775 million. That is down 13% year on year. And an ROE for this business of 35% for the quarter.

Revenue of $4.3 billion. That is relatively flat quarter on quarter but down 4% year on year, and that reduction year over year is generally consistent with our guidance on the impact of the Durbin Amendment, which we had this quarter and didn't come through in the first quarter of last year.

We continue to see solid year over year underlying performance trends in the business, so the deposit is up $29 billion, which I talked about, up 8%. We believe that is a growth rate faster than the industry growth rate. Business banking originations up 8% year on year.

We had very strong investment sales this quarter as the markets improved and we continue to build out CPC, our Chase Private Client business, up 41% quarter on quarter. In fact, client investment assets of $147 billion is a record for Chase Wealth Management.

On page six you see Mortgage Production and Servicing. Circled net income of $460 million for the quarter, that compared with a net loss of $1.1 billion in the prior year, so $1.5 billion swing year on year. We had very strong production-related revenues of $1.6 billion and that is driven somewhat by higher volumes. Originations were up 6% year on year; applications, as I mentioned, up 33%; a very favorable refinancing environment including the impact of HARP 2.0.

But we also had higher margins this quarter as a function of those volumes and some mix issues. We should be cautious about that because we are likely to see those margins returned to more normalized levels on a go-forward basis.

Purchase losses in the quarter were $300 million. That is lower than our expectations on a quarterly basis, which remain $350 million plus or minus. In large part that was a function of timing.

If you now move to the servicing side, in the middle of the page you will see expenses there of $1.2 billion. That includes approximately $200 million of costs for the foreclosure-related matters associated with the settlement. So if you exclude that $200 million, servicing costs continue to remain very elevated at $950 million for the quarter. And of that number $700 million is related to default expense, which was essentially flat quarter on quarter but very, very high.

As we discussed at investor day, you should expect to see our servicing costs come down over time. Volume of delinquencies, as the units decline costs will come down. We are also working very hard to make our processes more efficient.

Over time you would expect, consistent with what we shared over at investor day, that our normalized expenses for servicing should be in the $300 million to $350 million range. But that will take a number of years to get to.

On page seven you see our Real Estate Portfolios. Circled net income of $500 million in the quarter, that compares to a loss of $160 million in the prior year. Revenues down 7% year on year. It's the result of the run-off we have been talking about for a while.

Loan balances are down $24 billion, 11% year on year, consistent with our guidance. And we have said that you can expect a reduction in NII in this portfolio of about $500 million, plus or minus, for the year as we continue to run off about WaMu portfolio and our other non-core mortgage assets.

Credit costs you see is a benefit of almost $200 million and that is a function of delinquency trends improving across all the mortgage asset classes, including home equity. You see a circled number of $808 million for the quarter in net charge-offs, and as I mentioned, that is down 25% year on year.

So based on the reduction in delinquencies, which, by the way, is in the appendix on page 16, the resolution of the foreclosure settlement and what we are seeing is stability in our severity numbers. We reduced our allowance this quarter by $1 billion. That is, again, part of the significant items on page one.

But I will say, even after that reduction, allowance coverage remains at 6% for the portfolio, $7.7 billion, which is a very conservative approach to our risks and, quite frankly, the $1 billion release is reflective of what we had to do as an accounting matter.

I would note one other reporting change here, which is due to the industrywide regulatory guidance we moved $1.6 billion of our high-risk seconds into the non-performing loan category. And that is despite the fact that $1.4 billion of those $1.6 billion are current today.

As you know, we have identified those high-risk seconds early. We put reserves up against them early and so our reserves remain unaffected. But if you excluded these changes, NPLs would have trended down year on year, down quarter on quarter, and the same would be true at the companywide level as you look at the company statistics.

On page eight, Card Services and Auto, circled net income of $1.2 billion. That is on revenues of $4.7 billion. Revenues and outstandings are lower year on year, that is the impact of runoff. And modestly lower quarter on quarter, and that is primarily due to the seasonal growth that we saw and we tend to see in the fourth quarter around the holidays.

We did see strong sales volume in Card. As I mentioned, up 12%. But if you exclude the sale of Kohl's, sales were actually up 15% for the system and the new product sales growth for our Freedom, Sapphire, and Ink products were actually in excess of that growth rate.

Auto originations also up 21% year on year and that, quite frankly, reflects higher industry sales.

Credit costs of $740 million really reflect two factors. Total net charge-offs are $1.5 billion that is down a little under $900 million year on year. We have got lower delinquency and net charge-off rates circled for Card at the bottom of the page.

We do expect, by the way, the net charge-off rate to be 4.25% plus or minus in the next quarter. I would also note loss rates in Auto remain very low. We recognized 28 basis points of charge-offs this quarter. As a result of all of that information, we released $750 million this quarter in Card and, again, reserves here remain very robust even after that release.

One other comment on Card, expenses were up 6% year on year and that really was related to exiting a non-core product in the business.

Page nine. Commercial Banking. Circled net income of almost $600 million on revenues of $1.7 billion; 25% return on equity and that is based on a higher capital allocation for this business this year. 9% year-over-year revenue growth. It has been driven by the themes we have been talking about, growth in loans and liability balances, and that is offset by the spread compression we have experienced year on year.

It is our seventh consecutive quarter of loan balance growth. You see the circled loan balances of almost $116 billion, up 16%. We had record revenue and record loan balances in our middle-market business for the quarter; that was up 19%.

C&I loans up 24% year on year and I think the best of what we have got in industry data, industry volumes are up 12% year on year. So if you think of all that it really does reflect two underlying trends -- growth, we believe, in terms of demand, as well as a combination of improvements in market share across those product sets.

I will continue to note utilization does remain relatively stable where it has been at a low rate for the last several quarters. Credit costs were $80 million in the quarter here but net charge-offs were exceedingly low at 4 basis points.

Page 10, Treasury & Security Services, solid results here. Net income of $350 million, up 11% year on year, 40% quarter on quarter. Revenues of $2 billion, up 9% year on year and that is again resulting from some underlying fundamental trends that are offsetting that spread compression that we have talked about.

Liability balances are up 34%; international revenue was up 12%; assets under custody is a record $17.9 trillion, up 8%; and trade finance loan balances are up 40% year on year. You will notice there, by the way, we had a modest decline in trade finance quarter on quarter. Really a function of a little bit of seasonality and I would say an increased return of competition, particularly from some of our European competitors in the fourth -- in the first quarter.

Page 11, Asset Management. We had improved quarter-on-quarter results in AM, largely driven by market conditions, but we are down from what was a strong first quarter 2011. Circled net income of $386 million, that is on revenues of $2.4 billion.

The results were really driven by some underlying growth as well as the market improvement we saw this last quarter. It's the 12th consecutive quarter of long-term flows -- $17 billion, $43 billion over the latest 12 months. We did set records for assets under supervision and records for assets under management. Expenses were up year on year and that has largely been from the investment spending we have been talking about for a number of quarters.

Page 12, Corporate and Private Equity. Private Equity net income of $130 million. That is on $250 million of revenue, predominately mark-to-markets for public positions and some modest realizations this quarter.

So corporate we recorded a net loss of $700 million and the loss included two significant items. The first is a $2.5 billion addition to our litigation reserves, predominately mortgage related, and we identified that up on page one. So I am going to make a couple of comments here on the litigation reserve.

As you know, including the actions this quarter, we have been building very significant reserves. We believe that currently these reserves are both comprehensive in nature and appropriately conservative, given what we know about these exposures, including the information with the first quarter of this year.

And I would think, absent a material adverse development that could certainly change our views, we don't anticipate making material addition to these reserves over the course of the year. But I do want to caution facts and circumstances can change, reserves can go up, they can go down, but we feel based on what we know today that we are unlikely to add materially to this position.

We did book an addition of $1.1 billion pretax gain that was also identified on page one. That is from the WaMu bankruptcy settlement. And if you excluded those two items, corporate net income, excluding PE, we note on the bottom right was $175 million for the quarter.

Page 13, the Fortress balance sheet. I have covered a lot of the topics already but let me just add two comments to the page.

First, as you know, we authorized a new $15 billion share repurchase. We have spent approximately $450 million year-to-date on that new authorization, and for those that are likely to ask, it's at a price of about $44.75.

Second, on trust preferred or TRuPS, we have $20 billion outstanding as you all know. We do expect to redeem $10 billion of that $20 billion in total this year, and that is pursuant to the capital plan that we submitted in the CCAR process. For much of that those securities we are going to wait until there is a regulatory call event to call those. We were in the market for a $400 million call on a single security that didn't require that trigger.

And for the remaining $10 billion currently our view is that is very attractive long-term financing.

On page 14 we do have the outlook. I think I have covered all of that. And so, before I turn it over to Jamie, I did want to talk about the topics in the news around CIO and just take a step back and remind our investors about that activity and performance.

We have more liabilities, $1.1 trillion of deposits than we have loans, approximately $720 billion. And we take that differential and we invest it, and that portfolio today is approximately $360 billion. We invest those securities in very high grade, low risk -- we invest those dollars in high grade, low-risk securities.

We have got about $175 billion worth of mortgage securities, we have got government agency securities, high-grade credit and covered bonds, securitized products, municipals, marketable CDs. The vast majority of those are government or government-backed and very high grade in nature.

We invest those in order to hedge the interest rate risk of the firm as a function of that liability and asset mismatch. We hedge basis risk, we hedge convexity risk, foreign exchange risk is managed through CIO, and MSR risk. We also do it to generate NII, which we do with that portfolio.

The result of all of that is we also need to manage the stress loss associated with that portfolio, and so we have put on positions to manage for a significant stress event in Credit. We have had that position on for many years and the activities that have been reported in the paper are basically part of managing that stress loss position, which we moderate and change over time depending upon our views as to what the risks are for stress loss from credit.

All of those decisions are made on a very long-term basis. They are done to keep the Company effectively balanced from a risk standpoint. We are very comfortable with our positions as they are held today.

And I would add that all those positions are fully transparent to the regulators. They review them, have access to them at any point in time, get the information on those positions on a regular and recurring basis as part of our normalized reporting. All of those positions are put on pursuant to the risk management at the firm-wide level.

The last comment that I would make is that based on, we believe, the spirit of the legislation as well as our reading of the legislation and consistent with this long-term investment philosophy we have in CIO we believe all of this is consistent with what we believe the ultimate outcome will be related to Volcker.

So with that, maybe, Jamie, I will turn it over to you before we open it up for questions.

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

Doug, thank you. So let me just -- let me talk about one thing and then we will open to questions.

When is the stock buyback? Obviously we got permission to buy back $15 billion worth of stock. We would have preferred to have been able to buyback substantial amounts below tangible book value, but we were unable to.

We will always, as a disciplined buyback of the approximately $3 billion we issue every year, and that is the $3 billion we issue mostly for comp. And that is not on a GAAP basis. It's [going to be] issued before investing, etc.

At 45 we will -- we reserve -- right now we are buying back at that rate, but we may do more. So we reserve the right at any point in time to do whatever we want and it's based upon basically for things.

What are the organic opportunities? They might be there, portfolios or more organic growth. What are the investment opportunities? There are a lot of things you can buy, both investments or acquisitions, which we don't really expect big ones now.

Our own desire to get quickly -- how fast do we want to get to our new capital requirements under Basel III. And the stock price. So it does not mean at $45 -- obviously when the stock goes up I think we will be consistent and we will buy less. When it goes down we will buy more.

We are a buyer in size around tangible book value. And then, obviously, we reserve the right to change that at will.

So let's open up to questions or comments about any subject at all.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Glenn Schorr, Nomura.

Glenn Schorr - *Nomura - Analyst*

Jamie, just because you brought it up, I think it's interesting. If you took the midpoint of the range that you outlined in the shareholder letter and you took the $23 billion, $24 billion of over-the-cycle earnings, that is a sub-7 times multiple. It seems very attractive at the midpoint of the range.

I am just curious on how you think through the valuation when you are thinking about the use proceeds on the buyback.

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

Well, I mean, look, you said it yourself, anyone can do the numbers. Our tangible book value is extremely attractive, at 40 it will probably be attractive and at 45 --I am not saying it's not attractive, but our best thing is to grow our business and not to worry about buying back the stock.

We are going to buy back the stock when it's a bargain, not just because we feel like it. And so you guys can all do the numbers, we are just not going to tell you what we are going to do.

Glenn Schorr - *Nomura - Analyst*

All right, fair enough. If you look on the quarter for year-on-year basis, expenses are up like 15%. Now there is litigation costs in there and things like that. I think on the investor day you had suggested flat expenses year on year. Obviously it depends on Investment Bank revenues, but can you just talk about the revenue expense dynamic?

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

We said flat expenses; we still expect that. The first quarter is a little bit higher because of FICA and payroll, a whole bunch of things like that, and some one-off expenses that run through there. And that is flat if you back out IB comp and extraordinary stock.

That number should be about $12 billion a quarter. Obviously it was a little bit higher this quarter to do that, but it will come down over time we think.

Glenn Schorr - *Nomura - Analyst*

Okay, so still flat --.

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

Remember, it's flat but we are still doing a lot of investing. So we are getting other efficiencies to help pay for the investing.

Glenn Schorr - *Nomura - Analyst*

Fair enough. And then maybe last one for me. I think the fear around issues in Europe has started to subside post the LTRO, and I think we discussed that last call. We got a little bit of a scare, though, the last week or two with Spain.

Just curious on your thoughts right now; where are we in that process and do you still feel comfortable on the counterparty exposures?

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

Yes, I constantly read about counterparties. Our numbers -- we disclosed around $15 billion, a little bit higher than that now. They obviously move around.

I would still say exactly the same thing. The LTRO was a massive thing that took the real catastrophe in the short run off the table, but obviously the world is going to evaluate over time whether the fiscal union is tightened and given teeth and carrots and sticks and all that. It's going to look at Spain and Italy's both austerity and growth plans, and it's going to be like an accordion for the next 18 months. So I personally am not going to over react to that.

But I think they have to do some things to give it the real stability. The LTRO wasn't sufficient. It was not a -- it was a short-term fix not a permanent fix.

Glenn Schorr - *Nomura - Analyst*

Okay, I appreciate it. Thank you.

Operator

Guy Moszkowski, Bank of America.

Guy Moszkowski - *BofA Merrill Lynch - Analyst*

Good morning. On the CIO question, which obviously you have addressed and has gotten so much attention in the press this week, can I just ask one further question, which is are all of the results of the CIO group reflected only within Corporate and Other? There is no sharing of any of those results with, say, FICC in terms of the reporting that we would see in the Investment Bank?

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

No, God, no. No, no. A lot of the NII is given to the businesses that generate that deposits on a consistent fund transfer methodology, which -- but not with the investment bank. Remember, most of that portfolio is an AFS portfolio, not all of it, but most of it.

Guy Moszkowski - *BofA Merrill Lynch - Analyst*

Right, fair enough. It's just I (multiple speakers)

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

We disclosed both realized gains, unrealized gains, and mark-to-market gains. You get all of that.

Guy Moszkowski - *BofA Merrill Lynch - Analyst*

Yes, that is just a question that I ask in order to assess the tempest in the teapot nature of the stories relative to the revenues that we see that just don't seem to be that big.

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

It's a complete tempest in a teapot. Every bank has a major portfolio; in those portfolios you make investments that you think are wise to offset your exposures.

Obviously, it's a big portfolio; we are a large company and we try to run it -- it's sophisticated obviously with complex things. But at the end of the day that is our job is to invest that portfolio wisely, intelligently over a long period of time to earn income and to offset other exposures that we have.

Guy Moszkowski - *BofA Merrill Lynch - Analyst*

Then turning to the capital questions, obviously you have had a rapid growth towards your eventual Basel III targets, although of course we still don't know exactly what they are, and you have alluded to the conditions under which you would return capital through buybacks. But what about the potential for special dividends along the way? If you felt that you had excess capital and that share buybacks were not that attractive, how would you think about that?

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

Guy, I think the right way to look at that is ask that question in two years. I mean we are not at the Basel III targets yet. You should expect dividends on a regular -- we may change our minds, but on a regular annual basis from us that will look at what to do.

Obviously, this is a Board-level decision. But there is going to certainly be no special dividend before we know what the real capital rules are.

Guy Moszkowski - *BofA Merrill Lynch - Analyst*

Fair enough.

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

Take that off the table.

Guy Moszkowski - *BofA Merrill Lynch - Analyst*

Okay, that is completely fair. Mortgage origination you alluded to better spreads obviously, and maybe you could just give us a little bit more color of how that came through. Because it certainly does look like they improved meaningfully given how the revenue evolved versus last quarter versus the origination volumes.

Jamie Dimon - *JPMorgan Chase & Company - Chairman & CEO*

They were several hundred million dollars higher than what we would call normal for a whole bunch of different reasons, including HARP, supply/demand, the price at which Fannie Mae and Freddie Mac are securitizing things. So I would expect that to normalize over time.

From: Dimon, Jamie <jamie.dimon@jpmchase.com>
Sent: Fri, 11 May 2012 09:07:24 GMT
To:
CC: Will, Kathleen <KATHLEEN.WILL@jpmchase.com>
Subject: Fw: 10-Q call - Buyside and sellside comments (2)

From: Youngwood, Sarah M
Sent: Thursday, May 10, 2012 10:31 PM
To: Dimon, Jamie; Braunstein, Douglas; Drew, Ina; Staley, Jes; Cutler, Stephen M; Evangelisti, Joseph; Lemkau, Kristin C; Miller, Judith B.
Cc: Investor Relations
Subject: 10-Q call - Buyside and sellside comments (2)

Here is the balance of calls for the evening. All calls returned. See below regarding comments. We have also left messages to the extent we couldn't connect (see bottom of mail).
For reference, we had 3,248 people on the webcast and 4,543 people on the telephone lines. A total of 7,791 people on the call.

Betsy Graseck – Morgan Stanley – Sellside

- Appreciate Jamie's public apology
- How long will it take to unwind the trades?
- Why not offset the whole thing with unrealized gains in the AFS book?
- Is this something that happened in the month of April? Did you become aware of this while closing your books or was this something you were aware of in the first quarter?
- What was the sequence of the events?
- Why did you go back to the old model?
- What can you point to in terms of market movements?
- Can we approximate the size of your position based on the losses?
- Anyone in particular that is putting on these types of trades in? How did this happen?
- Will you still do your buybacks?
- Please detail changes in Basel III

Glenn Schorr – Nomura

- Everyone should give up on trying to figure what the trades are
- There weren't any issues with credit in the market. Why the big loss?
- The loss was not that big in the grand scheme of things so why have a call on it?
- I want to understand for intellectual reasons what happened
- Obviously not about the P&L impact and the capital ratio impact
- One of the few companies that trades on a premium will now lose some of that premium
- So nothing gets changed for Q1 except VaR and BIII Tier 1?
- This is just something you found in your internal risk management, right?

Andrew Marquardt – Evercore – Sellside

- Is this something we should be concerned about in terms of the culture and risk management across the firm?
- Is this just a strategy gone wrong? On the wrong side of a trade?
- Is this a red flag for regulators? Are the regulators now going to review your controls?

Permanent Subcommittee on Investigations
EXHIBIT #95

- Can you explain what happened in terms of reducing the credit protection? What was the strategy? What was the change?
- Any impact on buybacks?
- Anything else in the Q that changed?
- Thought it was a good call; appreciate the conversation being upfront, the JPMorgan way

Guy Moszkowski – BACML – Sellside

- Thank you for the public apology
- What does the repositioning of hedges mean?
- Is the $127B of derivative disclosure related to the $2B losses?
- How sweeping are the changes not just in model but in personnel?
- Did you restate the 12/31 VaR?
- Did Jamie say that the old model was inadequate?
- Can you continue to do buybacks? Any updates to that? What about the Fed? They just issued $12-$15B in buybacks. Are they going to rescind their authorization?
- The 20 bps decline in Basel III, was that related to the stressed VaR?
- Is it fair to say that if you had suffered theses losses in the IB you wouldn't have had this call but because this was in CIO and you were so far off guidance that you felt you had to have this call?
- This will look like prop trading to a lot of people; already had Senator Levin on the tapes saying this is why Volcker has to be in place; not good from a Washington stand point
- Embarrassment for JPMorgan but worst for GS and the industry because of the timing of the whole Volcker rule
- Jamie was clearly falling on his sword -- very noble

Richard Ramsden – GS – Sellside

- Restated VaR. On what?
- Change in VaR must be because you changed your risk model correct?
- So you want from a standard model to an advanced model and the model didn't work as you thought?
- You didn't give disclosure on your position. Does that mean your position is still open?
- You must have considerable gains in that portfolio as well correct?
- Are you disclosing this because the auditors thought you should or you thought you should? Was this your decision?
- Did this have to do with all the articles Bloomberg has written?
- Did this hedge have to do with tail-risk? Would have thought you would have made money; unless you were reducing the hedge?
- Are there going to be other type of effects?
- Does this impact the buyback program?
- The impact doesn't really change anything; don't think it was that big; don't think it changes the earnings power and doesn't impact the capital return story; financially, don't think it was a big deal
- Problem is that people don't expect this from you

Jim Mitchell – Buckingham Research – Sellside

- Was this set up to hedge your previous hedges?
- Was it meant to hedge your AFS portfolio from tail risk?
- Why would the VaR change retroactively? In light of this situation, you re-evaluated the prior model?
- What does it mean when you say "not monitored well"?
- This was not related at all to the IB correct?
- When were these positions put on?
- Did the fourth quarter number changed?

Marty Mosby – Guggenheim – Sellside

- Please confirm this was mark-to-market
- This was in the corporate division correct? Not related to clients?

- Can you give details on your hedge?
- Is CIO taking proprietary positions? What do you mean by excess liabilities?
- Was this related to hedge ineffectiveness?
- What was the core thing that you were trying to hedge?
- Have you given the principal outstanding related to the position?

Jeff Harte – Sandler O'Neil – Sellside

- How profitable has the portfolio been?
- Why shouldn't we be concerned about all of JPMorgan's risk management?
- Was the jist of this that you hedged the portfolio, had the hedges for a long time and you were trying to take the hedges off?
- Can you still buyback stock?
- Is it fair to assume this is new guidance? Does this contradict guidance you had given before?
- What was the $7B+ of unrealized gains?
- Is this related to a hedge being ineffective?
- Would the gains or losses show up in the P&L?
- How has the reaction been so far?

Dan Marchon – Raymond James – Sellside

- What is a synthetic credit portfolio?
- On the call, Jamie had mentioned that these were trading losses, but then in the 10Q the language was different, is that the same thing as mark-to-market?

Ben Hesse – Fidelity – Buyside

- Over the Easter weekend we spoke and you said there was no losses related to this
- Have a lot of contacts in Washington who said this is going to be a big deal for Volcker; need to manage this in DC because the hit there is going to be a lot bigger than the hit on earnings

Greg Wachsman – Lord Abbett – Buyside

- Is the $2B realized or unrealized?
- So from my understanding it sounds like you're managing exposure at the top of the house, and then you have some repositioning and re-hedging of the portfolio – can you go over it again what transpired because I need to better understand what happened?
- Synthetic credit portfolio – what is that? Is that CDS? What does that entail?
- What did he mean when he said, "it could be another billion on top of that"?
- Can you quantify the absolute long-term loss?
- Do you know what the notional loss amount was?
- The VaR changed from $67mm to $129mm – can you talk about the model behind it?
- Was this a hedge or prop trading?
- Any capital plan changes?
- Since it wasn't that material, why did you guys host the call?

Matthew Antle – Putnam Investments – Buyside

- When you gave your Basel III hit, did you consider the multiplier effect?
- Soc Gen had to adjust their VaR even higher after their rogue trading incident – is this considered rogue trading?
- Did the Fed confirm that you can continue to do share repurchase?

Jeff Busconi – Viking – Buyside

- What does the $67mm in VaR represent in the restated supplement?
- Is the real problem in the marking of the position? Was it mismarked, or did it move against you?
- Why did you come out and do this call? It seems like to numbers aren't that big. "I'd say the $800mm loss is immaterial." All the dealers on the Street know what the position is, and my guess is other people would know

what the position is before long. Seems like you've exacerbated the issue. Most of the dealer community is aware of the positions

- What are the changes you've made in risk management?
- How is the CIO office actually structured? Does the CIO report to Jamie?
- Was part of the losses an adjustment to your mark?
- There are probably other counterparties on the other side of the trade if these are synthetic that are aware of the position. And, I'd guess the dealer community is aware of the position as well. It must be a pretty big notional amount to have lost $2B in a short amount of time. $2B is not large relative to your balance sheet, but it is big in the context of tranches.

Bill Rubin – Blackrock – Buyside (e-mail)

This note further below from Ed Najarian says it all.
I've spoken with several of our team members at Blackrock.
Please forward the following comments to executive management if you deem appropriate.
We are very disappointed by this turn in events, not so much by the size of the loss, but more by the bad stumble in risk management/controls.
Major reputation and sentiment hit, damaging.
Stepping up and coming clean, mea culpa, was the right thing to do. Appreciated.

We expect aggressive response on 4 fronts:
1) As smoothly as possible exiting riskiest remaining positions with least amount of further damage to balance sheet and inc statement, and fixing policies/procedures/risk controls,...as Jamie Dimon discussed.
2) Offsets...are tax implications from reaping further securities gains really that prohibitive?
3) Yet another look at cost reductions where possible/feasible...especially with weaker capital markets revenues in 2Q and likely 2H12, we believe the cost structure remains too high. We believe JPM's revenue opportunity will not be hurt by reducing costs further - the company and most of its people are too good to not capture opportunities when they arise, and being another -1%2% lighter in costs will not materially diminish that capability.
4) Buy back stock more aggressively. For what it's worth, at ~ $38 price, we believe P/BV 0.8x, P/TBV 1.1x, and P/E 7x is stupid cheap. The market cap of JPM will be down at least $10 billion tomorrow. If the company can truly generate $24 bn in net income in a couple years, any stock repurchase anywhere remotely close to these stock prices will be very, very attractive prices indeed.

Just ideas and suggestions to consider.
Please forward to executive management if you deem appropriate.

(Ed Najarian's note below.)

ISI: JPM - JPM announces $2bn trading loss
Company Note: JPMorgan Chase (Buy, $52 PT)
Maintain Buy; stock over-discounting the loss

* **After the market closed, JPM announced a slightly more than $2bn mark-to-market trading loss in a synthetic credit portfolio** that was initially designed to hedge global credit exposure. The hedge was initially designed to deliver positive revenue in a credit stressed environment. However, a first quarter strategy to reduce the hedge was poorly designed, poorly executed, and poorly monitored and have resulted in more than $2bn in mark-to-market losses thus far in 2Q. JPM plans to partially offset the loss by reaping $1bn of investment securities gains. Thus, the net loss to 2Q EPS thus far is about $800mm after tax or equal to about $0.21 per share. Additionally, the loss could grow or shrink over the balance of this quarter and is likely to lead to more earnings volatility over the balance of this quarter and next quarter. For example, it is not unreasonable to assume that JPM could lose another $1bn on this position. Accordingly, based on this loss and our perception that core trading revenue has been weaker than expected thus far in 2Q, we are reducing our 2012 EPS estimate by $0.35 from $5.05 to $4.70. We are maintaining our 2013 and 2014 EPS estimates at $5.50 and $6.10. We are also maintaining our one year price target of $52.

*** However, JPM stock is now off nearly 7% in after hours trading or about $2.70 per share.** We would note that with JPM stock off $2.70/sh that represents about $10bn of lost market cap based on only a $2bn pre-tax trading loss. We find it very difficult to imagine that this poorly structured synthetic credit position will ever lead to $10bn of cumulative after-tax losses. We would expect the cumulative loss figures to remain significantly below that threshold (perhaps in the several billion dollar range and thus not more than $1 per share). Additionally, we remind investors that JPM recently received approval to repurchase up to $15bn of stock over the 12 months from 3/31/12 - 3/31/13 and we fully expect JPM to use near term weakness in the stock to buy it back aggressively. Furthermore, at a current after-hours price of about $38 this stock is yielding 3.2%. Accordingly, we would advise investors to not sell into tomorrow's weak JPM stock price. In fact, we would regard tomorrow's weakness as a buying opportunity.

*** While this incident is unfortunate and clearly represents a major error of judgment, risk management, and execution within the Chief Investment Office of JPM,** we have confidence that JPM will work diligently, aggressively, and thoughtfully to resolve it in the best way possible with a focus on minimizing its additional damage to shareholder value. Finally, we note that based on this position JPM did revise its 3/31/12 Basel 3 Tier 1 Common equity ratio to 8.2% from 8.4%. But the company remains well positioned to repurchase significant amount of stock and surpass a 9.5% Basel 3 threshold by the end of 2013.

Voicemails (calls returned; left vm; will connect tomorrow)

- Sellside: Thang To (ISI junior), John Dunn/Marc Lombardo (Meredith Withney), Paul Miller (FBR)
- Buyside: Kush Goel (Neuberger), Dick Manuel (Columbia), Bill Auslander (Alliance Bernstein), Patrick Hughes (Olayan), Ryan Long (Chesapeake), Jay Mai (Glenview), Ryan Lentell (Manulife), John Baldi (Clearbridge), Ravi Chopra/Jeff Barnes (Samlyn), Greg Anderson (UBS AM)

Sarah

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Raw Transcript

10-May-2012

JPMorgan Chase & Co. *(JPM)*

Business Update Call

Permanent Subcommittee on Investigations
EXHIBIT #96

MANAGEMENT DISCUSSION SECTION

Operator: Please stand by. We are about to begin. This call is being recorded. Your lines will be muted for the duration of the call. Please stand by.

At this time, I would like to turn the call over to JPMorgan Chase's Chairman and CEO, Jamie Dimon. Mr. Dimon, please go ahead.

Jamie Dimon

Operator, thank you. Good afternoon, everybody. I would like to thank you all for joining on short notice. I want to update you on a few items that we have in our just filed 10-Q.

Specifically, we had given prior guidance that Corporate – that net income in the Corporate segment – notice it's not the corporation, it's one of the segments – ex Private Equity and litigation would be approximately plus or minus $200 million. This includes the CIO's overall performance.

We currently estimate this number to be minus $800 million after-tax. This change is due to two items, both in CIO this quarter – I'm going to get back to give you pre-tax numbers now – slightly more than $2 billion trading loss on our synthetic credit positions and a $1 billion of securities gain, largely on the sale of credit exposures.

I want to remind you that CIO has over $200 billion in its investment portfolio and unrealized gains as of March 30th of $8 billion. CIO manages all its exposures in total as a whole, and it doesn't in light of the Firm's total requirements.

We are also amending a disclosure in the first quarter press release about CIO's VAR, Value-at-Risk. We'd shown average VAR at 67. It will now be 129. In the first quarter, we implemented a new VAR model, which we now deemed inadequate. And we went back to the old one, which had been used for the prior several years, which we deemed to be more adequate. The numbers I just gave are effective March 30th, the first quarter.

Regarding what happened, the synthetic credit portfolio was a strategy to hedge the Firm's overall credit exposure, which is our largest risk overall in its trust credit environment. We're reducing that hedge. But in hindsight, the new strategy was flawed, complex, poorly reviewed, poorly executed and poorly monitored. The portfolio has proven to be riskier, more volatile and less effective than economic hedge than we thought.

What have we done? We've had teams from audit, legal, risk and various control functions all from corporate involved in an extensive review of what happened. We have more work to do, but it's obvious at this point that there are many errors, sloppiness and bad judgment. I do remind you that none of this has anything to do with clients.

We've had many lessons learned and we've already changed some policies and procedures, as we've gone along. In addition, you should know that all appropriate corrective actions will be taken, as necessary, in the future. Most important, some of our best talent from across the company, particularly traders and risk managers, are fully engaged in helping to manage the portfolio.

The portfolio still has a lot of risk and volatility going forward. So how are we going to manage that? So, number one, we're going to manage it to maximize the economic value for shareholders. What does that mean? It means that we're not going to do something stupid. We're willing to hold as long as necessary inventory, and we're willing to bear volatility.

Therefore, the volatility for the rest of this quarter and next quarter or so will be high. It could cost us as much as $1 billion or more. Obviously, we're going to work hard to have that not be a negative at all. But it is risky, and it will be for a couple of quarters.

Clearly, markets' and our decisions will be a critical factor here. Hopefully, this will not be an issue by the end of the year, but it does depend on the decisions and the markets – the decisions we make in the markets we have.

However unfortunate this event is, I do want to put this in perspective. One of the reasons we keep a fortunate balance sheet is to handle surprises, although this is not the kind of surprise we wanted to have. Our Basel I ratio will stay very strong and it doesn't change at all as a result of – March 31 result is, our Basel III ratio, which remembers a rough estimate anyway will be amended down to 8.2% from 8.4% effective March 30. We will however in the future continue to meet our very conservative targets for both Basel I and Basel III.

While we don't go – I also want to say, while we don't give overall earnings guidance and we are not confirming current analyst estimates, if you did adjust current analyst estimates for the loss, we still earned approximately $4 billion after-tax this quarter give or take.

Neither of these things absorbs us from blame. So speaking for the Senior Management team and myself, while we can't assure you we won't mistakes, we will – we can assure you we are going to try not to. These were grievous mistakes, they were self inflicted, we were accountable and we happened to violate our own standards and principles by how we want to operate the company. This is not how we want to run a business.

We will discuss all these matter and more and in fulsome detail on our second quarter analyst call and we are going to take some questions on this call. I do want to tell you now we are not going to take questions about specific risk positions, strategies or specific people.

Finally, however unfortunate incident is, we will do what we always do, we admit it, we will learn from it, we will fix it, we will move on, hopefully in the end, it will make us a better company. We are business to serve clients and nothing here distracts all the great things that our 203,000 employees around the world do every day for our clients and communities.

So thank you for spending a little time with us and we'll be happy to take a few minutes of questions.

QUESTION AND ANSWER SECTION

Operator: Your first question is from Glenn Schorr with Nomura.

Glenn Schorr — Q

Hi thanks. Just curious on when this was caught, if it wasn't caught internally or caught by a regulator when you update the regulators, when you talk to the rating agencies, just curious on how all inner workings works?

Jamie Dimon — A

You should assume that we try to keep our readers update about what we know and when we know it and it's just a constant practice of the company. And when I said, it was caught, we started dig into this more and more, most of things were bearing big losses in the second quarter. And of course, when you start to see something like that you act probably – obviously we should have acted sooner.

Glenn Schorr — Q

So I am not clear when did the losses accumulate? In other words was this something that happened most recently or this was an era in the past and is just updating your risk amount now?

Jamie Dimon — A

There were small ones in the first quarter, but real ones that we talked about the $2 billion were all in the second quarter. And it kind of grew as the quarter went on. And obviously it got our attention, that and other things, which come to our attention.

Glenn Schorr — Q

Got it. Okay, thanks, Jamie.

Jamie Dimon — A

You are welcome.

Operator: Your next question is from Guy Moszkowski with Bank of America Merrill Lynch.

Jamie Dimon — A

Hey, Guy. Guy?

Operator: Guy, your line is open. Please make sure that your line is not muted. There is no response from Guy. So we will move to the next question, that question is from Matt Burnell with Wells Fargo Securities.

Matthew Burnell — Q

Good afternoon, Jamie. Just two interrelated question, does this change your capital plan for 2012, or does this have any effect of the regulatory plan that submitted earlier this year to the regulators?

Jamie Dimon — A

No. I do want to say one other thing that a lot of us have analysis week, buy-side and sell-side and we feel terrible because we obviously knew a lot but because of FD we couldn't say anything. So on behalf of all of the JPMorgan people who did that and I personally know that it's the [indiscernible] this week we do obviously apologize for that.

Matthew Burnell — Q

Thank you.

Operator: Your next question is from Moshe Orenbucb with Credit Suisse.

Moshe Orenbuch — Q

Great, thanks. Was that – the 1 billion of securities gain you said was related to that coming out of CIO was that part of the same reduction and could you talk a little bit about the process of kind of mitigating the risk of the balance of the next couple of quarters?

Jamie Dimon — A

Yeah, we wanted to reduce our overall credit exposure and there were AFS securities in CIO gains we sold those and took gains.

Moshe Orenbuch — Q

And in terms of the process of getting the exposure down over the next several quarters, I mean can you talk a little bit about – about how that...

Jamie Dimon — A

We're going – we have the top teams involved we've reviewed a couple of – probably a couple of times a day at this point and I've always said that the principle wise how we're going to do that. Maximize economic value, volatility obviously you can lose more money and I mean I can repeat it five times but that's what we're going to do.

Moshe Orenbuch

Q

Okay, thanks.

Jamie Dimon

A

Yeah.

Operator: Your next question is from Matt O'Connor with Deutsche Bank.

Jamie Dimon

A

Hi, Matt.

Matthew O'Connor

Q

Hi. I hope this is another stupid question but I guess when I sit back and I think about the earnings power and all the moving pieces of your company my first thought is on a net basis $1 billion I guess I still like the message maybe it's worst than what the numbers are and I'm trying to better understand you know why you felt like you need to disclose it in the Q, what's – because last quarter you had 2.5 billion of litigation and you absorbed that then some.

Jamie Dimon

A

Yeah.

Matthew O'Connor

Q

So it just seems like...

Jamie Dimon

A

No, it's a very good question and that fact is, first of all – we've already said it could get worse and it's been going on for a little bit, unfortunately. That's number one. Number two is, so soon after the end of the first quarter when we basically gave you different kind of guidance.

And number three just what to tell you what we know, we're not telling its worse, not could I completely agree what you said. It's not going to stop us to building a great company. But it's unfortunate and of course it's going to raise questions and we just want to answer those as best we can.

Matthew O'Connor

Q

Okay. Thank you.

Operator: Your next question is from John McDonald with Sanford Bernstein.

John McDonald — Q

Yes.

Jamie Dimon — A

Hi, John.

John McDonald — Q

Yeah. Hi, Jamie. So just – while we have you, did – was there any other items in the Q that changed in terms of your outlook not having any chance to go through it yet?

Jamie Dimon — A

I don't know it they were running it on CNBC, the litigation and potential future, but I think it was like almost the same number from the past. And I think most of the guidance was approximately the same, right?

A

A little bit of guidance around the investment bank trading and...

Jamie Dimon — A

Right, okay.

A

And mortgage margin?

John McDonald — Q

Okay. No, change on your expense. You're still looking to keep you adjusted at the 49 billion this year?

Jamie Dimon — A

There was – yeah, there was no comment in there at all.

John McDonald Q

Okay. So we should assume you're still shooting for that?

Jamie Dimon A

Well, of course. Yeah. But that can change too, but yes.

John McDonald Q

Okay. And then, any – too early to kind of just think about a broader rethinking of CIO and how it's structured or how you managed the risk that you're looking to hedge there. Is it too early on that or any comments just from a big picture there?

Jamie Dimon A

Yeah, so all – remember all banks have fairly big – all banks have portfolio and big banks have basically large portfolios. You have to invest excess cash, have invested around the world in deposits and remember the CIO has done a great job for a long extended period of time. This was a unique thing we did and obviously it had a lot of problems and we are changing appropriately as we are getting our hands around it, but we are going to have a CIO who is going to have talented people there, continue to do what they've always done.

John McDonald Q

Okay. And a last thing, the $800 million for this quarter, that's only for this quarter, you are not talking about continuing we will see on the future quarters but that's just for this quarter right.

Jamie Dimon A

It's this quarter currently. So we were telling you, there is going to be a lot of volatility here and could easily get worse this quarter or better, but could easily get worse and the next quarter we also think we have a lot of volatility next quarter. I am not going to update about number changes a lot. We are not going to make calls every time the number moves around, by $0.5 billion.

John McDonald Q

Okay. Thanks.

Jamie Dimon A

Okay. Yes.

Operator: Your next question is from Bill Rubin from BlackRock.

Bill Rubin

Q

Yes. I don't know if this was asked or ranched [ph] yet, but this doesn't change anything with the c-core [ph] capital plan or the buyback capability at all, does it?

Jamie Dimon

A

I don't think so because our capital is strong, we are going to meet all our commitments, we can handle highly stressed environment, so no, we don't think so.

Bill Rubin

Q

So you can be in the market tomorrow after this?

Jamie Dimon

A

I believe so.

Bill Rubin

Q

Okay. Thanks.

Jamie Dimon

A

My general counsel is sitting right here, so he would have kicked me if I was wrong.

Bill Rubin

Q

Thank you.

Operator: Your next question is from Guy Moszkowski with Bank of America Merrill Lynch.

Guy Moszkowski

Q

Hi hopefully this will work better.

Jamie Dimon

A

Hey Guy, did you hear my little apology?

Guy Moszkowski Q

No, I didn't. But I didn't hear anything for a few minutes. So – but, thank you.

Jamie Dimon A

I apologize. When you were here, I knew you were here and I didn't have – obviously I couldn't tell you about this and, of course, I feel terrible about that.

Guy Moszkowski Q

Well, that's okay. Thank you. Listen, I'd really like to understand what type – why you felt that you needed to add this kind of synthetic credit exposure? Were you...

Jamie Dimon A

Okay.

Guy Moszkowski Q

Were you not esteemed that you had enough exposure through core lending businesses, and what was going on?

Jamie Dimon A

Exactly. The original premise of the synthetic credit exposure was to hedge the company in a stress credit environment. Our largest exposure is credit across all forms of credit. So we do look at the fat tails that would affect this company. That was the original proposition for this portfolio.

In re-hedging the portfolio, I've already said, it was a bad strategy. It was badly executed. It became more complex. It was poorly monitored. We don't – obviously, we don't have to do anything like this at all, if we don't want. And I understand you can ask that question. So I don't want to give you specifics because we've already said we're not going to talk about the actual positions or anything like that.

Guy Moszkowski Q

And, Jamie, the $1 billion that you referred to in your prepared remarks about – of incremental loss potential, is that the max that you envision above and beyond this sort of net $800 million...

Jamie Dimon A

No.

Guy Moszkowski — Q

... after-tax number?

Jamie Dimon — A

No. That is – I said the volatility could easily be that. Obviously, it could be worse than that. We're going to manage this for economics. Hopefully, by the end of the year, it's the hope that this won't be a significant item for us. We want to maximize the economic value of these positions and not panic to do anything stupid. Therefore, we're willing to hear volatility.

Guy Moszkowski — Q

And the final question is how liquid do you view these exposures as being? In other words, granted you don't want to, you know, make economically silly decisions and just cut it off right here, but how easy would it be for you to exit completely and just call it a day and be done with it?

Jamie Dimon — A

I think, I have already said, I am not going to talk about specific risk positions at all.

Guy Moszkowski — Q

Okay, I am not asking specific positions just liquidity.

Jamie Dimon — A

Yet, you are getting specific. We will do what we have to do to maximize the shareholder value. We've got to stay in power and we are going to use it.

Guy Moszkowski — Q

Okay, fair enough. And thanks very much and thanks for putting me back in the queue. Appreciate it.

Operator: Your next question is from Brennan Hawken with UBS.

Brennan Hawken — Q

Hi. Just kind of curious to the extend that you can comment, if you – if the regulators are aware of this and whether there has been any regulatory response, if there is heaven forbid any kind of vocal related implications on this matter?

Jamie Dimon

A

I think you should assume, I can answer this 100 times, you should assume that we keep our regulators up to date. That is a policy of the company. Sometimes you don't give them great information, we don't have great information. You can assume they are up to date. They will take their own point of view on this.

Brennan Hawken

Q

Okay. I just didn't know whether they made...

Jamie Dimon

A

We always said, this violates our principles whether or not it violates Volcker principles and you know we want to run and build a great company. We do believe we need to have the ability to hedge in a CIO type position and that Volcker allows that. This trading may not violate the Volcker rule but it violates the diamond principle.

Brennan Hawken

Q

Okay. And you had mentioned that this was a new strategy that you had decided to exit, is it possible for you to let know how new that strategy was?

Jamie Dimon

A

Not new, it was the – I said new but what I meant is it was the strategy to reduce the credit hedge. So it's kind of a new strategy was devised. And as I already said it was poorly constructed and poorly monitorial that and that's the place over the course of less couple of months.

Brennan Hawken

Q

And the implication I guess might have been that there was all this fresh speculation about certain trading individuals out of London where some staff fairly new that came into execute this new or this some of this new angle and are those folks no longer in that that's been retriggered I think you said, right?

Jamie Dimon

A

No, no nothing new folks a little bit to do with the Oracle the press so it was somewhat related to that it's obviously more than that but somewhere related to that. And I also think we acted a little too defensively to that.

Brennan Hawken

Q

Okay, thanks for the color.

Jamie Dimon

A

Yeah.

Operator: Your next question is from Mike Mayo with Credit Agricole Securities.

Mike Mayo

Q

Hi.

Jamie Dimon

A

Hi.

Mike Mayo

Q

How much of the $2 billion trading loss is due to terrible execution which you mentioned versus the environment you seem to be implying none of this is due to the environment?

Jamie Dimon

A

No, no I'm sorry. I think in hindsight their strategy that execution obviously the environment because these are mark to market positions. So obviously that. I just don't want to make excuses and start talking about market and dislocational stuff like that because that's truly just an excuse.

Mike Mayo

Q

And so would this be a JPMorgan specific issue or is there a chance to others also have some losses on similar positions?

Jamie Dimon

A

I don't know just because we are stupid doesn't mean everybody else was. I have no idea what the people are doing.

Mike Mayo

Q

And just in real simple terms in six weeks you lost $2 billion so – and as simple as you can simple it what went wrong?

Jamie Dimon

A

You already mentioned, there're huge moves in the market place, is a – we made this position more complex. The strategy was barely executed, barely monitored. And like I repeated 800 times, I'm not going to get into too more specifics than that.

Mike Mayo Q

And you mentioned...

Jamie Dimon A

But Mike, we will be – I already said, at the end of the quarter we will be talking more about this to satisfy your needs and ours.

Mike Mayo Q

And you – can you say what recon [ph] this was done and you're not going to disclose any of that?

Jamie Dimon A

Global.

Mike Mayo Q

Global. And what caused you to change the VaR model in the first place? I mean you had something that was working and you changed it.

Jamie Dimon A

There are constant changes and updates to models, always trying to get them better than they were before. That is an ongoing procedure.

Mike Mayo Q

And this is kind of sensitive, but you've – probably just helping the company of having – being great risk managers and this is mistake and you'll – as you say, you'll learn from that. But is there any sense that the mistake made in the CIO office could also be in place where at JPMorgan?

Jamie Dimon A

Mike, we operate in a risk business and obviously it puts egg on our face and we deserve any criticism we get, so feel free to give it to us. We'll probably agree with you. But we think we run a pretty good company, with pretty good risk controls and pretty risk management. We are not in a business where we're not going to make mistakes; we are going to make mistakes.

We've always said that, hopefully this small, hopefully few and far between. I'm sorry, could never promise you no mistakes. This one, we will put in egregious category and I understand full why you or anybody else will question us generally.

Mike Mayo — Q

And lastly, just one last follow-up. You said you had some smaller losses in the first quarter whether – even in retrospect were there any sings that perhaps you should have paid more attention to looking back?

Jamie Dimon — A

Yes. In retrospect, yes.

Mike Mayo — Q

What would those be?

Jamie Dimon — A

Trading losses.

Mike Mayo — Q

Okay. So actually...

Jamie Dimon — A

There is some stuff in the newspaper and bunch of other stuff.

Mike Mayo — Q

Got it.

Jamie Dimon — A

Hindsight is – even in hindsight, it's not 20/20. But with hindsight, yes, obviously, we should have been paying more attention to it.

Mike Mayo — Q

All right. Thank you.

Jamie Dimon

A

Yeah. You're welcome.

Operator: Your next question is from Chris Kotowski with Oppenheimer.

Chris Kotowski

Q

Yeah. Hi. You said that you still have an $8 billion gain in the AFS securities portfolio. So should we assume that that's the combination of some gains and sort of the plain vanilla investment portfolio securities that you normally have and then a negative position here?

Jamie Dimon

A

No. The $8 billion – the synthetic credit is mark-to-market. There are no unrealized gains or losses. The AF portfolio is held at cost. The $8 billion is an unrealized gain in the AFS portfolio. And if you go to our 10-Q, you could see exactly where those gains reside as of December 31st.

Chris Kotowski

Q

Okay.

Jamie Dimon

A

Okay. They're in positions all over from mortgages, etcetera.

Chris Kotowski

Q

All right.

Jamie Dimon

A

And we can take some of those gains...

Chris Kotowski

Q

Okay.

Jamie Dimon

A

We can take some of those gains, and we can take them to offset this loss. We can take them because we want to reduce other exposures. But usually, it's tax inefficient. So we're very careful about taking gains.

Chris Kotowski

Q

Right. And so when you said this quarter there was $1 billion of gains and a $2 billion trading loss, the $1 billion of gains, that was in other portfolios. It had nothing to do with these.

Jamie Dimon

A

No. The $1 billion of gains is in the AFS portfolio. On March 31st, it had an $8 billion unrealized gain. We realized $1 billion of it, bringing it down to $7 billion, but it's higher today than it was then. So it should be something 7-plus right now.

Chris Kotowski

Q

Okay. And I have a feeling, I know the answer, but obviously in a skittish world where people are always worked about exposures to pigs and all these kinds of things and there is always a feeling that one can rarely get the real exposures, is there any way you can draw a box around how big the bread box is and...

Jamie Dimon

A

I've already done that for you, to the extent I am going to do it.

Chris Kotowski

Q

Okay. Thank you.

Jamie Dimon

A

You're welcome.

Operator: Your next question is from Keith Horowitz with Citigroup.

Keith Horowitz

Q

Hey Jamie. Thanks for coming clean on this and I think it's important that you did, I guess the question I really had is you are open about the strategy that was poorly monitored, but the real question I guess I had is do you feel that the hedge put on, the position put on, was the intention really to hedge or do you feel like the person you put it on, his intention for profits [ph] or to make sure...

Jamie Dimon

A

It's been on for a long time, it actually made money. I won't talk about what it did, it actually did quite well. It was there to deliver a positive result in a quite stressed environment and we feel we can do that and make some net income. And that was – and in the process of changes new environments, new markets and all that, I've already described the outcome.

Keith Horowitz

Q

So we had a stressed environment in terms of credit and so this is where your strategy [ph] didn't work but you feel that as you go back and put money more in quarter back and you look at how the position got so big, do you feel that it was done with the intention of trying to hedge the tail risk for JPMorgan?

Jamie Dimon

A

I know it was done with the intention to hedge the tail risk for JPMorgan, but I am telling you, it morphed over time and the new strategy which was meant to reduce the hedge overall made it more complex, more risky and it was unbelievably ineffective. And poorly monitored and poorly constructed and poorly reviewed and all that.

Keith Horowitz

Q

Okay. The other thing on that is you had guidance of 200 million per quarter for corporate and its mostly for 2012 but as you kind of think longer term for that business line is that a business line you still think will continue to make money or is this kind of meant to be more just hedge...

Jamie Dimon

A

It's not a business line for the most part it is net corporate expenses which move around we always give you what we think that number is going to be so you can put in your models. And it's the net income that is not allocated from CIO's portfolio to the businesses. The net income from CIO's portfolio is allocated on the consistent basis and this is the net residual space here. There are also other things in corporate that run through this. You know there is just a lot of things that run through corporate. So as you know the 200 million was its kind of a guidance that bounce around overtime.

Keith Horowitz

Q

And then the last question is I guess when you thought about the business when you took over and you thought about this corporate line business is going to shape up investment office do you feel like the mandate has changed over the last five years or do you feel that the mandate is still the same as it was five years ago?

Jamie Dimon

A

You know a little change I mean first of all when we got here remember the portfolio went from $150 billion to 300 there were a lot of cash coming in which we had to invest. And we did – I think we improved – I read somewhere that we made it more aggressive I wouldn't call more aggressive I would call better which we added different types of people, talented people and stuff like that. That is what we were supposed to do. We will manage that fixed income portfolio to maximize the returns to the shareholders and we've been very, very careful. So look at all the things we've done we've been very careful. So if you look at all of the things we've done, we've been very careful and, I think, quite successful. And this is obviously not in that category.

Keith Horowitz

Q

Okay. Thank you.

Jamie Dimon

A

All right. I should point out to all the folks on the phone, you could see – you can go to the 10-Q and see what people have those portfolios. And some banks do some things and some do others, but to invest it in actual [ph] deposits, you buy securities. That's been going on for 100 years in banking.

Operator: [Operator Instructions] Your next question is from Nancy Bush with NAB Research.

Jamie Dimon

A

Hey, Nancy.

Nancy Bush

Q

Good afternoon. Obviously, Jamie, the timing of this could not be much worse. And I kind of go back to the Volcker issue. If Dick Durbin stands on the floor of the Senate tomorrow and says this is why we need the Volcker Rule, what's your replay?

Jamie Dimon

A

It is very unfortunate. But the fact of it is this does not change analyses, facts, detailed argument. It is very unfortunate. It plays right into all the hands of a bunch of pundits out there, but that's like not to do with that.

Nancy Bush

Q

Okay. Thank you.

Operator: There are no further questions at this time.

Jamie Dimon

Folks, thank you very much. We're sorry to have to call you on a short notice for something like this, but we appreciate you taking the time. Thank you.

Operator: Thank you for participating in today's teleconference. At this time, you may now disconnect.

JPMORGAN CHASE & CO.

February 4, 2013

Douglas L. Braunstein
Vice Chairman

Zachary I. Schram, Esq.
Senior Counsel
U.S. Senate Permanent Subcommittee on Investigations
199 Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Schram:

I am writing to clarify one aspect of my interview with you and others on September 12, 2012, as to which I understand from discussions with my counsel that there may be some misunderstanding.

By way of background, between April 5 and April 13, I received information from a number of sources regarding the CIO/London Whale issue. During that period, I had numerous conversations with Ina Drew, J.P. Morgan's Chief Investment Officer, members of her London-based team, including CIO's Chief Risk Officer and Chief Financial Officer, as well as with John Hogan, J.P. Morgan's Chief Risk Officer. I also reviewed several presentations relating to the CIO's trading strategy and the status of the Synthetic Credit Book as of April. During the interview, I specifically recalled, and directed your attention to, the "Synthetic Credit Summary: Risk & P/L Scenarios," an eight-page presentation prepared by the London team, with input from C.S. Venkatakrishnan and Olivier Vigernon in Risk Management. That presentation was provided to me and others on April 11. I specifically recall that I referred to page seven of that presentation as one of the bases for my statement on April 13 that J.P. Morgan was "very comfortable" with the positions, and I directed your attention to the central scenarios included on that page describing an 80% likelihood of a range of outcomes between a loss of $250 million and a gain of $350 million.

I wish to clarify two points. First, I did not state during the interview that I had relied on page seven of the April 11 presentation for my understanding regarding the hedging characteristics of the portfolio. Second, my statements on April 13 regarding those hedging characteristics were references to the portfolio's design and historical performance as a hedge. I was not commenting on the hedging effectiveness of the portfolio as of April 13.

I hope this information is helpful to you and your colleagues. Please contact Reg Brown (202-663-6430) or Harry Weiss (202-663-6993) if you have any further questions.

Sincerely yours,

Doug Braunstein

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Permanent Subcommittee on Investigations
EXHIBIT #97

Report of JPMorgan Chase & Co. Management Task Force
Regarding 2012 CIO Losses

January 16, 2013

Permanent Subcommittee on Investigations
EXHIBIT #98

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This Report summarizes the review of the JPMorgan Chase & Co. ("JPMorgan" or the "Firm") Management Task Force regarding the losses incurred in 2012 by the Firm's Chief Investment Office ("CIO").[1] These observations are based on a review conducted by the Task Force and its legal advisors, which has included a significant number of interviews of current and former JPMorgan employees, and an examination of millions of documents and tens of thousands of audio files. The Task Force has shared and discussed these observations with the Review Committee established by the Board of Directors (the "Board") as well as the full Board.

I. <u>Executive Summary</u>

This Report addresses three basic questions. First, it addresses *what happened* by describing the trading strategies and activities that in 2012 led to large losses in a portfolio managed by CIO (the "Synthetic Credit Portfolio"). Second, the Report addresses *how it happened* by offering observations about the flawed trading strategies, lapses in oversight, deficiencies in risk management, and other shortcomings this incident has highlighted. Finally, the Report addresses *where the Firm is now* by summarizing the comprehensive remedial measures the Firm has undertaken in light of the lessons learned.

[1] The Task Force was led by Michael Cavanagh, currently co-Chief Executive Officer of the Corporate and Investment Bank.

A. Summary of Events[2]

The Synthetic Credit Portfolio managed by CIO was intended generally to offset some of the credit risk that JPMorgan faces, including in its CIO investment portfolio and in its capacity as a lender. The Synthetic Credit Portfolio was composed of both long and short positions in credit default swap indices and related instruments.[3]

By late December 2011, CIO was considering major changes to the Synthetic Credit Portfolio, both because senior Firm management and CIO management had a more positive view of the economy, and because the Firm was in the midst of an effort to reduce its "risk-weighted assets" ("RWA"), in connection with which senior Firm management directed CIO to reduce RWA. In particular, CIO was considering reducing the size of the Synthetic Credit Portfolio and, as explained afterwards by CIO, also moving it to a more credit-neutral position (a shift from its short risk orientation in the fourth quarter of 2011). CIO was led at this time by the

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[2] The description of "what happened" is not a technical analysis of the Synthetic Credit Portfolio or the price movements in the instruments held in the Synthetic Credit Portfolio. Instead, it focuses on the trading decision-making process and actions taken (or not taken) by various JPMorgan personnel. The description of activities described in this Report (including the trading strategies) is based in significant measure on the recollections of the traders (and in particular the trader who had day-to-day responsibility for the Synthetic Credit Portfolio and was the primary architect of the trades in question) and others. The Task Force has not been able to independently verify all of these recollections.

[3] In simple terms, positions in credit default swap indices can be analogized to buying protection similar to insurance policies on the credit risk presented by groups of companies. Trader A sells Trader B protection (in the form of credit default swaps) against a range of corporate credit events (for example, bankruptcy, failure to pay, and/or restructuring) in exchange for periodic premiums. In this scenario, Trader A is said to be "long risk" and Trader B is "short risk." Unlike most insurance policies, it is unnecessary for the buyer of protection to own the underlying credit risk.

Firm's Chief Investment Officer, Ina Drew, and responsibility for implementing these changes belonged primarily to her, together with the Synthetic Credit Portfolio's managers and traders.[4]

CIO initially considered achieving these goals by unwinding some of the positions in the Synthetic Credit Portfolio, including certain high-yield short positions. In mid-January, however, one of the traders advised Ms. Drew that their unwind efforts had been costly. In response, Ms. Drew said that the team might have additional flexibility on the RWA reduction mandate, and that the team should be more sensitive to the profit-and-loss impact of their trading activities. Thereafter, that trader informed another of the traders who managed the Synthetic Credit Portfolio that he was not to worry as much about RWA reduction, and that he should instead focus on profits and losses. Around this same time, this latter trader was also directed to ensure that the Synthetic Credit Portfolio was well-positioned for future corporate defaults.

In the ensuing weeks, the traders began to add substantially to their investment-grade long positions, and by January 26, the Synthetic Credit Portfolio had a roughly credit-neutral position[5] (as reflected in a measure called CSW 10%).[6] By the end of January, the portfolio's

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[4] The names of certain UK-based individuals have been excluded from this document in order to comply with United Kingdom data privacy laws.

[5] It continued to fluctuate thereafter.

[6] Credit spread widening of 10% ("CSW 10%") is one of several different measurements of how long or short risk a credit book is. CSW 10% stresses all credit spreads in a book upwardly by 10% and then calculates the resulting profit-and-loss effect. This one measure is not determinative of the overall risk status of a portfolio as complex as the Synthetic Credit Portfolio. CSW 10% assumes that all spreads on all instruments for all maturities change by the same percentage at the same time. CSW 10% ignores the historical relationships among various instruments as well as any relationships among them that may be inferred from the market, both of which might provide a more realistic risk predictor. In addition, CSW

year-to-date, mark-to-market losses were approximately $100 million. The traders continued to add to the investment-grade long positions in February. The concept of "defending" their positions may have played a role in these transactions.[7] The traders also at this time began to add substantial high-yield short positions. The traders hoped that the combined effect of these additions would allow them, among other things, to earn premiums (from the addition of the long positions); position the Synthetic Credit Portfolio to earn revenues in the event of corporate defaults (from the short positions); and potentially prevent RWA from substantially increasing (from a combination of both). The losses continued to grow, however: by the end of February, the Synthetic Credit Portfolio had experienced an additional $69 million in reported mark-to-market losses.

The traders continued to grow the Synthetic Credit Portfolio throughout much of March. In the latter half of the month, the traders concluded that the portfolio remained short (notwithstanding the fact that under CSW 10%, it appeared relatively balanced), and they therefore significantly added to its long exposure over the course of several days. By the time Ms. Drew suspended trading in the portfolio on or about March 23, the traders had significantly increased both the overall notional size and the long exposure of the Synthetic Credit Portfolio.

10% does not reflect the impact on a portfolio of a corporate default. The CSW 10% measure is explained in more detail in Section II.D.3.

[7] For an explanation of "defending" positions, see Section II.C.1.

The portfolio's year-to-date mark-to-market losses as of the end of the first quarter of 2012 were approximately $718 million.[8]

On April 5, Ms. Drew informed the JPMorgan Operating Committee that the *Wall Street Journal* and Bloomberg were planning to run stories about CIO's trading and specifically about one trader, who was referred to in the articles as the "London Whale." CIO was asked to and did provide information and analyses about the Synthetic Credit Portfolio to JPMorgan Chief Executive Officer Jamie Dimon, Chief Financial Officer Douglas Braunstein and Chief Risk Officer John Hogan. These analyses concluded, in broad terms, that the Synthetic Credit Portfolio was generally "balanced," that the market was currently dislocated, and that mark-to-market losses were temporary and manageable. One of the traders in particular expressed confidence that mark-to-market prices in the Synthetic Credit Portfolio would "mean revert."[9] On an April 13 analyst call, Mr. Dimon agreed with an analyst's characterization of the publicity surrounding the Synthetic Credit Portfolio as a "tempest in a teapot" and Mr. Braunstein stated that the Firm was "very comfortable" with its positions.

The losses in the Synthetic Credit Portfolio, however, increased in the weeks after the April 13 earnings call. These losses prompted senior Firm management in late April to direct

[8] This figure includes a $155 million liquidity reserve that was taken on certain of the portfolio's positions, but does not reflect the additional losses reported in the Firm's first-quarter restatement described in Section II.C.5.

[9] In this context, the phrase "mean revert" refers to the potential for the prices or correlations of certain instruments held in the Synthetic Credit Portfolio to return to their historic average relationships to other instruments.

non-CIO personnel to review and, ultimately, assume control of the Synthetic Credit Portfolio. A team led by a senior member of Firm-wide Market Risk examined the portfolio, and after analyzing, among other things, correlations of the positions and sensitivities under a range of market scenarios, the team concluded – and informed senior Firm management – that the portfolio faced much greater exposure than previously reported by CIO. The team also found that the market's knowledge of CIO's positions would make it even more challenging to reduce the risks presented by those positions.

In addition to this risk-related review, in preparation for the filing of its Form 10-Q for the first quarter of 2012, the Firm undertook a review relating to the valuations of certain positions in the Synthetic Credit Portfolio. Based on this review, the Firm concluded that its marks at March 31 for the Synthetic Credit Portfolio complied with U.S. Generally Accepted Accounting Principles ("U.S. GAAP"). This conclusion was reached in consultation with the Firm's outside auditors, PricewaterhouseCoopers LLP ("PwC").

On May 10, the Firm disclosed that there were significant problems with the trading strategy for the Synthetic Credit Portfolio. In Mr. Dimon's words, the strategy was "flawed, complex, poorly reviewed, poorly executed, and poorly monitored." The Firm disclosed that the Synthetic Credit Portfolio had incurred slightly more than $2 billion in mark-to-market losses up to that point in the second quarter, with the possibility of additional future losses and volatility.

Shortly after May 10, a Task Force was formed to investigate the causes of the losses. In the course of the Task Force's ensuing work, it became aware of evidence – primarily in the form of electronic communications and taped conversations – that raised questions about the integrity of the marks in the Synthetic Credit Portfolio in March 2012. After consulting with PwC, the Firm concluded that it was no longer confident that the March 31 marks reflected good-faith estimates of the fair value of all the instruments in the Synthetic Credit Portfolio. Accordingly, on July 13, the Firm announced that it would be restating its first-quarter net income, to lower it by $459 million. At the same time, the Firm also announced that it had been expeditiously reducing risk in the Synthetic Credit Portfolio and that the cumulative year-to-date losses through June 30, 2012 had grown to approximately $5.8 billion.

B. Key Observations

The Task Force has made five key observations based on its review. These observations reflect the Task Force's view that direct and principal responsibility for the losses lies with the traders who designed and implemented the flawed trading strategy. They also reflect the Task Force's view that responsibility for the flaws that *allowed* the losses to occur lies primarily with CIO management but also with senior Firm management.

To this end, and before outlining its Key Observations, the Task Force offers its perspective on the roles of some of the Firm's senior-most managers in these events. In particular, the Task Force believes that as the Firm's Chief Investment Officer, Ina Drew failed in three critical areas with respect to the Synthetic Credit Portfolio: *first*, by failing to ensure that CIO management properly understood and vetted the flawed trading strategy and appropriately monitored its execution; *second*, by failing to ensure that the CIO control functions – including the CIO Risk and Finance organizations – were performing well and were providing effective oversight of CIO's trading strategy; and, *third*, by failing to appreciate the magnitude and significance of the changes in the Synthetic Credit Portfolio during the first quarter of 2012, including the increases in RWA, size, complexity and riskiness of the portfolio.

The Task Force also believes that Barry Zubrow, as head of the Firm-wide Risk organization before he left the position in January 2012,[10] bears significant responsibility for failures of the CIO Risk organization, including its infrastructure and personnel shortcomings, and inadequacies of its limits and controls on the Synthetic Credit Portfolio. The CIO Risk organization was not equipped to properly risk-manage the portfolio during the first quarter of 2012, and it performed ineffectively as the portfolio grew in size, complexity and riskiness during that period.

As the Firm's Chief Financial Officer, Douglas Braunstein bears responsibility, in the Task Force's view, for weaknesses in financial controls applicable to the Synthetic Credit Portfolio, as well as for the CIO Finance organization's failure to have asked more questions or to have sought additional information about the evolution of the portfolio during the first quarter of 2012. This includes the failure by CIO Finance to have sufficiently questioned the size of the positions, the increase in RWA notwithstanding the RWA reduction mandate and the Synthetic

[10] John Hogan, who succeeded Mr. Zubrow as the Firm's Chief Risk Officer in January 2012, did not have sufficient time to ensure that the CIO Risk organization was operating as it should. Nevertheless, the Task Force notes that there were opportunities during the first and second quarters of 2012 when further inquiry might have uncovered issues earlier.

Credit Portfolio's profit-and-loss performance. And while the Task Force believes that the principal control missteps here were risk-related, the CIO Finance organization could have done more. That they did not stems, in part, from too narrow a view of their responsibilities – *i.e.*, a view that many of the issues related to the Synthetic Credit Portfolio were for the Risk organization and not for Finance to flag or address.

The Task Force's views regarding Firm Chief Executive Officer Jamie Dimon are consistent with the conclusions he himself has reached with respect to the Synthetic Credit Portfolio. Mr. Dimon has stated:

> CIO, particularly the Synthetic Credit Portfolio, should have gotten more scrutiny from both senior management, and I include myself in that, and the Firm-wide Risk control function. . . . . Make sure that people on risk committees are always asking questions, sharing information, and that you have very, very granular limits when you're taking risk. . . . . In the rest of the company we have those disciplines in place. We didn't have it here.
>
> * * *
>
> These were egregious mistakes. They were self-inflicted, we were accountable and what happened violates our own standards and principles by how we want to operate the company. This is not how we want to run a business.

As Chief Executive Officer, Mr. Dimon could appropriately rely upon senior managers who directly reported to him to escalate significant issues and concerns. However, he could have better tested his reliance on what he was told. This Report demonstrates that more should have been done regarding the risks, risk controls and personnel associated with CIO's activities, and

Mr. Dimon bears some responsibility for that. Importantly, once Mr. Dimon became aware of the seriousness of the issues presented by CIO, he responded forcefully by directing a thorough review and an internal program of remediation. Mr. Dimon reports to the Board, and the Board will weigh the extent of Mr. Dimon's responsibility.

* * * * *

The Task Force's five key observations are summarized as follows:

First, CIO's judgment, execution and escalation of issues in the first quarter of 2012 were poor, in at least six critical areas: (1) CIO management established competing and inconsistent priorities for the Synthetic Credit Portfolio without adequately exploring or understanding how the priorities would be simultaneously addressed;[11] (2) the trading strategies that were designed in an effort to achieve the various priorities were poorly conceived and not fully understood by CIO management and other CIO personnel who might have been in a position to manage the risks of the Synthetic Credit Portfolio effectively; (3) CIO management (including CIO's Finance function) failed to obtain robust, detailed reporting on the activity in the Synthetic Credit Portfolio, and/or to otherwise appropriately monitor the traders' activity as closely as they should have; (4) CIO personnel at all levels failed to adequately respond to and escalate (including to senior Firm management and the Board) concerns that were raised at various points during the

[11] As discussed below, these priorities included (1) balancing the risk in the Synthetic Credit Portfolio, (2) reducing RWA, (3) managing profits and losses, (4) managing or reducing VaR, and (5) providing "jump-to-default" protection.

trading; (5) certain of the traders did not show the full extent of the Synthetic Credit Portfolio's losses; and (6) CIO provided to senior Firm management excessively optimistic and inadequately analyzed estimates of the Synthetic Credit Portfolio's future performance in the days leading up to the April 13 earnings call.

The Task Force has also considered whether compensation might have played a role in these matters. Here, the Task Force has concluded that, although the Firm could have done a better job in communicating to the traders that they would be fairly compensated notwithstanding the eventual wind-down of the Synthetic Credit Portfolio, the Firm's compensation system did not unduly incentivize the trading activity that led to the losses.

Second, the Firm did not ensure that the controls and oversight of CIO evolved commensurately with the increased complexity and risks of CIO's activities. As a result, significant risk management weaknesses developed within CIO that allowed the traders to pursue their flawed and risky trading strategies. On this point, the Task Force has concluded that senior Firm management's view of CIO had not evolved to reflect the increasingly complex and risky strategies CIO was pursuing in the Synthetic Credit Portfolio; instead, they continued to view CIO as the manager of a stable, high-quality, fixed-income portfolio. As a result, they were less focused on CIO relative to client-facing businesses, and did not do enough to verify that CIO was well managed or that the Firm was fully applying its various risk and other controls to the

Synthetic Credit Portfolio's activities.[12] Compounding the matter, the CIO Finance function failed to ensure that its price-testing procedures for the Synthetic Credit Portfolio were being properly and rigorously implemented, and that it produced robust reporting and analytics regarding the portfolio's performance and characteristics. More generally, although primary responsibility for managing risk lies with the business head and Risk organization, the CFO of CIO (like the other members of CIO senior management) missed a number of opportunities during the first quarter to meaningfully challenge the trading strategy.

Third, CIO Risk Management lacked the personnel and structure necessary to manage the risks of the Synthetic Credit Portfolio. With respect to personnel, a new CIO Chief Risk Officer was appointed in early 2012, and he was learning the role at the precise time the traders were building the ultimately problematic positions. More broadly, the CIO Risk function had been historically understaffed, and some of the CIO risk personnel lacked the requisite skills. With respect to structural issues, the CIO Risk Committee met only infrequently, and its regular attendees did not include personnel from outside CIO. As a result, the CIO Risk Committee did not effectively perform its intended role as a forum for constructive challenge of practices, strategies and controls. Furthermore, at least some CIO risk managers did not consider themselves sufficiently independent from CIO's business operations and did not feel empowered

[12] The Task Force recognizes that, by the time the Firm's new Chief Risk Officer was appointed in January 2012, separate initiatives were underway both to ensure that appropriate risk management practices were in place throughout the Firm, and to review and revamp risk limits within CIO. These initiatives came too late to prevent the losses.

to ask hard questions, criticize trading strategies or escalate their concerns in an effective manner to Firm-wide Risk Management. And finally, the Task Force has concluded that CIO management, along with Firm-wide Risk Management, did not fulfill their responsibilities to ensure that CIO control functions were effective or that the environment in CIO was conducive to their effectiveness.

CIO Risk Management made a number of key missteps, including failures to (1) review the appropriateness of the CIO risk limits used from 2009 to 2012; (2) ensure that the change to the CIO Value-at-Risk ("VaR") model for the Synthetic Credit Portfolio in January 2012 was appropriate and being properly implemented;[13] and (3) appreciate thc significance of the changes in the Synthetic Credit Portfolio during early 2012.

Fourth, the risk limits applicable to CIO were not sufficiently granular. There were no limits by size, asset type or risk factor specific to the Synthetic Credit Portfolio; rather, limits in CIO were applied only to CIO as a whole. The absence of granular limits played a role in allowing the flawed trading strategies to proceed in the first quarter, especially as the positions grew in size.

Fifth, approval and implementation of the new CIO VaR model for the Synthetic Credit Portfolio in late January 2012 were flawed, and the model as implemented understated the risks presented by the trades in the first quarter of 2012. As discussed in detail in Appendix A, the

[13] For more information on the issues that were identified by the Task Force with respect to the action plans embedded in the CIO VaR model's approval, see Appendix A below.

model suffered from significant operational shortcomings that received inadequate scrutiny by CIO Market Risk, the Model Review Group, and the model's developer in the model approval process. Moreover, although the model produced significantly different results from its predecessor, the personnel involved in reviewing and approving the new model required only limited back-testing.

C. Remedial Measures

The Firm has taken comprehensive remedial steps to address deficiencies identified since the losses. These include the following:

First, the Firm has replaced the individuals within CIO responsible for the losses. It has terminated the employment or accepted the resignations of the traders and managers who were responsible for the trades that generated the losses, and is pursuing the maximum clawback of their compensation. It has also accepted Ms. Drew's retirement, as well as her voluntary agreement to return or waive amounts that the Firm otherwise deemed subject to a clawback.[14] The Firm has also substantially reduced (in some cases, to zero) the 2012 incentive compensation for a number of employees and, in addition to reductions for specific CIO employees, has also reduced the 2012 incentive compensation pool for all of CIO.

[14] Three of the individuals whose employment was terminated also subsequently agreed to the Firm's clawback demands. In addition, as described in Section IV.A.2, the Firm also expanded the existing protection-based vesting provisions in certain equity awards to include a specific threshold for CIO. These provisions permit the Firm to conduct a review of an employee's compensation in the event the financial results for that employee's business or function fall below a certain threshold and, as appropriate, claw back portions of that employee's compensation.

Second, the Firm has appointed a new, experienced CIO leadership team, headed initially by Matthew Zames and now by Craig Delany as the new Chief Investment Officer,[15] Marie Nourie as the new CIO Chief Financial Officer, and Chetan Bhargiri as the new Chief Risk Officer for CIO, Treasury and Corporate. The new leadership team began promptly to reposition CIO to focus on its basic mandate, and the Firm also has increased resources for key support functions within CIO, including Finance and Risk Management.

Third, the Firm has adopted a variety of governance measures to improve its oversight of CIO, and ensure that CIO is better integrated into the rest of the Firm. For example, the Firm has instituted new and robust committee structures within CIO, and has taken steps to enhance the Firm's internal audit coverage of CIO activities and ensure tight linkages among CIO, Corporate Treasury and other operations within the Firm's Corporate sector.[16] The Firm has also integrated the existing CIO Valuation Control Group ("VCG") staff into the Investment Bank's Valuation Control Group. In addition, the Firm has established a CIO Valuation Governance Forum ("VGF") as part of a Firm-wide initiative to strengthen the governance of valuation activities. The Firm has also mandated that the CIO Corporate Business Review be conducted with increasing frequency, and with the same rigor as similar reviews for the Firm's client-facing lines of business.

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[15] Mr. Delany reports to Mr. Zames, who has been named co-Chief Operating Officer of the Firm.

[16] The Corporate sector (also referred to as the "Corporate/Private Equity" sector) comprises Private Equity, Treasury, Chief Investment Office, and Other Corporate, which includes corporate staff units (such as Audit, Finance, Human Resources, and others) and other centrally managed expense.

Fourth, the Firm has overhauled the Risk Committee for CIO and enhanced the independence of the CIO Risk function. For example, the new CIO Chief Risk Officer's functional reporting practices now conform to his official reporting line; there is no confusion about his accountability to the Firm-wide Risk function. His compensation and career advancement will be controlled by the Firm Chief Risk Officer, with input about his performance from others, as appropriate. CIO's Risk Committee has been renamed the CIO, Treasury and Corporate Risk Committee, and now has broader responsibilities, covering Treasury and Corporate functions as well as CIO, and significant representation beyond CIO. The committee now meets on a weekly basis. Meetings are chaired by Mr. Bhargiri as the Chief Risk Officer for CIO, Treasury and Corporate, and Mr. Zames as the Firm's co-Chief Operating Officer. Attendees also now include other members of senior management, from within and outside of CIO.

Fifth, CIO has implemented more than 200 new or restructured risk limits covering a broad set of risk parameters, including geographic and concentration risks. With respect to the Synthetic Credit Portfolio in particular, a total of 25 new granular limits were applied in May 2012, including limits specific to the Synthetic Credit Portfolio and limits measuring geographic exposure, credit-type exposure, single-index positions (effectively a notional-type limit), and curve shifts and compression.

Finally, under the guidance of its Chief Risk Officer, the Firm has conducted a comprehensive self-assessment of its entire Risk organization and, as a result, has implemented a series of improvements both Firm-wide and within the lines of business. In addition to working to improve model development, review, approval, and monitoring, the Firm is reaffirming and, where appropriate, revising its market risk limits across all of its lines of business, and has already introduced additional granular and portfolio-level limits. It has strengthened the Firm-wide limit excession policy to provide for more rapid escalation and a more thorough review. It is working to further improve market-risk reporting, and has made substantial enhancements to risk reports presented to the Board of Directors' Risk Policy Committee ("DRPC").[17] The Firm also has restructured its Firm-wide Risk Operating Committee in order to increase focus on identifying and implementing best practices across the Firm. Finally, the Firm has enhanced the structure of its Risk Governance Committee and established a Firm-wide Risk Committee.

The Task Force noted that while substantial progress has been made with respect to each of these initiatives, the Firm considers the improvement of its risk practices to be a continuing exercise and thus, its work in this area is ongoing.

[17] According to its charter, the DRPC is responsible for oversight of management's responsibilities to assess and manage the corporation's credit risk, market risk, interest rate risk, investment risk, liquidity risk and reputation risk, and is also responsible for review of the Firm's fiduciary and asset management activities.

II. Key Facts

A. Relevant Personnel

The key individuals discussed in this Report include:

Senior Firm Management

- **Jamie Dimon**: Mr. Dimon is the Chief Executive Officer and Chairman of JPMorgan. Mr. Dimon became CEO on January 1, 2006, and one year later also became Chairman of the Board. He was named President and Chief Operating Officer upon the Firm's merger with Bank One Corporation on July 1, 2004.
- **Douglas Braunstein**: Mr. Braunstein was the Chief Financial Officer and a member of the Operating Committee[18] of JPMorgan between 2010 and the end of 2012, reporting until July 2012 to Mr. Dimon and thereafter to Mr. Zames. He recently stepped down from his role as CFO and currently serves as a Vice Chairman of the Firm. Marianne Lake, the former Chief Financial Officer of the Firm's Consumer & Community Banking business, succeeded Mr. Braunstein as CFO.
- **John Hogan**: Mr. Hogan is the Chief Risk Officer and a member of the Operating Committee of JPMorgan, reporting to Mr. Dimon. Mr. Hogan was

[18] The Operating Committee is the most senior management committee responsible for the major lines of business and functions of the Firm.

appointed to this position in January 2012, and previously served as the Chief Risk Officer for JPMorgan's Investment Bank since 2006.

- **Barry Zubrow**: Mr. Zubrow is the Head of Corporate and Regulatory Affairs. He previously served as Chief Risk Officer of JPMorgan. He reported to Mr. Dimon from the date he joined the Firm in 2007 until July 2012, when he began reporting to Mr. Zames. He served on the Firm's Operating Committee from 2007 until October 2012. Mr. Zubrow announced his retirement from JPMorgan in October 2012; his retirement is effective February 2013.

CIO Management and Traders

- **Ina Drew**: Ms. Drew was JPMorgan's Chief Investment Officer from 2005 until May 2012, when she retired from the Firm. She was a member of the Firm's Operating Committee and reported to Mr. Dimon.
- Other UK-based CIO managers and traders with responsibility for the Synthetic Credit Portfolio who are not named in this document due to United Kingdom data privacy laws.

CIO Risk Personnel

- **Irvin Goldman**: Mr. Goldman was CIO's Chief Risk Officer from January through mid-May 2012, reporting to Mr. Hogan with "dotted line" reporting to Ms. Drew. Prior to becoming Chief Risk Officer, Mr. Goldman had served as CIO's Head of Strategy. He resigned in July 2012.

- **Peter Weiland**: Mr. Weiland was the Head of Market Risk for CIO and the most senior risk officer within CIO prior to mid-January 2012, when he began reporting to Mr. Goldman. Mr. Weiland resigned in October 2012. From 2009 until mid-January 2012, Mr. Weiland reported to Mr. Zubrow, with "dotted line" reporting to Ms. Drew. From January 2012 until May 2012, Mr. Weiland reported to Mr. Goldman. Thereafter, Mr. Weiland reported to Mr. Bhargiri until October 2012.

CIO Finance Personnel

- **John Wilmot**: From January 2011 to mid-May 2012, Mr. Wilmot was CIO's Chief Financial Officer, reporting to Ms. Drew, with "dotted line" reporting to Mr. Braunstein. Prior to serving as the CFO of CIO, Mr. Wilmot was responsible for Bank Owned Life Insurance and JPMorgan Partners Private Equity Investments within CIO. Mr. Wilmot has announced his resignation and is expected to leave JPMorgan in 2013.

Other CIO Personnel

- Other UK-based CIO personnel who were involved at various times with the Synthetic Credit Portfolio but who are not named in this document due to United Kingdom data privacy laws.

Risk Personnel

- **C.S. Venkatakrishnan:** Mr. Venkatakrishnan is the Head of Model Risk and Development. Mr. Venkatakrishnan assumed this position in February 2012, and reports to Mr. Hogan. Prior to February 2012, Mr. Venkatakrishnan was the Head of Investment Bank Structuring and Pricing Direct.
- Other UK-based Risk Personnel who were involved at various times with the Synthetic Credit Portfolio but who are not named in this document for data protection purposes.

B. Overview of CIO and its Functions

JPMorgan is a global financial services firm and one of the largest banking institutions in the United States, with more than 250,000 employees. The Firm had $2.3 trillion in assets and $183.6 billion in stockholders' equity as of December 31, 2011. The Firm's major businesses include financial services for consumers and small businesses (including mortgage lending, student and auto lending, credit card lending and branch banking), commercial banking, financial transaction processing, investment banking and asset management.

JPMorgan's businesses take in more in deposits than they make in loans and, as a result, the Firm has excess cash that must be invested to meet future liquidity needs and provide a reasonable return. The primary responsibility of CIO, working with JPMorgan's Treasury, is to manage this excess cash. CIO is part of the Corporate sector at JPMorgan and, as of December 31, 2011, it had 428 employees, consisting of 140 traders and 288 middle and back office employees. Ms. Drew ran CIO from 2005 until May 2012 and had significant experience in CIO's core functions.[19] Until the end of her tenure, she was viewed by senior Firm management as a highly skilled manager and executive with a strong and detailed command of her business, and someone in whom they had a great deal of confidence.

CIO invests the bulk of JPMorgan's excess cash in high credit quality, fixed-income securities, such as municipal bonds, whole loans, and asset-backed securities, mortgage-backed securities, corporate securities, sovereign securities, and collateralized loan obligations. The bulk of these assets are accounted for on an available-for-sale basis ("AFS"), although CIO also holds certain other assets that are accounted for on a mark-to-market basis.

Beginning in 2007, CIO launched the Synthetic Credit Portfolio, which was generally intended to protect the Firm against adverse credit scenarios. The Firm, like other lenders, is structurally "long" credit, including in its AFS portfolio, which means that the Firm tends to perform well when credit markets perform well and to suffer a decline in performance during a credit downturn. Through the Synthetic Credit Portfolio, CIO generally sought to establish positions that would generate revenue during adverse credit scenarios (*e.g.*, widening of credit

[19] Prior to assuming her role as the Firm's Chief Investment Officer, Ms. Drew had more than 20 years of experience performing asset-liability management for the Firm and its predecessors, including as head of the Treasury function.

spreads and corporate defaults) – in short, to provide protection against structural risks inherent in the Firm's and CIO's long credit profile.[20]

The positions in the Synthetic Credit Portfolio consisted of standardized indices (and related tranches[21]) based on baskets of credit default swaps ("CDS") tied to corporate debt issuers. CIO bought, among other things, credit protection on these instruments, which means that it would be entitled to payment from its counterparties whenever any company in the basket defaulted on certain payment obligations, filed for bankruptcy, or in some instances restructured its debt.[22] In exchange for the right to receive these payments, CIO would make regular payments to its counterparties, similar to premiums on insurance policies. As described in greater detail below, the actual trading strategies employed by CIO did not involve exclusively

[20] Although the Task Force has reviewed certain general background information on the origin of the Synthetic Credit Portfolio and its development over time, the Task Force's focus was on the events at the end of 2011 and the first several months of 2012 when the losses occurred.

[21] CDS index tranches are financial instruments based on a CDS index, where each tranche references a different segment of the loss distribution of the underlying CDS index. Tranches have been issued on several indices, including the CDX North American Investment Grade Index (the "CDX.NA.IG"). The lowest tranche, known as the equity tranche, absorbs the first losses on the index due to defaults up to a maximum of 3% of the total index. The next tranche (mezzanine) absorbs losses of 3–7%. Further losses are absorbed by higher-ranking tranches (senior and super-senior tranches). In return for being more likely to suffer losses, the equity tranche yields the highest coupon (or stream of payments); conversely, the super-senior tranche yields the smallest coupon.

[22] For certain indices, the triggering criteria include other types of adverse credit scenarios. The list of events that trigger payment is established in the CDS contracts, and the question of whether a triggering event has occurred is determined by an industry panel convened by the International Swaps and Derivatives Association.

buying protection or always maintaining a net credit short position (under CSW 10%);[23] rather, CIO traded in an array of these products, with long and short positions in different instruments.[24]

The standardized indices in which CIO traded are created by a company named Markit, and like equity indices, such as the Dow Jones Industrial Average or the S&P 500, these credit indices can be used by market participants to express general market views rather than a view as to one particular company. There are two primary CDS index groups, CDX and iTraxx. CDX is a group of North American and Emerging Markets indices, and iTraxx is a group of European and Asian indices. Each index group has a number of more specialized indices, such as those focused on "investment-grade" ("IG" for CDX, or "MN" for iTraxx) or "high-yield" ("HY" for CDX, or "XO" for iTraxx) companies.

Markit creates a new series of each index every six months; by way of example, the CDX investment-grade index issued in September 2012 is "IG-19" and a corresponding index issued in September 2007 is "IG-9." The newly created indices have updated reference entities: new companies are added to replace those no longer qualifying for inclusion in a particular index

[23] The Synthetic Credit Portfolio's trading strategies sought, among other things, to take advantage of changes in the relative prices (the "basis") among different CDS indices and tranche instruments. These relationships reflect supply and demand in the market, theoretically driven by views on such matters as the relative strength of U.S. versus European credit, or investment-grade versus high-yield corporate credit; the likelihood of deteriorating credit in the short term versus strengthening credit in the longer term; and the likelihood that there will be some, but not too many defaults. In addition, some market participants trade the "skew," or the basis between the index CDS price and prices for the single name CDS that make up the index.

[24] Even when the Synthetic Credit Portfolio was net long under CSW 10%, it could still maintain "jump-to-default" protection.

because of corporate actions, ratings changes, lack of liquidity or other reasons. The date on which a new index is published is referred to as the "roll" date, and because many market participants seek to take positions in the new index, the roll date is typically a time when there is a significant amount of trading and liquidity in the market. After the roll date, the older ("off-the-run") series continue to be traded, and some of those series are liquid, but liquidity typically is concentrated in the newly issued "on-the-run" series. All of these instruments are issued in different maturities, of which the most widely traded are the five and ten years.

As of December 31, 2011, the Synthetic Credit Portfolio contained[25] approximately $51 billion in net notional positions of credit index and tranche positions.

C. Key Events[26]

1. *Trading*

From its inception until late 2011, the Synthetic Credit Portfolio generated roughly $2 billion in gross revenues.[27] Coming into the end of 2011, the Synthetic Credit Portfolio contained sizeable long and short positions in many of the CDX high-yield and CDX investment-

[25] The Synthetic Credit Portfolio, on a gross basis, held a larger total of long and short positions. However, when the long and short positions are netted against each other, these positions result in a portfolio of approximately $51 billion in net notional positions.

[26] This Report sets out the facts that the Task Force believes are most relevant to understanding the causes of the losses. It reflects the Task Force's view of the facts. Others (including regulators conducting their own investigations) may have a different view of the facts, or may focus on facts not described in this Report, and may also draw different conclusions regarding the facts and issues. In addition, the Task Force notes that its mandate did not include drawing any legal conclusions, and accordingly, this Report does not purport to do so.

[27] This figure reflects the aggregate mark-to-market net gains (profit) for all Synthetic Credit Portfolio transactions, including the impact of premiums paid and received.

grade series, among others, including both off-the-run and on-the-run series and spanning multiple maturities and tranche positions. In the fourth quarter of 2011, the Synthetic Credit Portfolio was in an overall short risk posture (as measured by CSW 10%), with a short risk position in high-yield offset to some extent by a long-risk investment-grade position.

In late 2011, CIO considered making significant changes to the Synthetic Credit Portfolio. In particular, it focused on both reducing the Synthetic Credit Portfolio, and as explained afterwards by CIO, moving it to a more credit-neutral position. There were two principal reasons for this. First, senior Firm management had directed that CIO – along with the lines of business – reduce its use of RWA. Second, both senior Firm management and CIO management were becoming more optimistic about the general direction of the global economy, and CIO management believed that macro credit protection was therefore less necessary.

Under a series of international agreements known as the Basel Accords, banking organizations must maintain certain capital ratios. The amount of capital that a banking organization is required to hold, under most regulatory capital ratios, is measured against the amount of its RWA, which, broadly speaking, considers the nature of the assets held by the banking organization, and certain off-balance sheet exposures. Two of the recent Basel Accords, commonly referred to as "Basel II.5" and "Basel III," alter the RWA calculation for JPMorgan and other banking organizations. As the new standards become effective over a phase-in period, certain assets held by banking organizations such as JPMorgan will generally be assigned a higher risk-weighting than they are under the current standards; in practical terms, this means

JPMorgan will be required to either increase the amount of capital it holds or reduce its RWA. Basel III has not yet become effective, but JPMorgan has begun voluntarily disclosing estimated calculations under Basel III in its financial reporting.

In 2011, JPMorgan was engaged in a Firm-wide effort to reduce RWA in anticipation of the effectiveness of Basel III. The Synthetic Credit Portfolio was a significant consumer of RWA, and the traders therefore worked at various points in 2011 to attempt to reduce its RWA. As part of this effort, in late 2011, CIO discussed unwinding certain positions in the Synthetic Credit Portfolio.

In the last week of December, Mr. Braunstein asked CIO to evaluate the impact of a further reduction of $20, $40 or $60 billion of RWA (in addition to a $30 billion reduction that, according to Mr. Wilmot, was already called for under the initial 2012 CIO RWA budget).[28] Ms. Drew, Mr. Wilmot and two senior members of the Synthetic Credit Portfolio team conferred as to how they could accomplish this in a manner that would minimize costs and trading losses, and in their internal discussions on the matter considered the possibility of unwinding additional positions in the Synthetic Credit Portfolio. According to one of the traders, on or about December 26, one of the Synthetic Credit Portfolio team members who had been party to these discussions called him and informed him that Ms. Drew wanted to know how much it would cost to reduce RWA by an additional amount. The trader informed him that, under the circumstances,

[28] Contemporaneous e-mails suggest that the initial 2012 CIO RWA budget called for a $20 billion reduction.

he believed that the solution would be an unwind and that he would ask another trader to prepare an estimate of how much it would cost. Shortly thereafter, an analysis prepared by another trader and provided to Ms. Drew, Mr. Wilmot and an executive from the Synthetic Credit Portfolio team indicated that a 35% proportional unwind of the Synthetic Credit Portfolio would result in a $10 billion RWA reduction, but could cost slightly more than $500 million. These cost estimates included trading and execution costs associated with reducing the positions, as well as the prospective loss of premiums received for any long-risk positions that CIO unwound.[29] Ultimately, the Firm chose not to modify its initial RWA budget, and for 2012, CIO as a whole was only required to make the RWA reduction contemplated by its original budget.

In early January, the Synthetic Credit Portfolio incurred mark-to-market losses of approximately $15 million. On January 10, one of the traders informed Ms. Drew that the losses resulted from the fact that (among other things) it "ha[d] been somewhat costly to unwind" positions in the portfolio. Ms. Drew responded that there might be additional flexibility on the RWA reduction mandate, and requested a meeting to review the unwind plan to "maximize p [&] l."[30]

[29] Other materials from this time indicate that the traders also believed that an unwind of short positions would cause them to forfeit revenue that they were positioned to earn upon the occurrence of defaults.

[30] Shortly before this exchange, Ms. Drew and Mr. Wilmot had notified Messrs. Dimon and Braunstein that CIO (as part of its budgeted RWA reduction) would reduce the Synthetic Credit Portfolio's RWA by year-end 2012, from $43 billion to $20.5 billion. They explained that this would be accomplished by allowing existing positions to expire ($13 billion), as well as via "active reduction" ($10 billion). Ms. Drew discussed the RWA mandate around this time with Mr. Braunstein, who informed her that the deadline for CIO to meet its RWA requirement was the end of 2012.

Around this time, Ms. Drew participated in a conference call with Mr. Wilmot and members of the Synthetic Credit Portfolio team, during which the RWA reduction mandate was discussed. According to one of the traders, he informed Ms. Drew during that call that the only certain approach to RWA reduction was to unwind positions, and he advised her that unwinding 25% of the Synthetic Credit Portfolio would cost approximately $500 million. After the meeting, one of the more senior members of the Synthetic Credit Portfolio team who attended the meeting instructed the trader to formulate multiple options for RWA reduction for Ms. Drew to consider.

On or about January 18, Ms. Drew, Mr. Wilmot, Mr. Weiland and two senior members of the Synthetic Credit Portfolio team met to further discuss the Synthetic Credit Portfolio and RWA reduction. According to a trader who had not attended the meeting, after the meeting ended, one of the Synthetic Credit Portfolio team members who had attended the meeting informed him that they had decided not to reduce the Synthetic Credit Portfolio, and that the trader's focus in managing the Synthetic Credit Portfolio at that point should be on profits and losses. Nonetheless, RWA continued to be a matter of real concern for that individual and CIO, and he thus also sent a follow-up e-mail to the meeting participants in which he set out a number of options for achieving RWA reduction by the end of 2012. In that e-mail, he stated that the preferred approach was to select an option under which CIO would attempt to convince the Firm to modify the model that it used to calculate RWA for the Synthetic Credit Portfolio, and delay any efforts to reduce RWA through changes in positions in the Synthetic Credit Portfolio until mid-year.

At approximately the same time as the mid-January discussions were taking place, a significant corporate issuer defaulted on its debt. The Synthetic Credit Portfolio was not well positioned for this event, and a number of the portfolio's positions suffered significant losses as a result.[31] These losses caused management to become concerned that the Synthetic Credit Portfolio was not providing sufficient credit loss protection. Management therefore instructed the relevant trader to avoid similar losses on defaults in the future, and to ensure that the Synthetic Credit Portfolio had appropriate "jump-to-default" protection in place.[32]

In response to this instruction, the traders began to discuss adding high-yield short positions in order to better prepare the Synthetic Credit Portfolio for a future default.[33] The traders, in late January, also added to their long positions, including in the IG-9 index (and related tranches).[34] These long positions generated premiums, and (among other things) would help to fund high-yield short positions; the traders also believed that these long positions would

[31] One of the traders expressed the view that these losses stemmed from the expiry or unwind of certain high-yield short positions in late 2011. The trading data confirms that certain high-yield short positions did expire or were unwound during this time, but also indicates that the traders largely replaced them at or around the same time.

[32] "Jump-to-default" exposure refers to the risk that a position will experience losses through the instantaneous move to a default on a reference name as a result of a credit event, such as a bankruptcy.

[33] Trading data shows that the traders had been adding some high-yield short positions throughout much of January, prior to this instruction. However, the additions increased substantially in the period after this instruction.

[34] As described below, the traders continued to build this position in February.

help offset (from both a credit risk and, potentially, an RWA perspective) their high-yield short positions. The traders chose to use the IG-9 index for this offset because, as one of them explained, it had the liquidity of investment-grade credit derivatives but with a feature that allowed the traders to hedge part of the high-yield structural short as well. The feature to which that trader was referring is the fact that the IG-9 index contained a number of so-called "fallen angels," which are companies whose debt had been considered investment-grade at the time of the IG-9's issuance in September 2007, but had subsequently become high-yield. Because the IG-9 index contained these high-yield reference entities, the traders believed that a long position in the IG-9 would offset to some degree the high-yield short positions.[35]

By the end of January, the Synthetic Credit Portfolio traders had added approximately $20 billion in long-risk notional positions to their 10-year IG-9 position. At the same time, however, they also added $12 billion in 5-year IG-9 short risk notional positions – *i.e.*, they bought credit protection on the same companies for which they were selling protection – except that the maturities for this short position were five years from the creation of the index rather than ten years.[36] The net effect of these additions was to increase the Synthetic Credit Portfolio's long credit exposure, both because they added more long positions than short positions, and also

[35] Because not all of the reference entities in the IG-9 instruments overlapped with those in the high-yield instruments, this strategy also introduced new risks into the Synthetic Credit Portfolio.

[36] The traders referred to this trade (the "IG-9 Forward Trade") as the forward trade, or at times, as a flattener.

because longer-dated trades are more sensitive to movements in credit spreads than shorter-dated trades,[37] due to the fact that the exposure to risk is for a longer period.[38]

Ms. Drew did not receive detailed trading or position reports on the Synthetic Credit Portfolio in the ordinary course, did not request any such reports during this time,[39] and regularly monitored only the Synthetic Credit Portfolio's profits and losses, VaR and stress VaR.[40] She did understand generally around this time that the traders were planning to add long positions in order to balance the Synthetic Credit Portfolio, and she also participated in a number of meetings at which RWA and the profits and losses of the Synthetic Credit Portfolio were discussed.[41]

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[37] A longer-dated CDS instrument will move more in price to a given change in a credit spread in the same way that a longer-dated bond's price moves more to a given change in credit spreads or interest rates than a shorter-dated bond.

[38] A trader from the Synthetic Credit Portfolio team appears to have described this trading strategy in a January 26 "Core Credit Book Highlights" PowerPoint that he circulated to other traders on January 26 and on February 2. In that PowerPoint, the trader described the technical details of the "trades that make sense," which involved building a long position and then adding various short positions in the event of a market rally.

[39] Among other things, there is no evidence that Ms. Drew received the January 26 PowerPoint described in Footnote 38.

[40] Stress VaR is a charge for market risk under Basel II.5 based on a 10-day, 99%-confidence level VaR that incorporates inputs using historical data from a one-year period of significant financial stress relevant to the Firm's portfolio. While VaR assumes volatility consistent with recent market conditions, stress VaR assumes difficult market conditions.

[41] With respect to RWA reduction, Mr. Weiland sent an email to a member of the Synthetic Credit Portfolio team on February 3 expressing concern that the member was providing overly optimistic estimates to Ms. Drew as to the likelihood that CIO would be able to convince the Firm to modify its RWA calculation model.

By January 26, the Synthetic Credit Portfolio was roughly balanced, as measured by CSW 10%.[42] One of the trader's contemporaneous e-mails reflect that he understood this, but also reflect that he began to have concerns – which he shared with other members of the Synthetic Credit Portfolio team – about the continued mark-to-market losses in the Synthetic Credit Portfolio. Around the same time, in light of these losses, an executive responsible for the Synthetic Credit Portfolio directed the senior-most trader to focus solely on the Synthetic Credit Portfolio to the exclusion of his other responsibilities. On January 31, that executive sent an e-mail to the same trader – which he also forwarded to Ms. Drew – in which he stated that the Synthetic Credit Portfolio was not behaving as intended and described the Synthetic Credit Portfolio's performance as "worrisome." In the same e-mail, he included one of several late January e-mails reflecting another trader's concern about the Synthetic Credit Portfolio's positions.[43] In that e-mail, the trader explained that, as designed, the Synthetic Credit Portfolio "would lose money now on a default in us hy and make money if the default occurs in ig world." According to this trader, however, the high-yield positions were losing more money than expected, and the investment-grade positions were earning less money than expected (*i.e.*, the price movements were not correlating as expected, leading to mark-to-market losses).

[42] By January 31, the Synthetic Credit Portfolio had moved to a modest net long position as measured by CSW 10%, and it continued to fluctuate thereafter. Although the Synthetic Credit Portfolio was long as measured by CSW 10% by this time, it could continue to maintain substantial protection against corporate defaults.

[43] This was one in a series of e-mails that the other trader wrote to himself and to other traders in the last two days of January, all expressing similar views about the performance of the Synthetic Credit Portfolio, and the options available as to how best to manage it.

In separate e-mails on January 30, the same trader suggested to another (more senior) trader that CIO should stop increasing "the notionals," which were "becom[ing] scary," and take losses ("full pain") now; he further stated that these increased notionals would expose the Firm to "larger and larger drawdown pressure versus the risk due to notional increases." While the documentary record does not reflect how, if at all, the more senior trader responded to these concerns, the traders nonetheless continued to build the notional size of the positions through late March.

By early February, the trader's concern about the losses – including his lack of understanding as to why they were occurring – prompted him to request a meeting with his managers, including Ms. Drew, in order to discuss the Synthetic Credit Portfolio. He prepared a presentation for the meeting, which he sent to the more senior trader on February 2. The presentation was provided to Ms. Drew and an executive responsible for the Synthetic Credit Portfolio on February 3.[44]

The trader did not present his slides at the meeting. Ms. Drew did ask the trader how much more he thought CIO could lose if they reduced the Synthetic Credit Portfolio. According to this trader, he explained that he thought that the Synthetic Credit Portfolio could lose a significant amount, perhaps an additional $100 million, and that it was possible that they did not have the right long position in light of the characteristics of the IG-9 position and the relevant

[44] According to a calendar invite sent by Ms. Drew's executive assistant for a February 3 meeting (likely the meeting in question), Mr. Wilmot, Mr. Goldman, Mr. Weiland and various members of the Synthetic Credit Portfolio team were invited, among others.

market dynamics. Ms. Drew appeared not to be overly concerned by this potential $100 million loss for the portfolio, and instead focused on the Synthetic Credit Portfolio's RWA profile.[45]

One week after this meeting, the same trader conferred with the attendees of that meeting (but not Ms. Drew) regarding an anticipated credit event involving another company.[46] He explained that in order to be better positioned for this event, he would need to buy further protection on the high-yield index, and finance that protection by adding long positions in an investment-grade index. He explained that this trading would increase RWA, but was instructed to proceed, and to concentrate on managing profits and losses. The executive with whom he conferred also instructed a senior trader to travel to JPMorgan's New York offices to see what could be done to remove the RWA constraint from the Synthetic Credit Portfolio.

Throughout February, the traders continued to add to their investment-grade long positions, and also at this time began to add significantly to their high-yield short positions. It appears that among the reasons for at least some of this trading (and possibly other trading during the first quarter) was that the traders sought to "defend the position" or "defend the P&L." The phrase was not defined in a consistent way by the traders who used it, but it appears to be a response to one or more concerns expressed by the traders throughout much of the first quarter.

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[45] Also on February 3, Mr. Wilmot sent an email to Mr. Braunstein requesting "approval to raise [CIO's] 1Q12 RWA by $7bn to $167bn." Mr. Wilmot explained that it was a "one quarter request" and that CIO believed they were "on target to achieve the $160bn level for 2Q12-4Q12." Mr. Wilmot wrote that CIO was "less confident in the RWA reduction from the MTM book, specifically the tranche book which is where [CIO hoped] to continue to achieve significant reductions throughout the year."

[46] The company in question ultimately filed for bankruptcy in the second quarter.

First, the traders appeared to be concerned about creating a perception in the market that CIO was reversing course on its trading strategy, which would cause other market participants to take advantage in pricing and trading behavior. Second, they expressed concern that the prices they were receiving from other market participants were distorted because those with opposing positions (*e.g.*, CIO was long where they were short) were engaged in tactical trading or were providing indicative prices that they would not stand behind. The traders appeared to believe that if they did not respond through additional trading, they would be forced to recognize losses.

Notwithstanding the continued trading, the Synthetic Credit Portfolio continued to experience mark-to-market losses. On February 13, 2012, a trader advised Ms. Drew of mark-to-market losses in the Synthetic Credit Portfolio, explaining in an e-mail that "we report a loss of 28m from last Tuesday close" and attributing most of the losses to the IG-9.[47] The trader in question subsequently forwarded this e-mail to senior members of the Synthetic Credit Portfolio team (but not Ms. Drew).

By late February, the Synthetic Credit Portfolio had experienced year-to-date losses of approximately $169 million. A trader observed around this time that, although credit spreads had stayed relatively constant, the IG-9 continued to lose ground. This was contrary to his expectations, and he therefore advised another Synthetic Credit Portfolio trader not to trade IG-9 because he wanted to observe its behavior. He also advised a more senior trader of his plans, but

[47] Ms. Drew also received separate daily profit-and-loss reports on the Synthetic Credit Portfolio.

the latter instructed him to trade because they needed to participate in the market to understand the price at which parties were actually willing to transact.

The trader engaged in a significant amount of trading at the end of February, after being directed by at least one senior member of the Synthetic Credit Portfolio team to increase the default protection in the Synthetic Credit Portfolio. The trader also traded at this time in order to determine the market prices of the positions. His trading was not limited to short positions; he also added a significant amount of long positions – specifically in the IG-9 index – in order to offset the cost and risk of the additional short positions. In an e-mail sent to another trader late in the evening of February 29, he explained, "I have sold important amounts of protection in ig9 10yr (close to 7bln all day or 3.5m cs01) and this will push the cs01 beyond the 25m limit. This is related to month end price moves that were all adverse although we could limit the damage.... I picked [the IG-9 10-year index] because this is the most obvious one when we analyze the lags we have in the core book.... This trade will also increase the rwa snapshot at month end I am afraid."[48]

On February 29, Ms. Drew, Mr. Wilmot, Mr. Goldman and an executive from the Synthetic Credit Portfolio participated in a regularly scheduled "business review" meeting with Messrs. Dimon, Braunstein, Hogan, Zubrow and others. The meeting covered all of CIO's activities. With respect to the Synthetic Credit Portfolio, the primary focus of the discussion was

[48] It is unclear to what limit the trader was referring because neither CIO CS01 limit was $25 million (the mark-to-market CS01 limit for CIO was $5 million and the aggregate CS01 limit was $12 million), and both limits had been exceeded by this point.

RWA reduction, and the written materials, which were prepared by individuals from Market Risk and the Synthetic Credit Portfolio team, indicate that CIO was taking steps to reduce RWA. CIO management did not disclose any significant problems or concerns with the Synthetic Credit Portfolio, and CIO management did not explain that CIO was not pursuing the expected course of action of achieving the RWA reduction via an unwind and was instead embarking on a more complicated and different strategy that entailed adding significantly to the size of the positions. The written materials prepared by CIO described the Synthetic Credit Portfolio at a very high level as a "Tail Risk Book," and as an "option with positive convexity, positive carry and upside on large spread widening and default waves (similar to 2008-2009)."[49] The materials do not explain under what scenarios the Synthetic Credit Portfolio could be expected to lose money, or that:

- CIO had decided not to reduce the size of the Synthetic Credit Portfolio (at least in the near term);
- the Synthetic Credit Portfolio had increased substantially in both gross and net notional size; and

[49] A *tail event* is generally understood to be one that arises when the market environment moves more than three standard deviations from the mean based on predictions from a normal distribution of historical prices. *Carry* is generally understood to be the profit or loss experienced by a portfolio with the passage of time but with no change in any other market variable or additional trading. *Positive convexity* exists when a portfolio is predicted to profit more (or lose less) on a larger market move than the profits (or losses) predicted for a smaller market move would imply. *Negative convexity* exists when a portfolio is predicted to profit less (or lose more) on a larger market move as compared to the predicted profits (or losses) on a smaller market move. Using CSW 10% and CSW 50% as an example, if a portfolio is predicted to lose $100 if credit spreads widen by 10%, but to lose $400 if credit spreads widen by 50%, then the portfolio reflects positive convexity (a portfolio with no convexity would lose $500). It is unclear if the written materials for the February 29 meeting were employing these definitions.

- the plan was no longer to reduce RWA by $23 billion by allowing positions to expire and by active reduction (to the contrary, the February Business Review materials suggest that CIO was unwinding the portfolio, explaining that "the change in regulatory capital regime is likely to force a re-size / run-off of synthetic portfolio in order to maintain RWA targets for the Firm" and "CIO is currently working to reduce [RWA])."

By the end of February, the Synthetic Credit Portfolio had experienced an additional $69 million in mark-to-market losses, from approximately $100 million (year-to-date through January) to $169 million (year-to-date through February).

On March 1, the day after the CIO Business Review, an executive with responsibility for the Synthetic Credit Portfolio e-mailed one of the traders to express concern that if the traders needed to "[a]ctually reduce the [Synthetic Credit Portfolio]" in order to decrease RWA, they would not be able to "defend" their positions. This e-mail appears to address the concern that an unwind of positions to reduce RWA would be in tension with "defending" the position. The executive therefore informed the trader (among other things) that CIO would have to "win on the methodology" in order to reduce RWA. This phrase refers to the traders' goal, described above, to convince the Firm that it should change the methodology of the model used to calculate RWA for the Synthetic Credit Portfolio.

On March 7, Mr. Venkatakrishnan reported to Ms. Drew, Mr. Hogan, Mr. Goldman, Mr. Weiland and a member of the Firm-wide Market Risk team on the results of model-related work he had been performing relating to the accuracy of CIO's RWA calculation. Mr. Venkatakrishnan had gotten involved in early March in response to concerns in CIO about the increase in RWA. Mr. Venkatakrishnan reported on March 7 that RWA for the Synthetic Credit Portfolio had increased significantly since the beginning of the year, and explained that this increase was "entirely explained by a $33bn notional increase in short protection (long risk) in [CIO's] portfolio between [January] and [February]." Ms. Drew forwarded this information to Mr. Goldman, Mr. Weiland and two members of the Synthetic Credit Portfolio team. In response, one of the recipients from the Synthetic Credit Portfolio team expressed the view that the notional amounts reflected in Mr. Venkatakrishnan's calculations were incorrect,[50] despite the fact that this information had been provided by CIO's middle office, and asked to discuss the methodology used to calculate RWA.[51]

By mid-March, the Synthetic Credit Portfolio was still experiencing mark-to-market losses.[52] A trader performed a detailed analysis around this time and determined that, even though the Synthetic Credit Portfolio appeared to be balanced under CSW 10%, its actual performance – and in particular, the fact that it lost money when the markets rallied – suggested

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[50] The relevant recipient may have been expecting Mr. Venkatakrishnan to calculate the notional amounts on a monthly basis (*i.e.*, January 1 to 31 and February 1 to 29) and not January 18 to February 22, as Mr. Venkatakrishnan had done.

[51] Mr. Venkatakrishnan's analysis, which was only of those positions that drove the increase in RWA, did not trigger further inquiry or concern within or outside CIO at this time regarding the size of the portfolio. CIO management likewise appears to have focused on the notional increase only insofar as it affected RWA. In addition, at that time, there were discussions within CIO and with Mr. Hogan that some of the positions in the Synthetic Credit Portfolio would more appropriately receive a different treatment for capital purposes than under the currently used method, and that this change would result in a reduction of RWA to acceptable levels. At the time, the rules under Basel II.5 and III, which alter the RWA calculation for JPMorgan and other banking organizations, had not been finalized by U.S. regulators.

[52] As discussed below, the losses during this period were likely more substantial on at least some days than were being reflected in CIO's daily valuation estimates.

that it continued to have a short bias. The trader attributed this to the significant amounts of protection that he had purchased since January, and he therefore considered what steps he might take to finally balance the Synthetic Credit Portfolio. He concluded that he did not want to sell more protection in IG-9 because the instrument had not behaved as he had expected all year and the position was already quite large and "dangerous"; he also understood that he could not reduce his high-yield position because of the expense associated with that projected liquidation. The remaining option, in his view, was to increase his long exposure in on-the-run investment-grade instruments, such as IG-17 and IG-18, with a goal of stemming the losses that he attributed to its imbalance, and ultimately "put[tin]g [the Synthetic Credit Portfolio] to sleep." Once the portfolio was balanced, he believed he could wait for CIO Management to decide how to proceed.

Consistent with this strategy, by March 15, the trader proposed to add a very large position in an on-the-run investment-grade index. He reasoned that this was the best way to balance the Synthetic Credit Portfolio because: using the on-the-run index would make the positions less transparent to other market participants, especially if the positions were acquired on or near the roll date (presumably because of increased liquidity); and if he could put on a large position very quickly near the roll date (March 20), Risk Management personnel would have sufficient time in advance of the quarter-end to calculate the attendant changes in RWA, VaR and other risk metrics.

The trader described his plan in a series of e-mails to another trader. On March 15, he sent an e-mail explaining that "[t]his [] may be the solution: let the book run off. So I prepare it for this outcome." Similarly, on March 19, he wrote to some of the other traders that his proposed strategy was to "let the P&L fluctuate while not defending, just maintaining the upside on defaults over time." Further, he wrote, "the solution proposed amounts to be longer risk and let the book expire carrying the upside on default: I think we own [] a very good position for a size that is also significant . . . ."

Beginning on March 19 and continuing through March 23, the trader added significant long positions to the Synthetic Credit Portfolio. These additions roughly coincided with the roll date and the issuance of the IG-18, and included additions to the 5-year IG-17 long position (a notional increase of approximately $8 billion), the 5-year IG-18 long position (a notional increase of approximately $14 billion), and several corresponding iTraxx series, most notably the 5-year-S16 ($12 billion) and the 5-year-S17 ($6 billion).

While this trading was being considered and implemented, on March 20, a review of CIO was presented to the DRPC (a summary of which was later presented to the full Board), in which Ms. Drew and Mr. Goldman provided a structural risk summary and addressed overall portfolio allocations within CIO, how interest rate movements would affect the company, and how CIO manages the attendant risk. CIO management did not disclose the increasing mark-to-market losses, the recent breaches in certain of CIO's risk limits, the substantial increase in RWA, the significant growth in the Synthetic Credit Portfolio's notionals, or the breaches in the VaR limit earlier in the year.[53] Further, CIO management did not explain that CIO was embarking on a complicated strategy that differed from the unwind that had been previously described to senior Firm management.

On March 23, a trader explained to CIO Market Risk the trading he had done: "[I] switched the book to long risk[.] [I] am done[.]" He explained his view that "this is it for a neutral profile[, and] right now we have a market neutral ratio between HY and IG." He further explained that "the reason why I did that is because [I] wanted to have the position set in order to prepare for month end and avoid defending the pnl [] because it would have resulted in larger positions[.] This one position I put [on] is different and liquid." The relevant individual from CIO Market Risk noted that, "somehow I think the percep[tion] was that you would be add[ing] to the [on-the-run index] and reducing elsewhere[.] [I am n]ot sure how this was established[, but I] think what happened is that people seeing [that] the book is longer in 5y maturity[, and has] bigger risk[,] and bigger capital[,] and the issue is RWA." The trader stated, "ok the RWA[,] this is what kills me." He proceeded to explain that, because of pressure to reduce

[53] Under the Firm-wide Risk Appetite policy in effect at the time, either the CEO or the CRO was required to notify the Chairman of the DRPC of modifications to or breaches of the prescribed DRPC market risk stress or VaR "limits." The Firm-wide Market Risk Management policy likewise required the CRO to "report all material excesses to the Chairman of the DRPC." (These DRPC-approved limits were not identical to Firm-wide limits; as a result, not all breaches of Firm-wide limits necessarily required reporting to the DRPC.) As of January 2012, the DRPC-approved VaR limit was $200 million (as opposed to the Firm-wide VaR limit of $125 million). Although Firm-wide Market Risk provided the DRPC with an update on Market Risk Limits at the March 20, 2012 DRPC meeting, this update only covered (as intended) developments through year-end 2011. The breaches in the CIO and Firm-wide VaR limits that occurred in January 2012 were not discussed. (The highest the Firm-wide VaR reached in January 2012 was approximately $160 million.)

RWA, the market could come to the conclusion that he did not like his position, and he therefore wanted to "[drop] out of the radar screen and earn carry." He predicted that "eventually" the Synthetic Credit Portfolio would profit, and in the meantime, "the carry is 2-3m a day[, and] the protection I sold grossly added 1.1M a day of carry."

On March 21 (*i.e.*, while the traders were adding large long positions), one of the traders met with Ms. Drew to discuss both the mark-to-market losses and the increase in RWA for the Synthetic Credit Portfolio. Before the meeting, he informed Ms. Drew that he believed the Synthetic Credit Portfolio's positions had been leaked to the market (a concern he and another trader voiced previously), and explained that he was nervous that other market participants could use this information against CIO in their trading. He also e-mailed Ms. Drew that the traders had already reduced RWA by $10 billion in the Synthetic Credit Portfolio, and recommended that they "sligh[t]ly" increase the investment-grade long position, and address RWA the following quarter. In fact, RWA for the Synthetic Credit Portfolio had increased from the beginning of the year.

The day after the meeting, Ms. Drew learned that the positions in the Synthetic Credit Portfolio were significantly larger than had been reflected in the figures discussed at the prior day's meeting, as the figures used during the March 21 meeting were from March 7 and did not reflect trading activity during the intervening two weeks.[54] Ms. Drew reacted strongly to this

[54] The written materials prepared for the March 21 meeting noted that the figures were as of March 7, but did not indicate that there had been significant changes in the positions since then.

and a meeting was scheduled for March 23. A senior member of the Synthetic Credit Portfolio team informed her at that time that he believed the Synthetic Credit Portfolio had the "right position," because the Synthetic Credit Portfolio was "long IG [and] the market [was] moving tighter and tighter." Around this time, a trader informed Ms. Drew that he wanted to continue trading in order to defend the position; Ms. Drew reacted strongly to this as well and informed him that he was not permitted to do so. Either on Friday, March 23, or soon after, Ms. Drew directed the traders to suspend trading, and shortly thereafter, trading in the Synthetic Credit Portfolio largely stopped.[55] By this point, the Synthetic Credit Portfolio had assumed an overall net-long credit-risk orientation on a CSW 10% basis.[56]

On March 30, the executive responsible for the Synthetic Credit Portfolio requested assistance from Firm-wide Market Risk in understanding the relationship between their trading and RWA. In an e-mail to Mr. Hogan on the subject, the executive stated that the Synthetic Credit Portfolio's "prox[y]ing" of the IG-9 position as an offset of the high-yield short "did not work and resulted in almost total loss of hedging effectiveness." He also stated that he was no longer confident in his team's "ability to achieve the targeted RWA and their understanding of the synthetic levers to achieve the RWA objectives." He therefore requested that an expert from

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[55] There was a change in position on March 28, when the IG-9 5-year short position was reduced by $4.2 billion notional, from $36.9 billion to $32.7 billion notional.

[56] Even after these trades, the traders did not view the Synthetic Credit Portfolio as net long despite the fact that the Synthetic Credit Portfolio's CSW 10% profile showed a long risk bias.

the Investment Bank be assigned to CIO for the second quarter of 2012 to help the Synthetic Credit Portfolio traders understand and meet their RWA targets.

2. *Valuation*

As noted, the Synthetic Credit Portfolio was experiencing regular mark-to-market losses throughout much of the first quarter. We describe here the valuation process and how, from at least mid-March through early April, the Synthetic Credit Portfolio's losses appear to have been understated.

One of the junior traders in CIO had responsibility for estimating the fair value of each position in the Synthetic Credit Portfolio on a daily basis. Because the market for at least some of these instruments is small and relatively illiquid, he – like other market participants – generally could not simply look to a single definitive source to perform that task. Rather, he collected data from a number of different sources about the value of the positions and, after exercising judgment and often in consultation with another trader, assigned a value to each position.

In general, the trader looked to three different sources in order to value the positions in the Synthetic Credit Portfolio: (1) recently executed trades; (2) indicative, or non-binding, price quotes received from dealers and counterparties (including for both the specific instrument and, at times, similar instruments); and (3) his observations of and judgment regarding market conditions, including the relationships between and among different instruments. The information he received from other market participants was typically in the form of a bid-offer quotation. However, in order to perform the daily valuation process, he was required to identify a specific price. For each instrument, he therefore selected one quote (often among several he received) and then assigned a price within the bid-offer spread for that quote. Once he had identified a price for each position, he would input this data into a series of programs that would generate an estimate of the daily profit or loss, known as the "P&L Predict." He would also draft, often together with another trader, an explanation for the gains or losses, which would be included in the daily P&L Predict. The daily profit-and-loss numbers were circulated within CIO and to certain personnel within the Firm-wide Risk organization. Ms. Drew received the daily P&L information (although not the P&L Predicts themselves), and also received some or all of the commentary in her daily reports.

At certain points throughout early 2012, the information the trader was collecting from the market indicated losses in the Synthetic Credit Portfolio. But on a number of days beginning in at least mid-March, at the direction of his manager, he assigned values to certain of the positions in the Synthetic Credit Portfolio that were more beneficial to CIO than the values being indicated by the market. The result was that CIO underreported the losses, both on a daily basis and on a year-to-date basis. The traders variously referred to the aggregate differential between the prices being assigned and the unadjusted mid-market price (*i.e.*, the mathematical mid-point between the best bid and best offer in the market, often referred to as the "crude mid") as the "divergence," "lag" or "distance."[57] In the view of one trader, the divergence resulted from the fact that the price information supplied by this illiquid market was distorted. Along these lines, the traders believed that CIO's counterparties had obtained information about the Synthetic Credit Portfolio's positions, and that CIO's counterparties were engaging in strategic pricing behavior and intentionally providing prices that did not accurately reflect market values, *i.e.*, they were not prices at which the counterparties would actually be willing to transact.[58] Furthermore, one trader expressed the belief that the market prices would ultimately correct, vindicating the CIO valuations.

Notwithstanding any genuinely held views on the validity of quoted prices or the integrity of counterparties' trading activities, both U.S. GAAP and Firm policy required that CIO make a good-faith estimate of the exit price[59] for a reasonably sized lot of each position, and

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[57] Certain traders also, at times, appeared to use the term "lag" to refer to the amount by which the Synthetic Credit Portfolio was underperforming a theoretical or fundamental valuation of the positions – *i.e.*, how far behind their expectations it was.

[58] The prices provided by market participants that were considered in valuing certain positions in the Synthetic Credit Portfolio were "indicative," which meant that CIO could not expect counterparties to transact at those prices. On occasion, CIO would attempt to transact at an indicated price, and a market participant, who had posted the bid or offer, would decline. The Synthetic Credit Portfolio traders referred to this behavior as the market participants "framing" prices.

[59] Neither U.S. GAAP nor the Firm policy required CIO to mark to the "crude mids." Accounting Standards Codification paragraph 820-10-35-36C notes that "if an asset or a liability measured at fair value has a bid price and an ask price (for example, an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value . . . ." While paragraph 820-10-35-36D notes that mid-market pricing is not precluded from being used "as a practical expedient," such conventions are not required and good faith estimates of the appropriate exit price are necessary.

assign values reflecting those estimates.[60] At the direction of a more senior trader, however, the relevant trader may not have always done so.[61] The Task Force has found no evidence that others beyond three of the Synthetic Credit Portfolio traders were aware of or part of this directive.

One instance of "divergence" occurred on or about March 12, when a trader informed another trader that the "crude mids" had moved away from where he and the third trader expected them to be. He told the trader that, as a result, the mark-to-market losses in the Synthetic Credit Portfolio based on "crude mids" had grown to approximately $50 million, and that he viewed these losses as a warning sign. He recommended that they reflect this as a loss on the books, even though they could not explain the market movement. The trader in question disagreed with his recommendation, apparently because he did not believe that the market moves around this time were real. He then informed the first trader that they should discuss this issue the following week.

According to a trader-maintained spreadsheet reflecting prices from March 12 to March 16, the divergence from the crude mids for at least some of the positions had grown to approximately $292 million[62] year-to-date for the Synthetic Credit Portfolio.[63] On March 16, a

[60] *See* n. 59. By convention, the exit price is estimated for normal trading size, and CIO was not required to estimate the prices it would have received if it attempted to sell its entire (large) position at once.

[61] As noted, the more senior trader may have believed that his view of the true value of these positions would ultimately be realized once the market returned to normal.

[62] This figure may include amounts by which the traders believed that the positions were underperforming vis-à-vis their expectations, including as a result of market participants distorting the prices; it is not

trader informed another trader that he estimated that the divergence would likely reach $400 million in the near future.

By March 19, the relevant trader had showed a small loss on the daily P&L Predicts every day for seven consecutive days. He told another trader that a more senior trader had pressured him throughout this period not to show large losses in the Synthetic Credit Portfolio. On March 20, that other trader apparently directed the relevant trader to show the full loss he had calculated for that day and said that he himself would accept responsibility for the loss with the more senior members of the team.

The relevant trader reflected a loss on his March 20 daily P&L Predict of approximately $40 million. Shortly thereafter, a more senior trader called the other trader to discuss the loss. The senior trader expressed two related concerns. First, he stated that the report would cause problems for him during a meeting scheduled for the following day with Ms. Drew (the March 21 meeting described above), and stated that he wished that he could have raised the loss issue with Ms. Drew in person during that meeting.[64] Second, he expressed concern that Ms. Drew might prohibit his team from adding to their long positions.

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necessarily a measure of the aggregate amount of any mis-mark since the crude mid is not necessarily reflective of the price at which market participants are transacting.

[63] The spreadsheet showing the divergence from March 12 to March 15 was circulated to a senior member of the Synthetic Credit Portfolio team on March 15. The Task Force also located an additional copy of the spreadsheet that included the divergence for March 16.

[64] Ms. Drew would historically follow up with the more senior trader in the evening if the Synthetic Credit Portfolio experienced losses greater than $5 million for a particular day.

The estimated mark-to-market losses continued to grow throughout the end of March. On March 23, a trader sent another trader an informal loss estimate – likely year-to-date – of $300 million using, for each position, the "best" bids or asks and $600 million using the "mids." The third trader also continued to report losses to him during this period, and continued to be directed by the other trader to show them. The year-to-date losses reported by the traders totaled about $400 million through March 29.

These valuation issues received additional attention from the traders on March 30, which was the last trading day of the first quarter.[65] As shown by the following four sets of conversations, one of the traders was very focused on the impact of showing significant losses on that day.

First, throughout the day, that particular trader (who was more senior and to whom the other traders reported) repeatedly discussed with a second trader the size of the estimated losses. Early in the day, the second trader had informed the more senior trader that the daily loss would be approximately $250 million. The senior trader asked him if he could reduce the loss to $200 million and encouraged him to trade, even though, as discussed above, Ms. Drew had just ordered the team to stop trading. The second trader declined to continue trading. Nevertheless, throughout the day, a third trader reported to the second trader that the prices he was observing in the market were improving, and the second trader therefore reported improved numbers to the

[65] The marks on the final trading day of the quarter are subject to VCG price-testing procedures described below.

senior trader as the day progressed. Each time he or the third trader showed a smaller loss figure, the senior trader urged him to reduce the size of the loss further.

Second, the more senior trader and Mr. Goldman discussed the estimated losses for the day. During this conversation, Mr. Goldman pressed the trader for estimates, and he responded that he was expecting the losses to be significant because he would not be "defend[ing]" the position. He further stated that he did not want to "fight" and increase the position, and added that they should have "stopped doing this three months ago and just rebalanced the [Synthetic Credit Portfolio]."[66] He also asked Mr. Goldman (who had called him at Ms. Drew's request) not to share these estimates with Ms. Drew because the market had not yet closed and, given the size of CIO's positions, a small movement could result in a significant change in the profits and losses.

Third, at the end of the day, the same more senior trader directed another trader to stay late and monitor prices until the markets closed in New York, in the hopes that he would be able to use later – and more advantageous – prices in marking the Synthetic Credit Portfolio.

Fourth, the same more senior trader directed another (more junior) trader on March 30 to use the "best" prices, which appears to have prompted that more junior trader to take two steps. First, for at least one instrument, he selected the most beneficial dealer quote when marking his positions. Another trader encouraged him to use this more beneficial quote – which was more

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[66] This statement is difficult to reconcile with another trader's statement that, at the same time, the more senior trader was encouraging him to trade.

advantageous than the quotes he had received earlier in the day – telling him that it was not too aggressive and that it was "very good." Second, the more junior trader priced many of the positions at or near the most advantageous boundary of the bid-offer spread. And for at least one position, he consulted with the other trader, who advised him to be slightly less aggressive. Later in the evening of March 30, he reported an estimated loss for the day of $138 million. Unlike the January and February month-end prices, the marks for March 30 were not generally at or near the mid.

The quarter-end prices generated on March 30 were to be used as the basis of the Firm's financial reporting. Accordingly, per standard practice in CIO, they were subjected to a separate review by CIO's VCG, a price-testing group that is part of the Finance function and analyzes market data to test month-end front office marks. VCG is responsible for confirming the traders' marks or making necessary adjustments to the front office marks to arrive at the fair value for purposes of the U.S. GAAP for the Firm's books and records.

Under the applicable policy, CIO VCG's price-testing procedures involved multiple steps, including the following: First, the relevant member of the VCG team received the March 30 front office marks. Second, that individual reviewed information about the value of each position derived from third-party sources – principally, quotes from dealers, recent transaction data, and consensus pricing data from third-party pricing services such as Markit and Totem – and generated a price (the "VCG mid price") for each position. He then compared the trader's prices to the VCG mid price.

As noted above, Firm policy called for the positions to be marked at fair value, which in accordance with accounting rules, it defines (consistent with U.S. GAAP) as the exit price for a reasonably sized lot. CIO VCG recognized that, given the nature of the market, market participants could arrive at different yet reasonable conclusions as to the fair value of a particular position. When comparing the VCG mid price to a trader-provided price, CIO VCG's policy was to consider a VCG-generated price-testing threshold designed to reflect the bid-offer spread to the VCG mid. For example, if the CIO VCG mid price was 35 and the threshold was 2, the acceptable valuation range for the trader-provided price would be 33 to 37. If the trader's price fell within that range, under the Firm's policy, CIO VCG could adopt that price as final. If the trader's price fell outside that threshold, under the Firm's policy, CIO VCG was to adjust the price to the closest outer boundary of the threshold. Thus, in the above example, if the trader had a price of 38, CIO would make a one-point adjustment to move the mark back to the closest outer boundary of 37.[67] PwC was aware of CIO VCG's use of thresholds prior to the first quarter of 2012.

CIO VCG conducted its price testing on the March 30 valuations for the Synthetic Credit Portfolio in April. In the course of this price testing, it observed that many of the positions were marked at or near the boundary of the bid-offer spread. However, because it concluded that they

[67] VCG did not, as a technical matter, actually adjust the trader's marks for individual instruments, rather it provided information to the CIO Middle Office, which simply made an aggregate dollar amount adjustment that resulted from the adjusted marks.

were within VCG thresholds (with exceptions for which an adjustment was made), it concluded that the trader marks were acceptable.[68]

Although CIO VCG's independent price-testing process, including the use of thresholds, was appropriately designed to determine whether a trader's mark is a reasonable estimate of fair value, CIO VCG price testing had been identified as having some deficiencies and inconsistencies in its price-testing practices. Specifically, on March 30, 2012, the Firm's Internal Audit group issued a report on EMEA CIO Credit Market Risk and Valuation Practices in which it assigned a rating of "Needs Improvement."[69] This assessment of CIO VCG was due, in part,[70] to the lack of "a formally documented price sourcing hierarchy to govern the consistent use and appropriate application of independent prices for price testing purposes" and "the lack of formally documented/consistently applied price testing thresholds." With respect to the latter, Internal Audit concluded that thresholds were applied by CIO VCG "without sufficient transparency or evidence." The "root cause" of the deficiencies and inconsistencies in CIO

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[68] VCG's calculation of the March month-end pre-adjustment difference between VCG prices and the traders' marks contained mathematical and methodological errors; as these errors were discovered, the figure was revised upwards to $512 million on May 9. In July, the difference between the VCG mid and the front office marks was adjusted to $677 million before the application of the thresholds, $660 million after the application of thresholds, and $472 million after the subsequent application of a liquidity reserve. *See* Section III.B.

[69] Internal Audit issues three ratings: Satisfactory, Needs Improvement, and Inadequate. The latter two are considered "adverse" ratings. CIO VCG received a "Satisfactory" rating in its prior audit of CIO EMEA Credit on February 26, 2010.

[70] As part of this same report, Internal Audit also identified weaknesses in CIO's risk management practices, such as the use of unapproved risk and valuation models, a lack of documented stress testing methodology, and a need to enhance controls around certain aspects of the VaR calculation.

VCG's price-testing practices was identified as "insufficient assessment/formalisation of certain price testing methodologies and poorly documented CIO VCG practices."[71]

The Internal Audit report included an action plan for VCG to, among other things: (1) define and implement a price sourcing hierarchy to ensure a consistent and appropriate price sourcing and testing approach; (2) ensure price testing is performed consistently with front office marking policy; (3) document the rationale for and clearly define certain price-testing thresholds; and (4) improve evidence of certain price-testing processes. The individual who was the "issue owner" for this action plan had a target date of July 31, 2012, to complete the action plan. As part of his response to Internal Audit's recommendation to more clearly demonstrate and document the use of thresholds, this individual immediately made certain adjustments to formulas in the spreadsheets he used. These changes, which were not subject to an appropriate vetting process, inadvertently introduced two calculation errors, the effects of which were to understate the difference between the VCG mid-price and the traders' marks.

3. *The "London Whale" Story and Senior Management's Response*

On April 5, Ms. Drew sent an e-mail to the JPMorgan Operating Committee (which included Messrs. Dimon and Braunstein) in advance of articles that the *Wall Street Journal* and Bloomberg would be publishing the following day about one of the Synthetic Credit Portfolio

[71] Although the report was formally issued on March 30, consistent with Internal Audit's processes, Internal Audit personnel interacted with CIO VCG, market risk management and Finance personnel during the audit process. In mid-to-late March, members of the audit team shared findings, communicated about management's action plan, and obtained other input from Messrs. Goldman, Wilmot, Weiland and other members of CIO Market Risk, Finance and VCG, among others.

traders, whom the articles referred to as the "London Whale." In her e-mail to the Operating Committee, Ms. Drew provided a brief overview of CIO's investment strategies, explaining that the strategies had turned pro-risk and the Synthetic Credit Portfolio was moved into a long position, and that it had not performed as expected in 2012.[72] She acknowledged that (1) the position was not sized or managed well; (2) mistakes were made, which she was in the process of addressing; (3) the losses to date were approximately $500 million, which netted to negative $350 million as a result of gains in other positions; and (4) Firm earnings for the first quarter had not been affected "since [CIO] realized gains out of the [$]8.5 billion of value built up in the securities book."

Mr. Braunstein and Ms. Drew met the following day, on April 6. Mr. Braunstein asked Ms. Drew to provide a detailed overview of the Synthetic Credit Portfolio's position by the following Monday, April 9. Later on April 6, Mr. Braunstein sent Mr. Dimon a brief update on his discussions that day regarding the Synthetic Credit Portfolio. He informed Mr. Dimon that he "[s]poke with Ina. Would like to add a liquidity reserve[73] for [the] Series 9 Tranche Book (approx 150mm). Wilmot will be sending e-mail detailing analysis." Mr. Braunstein also informed Mr. Dimon of the overview he had just asked Ms. Drew to prepare by April 9, and added that he was "working with [the Investment Bank] to make sure there are no similar

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[72] Although the Synthetic Credit Portfolio had shifted to a net long position by early April under CSW 10%, it also continued to hold short risk positions and substantial "jump-to-default" protection.

[73] A liquidity reserve is taken to mitigate uncertainty when a price is not available or where the exit cost may be uncertain due to illiquidity.

positions in the [Investment Bank's] book.... Separately think we need to look at coordinating between the CIO and [Investment Bank] approaches. Have talked to John Hogan about this as well."[74]

Meanwhile, Ms. Drew reached out to a senior member of the Synthetic Credit Portfolio team on the afternoon of April 6 and asked for a "full diagnostic," explaining that the analysis should be "[m]ore focused on p [&] l than rwa at [the] moment[.]"[75] This individual said he would perform the work, and explained that any further losses would be the "result of further distortions and marks between the series where we are holding large exposures." He added that he had "no doubt that both time and events are healing our position," and stated that a trader with whom he had consulted was "convinced that our overall economic risk is limited." He also noted that the traders were concerned that information about CIO's Synthetic Credit Portfolio position had been leaked to the market – a concern they had expressed previously – suggesting that the losses may have been driven by their counterparties who, they believed, knew of CIO's positions and were distorting the market. In a separate e-mail to Ms. Drew, a trader estimated

[74] Late on April 6, Mr. Braunstein also received an e-mail from Mr. Venkatakrishnan, via Mr. Hogan, stating that Mr. Venkatakrishnan had noticed that the notional exposures at CIO were very large, totaling about $10 trillion in each direction. Mr. Venkatakrishnan – who had become involved in early March to assist with RWA calculations – was concerned about counterparty credit risk (*i.e.*, risk that a counterparty would fail), and pointed out that $6.5 trillion of these positions came from just four trades. Mr. Venkatakrishnan subsequently determined that these numbers were incorrect, however (he had not recognized that many of these trades were internal and thus netted out), and the total notionals were much smaller than he had initially thought (although still large). Upon learning of this, on April 9, he informed Messrs. Hogan and Goldman that he was "more comfortable now."

[75] This focus differed from the focus at the end of March, which at that time was principally on RWA.

that, although he would conduct a confirmatory analysis, the worst-case scenario for the second quarter (excluding "very adverse" outliers) would involve losses of no more than "-200 MM USD . . . with the current book as it is."

Over the weekend of April 7 and 8, two of the traders prepared the requested analysis. One of them initially attempted to formulate a loss estimate by constructing numerous loss scenarios that were very harsh, and then evaluating how those scenarios would impact the Synthetic Credit Portfolio's positions. For example, he assessed how the market might behave in a "bond market crash" or a "Middle East shock," and then attempted to determine how that market behavior could affect the Synthetic Credit Portfolio. In this way, he generated a number of probability-weighted profit-and-loss estimates for the second quarter; the estimates ranged from losses of $750 million to gains of $1.925 billion, with six of the nine scenarios generating losses (the smallest of which was a loss of $350 million).

This trader sent his loss estimates to the other on April 7. According to the trader who prepared the loss estimates, the other trader responded that he had just had a discussion with Ms. Drew and another senior team member, and that he (the latter trader) wanted to see a different analysis. Specifically, he informed the trader who had generated the estimates that he had too many negative scenarios in his initial work, and that he was going to scare Ms. Drew if he said they could lose more than $200 or $300 million. He therefore directed that trader to run a so-called "Monte Carlo" simulation to determine the potential losses for the second quarter. A Monte Carlo simulation involves running a portfolio through a series of scenarios and averaging the results. The trader who had generated the estimates did not believe the Monte Carlo simulation was a meaningful stress analysis because it included some scenarios in which the Synthetic Credit Portfolio would make money which, when averaged together with the scenarios in which it lost money, would result in an estimate that was relatively close to zero. He performed the requested analysis, however, and sent the results to the other trader in a series of written presentations over the course of the weekend. This work was the basis for a second-quarter loss estimate of -$150 million to +$250 million provided to senior Firm management, described below.

On April 8, the same trader sent a draft presentation – prepared based on the Monte Carlo analysis – to the other trader, and advised him that "[w]e should stress that some standalone economic scenarios can cost up to 500M although, mixing all the stress scenarios we get to a more decent number of 150 to 250 depending on whether spreads widen in Q2. The book keeps a useful optionality [i]f things turn really bad again. This is what it is meant for. I am reviewing now the names in IG on the run that could be damaging to us.. they are very few given that we still have a short risk in IG14-IG15 and IG16 . . . ."

On the afternoon of April 8, the trader who had generated the estimates was asked by a more senior team member for an estimate of potential profit-and-loss for the second quarter, with an 80% degree of confidence, assuming CIO held the positions and that they "maintain the book as balanced and 'neutral' as possible . . . ." The trader responded that he was "80pct confident the pnl for q2 is going to range between -150m and 250m.... This forecast includes the fact that I am NOT optimistic for now about the impact of the recent press releases. I prefer to forecast q2 results in light of what happened in end of q1." His senior responded "Got . . . it – let'[s] hope it['s] true – we must prove the point today[.]"[76]

That evening, Ms. Drew led a call with Mr. Goldman and the senior members of the Synthetic Credit Portfolio team – who, along with CIO Market Risk and others, had been involved with the profit-and-loss analysis and discussions over the weekend – to prepare for the following day's meeting with Mr. Braunstein. After the call, one of the attendees from the Synthetic Credit Portfolio team e-mailed Ms. Drew, copying Messrs. Dimon, Braunstein and others, and provided an overview of the trading strategies. He explained that CIO had decided to neutralize the Synthetic Credit Portfolio at the end of 2011 because of large realized gains at the end of 2011 from a corporate default, among other things. He stated that the "attempt to neutralize the book ha[d] been unsuccessful," and that they had lost $575 million on the high-yield short positions, but the investment-grade trade meant to neutralize the high-yield short position had delivered only $50 million in revenue, meaning that the Synthetic Credit Portfolio had lost $525 million year-to-date. He offered two reasons that the price movements of long and short positions had acted in what he characterized as an "idiosyncratic" manner and had not correlated with each other as expected: (1) the off-the-run long positions (IG-9 and iTraxx 9) steepened by 24 basis points because of excess liquidity and a "pro-risk environment" in the

[76] The full text of the senior team member's e-mail stated that they must "prove the point today with as much ambiguity as poss[ible]." It is the Task Force's understanding that he meant to say "little" rather than "much."

market; and (2) the series in which the Firm held key long positions (*i.e.*, the IG-9) underperformed other investment-grade indices. He also explained that "we [had] chosen these IG proxies" to offset the short high-yield positions because they contained "the very names that we are short in the HY instruments," and that "although thus far unsuccessful, these IG proxies best neutralize and balance our synthetic books to event risk."

He concluded that the Synthetic Credit Portfolio was "overall risk balanced," and for the second quarter, he provided an estimate of "a P&L range of -150MM to +250MM," with a "significantly positive" upside potential in the event of corporate defaults. His statement about default protection was consistent with a contemporaneous analysis that was being performed by Mr. Venkatakrishnan and a member of Model Risk and Development, and provided to Messrs. Dimon and Braunstein, which concluded that "[t]oday there is considerable default protection coming from IG9 tranches . . . ," explaining that the IG-9 positions were currently positioned for a "gain of +146m on average per name to a loss of -572m per name post December 2012" for each of the 121 names in the IG-9 index."

On April 9, Ms. Drew, Mr. Braunstein, Mr. Wilmot, and an executive from the Synthetic Credit Portfolio team met to discuss the Synthetic Credit Portfolio. Ms. Drew told Mr. Braunstein that the Synthetic Credit Portfolio was balanced, and Mr. Braunstein requested additional follow-up, including a "clear analysis of the positions – maturities, balances, spreads (current) and normalized." Mr. Braunstein updated Mr. Dimon by e-mail on this meeting, as well as on a number of other press- and analyst-related topics. Shortly after the meeting, the executive from the Synthetic Credit Portfolio also forwarded Mr. Braunstein a written presentation on the Synthetic Credit Portfolio and information on a proposed liquidity reserve for the IG-9 tranches in the Synthetic Credit Portfolio. The presentation summarized likely profit-and-loss impacts under a variety of scenarios, all of which were viewed by Mr. Braunstein as manageable.

That evening, Mr. Hogan e-mailed Mr. Dimon regarding CIO. Mr. Hogan had been independently discussing the Synthetic Credit Portfolio with Mr. Venkatakrishnan and an individual from Model Risk and Development, who were in London and had been assisting in assessing certain aspects of the Synthetic Credit Portfolio. Among other things, Mr. Hogan told Mr. Dimon that "the current issue [relating to losses incurred by the Synthetic Credit Portfolio] is fine and I understand the rationale for it," but added that he thought the CIO needed "tighter governance/controls/escalation protocols" and that he believed Ms. Drew agreed. Messrs. Braunstein and Hogan also received an analysis from Mr. Goldman regarding the Synthetic Credit Portfolio's counterparty risk (*i.e.*, risk based on the creditworthiness of particular counterparties and their ability to perform their contractual obligations).

The following day, one of the traders also e-mailed Ms. Drew, Mr. Wilmot, Mr. Goldman, Mr. Weiland and an executive from the Synthetic Credit Portfolio team an explanation of why his team had decided to increase their investment-grade position instead of reducing high-yield short positions. He stated that they had been unable to trade out of the high-yield short positions and viewed the addition of a long-risk position in IG-9 as the "next best hedge."

Mr. Wilmot forwarded a slightly revised version of this explanation to Messrs. Dimon, Braunstein, and Hogan.

Mr. Wilmot also e-mailed Mr. Dimon, Mr. Braunstein, Mr. Hogan, Ms. Drew, and others, providing information on the size of the net positions in the Synthetic Credit Portfolio. The e-mail stated that CIO's IG-9 position represented the equivalent of 10-15 trading days of 100% of the average daily trading volume.[77] This e-mail (along with a subsequent April 12 e-mail showing longer exit periods for certain of the IG-9 instruments) indicated that the positions were large, but senior Firm management took comfort from the fact that CIO had no need to sell the positions and could therefore wait until the market normalized.

April 10 was the first trading day in London after the "London Whale" articles were published.[78] When the U.S. markets opened (*i.e.*, towards the middle of the London trading day), one of the traders informed another that he was estimating a loss of approximately $700 million for the day. The latter reported this information to a more senior team member, who became angry and accused the third trader of undermining his credibility at JPMorgan. At 7:02 p.m. GMT on April 10, the trader with responsibility for the P&L Predict circulated a P&L Predict indicating a $5 million loss for the day; according to one of the traders, the trader who circulated this P&L Predict did so at the direction of another trader. After a confrontation between the

[77] This estimate was prepared by CIO Market Risk, and initially circulated to Ms. Drew, Mr. Venkatakrishnan, Mr. Goldman, Mr. Weiland and senior members of the Synthetic Credit Portfolio team. The estimate does not account for the size of IG-9 tranche positions, and also does not reflect the potential time required to exit the position, generally.

[78] The markets were closed in London on Monday April 9 due to the Easter holiday.

other two traders, the same trader sent an updated P&L Predict at 8:30 p.m. GMT the same day, this time showing an estimated loss of approximately $400 million. He explained to one of the other traders that the market had improved and that the $400 million figure was an accurate reflection of mark-to-market losses for the day.

After the markets closed, Ms. Drew notified Messrs. Dimon and Braunstein about the day's mark-to-market loss of $412 million. It was, she observed, an eight-standard-deviation event that she attributed to the market's belief that JPMorgan would have to liquidate the positions described in the articles.[79] Shortly thereafter, Ms. Drew circulated a second e-mail to Messrs. Dimon, Braunstein, Hogan, Zubrow, Staley, Goldman, Wilmot and an executive from the Synthetic Credit Portfolio, attaching the trader's updated second-quarter profit-and-loss summary and scenario analysis, which was to be discussed the following morning.[80] The analysis showed an 80% likelihood of a second-quarter result in the range of -$250 million to +$350 million for the Synthetic Credit Portfolio, with a 10% "extreme" result of -$650 million and a 10% "optimistic" result of +$1.725 billion.

On April 11, Messrs. Dimon and Braunstein received updates related to the Synthetic Credit Portfolio. Mr. Hogan also copied them on a description of the Investment Bank's risk limits for comparable products and expressed the view that these should be implemented in CIO

[79] A senior member of the Synthetic Credit Portfolio team stated at the time that the losses were attributable to the market's increased awareness of JPMorgan's position and were thus part of an aberrational pattern that would eventually "mean revert."

[80] The updated estimate noted that "these scenarios do not include 10 April P&L, which would accrete back into each scenario +$400MM, if re-calibrated for today's market moves."

as soon as possible. Mr. Hogan separately informed Mr. Braunstein that Mr. Venkatakrishnan had informed him – and had included in an analysis being prepared – that in an extreme loss scenario (of a steepening movement of 20 basis points), the total loss for the second quarter could be up to $1 billion if certain offsetting hedges did not work, and up to $550 million if they did work.[81]

On April 11, Mr. Wilmot circulated to Messrs. Dimon, Braunstein and others a presentation on the Synthetic Credit Portfolio that addressed, among other things, notional exposure relative to various counterparties,[82] maturities, certain positions and profit-and-loss scenarios, noting that it had been reviewed with Jes Staley,[83] Mr. Braunstein, Ms. Drew, Mr. Zubrow and Mr. Hogan. The presentation outlined second-quarter profit-and-loss estimates for a number of scenarios, including a -$150 million "Status Quo" estimate and a +$350 million "Central Scenario" estimate."[84] The presentation also detailed the extent of the Synthetic Credit Portfolio's considerable default protection coming from the IG-9 tranche positions. It further

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[81] The email circulating these materials reads: "Jamie, Attached please find a presentation on the synthetic credit book that was reviewed this afternoon with Doug, Jes, Ina, Barry and John. It covers the relevant data requests from the past several days." This presentation was created by a member of CIO Market Risk, and initially circulated to Ms. Drew, Mr. Goldman, Mr. Wilmot, Mr. Weiland, Mr. Venkatakrishnan, and members of the Synthetic Credit Portfolio and Model Risk and Development teams, to use in an unspecified meeting.

[82] The notional information appears to be directed at counterparty risk, and identifies (among other things) the net notionals outstanding with other parts of the Firm ($13 billion), with an exchange through which certain third-party trades are cleared ($96.7 billion) and with third parties for whom trades are not cleared through the exchange ($47.5 billion).

[83] Mr. Staley was, at this time, the Chief Executive Officer of the Investment Bank.

[84] The presentation also outlined a 10% "extreme" result of a $650 loss million and a 10% "optimistic" result of $1.725 billion gain.

included a description of Mr. Venkatakrishnan's April 11 extreme loss scenario analysis, described above.[85]

Finally, Messrs. Dimon and Braunstein were provided an update on press activity. This included a *Wall Street Journal* article entitled "Making Waves Against the Whale," which suggested that CIO's activity in the market had affected prices, first by driving down the price of buying protection when it was selling a large amount of protection, and then causing the price of protection to go back up when CIO completely stopped selling protection. Mr. Braunstein forwarded the article to Ms. Drew and others and asked, "[i]f the selling pressure impact described in the article was accurate[,] then [might] the change in value [that is causing CIO to lose money]...be in part a return to a more normalized range post our selling activity." One of the recipients responded by circulating an analysis from CIO Market Risk that, as he described it, demonstrated that CIO's activity was "not a big driver of the market moves."

That same day (April 11), Ms. Drew forwarded to Messrs. Dimon, Braunstein, Hogan, Zubrow and others an "Executive Summary" e-mail written by one of the traders. This trader characterized the Synthetic Credit Portfolio as "balanced in terms of directionality." He

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[85] Mr. Venkatakrishnan's estimate was based on an underlying analysis performed by CIO. Although not evident on the face of the document, the Task Force has determined that the underlying analysis was based on an incomplete analysis by CIO London of the potential risks presented by the Synthetic Credit Portfolio. Specifically, the analysis is predicated on losses arising from a steepening of the credit curve, and assumes the existence in the Synthetic Credit Portfolio of a significant flattening position that would limit potential exposure. In fact, there was not a significant flattener in the Synthetic Credit Portfolio, and the analysis also did not consider the impact of an outright movement in the curve. As a result, the presentation's estimate of the worst-case profit-and-loss scenarios was understated. Mr. Venkatakrishnan was not aware of these issues when he assisted CIO.

acknowledged that the hedges in the Synthetic Credit Portfolio had not performed as expected and that the market "goes against all economic sense," but stated that, although it "might take some time," he remained "very confident" that the Synthetic Credit Portfolio would recover its losses for three reasons: (1) because of the increased carry the Synthetic Credit Portfolio gained as a result of market moves; (2) because of the possibility of future defaults that might generate revenue; and (3) because the market for the positions that should have (but had not yet) offset the losses would, in his view, "mean revert" and eventually begin to operate as expected. He also suggested that the press coverage may have played a role in distorting the market value of the positions. A chart attached to the e-mail shows that the Synthetic Credit Portfolio had almost doubled its net notional amount of certain synthetic credit positions since January 2012.

Messrs. Dimon and Braunstein also received additional data from Ms. Drew and Mr. Goldman regarding the Synthetic Credit Portfolio on April 12, including additional information about the Synthetic Credit Portfolio's net notionals, background on the synthetic credit market, the historic purpose of the Synthetic Credit Portfolio, and information regarding the size of certain IG-9 and high-yield positions. On the evening of April 12, as is customary, the Firm's Executive Committee met in advance of the first-quarter earnings call that was scheduled for the following day. Ms. Drew spoke about CIO-related issues that would likely be raised the next morning. She stated that the Synthetic Credit Portfolio had significant value and was well-balanced, and that the current issues were a media event that had pushed the market against CIO. After the meeting concluded, Mr. Dimon confirmed with Ms. Drew that CIO could hold its positions for as long as it wanted, and that no third party had a contractual right to force it to sell. Mr. Dimon wanted to confirm that CIO could hold the positions until the market returned to normal levels, and that there was no contractual risk that CIO would be required to sell unless it wanted to do so.

The first-quarter earnings call was held on the morning of April 13. During the earnings call, Mr. Braunstein addressed the Synthetic Credit Portfolio issues. While he had prepared remarks regarding the Firm's financial results, he had not planned on addressing Synthetic Credit Portfolio positions, and thus did not have prepared remarks relating to CIO. However, shortly before the call, the Global Head of Corporate Communications suggested that Mr. Braunstein address the matter and he agreed to do so. Mr. Braunstein explained on the call that the Synthetic Credit Portfolio had historically taken positions designed to manage the potential losses that could result from a significant stress credit environment. Specifically, Mr. Braunstein explained that:

> . . . [W]e also need to manage the stress loss associated with that portfolio, and so we have put on positions to manage for a significant stress event in Credit. We have had that position on for many years and the activities that have been reported in the paper are basically part of managing that stress loss position, which we moderate and change over time depending upon our views as to what the risks are for stress loss from credit.

Mr. Braunstein further stated his belief that the Firm was "very comfortable" with the positions. Mr. Dimon did not discuss the Synthetic Credit Portfolio in his opening remarks, but he responded to analyst questions on the subject and agreed with an analyst's characterization of the issue as a "tempest in a teapot."

Mr. Dimon had been briefed on the issue and the work being performed, although he had not been involved firsthand in many of the discussions that had taken place during that period.[86] After the analyst call, Mr. Dimon sent an e-mail to Mr. Hogan asking why the Synthetic Credit Portfolio team had decided to increase their investment-grade position instead of reducing the high-yield position. Mr. Hogan responded that he and Mr. Braunstein had asked the same question and had been told that increasing the position "was [the] most 'efficient' way to do it," but that he (Mr. Hogan) thought that CIO had "wanted to improve the carry on the book by selling protection and taking in some premium."

4. *Continued Declines and Internal Reviews*

In the week after the April 13 earnings call, the Synthetic Credit Portfolio experienced additional losses totaling approximately $117 million.[87] By the week of April 23, the losses began to accelerate rapidly. On April 23, the Synthetic Credit Portfolio experienced a single-day

[86] Mr. Dimon had not been in the office from April 2 until his return on April 12.

[87] Mr. Goldman provided the DRPC on April 17 with an update on CIO's activity, focusing on recent news reports regarding the so-called "London whale." According to the meeting minutes, Mr. Goldman "reviewed the history of CIO's synthetic credit book and how it fits within CIO's overall hedging strategy. He described the attributes of the IG-9 index and how purchasing of that index was used to offset other existing positions. Mr. Goldman noted that recent news reports were based on an inaccurate market perception that the portfolio was unhedged, based on a lack of knowledge of how CIO manages the structural risk of the company; he reported that in fact the risk was balanced. In response to questions from the Committee, Messrs. Braunstein and Hogan noted that the information they had received was consistent with this analysis. Messrs. Goldman and Hogan also described an ongoing post mortem on these trades that includes governance and market limits."

loss of approximately $161 million. This was followed by losses of approximately $82 million and $188 million on April 24 and 25, respectively (with a total loss of almost $800 million over the course of the six trading days ending on April 30). These losses were inconsistent with the earlier loss estimates and prediction from one of the traders that the market would "mean revert," and they caused Messrs. Dimon, Braunstein and Hogan as well as Ms. Drew to question whether the Synthetic Credit Portfolio team adequately understood the Synthetic Credit Portfolio or had the ability to properly manage it.

Senior Firm management decided to commission a thorough review of the Synthetic Credit Portfolio, conducted by personnel outside of CIO, in order to better understand the losses it was experiencing and whether the Synthetic Credit Portfolio was being properly managed. On April 26, Mr. Hogan directed a senior member of Firm-wide Market Risk to commence a position-by-position review of the Synthetic Credit Portfolio. This individual, who was in New York on business, returned to London on April 27 and began working with an experienced trader from the Investment Bank and others to analyze the Synthetic Credit Portfolio. As requested by Mr. Hogan, this team examined every position in the Synthetic Credit Portfolio, and attempted to understand how each position was performing and how it was (or was not) correlated to the other positions in the Synthetic Credit Portfolio. The team worked long hours on this review, reporting back to senior Firm management on daily update calls. By Sunday, April 29, after hearing its initial reports, Messrs. Dimon and Hogan asked the team to take over responsibility for the Synthetic Credit Portfolio.

The team continued their intensive review (and the twice-daily update calls) throughout the following week. The team, purposefully not taking into account CIO's views as to what they had intended and how the Synthetic Credit Portfolio was supposed to work, independently analyzed the correlations among the various positions under a range of market scenarios. Based on this review, they concluded that the Synthetic Credit Portfolio was not as well protected against various market scenarios as had been previously thought. In addition, they found that the market's knowledge of the positions and a continued decrease in liquidity made risk reduction even more challenging.

5. *Disclosure of the Losses*

The JPMorgan Audit Committee met on May 2 to review a draft of the first-quarter Form 10-Q. At that meeting, Ms. Drew made a presentation on the Synthetic Credit Portfolio and explained the rationale for the trades that had been put on in the first quarter. Ms. Drew provided the explanation given to her previously by one of the traders as to the increase in the notional size of certain positions in the Synthetic Credit Portfolio, explaining (among other things) the RWA reduction required by the upcoming Basel rules, the anticipated improvement of the economy at the end of 2011, the purported difficulties encountered by the traders in unwinding the positions, and the ensuing use of the IG-9 long position as an offset to the high-yield short positions. She also explained that the Synthetic Credit Portfolio had, by the date of the meeting, moved to a net long credit position.

The deadline for filing the Form 10-Q was May 10, and management noted at the May 2 meeting that it would continue its efforts to understand the Synthetic Credit Portfolio's positions – and the likely losses – as it prepared the Form 10-Q for filing. On May 10, JPMorgan filed its first-quarter 2012 Form 10-Q, and on an analysts' call disclosed that the Synthetic Credit Portfolio had incurred approximately $2 billion in mark-to-market losses in the second quarter to date, with the possibility of additional future losses and volatility as the positions were unwound. As a result of the operational issues relating to the VaR model described in Appendix A, the Firm also stated on May 10 that it had reverted back to its prior VaR model for CIO.

In addition to the review led by the senior individuals from Firm-wide Market Risk and the Investment Bank, the Firm also performed substantial additional work from late April up until the May 10 filing relating to the valuation of the positions in the Synthetic Credit Portfolio to confirm that they had been priced consistently with Firm policy and U.S. GAAP. The review had two primary components. First, a combination of individuals from CIO Finance, the Firm's internal accounting department, valuation experts from the Investment Bank, and others examined the prices assigned by CIO to the positions in the Synthetic Credit Portfolio, including at March 30.[88] This work included collecting market information about the positions in the Synthetic Credit Portfolio; performing an analysis of the positions using the Investment Bank's valuation methodology and personnel; and obtaining explanations from the traders about the

[88] Price validation analyses were conducted by (among others) the Head of JPMorgan's Accounting Policy Group for CIO EMEA.

bases for the prices assigned to the positions in question. The review of the pricing data confirmed that the valuations of the positions in the Synthetic Credit Portfolio were within the range of reasonable fair values for such instruments. Individuals working on the review understood that, although the March 30 trader marks for the Synthetic Credit Portfolio were aggressive, they were predominantly within the VCG thresholds.[89] And, when questioned about the March 30 marks, the traders all confirmed that the marks at March 30 reflected their good-faith estimation of the positions' value, and one of them explicitly denied any bias.

Second, in addition to the review of the front office marks, the Firm also conducted a review of the VCG process related to the valuation of the Synthetic Credit Portfolio. As a result of its work, the Firm confirmed that PwC was aware of the CIO VCG process and the Firm concluded that the process – including the identification of a mid-market price and application of a threshold around that price – was designed to result in marks that were compliant with U.S. GAAP. The Firm therefore concluded, after consultation with PwC (which was conducting its quarterly review procedures), that the marks were determined in accordance with U.S. GAAP and Firm policy.

During its subsequent efforts to obtain and understand all the facts relating to the CIO losses, the Task Force became aware of facts that caused it (and the Firm and PwC) to revisit

[89] There were some marks that had been outside the thresholds, but those had been adjusted by VCG in early April to the threshold, for a total adjustment of approximately $17 million.

these conclusions.[90] With respect to the front office marks, the Task Force learned that not all of the marks appeared to reflect an unbiased assessment by the front office of exit prices and instead that some of the marks reflected, at least in part, pressure exerted by one of the traders to minimize the losses shown. This new information, which was uncovered in electronic communications and recorded conversations subsequent to the May 10 filing, was shared with PwC, and the Firm decided – following analysis and consultation with PwC – to restate its financial statements for the first quarter to reflect the valuations that would have been employed if the positions had been marked to an objectively determined "mid" valuation.[91] The announcement of the restatement was made on July 13.

D. Risk Limits and Excessions

The three primary categories of risk metrics applicable to CIO were VaR, stress, and non-statistical credit-spread widening metrics (Credit Spread Basis Point Value ("CSBPV") [92] and CSW 10%[93]). Pursuant to Firm policy, each of these metrics was subject to certain limits. Limits are classified by type, as Level 1, Level 2, or "threshold." A limit's type determines who is responsible for approving the limit, who receives notice of any excessions, and who within the Firm is responsible for approving any increases. The CIO Global 10-Q VaR and CIO stress

[90] Much of this subsequently discovered information is described in Section II.C.2 of this Report (among other places) and includes the discovery of the "divergence," as well as the March 30 and April 10 valuation-related events.

[91] The Firm re-marked the positions to objectively determined "mid" valuations, which the Firm believes was reasonable under the circumstances.

[92] *See* Section II.D.2.

[93] *See* Section II.D.3.

limits were Level 1 limits, while the CIO CSBPV and CIO CSW 10% limits were Level 2 limits. Any excessions of Level 1 or Level 2 limits had to be reported to the signatories to the limit, the Risk Committee for the line of business, and the Market Risk Committee or Business Control Committee for the line of business.[94] Under Firm policy, all excession notifications should include (1) a description of the limit excess, (2) the amount of the limit, (3) the exposure value (*i.e.*, the amount by which the limit has been exceeded) and the percentage by which the limit has been exceeded, and (4) the number of consecutive days the limit has been exceeded. Excessions are addressed differently depending on type, but in the event of an "active limit excess," which occurs when a business unit exceeds its own limit, the business unit "must take immediate steps to reduce its exposure so as to be within the limit," unless a "one-off approval" is granted. A "one-off approval" refers to a temporary increase for a limited period of time; it must be provided by the persons who were responsible for setting the original limit.

Limits are not rigid restrictions, and some excessions are expected. The excession process, however, serves an important function: triggering discussion and analysis of the reasons for an excession and of the limit that has been exceeded.[95]

[94] There was no specific number of days by which the notifications were required to be distributed at the time, although Market Risk Management typically sent such notifications within a matter of days of a limit having been exceeded. As described in Section IV.B.2, as part of its remedial measures, the Firm has instituted a policy specifying procedures, including time limits, for escalation of limit excessions.

[95] An earlier limit breach within CIO appears to have been part of the impetus for a review of CIO's limit structure begun by CIO's Head of Market Risk in the summer of 2011, described below. Beginning in March 2011, CIO's aggregate stress loss limit was in breach for some time. The breach, which was discussed among the Chief Investment Officer, the Firm-wide Chief Risk Officer, and the CIO Head of

At various points and for different reasons, discussed in further detail below, the limits for each of these metrics were exceeded in the first quarter of 2012. The CIO Global 10-Q VaR limit was exceeded in the second half of January. These excessions were addressed by position changes and by implementation of a new VaR model, which had been in process for almost six months when the CIO VaR began to be exceeded. The other excessions of CIO limits in the first quarter of 2012, namely, the CSBPV limit, the CSW 10% limits, and the stress loss limits, were the subject of discussion within CIO, and, in the case of the stress loss limit, among senior Firm management. However, the trading had largely ceased by the time the aggregate CSW 10% limit and the stress loss limits, in particular, were exceeded in late March and April 2012.[96]

1. *Value at Risk*

VaR is a statistical estimate of the risk of loss on a portfolio of assets. A portfolio's VaR represents an estimate of the maximum expected mark-to-market loss over a specified time period, generally one day, at a stated confidence level, assuming historical market conditions.

Beginning in mid-January 2012, CIO breached its VaR limit on multiple days, which also contributed to breaches of the Firm's VaR limit. CIO explained to Mr. Hogan and Firm-wide Market Risk that the breaches were being addressed in two ways: (1) continued management of CIO's positions, and (2) implementation of a new, "improved" VaR model for CIO. In response

Market Risk, appears to have been caused principally by activity unrelated to the Synthetic Credit Portfolio, in CIO's international rates sector.

[96] CIO's mark-to-market CSW 10% limit was first exceeded on March 22, 2012, the day before Ms. Drew gave the instruction to stop trading. The aggregate CSW 10% limit was not exceeded until April 10, 2012.

to the notification of a second consecutive breach in the Firm-wide VaR limit on January 18 (which was primarily driven by "position changes in CIO"), Mr. Hogan requested that Mr. Weiland and a senior member of Firm-wide Market Risk look into the factors driving the increase in the CIO VaR and report back with a recommendation. Mr. Weiland advised Firm-wide Market Risk that it was CIO's intention to "bring the VaR down, even under the current VaR model," and another member of CIO Market Risk further advised that they expected the breach of the VaR limit to be resolved through "active risk management," meaning by trading in a manner expected to reduce the risk profile of the portfolio. In an e-mail to Mr. Hogan on January 20, Mr. Goldman explained that "position offsets to reduce [the CIO] VaR" were happening daily. With respect to the implementation of a new VaR model, Mr. Weiland informed Firm-wide Market Risk that CIO was in the final phase of a model review for a "new VaR model for the tranche book" (meaning the Synthetic Credit Portfolio) and that the new model was expected to result in a lower VaR for CIO.

Mr. Weiland recommended a temporary, one-off increase in the Firm-wide VaR limit, with an expiration set to coincide with the expected timing of the VaR model approval. A subsequent e-mail from Market Risk Reporting on January 23 requested Messrs. Dimon and Hogan's approval for a temporary increase in the Firm's 10-Q VaR limit[97] from $125 million to $140 million, expiring on January 31, 2012. The request noted that there was an approval

[97] The Firm's "10-Q VaR" is the VaR for all the Firm's mark-to-market positions; it includes CIO's Global 10-Q VaR.

pending for a new model for the CIO Synthetic Credit Portfolio and that the new model was expected to reduce Firm-wide VaR back below the $125 million limit.[98] Messrs. Dimon and Hogan approved the temporary increase in the Firm-wide VaR limit, and Ms. Drew approved a temporary increase in CIO's 10-Q VaR limit. In an e-mail to Mr. Hogan on January 25, Mr. Goldman reported that the new model would be implemented by January 31 "at the latest" and that it would result in a "significant reduction" in the VaR. On January 28, in response to an inquiry from Mr. Hogan about the change in methodology, Mr. Goldman advised him that the new model had been approved by the Model Review Group and that the Model Review Group considered it to be "superior" to the model used by the Investment Bank. There was no corresponding change made to the CIO Global 10-Q VaR limit at the time of the new model's implementation – *i.e.*, it remained at $95 million.[99] Following implementation of the new model, the CIO VaR fell below the limit, as expected.

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[98] As explained in further detail in Appendix A, a significant reduction in the CIO VaR was expected upon implementation of the new model, which had been in development throughout the Fall of 2011. The previous model was viewed as too conservative and the VaR that it was producing thus was considered to be too high. The new model was thought to be a substantial improvement that would more accurately capture the risks in the portfolio.

[99] A reduction in the CIO VaR limit was being considered at this time as part of a broader ongoing discussion about a revised limit structure for CIO. For example, in a January 25, 2012 e-mail exchange, Mr. Hogan asked Mr. Goldman whether CIO had any intention of further increasing its temporary VaR limit or recommending an increase in the Firm-wide VaR limit in response to the ongoing breaches in the CIO and Firm-wide VaR limits. Mr. Goldman replied, "The new VaR model was approved today and we will get a significant reduction under the limit when implemented – January 31st at the latest. I do not think it's worth changing limits till [the new] model is implemented." Although a proposal to reduce the VaR limit and to change the limit structure of CIO was under active discussion at this time (Messrs. Goldman and Weiland presented a version of it to Ms. Drew in February 2012 and Mr. Weiland made a presentation to the CIO Risk Committee in March), a new CIO limit structure was not implemented until

2. *Credit Spread Basis Point Value*

CSBPV is one measure of the sensitivity of a portfolio to a one basis point move. With respect to the Synthetic Credit Portfolio, it reflected an aggregation of the CSBPV sensitivities of all the credit products *(e.g.*, investment-grade and high-yield), unadjusted for correlations. Although Ms. Drew did not regularly receive reports with CIO's CSBPV figures or receive notifications from Market Risk Reporting when the limit was exceeded (because it was a Level 2 limit and she was not a signatory to it), there was discussion among other personnel within the CIO Risk Management function when the CSBPV limit began to be exceeded in the first quarter. For example, when the CSBPV limit was first breached on January 6, 2012, an individual from CIO Market Risk, in an e-mail to Mr. Goldman, Mr. Weiland and two senior members of the Synthetic Credit Portfolio team noted that CIO was actively taking steps to reduce risk in order to move within the CSBPV threshold. This individual continued to monitor the CSBPV limit status and to update his manager. Ms. Drew was aware, by virtue of an e-mail she received from Mr. Goldman on February 13, 2012, that the CIO Global Credit Spread CSBPV limit had been in breach for most of the year. She responded that she had no memory of this limit and that, in any case, it needed to be "recast with other limits" because it was "old and outdated." It was one of

May 2012, and those limits were substantially different from and more detailed than the limits that had been included in Mr. Weiland's proposal.

the limits that was to be adjusted or replaced altogether as part of a proposal by Mr. Weiland to revise the CIO limit structure, which was pending at that time.[100]

At various times, beginning in February, CIO Market Risk suggested a temporary increase in the mark-to-market ("MTM") CSBPV limit, from $5 million to $20 million, $25 million or $30 million. On March 1, Firm-wide Market Risk Management e-mailed Mr. Weiland and a senior member of the Synthetic Credit Portfolio team (the signatories to the limit) requesting their approval to temporarily increase the aggregate and MTM CSBPV limits until March 31.[101] Although Mr. Weiland agreed with the suggestion to increase the limit, neither he nor his co-signatory from the Synthetic Credit Portfolio approved the request for a temporary increase and no such increases were implemented. An e-mail from Market Risk Management to the same signatories on March 26 advised that CIO had been breaching its aggregate and MTM CSBPV limits from February 21 through March 21 and that the breaches were "the result of portfolio and hedge rebalancing since start of 2012." The notification went on to point out that the CSBPV had certain flaws that made it less reliable than the CSW 10% (*i.e.*, that it was not normalized for the level of spreads and did not capture convexity) and that a full limit review was underway for the CIO business, which would result in a proposal that was expected to address those issues.

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[100] *See* n. 99.

[101] The CSBPV for both the mark-to-market portfolio and part of the asset-backed securities portfolio are included in the calculation of the aggregate CSBPV metric. The MTM CSBPV limit takes into account only the CSBPV for the mark-to-market portfolio.

3. *Credit Spread Widening 10% and Stress Loss*

The CIO CSW 10%[102] aggregate and mark-to-market limits and the aggregate and mark-to-market stress loss limits began to be exceeded in late March. CSW 10% stresses all credit spreads in a book wider by 10% – for example, a CDS currently marked at 100 basis points will be revalued at 110 basis points – and then calculates the profit-and-loss effect.

The CSW 10% mark-to-market limit began to be exceeded on March 22, 2012, and the CSW 10% aggregate limit began to be exceeded on April 10, 2012. The MTM limit breach was first reported in the CIO Daily Limit Report on March 26, 2012, and the aggregate limit breach was reported on April 11, 2012. The Daily Limit Report was distributed within CIO to, among others, Mr. Goldman and Mr. Weiland, although it was not distributed to Ms. Drew. It included a Position Limit and Loss Advisory Summary Report that provided detail on each of CIO's limits, including the amount of each limit, the limit's current level of utilization, the percentage by which a limit was in excess, if any, the amount of each limit in the previous four trading days, and the monthly trend for each limit. Both CIO CSW 10% limits continued to be exceeded throughout April. The excessions were attributed to "portfolio and hedge rebalancing since [the] start of 2012."

On March 29, 2012, the aggregate and mark-to-market stress limits for CIO, which were tested weekly, also began to be exceeded. Stress testing is used to measure the Firm's vulnerability to losses under adverse and abnormal market environments. Its purpose is to assess

[102] For an explanation of CSW 10%, see n. 6.

the magnitude of potential losses resulting from a series of plausible events in these hypothetical abnormal markets. Stress testing is performed by applying a defined set of shocks, which vary in magnitude and by asset class, to a portfolio. For example, weekly testing stresses the Firm's positions under a number of hypothetical scenarios such as a credit crisis, an oil crisis, and an equity collapse. On March 29, CIO exceeded its aggregate stress loss limit threshold, with the "oil crisis" stress test resulting in the "worst case scenario." This excession and those that followed reflected the potential loss that was calculated by stressing the underlying positions. As described above, the notional value of the Synthetic Credit Portfolio grew over time during the months preceding March 29. The increase in notional value in turn resulted in a higher hypothetical stress loss when the Firm ran the Synthetic Credit Portfolio through its various stress scenarios. The stress loss excessions were reported in the first weekly stress report that followed, on April 6, 2012.[103] CIO's mark-to-market stress limit continued to be exceeded throughout April. By then, however, the trading that precipitated the losses in the Synthetic Credit Portfolio had ceased.

III. Key Observations

The Task Force agrees with Mr. Dimon's public acknowledgement that CIO's trading strategies for the Synthetic Credit Portfolio in the first quarter of 2012 were "poorly conceived and vetted," CIO "did not have the requisite understanding of the risks [it] took," and "risk

[103] The report was circulated to Mr. Dimon, Mr. Staley, Mr. Hogan, Mr. Zubrow, Ms. Drew, Mr. Goldman and Mr. Weiland, among others.

control functions were generally ineffective in challenging the judgment of CIO's trading personnel."

A. CIO Judgment, Execution and Escalation in the First Quarter of 2012 Were Poor

The Task Force has identified six areas in which CIO failed in its judgment, execution and escalation of issues in the first quarter of 2012: (1) CIO management established competing and inconsistent priorities for the Synthetic Credit Portfolio without adequately exploring or understanding how the priorities would be simultaneously addressed; (2) the trading strategies that were designed in an effort to achieve the various priorities were poorly conceived and not fully understood by CIO management and other CIO personnel who might have been in a position to manage the risks of the Synthetic Credit Portfolio effectively; (3) CIO management (including CIO's Finance function) failed to obtain robust, detailed reporting on the activity in the Synthetic Credit Portfolio, and/or to otherwise appropriately monitor the traders' activity as closely as they should have; (4) CIO personnel at all levels failed to adequately respond to and escalate (including to senior Firm management and the Board) concerns that were raised at various points during the trading; (5) certain of the traders did not show the full extent of the Synthetic Credit Portfolio's losses; and (6) CIO provided to Firm management excessively optimistic and inadequately analyzed estimates of the Synthetic Credit Portfolio's future performance in the days leading up to the April 13 earnings call. In addition, the Task Force has considered the impact of the Firm's compensation structure on the events in question.

1. *The Priorities*

By early 2012, CIO management, including Ms. Drew, had imposed multiple priorities on the Synthetic Credit Portfolio. These priorities included (1) balancing the risk in the Synthetic Credit Portfolio, (2) reducing RWA, (3) managing profits and losses, (4) managing or reducing VaR, and (5) providing "jump-to-default" protection. These priorities were potentially in conflict, and the requirement that the traders satisfy all of these goals appears to have prompted at least some of the complicated trading strategies that led to the losses. Rather than imposing a multitude of potentially competing priorities on the traders, CIO management should have determined (or engaged senior Firm management on the question of) which of these priorities should take precedence, how they could be reconciled, and how CIO intended to execute on the priorities. That did not occur and instead, CIO management imposed inconsistent and potentially competing priorities on its traders.

2. *The Trades*

The trading strategies that were put in place in early 2012 were poorly conceived and vetted, and neither the trading nor its impact on RWA were fully understood by CIO management or the traders. The Firm expected them to subject CIO trading strategies to rigorous analysis and questioning prior to implementation, and to understand the risks inherent in the trading strategies. Here, they did not, and instead put in place the trading strategy without fully understanding what risks were being taken on, particularly in light of the size of the positions being built over the course of the first quarter of 2012.

3. *The Reporting*

The Firm's Chief Investment Officer did not receive (or ask for) regular reports on the positions in the Synthetic Credit Portfolio or on any other portfolio under her management, and instead focused on VaR, Stress VaR, and mark-to-market losses. As a result, she does not appear to have had any direct visibility into the trading activity, and thus did not understand in real time what the traders were doing or how the portfolio was changing. And for his part, given the magnitude of the positions and risks in the Synthetic Credit Portfolio, CIO's CFO should have taken steps to ensure that CIO management had reports providing information sufficient to fully understand the trading activity, and that he understood the magnitude of the positions and what was driving the performance (including profits and losses) of the Synthetic Credit Portfolio.

4. *The Concerns*

A number of CIO employees, including Ms. Drew, Mr. Goldman, Mr. Wilmot, Mr. Weiland and members of the Synthetic Credit Portfolio team became aware of concerns about aspects of the trading strategies at various points throughout the first quarter.[104] However, those concerns failed to be properly considered or escalated, and as a result, opportunities to more closely examine the flawed trading strategies and risks in the Synthetic Credit Portfolio were missed. Examples include (but are not limited to):

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[104] *See* Section II.C.1.

December 2011

- One of the traders raised concerns with senior members of the Synthetic Credit Portfolio team about P&L volatility that could accompany an effort to reduce RWA by selling protection.

January 2012

- In late January, Mr. Wilmot expressed concern to Mr. Goldman about the VaR levels.

- On January 30, one of the traders wrote to another trader expressing concerns about the lack of liquidity in the market and the fact that any additions to the positions, notwithstanding any near-term benefits, would ultimately increase the risks and size of the Synthetic Credit Portfolio, as well as its sensitivity to price moves and trading costs.

- On January 31, a senior member of the Synthetic Credit Portfolio team forwarded to Ms. Drew an e-mail exchange between himself and one of the traders, which included an e-mail from another of the traders. That senior member expressed the view that the Synthetic Credit Portfolio was not behaving as intended and that financial performance was "worrisome"; the trader's underlying e-mail noted that the losses were large because the notional size of the positions was large, and that the Synthetic Credit Portfolio was losing money on a number of positions.

February 2012

- On February 2, according to one of the traders, he advised Ms. Drew and another trader that the Synthetic Credit Portfolio could experience additional losses of $100 million, and explained that it was possible that they did not have the right long position in light of the characteristics of the IG-9 position and the relevant market dynamics.

- On February 2, Mr. Weiland sent an e-mail to one of the traders regarding VaR and RWA measurements for the Synthetic Credit Portfolio, expressing concern that that trader had provided an "overly optimistic" view of the likelihood that the Firm's RWA model would be changed and the forward projection for RWA reduction.

- On February 13, Mr. Goldman e-mailed Ms. Drew and noted that the CIO Global Credit Spread CSBPV limit had been in breach for most of the year.

- On February 15, Mr. Weiland noted for a member of CIO Market Risk (among others) that CIO had, since mid-January, been in breach of its CSBPV limits, primarily as a result of position changes in the Synthetic Credit Portfolio.

March 2012

- On March 1, one senior member of the Synthetic Credit Portfolio team expressed concern to another such member that the traders would be unable to defend their positions if they were forced to effect an unwind in order to meet RWA targets.

- On March 7, Mr. Venkatakrishnan wrote to Ms. Drew, Mr. Hogan, Mr. Goldman, Mr. Weiland and Firm-wide Market Risk that the Synthetic Credit Portfolio's RWA had increased by approximately $3 billion between January and February as a result of a $33 billion increase in notionals in long index risk.

- On March 20, Ms. Drew and Mr. Goldman presented an overview of CIO to the DRPC. Neither of them raised the increasing mark-to-market losses, the substantial change in the trading strategy, the recent and ongoing breaches in certain of CIO's risk limits, the significant growth in the Synthetic Credit Portfolio's notionals, or the delay in the trading-based RWA reduction effort. The change in the VaR model and breaches of the CIO and Firm-wide VaR limits that had occurred in January 2012 were also not discussed.

- By late March, one of the traders informed Ms. Drew that he was considering adding to the size of the Synthetic Credit Portfolio in order to "defend" their position.

April 2012

- In early April, Mr. Wilmot raised questions with Ms. Drew about whether the traders could effect the RWA reduction without an unwind of positions.

These concerns were not fully explored. At best, insufficient inquiry was made into them and, at worst, certain of them were deliberately obscured from or not disclosed to CIO management or senior Firm management. Although in some instances, limited steps were taken to raise these issues, as noted above, no one pressed to ensure that the concerns were fully considered and satisfactorily resolved.

5. *The Marks*

From at least mid-March through at least March 30, the traders did not provide good-faith estimates of the exit prices for all the positions in the Synthetic Credit Portfolio.[105] That practice concealed from Ms. Drew and others their good-faith view of the market price of these positions, and it deprived management of a possible opportunity to curtail the trading before late March and potentially avoid some of the ensuing losses. When questioned about the marks in late April and early May prior to the Firm's filing of its first-quarter Form 10-Q, they maintained that the marks had represented their good-faith judgments regarding fair value of the positions. The Task Force's subsequent discovery that these statements were likely untrue caused the Firm to restate its earnings and re-file financial reports.

6. *The Estimates*

CIO provided in early April what in hindsight were overly optimistic and inaccurate analyses regarding the potential losses to which the Synthetic Credit Portfolio was exposed. These estimates all predicted that any losses would be in a range that was manageable for the Firm, and they were accompanied by assurances from CIO that the market was temporarily dislocated. The estimates generally predicted that the market would recover or "mean revert,"

[105] The Task Force has noted that some of the marks on the Synthetic Credit Portfolio's positions at March 30 were within the bid/offer spread, but were to the benefit of the portfolio's positions.

meaning that the market prices were distorted and that the prices would return to their historic average relationships to other instruments. CIO advised senior Firm management that the Synthetic Credit Portfolio was "overall risk balanced," and for the second quarter, showed "a P&L range of -150MM to +250MM," with a "significantly positive" upside potential in the event of defaults. In fact, this profit-and-loss range turned out to be significantly off-the-mark, and the record uncovered during the Task Force's subsequent investigation revealed that this profit-and-loss estimate was largely based on a Monte Carlo analysis in which the person performing the analysis did not have confidence, and which appears to have been selected by his supervisor specifically because it generated more positive profit-and-loss estimates. Against the backdrop of the concerns that had been expressed internally at various points during the first quarter of 2012 by (or to) Ms. Drew, Mr. Wilmot, and members of the Synthetic Credit Portfolio team, the optimistic estimates failed to provide Messrs. Dimon, Braunstein and Hogan with a complete picture of how the team managing the Synthetic Credit Portfolio viewed it and the concerns they had previously raised within CIO. This failure was especially critical in early April when senior Firm management was focused on preparations for the April 13 earnings call and was relying on Ms. Drew to provide and explain information regarding the Synthetic Credit Portfolio.

It bears mention that, although these faulty estimates were largely initially generated by a trader (working with another more senior trader), there were other employees in CIO, including in its Risk, Finance and management functions, who were positioned to consider and question the validity of these estimates. They failed to do so adequately, and instead, accepted these estimates – together with the assertions that the Synthetic Credit Portfolio was "balanced" – and passed them along to senior Firm management. On this score, senior members of the Synthetic Credit Portfolio team, including Ms. Drew, as well as CIO Finance and CIO Risk Management, should have more thoroughly questioned, tested and/or caused others to test the estimates and conclusions being presented.

7. *Compensation Issues*

Incentive-based compensation systems are premised on the basic assumption that one of the factors that influence individuals' performance and conduct is financial reward. When employees take steps such as those that led to the losses in the Synthetic Credit Portfolio, the question naturally arises whether something in the compensation framework incentivized them to do so and whether the Task Force should be recommending adjustments to that framework. Based on the Task Force's review, however, there does not appear to be any fundamental flaw in the way compensation was and is structured for CIO personnel.[106] What the incident does highlight is the particular importance of clear communication to front office personnel engaged in activities not expected to generate profits (such as the winding down of a trading portfolio) that they will nonetheless be compensated fairly for the achievement of the Firm's objectives, including effective risk management.

[106] To this end, the Task Force believes that even if the traders and others had received only a fixed salary and no incentive compensation, they nevertheless might have harbored concerns about the consequences of losses on their future salary and professional prospects in light of the Synthetic Credit Portfolio unwind.

CIO does not have its own incentive compensation system; instead, it participates in the Firm-wide annual incentive plan that is reviewed and overseen by the Compensation and Management Development Committee of JPMorgan's Board of Directors. Awards under the plan are discretionary and non-formulaic, and compensation is dependent on multiple factors that can be adjusted and modified depending on the particular circumstances. These factors include financial performance – for the Firm, for the business unit and for the individual in question – but they also consider "how" profits are generated, and compensation decisions are made with input from Risk Management and other control functions (as was the case for CIO).[107]

The Task Force has found little in the form of direct evidence to reveal what Ms. Drew and the other Synthetic Credit Portfolio managers and traders were thinking about their own specific compensation as they made decisions with respect to the Synthetic Credit Portfolio. Throughout the relevant period, however, at least two of the traders clearly maintained a strong focus on daily, monthly and quarterly profit-and-loss numbers, and were acutely concerned about mounting losses in the Synthetic Credit Portfolio. At the beginning of 2012, a priority for CIO was to reduce RWA, and the Synthetic Credit Portfolio was a significant user of RWA. There was also a belief that CIO should neutralize the credit exposure of the Synthetic Credit Portfolio. And there was recognition, reflected in the February 2012 CIO Business Review, that "[d]espite the effectiveness of the Tail Risk Book hedging credit portfolio, the change in regulatory capital

[107] Risk management personnel were asked to provide input on the traders during their 2011annual performance reviews. None of the input raised risk-oriented concerns.

regime is likely to force a re-size / run-off of synthetic portfolio in order to maintain RWA targets for the Firm." Ms. Drew and other senior members of the Synthetic Credit Portfolio team knew that winding down the portfolio brought with it the likely prospect of significant trading costs (that is to say, from a profit-and-loss perspective) in implementing this priority.

As a result, the Task Force believes that the CIO management, including Ms. Drew, should have emphasized to the employees in question that, consistent with the Firm's compensation framework, they would be properly compensated for achieving the RWA and neutralization priorities – even if, as expected, the Firm were to lose money doing so. There is no evidence that such a discussion took place. In the future, when the Firm is engaged in an exercise that will predictably have a negative impact (either in absolute terms or relative to past performance) on a front office employee's or business unit's contribution to the Firm's profits and losses, the Firm should ensure those personnel are reminded that the Firm's compensation framework recognizes that losses (as well as profits) are not necessarily the measure of success. This approach is fully consistent with the current incentive compensation structure, but should be reinforced through clear communication.

B. The Firm Did Not Ensure that the Controls and Oversight of CIO Evolved Commensurately with the Increased Complexity and Risks of Certain CIO Activities

The Task Force believes that the Firm did not ensure that the controls and oversight of CIO evolved commensurately with the increased complexity and risks of CIO's activities. As a result, there existed significant risk management weaknesses within CIO that played a key role in allowing the flawed, risky trading strategies to be pursued.

For a significant period of time prior to the first quarter of 2012, CIO was subjected to less rigorous scrutiny than client-facing lines of business. The lower level of oversight engendered weak risk management and infrastructure within CIO, which performed ineffectively at a time when robust, effective controls were most needed. Granular limits were lacking, and risk managers did not feel adequately empowered. These matters became even more critical once the Synthetic Credit Portfolio grew in size, complexity and risk profile during the first quarter of 2012. Further, by the time the Firm's new Chief Risk Officer was appointed in January 2012 and launched an effort to compare and improve practices throughout the Firm, it was too late to build the risk controls and develop the structure that may have helped to prevent the losses in CIO.

The Task Force has identified six factors that it believes may have led to less rigorous scrutiny for CIO. *First*, CIO and the Synthetic Credit Portfolio had largely performed very well in the past. Neither had a history of significant losses and, as Mr. Dimon has explained, there "was a little bit of complacency about what was taking place [in CIO] and maybe overconfidence." Moreover, CIO EMEA Credit – the unit in which the Synthetic Credit Portfolio was located – had not previously experienced major control issues. In particular, CIO EMEA Credit received "Satisfactory" ratings in prior audits. Nevertheless, senior Firm management did not take sufficient steps to confirm the belief that CIO was subject to appropriate oversight and risk limits, nor did they confirm how the Firm-wide Risk organization was monitoring and overseeing CIO's activities.

Second, CIO is not a client-facing business and does not involve the host of regulatory, risk and other limits applicable to dealings between the lines of business and their clients, which require more attention from various control functions, including compliance, audit, legal and finance. There was no meaningful effort to ensure that, notwithstanding this fact, CIO was subject to appropriately rigorous risk and other limits and was updating those limits on a regular basis.

Third, the more conservative nature of the majority of CIO's portfolio, as well as its overall mandate to invest the Firm's investment portfolio in "top of the capital structure" instruments, may have suggested to senior Firm management that CIO did not present significant risks.

Fourth, the large size of CIO's overall portfolio may explain the lack of an aggressive reaction of numerous people, including senior Firm management, to the relative size of the Synthetic Credit Portfolio. When coupled with representations of CIO traders and management that the Synthetic Credit Portfolio was "balanced" (as well as the fact that CIO could hold the positions for a long period), the notional numbers that were being discussed at the time were large but not alarming. But, the growth in the notional size of the Synthetic Credit Portfolio during the first quarter of 2012 should have prompted additional scrutiny by the Risk organization (at both the Firm and CIO level) into both the trading strategies that had caused this growth and the proposed exit strategy.

Fifth, the implementation of a new model that significantly reduced CIO's VaR likely distracted focus from the increase in VaR that occurred in January 2012. Absent the new model, or if VaR limits had been promptly adjusted downward following the implementation of the new model, breaches of the CIO Global 10-Q VaR limit would have continued, and could have triggered a more rigorous analysis by Risk Management personnel both inside and outside CIO – potentially leading to earlier discovery of the risks in the Synthetic Credit Portfolio and modification or termination of the trading strategies that persisted through late March.

Sixth, the CIO Risk organization did not mature into the type of robust and independent function that is needed for trading activities that involve significant risk. The CIO Risk function was not staffed with as many experienced or strong personnel as it should have been. The Firm-wide Risk organization bears responsibility for not having built, over time, a strong, independent Risk function within CIO. This failure meant that notwithstanding the new Chief Risk Officer's efforts beginning in early 2012 to improve controls and oversight, the necessary infrastructure was not in place when the need arose and the CIO Risk function was tested. CIO management also bears responsibility for this weakness in the CIO Risk function.

In addition to these risk-related controls, the Task Force has also concluded that the Firm and, in particular, the CIO Finance function, failed to ensure that the CIO VCG price-testing procedures – an important financial control – were operating effectively. As a result, in the first quarter of 2012, the CIO VCG price-testing procedures suffered from a number of operational deficiencies. For example, CIO VCG did not have documentation of price-testing thresholds. In addition, the price-testing process relied on the use of spreadsheets that were not vetted by CIO VCG (or Finance) management, and required time-consuming manual inputs to entries and formulas, which increased the potential for errors.

C. CIO Risk Management Was Ineffective in Dealing with Synthetic Credit Portfolio

CIO Risk Management lacked the personnel and structure necessary to properly risk-manage the Synthetic Credit Portfolio, and as a result, it failed to serve as a meaningful check on the activities of the CIO management and traders. This occurred through failures of risk managers (and others) both within and outside of CIO.

CIO's Risk Management group faced key organizational challenges during the relevant period – from the end of 2011 through the first quarter of 2012 – and in particular was faced with transitions in key roles. The position of Chief Risk Officer within CIO was filled by Mr. Goldman in January 2012. Previously, Mr. Weiland, the head of CIO Market Risk, had overseen Risk Management within CIO since the principal risks taken by CIO were market risks. In his capacity as *de facto* Chief Risk Officer for CIO, Mr. Weiland had reported to Mr. Zubrow, who served as the Firm's Chief Risk Officer until January 13, 2012.[108] Mr. Weiland participated in

[108] After Mr. Goldman took over as CRO for CIO, Mr. Weiland maintained his responsibilities for CIO Market Risk but reported to Mr. Goldman rather than Mr. Zubrow, with "dotted line" reporting to Firm-wide Market Risk in February 2012.

Mr. Zubrow's management team meetings and sat on the Firm-wide Risk Working Group, chaired by Mr. Zubrow.

Prior to Mr. Goldman's appointment as CIO Chief Risk Officer, his previous experience had been as a trader and as a manager and executive responsible for corporate strategy. His only previous direct experience with risk management was as chair of the Fixed Income Trading Risk Management Committee at another large firm, a position he had held more than 10 years earlier.[109] As a result, although he had been working in another role within CIO before being

[109] Mr. Goldman was previously Head of Strategy for CIO. Before joining JPMorgan, Mr. Goldman held several roles at Cantor Fitzgerald. He served first as Chief Executive Officer and President of debt capital markets and asset management, and then as Chief Executive Officer and President of Cantor's broker dealer, where he oversaw that firm's strategy and global expansion. After leaving Cantor Fitzgerald in 2007, Mr. Goldman was hired by Ms. Drew as a portfolio manager in CIO in January 2008. He subsequently took a leave of absence in June 2008, and later resigned, in order to respond to a New York Stock Exchange investigation involving allegations that Cantor Fitzgerald had failed to supervise Mr. Goldman because he had traded stocks in his personal accounts while simultaneously trading in those same stocks in Cantor Fitzgerald's proprietary accounts. After the New York Stock Exchange inquiry concluded with no action against Mr. Goldman, Ms. Drew hired him to work directly for her on strategic projects, primarily related to asset allocation. In late 2010/early 2011, Ms. Drew and Mr. Zubrow, whose wife's sister is married to Mr. Goldman, began a search to fill the newly created position of Chief Risk Officer of CIO. Ms. Drew and Mr. Zubrow created the position because CIO had been growing and their view was that they needed to enhance CIO's Risk staffing. They engaged an executive search firm, which met with nearly a dozen individuals. However, none of the candidates who advanced to interviews with CIO management was deemed to be right for the position, and in late 2011, the search was put on hold. Shortly after learning of Mr. Hogan's impending appointment as Chief Risk Officer for the Firm, Mr. Zubrow and Ms. Drew discussed Mr. Goldman for the role of Chief Risk Officer of CIO. Ms. Drew believed that Mr. Goldman was a good choice for the job, based on, among other things, his understanding of markets. She secured Mr. Hogan's assent to the appointment. While others at the Firm were aware of Mr. Goldman's background and relationship with Mr. Zubrow and Ms. Drew and Mr. Zubrow may have assumed Mr. Hogan's awareness, Mr. Hogan did not in fact know of the relationship between Messrs. Zubrow and Goldman, or of the earlier New York Stock Exchange investigation. Mr. Hogan considered the hiring of Mr. Goldman as CIO Chief Risk Officer as effectively Mr. Zubrow's last personnel appointment rather than as his first. Nevertheless, in reliance on the recommendations of Mr. Zubrow and Ms. Drew, Mr. Hogan believed that Mr. Goldman was a good fit for the CIO CRO position,

appointed CIO Chief Risk Officer, he was still climbing the learning curve when much of the trading at issue was conducted.[110]

Meanwhile, other senior risk management positions were in transition during this time, including the Firm's Chief Risk Officer (Mr. Hogan) and the Firm's Head of Market Risk. (Mr. Hogan was appointed Chief Risk Officer in January 2012.) Having both previously served in the Investment Bank, these individuals were still in the process of becoming acquainted with CIO's activities and Risk Management function, as well as that of other parts of the Firm, at the time the relevant trading strategies were being executed.

The CIO Risk function had also been understaffed for some time, and CIO management, rather than the Risk function, had been the driving force behind the hiring of at least some of the risk personnel. Although CIO had long-tenured Risk personnel in less senior positions (such as Mr. Weiland), they appear not to have been expected, encouraged or supported sufficiently by CIO management or by the Firm-wide Risk organization to stand up forcefully to the CIO front office and to vigorously question and challenge investment strategies within CIO. Rather, at

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and was comfortable that Mr. Goldman's broad managerial and trading experience had provided him with the necessary skill set for the position. The Task Force notes that the Firm should have a more formal process in place, with the participation of the Firm's Human Resources personnel, to assure that, in connection with the hiring of Operating Committee members and their direct reports, the Firm and all appropriate personnel are aware of all relevant background information. If, with that additional information, Mr. Hogan had any concerns or reservations about Mr. Goldman, he could have taken any steps he deemed necessary to satisfy himself.

[110] The Task Force has considered whether former traders are qualified to serve as risk managers, and believes that they can be, as trading experience is highly relevant. Indeed, some of the Firm's best risk managers have backgrounds as traders.

least with respect to some Risk managers, such as Messrs. Goldman and Weiland, there was a sense that they were accountable first and foremost to CIO managers rather than to the Firm's global Risk organization. They generally did not feel empowered to take the kinds of actions that risk managers elsewhere within the Firm believed that they could and should take. Responsibility for this failure lies not only with CIO Risk managers, but with Ms. Drew as well.

Further, the CIO Risk Committee met only three times in 2011. There was no official membership or charter for the CIO Risk Committee and attendees typically included only personnel from CIO, such as the regional Chief Financial Officers and Chief Investment Officers, the Chief Risk Officer, the Chief Operating Officer, the Global Chief Financial Officer, and Ms. Drew. Although Mr. Zubrow regularly was invited to attend CIO Risk Committee meetings, he typically did not do so, in contrast with his frequent participation in Investment Bank Risk Committee meetings. Had there been senior traders or risk managers from outside CIO or had the CIO Risk Committee met more often, the process might have been used to more pointedly vet the traders' strategies in the first quarter of 2012. As it was, the Committee was too slow to recognize the need to put in place risk limits specific to the Synthetic Credit Portfolio or an updated limit structure for CIO as a whole.[111]

[111] Internal Audit's report dated March 30, 2012, which examined CIO EMEA Credit's control structure as of year-end 2011, stated that "CIO is currently undertaking a comprehensive review of the risk measurement limits framework across all asset classes to assess potentially required enhancements including whether additional risk factors are required for inclusion." As a result, although Internal Audit noted that CIO did not "explicitly measure the portfolio sensitivity to certain potentially applicable risk measures such as bond/CDS basis, index basis and prepayment risk," a detailed assessment was not

CIO Risk Management personnel fell well short of the Firm's expectations. *First,* contrary to Firm policy, they did not conduct any review of the adequacy of CIO's risk limits between 2009 and 2011.[112] *Second,* they failed to appreciate and to escalate the significance of the changes in the nature and size of positions that were occurring in the Synthetic Credit Portfolio, despite having been presented with information and metrics that could have alerted them to a problem earlier, and dismissed too easily breaches of existing limits. *Third,* as discussed in Appendix A, they were not sufficiently engaged in the development and subsequent implementation and operation of the VaR model. They took passive roles in the model's development and review and took no steps to ensure that the action plans required by the model approval were completed or that the model was implemented as intended. Similarly, although a proposal was under consideration to lower the VaR limit contemporaneously with the VaR model change in January, it was not acted upon until May 2012. *Fourth,* CIO Risk managers

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performed of the market risk limits as part of this audit and the existing limits were not identified as significantly outdated.

[112] Under the Market Risk Limits Policy applicable to CIO before May 2011, the review of limits and limit utilizations was required only annually, as opposed to semi-annually. Notwithstanding this requirement, prior to May 2011, the last review of all CIO limits was conducted by CIO in 2009. A new Market Limits Policy became effective in May 2011. Under the more recent policy, limits are required to be established by Market Risk and business heads, and certain of these are required to be reviewed at least annually by the Board and semi-annually within each line of business. In the first quarter of 2012, Mr. Weiland was in the process of developing a proposal to revise the CIO limit structure. He began that process in July 2011, recognizing that a semi-annual review of the limits had not yet been conducted and that certain of CIO's limits need to be revised and/or updated. He discussed an early version of his proposal at one of his weekly meetings with Ms. Drew in the summer of 2011. When Mr. Goldman became CIO's Chief Risk Officer in January 2012, he became involved in the process as well. Although the proposal was the subject of active discussion in the first quarter of 2012 and a version of it was presented to the CIO Risk Committee in late March, new limits were not implemented until May 2012.

themselves fell short of expectations in implementing a strong Risk function. In particular, they did not establish a relationship with CIO management that enabled Risk personnel to feel comfortable voicing opposition to management.

The Task Force notes that, although it believes that primary control failures were risk management failures, it has also considered whether the CIO Finance organization – and in particular its former CFO – could or should have done more. The primary responsibility of the CFO of CIO, like the CFO of the lines of business, is to oversee the Finance organization within that unit and ensure that effective financial controls are in place. As described above, the Task Force notes that the CIO Finance organization's VCG process, while appropriately designed, suffered from operational shortcomings that became more pronounced in the first quarter of 2012 as the size and characteristics of the Synthetic Credit Portfolio changed. In addition, the failure to have robust reporting protocols, including sufficient circulation of daily trading activity reports, made early detection of problems less likely.

In addition to the core responsibility of overseeing the line of business Finance function, the Task Force believes that a line of business CFO – like all members of senior management of a unit – bears additional responsibility for identifying and reacting to significant financial risks. To this end, the Task Force believes that, although primary responsibility for managing risk lies with the business head and Risk organization, the CFO of CIO (like the other members of CIO senior management) missed a number of opportunities during the first quarter to meaningfully challenge the trading strategy.

D. Risk Limits for CIO Were Not Sufficiently Granular

The risk limits in place before May 2012 applied to CIO as a whole (and not to the Synthetic Credit Portfolio in particular) and were insufficiently granular. There were no limits by size, asset type or risk factor for the Synthetic Credit Portfolio; indeed, there were no limits of any kind specific to the Synthetic Credit Portfolio. When contrasted against the granular and tailored risk limits that are applied elsewhere in the Firm, it is evident that the Firm-wide Risk organization failed to ensure that CIO was subject to appropriately rigorous risk controls.[113]

The risk limits for the Synthetic Credit Portfolio should have been specific to that portfolio and should have applied to the specific risks being taken. For example, these more granular limits should have included specific controls on notional size (particularly for less liquid

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[113] Prior to 2009, Single Name Position Risk ("SNPR") limits applied to the Investment Bank, but CIO did not trade in any single names and hence did not have any single name limits. The Firm's SNPR policy thus exempted the following assets, among others, from its scope: (1) investments managed by CIO as part of the Firm's Strategic Asset Allocation investment portfolio; and (2) CIO index and index tranche activity. Messrs. Zubrow and Weiland agreed that these assets should be exempt from the policy because they were longer-term, strategic investments and because calculating single name default exposure for a portfolio of indices and tranches is extremely complex. As CIO began to add positions with exposures to single names, Messrs. Zubrow and Weiland approved sets of name-specific limits for the particular names to which CIO's indices and tranches had single name exposure. These limits were separate from the SNPR limits applicable to the Investment Bank, and trading in these instruments by CIO did not result in SNPR limits usage. By late 2011 and early 2012, CIO's exposure to single names grew to the point that Mr. Weiland and Firm-wide Market Risk agreed that it made sense to include the calculation of that exposure within the SNPR policy, because the amount and aggregation of those exposures were becoming more significant. In early 2012, they began to discuss how to include CIO's index and index tranche activity within the SNPR. The exact means by which that would be done were the subject of ongoing discussion throughout the first quarter of 2012, due to the complexity of the calculations and the fact that including the short positions in the Synthetic Credit Portfolio in the SNPR would have had the effect of creating more availability for the limit (in part, because CIO owned equity protection, meaning that it earned money on individual defaults).

positions) as well as specific limits on credit risk and on counterparty risk. More numerous and specific limits may have increased focus on the risks in the Synthetic Credit Portfolio earlier.

E. Approval and Implementation of CIO Synthetic Credit VaR Model Were Inadequate

In a number of respects, the process surrounding the approval and implementation of the new VaR model was inadequate. *First*, inadequate resources were dedicated to the development of the model. The individual who was responsible for the model's development had not previously developed or implemented a VaR model, and was also not provided sufficient support – which he had requested – in developing the model.

Second, the Firm model review policy and process for reviewing the new VaR model inappropriately presumed the existence of a robust operational and risk infrastructure similar to that generally found in the Firm's client-facing businesses. It thus did not require the Model Review Group or any other Firm unit to test and monitor the approved model's implementation. Back-testing was left to the discretion of the Model Review Group before approval and was not required by Firm policy. In this case, the Model Review Group required only limited back-testing of the new model, and it insufficiently analyzed the results that were submitted.

Third, and relatedly, the Model Review Group's review of the new model was not as rigorous as it should have been and focused primarily on methodology and CIO-submitted test results. The Model Review Group did not compare the results under the existing Basel I model to the results being generated under the new model. Rather, it theorized that any comparison of the numbers being produced under the two models was unnecessary because the new model was more sophisticated and hence was expected to produce a more accurate VaR.

Fourth, the model was approved despite observed operational problems. The Model Review Group noted that the VaR computation was being done on spreadsheets using a manual process and it was therefore "error prone" and "not easily scalable." Although the Model Review Group included an action plan requiring CIO to upgrade its infrastructure to enable the VaR calculation to be automated contemporaneously with the model's approval, the Model Review Group had no basis for concluding that the contemplated automation would be possible on such a timetable. Moreover, neither the Model Review Group nor CIO Risk followed up to determine whether the automation had in fact taken place.

Fifth, CIO Risk Management played too passive a role in the model's development, approval, implementation and monitoring. CIO Risk Management personnel viewed themselves more as consumers of the model than as responsible in part for its development and operation.

Sixth, CIO's implementation of the model was flawed. CIO relied on the model creator, who reported to the front office, to operate the model. Data were uploaded manually without sufficient quality control. Spreadsheet-based calculations were conducted with insufficient controls and frequent formula and code changes were made. Inadequate information technology resources were devoted to the process. Contrary to the action plan contained in the model approval, the process was never automated.

IV. Remedial Measures

JPMorgan has taken a broad range of remedial measures to respond to and act on the lessons it has learned from the events described in this Report.

A. CIO Leadership, Governance, Mandate and Processes Revamped.

1. *Team*

Once it discovered the source and scope of the Synthetic Credit Portfolio's losses, the Firm responded by accepting the retirement of Ms. Drew and terminating the employment of some members of the Synthetic Credit Portfolio team, and accepting resignations from others, including Messrs. Goldman, Wilmot,[114] and Weiland.[115] In addition, the Firm announced on July 13 that it would pursue the maximum clawback of compensation from three individuals, each of whom subsequently acceded to the Firm's demands regarding the cancellation and recovery of the relevant awards. This equates to approximately two years' worth of each individual's total compensation. In the Task Force's view, these steps were appropriate given each individual's role in the losses at issue. Ms. Drew agreed voluntarily to the cancellation and recovery of her awards that were subject to clawbacks. Senior Firm management, in consultation with the Board, has also reduced compensation for other employees, and the incentive compensation pool for all of CIO was reduced as well.

[114] Mr. Wilmot has announced his resignation and is expected to leave the Firm in 2013.
[115] Mr. Zubrow has also announced his retirement.

The Firm has put in place a new CIO leadership team. Matthew Zames, who had served as co-Head of Fixed Income in the Investment Bank, replaced Ms. Drew as the Firm's Chief Investment Officer. He occupied that role from May 14, 2012 through September 6, 2012. Mr. Zames is now the co-Chief Operating Officer of the Firm and oversees, among other things, both the CIO and Treasury functions. Craig Delany replaced Mr. Zames as Chief Investment Officer and currently reports to him. Other key appointments include Marie Nourie (CFO for CIO); Chetan Bhargiri (Chief Risk Officer for CIO, Treasury and Corporate); Brendan McGovern (CIO Global Controller, a position that had been open since January 2012); Diane Genova (General Counsel for CIO and General Counsel for Markets in the Corporate and Investment Bank); Pat Hurst (Chief Auditor); and Ellen Yormack (Senior Audit Manager). These are experienced, tested professionals, with knowledge of best practices that they are able to bring to bear in their new roles in CIO. Resources were also increased in key support functions; within the Risk function alone, Mr. Bhargiri has added 20 new employees since May 2012. With these new appointments, the Firm has reconfigured the entire CIO management team with strong and knowledgeable individuals who are expected to bring more rigor to the management of CIO. At the same time, this new team has established stronger linkages within CIO by introducing formal lines of communication across the various regions, and the practical result has already been increased dialogue and consistency in each of the three regions reporting to Mr. Delany.

2. *Governance*

The Firm has enhanced governance within CIO and the Corporate sector more generally. New and more robust committee structures have been instituted, including weekly CIO Investment Committee meetings run by Mr. Delany, with a set schedule and set attendees. There are also now monthly Business Control Committee meetings and a monthly Valuation Governance Forum ("VGF"), both of which are new structures.

The CIO Valuation Governance Forum, whose membership includes Ms. Nourie, Mr. Bhargiri and Mr. McGovern, is responsible for understanding and managing the risks arising from valuation activities within CIO and for escalating key issues to a Firm-wide VGF, which was established in 2012 as part of a Firm-wide initiative to strengthen the governance of valuation activities. The CIO VGF has recently overseen the integration of CIO VCG staff into the Investment Bank VCG reporting structure, the review of CIO VCG processes (including a review of all manual spreadsheets and the implementation of enhanced controls for key spreadsheets), and the enhancement of other CIO VCG procedures based on the Investment Bank VCG's guidelines and best practices. The Firm has also increased the CIO VCG headcount and hired a new head of EMEA VCG for CIO.

Beyond new structures within CIO, the Firm has implemented additional linkages among CIO, Corporate Treasury and other Corporate activities. In particular, Mr. Zames is now in charge of CIO, Treasury and Corporate, so that overall management of these related functions has been brought together. Similarly, Mr. Bhargiri is now the Chief Risk Officer for CIO, Treasury and Corporate. Furthermore, Corporate Business Reviews of CIO are to be conducted with increasing frequency and with the same structure as they are performed in the Firm's client-facing businesses. The Firm will also expand the CIO VGF in 2013 into a Corporate VGF, which will cover Treasury and other Corporate functions in addition to CIO.

Finally, the Firm has modified and expanded the criteria that will allow it to claw back certain equity awards in the event of poor performance by CIO. Under the Firm's protection-based vesting provisions, the Firm is entitled to conduct a discretionary review of certain senior personnel and, in the event of certain types of poor financial performance, cancel certain equity awards to which those personnel might otherwise have been entitled. Historically, senior CIO personnel were only subject to such a review upon poor performance by the entire Firm, whereas senior personnel from the lines of business were subject to these reviews upon poor performance by their line of business (and not just the entire Firm).[116] The Firm has determined to modify the protection-based vesting trigger for 2013 equity awards for senior-level CIO personnel, and it now includes a CIO-specific trigger. The Firm's intent is to ensure that, based upon significantly poor performance in CIO, the Firm has the ability to recover certain previously granted equity awards from those responsible.

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[116] The protection-based vesting program is distinct from the Firm's other compensation recovery programs, which have been employed against CIO personnel in this matter and allow the Firm to claw back prior equity awards for other reasons such as termination for cause and improper or grossly negligent risk assessments.

3. *Mandate*

Under the leadership of Mr. Zames and now Mr. Delany, CIO has refocused on its core mandate of traditional asset-liability management. As part of this refocusing, the Firm moved a substantial portion of the Synthetic Credit Portfolio from CIO to the Investment Bank, and effectively exited the remainder of the Synthetic Credit Portfolio's positions in the third quarter of 2012. As a result of these changes and others, CIO no longer engages in the type of trading that generated the losses, and any CIO synthetic credit positions in the future will be simple and expressly linked to a particular risk or set of risks.

4. *Reporting and Controls*

Since the appointment of the new management team in May, CIO has also enhanced its key business processes and reporting. For example, the CIO Executive Management Report and Global Daily Risk Report now contain trading and position reports and are more appropriately distributed so that this content reaches the appropriate managers. The Global Daily Risk Report provides management with a consolidated and transparent view of all risk positions; its distribution includes the Firm-wide CEO, CRO, Deputy CRO and co-COO in addition to senior managers within CIO (including CIO Finance). In addition, Ms. Nourie and her team have spent substantial time since May reviewing and revising basic policies and procedures with respect to valuation and price verification. That initiative has improved the quality control of the VCG by enhancing CIO senior finance management supervision of the valuation control process, implementing more formal reviews of price-testing calculations, and instituting more formal procedures around the establishment and monitoring of price-testing thresholds.

Beyond these specific steps, the new CIO leadership team – as well as senior Firm management – recognizes the importance of an open and transparent culture, including in its communications with the Firm's regulators. The Firm has been working to improve CIO's culture and its communications – both internally and with regulators – to ensure regulators consistently have full and timely visibility into CIO's activities. More broadly, senior Firm management continues to be committed to enhancing a culture of prompt and complete disclosure to its regulators in accordance with regulators' expectations.

In addition, the Firm has recently established a new Oversight and Control Group that is especially dedicated to solidifying an effective control framework, and looking within and across the lines of business (and CIO) to identify and remediate control issues. Oversight and Control will work closely with all control disciplines – partnering with Compliance, Risk, Audit and other functions – in order to provide a cohesive and centralized view of and from all control functions. Among other things, Oversight and Control will allow the Firm to detect problems and escalate issues quickly, get the right people involved to understand the common threads and interdependencies among various businesses, and then remediate these issues across all affected areas of the Firm.[117]

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[117] While the Oversight and Control function will facilitate a Firm-wide view of the control framework and operational risk across the Firm, serving as both a partner and a check and balance to line of business

B. Risk Self-Assessment and Risk Management Changes

In the wake of the Synthetic Credit Portfolio's losses, in May 2012 the Firm – under the guidance of its Chief Risk Officer – mandated a self-assessment of the Risk function within each line of business and CIO. As part of the self-assessment process, the Firm identified three general categories for review and improvement: Model Governance and Implementation, Market Risk and Governance, and Risk Independence. Within each category, the Firm identified specific areas of focus. In Model Governance and Implementation, the Firm focused on conducting a spot check of significant drivers of the Firm's VaR and broadening the model approval process to encompass implementation and ongoing monitoring. Within the category of Market Risk and Governance, the areas of focus were: (1) the appropriateness of the limit structure relative to risks undertaken; (2) the appropriateness of the risks undertaken; (3) policy, response, and escalation process concerning limit breaches; and (4) consideration within line of business risk committees of liquidity and concentration in positioning. Within the category of Risk Independence, the Firm reviewed its risk committee structure.

Mr. Hogan directed each of the Firm's lines of business to review these areas of focus to assess whether any of the issues identified in CIO existed elsewhere across the Firm and, if so, to remediate those issues immediately. The Chief Risk Officer for each line of business was required to attest to the completion of the necessary actions identified in that business's review,

management and Corporate functions, it will not remove ultimate responsibility for the effectiveness of the control environment from the line of business CEOs and Corporate Functional Heads.

and to provide documentation supporting completion of remediation. Each line of business CEO also was required to sign off on completion of the action plan, along with the line of business Risk Committee, and Mr. Hogan and Firm-wide Market Risk.

The Firm has now undertaken, or is in the process of undertaking, substantial remedial measures, described in further detail below, to address the concerns arising from this self-assessment in each of these areas.

1. *Model Governance and Implementation*

In the area of Firm-wide Model Governance and Implementation, the Firm has substantially reformed its model risk policy, which governs model development, review, approval, and monitoring. It is working to minimize model differences for like products; capture all of its models in a central database; improve functionality and support for that central database; review its old or rarely used models; and identify its most significant models. It also will emphasize model implementation testing and comparisons to benchmark models, and institute a formal escalation process for model reviews, as necessary. The Model Review Group is now required to sign off on closure of all action plan items.[118] In addition, the Firm is enhancing staffing of the Model Review Group, and is working to implement and staff a model governance function.

With respect to VaR in particular, the Firm has conducted a spot review of significant drivers of VaR throughout the Firm, including in CIO, to ensure accuracy of the Firm's 10-Q

[118] For more information on action plans, see Appendix A below.

VaR. In CIO, that spot review involved confirming that all of the positions comprising the CIO 10-Q VaR were being captured accurately, and included a comprehensive one-day check to ensure accurate data feeds into the CIO VaR model; a horizontal review to identify data quality issues among key data streams and a comparison with third-party data sources, where possible; a comparison of calculators identified in approved model reviews with those actually employed; a review of the process used to identify and separate 10-Q VaR vectors; and resolution of then-outstanding model issues identified as "high" importance.

2. *Market Risk and Governance*

The Firm has now substantially reconstituted the Risk function within CIO. First, as noted above, it has appointed Mr. Bhargiri to replace Mr. Goldman as Chief Risk Officer for CIO, Treasury and Corporate. Mr. Bhargiri came to this role with substantial experience as a managing director of Market Risk at the Investment Bank, and the Firm has ensured that Mr. Bhargiri's functional reporting practices conform to his official reporting lines. Second, it has authorized Mr. Bhargiri to hire additional risk management officers, including senior level officers, to extend the capacity of the Risk function within CIO, Treasury and Corporate, and he has made 20 such hires since May 2012. The CIO Risk team has added product expertise in emerging markets, securitized products, credit (single name), municipal bonds, and interest rates and currency trading.

The Firm has reviewed and, where appropriate, revised market risk limits across all of its lines of business and introduced additional granular and portfolio-level limits. As part of its ongoing risk management governance, it continues to conduct periodic reviews of the effectiveness of existing limit structures. CIO now has in place a total of 260 limits. Enhancements to the limits structure (as of December 6) include 67 redesigned VaR, stress and non-statistical limits, including both global and regional Level 1 and Level 2 limits; 80 new asset class concentration limits for the AFS securities portfolio, applicable to both CIO and Treasury; 60 new single name limits for the CIO Municipal AFS portfolio; and 53 new country exposure limits, also applicable to both CIO and Treasury, as a subset to the Firm-wide Country Exposure Limits. New limits related to geographic concentration, curve risk, single name risk, and compression risk were made specifically applicable to the Synthetic Credit Portfolio during the second and third quarters of 2012 (while it continued to be held by CIO, before it was transferred to the Investment Bank and effectively closed out).

In addition, the Firm has strengthened its processes across all businesses to deal with limit excessions. Aged or significant excessions must be further escalated to senior management and to risk committees. All valid[119] or "under investigation" limit excessions, whether at the lines of business or Firm-wide level, that are in excess for three business days or longer, or over limit by 30% will be escalated to the line of business CEO, Chief Risk Officer, and Market Risk Head, as well as to the Firm's CEO, CRO, co-COO and Deputy CRO/Head of Firm-wide Market Risk, and to the Firm-wide Risk Committee.

[119] In contrast to "valid" excesses, "invalid" excesses are caused by data quality issues and do not require remedial steps.

3. *Risk Independence*

The Firm has reviewed its Risk Operating Committee structure and governance and restructured the Risk Operating Committee to increase focus on identifying and implementing best practices where appropriate across lines of business. The Firm's Risk Governance structure was enhanced to include the creation of the Firm-wide Risk Committee and Risk Governance Committee.

Within CIO, the Firm has overhauled the CIO Risk Committee which, as noted, previously had met only infrequently, without any official membership, and was composed entirely of personnel from within CIO. There is, in its place, a CIO, Treasury and Corporate Risk Committee, which conducts weekly meetings chaired by Messrs. Zames and Bhargiri. It includes representatives from CIO, Treasury, and Corporate as well as other key senior management from within and outside of CIO, including the Firm's CRO, Deputy CRO, and CFO, in order to ensure greater consistency across the Firm's various lines of business.

C. Firm-wide Risk Governance and Organization

In addition to the specific improvements described above in the areas of focus addressed by the Firm-wide risk self-assessment, the Firm has conducted a review of its entire Risk organization in response to the events in CIO and has made or is making changes to that Risk organization's governance, organizational structure and interaction with the Board.

1. ***Risk Governance***

In the area of risk governance, the Firm created the new roles of Deputy CRO/Head of Firm-wide Market Risk and Wholesale Chief Credit Officer ("WCCO"). The role of Deputy CRO/Head of Market Risk involves review and assessment of Firm-wide market risk. The incumbent's responsibilities include managing the Firm's risk appetite and risk limits, risk mitigation strategies, and working with Mr. Hogan to lead and develop the Firm's Risk organization. He is also responsible for directing the Firm's market risk coverage resources. Stephen Eichenberger, who also currently serves as Chief Credit Risk Officer for the Investment Bank, assumed the newly created role of WCCO in July 2012. The WCCO reports to Mr. Hogan and is responsible for credit risk across all wholesale businesses. In this capacity, the WCCO will chair a Wholesale Credit Risk forum to ensure better communication between each business and across all Risk functions; work with line of business Chief Risk Officers to identify and effectively manage key credit risks and concentrations across the wholesale businesses; and partner with the line of business Chief Risk Officers to engage in initiatives across wholesale lines of business, including defining credit risk appetite and setting appropriate limits, supporting key growth initiatives while maintaining strong credit risk management controls, coordinating regulatory responses, building a credit risk stress framework, and enhancing credit risk reporting and credit risk systems.

2. ***Risk Organization***

Four Firm-wide risk committees have been added and will focus on risk themes.

The Risk Governance Committee will meet monthly and will focus on risk governance and other policy matters, risk analytics, model governance, Basel/Regulatory issues, risk appetite, and updates to Firm-wide risk programs in the areas of compliance, liquidity, and operational risks. Required attendees at these meetings include the Firm's CRO, CFO, Controller, line of business CROs, Chief Investment Officer, and personnel from Legal, Compliance, Audit, and Regulatory Policy.

The Firm-wide Risk Committee will focus on business activity, including by conducting periodic reviews of Firm-wide risk appetite and certain aggregate risk measures, serving as an escalation point for matters arising in the line of business Risk Committees and for certain limit breaches pursuant to the limits policy, and considering relevant business activity issues escalated to it by line of business Chief Risk Officers and CEOs. It will meet monthly and required attendees include the Firm's CEO, CFO, CRO, Deputy CRO/Head of Market Risk, line of business CEOs, CIO Head, General Counsel, Chief Auditor, Compliance Head, Regulatory Policy Head, Consumer Risk CRO, Wholesale Credit Risk CRO, Model Risk and Development Reputation Risk Officer, Country Risk Head, Corporate Risk CFO and Chief Administrative Officer and line of business risk officers.

The Risk Management Business Control Committee will meet quarterly and will focus on the control environment, including outstanding action plans, audit status, operation risk statistics (such as losses, risk indicators, etc.), compliance with critical control programs, and risk technology. Required attendees at these meetings include the CRO, the Deputy CRO, the line of business CROs, the Risk CFO and Risk Chief Administrative Officer, the Operational Risk Head, and personnel from Model Review and Development, Audit, and Compliance.

Finally, the Risk Operating Committee will focus on risk management, including setting risk management priorities, escalation of risk issues, and other issues brought to its attention by line of business Chief Risk Officers and the Risk Team. Mr. Hogan will direct these bi-weekly meetings, which will also include Risk Human Resources and Risk Chief Technology Officers.

In addition to these Risk committees, the Firm established a Valuation Governance Forum in June 2012 to oversee the management of risks arising from valuation activities conducted across the Firm. The Firm-wide VGF is chaired by the Firm-wide head of VCG, and its membership includes the Corporate Controller; the Deputy CRO; the CROs and Controllers of the Investment Bank, Mortgage Bank, and CIO; the CFOs of the Investment Bank, CIO, and Asset Management; and the Firm-wide Head of Model Risk and Development. The Firm-wide VGF will meet twice per quarter to review issues and matters relating to valuation, the VCG function, and related issues, and to address issues elevated to it by line of business VGFs.

Finally, the Firm is continuing its efforts to improve the process for highlighting key issues to the DRPC, with an emphasis on conveying information in a manner that is more timely, useful and focused.

V. Conclusion

The Task Force does not believe that the CIO losses stemmed from any one specific act or omission. Rather, as described in this Report, the Task Force has concluded that the losses were the result of a number of acts and omissions, some large and some seemingly small, some involving personnel and some involving structure, and a change in any one of which might have led to a different result. This experience, as we hope is clear from this Report, has caused substantial and healthy introspection at the Firm and recognition of the need for continued improvement in multiple areas. Ultimately, the Task Force believes that this incident teaches a number of important lessons that the Firm is taking very seriously.

Appendix A: VaR Modeling

VaR is a metric that attempts to estimate the risk of loss on a portfolio of assets. A portfolio's VaR represents an estimate of the maximum expected mark-to-market loss over a specified time period, generally one day, at a stated confidence level, assuming historical market conditions. Through January 2012, the VaR for the Synthetic Credit Portfolio was calculated using a "linear sensitivity model," also known within the Firm as the "Basel I model," because it was used for purposes of Basel I capital calculations and for external reporting purposes.

The Basel I model captured the major risk facing the Synthetic Credit Portfolio at the time, which was the potential for loss attributable to movements in credit spreads. However, the model was limited in the manner in which it estimated correlation risk: that is, the risk that defaults of the components within the index would correlate. As the tranche positions in the Synthetic Credit Portfolio increased, this limitation became more significant, as the value of the tranche positions was driven in large part by the extent to which the positions in the index were correlated to each other. The main risk with the tranche positions was that regardless of credit risk in general, defaults might be more or less correlated.

This limitation meant that the Basel I model likely would not comply with the requirements of Basel II.5, which originally had been expected to be formally adopted in the United States at the end of 2011. One of the traders responsible for the Synthetic Credit Portfolio therefore instructed an expert in quantitative finance within the Quantitative Research team for CIO International to develop a new VaR model for the Synthetic Credit Portfolio that would comply with the requirements of Basel II.5. That individual (henceforth referred to in this Report as "the modeler") began work on developing that model in or around August 2011.

The trader who had instructed the modeler to develop the new VaR model (and to whom the modeler reported at the time), CIO Market Risk, and the modeler himself also believed that the Basel I model was too conservative – that is, that it was producing a higher VaR than was appropriate.[120] The modeler believed that an improved model should both (1) adequately capture correlation risk in the Synthetic Credit Portfolio, and (2) produce a lower and more accurate VaR.

A. Development of the New VaR Model

The modeler is a London-based quantitative expert, mathematician and model developer. In addition to the considerable responsibility of developing a new VaR model, he continued to perform his existing responsibilities in providing analytical support to the Synthetic Credit Portfolio traders. On a number of occasions, he asked the trader to whom he reported for additional resources to support his work on the VaR model, but he did not receive any.

Early in the development process, CIO considered and rejected a proposal to adopt the VaR model used by the Investment Bank's credit hybrids business for the Synthetic Credit

[120] As noted above, VaR is a metric that attempts to estimate the risk of loss on a portfolio of assets. Both the modeler and a member of the CIO Market Risk team who was also involved in the new model's development were of the view that the Basel I model might be overstating the VaR for the Synthetic Credit Portfolio, in part because the amount of losses had exceeded the stated VaR limit less frequently than would be expected based on the stated confidence level.

Portfolio. Because the Investment Bank traded many bespoke (*i.e.*, customized), illiquid CDS, its VaR model mapped individual instruments to a combination of indices and single name proxies, which CIO Market Risk viewed as less accurate for CIO's purposes than mapping to the index as a whole. He believed that, because the Synthetic Credit Portfolio, unlike the Investment Bank, traded indices and index tranches, the Investment Bank's approach was not appropriate for CIO. The Model Review Group agreed and, in an early draft of its approval of the model, described CIO's model as "superior" to that used by the Investment Bank "in that it [was] a full revaluation approach."

From September to November 2011, the modeler corresponded regularly with the relevant individuals from the Model Review Group, and on November 25, 2011, he submitted his new methodology (known internally as the "full revaluation" or "Basel II.5 model") for formal approval. The Model Review Group performed only limited back-testing of the model, comparing the VaR under the new model computed using historical data to the daily profit-and-loss over a subset of trading days during a two-month period. The modeler informed the Model Review Group that CIO lacked the data necessary for more extensive back-testing of the model (running the comparison required position data for the 264 previous trading days, meaning that a back-test for September 2011 would require position data from September 2010). Neither the Model Review Group nor CIO Market Risk expressed concerns about the lack of more extensive historical position data.

During the review process, additional operational issues became apparent. For example, the model operated through a series of Excel spreadsheets, which had to be completed manually, by a process of copying and pasting data from one spreadsheet to another. In addition, many of the tranches were less liquid, and therefore, the same price was given for those tranches on multiple consecutive days, leading the model to convey a lack of volatility. While there was some effort to map less liquid instruments to more liquid ones (*i.e.*, calculate price changes in the less liquid instruments derived from price changes in more liquid ones), this effort was not organized or consistent.

By the end of 2011, some of the pressure to complete the review of the new model appears to have abated because it became clear that Basel II.5 would not be implemented on the previously anticipated timetable. However, as described in Section II.D.1, CIO exceeded its Global 10-Q VaR limit at several points between January 16 and January 26, 2012, which in turn caused a breach in the overall Firm 10-Q VaR limit. The Synthetic Credit Portfolio was the primary driver of each of those excessions. A temporary limit increase was requested[121] and required approval of senior Firm management. CIO recommended a temporary limit increase on the grounds that it was taking steps to reduce the VaR and that, in any event, the newly developed model was about to come online that would show a substantially reduced VaR.

[121] Firm-wide Market Risk raised the possibility of a temporary limit increase to Mr. Hogan on January 20, 2012. On January 21, 2012, the then-head of the Risk Reporting and Finance function – told Mr. Hogan "We are working towards a temporary one-off for CIO and the Firm proposed as follows: JPMC $140mm (vs. $125mm permanent limit) CIO $105mm (vs. $95mm permanent limit." Mr. Weiland also e-mailed Mr. Hogan on January 22, 2012 regarding a proposed temporary VaR limit increase.

Mr. Weiland and another member of CIO Market Risk contacted the Model Review Group regularly in the last two weeks of January to inquire into the progress of the model approval and, in a January 23, 2012 e-mail to the modeler, the trader to whom the modeler reported wrote that he should "keep the pressure on our friends in Model Validation and [Quantitative Research]." There is some evidence the Model Review Group accelerated its review as a result of this pressure, and in so doing it may have been more willing to overlook the operational flaws apparent during the approval process.

On January 26, the Model Review Group discovered that, for purposes of a pricing step used in the VaR calculation, CIO was using something called the "West End" analytic suite rather than Numerix, an approved vendor model that the Model Review Group had thought was being used. The Model Review Group had never reviewed or approved West End, which (like Numerix) had been developed by the modeler.[122] CIO provided the Model Review Group with a reconciliation test, based on a limited number of days, showing that the valuations from West End and Numerix were in "good agreement," and the Model Review Group committed to conduct a full review of West End separately, but not before approving the VaR model. The Model Review Group did not examine West End until early May 2012 (the results of which are discussed below).

[122] The modeler had previously worked at Numerix. While there, the Numerix repricing model was developed under his supervision.

On January 30, the Model Review Group authorized CIO Market Risk to use the new model for purposes of calculating the VaR for the Synthetic Credit Portfolio beginning the previous trading day (January 27). Once the new model was implemented, the Firm-wide 10-Q VaR limit was no longer exceeded. Formal approval of the model followed on February 1. The formal approval states that the VaR calculation would utilize West End and that West End in turn would utilize the Gaussian Copula model[123] to calculate hazard rates[124] and correlations. It is unclear what, if anything, either the Model Review Group or CIO Market Risk did at the time to validate the assertion that West End would utilize the Gaussian Copula model as opposed to some other model, but that assertion later proved to be inaccurate.[125]

As part of its approval of the new model, the Model Review Group included an action plan with respect to two of the risk areas that were identified. First, it mandated automation of the VaR model by January 31, 2012 (*i.e.*, contemporaneously with the model's approval).

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[123] The Gaussian Copula is a commonly accepted model used to map the approximate correlation between two variables.

[124] A hazard rate is the probability of failure per unit of time of items in operation, sometimes estimated as a ratio of the number of failures to the accumulated operating time for the items. For purposes of the model, the hazard rate estimated the probability of default for a unit of time for each of the underlying names in the portfolio.

[125] A March 30, 2012 Internal Audit report on the Market Risk and Valuation Practices in CIO's credit portfolios (including the Synthetic Credit Portfolio) assigned a rating of 'Needs Improvement' due in part to CIO's use of "unapproved models in the calculation of risk (including VaR)." The reference to the use of "unapproved models" in the calculation of the VaR is to West End, which, as the Internal Audit report noted, had not been submitted to the Model Review Group for Review. The Internal Audit report included an action plan for CIO to document the West End analytics engine and submit to the Model Review Group with a target completion date of June 30, 2012. While the Internal Audit report also noted problems with the control processes surrounding the VaR calculation, Internal Audit found no specific examples of incomplete or inaccurate data.

Second, it required monitoring of illiquid tranches to assess whether mapping to more liquid tranches would be necessary, and ultimately development and submission to the Model Review Group of a risk mapping methodology. Neither of these action plans was completed. The Model Review Group and CIO Market Risk apparently believed that work was already underway to complete automation but took no steps to determine that automation had in fact been completed. The modeler likewise did not submit, nor was he ever required to submit, a complete risk mapping methodology.

B. Operation of the VaR Model

From February to April, the new VaR model was in operation. A CIO employee who reported to the modeler was responsible for daily data entry and operation of the new model. In April, an employee from the IT Department (who had previous experience as a senior quantitative developer) also began to provide assistance with these tasks. Notwithstanding this additional assistance, a spreadsheet error caused the VaR for April 10 to fail to reflect the day's $400 million loss in the Synthetic Credit Portfolio. This error was noticed, first by personnel in the Investment Bank,[126] and by the modeler and CIO Market Risk, and was corrected promptly. Because it was viewed as a one-off error, it did not trigger further inquiry.

[126] On April 18, a member of the market risk team for the Investment Bank obtained information on the Firm-wide and CIO VaR calculations to determine the impact of the April 10 loss on the Firm-wide VaR. Upon discovering that the loss was not reflected in the CIO VaR, he reported his findings to Firm-wide Market Risk, who in turn reported to Mr. Hogan that CIO's VaR appeared to have an error.

C. Discovery of Problems with the New VaR Model and Discontinuance

In early May 2012, in response to the recent losses in the Synthetic Credit Portfolio, Mr. Venkatakrishnan asked an employee in the Model Review Group to perform a review of the West End analytic suite, which, as noted, the VaR model used for the initial steps of its calculations. The West End analytic had two options for calculating hazard rates and correlations: a traditional Gaussian Copula model and a so-called Uniform Rate model, an alternative created by the modeler. The spreadsheet that ran West End included a cell that allowed the user to switch between the Gaussian Copula and Uniform Rate models.

The Model Review Group employee discovered that West End defaulted to running Uniform Rate rather than Gaussian Copula in this cell, including for purposes of calculating the VaR, contrary to the language in the Model Review Group approval. Although this error did not have a significant effect on the VaR, the incident focused the reviewer's attention on the VaR model and ultimately led to the discovery of additional problems with it.

After this re-review, a decision was made to stop using the Basel II.5 model and not to rely on it for purposes of reporting CIO VaR in the Firm's first-quarter Form 10-Q. Following that decision, further errors were discovered in the Basel II.5 model, including, most significantly, an operational error in the calculation of the relative changes in hazard rates and correlation estimates. Specifically, after subtracting the old rate from the new rate, the spreadsheet divided by their sum instead of their average, as the modeler had intended. This error likely had the effect of muting volatility by a factor of two and of lowering the VaR, although it is unclear by exactly what amount, particularly given that it is unclear whether this error was present in the VaR calculation for every instrument, and that it would have been offset to some extent by correlation changes. It also remains unclear when this error was introduced in the calculation.

Office of the Comptroller of the Currency

Washington, DC 20219

April 15, 2013

The Honorable Carl Levin, Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Government Affairs
United States Senate
Washington, DC 20510

Dear Chairman Levin:

During the March 15, 2013 hearing on "JPMorgan Chase Whale Trades: A Case History of Derivatives Risks & Abuses" held by the Permanent Subcommittee on Investigations (PSI), you requested that the OCC inquire about whether JPMorgan Chase's (JPMC) pricing of certain positions in its synthetic credit portfolio (SCP) was consistent with U.S. Generally Accepted Accounting Principles (GAAP).

Specifically, you requested that we inquire of those charged with establishing and enforcing accounting standards whether JPMC's Chief Investment Office's fair value marks of the positions within the SCP complied with GAAP during the first quarter of 2012 and before JPMC determined a restatement was necessary. In response to your request, the OCC's Office of the Chief Accountant consulted with representatives from the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission's (SEC's) Office of the Chief Accountant.

As you are aware, there are multiple ongoing governmental investigations of JPMC's trading losses, including the fair value marks of the positions within the SCP, that have not yet concluded. Because these investigations have yet to conclude, we are unable to provide any final determinations about this matter at this time. However, we have shared both the testimony from the hearing and the report released by PSI with the agencies' respective investigation teams. The OCC continues to coordinate with the SEC and other governmental agencies in support of their investigations.

As a matter of policy, FASB does not opine on the application of its standards by individual reporting entities. However, FASB staff provided excerpts of the sections of the relevant standard that addresses the use of pricing conventions and the related disclosure requirements. I have attached these excerpts to this letter for your information.

Should you have any further questions, please feel free to contact me, or Carrie Moore, Director of Congressional Liaison, at (202) 649-6737.

Sincerely,

Thomas J. Curry
Comptroller of the Currency

Attachment

cc: Leslie Seidman, Chairman, FASB
Paul Beswick, Chief Accountant, SEC

Permanent Subcommittee on Investigations
EXHIBIT #99

Selected Accounting Standard References from the Financial Accounting Standards Board

ASC 820 ***Fair Value Measurements***
Inputs Based on Bid and Ask Prices
820-10-35-36C
If an asset or a liability measured at fair value has a bid price and an ask price (for example, an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorized within the fair value hierarchy (that is, Level 1, 2, or 3). The use of bid prices for asset positions and ask prices for liability positions is permitted but is not required.

820-10-35-36D
This Topic does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread.

Disclosure
820-10-50-1
A reporting entity shall disclose information that helps users of its financial statements assess both of the following:

a. For assets and liabilities that are measured at fair value on a recurring or nonrecurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements

b. For recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) or other comprehensive income for the period.

820-10-50-2 (bbb)

bbb. For recurring and nonrecurring fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (for example, changing from a market approach to an income approach or the use of an additional valuation technique), the reporting entity shall disclose that change and the reason(s) for making it. For fair value measurements categorized within Level 3 of the fair value hierarchy, a reporting entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement. A reporting entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the reporting entity when measuring fair value (for example, when a reporting entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure, a reporting entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the reporting entity.

820-10-50-2 (f-g)

f. For recurring and nonrecurring fair value measurements categorized within Level 3 of the fair value hierarchy, a description of the valuation processes used by the reporting entity (including, for example, how an entity decides its valuation policies and procedures and analyzes changes in fair value measurements from period to period). See paragraph 820-10-55-105 for further guidance.

g. For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, a reporting entity shall also provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying with paragraph 820-10-50-2(bbb).

820-10-55-105

For fair value measurements categorized within Level 3 of the fair value hierarchy, this Topic requires a reporting entity to disclose a description of the valuation processes used by the reporting entity. A reporting entity might disclose the following to comply with paragraph 820-10-50-2(f):

a. For the group within the reporting entity that decides the reporting entity's valuation policies and procedures:

- 1. Its description
- 2. To whom that group reports
- 3. The internal reporting procedures in place (for example, whether and, if so, how pricing, risk management, or audit committees discuss and assess the fair value measurements).

b. The frequency and methods for calibration, back testing, and other testing procedures of pricing models.

c. The process for analyzing changes in fair value measurements from period to period.

d. How the reporting entity determined that third-party information, such as broker quotes or pricing services, used in the fair value measurement was developed in accordance with this Topic.

e. The methods used to develop and substantiate the unobservable inputs used in a fair value measurement.

Information about Sensitivity to Changes in Significant Unobservable Inputs
820-10-55-106
For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, this Topic requires a reporting entity to provide a narrative description of the sensitivity of the fair value measurement to changes in significant unobservable inputs and a description of any interrelationships between those unobservable inputs. A reporting entity might disclose the following about its residential mortgage-backed securities to comply with paragraph 820-10-50-2(g).

> The significant unobservable inputs used in the fair value measurement of the reporting entity's residential mortgage-backed securities are prepayment rates, probability of default, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

RESPONSES TO QUESTIONS FOR THE RECORD
for
Douglas Braunstein and Michael Cavanagh
JPMorgan Chase & Co.

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
Hearing on
JPMorgan Chase Whale Trades:
A Case History of Derivatives Risks & Abuses

March 15, 2013

Permanent Subcommittee on Investigations
EXHIBIT #100a

<u>JPMorgan's Responses to the April 12, 2013 Letter from the United States Senate Permanent Subcommittee on Investigations</u>

1. **Does JPMorgan Chase currently provide daily profit and loss data for the Chief Investment Office (CIO) to the Office of the Comptroller of the Currency (OCC)? If so, does it also provide daily profit and loss data for the CIO's individual investment portfolios? How often is that profit-loss information provided?**

JPMorgan currently provides daily profit and loss ("P&L") data for CIO to the OCC on a daily basis. This data is contained in the daily CIO Senior Management Report ("CIO SMR"). On a weekly basis, the OCC also receives the information that goes into the CIO Finance and Risk Weekly Review Report, which includes more granular CIO P&L information. The current CIO SMR is in the process of being enhanced to provide more granularity on products and portfolios.

2. **Hearing Exhibit 39 is a list of CIO risk limit breaches prepared by JPMorgan Chase in May 2012. The list indicates that, in the fourth quarter of 2011, the Synthetic Credit Portfolio breached its risk limits 6 times; in the first quarter of 2012, it breached its risk limits 170 times, and in the month of April alone, it breached its risk limits 160 times. Were JPMorgan Chase's risk management personnel aware at the time of this sudden increase in the number of risk limit breaches by the Synthetic Credit Portfolio? If so, please identify who knew and what action was taken in response. If not, has JPMorgan Chase since established a system to alert risk management personnel to that type of sudden increase in risk limit breaches?**

Risk management personnel who were signatories to a limit would have received notifications of any excessions of that limit. The signatories to a limit are dependent on its type—whether it is Firm-wide or CIO and whether it is categorized as Level 1 or Level 2. None of the limits described in Question 2 were specific to the Synthetic Credit Portfolio, and not all of the limit excessions identified were attributable to contemporaneous activity in the Synthetic Credit Portfolio or constituted a valid excession of a Firm-wide or CIO risk limit. The limit excessions that occurred in the fourth quarter of 2011 and in the first and second quarters of 2012 that were caused by contemporaneous activity in the Synthetic Credit Portfolio were of a combination of Firm-wide and CIO Level 1 and Level 2 limits. During this time period, the only person in JPMorgan's risk management organization who received notifications for both Level 1 and Level 2 limit excessions was the former Head of Market Risk for CIO, Peter Weiland. We have not determined whether individuals in the Firm or CIO risk organization received information about the number of excessions outside the formal notification system.

In addition to the notifications, limit excessions that occurred during the preceding quarter were a topic of discussion at quarterly CIO Risk Committee meetings. Discussions often included reference to the number of days a limit was in excess during the quarter. However, as the Firm's Management Task Force Report (the "Task Force Report") acknowledged, the CIO risk function's response to the limit excessions that occurred in the first quarter of 2012 was inadequate, as were the frequency with which the CIO Risk Committee met and the composition of the Committee itself. Had the CIO Risk Committee met more often or had risk officers from outside CIO been in attendance, the process might have worked to more effectively review CIO activities in the first quarter of 2012.

As part of the remedial measures instituted in response to the Task Force Report, the Firm has made a number of changes to both the CIO and the Firm-wide Risk Management functions. The CIO Risk Committee has been reconstituted as the CIO, Treasury and Corporate Risk Committee. It now meets on a weekly basis, and those meetings are chaired by the Firm's Chief Investment Officer and the Chief Risk Officer ("CRO") for CIO, Treasury and Corporate. The Committee includes representatives from CIO, Treasury and Corporate, as well as other key senior management from within and outside of CIO, including the Firm's Chief Financial Officer, CRO, and Deputy CRO. In addition, the Firm has strengthened its processes across all businesses to deal with limit excessions. If a Firm or Line of Business-level limit has been in excess for more than three business days or is over limit by 30% or more, that excession is automatically escalated to the Corporate or Line of Business Chief Executive Officer ("CEO"), CRO, and Market Risk Head, as well as to the Firm's CEO, CRO, Deputy CRO/Firm-wide Head of Market Risk, and the Firm-wide Risk Committee. If a Business Unit-level limit has been in excess for more than three business days or is over limit by 30% or more, that excession is automatically escalated to the Business Unit Head and Business Unit Market Risk Executive, as well as to the Corporate or Line of Business CEO, CRO and Market Risk Head, the Firm's Deputy CRO/Firm-wide Head of Market Risk, and the Line of Business Risk Committee. These notifications are sent every day that the escalation criteria applies.

5. **On March 30, 2012, at the end of the business day in London, CIO personnel sent an email to their CIO colleagues predicting that the Synthetic Credit Portfolio would incur a daily loss of about $138 million. According to its profit-loss records, however, the CIO reported internally that, on March 30, the Synthetic Credit Portfolio incurred a daily loss of about $319 million.**

    a. **Who made the decision to increase the amount of daily losses on March 30, 2012, from about $138 million to about $319 million?**

    b. **Please explain the reasons for the increase, including by identifying the three credit derivative positions whose values changed the most from the initial estimate to the final reported loss and, for each such position, its prior and subsequent reported price and total dollar value.**

The P&L Predict circulated by CIO traders on the evening of March 30 reflected an approximately $138 million loss for the Synthetic Credit Portfolio.[1] The P&L Predicts were generated daily on the basis of the marks entered by the traders for each instrument that day.

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[1] JPM-CIO-PSI 0015283.

The Total Rate of Return Report ("TRR"), which reflects the official March 30 P&L for the Synthetic Credit Portfolio, reported $149 million.

Per the standard practice at quarter-end, the March 30 trader-based marks were subject to a separate review by CIO's finance function. The $319 million loss number is the final post-quarter number after liquidity reserves of $153.1 million and CIO Valuation Control Group ("VCG") adjustments of $16.9 million made by CIO Finance. The individuals from CIO Finance involved in that process were John Wilmot and Ed Kastl. The VCG adjustment resulted from an analysis performed by an individual in CIO VCG.

8. **The CIO changed its derivatives pricing practices for the Synthetic Credit Portfolio after that portfolio began incurring substantial losses, moving from marking at or near the midpoint to marking at, near, or outside the boundaries of the daily price range (bid-ask spread). Has JPMorgan Chase taken any steps to inform its personnel that changing derivatives pricing practices to minimize losses—even if the prices being used fall within the bid-ask spread—is against bank policy? If so, what steps, if any, has JPMorgan taken to enforce compliance with that policy?**

Throughout the relevant time period, JPMorgan's corporate accounting policy was to mark at fair value mark-to-market positions, such as those contained in the Synthetic Credit Portfolio,[2/] as required by U.S. generally accepted accounting principles ("US GAAP"). During the relevant period, JPMorgan believed that the CIO traders were continuing to mark the portfolio at fair value; however, as the Firm now knows based on evidence uncovered by the Management Task Force (and not known at the time the Form 10-Q was issued), the CIO traders' marks may not have represented reasonable, good faith estimates of fair value on particular days in the first quarter of 2012.

The Firm has issued guidance to all front office personnel in CIO and the Corporate and Investment Bank ("CIB") reinforcing their obligation to comply with US GAAP and Firm-wide policy and to reflect fair value in the marks they assign to financial assets.[3/] The guidance states that knowingly marking or valuing a Firm position or instrument in a way that is not representative of fair value is prohibited and constitutes a falsification of the Firm's business records. Any employee who is aware of a position not being marked at fair value or suspects that a position may not be marked at fair value is required to notify Compliance immediately.[4/]

2/ Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is sometimes referred to as "exit price."

3/ See December 2012 Front Office Valuation Guidance, circulated on December 20, 2012. Produced at JPM-CIO-PSI-H 0006945.

4/ *Id.*

9. With respect to the Value-at-Risk (VaR) model change that was disclosed in JPMorgan Chase's third quarter 2012 10-Q filing and resulted in an approximately 20% decrease in the VaR results reported to the public, please explain:

a. Who developed the model change;

The new model implemented in the third quarter of 2012 (known internally as the "Index VaR" model) was developed by an individual in the Firm's Market Risk group, in conjunction with the head of the model development team in the Firm's Model Risk and Development group.

b. When the model change took effect;

The review of the model was completed on June 30, 2012 and the model change took effect on July 1, 2012.[5/]

c. What units within JPMorgan Chase use the revised VaR model;

The model is used by the CIB.

d. Whether the change applies to VaR models with a 95% or 99% confidence level;

The model produces a 95% confidence level VaR.

e. Whether the model change created a difference between the VaR models used by JPMorgan Chase to calculate its capital requirements and the VaR models used by JPMorgan Chase to inform the public about its risk analysis;

The model has been used solely to calculate the Firm's VaR as reported in the Firm's Form 10-Q for the third and fourth quarters of 2012. It also was submitted to regulators during the third quarter of 2012 for approval for regulatory capital purposes as part of the Basel 2.5 model review process. (The Firm's regulators do not provide approvals of VaR models for purposes of risk management or SEC filings.) As in the first and second quarters of 2012, the legacy Basel I model continued to be used for purposes of calculating Basel I regulatory capital requirements. At present, the Firm's general practice is to use the same models for purposes of financial reporting and the calculation of regulatory capital. Going forward as well, the Firm intends, where possible, to maintain consistency in the application of models for purposes of

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5/ As the Firm disclosed in its first quarter 2013 earnings supplement, in order to achieve consistency among like products within CIB and consistent with the implementation of Basel 2.5 requirements, the Firm moved the Synthetic Credit Portfolio to an existing VaR model within the CIB. This change had an insignificant impact to the average fixed income VaR and average total CIB trading and credit portfolio VaR, and it had no impact to the average total VaR compared with the models used in the third and fourth quarters of 2012. When compared with the model used prior to the model change in the third quarter of 2012, this VaR model resulted in a reduction to average fixed income VaR of $11 million, average total CIB trading and credit portfolio VaR of $10 million, and average total VaR of $8 million, for the three months ended March 31, 2013.

public disclosures, risk management, and regulatory capital, subject to regulatory approvals and changing requirements governing the calculation of regulatory capital.

f. What specific components of the revised model are primarily responsible for the decrease in reported VaR results;

The relevant components are: (i) correlation modeling; (ii) valuation input; (iii) index approach; and (iv) time series.

g. Why JPMorgan Chase believes its activities should be seen as substantially less risky than they were prior to the model change; and

The impetus behind the model change was to enhance aspects of the prior VaR model and to build a model that could be approved for use for regulatory capital purposes as part of the Basel 2.5 model review process. With respect to the Index VaR model itself, it should be noted that the model does not produce a consistently lower VaR than the Basel I model, and that the average difference between the output of the two models over the second quarter of 2012 was only 4%. The Firm believes that the Index VaR model is more robust than the prior model because it uses approved valuation models for inputs and uses underlying CIB-risk management systems to calculate risk sensitivities. Independent of the model change, the Firm has continued to de-risk the positions through active portfolio management prior to and throughout the period of the model's implementation.

h. Whether the model change was approved by the OCC and, if not, why not.

As indicated above, the Firm's regulators do not approve VaR models for risk management or reporting purposes. The OCC and other banking regulators were informed of the upcoming change during the model's development phase and notified of the model's formal implementation the same day it went live. In the third quarter of 2012, the Firm sought regulatory approvals for the use of the Index VaR model for regulatory capital purposes.

10. After purchasing a credit derivative position, does the CIO or the Investment Bank currently determine whether that position should be evaluated using the Comprehensive Risk Measure (CRM) or the Incremental Risk Charge (IRC) required by the OCC, by calculating which measure would produce lower Risk Weighted Assets (RWA) results? If not, please indicate whether the CIO or Investment Bank ever used that approach in the past and, if so, during what dates. If the CIO or Investment Bank uses that same approach for other types of derivatives, please identify those other types of derivatives.

The Firm does not determine the evaluation of positions in this manner. Positions are booked into the Firm's CRM and IRC models based on regulatory requirements and standards. JPMorgan's policy is—and always has been—that the interpretation of those requirements and standards is controlled by the Corporate Regulatory Policy Group (which is independent from the lines of business) and the Firm's capital governance process, which has not evaluated and does not evaluate positions in this manner.

11. **Has JPMorgan Chase ever hired or contracted with any third party, including any accounting firm, to obtain advice or services related to mathematical model revisions, procedures for categorizing assets, or other practices to "optimize" Risk Weighted Assets, produce lower RWA results, or minimize capital requirements? If so, please identify each such third party, the nature of the advice or services provided, and approximate dates.**

No, the Firm has not hired or contracted with any third party, including any accounting firm, with the purpose of obtaining advice or services related to mathematical model revisions, procedures for categorizing assets, or other practices to "optimize" Risk Weighted Assets ("RWA"), produce lower RWA results, or minimize capital requirements.

12. **During his hearing testimony on March 15, when asked about the Synthetic Credit Portfolio, Mr. Braunstein stated: "In hindsight, Senator, the position and the portfolio did not act as a hedge."**

    a. **When did JPMorgan Chase come to that conclusion?**

    b. **What is the basis for that conclusion?**

While the Firm is not aware of a specific moment when it concluded that the Synthetic Credit Portfolio had ceased to act as a hedge, the Firm believes that at some point between April 30, 2012 and May 10, 2012, the Firm understood that the Synthetic Credit Portfolio no longer provided the hedging protection it had provided historically. Beginning on April 23, the Synthetic Credit Portfolio began to suffer large losses, totaling almost $800 million over the course of six trading days. These large losses were inconsistent with the assurances CIO had provided to management prior to April 13 that the portfolio was a hedge, was balanced, and would "mean revert," and they caused senior Firm management to send a new team – headed by a senior member of Firm-wide Market Risk – to conduct a detailed analysis of the positions in order to provide an independent assessment of the portfolio and its risks. During the course of this review in late April and early May, the team concluded that the positions in the Synthetic Credit Portfolio were not as well correlated as had been previously understood, and as a result, the Synthetic Credit Portfolio was both different from – and riskier than – how it had previously been described by CIO.

13. **At the hearing, JPMorgan Chase indicated that it supported requiring contemporaneous hedging documentation to identify the assets being hedged, how the hedge would reduce the risks associated with those assets, and how the hedge would be tested for effectiveness. Please describe any steps JPMorgan Chase has taken to institute that requirement and provide copies of any relevant forms.**

JPMorgan understands that its regulators are currently developing rules that will contain appropriate documentation and other control requirements regarding hedging activity, and JPMorgan will adhere to those requirements. In the meantime, JPMorgan has taken steps to impose stronger internal controls over its structural hedging activity in a manner that appropriately reflects the approach in the proposed rules.

CIO investments are subject to the investment parameters and investment targets as established by the CIO Investment Committee and in accordance with the Firm-wide risk policy and limit frameworks. Investment strategies and portfolio management processes are established by CIO senior management and the Investment Committee, with adherence to safe and sound banking practices. The risk appetite for CIO is set annually by the Firm-wide Chief Operating Officer and the CIO, Treasury and Corporate Chief Risk Officer, Firm-wide CEO and Firm-wide CRO and presented to the Directors Risk Policy Committee.

The CIO Investment Committee, which is chaired by the Global Chief Investment Officer, is responsible for establishing the overall investment strategies to effectively manage the Firm's structural interest rate and FX risks and overseeing hedging activities involved in managing those risks.

The CIO Investment Committee is also required to approve new or changes to CIO hedging mandates. As part of the approval, the risks being hedged and the parameters to be applied to the management of those risks must be clearly defined and documented. This sets the framework for the effective hedging of those risks and the basis of the reporting and monitoring of that effectiveness.

14. Please identify by date and description, and provide a copy of, the earliest document that JPMorgan Chase provided to the Office of the Comptroller of the Currency (OCC) identifying the Synthetic Credit Portfolio by name.

While the name of the portfolio, both within JPMorgan and in communications with regulators, has changed over time, JPMorgan provided the OCC with regular reporting with respect to the portfolio. On a routine basis, JPMorgan sent weekly Stress Results Reports to the OCC. In 2011 and early January 2012, a number of these Stress Results Reports contain specific references to the "synthetics credit portfolio";[6/] the "synthetic credit book";[7/] and the "synthetic credit tranche book".[8/] In the years prior to 2011, reporting sent to the OCC also specifically

6/ Stress Report – JPM-CIO-PSI-H 0006898 (Nov. 18, 2011); Stress Report – JPM-CIO-PSI-H 0006947 (Nov. 26, 2011); Stress Report – JPM-CIO-PSI-H 0006949 (Jan. 6, 2012).

7/ Stress Report – JPM-CIO-PSI-H 0006951 (Nov. 4, 2011).

8/ *See, e.g.,* Stress Report – JPM-CIO-PSI-H 0006953 (Apr. 14, 2011); Stress Report – JPM-CIO-PSI-H 0006955 (June 3, 2011); Stress Report – JPM-CIO-PSI-H 0006957 (July 1, 2011); Stress Report – JPM-CIO-PSI-H 0006959 (August 12, 2011); Stress Report – JPM-CIO-PSI-H 0006961 (Sept. 9, 2011).

referred to the portfolio, but it was generally referred to as the "Core Credit Book", "EMEA Credit Tranche" book and the "CIO international credit tranche" book.

We are continuing to look for additional, earlier references to the Synthetic Credit Portfolio, by that name, in communications with the OCC and will supplement this response as necessary.

JPMorgan Chase & Co. Response to Questions 3, 4, 6 and 7 of the April 12, 2013 Letter from the United States Senate Permanent Subcommittee on Investigations

Questions 3, 4, 6 and 7 of your April 12, 2012 letter ask JPMorgan Chase & Co. ("JPMorgan" or the "Firm") to reconstruct the historic bid-ask spread for March 16 and 23 and April 11 and 17, 2012; and to explain whether the CIO used prices within the daily bid-ask spread on those dates and how the CIO traders' reported loss amounts were derived.

Unlike the U.S. equities market, where market participants have access to centralized, aggregated, real-time information reflecting the best bids and offers for a security, the derivatives market is a decentralized over-the-counter market where dealers are not required to publish binding bid-ask quotes and where their indicative quotes are not systematically disseminated. Because there is no mandated consolidated quotation system for derivatives, there is no uniformly acknowledged mechanism for identifying, on a historic basis, the relevant bids and offers in the market. While certain consensus prices for indices are available, those prices do not show a bid-ask spread; moreover, consensus prices for index tranches are not available on an intra-month basis. Consequently there is no historic data trail that shows bid-ask spreads for the dates you have asked about. After consulting with Firm personnel and a number of market experts, JPMorgan has not been able to identify any third party service or vendor who can create, maintain or reconstruct definitive bid-ask spreads for the indices and tranches. In addition, the CIO traders were not required to retain copies of all the indicative quotes and other market data they may have received and referred to when determining their marks on a day-to-day basis. For these reasons, JPMorgan has not been able to reconstruct a reliable and accurate historic market bid-ask spread for the intra-month dates you asked about and is therefore not able to state whether the CIO used prices within such a bid-ask spread on those particular trading days.

3. **On March 16, 2012, Julien Grout prepared a spreadsheet indicating that, on that day, losses incurred by the Synthetic Credit Portfolio had increased by at least $140 million. According to its profit-loss records, however, the CIO reported internally that, on March 16, the Synthetic Credit Portfolio incurred a daily loss of about $3.9 million.**

    a. **In calculating that $3.9 million loss, did the CIO use prices within the daily price range (bid-ask spread)?**

As discussed above, the Firm is not able to reconstruct an historic bid-ask spread and therefore is not able to state whether the CIO used prices within such a bid-ask spread.

    b. **Please explain how the $3.9 million loss amount was derived, including whether prices at, near, or outside of the boundaries of the daily price range (bid-ask spread) were used.**

The profit and loss ("P&L") for each of the four days identified in Questions 3, 4, 6 and 7 were generally derived as follows: On the basis of observable market data, including non-binding bid-ask quotations, from a number of different sources, the traders were responsible for assigning a value for each instrument in the book every business day. The traders entered the value for each instrument into the Firm's trade management systems. Those values together with the book's position data were used to generate the daily P&L for the Synthetic Credit Portfolio. Because it is not possible to recreate the historic bid-ask spread data for each of the instruments in the book, the Firm is not able to determine whether the value assigned for such instruments by the traders were at, near or outside the boundaries of the spreads.

4. **On March 23, 2012, Bruno Iksil sent the following communication to his supervisor, Javier Martin-Artajo: "I reckon we have today a loss of 300M using the best bid asks and approx. 600m from mids." According to its profit-loss records, however, the CIO reported internally that, on March 23, the Synthetic Credit Portfolio incurred a daily loss of about $12.6 million.**

    a. **In calculating that $12.6 million loss, did the CIO use prices within the daily price range (bid-ask spread)?**

    See above response to Question 3.a.

    b. **Please explain how the $12.6 million loss amount was derived, including whether prices at, near, or outside the boundaries of the daily price range (bid-ask spread) were used.**

    See above response to Question 3.b.

6. **On April 11, 2012, according to its profit-loss records, the CIO reported internally that the Synthetic Credit Portfolio incurred a daily loss of about $6.3 million, even though the prior day, the reported losses totaled about $415 million.**

    a. **In calculating that $6.3 million loss, did the CIO use prices within the daily price range (bid-ask spread)?**

    See above response to Question 3.a.

    b. **Please explain how the $6.3 million loss amount was derived, including whether prices at, near, or outside the boundaries of the daily price range (bid-ask spread) were used.**

    See above response to Question 3.b.

7. **On April 17, 2012, according to its profit-loss records, the CIO reported internally that the Synthetic Credit Portfolio incurred a daily gain of about $10 million, after eight consecutive days of losses.**

    a. **In calculating that $10 million gain, did the CIO use prices within the daily price range (bid-ask spread)?**

See above response to Question 3.a.

b. Please explain how the $10 million gain amount was derived, including whether prices at, near, or outside the boundaries of the daily price range (bid-ask spread) were used?

See above response to Question 3.b.

FRONT OFFICE VALUATION GUIDANCE, December 2012

I. Valuation Principles

It is a critical core value that employees act with integrity at all times when conducting firm business, including the maintenance of accurate business records relating to the valuation principles and processes described in this communication. As a U.S. regulated corporation, J.P. Morgan Chase & Co. (the "Firm") is required to follow U.S. generally accepted accounting principles ("US GAAP"). Under US GAAP, the Firm records certain financial assets and liabilities at fair value on the balance sheet, with changes in fair value reported in the Income Statement or Other Comprehensive Income. In addition, the Firm manages certain other assets or liabilities on a fair value basis and produces daily estimates of fair value and associated reporting, even though they are not carried at fair value on the balance sheet for US GAAP purposes. This communication relates to any financial asset or liability where a fair value estimate is required.

US GAAP defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." This is sometimes referred to as "exit price." Fair value is the price that a third party would be willing to pay for an asset, not what JPM may believe the asset should be worth. Fair value is measured for a 'normal' sized position.

The determination of exit price within the bid-offer spread typically involves judgment by the trading desk or risk taking business that manages the Firm's open positions (the "Front Office") and specific practices and norms should be agreed with VCG and the LOB CFO. For example, the Firm marks to a mid level for derivative market making books as a practical expedient. Any additional valuation adjustments, including those for size, would need to be agreed with VCG through the Fair Value Adjustment process.

Knowingly marking or providing a valuation on a Firm position or instrument by the Front Office which is not representative of fair value is a falsification of business records – it is known as "mismarking" and is prohibited. You must provide marks and valuations consistent with the guidance herein. If you are aware or suspect that a position or instrument may not be marked at fair value, you have an obligation to notify Compliance immediately.

Any questions or uncertainty about the applicability of this communication to a particular circumstance must be raised with your manager and the LOB CFO contact in your business. In addition, trading or risk taking personnel who manage the Firm's open positions must identify to their management and LOB CFO any situation where a position or instrument is not being valued in accordance with the Firm's fair valuation process described below.

II. Front Office Valuations

The Front Office has the responsibility for marking the Firm's instruments to fair value on a regular basis. This responsibility extends to instruments classified in all levels of the fair value hierarchy. All Front Office marks form the foundation for the Firm's estimates of fair value and daily profit and loss reporting.

Front Office marks must be calculated using available market-based information, including recent transaction data, price quotations, and other valuation inputs. Fair value should be estimated using the following hierarchy. Regardless of the method used, or the type of asset (*e.g.* private equity or an exchange traded equity), the objective remains the same, to most accurately estimate the exit price in the current market:

- Quoted market prices or inputs for the same instrument, such as recent transaction data, where available
- Quoted market prices or inputs for similar but still liquid instruments
- Quoted market prices or inputs for less liquid similar instruments
- For those positions where an observable market does not exist (Level 3), the Front Office may use a valuation model if it has been approved by the Model Review and Development Group ("MRG") to estimate fair value

For certain instruments where automated data feeds of pricing information are available on a continuous basis (price sourcing) the Front Office may use the feed to serve as the basis for valuations.

In addition, the Front Office is also responsible for ensuring that any model used to estimate fair value, to the best of their knowledge, is being used appropriately. For any trade that is approximately loaded, the Front Office must ensure that it is appropriately flagged in the system and that the Middle Office and VCG are both notified. For any trade that is approximately modeled, the Front Office should notify both Quantitative Research and MRG to highlight the approximation for further review.

III. VCG Verifies Fair Value

VCG is a control function, independent of the Front Office, whose responsibility is to: (i) independently verify the Front Office marks, and (ii) determine any valuation adjustment required to the Front Office marks to ensure that assets and liabilities are recorded at fair value as defined by US GAAP. VCG has sole responsibility for determining, documenting and executing any valuation adjustments required to record positions at fair value.

In the event there is a difference of opinion around Fair Value between the Front Office and VCG, the burden of proof rests with the Front Office to support its opinion and VCG will determine the Fair Value to be recorded in the books and records of the Firm.

RESPONSES TO QUESTIONS FOR THE RECORD
for
Thomas Curry, Scott Waterhouse, and Michael Sullivan
Office of the Comptroller of the Currency

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
Hearing on
JPMorgan Chase Whale Trades:
A Case History of Derivatives Risks & Abuses

March 15, 2013

Contents — ***Bates Number Page***

Permanent Subcommittee on Investigations
EXHIBIT #101

Office of the Comptroller of the Currency

Washington, DC 20219

June 27, 2013

The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
Washington, DC 20510

Dear Chairman Levin:

Enclosed please find my responses to the questions for the record submitted following the March 15, 2013, hearing on "JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses."

Since the hearing, the OCC has been giving careful consideration to the recommendations in the PSI's report on the JPMorgan Chase trades, and has taken several steps to improve our supervision of large bank derivatives portfolios. We have detailed these steps in our responses to the questions that follow.

In addition, I wanted to ensure you were aware that our Large Bank Supervision (LBS) program has nine network groups in specialty risk areas, including one for Capital Markets. Examiners from each large bank team are members of the network groups, and each group is headed by a Lead Expert. These groups are intended to ensure that the following key objectives are accomplished:

- Systemic and emerging risk issues and policy related issues are identified and discussed;
- Information and unique supervision techniques to promote consistent and progressive supervision are shared;
- Senior LBS leadership is kept informed of systemic and emerging risk issues, and policy related issues;
- Appropriate risk metrics are developed by working with Data and Analytics User groups; and
- Examiner training and development initiatives are sponsored and formalized.

With these objectives in mind, our Capital Markets network group will be critical to the success of the improvements we are making to our supervision of derivatives portfolios.

I hope the information detailed in the enclosure is helpful to the Committee. If you have any questions, please contact Carrie Moore, Director, Congressional Liaison, at (202) 649-6737.

Sincerely,

Thomas J. Curry
Comptroller of the Currency

Enclosure

QUESTIONS FOR THE RECORD
for
Thomas Curry, Scott Waterhouse, and Michael Sullivan
Office of the Comptroller of the Currency
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
Hearing on
"JPMorgan Chase Whale Trades: A Case History of Derivatives Risks & Abuses"

1. JPMorgan Chase did not fully disclose to the OCC the existence and nature of the Synthetic Credit Portfolio for five years. Please describe what steps the Office of the Comptroller of the Currency (OCC) has taken or plans to take, if any, to require the large banks it regulates to identify all internal investment portfolios or trading books with derivatives over a specified notional size, and provide periodic performance data for those activities or holdings. Please provide copies of any related written materials given to examiners on this issue.

Response: The OCC is taking several steps to require the large banks we regulate to identify large derivatives holdings. The recommendations in the report of the Senate Permanent Subcommittee on Investigations (PSI) regarding the JPMC trading loss, along with the results of our internal review, were widely discussed with, and distributed to, our large bank examiners and already are being incorporated into the OCC's examination processes. Our examiners have reinforced with all large institutions our expectation that they report to the OCC all material aspects of their operations. In addition, OCC examiners are reviewing the effectiveness of bank reporting and other control processes to ensure that banks' derivative activities and performance are transparent, both to their own internal control personnel and to examiners.

Second, the OCC is revising our examination handbook that covers trading and derivatives activities, to integrate the recommendations from the PSI report and lessons learned from the OCC's own internal investigation. The handbook will incorporate these recommendations into procedures for use by all of our large bank examiners to ensure that trading and derivative activities of large banks are examined in a consistent and rigorous manner. The revised handbook will describe the control framework that banks are expected to maintain for the safe and sound use of derivatives, including when that use is for hedging purposes. The handbook will specifically make clear that the framework will need to include the identification and reporting of significant derivatives exposures, anywhere in the bank. The OCC plans to expedite the communication to the industry of this aspect of the handbook through the issuance of interim supplemental examination procedures.

The OCC will share the new handbook and any guidance referenced in our answers with the Subcommittee, as soon as they are issued.

2. Please describe what steps the OCC has taken or plans to take, if any, to detect at the large banks it regulates undisclosed derivatives trading with notional values, net exposures, or profit-loss reports over specified amounts. Please provide copies of any related written materials given to examiners or other OCC personnel on detecting undisclosed derivatives trading.

Response: As discussed above, the OCC is taking several steps to require the large banks we regulate to identify and provide more detailed reports on significant derivative exposures. Consistent with the lessons we have learned from the Whale incident, and the recommendations of the PSI's Report, we also are taking steps to detect undisclosed derivatives trading activity.

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We have directed our large bank examiners to review carefully the reports provided by the large banks we regulate, and we have specifically emphasized to our examiners the importance of reviewing these reports to identify inconsistencies with information provided to senior management and regulators. We have also directed our examiners to evaluate the effectiveness of banks' risk management and internal audit functions in ensuring that bank management reports accurately represent risks posed by banks' derivative activities. We will incorporate specific reference to these procedures into our revised examination handbook.

In addition, the OCC is using data from third-party repositories as a means to identify concentrated risk positions and undisclosed trading activity. As described in greater detail below, the OCC is monitoring data on credit default swap (CDS) transactions using data we obtain from the Trade Information Warehouse of the Depository Trust and Clearing Corporation (DTCC). While this data has some limitations, it provides an independent source of information on bank CDS activities. Since April 2012, the OCC has been providing this data to examiners for use in their regular interaction with bank risk managers, and as a cross-check to bank-reported information for CDS.

The OCC also is exploring options to obtain more detailed and comprehensive trade data regarding CDS and certain other types of derivatives from swap data repositories (SDRs). SDRs, which were mandated by the Dodd-Frank Act (DFA), will ultimately be the repositories for detailed transaction data on all categories of swaps. However, the DFA requires the OCC and other prudential regulators to agree to indemnify the SDR in order to access swap data, impeding our access to it. The OCC cannot provide an open-ended indemnification to SDRs that would expose the agency to an unknown contingent liability. In addition to supporting a legislative solution to this problem, the OCC is working with other agencies to find a means to obtain this data. This data would provide us with another means to identify undisclosed trading activity in a broader range of asset classes, in addition to CDS.

Examples of related written materials given to examiners on detecting undisclosed derivatives trading are included in Appendix A. This topic is also discussed in the following handbooks:

> Comptroller's Handbook: Risk Management of Financial Derivatives
> http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/deriv.pdf
> (which is being revised)
>
> Comptroller's Handbook: Management and Board Process
> http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/management1.pdf
>
> Comptroller's Handbook: Management Information System
> http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/mis.pdf

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Comptroller's Handbook: Internal and External Audits
http://www.occ.gov/publications/publications-by-type/comptrollers handbook/2003AuditHB.pdf

3. JPMorgan Chase increased the notional size of the Synthetic Credit Portfolio from $4 billion to $51 billion in 2011, and to $157 billion in the first quarter of 2012. Please describe what procedures the OCC uses or plans to use to monitor the size of the derivatives holdings at the large banks it regulates, to track rapid increases within a quarter, and to determine when the sheer size of a particular derivatives holding or portfolio is incurring too much risk and needs to be reduced. In addition, please describe what actions a bank examiner is expected to take when a particular derivatives holding or portfolio becomes too large or too risky. Please provide copies of any related written materials given to examiners on monitoring and evaluating the size of bank derivative holdings.

Response: As described above, the OCC is taking several steps to require the large banks we regulate to identify and provide reports on significant derivative positions. The OCC is using these reports to monitor the size of the derivatives holdings at large banks, to track rapid increases within a quarter, and to identify when the sheer size of particular derivatives holdings may be overly risky. As mentioned above, we also are using CDS trade data from DTCC's Trade Information Warehouse, which is available at the transaction-level, to monitor the size of certain derivatives holdings of the institutions that we supervise. The OCC also is routinely reviewing the Warehouse's data for concentrated positions in individual reference names (e.g., credit derivatives indices) to identify positions that may become illiquid, exacerbating risk.

A goal of supervision is to ensure bank processes (particularly limit structures and internal control functions) are strong enough to prevent an exposure that is imprudent. When an examiner believes that a portfolio or holding has become too large or too risky, we expect the examiner to inform the bank's examiner-in-charge and investigate the issue more fully. The examiner is expected to meet with management to discuss the nature of the exposures created by the portfolio or holdings and any limit breaches. If warranted, the examiner is expected to perform a targeted examination to identify any imprudent risks created by the bank's portfolio or holdings. If a bank is found to be taking excessive risks, the OCC expects our examiners to initiate a supervisory action.

The OCC's general expectation for examiners to identify and communicate to bank management areas of emerging risks was reinforced in the OCC's Supervisory Memo 2011-5 on the use of the OCC's Risk Assessment System (RAS). As noted in that memo, the RAS is meant to be used as a tool to identify, communicate, and effect appropriate responses to the build-up of risks or deficiencies in risk management systems at OCC-supervised institutions. The memo instructed examiners that they should take appropriate supervisory actions when there are unwarranted risks that require better mitigation, exposures that must be reduced, or inadequate/ineffective risk management practices that must be remediated. We plan to reinforce these general expectations in our revised trading and derivatives handbook.

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Examples of related written materials given to examiners on monitoring and evaluating the size of bank derivative holdings are included in Appendix A. This topic is also discussed in the following handbooks:

Comptroller's Handbook: Risk Management of Financial Derivatives
http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/deriv.pdf
(which is being revised)

Comptroller's Handbook: Management Information System
http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/mis.pdf

Comptroller's Handbook: Large Bank Supervision
http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/lbs.pdf

4. Does JPMorgan Chase currently provide the OCC with daily profit and loss data for the Chief Investment Office (CIO)? Does it also provide daily profit and loss data for the CIO's individual investment portfolios or trading books? If not, does the OCC plan to require daily profit and loss data for the CIO's individual investment portfolios or trading books?

Response: Yes. We now receive daily profit and loss statements covering all CIO investment and trading activities.

5. Hearing Exhibit 39 is a list prepared by JPMorgan Chase of CIO risk limit breaches. The list indicates that, in the fourth quarter of 2011, the Synthetic Credit Portfolio breached its risk limits 6 times; in the first quarter of 2012, it breached its risk limits 170 times; and in the month of April alone, it breached its risk limits 160 times.

a. Were OCC examiners at JPMorgan Chase aware at the time of this sudden increase in the number of risk limit breaches by the Synthetic Credit Portfolio?

Response: The OCC received a daily e-mail that contained spreadsheet attachments highlighting limit excesses. We reviewed Corporate and Investment Bank positions on a regular basis. However, based on our faulty assumption that the CIO was not engaged in any high-risk activities, we did not regularly review the CIO spreadsheets and, consequently, we did not detect the rapid increase in exposures.

b. Please describe what steps the OCC has taken or plans to take, if any, to ensure on-site examiners at large banks analyze the bank's risk limit breach data on a timely basis to identify sudden or prolonged increases in the number of risk limit breaches or other problems. Please provide copies of any related written materials given to examiners requiring the analysis of bank risk limit breach data.

Response: The OCC is taking a number of steps to ensure that our large bank examiners analyze banks' risk limit breach data in a timely manner to identify sudden or prolonged increases in the

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number of risk limit breaches. First, we have emphasized the importance of evaluating limits and breaches in the context of discussing the JPMC trading loss, and the results of our internal review, with our large bank examiners. We also have continued to emphasize the importance of evaluating the ongoing effectiveness of processes and trends in bank exposures, including breaches, both through the process of setting supervisory strategies for large banks and in regular discussion groups organized for large bank examiners. In addition, the OCC's revised handbook will make clear that examiners must review banks' risk limit breach data on a timely basis. It also will clarify that examiners must determine whether banks themselves have strong risk management processes, including audit functions to ensure that risk limit breaches are appropriately monitored and addressed.

Written materials regarding analysis of bank risk limit breaches is discussed in the slide deck used for training purposes titled "Derivatives Basics and Bank Supervision" included in Appendix A, and in:

> Comptroller's Handbook: Risk Management of Financial Derivatives
> http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/deriv.pdf
> (which is being revised)

c. If an on-site examiner at a large bank becomes aware of a sudden or prolonged increase in the number of risk limit breaches at a bank, please describe what steps the OCC has taken or plans to take, if any, to instruct that examiner on the actions to be taken in response. Is it sufficient for the OCC examiner simply to determine that the bank itself is aware of the breach data, or must the examiner also identify the risky activities causing the breaches and ensure those risky activities are being curbed? Please provide copies of any related written materials given to large bank examiners on the actions to be taken in response to elevated risk limit breaches.

Response: During monthly calls with our large bank examiners, we have emphasized that the OCC expects our examiners to assess the reasons for sudden or prolonged breaches, and determine if management's actions in response to such breaches are appropriate. It is not sufficient for an examiner to simply ensure the bank is aware of risk limit breaches. If an examiner determines that the bank has inadequate risk controls, we expect the examiner to escalate the issue to more senior levels of bank and OCC management, through discussions or an in-depth review. A bank's failure to prudently address limit breaches could result in a supervisory action. Our expectation that examiners need to investigate the root cause of sudden and prolonged breaches of a bank's risks limits, and to direct that the bank take appropriate corrective action, is an underlying principle of our examination manuals and procedures. As we update our revised handbook for trading and derivatives activity, we will be sure that these expectations are clearly articulated.

The examination of risk controls is currently discussed in:

> Comptroller's Handbook: Bank Supervision Process
> http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_pdf/banksupervisionprocess.pdf

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Comptroller's Handbook: Management and Board Process
http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/management1.pdf

Comptroller's Handbook: Large Bank Supervision
http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/lbs.pdf

Copies of OCC enforcement policies also are included in Appendix A.

6. The JPMorgan Chase whale trades disclosed how, once the Synthetic Credit Portfolio began incurring losses, the bank's personnel changed the way they were valuing the derivatives and used prices that produced smaller reported losses. However, because they still used prices that generally fell within the daily price range (bid-ask spread), JPMorgan Chase supported their changed derivative valuation practices.

a. Please describe what steps the OCC has taken or plans to take, if any, to strengthen its oversight of derivative valuation practices at large banks and stop the manipulation of derivative prices to reduce reported losses. Please provide copies of related written materials given to examiners to evaluate derivative valuation practices.

Response: The OCC is taking a number of steps to strengthen the oversight of derivative valuation practices at large banks. First, the OCC has made clear to our large bank examiners that they are responsible for reviewing banks' valuation controls relating to the pricing of derivatives. Traders provisionally mark their portfolios on a daily basis. At month-end, banks use various sources to determine the portfolios' fair value as required by U.S. GAAP. When determining fair value, GAAP requires prioritizing observable, unadjusted inputs, such as prices from a stock exchange, over unobservable, adjusted inputs, such as internal models. To ensure accurate pricing, large banks have valuation control groups to confirm independently those month-end prices. The OCC expects our examiners to review the effectiveness of these independent efforts, including reviewing summary reports issued by valuation control groups that identify variations in desk level activity. For example, examiners must evaluate how a bank resolves pricing disagreements between the independent control group and traders and confirm that the independent control group is prevailing in pricing disagreements.

The OCC also plans to reinforce widely recognized best practice guidance issued by the G-30[1] by indicating that market-makers should value derivative positions at the mid-market price, less adjustments (e.g., credit or liquidity). The OCC will also emphasize that, by contrast, end-users (i.e., a non-market-making price taker), should mark a derivative on the bid side of the market if the position is long, and the offered side of the market, if the position is short.

[1] Derivatives: Practices and Principles (Global Derivatives Study Group), July, 1993

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These practices and principles will be included in the revisions to the examination handbook that covers trading and derivatives activities, mentioned above. Additionally, OCC policy units are reviewing other potential avenues, such as the OCC's Bank Accounting Advisory Series, to reinforce appropriate valuation principles and compliance with GAAP.

The evaluation of derivative valuation practices is discussed in the following materials provided to examiners:

OCC Bulletin 1999-2, Risk Management of Financial Derivatives and Banking Trading Activities – Supplemental Guidance
http://www.occ.gov/news-issuances/bulletins/1999/bulletin-1999-2.html

Comptroller's Handbook: Risk Management of Financial Derivatives
http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/deriv.pdf
(which is being revised)

Comptroller's Handbook: Management and Board Process
http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/management1.pdf

Comptroller's Handbook: Internal and External Audits
http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/2003AuditHB.pdf

b. Has the OCC taken or does it plan to take any steps to encourage large banks to use independent derivatives pricing services that mark derivative values at or near the midpoint of the daily price range (bid-ask spread)?

Response: Independent derivatives pricing services provide important information for bank valuation processes and have been in regular use at the largest banks for years. The OCC expects banks to also use independent pricing services as well as other independent sources to value derivatives.

The revised examination handbook will emphasize the OCC's expectations with respect to bank use of independent sources for pricing derivatives, as described in 6a.

c. What examination activities, if any, does the OCC currently conduct with respect to independent derivatives pricing services?

Response: The OCC does not directly examine independent pricing services. Instead, as discussed further below, the OCC reviews bank valuation controls to ensure that banks have independent processes to evaluate the integrity of all sources used in valuing their positions. In addition, we examine the effectiveness and results of these valuation control processes.

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d. At the hearing, you indicated that the OCC requires the banks it regulates to comply, at a minimum, with U.S. Generally Accepted Accounting Principles, including Accounting Standards Codification Topic 820-10-35 on fair value measurements and disclosures related to derivatives. Has the OCC taken or does it plan to take any steps to inform the large banks it regulates that it is against OCC policy for a bank to change its derivatives pricing practices when losses are occurring and report smaller losses – even when the prices fall within the bid-ask spread?

Response: Federal law requires large insured depository institutions to prepare financial statements in accordance with GAAP. See 12 U.S.C. 1831m; 12 CFR part 363. U.S. GAAP does not allow entities to change valuation practices to minimize losses. A forthcoming addition of the OCC's Bank Accounting Advisory Series, and the revised handbook will make this clear.

e. Has the OCC taken or does it plan to take any steps to require large banks to quantify and disclose at month or quarter end the extent to which their derivatives prices deviated from the midpoint prices during the covered time period, and disclose when their derivative prices fell at, near, or outside the boundaries of the daily price range (bid-ask spread)?

Response: As described in response to question 6(a), the OCC is taking a number of steps to strengthen the oversight of derivative valuation practices at large banks. The revised handbook will emphasize that banks' control processes need to provide support for all prices used in valuing positions. It will state that prices used must be independently confirmed, including an independent and thorough analysis of the validity of the information that control processes rely on to verify valuation. We also will incorporate these expectations in the interim supplemental examination procedures that we are developing.

7. With respect to the Value-at-Risk (VaR) model change that was disclosed in JPMorgan Chase's third quarter 2012 10-Q filing and resulted in an approximately 20% decrease in the VaR results reported to the public, please explain:

a. What units within the JPMorgan Chase bank use the revised VaR model?

Response: The model was used by the Chief Investment Office and the Corporate and Investment Bank.

b. whether the change applies to VaR models with a 95% or 99% confidence level;

Response: The change applies only to the VaR model with a 95% confidence level, which is the confidence level mandated by the SEC.

c. whether the model change was approved by the OCC and, if not, why not.

Response: JPMC requested OCC approval to use the revised VaR model at a 99% confidence level for regulatory capital purposes. The OCC reviewed the bank's methodology and decided not to approve the change because it did not meet OCC requirements for market risk regulatory capital models: it did not adequately capture single name exposures and was not consistent with

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the model used in the Investment Bank for other CDS index and tranche positions. Furthermore, the OCC was not satisfied with the bank's model controls and would not have approved the model change for capital purposes until the bank had improved its established controls to the OCC's satisfaction. However, the bank was not required to obtain OCC approval for its SEC filings.

d. whether the model change has created a difference between the VaR models used by JPMorgan Chase to calculate its capital requirements and the VaR models used by JPMorgan Chase to inform the public about its risk analysis and, if so, whether the OCC has any concerns about that difference;

Response: The OCC believes that banks should provide robust public disclosure of their market risks. Public disclosure imposes market discipline on banks' market risk capital models and banks' capital adequacy. Accordingly, the OCC now requires banks to make various public disclosures using the same VaR models they use to calculate capital. The OCC's revised market risk capital rule, effective January 1, 2013, requires banks to make public quantitative and qualitative disclosures regarding their market risk and market risk capital requirements. See 12 CFR part 3, appendix B, § 12. These disclosures include, for each material trading portfolio, the bank's high, low, and mean VaR and stressed-VaR and the characteristics of the bank's market risk capital models.

e. what review, if any, the OCC conducted of the model change and what specific components of the revised model are primarily responsible for the decrease in reported VaR results; and

Response: The OCC reviewed the bank's model documentation provided by the bank, including testing results and performance analysis. That analysis showed the two most important changes to the VaR model that caused a decrease in measured VaR were the use of price data from less actively-traded credit indices and the use of relative shifts in credit spreads.

f. whether the OCC agrees with JPMorgan Chase that its activities should be seen as substantially less risky than they were prior to the model change

Response: No, we do not agree with JPMorgan Chase that its activities should be seen as substantially less risky than they were prior to the model change. Changing the VaR model does not change the riskiness of the underlying activities; it only changes the way the risk is described.

8. The evidence indicates that JPMorgan Chase applies two sets of Value-at-Risk models to its credit derivative portfolios, a VaR model with a 99% confidence level for OCC bank call reports and a VaR model with a 95% confidence level for SEC public filings. Please describe the legal basis and substantive rationale for permitting a bank to apply two different Value-at-Risk models to the same portfolio and provide different VAR results in its OCC call reports versus its SEC public filings. Please also describe how common it is for large banks to use different VaR models and report different VaR results in their OCC call reports versus their SEC filings.

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Response: The OCC's market risk capital rule, which is consistent with the international Market Risk framework developed by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions, requires banks to measure general market risk using a VaR model with a 99% confidence level. The OCC believes this confidence level is necessary to determine an appropriately conservative capital requirement over the longer term, e.g., a 5-7 year credit cycle. Additionally, the disclosures that are required by the OCC's revised market risk capital rule, which became effective on January 1, 2013, provide transparency to market participants with regard to the calculation of a bank's market risk capital requirement. The SEC permits companies to make market risk disclosures using VaR models with a 95% confidence level. Using different confidence levels can be appropriate to meet different objectives. For example, the OCC's capital rules are designed to ensure that banks have adequate capital relative to risk, while the SEC's disclosure rules are designed to provide the public with information to make informed investment decisions based on how banks manage risks on a daily basis.

9. Please describe what coordination takes place, if any, between the OCC and the Securities and Exchange Commission (SEC) regarding disclosures in SEC filings by nationally chartered banks regarding VaR results or VaR model changes. In addition, please explain to what extent OCC and SEC requirements and procedures have been coordinated or integrated to ensure meaningful VaR disclosures about bank risks to investors.

Response: The OCC has recently reached out to SEC staff to discuss possible ways to achieve more clear and meaningful VaR disclosures. The OCC is currently in the process of reviewing VaR disclosures provided by large banking organizations, both domestic and foreign. We are working to identify "best practice" disclosures. We plan to share our conclusions regarding these best practice disclosures with the SEC.

10. Evidence shows that JPMorgan Chase took steps to change the models it used to calculate Value-at Risk, Comprehensive Risk Measure, and Risk Weighted Assets results to produce lower risk results and capital requirements. Please describe what steps the OCC has taken or plans to take, if any, to require large banks to disclose when a proposed change to a required risk or capital model is likely to produce materially lower risk results or capital requirements; to conduct a rigorous review of any such model changes to determine whether lower results or capital requirements are justified; and to uncover, punish, and prevent any attempts at model manipulation.

Response: The OCC's market risk capital rule requires the OCC's prior written approval before a national bank may use a model to calculate its capital requirements. The rule requires a national bank to notify the OCC if it plans to (1) make a change to an approved model that would result in a material change to the bank's risk-weighted assets, (2) extend the use of an approved model to a new business line or product type, or (3) make any material change to its modeling assumptions. The rule contains many additional requirements designed to ensure that models properly calculate risk. See 12 CFR part 3, appendix B, § 3. The OCC has published additional supervisory guidance on model risk management, the latest being OCC Bulletin 2011-12.

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The OCC will bring appropriate action against any national bank that attempts to manipulate its capital models or violate the OCC's capital rules. For example, the OCC's consent order with JPMC noted violations of the OCC's market risk capital rule. The order contains a detailed article requiring improvements to the bank's model risk management to comply with OCC rules and standards. The OCC issued a news release publicizing the order. Both the release and the order are on the OCC's website.

Finally, the federal securities laws could require a bank's holding company to disclose an OCC enforcement action in public SEC filings.

11. During his hearing testimony on March 15, 2013, when asked about the Synthetic Credit Portfolio, Mr. Braunstein stated: "In hindsight, Senator, the position and the portfolio did not act as a hedge."

a. When did JPMorgan Chase first provide that information to the OCC? Please describe the circumstances, including the date and the parties involved, and provide a copy of any related written materials.

Response: JPMorgan Chase did not provide this information to the OCC. However, various bank officials made public statements to this effect after the CIO's losses became public. For example, Jamie Dimon, JPMorgan Chase's chairman and chief executive, acknowledged in his testimony before the Senate Banking Committee in June 2012 that "this portfolio morphed into something that, rather than protect the firm, created new and potentially larger risks."

b. Does the OCC agree that the Synthetic Credit Portfolio did not act as a hedge?

Response: Yes, we agree.

12. Until the hearing, JPMorgan Chase had repeatedly described the Synthetic Credit Portfolio as a risk-reducing hedge, even though it was unable to produce contemporaneous documentation indicating the assets being hedged, how the hedge was designed or sized, or how its effectiveness was tested. Please describe what steps the OCC has taken or plans to take, if any, to require large banks to establish contemporaneous hedging documentation that identifies the assets being hedged, how the hedge lowers the risk associated with those assets, how and when the hedge will be tested for effectiveness, and how the hedge will be unwound and by whom.

Response: The OCC plans to incorporate the PSI's recommendations with respect to hedge documentation into the revised handbook for derivatives activities. The OCC also has discussed these recommendations with exam staff at the large trading firms as part of its normal monthly Price Risk calls. In addition, the OCC is in the process of developing interim supplemental examination procedures to clearly communicate our expectations regarding documentation of material derivatives hedges to our examiners.

13. Under current OCC risk weighted asset and capital rules, large banks may have lessened capital charges for derivatives positions than for other assets, including fully collateralized loans.

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Section 13(d)(3) of the Bank Holding Company Act (BHCA) explicitly authorizes the OCC and other regulators to impose higher capital charges for derivatives positions that arise from "permitted activities" under the Volcker Rule. Please describe what steps the OCC has taken or plans to take, if any, to implement higher capital charges for derivatives positions under Section 13(d)(3) of the BHCA, the Basel III framework, or other applicable statutes or rules.

Response: On August 30, 2012, the Federal banking agencies published revisions to our market risk capital requirements, which apply to banking organizations engaged in significant trading activities, including trading in derivatives. The final market risk capital rule, which became effective on January 1, 2013, substantially increases the overall capital requirements applicable to trading activities and adds other prudential requirements designed to improve risk management. Because the large majority of OTC derivatives traded by banks are capitalized using the market risk rules, this change will result in substantially more capital being held for derivatives activity.

In addition, the U.S. agencies, in conjunction with the Basel Committee for Banking Supervision, currently are engaged in a fundamental review of the capital requirements for trading positions. In the second half of 2013, we expect the Basel Committee to publish a proposal for comment based on this fundamental review.

Finally, in the Basel III rulemaking, which was published for notice and comment on the same day that the market risk capital rule was finalized, the Federal banking agencies proposed to revise the capital requirements applicable to derivatives activities that are not covered by the market risk rule. The proposed revisions generally would increase the capital requirements for OTC derivatives transactions and provide strong incentives for banking organizations to clear derivatives transactions through regulated central counterparties.

As we work toward developing and implementing final rules to implement Basel III and the Volcker Rule, the OCC remains committed to reviewing and evaluating the issues and the comments received, including the recommendations from the PSI Report.

14. Did the OCC have all the enforcement tools it needed to properly supervise JPMorgan Chase and the CIO when it traded in massive synthetic credit derivatives? If so, does the OCC continue to believe that it has the tools to fulfill its mission appropriately?

Response: The OCC had the enforcement tools it needed to properly supervise the bank. The actions by the bank were unsafe and unsound and in violation of law and regulation.

The OCC continues to believe that it has the tools to fulfill its mission appropriately. The OCC issued a comprehensive cease and desist order that requires the bank to correct the unsafe and unsound practices and violations of law and regulation. If necessary, the OCC may enforce the cease and desist order through the federal courts or through the assessment of civil money penalties. The OCC may take further enforcement actions against the bank and individuals in the future, as warranted.

PLACE: 999 E Street, N.W., Washington, D.C.

STATUS: This meeting will be closed to the public.

ITEMS TO BE DISCUSSED:

Compliance matters pursuant to 2 U.S.C. §437g.

Audits conducted pursuant to 2 U.S.C. §437g, §438(b), and Title 26, U.S.C.

Matters concerning participation in civil actions or proceedings or arbitration.

Internal personnel rules and procedures or matters affecting a particular employee.

DATE AND TIME: Wednesday, April 19, 1998 at 10:00 a.m.

PLACE: 999 E Street, N.W., Washington, D.C. (ninth floor).

STATUS: This hearing will be open to the public.

MATTER BEFORE THE COMMISSION: Who Qualifies as a "Member" of a Membership Association.

Federal Election Commission, Sunshine Act Notices for Meetings of April 28, 29, and 30, 1998.

DATE AND TIME: Thursday, April 30, 1998 at 10:00 a.m.

PLACE: 999 E Street, N.W., Washington, D.C. (ninth floor).

STATUS: This meeting will be open to the public.

ITEMS TO BE DISCUSSED:

Correction and Approval of Minutes.

Advisory Opinion 1998-6: Bacardi-Martini, USA, Inc. by counsel, Bobby R. Burchfield.

Soft Money: Revised Draft Notice of Proposed Rulemaking.

Administrative Matters.

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Marjorie W. Emmons,

Secretary of the Commission.

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FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities

AGENCY: Federal Financial Institutions Examination Council.

ACTION: Statement of policy.

SUMMARY: The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) (collectively referred to as the agencies), under the auspices of the Federal Financial Institutions Examination Council (FFIEC), have approved the Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities (1998 Statement) which provides guidance on sound practices for managing the risks of investment activities. By this issuance of the 1998 Statement, the agencies have rescinded the Supervisory Policy Statement on Securities Activities published on February 3, 1992 (1992 Statement). Many elements of that prior statement are retained in the 1998 Statement, while other elements have been revised or eliminated. In adopting the 1998 Statement, the agencies are removing the specific constraints in the 1992 Statement concerning investments by insured depository institutions in "high risk" mortgage derivative products. The agencies believe that it is a sound practice for institutions to understand the risks related to all their investment holdings. Accordingly, the 1998 Statement substitutes broader guidance than the specific pass/fail requirements contained in the 1992 Statement. Other than for the supervisory guidance contained in the 1992 Statement, the 1998 Statement does not supersede any other requirements of the respective agencies' statutory rules, regulations, policies, or supervisory guidance. Because the 1998 Statement does not retain the elements of the 1992 Statement addressing the reporting of securities activities (Section II of the 1992 Statement), the agencies intend to separately issue supervisory guidance on the reporting of investment securities and end-user derivatives activities. Each agency may issue additional guidance to assist institutions in the implementation of this statement.

EFFECTIVE DATE: May 26, 1998.

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SUPPLEMENTARY INFORMATION: In 1992, the agencies implemented the FFIEC's Supervisory Policy Statement on Securities Activities (57 FR 4028, February 3, 1992). The 1992 Statement addressed: (1) selection of securities dealers, (2) portfolio policy and strategies (including unsuitable investment practices), and (3) residential mortgage derivative products (MDPs).

The final section of the 1992 Statement directed institutions to subject MDPs to supervisory tests to determine the degree of risk and the investment portfolio eligibility of these instruments. At that time, the agencies believed that many institutions had demonstrated an insufficient understanding of the risks associated with investments in MDPs. This occurred, in part, because most MDPs were issued or backed by collateral guaranteed by government sponsored enterprises. The agencies were concerned that the absence of significant credit risk on most MDPs had allowed institutions to overlook the significant interest rate risk present in certain structures of these instruments. In an effort to enhance the investment decision making process at financial institutions, and to emphasize the interest rate risk of highly price sensitive instruments, the agencies implemented supervisory tests designed to identify those MDPs with price and average life risks greater than a newly issued residential mortgage pass-through security.

These supervisory tests provided a discipline that helped institutions to better understand the risks of MDPs prior to purchase. The 1992 Statement generally provided that institutions should not hold high risk MDPs in their investment portfolios.[1] A high risk MDP was defined as a mortgage derivative security that failed any of three supervisory tests. The three tests included: an average life test, an average life sensitivity test, and a price sensitivity test.[2]

These supervisory tests, commonly referred to as the "high risk tests," successfully protected institutions from significant losses in MDPs. By requiring a pre-purchase price sensitivity analysis that helped institutions to better understand the interest rate risk of MDPs, the high risk tests effectively precluded institutions from investing in many types of MDPs that resulted in large losses for other investors. However, the high risk tests may have created unintended distortions of the investment decision making process. Many institutions eliminated all MDPs from their investment choices, regardless of the risk versus return merits of such instruments. These reactions were due, in part, to concerns about regulatory burden, such as higher than normal examiner review of MDPs. By focusing only on MDPs, the test and its accompanying burden indirectly provided incentives for institutions to acquire other types of securities with complex cash flows, often with price sensitivities similar to high risk MDPs. The emergence of the structured note market is just one example. The test may have also created the impression that supervisors were more concerned with the type of instrument involved (i.e., residential mortgage products), rather than the risk characteristics of the instrument, since only MDPs were subject to the high risk test. The specification of tests on individual securities may have removed the incentive for some institutions to apply more comprehensive analytical techniques at the portfolio and institutional level.

As a result, the agencies no longer believe that the pass/fail criteria of the high risk tests as applied to specific instruments constitutes effective supervision of investment activities. The agencies believe that an effective risk management program, through which an institution identifies, measures, monitors, and controls the risks of investment activities, provides a better framework. Hence, the agencies are eliminating the high risk tests as binding constraints on MDP purchases in the 1998 Statement.

Effective risk management addresses risks across all types of instruments on an investment portfolio basis and ideally, across the entire institution. The complexity of many financial products, both on and off the balance sheet, has increased the need for a more comprehensive approach to the risk management of investment activities.

The rescission of the high risk tests as a constraint on an institution's investment activities does not signal that MDPs with high levels of price risk are either appropriate or inappropriate investments for an institution. Whether a security, MDP or otherwise, is an appropriate investment depends upon a variety of factors, including the institution's capital level, the security's impact on the aggregate risk of the portfolio, and management's ability to measure and manage risk. The agencies continue to believe that the stress testing of MDP investments, as well as other investments, has significant value for risk management purposes. Institutions should employ valuation methodologies that taka into account all of the risk elements necessary to price these investments. The 1998 Statement states that the agencies believe, as a matter of sound practice, institutions should know the value and price sensitivity of their investments prior to purchase and on an ongoing basis.

Summary of Comments

The 1998 Statement was published for comment in the **Federal Register** of October 3, 1997 (62 FR 51862). The FFIEC received twenty-one comment letters from a variety of insured depository institutions, trade associations, Federal Reserve Banks, and financial services organizations. Overall, the comments were supportive of the 1998 Statement. The comments generally approved of: (i) the rescission of the high risk test as a constraint on investment choices in the 1992 Statement; (ii) the establishment by institutions of programs to manage market, credit, liquidity, legal, operational, and other risks of investment securities and end-user derivatives activities; (iii) the implementation of sound risk management programs that would include certain board and senior management oversight and a comprehensive risk management process that effectively identifies, measures, monitors, and controls risks; and (iv) the evaluation of investment decisions at the portfolio or institution level, instead of the focus of the 1992 Statement on limiting an institution's investment decisions concerning specific securities instruments.

The following discussion provides a summary of significant concerns or requests for clarifications that were presented in the aforementioned comments.

1. Scope

The guidance covers a broad range of instruments including all securities in held-to-maturity and available-for-sale accounts as defined in the Statement of Financial Accounting Standards No. 115 (FAS 115), certificates of deposit held for investment purposes, and end-user derivative contracts not held in trading accounts.

Some comments focused on the 1998 Statement's coverage of "end-user derivative contracts not held in trading accounts." According to these comments, the 1998 Statement appears to cover derivative contracts not traditionally viewed as investments including: (i) Swap contracts entered into when the depository institution makes a fixed rate loan but intends to change the income stream from a fixed to floating rate, (ii) swap contracts that convert the interest rates on certificates of deposit from fixed to floating rates of interest, and (iii) swap contracts used for other asset-liability management purposes. Those commenters objected to the necessity of additional guidance for end-user derivatives contracts given current regulatory guidance issued by the agencies with respect to derivative contracts.

The guidance contained in the 1998 Statement is consistent with existing agency guidance. The agencies believe that institutions should have programs to manage the market, credit, liquidity, legal, operational, and other risks of both investment securities and end-user derivative activities. Given the similarity of the risks in those activities and the similarity of the programs needed to manage those risks, especially when end-user derivatives are used as investment vehicles, the agencies believe that covering both activities

[1] The only exceptions granted were for those high risk securities that either reduced interest rate risk or were placed in a trading account. Federal credit unions were not permitted these exceptions.

[2] Average Life: Weighted average life of no more than 10 years; Average Life Sensitivity: (a) weighted average life extends by not more than 4 years (300 basis point parallel shift in rates), (b) weighted average life shortens by no more than 6 years (300 basis point parallel shift in rates); Price Sensitivity: price does not change by more than 17 percent (increase or decrease) for a 300 basis point parallel shift in rates.

within the scope of the 1998 Statement is appropriate.

2. Board Oversight

Some commenters stated that the 1998 Statement places excessive obligations on the board of directors. Specifically, comments indicated that it is unnecessary for an institution's board of directors to: (i) Set limits on the amounts and types of transactions authorized for each securities firm with whom the institution deals, or (ii) review and reconfirm the institution's list of authorized dealers, investment bankers, and brokers at least annually. These commenters suggested that it may be unnecessary for the board—particularly for larger institutions—to review and specifically authorize each dealer. They indicated that it should be sufficient for senior management to ensure that the selection of securities firms is consistent with board approved policies, and that establishment of limits for each dealer is a credit decision that should be issued pursuant to credit policies.

The agencies believe that the board of directors is responsible for supervision and oversight of investment portfolio and end-user derivatives activities, including the approval and periodic review of policies that govern relationships with securities dealers. Especially with respect to the management of the credit risk of securities settlements, the agencies encourage the board of directors or a subcommittee chaired by a director to actively participate in the credit decision process. The agencies understand that institutions will have various approaches to the credit decision process, and therefore that the board of directors may delegate the authority for selecting dealers and establishing dealer limits to senior management. The text of the 1998 Statement has been amended to clarify the obligation of the board of directors.

3. Pre-Purchase Analysis

The majority of the commenters were in full support of eliminating the specific constraints on investing in "high risk" MDPs. Some commenters expressed opposition with respect to the 1998 Statement's guidance concerning pre-purchase analysis by institutions of their investment securities. Those commenters felt that neither pre-acquisition stress testing nor any specific stress testing methodology should be required for individual investment decisions. Some commenters involved in the use of securities for collateral purposes emphasized the benefits of pre-and post-purchase stress testing of individual securities.

The agencies wish to stress that institutions should have policies designed to meet the business needs of the institution. These policies should specify the types of market risk analyses that should be conducted for various types of instruments, including that conducted prior to their acquisition and on an ongoing basis. In addition, policies should specify any required documentation needed to verify the analysis. Such analyses will vary with the type of investment instrument.

As stated in Section V of the 1998 Statement, not all investment instruments need to be subjected to a pre-purchase analysis. Relatively simple or standardized instruments, the risks of which are well known to the institution, would likely require no or significantly less analysis than would more volatile, complex instruments. For relatively more complex instruments, less familiar instruments, and potentially volatile instruments, institutions should fully address pre-purchase analysis in their policies. In valuing such investments, institutions should ensure that the pricing methodologies used appropriately consider all risks (for example, caps and floors in adjustable-rate instruments). Moreover, the agencies do not believe that an institution should be prohibited from making an investment based solely on whether that instrument has a high price sensitivity.

4. Identification, Measurement, and Reporting of Risks

Some commenters questioned whether proposed changes by the agencies concerning Schedule RC–B of the Consolidated Reports of Condition and Income ("Call Reports") conflicted with the 1998 Statement's elimination of the high risk test for mortgage derivative products. The proposed changes to the Call Reports would require the disclosure of mortgage-backed and other securities whose price volatility in response to specific interest rate changes exceeds a specified threshold level. (*See* 62 FR 51715, October 2, 1997.)

The banking agencies have addressed the concerns presented in these comments within the normal process for changing the Call Reports. For the 1998 Call report cycle, there will be no changes to the high risk test reporting requirement in the Call Reports.

5. Market Risk

One commenter suggested that the agencies enhance the 1998 Statement by discussing and endorsing the concept of total return. The agencies agree that the concept of total return can be a useful way to analyze the risk and return tradeoffs for an investment. This is because the analysis does not focus exclusively on the stated yield to maturity. Total return analysis, which includes income and price changes over a specified investment horizon, is similar to stress test analysis since both examine a security under various interest rate scenarios. The agencies' supervisory emphasis on stress testing securities has, in fact, implicitly considered total return. Therefore, the agencies endorse the use of total return analysis as a useful supplement to price sensitivity analysis for evaluating the returns for an individual security, the investment portfolio, or the entire institution.

6. Measurement System

One respondent stated that the complexity and sophistication of the risk measurement system should not be a factor in determining whether pre- and post-acquisition measurement of interest rate risk should be performed at the individual investment level or on an institutional or portfolio basis. The agencies agree that this statement may be confusing and are amending the Market Risk section.

The text of the statement of policy follows.

Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities

I. Purpose

This policy statement (Statement) provides guidance to financial institutions (institutions) on sound practices for managing the risks of investment securities and end-user derivatives activities.[3] The FFIEC agencies—the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration—believe that effective management of the risks associated with securities and derivative instruments represents an essential component of safe and sound practices. This guidance describes the practices that a prudent manager normally would follow and is not intended to be a checklist. Management should establish practices and maintain documentation appropriate to the institution's

[3] The 1998 Statement does not supersede any other requirements of the respective agencies' statutory rules, regulations, policies, or supervisory guidance.

individual circumstances, consistent with this Statement.

II. Scope

This guidance applies to all securities in held-to-maturity and available-for-sale accounts as defined in the Statement of Financial Accounting Standards No.115 (FAS 115), certificates of deposit held for investment purposes, and end-user derivative contracts not held in trading accounts. This guidance covers all securities used for investment purposes, including: money market instruments, fixed-rate and floating-rate notes and bonds, structured notes, mortgage pass-through and other asset-backed securities, and mortgage-derivative products. Similarly, this guidance covers all end-user derivative instruments used for nontrading purposes, such as swaps, futures, and options.[4] This Statement applies to all federally-insured commercial banks, savings banks, savings associations, and federally chartered credit unions.

As a matter of sound practice, institutions should have programs to manage the market, credit, liquidity, legal, operational and other risks of investment securities and end-user derivatives activities (investment activities). While risk management programs will differ among institutions, there are certain elements that are fundamental to all sound risk management programs. These elements include board and senior management oversight and a comprehensive risk management process that effectively identifies, measures, monitors, and controls risk. This Statement describes sound principles and practices for managing and controlling the risks associated with investment activities.

Institutions should fully understand and effectively manage the risks inherent in their investment activities. Failure to understand and adequately manage the risks in these areas constitutes an unsafe and unsound practice.

III. Board and Senior Management Oversight

Board of director and senior management oversight is an integral part of an effective risk management program. The board of directors is responsible for approving major policies for conducting investment activities, including the establishment of risk limits. The board should ensure that management has the requisite skills to manage the risks associated with such activities. To properly discharge its oversight responsibilities, the board should review portfolio activity and risk levels, and require management to demonstrate compliance with approved risk limits. Boards should have an adequate understanding of investment activities. Boards that do not, should obtain professional advice to enhance its understanding of investment activity oversight, so as to enable it to meet its responsibilities under this Statement.

Senior management is responsible for the daily management of an institution's investments. Management should establish and enforce policies and procedures for conducting investment activities. Senior management should have an understanding of the nature and level of various risks involved in the institution's investments and how such risks fit within the institution's overall business strategies. Management should ensure that the risk management process is commensurate with the size, scope, and complexity of the institution's holdings. Management should also ensure that the responsibilities for managing investment activities are properly segregated to maintain operational integrity. Institutions with significant investment activities should ensure that back-office, settlement, and transaction reconciliation responsibilities are conducted and managed by personnel who are independent of those initiating risk taking positions.

IV. Risk Management Process

An effective risk management process for investment activities includes: (1) policies, procedures, and limits; (2) the identification, measurement, and reporting of risk exposures; and (3) a system of internal controls.

Policies, Procedures, and Limits

Investment policies, procedures, and limits provide the structure to effectively manage investment activities. Policies should be consistent with the organization's broader business strategies, capital adequacy, technical expertise, and risk tolerance. Policies should identify relevant investment objectives, constraints, and guidelines for the acquisition and ongoing management of securities and derivative instruments. Potential investment objectives include: generating earnings, providing liquidity, hedging risk exposures, taking risk positions, modifying and managing risk profiles, managing tax liabilities, and meeting pledging requirements, if applicable. Policies should also identify the risk characteristics of permissible investments and should delineate clear lines of responsibility and authority for investment activities.

An institution's management should understand the risks and cashflow characteristics of its investments. This is particularly important for products that have unusual, leveraged, or highly variable cashflows. An institution should not acquire a material position in an instrument until senior management and all relevant personnel understand and can manage the risks associated with the product.

An institution's investment activities should be fully integrated into any institution-wide risk limits. In so doing, some institutions rely only on the institution-wide limits, while others may apply limits at the investment portfolio, sub-portfolio, or individual instrument level.

The board and senior management should review, at least annually, the appropriateness of its investment strategies, policies, procedures, and limits.

Risk Identification, Measurement and Reporting

Institutions should ensure that they identify and measure the risks associated with individual transactions prior to acquisition and periodically after purchase. This can be done at the institutional, portfolio, or individual instrument level. Prudent management of investment activities entails examination of the risk profile of a particular investment in light of its impact on the risk profile of the institution. To the extent practicable, institutions should measure exposures to each type of risk and these measurements should be aggregated and integrated with similar exposures arising from other business activities to obtain the institution's overall risk profile.

In measuring risks, institutions should conduct their own in-house pre-acquisition analyses, or to the extent possible, make use of specific third party analyses that are independent of the seller or counterparty. Irrespective of any responsibility, legal or otherwise, assumed by a dealer, counterparty, or financial advisor regarding a transaction, the acquiring institution is ultimately responsible for the appropriate personnel understanding and managing the risks of the transaction.

Reports to the board of directors and senior management should summarize the risks related to the institution's investment activities and should address compliance with the investment policy's objectives, constraints, and

[4] Natural person federal credit unions are not permitted to purchase non-residential mortgage asset-backed securities and may participate in derivative programs only if authorized by the NCUA.

legal requirements, including any exceptions to established policies, procedures, and limits. Reports to management should generally reflect more detail than reports to the board of the institution. Reporting should be frequent enough to provide timely and adequate information to judge the changing nature of the institution's risk profile and to evaluate compliance with stated policy objectives and constraints.

Internal Controls

An institution's internal control structure is critical to the safe and sound functioning of the organization generally and the management of investment activities in particular. A system of internal controls promotes efficient operations, reliable financial and regulatory reporting, and compliance with relevant laws, regulations, and institutional policies. An effective system of internal controls includes enforcing official lines of authority, maintaining appropriate separation of duties, and conducting independent reviews of investment activities.

For institutions with significant investment activities, internal and external audits are integral to the implementation of a risk management process to control risks in investment activities. An institution should conduct periodic independent reviews of its risk management program to ensure its integrity, accuracy, and reasonableness. Items that should be reviewed include:

(1) Compliance with and the appropriateness of investment policies, procedures, and limits;

(2) The appropriateness of the institution's risk measurement system given the nature, scope, and complexity of its activities;

(3) The timeliness, integrity, and usefulness of reports to the board of directors and senior management.

The review should note exceptions to policies, procedures, and limits and suggest corrective actions. The findings of such reviews should be reported to the board and corrective actions taken on a timely basis.

The accounting systems and procedures used for public and regulatory reporting purposes are critically important to the evaluation of an organization's risk profile and the assessment of its financial condition and capital adequacy. Accordingly, an institution's policies should provide clear guidelines regarding the reporting treatment for all securities and derivatives holdings. This treatment should be consistent with the organization's business objectives, generally accepted accounting principles (GAAP), and regulatory reporting standards.

V. The Risks of Investment Activities

The following discussion identifies particular sound practices for managing the specific risks involved in investment activities. In addition to these sound practices, institutions should follow any specific guidance or requirements from their primary supervisor related to these activities.

Market Risk

Market risk is the risk to an institution's financial condition resulting from adverse changes in the value of its holdings arising from movements in interest rates, foreign exchange rates, equity prices, or commodity prices. An institution's exposure to market risk can be measured by assessing the effect of changing rates and prices on either the earnings or economic value of an individual instrument, a portfolio, or the entire institution. For most institutions, the most significant market risk of investment activities is interest rate risk.

Investment activities may represent a significant component of an institution's overall interest rate risk profile. It is a sound practice for institutions to manage interest rate risk on an institution-wide basis. This sound practice includes monitoring the price sensitivity of the institution's investment portfolio (changes in the investment portfolio's value over different interest rate/yield curve scenarios). Consistent with agency guidance, institutions should specify institution-wide interest rate risk limits that appropriately account for these activities and the strength of the institution's capital position. These limits are generally established for economic value or earnings exposures. Institutions may find it useful to establish price sensitivity limits on their investment portfolio or on individual securities. These sub-institution limits, if established, should also be consistent with agency guidance.

It is a sound practice for an institution's management to fully understand the market risks associated with investment securities and derivative instruments prior to acquisition and on an ongoing basis. Accordingly, institutions should have appropriate policies to ensure such understanding. In particular, institutions should have policies that specify the types of market risk analyses that should be conducted for various types or classes of instruments, including that conducted prior to their acquisition (pre-purchase analysis) and on an ongoing basis. Policies should also specify any required documentation needed to verify the analysis.

It is expected that the substance and form of such analyses will vary with the type of instrument. Not all investment instruments may need to be subjected to a pre-purchase analysis. Relatively simple or standardized instruments, the risks of which are well known to the institution, would likely require no or significantly less analysis than would more volatile, complex instruments.[5]

§703.90. See 62 FR 32989 (June 18, 1997).

For relatively more complex instruments, less familiar instruments, and potentially volatile instruments, institutions should fully address pre-purchase analyses in their policies. Price sensitivity analysis is an effective way to perform the pre-purchase analysis of individual instruments. For example, a pre-purchase analysis should show the impact of an immediate parallel shift in the yield curve of plus and minus 100, 200, and 300 basis points. Where appropriate, such analysis should encompass a wider range of scenarios, including non-parallel changes in the yield curve. A comprehensive analysis may also take into account other relevant factors, such as changes in interest rate volatility and changes in credit spreads.

When the incremental effect of an investment position is likely to have a significant effect on the risk profile of the institution, it is a sound practice to analyze the effect of such a position on the overall financial condition of the institution.

Accurately measuring an institution's market risk requires timely information about the current carrying and market values of its investments. Accordingly, institutions should have market risk measurement systems commensurate with the size and nature of these investments. Institutions with significant holdings of highly complex instruments should ensure that they have the means to value their positions. Institutions employing internal models should have adequate procedures to validate the models and to periodically review all elements of the modeling process, including its assumptions and risk measurement techniques. Managements relying on third parties for market risk measurement systems and analyses should ensure that they fully understand the assumptions and techniques used.

[5] Federal credit unions must comply with the investment monitoring requirements of 12 C.F.R. §703.90. *See* 62 FR 32989 (June 18, 1997).

Institutions should provide reports to their boards on the market risk exposures of their investments on a regular basis. To do so, the institution may report the market risk exposure of the whole institution. Alternatively, reports should contain evaluations that assess trends in aggregate market risk exposure and the performance of portfolios in terms of established objectives and risk constraints. They also should identify compliance with board approved limits and identify any exceptions to established standards. Institutions should have mechanisms to detect and adequately address exceptions to limits and guidelines. Management reports on market risk should appropriately address potential exposures to yield curve changes and other factors pertinent to the institution's holdings.

Credit Risk

Broadly defined, credit risk is the risk that an issuer or counterparty will fail to perform on an obligation to the institution. For many financial institutions, credit risk in the investment portfolio may be low relative to other areas, such as lending. However, this risk, as with any other risk, should be effectively identified, measured, monitored, and controlled.

An institution should not acquire investments or enter into derivative contracts without assessing the creditworthiness of the issuer or counterparty. The credit risk arising from these positions should be incorporated into the overall credit risk profile of the institution as comprehensively as practicable. Institutions are legally required to meet certain quality standards (i.e., investment grade) for security purchases. Many institutions maintain and update ratings reports from one of the major rating services. For non-rated securities, institutions should establish guidelines to ensure that the securities meet legal requirements and that the institution fully understands the risk involved. Institutions should establish limits on individual counterparty exposures. Policies should also provide credit risk and concentration limits. Such limits may define concentrations relating to a single or related issuer or counterparty, a geographical area, or obligations with similar characteristics.

In managing credit risk, institutions should consider settlement and pre-settlement credit risk. These risks are the possibility that a counterparty will fail to honor its obligation at or before the time of settlement. The selection of dealers, investment bankers, and brokers is particularly important in effectively managing these risks. The approval process should include a review of each firm's financial statements and an evaluation of its ability to honor its commitments. An inquiry into the general reputation of the dealer is also appropriate. This includes review of information from state or federal securities regulators and industry self-regulatory organizations such as the National Association of Securities Dealers concerning any formal enforcement actions against the dealer, its affiliates, or associated personnel.

The board of directors is responsible for supervision and oversight of investment portfolio and end-user derivatives activities, including the approval and periodic review of policies that govern relationships with securities dealers.

Sound credit risk management requires that credit limits be developed by personnel who are as independent as practicable of the acquisition function. In authorizing issuer and counterparty credit lines, these personnel should use standards that are consistent with those used for other activities conducted within the institution and with the organization's over-all policies and consolidated exposures.

Liquidity Risk

Liquidity risk is the risk that an institution cannot easily sell, unwind, or offset a particular position at a fair price because of inadequate market depth. In specifying permissible instruments for accomplishing established objectives, institutions should ensure that they take into account the liquidity of the market for those instruments and the effect that such characteristics have on achieving their objectives. The liquidity of certain types of instruments may make them inappropriate for certain objectives. Institutions should ensure that they consider the effects that market risk can have on the liquidity of different types of instruments under various scenarios. Accordingly, institutions should articulate clearly the liquidity characteristics of instruments to be used in accomplishing institutional objectives.

Complex and illiquid instruments can often involve greater risk than actively traded, more liquid securities. Oftentimes, this higher potential risk arising from illiquidity is not captured by standardized financial modeling techniques. Such risk is particularly acute for instruments that are highly leveraged or that are designed to benefit from specific, narrowly defined market shifts. If market prices or rates do not move as expected, the demand for such instruments can evaporate, decreasing the market value of the instrument below the modeled value.

Operational (Transaction) Risk

Operational (transaction) risk is the risk that deficiencies in information systems or internal controls will result in unexpected loss. Sources of operating risk include inadequate procedures, human error, system failure, or fraud. Inaccurately assessing or controlling operating risks is one of the more likely sources of problems facing institutions involved in investment activities.

Effective internal controls are the first line of defense in controlling the operating risks involved in an institution's investment activities. Of particular importance are internal controls that ensure the separation of duties and supervision of persons executing transactions from those responsible for processing contracts, confirming transactions, controlling various clearing accounts, preparing or posting the accounting entries, approving the accounting methodology or entries, and performing revaluations.

Consistent with the operational support of other activities within the financial institution, securities operations should be as independent as practicable from business units. Adequate resources should be devoted, such that systems and capacity are commensurate with the size and complexity of the institution's investment activities. Effective risk management should also include, at least, the following:

- Valuation. Procedures should ensure independent portfolio pricing. For thinly traded or illiquid securities, completely independent pricing may be difficult to obtain. In such cases, operational units may need to use prices provided by the portfolio manager. For unique instruments where the pricing is being provided by a single source (e.g., the dealer providing the instrument), the institution should review and understand the assumptions used to price the instrument.
- Personnel. The increasingly complex nature of securities available in the marketplace makes it important that operational personnel have strong technical skills. This will enable them to better understand the complex financial structures of some investment instruments.
- Documentation. Institutions should clearly define documentation requirements for securities transactions, saving and safeguarding important documents, as well as maintaining

possession and control of instruments purchased.

An institution's policies should also provide guidelines for conflicts of interest for employees who are directly involved in purchasing and selling securities for the institution from securities dealers. These guidelines should ensure that all directors, officers, and employees act in the best interest of the institution. The board may wish to adopt policies prohibiting these employees from engaging in personal securities transactions with these same securities firms without specific prior board approval. The board may also wish to adopt a policy applicable to directors, officers, and employees restricting or prohibiting the receipt of gifts, gratuities, or travel expenses from approved securities dealer firms and their representatives.

Legal Risk

Legal risk is the risk that contracts are not legally enforceable or documented correctly. Institutions should adequately evaluate the enforceability of its agreements before individual transactions are consummated. Institutions should also ensure that the counterparty has authority to enter into the transaction and that the terms of the agreement are legally enforceable. Institutions should further ascertain that netting agreements are adequately documented, executed properly, and are enforceable in all relevant jurisdictions. Institutions should have knowledge of relevant tax laws and interpretations governing the use of these instruments.

Dated: April 17, 1998.

Keith J. Todd,

Assistant Executive Secretary, Federal Financial Institutions Examination Council.

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DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of the Secretary

Notice of Interest Rate on Overdue Debts

Section 30.13 of the Department of Health and Human Services' claims collection regulations (45 CFR Part 30) provides that the Secretary shall charge an annual rate of interest as fixed by the Secretary of the Treasury after taking into consideration private consumer rates of interest prevailing on the date that HHS becomes entitled to recovery. The rate generally cannot be lower than the Department of Treasury's current value of funds rate or the applicable rate determined from the "Schedule of Certified Interest Rates with Range of Maturities." This rate may be revised quarterly by the Secretary of the Treasury and shall be published quarterly by the Department of Health and Human Services in the Federal Register.

The Secretary of the Treasury has certified a rate of 14% for the quarter ended March 31, 1998. This interest rate will remain in effect until such time as the Secretary of the Treasury notifies HHS of any change.

Dated: April 16, 1998.

George Strader,

Deputy Assistant Secretary, Finance.

[FR Doc. 98-10790 Filed 4-22-98; 8:45 am]

BILLING CODE 4150-04-M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Agency for Health Care Policy and Research

Notice of Meeting

In accordance with section 10(d) of the Federal Advisory Committee Act (5 U.S.C., Appendix 2) announcement is made of the following subcommittee scheduled to meet during the month of May 1998.

Name: Health Care Policy and Research Special Emphasis Panel "Grants for Health Services Dissertation Research".

Date and Time: May 7-8, 1998.

Place: Doubletree Hotel, 1750 Rockville Pike, Montrose Room, Rockville, Maryland 20852.

Purpose: To review and evaluate grant applications.

Agenda: The open session of the meetings will be devoted to business covering administrative matters and reports. During the closed sessions, the Subcommittees will be reviewing and discussing grant applications dealing with health services research issues. In accordance with the Federal Advisory Committee Act, section 10(d) of 5 U.S.C., Appendix 2 and 5 U.S.C., 552b(c)(6), the Administrator, Agency for Health Care Policy and Research, has made a formal determination that these latter sessions will be closed because the discussions are likely to reveal personal information concerning individuals associated with the grant applications. This information is exempt from mandatory disclosure.

Anyone wishing to obtain a roster of members, minutes of the meeting, or other relevant information should contact Mrs. Sheila Simmons, Committee Management Officer, Office of Scientific Affairs, Agency for Health Care Policy and Research, 2101 East Jefferson Street, Suite 400, Rockville, Maryland 20852, Telephone (301) 594-1452x1627.

Agenda items for this meeting are subject to change as priorities dictate.

Dated: April 14, 1998.

John M. Eisenberg,

Administrator.

[FR Doc. 98-10777 Filed 4-22-98; 8:45 am]

BILLING CODE 4160-90-M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

[Announcement 98037]

Centers for Disease Control and Prevention

Initiatives by Organizations To Strengthen National Tobacco Control Activities in the United States; Notice of Availability of Funds for Fiscal Year 1998

Introduction

The Centers for Disease Control and Prevention (CDC) announces the availability of funds for fiscal year (FY) 1998 for cooperative agreements with national organizations that serve one or more of the following special targeted populations: African-Americans, Hispanics/Latinos, Asians/Pacific Islanders, and youth, especially males (ages 12-24). The purpose of the awards is to improve or initiate tobacco control programs that are culturally appropriate to reduce nicotine addiction and other health related problems associated with the consumption of tobacco, with the ultimate goal of tobacco use reduction.

CDC is committed to achieving the health promotion and disease prevention objectives of Healthy People 2000, a national activity to reduce morbidity and mortality and improve the quality of life. This announcement is related to the priority area of Tobacco. (For ordering a copy of Healthy People 2000, see the section Where To Obtain Additional Information.)

Authority

This program is authorized under section 317(k)(2) and 317(k)(3) [42 U.S.C. 247b(k)(2) and 247b(k)(3)] of the Public Health Service Act, as amended.

Smoke-Free Workplace

CDC strongly encourages all grant recipients to provide a smoke-free workplace and to promote the nonuse of all tobacco products, and Public Law 103-227, the Pro-Children Act of 1994, prohibits smoking in certain facilities that receive Federal funds in which education, library, day care, health care, and early childhood development services are provided to children.

PPM 5310-10

POLICIES & PROCEDURES MANUAL

Comptroller of the Currency
Administrator of National Banks

Section: Enforcement and Compliance

Subject: Guidance to Examiners in Securing Access to Bank Books and Records

TO: All Examining Personnel

PURPOSE

The purpose of this issuance is to provide guidance to examiners when they encounter situations where a bank resists or refuses their requests to interview bank staff or review the bank's books and records. It discusses the OCC's statutory authority for access to bank information and records, reviews tactics that are sometimes used to obstruct examinations, sets forth the procedure to be followed when a "red flag" is identified, and lists remedies that examiners have when they encounter potential obstruction of an examination. Finally, it answers some commonly raised questions.

REFERENCE

Statute (12 USC 481). *(See* attached appendix.)

SCOPE

This issuance applies to all examining personnel.

POLICY

While national banks are generally forthcoming and cooperative in providing examiners access to books and records or other information needed to carry out their supervisory responsibilities, occasionally, a bank will resist or refuse such requests. When this happens, the bank's rationale for not complying with the request may be based on the alleged disruption or burden involved, or similar concerns. In some cases, however, the resistance or refusal may be based on the bank management's desire to conceal the true condition of the institution or to prevent discovery of improper conduct. It is important in all such situations for examiners to assure that they have access to the information they believe is necessary for them to carry out their responsibilities, and to understand clearly the extent of their authority to obtain access to needed information.

By statute (12 USC 481), examiners are entitled to prompt and unrestricted access to a bank's books, records, and staff. From time to time, examiners have encountered situations where bank management is reluctant or unwilling to give them such access. In some cases, this occurs due to a lack of understanding of the relevant legal authority on the part of bank management. Such problems can often be quickly resolved by having the examiners review the OCC's statutory authority with bank management as soon as the issue arises. However, in other cases, bank management's reticence may be an attempt to conceal fraud, derogatory information, or insider abuse. Resistance from bank management may be most likely to occur in an institution that may be in a worse condition than current CAMELS ratings indicate. Examiners should be alert to such behavior, regard it as a "red flag" indicating potentially serious problems, and follow up accordingly.

Statutory Authority

Under 12 USC 481, OCC examiners have complete and unfettered access to a bank's books and records during an examination. In some circumstances, examiners may also review the books and records of bank affiliates and subsidiaries. In addition, examiners have access to the books and records of bank service companies, and to the books and records of independent servicers that pertain to the services that are subject to the Bank Service Company Act. 12 USC 1867. (However, if a bank affiliate or subsidiary is "functionally regulated" by the Securities and Exchange Commission, the Commodities Futures Trading Commission, or a state insurance department, certain restrictions apply on the OCC's examination authority with respect to that entity. Examiners should consult with their district counsel before attempting to access books and records of such an affiliate or subsidiary.)

Where appropriate, examiners should remind bank management that the OCC may use its enforcement tools (*e.g.*, cease and desist and temporary cease and desist orders, and civil money penalty assessments) to obtain management's compliance with these access provisions. Concealment of the bank's books and records from an examiner is also grounds for a conservatorship or a receivership. 12 USC 1821(c)(5)(E). Furthermore, examination obstruction may subject individuals to criminal prosecution. (*See* 18 USC 1517.)

Red Flags

An unwillingness or resistance to allow examiners access to bank information may be an indicator that the bank is attempting to conceal evidence of violations of law or unsafe or unsound practices, or prevent examiners from discovering the bank's true financial condition. Examiners should learn to recognize the "red flags" and respond appropriately as described below.

The following are examples of some "red flags":

- **Delay Tactics.** Sometimes, banks do not provide requested information within a reasonable time period. For example, the examiner is told that the only staff member who knows where the records are is unavailable at that moment and will continue to be unavailable indefinitely. Or, the examiner is told that the particular computer with the necessary records is urgently needed for other purposes and cannot be made available to the examiners. Another example is if the examiner is told that the requested records are located off-site and there will be a lengthy delay in obtaining them. While examiners should always use judgment in evaluating the credibility of bank management's assertions, in cases where the examiner suspects obstruction, his or her response should be polite but firm: Unreasonable delays will not be tolerated.

- **Screening Tactics.** Banks may try to prescreen the documents that examiners need to conduct the examination. The bank may insert a screening agent, *e.g.*, bank counsel, requiring that the examiner request documents in advance, and in some detail, through the agent. While in some cases it is appropriate for bank counsel to review the documents in advance, *e.g.*, where legitimate privilege issues are raised, in other cases the bank's intent may be to sanitize requested documents before the examiner sees them. (*See* Alteration of Records.) This tactic is also unacceptable.

- **Access to Relevant Third-Party Records.** Banks may try to prevent examiners from accessing directly relevant books and records that are maintained for the bank off-site by third parties, such as servicers. If a bank tries to block access to relevant documents maintained by third parties, the examiner should consider whether this is being done to prevent the examiner from obtaining information that is important to the examination, or to otherwise conceal the bank's true condition.

- **Alteration of Records.** Banks or bank employees may attempt to alter records prior to the examiners' review to prevent the examiners from discovering significant losses, fraud, or insider abuse. They may also remove key documents from files, destroy records, or create required records (also known as "file stuffing"). These tactics are illegal and subject to criminal prosecution.

- **Removal of Records.** Bank management may remove important documents from bank offices and hide them from examiners off-site. This conduct will only be discovered when examiners remain alert to the fact that it may be occurring, and persistently follow up on staff comments and cross references to missing documents in other materials. This conduct could violate several criminal statutes.

- **Attacks on Examiners' Credibility.** Banks have attempted to neutralize negative findings by attacking the credibility of individual examiners. The best defense to this tactic is prevention. Use good judgment, comply with policy, always maintain a professional tone and demeanor, have another examiner present during important or potentially hostile meetings with institution staff, and document the outcome of such meetings. Firmness should be accompanied by a tactful and balanced – but persistent – manner. The OCC will not tolerate attempts to intimidate its examiners.

PROCEDURE

Whenever an examiner encounters situations like those noted above, the examiner should immediately discuss the problem with his or her EIC, ADC or deputy comptroller, and district counsel to seek a quick resolution to what could be a simple misunderstanding. The examiner should explain to bank management the statutory authority for gaining access to the bank's books and records. (A list of the legal authorities governing examiner access to information, which can be shared with bank management, is attached.) If access is not secured, or the situation is not resolved, then the examiner, together with his or her EIC, ADC or deputy comptroller, and district counsel should consider the remedies listed below. Other divisions of the Law Department will become involved as appropriate.

The examiner should fully document all instances where the bank's resistance or refusal to provide access to its books, records, or staff has become an impediment to conducting the examination.

Remedies

There are several tools available for a prompt and complete remedy. The right response depends on the specific facts relating to the conduct that the examiner encounters. The available remedies include:

- Reviewing the applicable statutes compelling prompt and complete access with the bank's management and board and politely, but firmly insisting on compliance. This might involve arranging a meeting of the board with the EIC, ADC or deputy comptroller, and district counsel present.

- Delivering a letter instructing the bank to comply promptly with examiner requests for information, or face formal enforcement action.

- Serving an administrative subpoena on the bank requiring production of the requested documents and, if necessary, enforcing the subpoena in U.S. district court. 12 USC 481, 1818(n), and 1820(c).

- Issuing a temporary cease and desist order requiring that inaccurate or incomplete records be brought immediately to a complete and accurate state. 12 USC 1818(c)(3)(A).

- Where appropriate, and in conjunction with the remedies listed above, filing a suspicious activity report for obstructing the examination (18 USC 1517), conspiracy to defraud the

United States by obstructing the examination (18 USC 371), or making false entries and statements to defraud the institution or deceive the regulators (18 USC 1001 and 1005).

- In extreme cases, appointing a conservator or receiver based on the institution's concealment of records and obstruction of the examination. 12 USC 1821(c)(5)(E).

- Also in extreme cases, or where other remedies have been exhausted, revoking the bank's charter if the bank refuses to provide information required in the examination of an affiliate, or refuses to permit such an examination. 12 USC 481.

QUESTIONS and ANSWERS

Question: What should an examiner do if a bank refuses to provide him or her with direct access to any records?

> **Answer:** The examiner should inform bank management that 12 USC 481 explicitly states that examiners are appointed by the Comptroller and, as such, are authorized to conduct a thorough examination of a bank's affairs. Therefore, bank management must provide the examiner with prompt and complete access. If bank management still refuses to do so, the examiner should consult with his or her EIC, ADC or deputy comptroller, and district counsel.

Question: What should an examiner do if bank management tells the examiner that the documents that he or she requested are inaccessible because they are in remote storage off-site?

> **Answer:** The examiner should inform bank management that that they must advise the examiner of the documents' specific location and retrieve them promptly. 12 USC 481.

Question: What should an examiner do if a bank tells him or her that it has no underwriting records on a loan?

> **Answer:** The examiner should inform bank management that the bank may be cited for an unsafe or unsound banking practice, and proceed with a more thorough review of this asset. The examiner should remain alert to the possibility that the documents exist, but are being withheld. Staff comments or documents in other files might indicate the missing records actually were created. Like withholding documents, failure to create and maintain critical documents is a "red flag" indicating possible fraud, insider abuse, or financial manipulation. The examiner should keep his or her EIC, ADC or deputy comptroller, and district counsel closely apprised of the matter.

Question: What should an examiner do if he or she requests documents during a targeted examination and is denied access because it is not a regularly scheduled, full-scope examination?

Answer: The examiner should inform bank management that, under 12 USC 481, the bank is required to give any examiner – including safety and soundness, compliance, trust, and information systems examiners – prompt and complete access to all bank records and personnel during any examination. The authority is not limited to examinations of a specific length, scope, or type.

Question: What should an examiner do if he or she requests accounting records on a particular transaction, and is denied access by a bank's auditor based on an assertion of accountant-client privilege?

Answer: The examiner should inform bank management that no such privilege is recognized under federal law. Prompt and complete access to the documents must be provided. The examiner should notify his or her EIC, ADC or deputy comptroller, district counsel, and the chief accountant because this may be an ethical or contractual breach by the auditor. Recognized privileges which may be asserted include the attorney-client and attorney work-product privileges. Whether or not one of these privileges applies in any given situation requires a legal and factual analysis. If the bank asserts a privilege claim, the examiner should consult with his or her EIC, ADC or deputy comptroller, district counsel, and the director of the Litigation Division.

Question: What should an examiner do if a bank denies his or her request outside of an examination for access to the documents necessary to perform a status update on a large, troubled loan?

Answer: The examiner should inform bank management that he or she is working to determine the condition of the bank in the course of supervision. The bank must provide prompt and complete access to all relevant documents and records of any type.

Question: What should an examiner do if bank management states that the examiner may review copies of loan files maintained on its computer, but may not review originals, because the originals are stored off-site in a remote facility for safekeeping and cannot be retrieved without considerable expense?

Answer: The examiner should consider whether this is an unacceptable screening tactic. The examiner has not received assurances that the copies are exactly the same as the originals, or that the originals have all the required disclosures and signatures. Further, the examiner has no assurances that the originals ever existed, or still exist. Additionally, the bank's computer may be tracking which documents the examiner is retrieving, permitting the bank to review and "correct" any problems with the originals before the examiner sees them. Under 12 USC 481, the bank must provide the examiner with prompt and complete access to all relevant documents of any type (including originals) wherever those documents may be.

Question: What should an examiner do if a bank's board of directors refuses to allow him or her to observe their meetings, citing reasons such as highly confidential merger discussions, personnel issues, or the like?

> **Answer:** The examiner should inform the directors that the bank is obligated to allow the examiner to attend the meeting. Additionally, the examiner may remind the directors that, as an examiner, he or she is prohibited from disclosing or permitting the disclosure of proprietary or confidential bank information obtained through the OCC's examination and supervision functions. (*See* 18 USC 1905 and 1906, and 12 CFR Part 4.)

Question: What should an examiner do if a bank designates a particular employee to help the examination team to find and locate documents, but that individual is frequently unavailable to assist?

> **Answer:** The examiner should inform bank management that it may be appropriate for the institution to designate an individual to assist the examination team, as long as the arrangement provides the examiner with prompt and complete access to records and staff. The examiner should insist upon access to information within a reasonable time period. In some circumstances, a "reasonable" time period may require immediate access to information.

Question: What should an examiner do if a bank (a) requires that outside counsel review requested documents for privilege before producing them for the examiner's review, or (b) insists that an attorney be present when he or she wishes to interview an employee?

> **Answer:** In both cases, the examiner should alert his or her EIC, ADC or deputy comptroller, and district counsel. With respect to (a), the examiner should insist that counsel's review be conducted quickly and without unreasonably delaying the examiner's access to the documents. If documents are withheld based on claims of privilege, the examiner should discuss the issue with his or her district counsel and the director of the Litigation Division. While, under 12 USC 481, examiners have complete access to the bank's books and records, there are some situations where the bank may assert valid privileges with respect to its documents. Whether or not the bank has a valid privilege claim can only be determined on a case-by-case basis, after considering the specific facts at hand. With respect to (b), depending on the circumstances, this may be an unacceptable restriction on the examiner's access to information. The examiner should consult with his or her EIC, ADC or deputy comptroller, and district counsel.

Question: What should an examiner do if a bank wants to tape record meetings and conversations with the examiner?

> **Answer:** Audiotaping or videotaping meetings and conversations is often used as an intimidation technique. An examiner should not agree to have his or her meetings and

conversations audiotaped or videotaped unless it has been discussed and approved by the examiner's EIC, ADC or deputy comptroller, and district counsel.

Question: What should an examiner do if he or she suspects that the examination team's conversations are being secretly recorded or subjected to electronic eavesdropping by bank employees or officials?

> **Answer:** The nonconsensual recording of a person's conversations, and electronic eavesdropping, are both serious, and potentially illegal, invasions of privacy that should not be tolerated. The examiner should immediately bring the matter to the attention of his or her EIC, ADC or deputy comptroller, and district counsel.

Question: What should an examiner do if he or she is subjected to abusive behavior on the part of bank employees or officials?

> **Answer:** The OCC will not tolerate the abuse of its employees. If an examiner is subjected to abuse by a bank employee or official, the examiner should document the incident, and immediately report the matter to his or her EIC, ADC or deputy comptroller, and district counsel.

Emory W. Rushton
Senior Deputy Comptroller
for Bank Supervision Policy

Attachment

Appendix

- Institutions are required to give examiners prompt, full access to all records and staff during any examination.

  Twelve USC 481 states: "The Comptroller of the Currency . . . shall appoint examiners who shall examine every national bank as often as the Comptroller of the Currency shall deem necessary. The examiner making the examination of any national bank shall have the power to make a thorough examination of all the affairs of the bank and in doing so he shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency."

- Examiners have access to the records and staff of service providers:

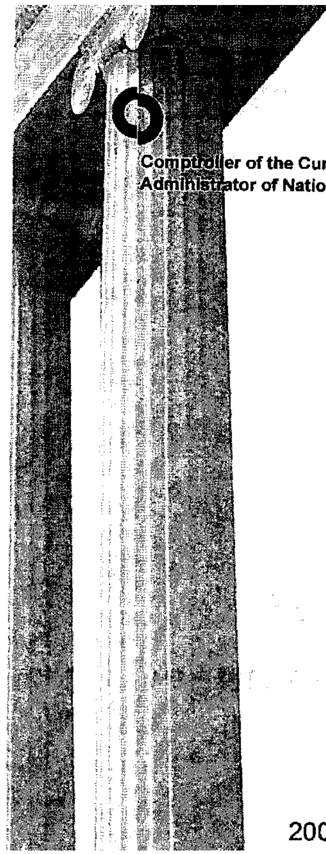
  Twelve USC 1867(a) provides that the OCC may examine and regulate services performed by a bank service company "to the same extent as its principal investor." Twelve USC 1867(c) states that the OCC may regulate and examine the performance of services by independent servicers "to the same extent as if such services were being performed by the bank itself on its own premises."

  [Note that the OCC's authority to examine servicers is limited if the servicer is a subsidiary or affiliate of the bank that is "functionally regulated" by the Securities and Exchange Commission, the Commodities Futures Trading Commission, or a state insurance department.]

- Obstructing an examination is a felony:

  Eighteen USC 1517 states: "Whoever corruptly obstructs or attempts to obstruct any examination of a financial institution by an agency of the United States with jurisdiction to conduct an examination of such financial institution shall be fined under this title, imprisoned not more than five years, or both."

Comptroller of the Currency
Administrator of National Banks



Derivatives Basics and Bank Supervision

A Discussion by Michael Kirk, Large Bank Supervision

2008

Produced in collaboration with Continuing Education and Communications

The contents of this discussion are segmented into three areas:

Basic Definitions

Risk Measures

Risk Management

Each segment can be viewed separately

Objectives

- Develop skills for supervising complex products and businesses
- Describe basic definitions
- Identify the Risk Measures
- Identify Risk and Risk Management Techniques

Basic Definitions

What are derivatives?

- **A derivative is a:**
  - **contract between two parties.**
  - **the value of this contract is a function of (*derived* from) the level of one or more underlying variables.** 1148
  - **the variables themselves do not need to be tradable.**

- **Can be OTC or exchange traded.**

What are derivatives - continued?

- The variables do not need to be market based but must be measurable. Examples are:
  - Financial prices (interest rates, equity prices, credit, FX etc).
  - Commodities (precious metals, energy, base metals, agricultural etc.).
  - Weather (temperature, rainfall level etc.).
  - Economic (inflation, GDP etc.).
- Derivatives can range from being simple to extremely complex contracts.

Why are derivatives so important?

- Hedging—using a derivative to offset or reduce risk
  - One of the earliest examples: agricultural futures
  - e.g. corn farmer expects harvest in six months, has to invest money now to grow crop but is worried about prices falling ------> sells corn forward on futures market to lock in price 1150

- Speculation—taking an open position with a view to making money
  - Derivatives can be attractive v. cash market
    - Little or no immediate cash outlay, so large potential leverage
    - Can use options to speculate; potential loss limited to premium amount

Why are derivatives so important?

- Arbitrage—lock in "riskless" profit by simultaneous purchase and sale of offsetting instruments
  - Arbitrage specialists look for mispricings between different markets and products
- Access - to markets not otherwise available (could be regulatory circumvention) or overly expensive to tap directly
- Leverage

Types of derivatives
Basic

- Futures
- Forwards
- Swaps
- Options

Types of derivatives
Advanced

- Exotics & Hybrids
- "Structured" Products

Futures & Forwards

Futures

- A standardized, transferable, exchange-traded contract that requires:
  - delivery of a commodity, bond, currency, stock, or index (financially settled), at a specified price,
  - on a specified future date. Unlike options, futures convey an obligation to buy/sell.

Futures - continued

- Futures contracts are:
  - forward contracts, meaning they represent a pledge to make a certain transaction at a future date.
  - The exchange of assets occurs on the date specified in the contract.
  - Futures are distinguished from generic forward contracts in that they contain standardized terms, trade on a formal exchange, are regulated by overseeing agencies, and are guaranteed by clearinghouses.

1156

Futures
- continued

- In order to insure that payment will occur, futures have a margin requirement that must be settled daily. Initial margin is placed upon a trade and variation margin is placed/received with fluctuations in the market.
- By making an offsetting trade, taking delivery of goods, or arranging for an exchange of goods, futures contracts can be closed.
- Hedgers often trade futures for the purpose of mitigating price risk.
- Speculators often trade futures to obtain leveraged exposure to an asset or liability.

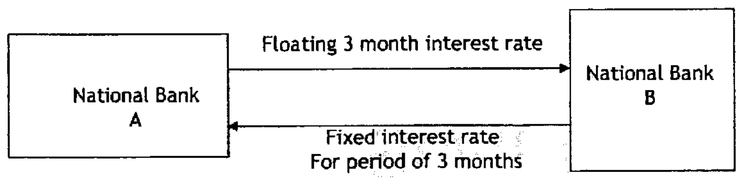
Forwards

- Can be thought of as *customized* futures.
- Distinguished from futures in that they are <u>not standardized</u> contracts, terms are negotiable. They do not trade on a formal exchange (they trade in the over the counter [OTC] market).
- Represent a pledge to make a certain transaction at a future date. The exchange of assets occurs on the date specified in the contract.
- Are unregulated.

Forwards-continued

- Are not guaranteed by clearinghouses and therefore have credit risk (futures do not have significant credit risk).
- Margin may not be required.
- Hedgers and speculators use forwards in a similar manner as futures.
- Simple example is FRA. Receive/Pay a fixed rate and Pay/Receive a floating rate.

Forward Example



1160

Give example & Why someone would do this.

Swaps

Swaps

- A contractual exchange of streams of payments over time according to specified terms. The most common type is an interest rate, in which one party agrees to pay a fixed interest rate in return for receiving a floating rate from another party.

Swaps-continued

- Types of swaps are usually just a function of the underlying:
  - Interest Rate (think of as a portfolio of FRAs).
  - Credit (credit default swaps).
  - Commodity.
  - Asset & Liability.
  - Total Return.
  - Catastrophic events.
  - Debt-Equity.

Swaps-continued

- "Flavors":
  - Vanilla= a fixed stream of payments vs. a floating stream of payments.
  - Basis= Floating vs. Floating. Similar asset but tenors or credit quality differs (examples 3m Libor vs. 6m Libor, CP vs. 3M Libor, Prime vs. 3m Libor).
  - Structured= Packaged to be a structured bond look a like. Also known as synthetic swaps. This type of swap can contain complex, perhaps exotic, cash flows, and typically entails optionality.

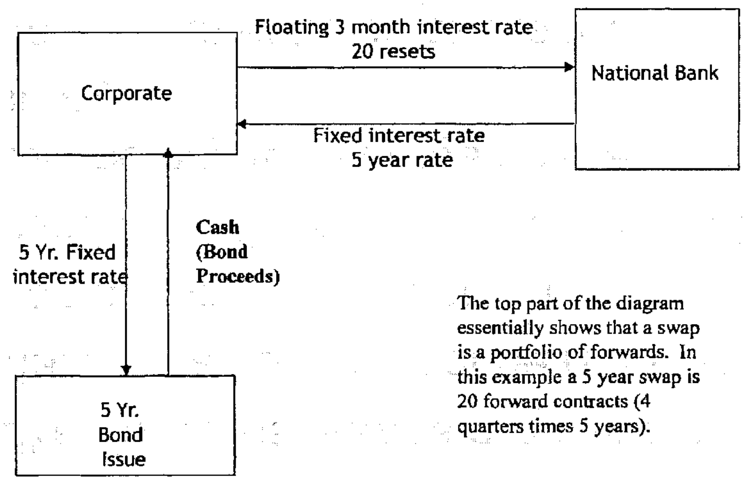
Swaps-continued

- "Flavors":
  - Exotic= Cash flows from one or both legs of a swap are driven by cutting edge complex derivative products and modeling techniques. Usually contain embedded correlation exposure.
  - Quanto= Currency of the underlying reference asset differs from the currency of payments. Examples USD Fixed Rate vs. USD 3m Libor but paid in EUR.

Swaps-continued

- Like Forwards, swaps are customizable.
- Margin may or may not be required.
- Contain both credit and price risk.
- Used by both hedgers and speculators.
- Can be highly leveraged depending upon margin (if any).
- Not regulated by an exchange.
- Payment not guaranteed by clearing houses.

Swap Example

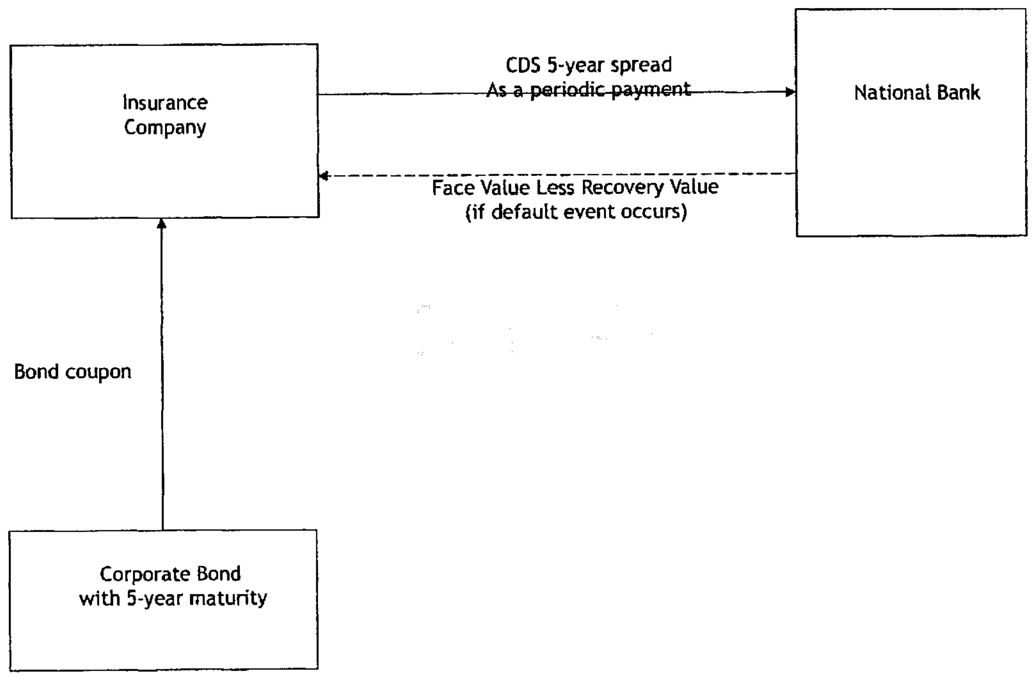


The top part of the diagram essentially shows that a swap is a portfolio of forwards. In this example a 5 year swap is 20 forward contracts (4 quarters times 5 years).

1167

PSI-OCC-27-000054

Credit Default Swap



Options

Options

- Each option has a buyer, called the holder, and a seller, known as the writer.
- Option holders have a right to exercise, option writers have contractual obligations to fulfill if notified of the buyers exercise.
- If the option contract is exercised, the writer is responsible for fulfilling the terms of the contract by delivering or taking delivery of the underlying (or cash if financially settled) to the holder.

Options-continued

- For the holder, the potential loss is limited to the price paid to acquire the option. Upside is unlimited for holders of calls and limited to holders of puts.
- Options have an asymmetrical payoff pattern; futures have symmetrical payoffs.
- Options are most frequently used for leveraged investments or protection.
- When an option is not exercised, it expires worthless.

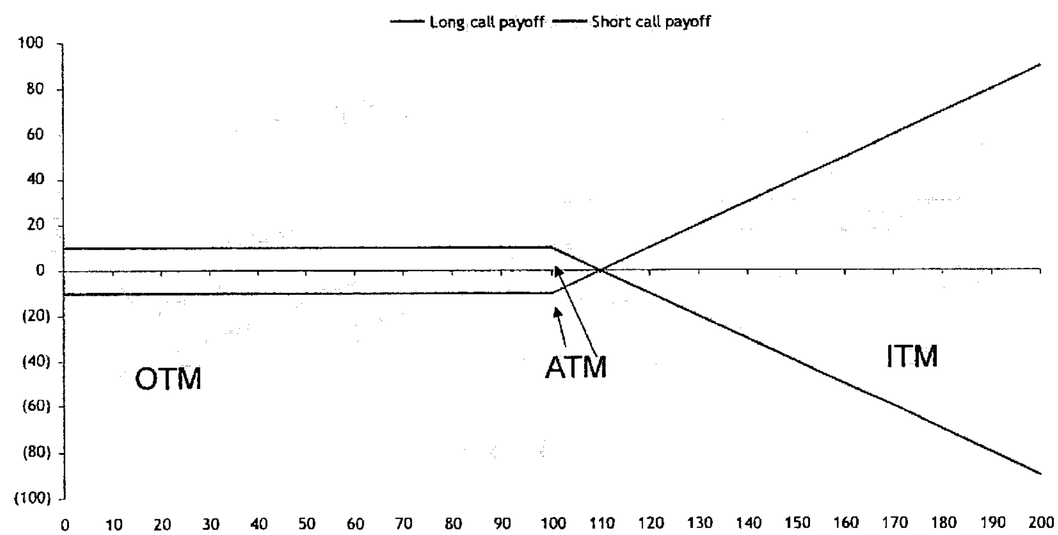
Options Terminology

- Call- The right, but not the obligation, to buy a specific amount of a given stock, commodity, currency, index, or bond, at a specified price (the strike price) during/at a specified period of time or times.
- Put- The right, but not the obligation, to sell a specific amount of a given stock, commodity, currency, index, or bond, at a specified price (the strike price) during/at a specified period of time or times.
- Strike- The specified price in an option contract at which the contract may be exercised; a price at which a call option buyer can buy the underlying or a put option buyer can sell the underlying.

Options Terminology (Continued)

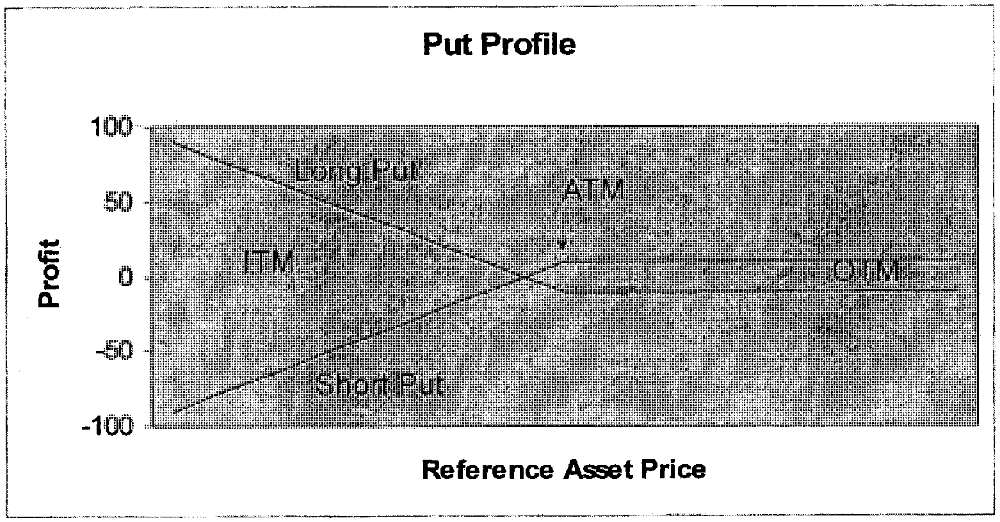
- Premium- Price paid to the option seller to acquire the rights conveyed in an option contract.
- Expiration date- If in the money, the date the contract takes effect; else the day it "matures" worthless.
- Exercise date- The date (s) an option right may be executed.
- Underlying. The reference item that the right to buy or sell is referring to.

Call Profiles



1174

Put



Put Profile
Profit
100
50
0
-50
-100
Long Put
Short Put
ITM
ATM
OTM
Reference Asset Price

Options

- Options can be exchange traded or OTC.
- Exchange Traded Options [ETO] are standardized, transferable contract that requires delivery of a commodity, bond, currency, stock, or index (financially settled), or cash if financially settled, at a specified price, on a specified future date. Unlike futures, options convey a right to the buyer and an <u>obligation</u> to the <u>seller</u> if the buyer exercises the option.

Options

- ETO are regulated by overseeing agencies, and are guaranteed by clearinghouses; OTC options are not.
- In order to insure that payment will occur for ETOs, they have a margin requirement that must be settled daily. Initial margin (Generally, the option premium) is placed upon a trade and variation margin is placed/received with fluctuations in the market. OTC options may or may not have margin provisions.

Options

Mechanics

More on Options

- By making an offsetting trade ETO contracts can be closed. OTC options generally can be assigned (novated) or closed out with the writer. (See example).
- Hedgers often trade options for the purpose of mitigating price risk. (See example).
- Speculators often trade options for the purpose leveraged exposure to an asset or liability. (See example).

Closing of an OTC option position
Example of Close Out.

- Party A originally purchased an option from party B for $10.
- Party A's option is now worth $25 due to changes in reference asset. Therefore has a mark to market gain of $15.00
- Party A can *close out the* trade with Party B if Party B and Party A agree on a price, say $15.

Example of Assignment (Novation)

- If Party A and Party B cannot agree on a price, or if Party B is unwilling/unable to close out the contract, Party A can ask Party B if the contract can be assigned.
- If Party B allows assignment, Party A can go to the market place to find a buyer for Party A's option contract. If a suitable price is obtained (say $25), Party A sells the option contract to Party C, with the understanding that the option writer is being assigned and known to be Party B.
- If assignment is not possible Party A can offset the option position with a new option trade with an other market participant.

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Novation
Confirmation Process

- Party A sends counterparty B written notification of assignment of Party A's rights to Party C. Party A sends a confirmation to Party C inclusive of the contract details and information pertaining to contract writer- Party B.
- Party A is now out of the contract and the contract is now between Party B and Party C.
- Party C will affirm and confirm trade with Party A. Party C will confirm assignment and contract details with Party B. Party B will issue a revised confirmation to Party C recognizing counterparty assignment (original confirmation was between Party A and Party B). Party B will send written notification to Party A acknowledging assignment to Party C.

Options

Hedging & Speculation

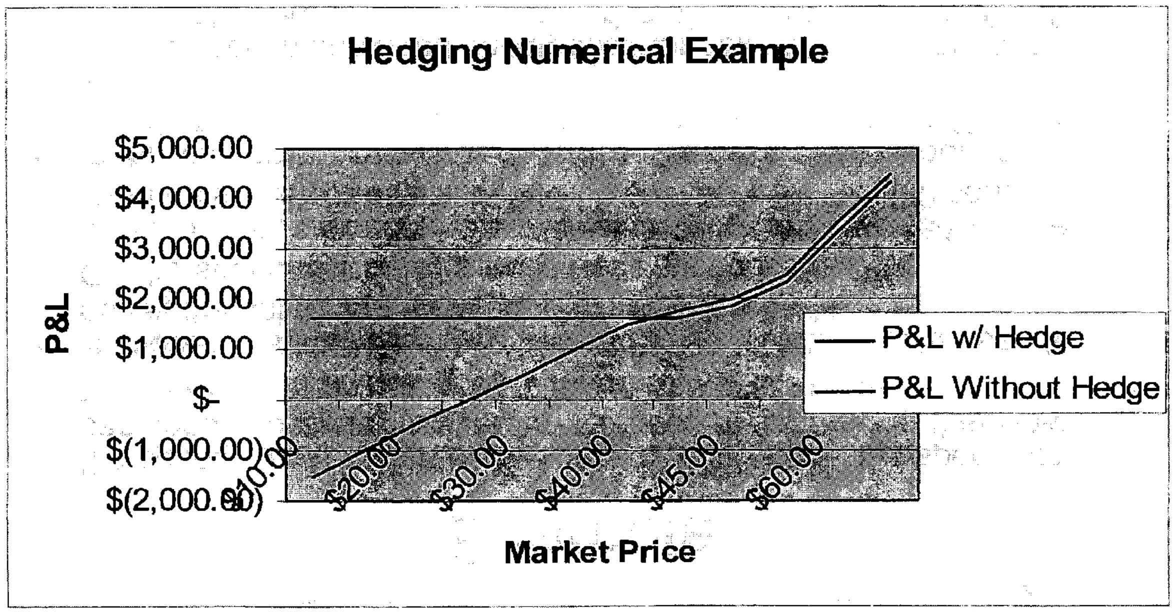
Hedging Price Risk
Example

- An investor owns 100 shares of JPMC stock at a purchase price of $25. The current market price is $45.
- The investor is believes that the stock can rise further, but wants to lock in part of the profits.
- The investor purchase a 1 Month Put option with a strike of $42.50 for $1.50
- For the next month the investors profit is locked in at a <u>minimum</u> of $1,600. ((strike – premium)- cost basis of stock position) * 100 shares (($42.50-$1.50)-25) * 100.
- The investors profit is not limited by this strategy, however the upside gain is reduced by the premium spent for the option hedge.

Hedging Price Risk Example
Numerical Example

Market Price	Cost/share	option strike	option premium	P&L per 100 shares with hedge	P&L per 100 shares w/o hedge
$ 10.00	$ 25.00	$ 42.50	$ 1.50	$ 1,600.00	$ (1,500.00)
$ 15.00	$ 25.00	$ 42.50	$ 1.50	$ 1,600.00	$ (1,000.00)
$ 20.00	$ 25.00	$ 42.50	$ 1.50	$ 1,600.00	$ (500.00)
$ 25.00	$ 25.00	$ 42.50	$ 1.50	$ 1,600.00	$ -
$ 30.00	$ 25.00	$ 42.50	$ 1.50	$ 1,600.00	$ 500.00
$ 35.00	$ 25.00	$ 42.50	$ 1.50	$ 1,600.00	$ 1,000.00
$ 40.00	$ 25.00	$ 42.50	$ 1.50	$ 1,600.00	$ 1,500.00
$ 42.50	$ 25.00	$ 42.50	$ 1.50	$ 1,600.00	$ 1,750.00
$ 45.00	$ 25.00	$ 42.50	$ 1.50	$ 1,850.00	$ 2,000.00
$ 50.00	$ 25.00	$ 42.50	$ 1.50	$ 2,350.00	$ 2,500.00
$ 60.00	$ 25.00	$ 42.50	$ 1.50	$ 3,350.00	$ 3,500.00
$ 70.00	$ 25.00	$ 42.50	$ 1.50	$ 4,350.00	$ 4,500.00

Hedging Price Risk Example



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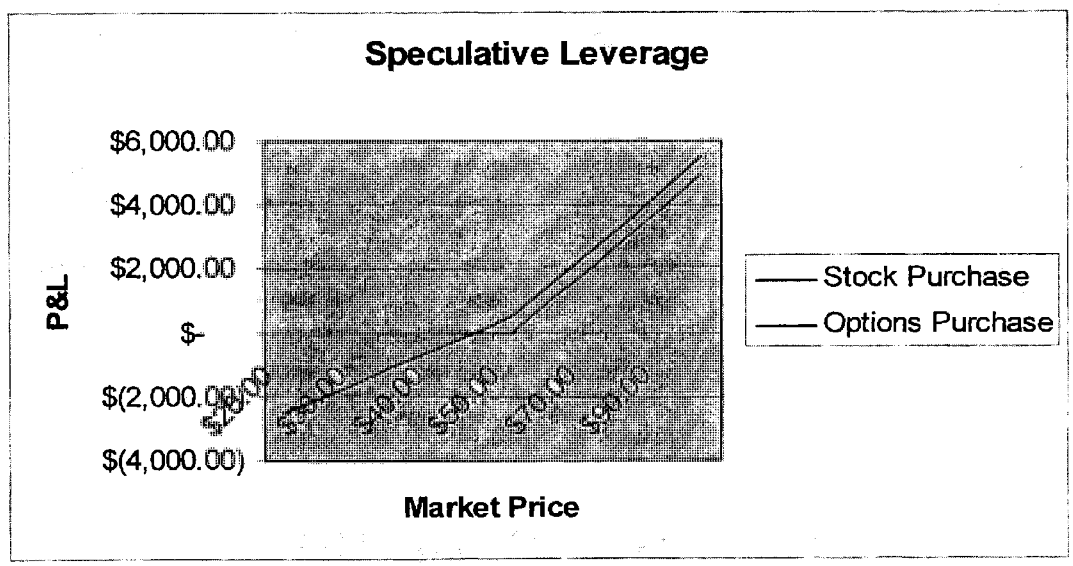
Options for speculative leverage Example

- If a speculator is bullish on the price of JPM stock, the speculator can choose between numerous methods of expressing that view.
- The simplest is an outright purchase of a JPM shares.
- However, that can be expensive as the speculator would need to outlay the entire purchase price to settle the trade.
- Or, the speculator could purchase call options on JPM.
- In our previous example the market price for JPM was $45. One month call options struck at $50.00 cost only $0.30. (30 cents).
- In this example, per hundred shares, the cash outlay would be $4,500 for the outright purchase and only $30.00 for the $50 call purchase.
- With an option purchase, the speculator risks only $30, but can enjoy unlimited gains should the price of JPM rally above $50.00.
- In an outright purchase the speculator is subject to liquidation and market risks, and therefore the entire purchase price is at risk.

Options for speculative leverage
Numerical Example

Market Price	Alt # 1 Stock purchase Stock purchase Cost/share	Alt. # 2 Buy Call option strike	Alt # 2 Buy Call option premium	P&L per 100 shares Alt # 1	P&L per 100 shares Alt # 2
$ 20.00	$ 45.00	$ 50.00	$ 0.30	$ (2,500.00)	$ (30.00)
$ 25.00	$ 45.00	$ 50.00	$ 0.30	$ (2,000.00)	$ (30.00)
$ 30.00	$ 45.00	$ 50.00	$ 0.30	$ (1,500.00)	$ (30.00)
$ 35.00	$ 45.00	$ 50.00	$ 0.30	$ (1,000.00)	$ (30.00)
$ 40.00	$ 45.00	$ 50.00	$ 0.30	$ (500.00)	$ (30.00)
$ 45.00	$ 45.00	$ 50.00	$ 0.30	$ -	$ (30.00)
$ 50.00	$ 45.00	$ 50.00	$ 0.30	$ 500.00	$ (30.00)
$ 60.00	$ 45.00	$ 50.00	$ 0.30	$ 1,500.00	$ 970.00
$ 70.00	$ 45.00	$ 50.00	$ 0.30	$ 2,500.00	$ 1,970.00
$ 80.00	$ 45.00	$ 50.00	$ 0.30	$ 3,500.00	$ 2,970.00
$ 90.00	$ 45.00	$ 50.00	$ 0.30	$ 4,500.00	$ 3,970.00
$ 100.00	$ 45.00	$ 50.00	$ 0.30	$ 5,500.00	$ 4,970.00

Speculative Leverage



Options

Types

Generic Option Types

- European= Can only be exercised on the expiration date.
- American=Can be exercised at anytime prior to expiration.
- Bermudan= Can be thought as a special case of an American option; they can be exercised at specific points in time (more than one) between the time the option is written and expiration.

Generic Option Types-continued

- Asian=Underlying price is calculated as an average price of the reference asset over some period of time. Note: the averaging time period does not have to be the same as the time period to expiration.
- Barrier= A trigger point that can cause an option to be terminated or to take effect. Examples are Knock In options and Knock Out options. Barrier can also be specified as one touch, multiple touch, or breach. Knock In options are options that become effective only after the barrier is actuated; Knock Out options terminate when the barrier is actuated. Barrier options often are used to reduce the cost of purchasing a more traditional option.

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Generic Option Types (Continued)

- Exotic= Could contain correlation, may involve path dependency such as a look back option.
- Compound= Options on options. Also known as Power Options.
- Spread Option= Also known as Diff Options. These are options on the difference between two distinct reference assets/liabilities.
- Quanto=Referenced Underlying Asset is in a currency other than the currency exchanged upon exercise for financially settled options.

Risk Measures

“The Greeks”

The Greeks

- Terminology can vary by market and by the organization. However, most shops measure most of the following "greeks" depending the referenced product (not all *greeks* relate to all products). Delta, Gamma, Rho, & Theta are fairly universal accepted terminology. The others may vary by market and employer.

- Delta- 1st order change in price with respect to the referenced asset.
- Gamma – 2nd order change in price with respect to the referenced asset.
- Vega-1st order change in option price with respect to the volatility of the referenced asset.
- Alpha- 2nd -order change in option price with respect to the volatility of the referenced asset.

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The Greeks-continued

- Theta- 1st order change in option price with respect to time.
- Rho- 1st order change in option price with respect to discount rate.
- Mu- 1st order change in option price with respect to dividends.
- Phi- 1st order change in option price with respect to correlation.
- DDelV- Cross derivative between changes in the underlying and the impact upon Vega. In other words, change in delta given change in volatility.

Delta

- Delta represents the change in price of a derivative for every change in the price of the underlying referenced asset.
- Delta is also called the "hedge ratio" as it is used to hedge the 1st order effect of the underlying assets price exposure.
  Delta- considered to be one **minimum** risk exposure to measure, regardless of the product and institution sophistication level.
- All derivatives have a delta. As delta measures the most basic exposure, change in the price of the derivative resulting from a change in price of the underlying.

Delta (Continued)

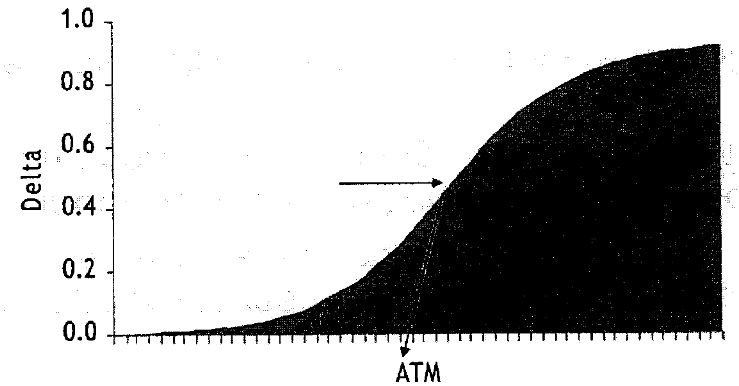
- The delta of a swap is analogous to the duration of a bond, and similarly the gamma of a swap is analogous to the convexity of a bond.
- The delta of a forward contract is essentially 1 (in reality it is less than 1 because it is *discounted* by a discount factor, like one would calculate for determining the present value of a future cash flow.).
- Delta's of options are bounded by 0 and 1, with deep in the money options having a delta of 1 and deep out of the money options having a delta of 0.

Delta (Continued)

- At the money [ATM] options (options where the price of the reference asset equals the strike), have delta's of 0.5.
- Example: If a dealer purchases 100 ATM calls on a particular 5 year US Government bond from a client and wants to have a market neutral position, the dealer would immediately sell 50 of that 5 year US Government bond.
- When dealers are referring to their *position* in the market place, they are generally referring to their delta position. Their delta position is the summation of all of the delta's resulting from their entire derivatives portfolio and all their corresponding underlying hedges.

Option Delta

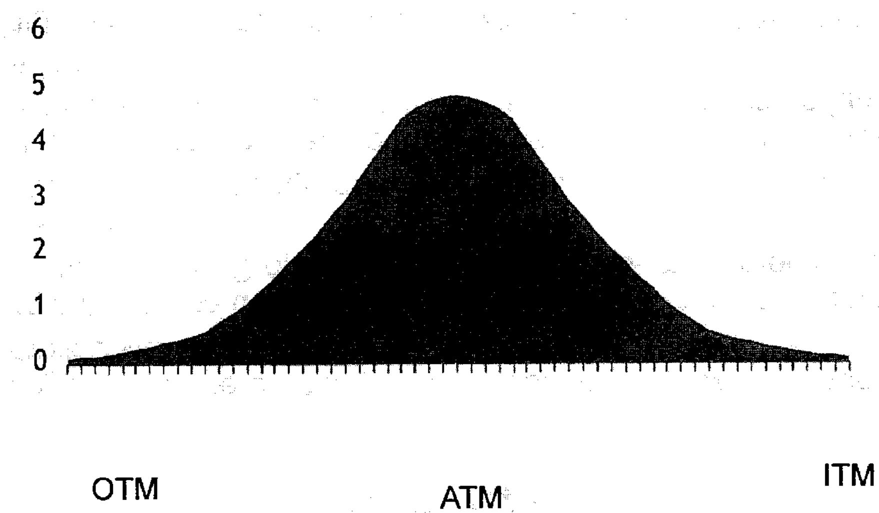
- Profile of option delta by underlying price



GAMMA

- Since many derivatives are non linear, one needs to measure *higher* order effects.
- Non-linear derivatives valuation changes are not at a constant proportion with changes in the level of the referenced asset.
- Non linear derivatives risk exposures are therefore also non-linear.
- Gamma measures the change in the derivatives delta per given change in the referenced asset price.
- Gamma is largest when an option is ATM
- Gamma increases as time decreases, so very short dated options have also have high gamma.

Option Gamma Profile

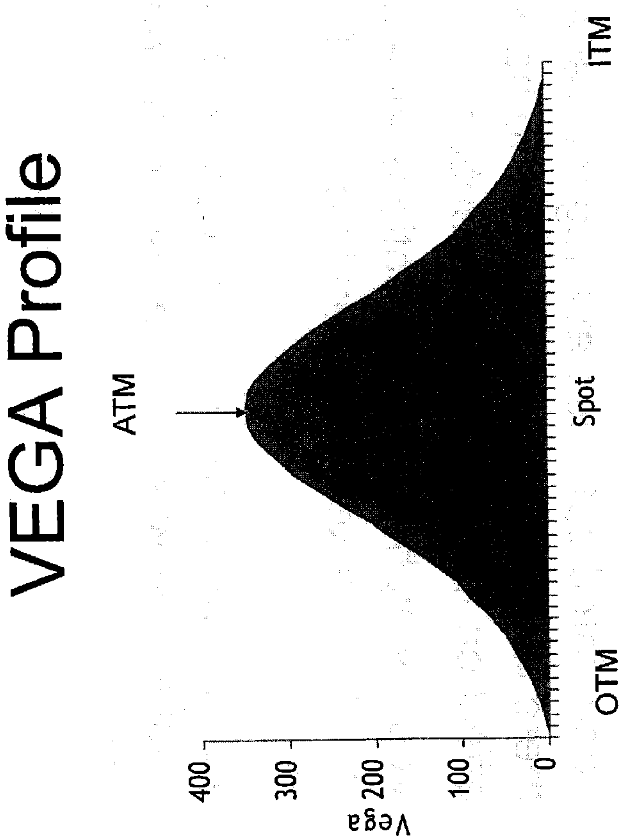


VEGA

- Vega is the rate of change of the option value with respect to implied volatility
- Volatility of the underlying referenced asset is not constant (although the BS option pricing model assumed implied volatility is constant).
- Option prices change due to changes in implied volatility.
- The higher the implied volatility the greater the future dispersion of referenced asset prices and this generally results in higher option prices.
- High Vega means the option is very sensitive to changes in vol.
- Low Vega means the option is not very sensitive to changes in vol.

Vega
(Continued)

- Long dated options have higher Vega as there is more time for volatility to have an effect on the payout of the option
- Vega is higher for ATM options as a change in vol can take the option in or out of the money.
- If a derivative has Vega exposure, then volatility skew/smile is a risk component as well.


VEGA Profile
ATM
Vega
400
300
200
100
0
OTM
Spot
ITM

Discussion on Volatility Measures

- Implied Volatility- forward looking
- Historical Volatility- backward looking
- Realized Volatility-What has occurred during the holding period.

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Discussion on Volatility Measures (Cont)

- Implied Volatility- Is the markets "best guess" at the degree of future variability of a referenced asset <u>for a particular time period</u>. It can be also thought of as the market price of risk. The level of implied volatility is generally the only unobserved variable; therefore it is determined by supply and demand for the option in the market place. 1207
- Historical Volatility is the <u>measured</u> volatility of a referenced asset over a specific previous time frame.

Discussion on Volatility Measures (Cont)

- Realized Volatility is the volatility of the referenced asset from the time a party acquires a derivative instrument to the time the instrument matures/expires or the party liquidates the instrument.
- Profitability of the participants that trade options on a delta neutral basis is driven by the disparity between realized volatility and implied volatility.

ALPHA

- Alpha is the second derivative of an option price with respect to changes in implied volatility.
- Therefore, Alpha measures the change in an options Vega Risk given changes in implied volatilities.
- It is analogous to Gamma which measures the change in the delta position per change in the reference asset.

DDelV

- DDelV is a *cross* derivative.
- It measures the change in a delta position per changes in volatility.
- Participants who run large complex books that contain numerous strikes (particularly for a long dated book that contains many OTM positions) find this risk measure helpful. 1210
- Often times implied volatility changes are driven by changes in the referenced asset prices. Therefore, if one knows the likely short term relationship between implied volatility and the referenced asset one can better position themselves for changes in the delta position due to changes in implied volatilities driven by market moves in the referenced asset.

THETA

- Theta is the rate of change of the option value with respect to time. It is often referred to as time decay because it measures the options decay in value over time.
- Theta generally increases as time to expiry increases.
- Theta is usually negative for purchased options; as the time to expiration decreases options become less valuable.
- Theta is largest for ATM.
- If Theta is large in absolute terms either Delta or Gamma must be large.

THETA
(Cont.)

- For traders there is a risk return trade off between theta positions and their gamma and vega positions.
- Theta measures what an option will make/lose over time. From an options vega position one can calculate the degree of market variability priced into the market.
- If the realized market volatility is higher than implied by an option's vega a trader should be able to trade the resultant gamma positions to recapture theta losses and make further gains.

RHO

- Rho is the rate of change of the option value with respect to changes in interest rates.
- Rho is managed on a portfolio basis.
- Rho is usually small with respect to Delta, Gama, and Vega.

MU

- Mu is the change in an option price given a change in a dividend.
- Mu risk is *hedged* by diversification.
- Mu is risk managed on a portfolio basis.

PHI

- Phi is the change in price given a change in implied correlation.
- As with volatility, there is implied, historical and realized correlation. They are typically NOT equal.
- Phi risk is very difficult to hedge, as correlation based products tend to have asymmetrical supply and demand characteristics. 1215
- In asymmetrical situations assumptions used in pricing become critical; model risks and valuation risks must be closely monintored, and book sizes must be monitored in relation to liquidity.

Market Risks

& Market Risk Management

Market Risk Grid

	Counter Party Credit	Delta	Gamma	Vega	Alpha	DDelV	Theta	Rho	Mu	Phi
Future		✓	*	*						
Forwards	✓	✓						✓		
Generic Bond		✓	✓							
Complex Bond		✓	✓	✓	✓	✓	✓	✓	Maybe	Maybe
Stock		✓								
Currency	✓	✓								
Commodity	Maybe	✓								
Generic Swap	✓	✓	✓					✓		
Complex Swap	✓	✓	✓	✓	✓	✓	✓	✓	Maybe	Maybe
Options	Maybe	✓	✓	✓	✓	✓	✓	✓	Maybe	Maybe
Exotics	✓	✓	✓	✓	✓	✓	✓	✓	Maybe	Maybe
Hybrids	✓	✓	✓	✓	✓	✓	✓	✓	Maybe	Maybe
Structure Products	Maybe	✓	✓	✓	✓	✓	✓	✓	Maybe	Maybe

* special case, interest rate futures contain these elements

Hedging Market Risks

	Hedgeable	Partially Hedgeable	Partially Diversifiable	Non Hedgeable Diversifiable	Non Hedgeable Non Diversifiable
Delta	✓				
Gamma		✓	✓		
Vega		✓	✓		
Skew/Smile		✓	✓		
Alpha		✓	✓		
DDelV		✓	✓		
Theta *		✓			
Rho	✓				
Mu				✓	
Phi					✓

* In practice Theta is not hedged as doing so will alter the desired portfolio, therefore it is accepted.

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Market Risk Measures
Where do they come from?

- Some measures of risk are "derived" directly from the models. These are often referred to as closed form formulas, as they can be directly solved for. An example would be the delta of a European option; it can be solved in a closed form equation supplied in Black & Scholes, 1971.
- Other measures cannot be solved for directly so *numerical* techniques are used. An example of solving for a risk numerically is by bumping a node on binomial tree up and down by a fixed quantity to determine the gamma of an American style option.

Market Risk Measures -continued Where do they come from?

1220

- Not all models are created equally, mathematical assumptions (distributions of underlying assets, drift processes and assumptions can be, and often are, different). This creates a challenge for risk measurement and consolidation.
- So, what do risk professionals do? They rely upon numerous techniques including, derived risk measures, statistical techniques (VAR) and stress tests.

Generic Market Risk Measures

- Generic risk measures are those that can be applied across all assets.
- VAR and Stress are two techniques.
- VAR is a statistical techniques that attempts to capture the maximum loss a portfolio (of either like or unlike assets) is likely to suffer.
- There are two common techniques. Historical simulated VAR and hypothetical simulated VAR.

VAR

- The historical simulation method is used to forecast the expected worst loss from the distribution of 1 years worth (typically) of daily, historical, market returns for the portfolio at a 99% confidence interval.
- Technique requires the maintenance of data for each reference asset and components of valuation (credit spreads, volatilities, correlations, etc.).
- Hypothetical simulated method does not use historical data, but instead relies upon either a standardized sets of assumptions, or a Monte Carlo technique.

VAR-continued

- Both methods are based upon statistical assumptions and are probabilistic.
- VAR distributions assumptions are often violated. Empirical evidence shows daily returns are typically not normally distributed and substantial kurtosis exists (daily losses are larger and more frequent than those predicted by the distribution [*Fat Tails*]).

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Stress

- This technique will revalue a portfolio of assets under adverse conditions in order to forecast a loss.
- Has the advantage of being easily understood.
- Adverse conditions can either be hypothetical, or historical. 1224
- Historical has the advantage of known quantifiable shocks, and impacts upon multiple markets, but suffers from the disadvantage of changing markets, changing behavior of participants, and new products. Examples include Crash of 1987, Russian Debt Crisis and the collapse of LTCM in 1998.

Stress-continued

- Hypothetical has the advantage of simplicity, but suffers from the limits of our imagination. Typically, severe market disruptions occur in manners which were unpredictable. The imaginable is often already hedged against, so by definition the unimaginable is what occurs.
- Recent credit crunch although predictable was ignored in many scenarios due to bubble mania.

Market Risk "Management"

- Control function related to the governance of risk taking.
- Risk Management is generally regarded as an independent function that monitors, and controls the risk taking by front office professionals.
- However qualified they are, this group is generally not actively managing risk. They advise prior to, during, and after risk events. But they do not generally manage risk (except in the case of initiating a overall management hedge to protect the bank from an adverse market environment). 1226
- Front office professionals and senior management initiate and manage market risk.
- Therefore, Risk Management's function is to create the "rules of the game" jointly with senior management based upon loss tolerances.

Effective Risk Management

- Effective risk management is a tremendous topic that cannot be summarized in a few slides.
- Entails:
  - Highly qualified (in the field of risk management as well as highly knowledgeable on the products/markets overseen), assertive, and communicative individuals. 1227
  - Sound, practical, and operationally efficient limit structure.
  - Multiple disciplines (not only market risk, there's model risk, operational risk, valuation risk etc.).
  - Flexibility.
  - Strong stomach.

Effective Risk Management (Cont.)

- Limits include:
  - Non statistical (i.e.delta, basis, term structure).
  - Statistical (VAR).
  - Stress.
- Limits should capture all the core elements of a business, yet not be so complicated that a trader cannot determine where the portfolio is-- versus the limits-- throughout the course of a volatile and busy trading day.
- Limits should not be so large that they are never breached, and should not be too small, resulting in overly frequent breaching.

Effective Risk Management (Cont.)

- Limits design should encourage diversification, and realization of profits.
- Revenue projections should be determined together with limits, taking into consideration senior managements risk tolerances.
- Limits, revenue projections, and business plans (including the annual plan and new business plans) are interrelated and should be determined as such.

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Effective Risk Management (Cont.)

- Is more than just limit setting and monitoring. Examples include:
  - Model risk management.
  - Valuation Risk- inputs, models, parameters.
  - Operational Risk
- Is an ongoing process.

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Risk Oversight

Much more than market risk

Risk Oversight

- Risks stemming from derivatives are numerous and involve multiple disciplines.
- Complexity of business necessitates a multi-pronged strategy of risk mitigation.
  - Silo approach
    - Market Risk
    - Credit Risk
    - Valuation
    - Model
    - Operational
  - Multi disciplined approach.
    - Business Control Committees (involve CFO, Front & Back Offices, Market Risk, Model Research, Model Control, Valuation, Accounting, Legal, etc..)
    - Internal Audit. – Perform regular (annual) audits of high risk areas.
    - Critical Self Assessments. To be done at least semi-annually.

Risk Oversight (Cont.)

- Communication & Culture is critical
  - Is senior management actively involved?
  - Are all facets of the organization communicating with each other effectively?
- Transparency of risks
  - Is information readily available?

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Other Risks

- Counterparty default (credit) risk
- Settlement Risk
- Model Risk
- Valuation Risk
- Operational Risk
- Reputation Risk

Credit Risk

- The risk to a bank whereby a counterparty fails to perform per contractual terms in a derivative transaction is referred to as counterparty default (credit) risk.
- In large complex banks, this risk is overseen by a specialized group of individuals in credit risk management. Smaller banks may combine this function with market risk management.
- Can be mitigated with (by):
  - Initial margin + variation margin (stronger if one way).
  - Legal documentation stipulating netting, default procedures, etc.
  - Credit default swaps.
  - CP exposure limits.

Credit Risk

- Credit exposure of derivative is always uncertain
- Depends on direction of movement of underlying market variable(s)
- Depends on amount of movement (a function of its volatility)
- Can be very complex to predict (i.e. value of equity option dependent not just on share price, but also volatility, interest rates, dividends, etc)
- Usually a fraction of the trade notional. But, unlike a loan it can sometimes be greater than the notional amount!

Credit Risk Measures/Terminology

- Peak and average exposures are both estimates of future Mark to Market exposure but use different levels of conservatism. Peak exposure: Is the “near worst case” exposure that could arise during the life of the trade
  - Peak is generally used in gross thresholds
  - Average exposure: Is the expected exposure of the derivative during the life of the trade
    - This is a “best estimate” of the exposure
    - Calculated as probability weighted average MTM over all possible future market scenarios
    - Average used to calculate credit charge (i.e. the minimum profitability to cover credit risk)
  - Derivative Risk Equivalent (“DRE”): Is a calculation of the amount of loan that would give the same credit risk capital as that derivative

DRE

- That is, DRE is a measure that allows a fair comparison with a loan exposure (so approving $50mm of DRE for a derivative and a $50mm loan should be comparable risks)
- DRE is a risk adjusted function of average exposure, it equals Average Exposure plus an add-on for the variability of exposure of the derivative, adjusted for the riskiness of the counterparty
- It is a stress based measure at some high confidence level (generally 97.5%).
- DRE is generally used for counterparty credit lines and approvals as well as Net Threshold
- Peak is always ≥ DRE ≥ average. Typically DRE is around half of Peak.

Model Risks

- The risk to a bank that results from a model not adequately capturing all of the relevant drivers of valuation in all adverse market environments.
- Risks that new models are developed supplanting existing models, but produce material impacts upon valuations.
- Complex products and associated models evolve through time. Improvements take time to be developed and implemented.
- Adverse market environments will demonstrate model weaknesses.
- How mitigate:
  - Large complex banks employ independent model reviewers that review models produced by derivatives research model developers.
    - Ensure sufficiently documented, so can be replicated upon staff turnover.
    - Error checking.
    - Testing for model effectiveness- does it measure what it purports to measure? Do risk measures account for changes in valuations? Test for limitations across reasonable input range. Back test against actual results.
  - Place limitations and market exposure upon use until concerns alleviate.

Valuation Risk

- Like many risks, valuation risk is not an island. It is closely related to market risk and model risk.
- This is the risk that considerable uncertainty surrounds the valuation of a derivative contract.
- Could result from:
  - Lack of information (illiquid markets).
  - Lack of transparency (deals occur but there is a multi- tiered market. More significant risk for smaller players).
  - Product complexity
  - Model simplicity or complexity (model short comings)
  - Unobservable parameters (correlations, prepayment speeds)

Valuation Risk (Cont.)

- Valuation Risk is mitigated by:
  - Independent Valuation Managers—separate and independent from line of business. This function may reside in either Finance or Market Risk.
  - Independent market prices-preferably not broker quotes.
  - Random market polling.
  - Reserves and adjustments to income.
  - Limitations on growth of business in complex illiquid products until senior management is comfortable with control environment/or acceptable risks.
  - Ensuring Accounting Policy group is consulted when developing policies and procedures.

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Operational Risk

- Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.
- Like all of the previous risks (credit, model, valuation) operational risks are significant.
- Operational risks result from the failure of the bank to perform according to its responsibilities.
- Could result in:
  - Opportunities for fraud by insiders who are aware of lack of operational controls. 1242
  - Penalties for failure to report, perform, or otherwise.
  - Interest charges for late payments.
  - Inadvertent default.
  - Failure to exercise a contract, thus losing its value.
  - Failure to execute a confirmation, thereby creating a potential legal out for a counterparty who has an adverse financial position with the bank.
  - Endless opportunities for economic loss, the possibilities for errors to cost the bank sometimes seem without boundary.

Operational Risk (Cont.)

- How is operational risk controlled?
  - MIS and metrics provided to senior management.
  - Internal Audit. High risk areas are audited annually.
  - Operational Risk committees.
  - Critical Self Assessments.
  - Independent Operational Risk Managers, perform functions similar to independent risk management, valuations, and models, but related to operational aspects of the organization.

Operational Risk (Cont.)

- Settlement Risk is a form of operational risk. It occurs when one party makes a payment (say on a swap) and the other party fails to do so.
  - Risk is difficult to control. Operations needs to have strong controls surrounding wire transfers, and be in communication with associated credit personnel. 1244
  - Netting is one form of mitigation.
  - Cross product and legal entity netting is another form of mitigation.

Internal Audit

- Needs to be completely independent.
- Needs to have sufficiently qualified personnel.
- Needs to have significant stature in the organization (i.e. There should be an audit committee at the board level, that has the support of the Board Chairman).
- Should perform annual audits of high risk areas.
- Should test controls, procedures and adherence to policy.
- Should be evaluating all of the aforementioned risk functions.
- Should ensure outstanding findings are corrected by verifying completion of action plans resulting from their findings.

Bank Examiners Check list

Bank Examiners should look at:

- How transparent is risk taking? What reports do the banks most senior managers receive? Do those reports provide sufficient details to understand most salient risks?
- Daily P&L results
- Risk positions (if possible obtain daily (ideally), weekly, or at least monthly).
  - Try to relate P&L to market events and position reports.
  - Know what the largest risk positions are by line of business.
- Performance reports.
  - Client, proprietary, and portfolio revenues
  - Revenue to risk measures.
- Limits: Structure, annual creation & affirmation process, reports, and monitoring.
  - Documentation surrounding breaches
  - Temporary excession allowances and reasons why.

Bank Examiners should look at: (Cont.)

- Risk Committee?
  - Is there one ?
  - Obtain Risk Committee report package and meeting mintues.
- Critical Self Assessments
- Business Control Committee reports and meeting minutes
- Model Reviews and adequacy of documentation
- Valuation metrics
  - Reserves & associated triggers.
  - Valuation adjustments & associated triggers.
  - Independent pricing coverage %s (and sources).

Bank Examiners should look at: (Cont.)

- Operational Metrics
  - Confirmation statistics
  - Nostro breaks (and aging)
  - % of Straight Thru processing.
  - P&L and Risk Explain
  - Error Trends.
- Internal Audit Reports.
- Management structure & Governance
- Business plans and new business initiatives
- New business post implementation reviews

Example FO to BO breaks

FO/BO Position Breaks	Current Week										Prior Week		Change		4Q 06 Avg		Rolling 12 Wk	
	NA		EMEA		Bullion		Base		Total		Total		Total		Total		Total	
	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $
# of Position Reconciliations Performed	1		1		2		2		6		6		-		4		6	
Total # of Breaks and Related $ Value	-	$ -	-	$ -	-	$ -	1	$ -	1	$ -	5	$0.3	(4)	($0.3)	3	$0.3	20	$6.8
Aging Analysis																		
5 - 10 days outstanding	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	3	$0.1	(3)	($0.1)	2	$0.2	4	$0.7
11 - 15 days outstanding	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	0	$0.0	0	$0.0
16 - 30 days outstanding	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	0	$0.0	8	$2.9
> 30 days outstanding	-	$ -	-	$ -	-	$ -	1	$ -	1	$ -	2	$0.2	(1)	($0.2)	1	$0.0	8	$3.3

FO/BO P&L Breaks	Current Week										Prior Week		Change		4Q 06 Avg		Rolling 12 Wk	
	NA		EMEA		Bullion		Base		Total		Total		Total		Total		Total	
	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $	Number	Abs. $
# of P/L Reconciliations Performed	1		1		2		2		6		6		-		4		6	
Total # of Breaks and Related $ Value	-	$ -	-	$ -	2	$0.1	1	$ -	3	$0.1	5	$0.3	(2)	($0.2)	25	$5.7	24	$7.0
Aging Analysis																		
5 - 10 days outstanding	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	3	$0.1	(3)	($0.1)	21	$4.4	5	$0.7
11 - 15 days outstanding	-	$ -	-	$ -	1	$0.0	-	$ -	1	$0.0	-	$ -	1	$0.0	1	$0.1	1	$0.0
16 - 30 days outstanding	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -	3	$1.2	8	$2.9
> 30 days outstanding	-	$ -	-	$ -	1	$0.1	1	$ -	2	$0.1	2	$0.2	-	($0.1)	0	$0.0	10	$3.4

Example Confirmations

Total Outstanding Affirmations	Current Week							Prior Week	Change	4Q 06 Avg	Rolling 12 Wk Avg
	Energy and Softs NA	Energy and Softs EMEA/AP	Energy and Softs eConfirm	Bullion	Base	Commodities Exotics	Total	Total	Total	Total	Total
# NYI-Counterparty to Issue			-		-		-	-	-		-
# NYI-JPM to Issue	56	80	13	6	23	2	180	252	(72)	261	231
# Confirmed (issued not yet affirmed)	387	404	79	386	229	12	1,497	1,430	67	995	1,313
Total # Outstanding Affirmations	443	484	92	392	252	14	1,677	1,682	(5)	1,142	1,241
Days Worth Activity											
Days Worth NYI - JPM + Cpty to Issue	-	-	-	0.00	1.10	-	0.07	0.10	(0.03)	0.19	0.11
Days Worth Confirmed - JPM	-	-	-	0.15	10.90	-	0.58	0.55	0.03	0.74	0.60
Days Worth Unaffirmed - JPM	-	-	-	0.15	12.00	-	0.65	0.65	(0.00)	0.85	0.57
High Risk Trades											
# With No Mitigation Factors (>30 days >$0.5m threshold) (Type A)	-	-	-	-	-	-	-	1	(1)	2	1
Absolute MTM of Type A ($million)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$0.6	($0.6)	$4.6	$3.1
# With Key Terms Under Dispute (type C)	-	-	-	-	-	-	-	-	-	-	0
Absolute MTM of Type C ($million)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$0.0
# With Nostro Breaks (type D)	-	-	-	-	-	-	-	-	-	2	0
Absolute MTM of Type D ($million)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$0.1	$ -
Aging Analysis											
Total # Outstanding Affirmations	443	484	92	392	252	14	1,677	1,682	(5)	1,204	1,241
0-14 days outstanding	357	438	92	199	225	13	1,324	1,317	7	1,005	1,261
15-30 days outstanding	33	34	-	148	24	1	240	256	(16)	182	174
31-60 days outstanding	50	2	-	42	3	-	97	88	9	60	85
61-90 days outstanding	-	6	-	2	-	-	8	18	(10)	7	9
91-180 days outstanding	1	4	-	1	-	-	6	1	5	2	10
180+ days outstanding	2	-	-	-	-	-	2	2	-	0	3
Total # Outstanding Affirmations not phone confirmed over 5 days	8	57	-	118	10	5	198	274	(76)	48	219
6-10 days outstanding	5	31	-	38	1	-	75	115	(40)	28	117
10-20 days outstanding	3	4	-	15	8	-	30	94	(64)	14	49
20-30 days outstanding	-	16	-	45	1	-	62	46	16	4	30
30+ days outstanding	-	6	-	20	-	-	26	19	7	2	22

P/L & Risk Sign Off

Product	Current Week		Prior Week		Change		4Q '06 Avg		Rolling 12 Wk Avg	
	% S/Off T+1	# Not S/Off T+1	% S/Off T+1	# Not S/Off T+1	% S/Off T+1	# Not S/Off T+1	% S/Off T+1	# Not S/Off T+1	% S/Off T+1	# Not S/Off T+1
NA Energy	82%	68	85%	71	(3%)	(3)	93.5%	26.3	75.7%	118.0
EMEA / AP Energy	100%	2	94%	15	5%	(13)	96.9%	8.1	91.7%	35.4
Strategic Trading	100%	-	100%	-	0%	-	98.8%	1.2	98.2%	0.7
Bullion	100%	-	100%	-	0%	-	100.0%	-	100.0%	-
Base	100%	-	100%	-	0%	-	99.4%	0.3	100.0%	-
		70		86		(16)		35.1		154.1

Product		Current Week		Prior Week		Change		Rolling 12 Wk Avg	
		% S/Off T+1	# Not S/Off T+1	% S/Off T+1	# Not S/Off T+1	% S/Off T+1	# Not S/Off T+1	% S/Off T+1	# Not S/Off T+1
Energy and Commodities Risk Sign Off	Energy - NA	61%	7	67%	6	(6%)	1	81%	5
	Energy - EMEA	93%	24	94%	26	(1%)	(2)	93%	22
	Energy - AP (T+2)	91%	5	85%	5	6%	-	93%	3
	Strategic Trading	100%	-	100%	-	-	-	100%	-
	Commodities Prop	91%	2	100%	-	(9%)	2	95%	2
	Bullion	100%	-	75%	1	25%	(1)	98%	0
	Base Metals	100%	-	96%	1	4%	(1)	98%	1

Explain process

LOB Energy & Softs - Rollup	NA Current Week Total	EMEA Current Week Total	AP Current Week Total	Current Week Global	Prior Week Global	Change Global	Rolling 12wk Avg Global
Portfolios #	459	367	32	858	1,056	(198)	965
Below Threshold	413	353	32	798	978	(180)	885
Above Threshold	45	14	0	59	76	(17)	77
Total Explained	458	367	32	857	1,055	(198)	965
Substantiated Variances	45	14	0	59	77	(18)	79
Daily Trigger Breach							
Linear Books #	0	0	0	0	0	0	0
Linear Books #	0	0	0	0	0	0	0
Non Linear Books #	0	0	0	0	0	0	0
MTD Net Breach							
Linear Books #	0	0	0	0	0	0	0
Non Linear Books #	0	0	0	0	0	0	0

Limits

- Types of VAR
  - Positives
  - Negatives
- Types of Stress
  - Positives
  - Negatives
- Types of Non Statistical
  - Positives
  - Negatives

LIMITS

Position Limit and Loss Advisory Summary Report
For Close of Business: 09/05/2007

Limit Detail			Current Day						Daily Trend				Monthly Trend (c)		
	(a)	(b)	Limit	Geo-Off		Excess		Utilization							
Type / Description	Freq	Units	Amount	Amnt	Exp Dt	%	Prds	Amount	9/4	9/3	8/30	8/29	Sep	Aug	Jul
VAR LIMITS															
OCC Energy VAR	D	T	40,000					13,782	13,160	13,102	13,302	13,604	13,338	14,516	19,128
NON STATISTICAL LIMITS															
Delta MV															
Oil	D	T	400,000					33,743	72,667	43,577	45,205	34,006	41,573	63,707	58,777
US Gas	D	T	400,000					-100,831	-152,472	-161,461	-178,827	-180,337	147,875	153,708	48,561
Power, Coal, Emissions & Freight															
US Power	D	T	450,000					-1,277	-6,173	-12,151	-9,546	-12,402	7,607	78,770	157,343
US Coal	D	T	250,000					16,878	8,474	10,804	10,804	10,674	8,753	78,481	13,311
Emissions															
SO2	D	T	300,000					-479	-360	-512	-406	-492	490	1,866	3,441
Freight	D	T	50,000					0	0	0	0	0	0	0	0
Energy Delta															
Oil															
Crude (Mbbl)	D	T	10,000					9,401	4,407	5,115	4,297	4,127	4,820	2,402	312
Fuels (Mbbl)	D	T	3,000					-709	-709	-236	-4	25	330	91	199
Distillates incl ULSD (Mbbl)	D	T	5,000					-300	-914	-627	-643	-463	494	303	1,073
Jet (Mbbl)	D	T	4,000					-1,887	-1,657	-1,733	-1,716	-1,422	1,746	1,730	527
Gasoline/Naptha (Mbbl)	D	T	3,000					-1,290	-1,154	-1,047	-451	-415	1,036	1,064	605
US Gas (mmbtu)															
NYMEX (mmbtu)	D	T	80,000					-14,573	-21,866	-23,180	-24,725	-29,068	21,030	19,709	10,319
UK Gas (mm Therms/Day)															
Day Ahead	D	T	2,000					0	0	0	0	0	0	0	0
Balance of Month	D	T	2,500					250	255	11	74	100	135	807	112
Month 1	D	T	2,000					77	560	581	787	524	506	395	528
Month 2	D	T	1,000	3000	08/30/07			128	201	229	199	715	189	325	301
Month 3	D	T	1,000	3000	08/30/07			488	392	417	307	171	417	304	510
Month 4	D	T	1,000	2000	08/30/07			3	540	564	538	385	412	303	178
Month 5	D	T	1,000					302	481	364	380	440	302	289	180
Month 6	D	T	1,000					121	73	315	290	281	200	275	165
Month 7	D	T	1,000					105	114	116	123	241	115	272	166
Month 8	D	T	1,000					102	110	115	121	125	112	107	151
Month 9	D	T	1,000					96	103	109	116	123	108	105	109
Month 10	D	T	1,000					127	133	137	145	118	136	105	108
Month 11	D	T	1,000					123	129	132	142	147	132	104	107
Month 12	D	T	1,000					119	125	128	138	144	128	103	88
Years 2 to 5	D	T	500					22	22	22	22	22	22	3	0
Power, Coal, Emissions & Freight															
Total Peak (Mwh)	D	T	5,000					653	802	989	1,021	1,017	943	1,589	2,247
Total Off Peak (Mwh)	D	T	6,300					1,037	1,507	973	930	949	974	1,747	2,620
East Peak (Mwh)	D	T	11,000					-6,658	-7,045	-6,911	-6,872	-7,182	6,872	7,141	7,746
West Peak (Mwh)	D	T	2,000					695	607	798	663	791	773	867	611
Ercot Peak (Mwh)	D	T	1,000					686	687	687	688	691	668	683	757
Midwest Peak (Mwh)	D	T	12,000					6,134	6,454	6,424	6,401	6,887	6,354	7,140	8,325
East Off Peak (Mwh)	D	T	15,000					-6,657	-7,326	-7,424	-7,432	-7,878	7,759	7,941	8,364
West Off Peak (Mwh)	D	T	4,000					42	53	66	68	66	65	253	250
Ercot Off Peak (Mwh)	D	T	2,000					315	314	314	314	323	314	327	365
Midwest Off Peak (Mwh)	D	T	15,000					7,512	7,867	7,865	7,860	8,478	7,494	8,108	10,480
European Power (Mwh)															
French Power (Mwh)	D	T	2,000					-779	-783	-777	-841	-843	797	325	755
Dutch Power (Mwh)	D	T	2,000					0	0	0	0	0	0	0	0
German Power (Mwh)	D	T	4,000					-1,418	-1,521	-1,598	-1,572	-1,827	1,521	1,537	147
UK Power (Mwh)	D	T	4,000					457	458	432	498	487	458	391	320
Nordpool Power (Mwh)	D	T	3,000					-456	-453	-438	-389	-350	430	708	145

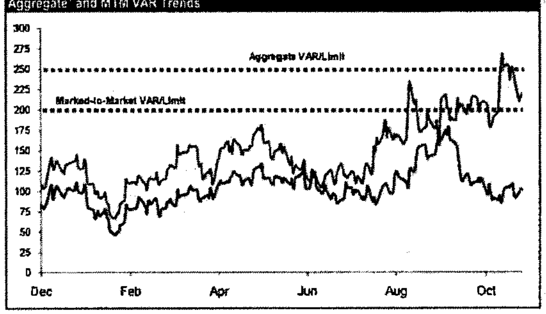
(a) Reporting Frequency: D=Daily, W=Weekly, M=Monthly, P=Periodic
(b) Reporting Units: S = Single Units, T = Thousands, MM = Millions
(c) Monthly trends are calculated as arithmetic averages for VaR and Stress limits and as absolute averages for Non-Statistical limits.

JPMorgan Chase & Co.
Market Risk Management

Market Risk VAR Trends

(USD MM's)

Aggregate[1] and MTM VAR Trends



Highlights

IB Aggregate VAR in October 2007 averaged $220mm, or $23mm higher than September's $197mm average. The increase in VAR was primarily driven by i) increased exposures in Credit Portfolio (accrual loans) and Credit Markets (bridge and excess books), ii) reduction of the IB macro hedge overlay which generally reduces the aggregate VAR, and iii) increased long equity delta in Global Equities. The VAR increase was partially offset by changes in long USD directional interest rate risk exposures within PPB and Rates & Currencies. The high levels of VAR in late October had breached the $250mm IB Aggregate VAR limit on 5 days, however in November of 2007 new Limits and Thresholds were signed allowing a $275mm IB Aggregate VAR Threshold.

IB Marked-to-Market VAR has averaged $100mm in October and has trended downwards since September as a result of i) a shift in overall Global Equities view going from being strong bearish to neutral to mildly bullish after the Fed rate announcement in late September ii) a decline of approximately $18mm in VAR terms after remapping the return series for CMIP (a hedge fund portfolio) to a more correlated index iii) some position reduction in Proprietary Po steepeners which also contributed to a overall decline in VAR, and iv) reduction of the macro hedge overlay which was a driver of MTM VAR.

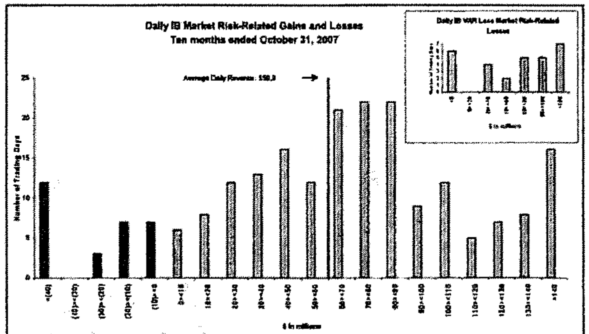
4Q2007 (quarter-to-date) Total Trading and CPG average VAR as of October has been reducing compared to the third quarter of 2007 as diversification benefits increased, mainly due to Equities being long delta/gamma against the rate steepeners & short credit positions in Proprietary Positioning.

As of October 2007

(USD MM's)

Externally Disclosed Trading VAR

	4QTD 2007				
	Average VAR	Minimum VAR	Maximum VAR	3Q 07 Average	YTD 07 Average
By Risk Type:					
Fixed Income	$96.0	$88.0	$104.4	$98.0	$75.0
Foreign Exchange	32.0	23.4	43.5	23.0	22.0
Equities	30.0	26.6	35.4	35.0	41.0
Commodities and Other	30.0	24.0	41.5	26.0	34.0
Less: Portfolio Diversification	(93.0)	NM	NM	(72.0)	(71.0)
Total Trading VAR	$95.0	$81.6	$109.8	$112.0	$101.0
Credit Portfolio VAR (a)	26.0	22.3	30.6	17.0	15.0
Less: Portfolio Diversification	(23.0)	NM	NM	(22.0)	(16.0)
Total IB Trading & CP VAR	$98.0	$82.3	117.7	$107.0	$100.0



(a) Includes VAR on derivative credit valuation adjustments, credit valuation adjustment hedges and mark-to-market loan hedges which are all reported in Trading revenue. This VAR does not include the accrual loan portfolio, which is not marked to market.

[1] Aggregate VAR includes DVA VAR related to the Credit Portfolio business.

PERFORMANCE SUMMARY

PSI-OCC-27-000143

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VAR History

Externally Disclosed Average Trading & Credit Portfolio VAR – October 2007 (in $ millions)

		3Q 06	4Q06	1Q 07	2Q 07	3Q 07	Oct 07	YTD 07
IB VAR (by risk type)								
	Fixed Income	62.7	50.5	45.2	73.8	97.9	95.8	74.9
	Foreign Exchange	24.2	20.1	18.9	20.0	22.9	32.1	21.9
	Equities	32.4	35.2	42.1	50.5	35.1	30.5	41.3
	Commodities & Other	46.1	34.7	34.3	40.4	28.4	29.6	33.9
Less: Portfolio Diversification		(62.3)	(57.6)	(58.8)	(73.2)	(70.1)	(93.2)	(70.9)
Total IB Trading VAR		93.0	82.9	81.9	111.5	114.1	94.7	101.1
Credit Portfolio VAR		14.3	14.9	13.5	11.5	16.9	25.6	15.2
Less: Portfolio Diversification		(9.0)	(10.3)	(12.0)	(12.7)	(23.7)	(22.3)	(16.1)
Total VAR		98.6	87.4	83.2	110.3	107.2	98.2	100.2
Principal Transactions		$2,449	$2,217	$3,126	$2,178	($848)	$493	$4,949
Principal Transactions per Total Average VAR ($ Actual)		$9.10	$9.46	$12.52	$6.58	($2.84)	$5.02	$4.94

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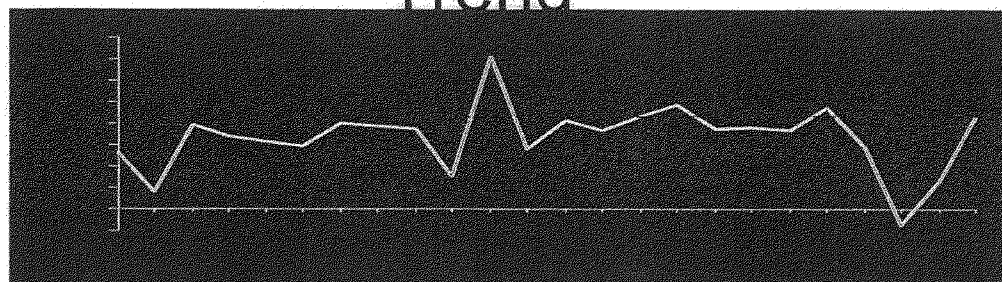
PSI-OCC-27-000144

Stress Report

- Exposure to catastrophic events.
- Does not imply a 1 day loss.
- IB initiative
  - Low
  - Medium
  - High

Fixed Income Markets Revenue Trend



Investment Bank Markets Revenue 12 Month Trend

Fixed Income Revenue 12 Month Trend

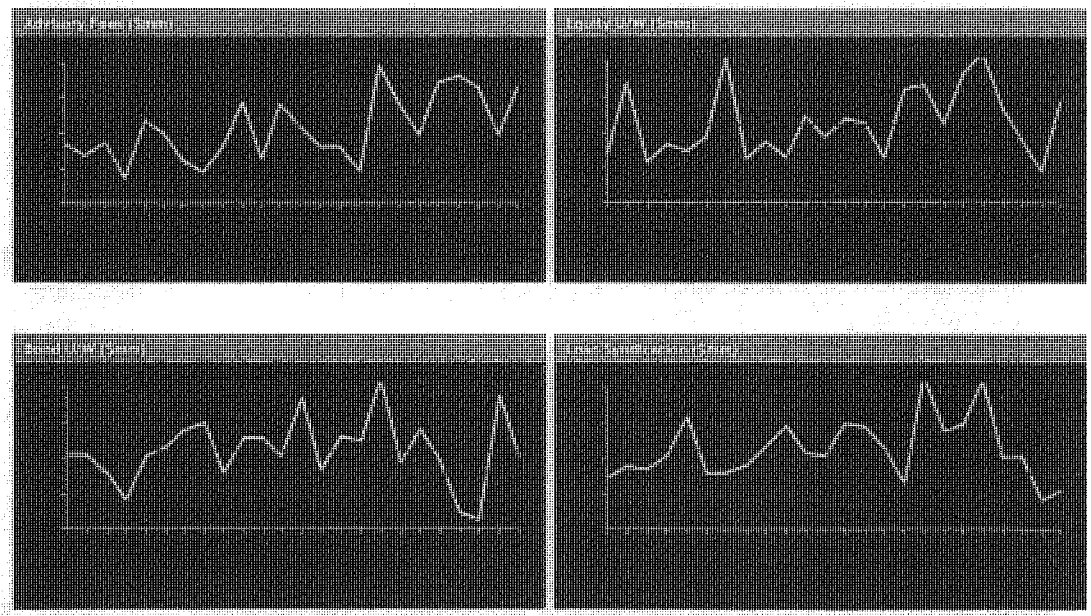
	Oct-07	Sep-07	Aug-07	Jul-07	Jun-07	May-07	Apr-07	Mar-07	Feb-07	Jan-07	Dec-06	Nov-06	12 Month Avg
Credit	227	(1,100)	(775)	(132)	(106)	164	173	38	168	243	7	118	(81)
Client	292	(846)	(31)	178	107	117	111	78	78	105	52	100	28
Portfolio Mgmt	(52)	(226)	(701)	(195)	(187)	35	40	(41)	85	124	(52)	2	(96)
Proprietary	(13)	(28)	(42)	(114)	(26)	12	3	3	8	14	8	17	(13)
Rates	481	475	432	214	221	180	205	166	164	156	119	176	246
Client	201	180	240	168	162	142	160	160	141	121	86	144	162
Portfolio Mgmt	260	291	187	46	41	40	43	7	21	34	33	34	83
Proprietary	1	3	4	(0)	(1)	(2)	2	0	0	1	(0)	(2)	0
Commodities	77	37	(9)	(6)	52	(127)	29	128	51	(90)	78	(25)	16
Client	19	21	24	90	17	13	32	15	16	10	41	35	24
Portfolio Mgmt	76	(11)	6	(99)	38	(140)	(3)	130	18	(89)	37	(68)	(2)
F&O	29	34	45	25	35	35	30	42	40	34	30	31	36
Prime Brokerage	5	6	5	5	4	4	4	4	4	4	3	3	4
Emerging Mkts	132	194	152	14	60	158	131	172	130	147	113	114	126
Client	56	43	66	54	50	61	54	47	46	56	23	54	50
Portfolio Mgmt	72	146	80	(116)	75	90	71	114	87	80	87	62	75
Proprietary	3	3	7	(24)	(15)	8	6	10	(3)	11	3	(2)	1
Fixed Income Exotics & Hybrids	148	158	356	45	169	84	180	206	116	123	41	154	142
Client	130	119	116	134	157	110	141	175	161	95	119	230	143
Portfolio Mgmt	10	40	238	(90)	12	(32)	(41)	31	(46)	28	(98)	(76)	(2)
Proprietary	8	(1)	2	-	-	-	-	-	-	-	-	-	1
Securitized Products	53	(28)	(241)	(19)	132	79	58	20	97	73	32	118	31
Client	236	41	54	34	87	27	49	40	52	41	31	57	63
Portfolio Mgmt	(186)	(82)	(317)	(54)	42	35	9	(4)	52	34	(25)	8	(41)
Proprietary	3	4	22	1	4	18	0	(17)	(7)	(2)	24	48	8
CPB	3	161	(61)	(152)	107	(11)	19	22	120	67	138	67	30
Principal Investing	65	64	12	134	202	91	63	79	82	64	62	62	82
Client	16	10	11	29	53	11	8	6	8	11	9	8	15
Portfolio Mgmt	0	0	0	(0)	0	(0)	0	(0)	0	0	0	(0)	0
Proprietary	49	54	1	105	149	80	56	73	74	53	53	54	67
Global Mgmt/Other (a)	(270)	344	(65)	447	81	77	(49)	(128)	1	9	105	16	39

External Reporting Classification

	Oct-07	Sep-07	Aug-07	Jul-07	Jun-07	May-07	Apr-07	Mar-07	Feb-07	Jan-07	Dec-06	Nov-06	12 Month Avg
Fixed Income	867	264	(151)	574	951	735	706	749	972	869	727	828	680

(a) Includes Global Management Centers & Global IBC & M&A)
Client numbers are as of November 14, 2007 DPR.

IB Fees Revenue Trend



PERFORMANCE SUMMARY

Fixed Income Markets Performance

OPERATING REVENUE	October Revenues	DVA	Net Marks	October Ex-DVA & Net Marks	Variance % vs Bdgt	Variance $ vs Bdgt	Variance $ vs. Oct 06	Trailing 24-Mth Avg	% Var to Avg	$ Var to Avg	Commentary
Fixed Income Markets	1,242	90	(325)	1,477	14%	156	472	845	40%	358	
Credit Markets	365	2	275	88	23%	69	87	187	95%	178	
Credit Trading	(29)			(29)	(140%)	(101)	(90)	25	(218%)	(54)	• In Americas, the desk had gains related to the "on the run" indices with offsetting losses on the "off the run" indices. Additional losses driven by IRS of ($4.5)MM and Treasury hedge of ($2.4)MM. Single name positions losses were concentrated in Financials across Cash, CDS and Pref. A record month for the STFI desk with the results driven by clients extending maturities out in front of the Fed, better volumes and wider spreads all contributing to the $10.8MM of gains relating to CP this month. In EMEA, the key driver of P&L was the losses incurred due to spread movements affecting single name CDS, 5yr points flattened out but post 5yr saw curve tightening leaving the desk exposed on short positions. Key individual names affected - Casio ($1.1)MM, Safeway ($1.1)MM, and Repsol ($0.7)MM. CRVG desk continues to unwind positions. The main driver for losses was costs, ($5)MM, associated with unwinding a number of the desk's tranche positions.
Loan Trading	42			42	68%	17	11	21	100%	21	• Gains across distressed debt and Euro JV desks. Distressed Debt revenues are driven by the sale of the Engineered Carbon loan for a gain of $12.8MM, a restructuring for Collins and Aikman with revenues of $16.3MM, and $2.4MM of gains in Calpine Corporation. Euro JV revenues are driven by gains across both Loans and Equity positions, with the two primary drivers being Bahrain Int'l Bank loan $4.8MM and Jarvis $2MM. Largest Par Loan driver was Sleep Innovations $1.9MM, with smaller gains across multiple names. EMEA saw an improvement in conditions in the loan markets. The HY Loan and European Mezzanine books showed MTM gains of $8MM and $1.5MM respectively.
Tax Exempt Capital Markets	21			21	(5%)	(1)	2	21	2%	0	• The Short Term Desk generated ~$12.5MM on strong remarketing and auction rate placement fees. NII was up on a modest pick up in inventory levels. Sec Trading results down $1.1MM due to volatility. The muni market displayed continued caution amid persistent uncertainty and speculation of the condition of leveraged funds, the impact to the market on paper wrapped by Merrill coming back into the market and the health of several bond insurers. The Syndicate Desk generated $3.7MM. Revenue product was on the lighter side as several larger deals where pushed into Nov and Dec due to market volatility and local politics, i.e. municipal budgets not passed as scheduled. The desk had a couple of note worthy deals, sr. manager on $1.2B Texas Transportation, and sr. manager on $337MM Dept of Water & Power of the City of LA. Oct '07 outperformed '06 by $3MM - positive variance is attributed to stronger results from the Short Term desk driven by a larger overall book of business.
Structured Credit	(11)			(11)	(134%)	(43)	(52)	7	(266%)	(18)	• Due primarily to Trups MTM move and pricing model re-calibration. No deal pricings occurred due to adverse, albeit improving, market conditions for CDO offerings. Trups down ($34.7)MM driven by general market moves, coupled with an adjustment to proxy pricing model. Loan warehouse MTM up $7.2MM due to general uptick in loan markets. . EMEA p&l was driven by MTM gains in six CDO warehouses as the loan markets rebounded. MTM gains were offset by losses related to the pricing of Ares Euro CLO.
SLF	300		275	25	168%	188	196	79	283%	221	• Revenues driven by Q3 writedowns being converted to loans; primarily TXU $177mm and Bausch & Lomb $18.4mm. In EMEA, majority of the revenue is driven by $13.6MM running NII on the Excess book positions.
High Grade Bond Origination	42			42	31%	10	19	39	7%	3	• Driven by fees from Motorola $5.0MM, Enterprise Rent a Center $4.5MM, and Tesco $3.1MM in the Americas. In EMEA there were a couple of significant issuances, notably Credit Agricole $1.7MM, P&G $1.4MM, Koninklijke $0.9MM, Suncorp-Metway $0.8MM and Bayerische Landesbank $0.6MM. CEEMA DCM made $1.3MM on the VTB Capital issuance.
Management / Other	0			0	(100%)	(1)	1	(4)	NM	4	• N/M
Rates & FX	401	5		396	105%	205	215	203	98%	198	
Rates	311			311	173%	197	216	118	165%	194	• Rates continues to deliver strong results amidst continued volatility in the housing sector and equity markets. Global Swaps and $ Options desks generated strong revenue due to sharp rallies on the front of the curve and significant spread widening. The Europe Government desk produced revenue being long bonds vs short Schatz futures. The US Financing desk outperformance was attributable to continued wide bid-offer spreads and long Fed Funds vs. Libor.
Currency	90			90	10%	8	(1)	85	5%	5	• Solid revenues driven by increased volumes in customer flow in the FX Options business, on the back of increased volatility in the market. Strong gains were also generated in Non Dollar rates trading, mainly on long stub positions in EUR and USD rates. Currency overlays contributed significantly to FX sales revenues this month as positions coming up for expiry were rolled over, and there was increased activity in agent's business due to a number of IPOs in Brazil.

PERFORMANCE SUMMARY

PSI-OCC-27-000148

Fixed Income Markets Revenue Trend

	OCT 07	SEPT 07	AUG 07	JULY 07	JUNE 07	MAY 07	APR 07	MAR 07	FEB 07	JAN 07	DEC 06	NOV 06	12 Month Avg
High Grade Bond Origination	(4.5)	2.1	0.1	(0.6)	(2.3)	4.0	(0.7)	(14.4)	(10.7)	14.2	(0.4)	11.9	(0.1)
Leverage Finance	221.7	(1028.5)	(280.5)	71.9	(13.6)	1.7	2.8	(7.3)	5.3	(1.0)	(8.6)	(7.7)	(87.0)
Tax-Exempt Capital Markets	10.5	21.1	(6.3)	21.3	10.0	9.5	10.3	7.6	10.7	9.6	12.8	11.0	10.7
Credit Trading	(41.7)	(103.1)	(311.4)	(39.5)	(60.7)	93.5	67.8	35.4	110.8	129.8	2.9	64.8	(4.3)
Loan Trading	52.2	18.7	(18.4)	(53.2)	(19.5)	49.7	59.0	35.7	53.9	80.7	15.3	29.0	25.3
Strategic Solutions	0.0	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Structured Credit	(11.4)	(12.7)	(160.3)	(127.2)	(13.3)	16.0	24.0	(14.9)	(0.4)	10.1	(7.4)	7.9	(24.1)
Management	0.4	2.2	2.1	(5.1)	(6.8)	(10.1)	10.3	(3.7)	(1.6)	(0.3)	(7.1)	0.9	(1.6)
Global Credit Markets	227.2	(1100.3)	(774.7)	(132.3)	(106.2)	164.2	173.4	38.4	167.9	243.2	7.5	117.8	(81.1)

	OCT 07	SEPT 07	AUG 07	JULY 07	JUNE 07	MAY 07	APR 07	MAR 07	FEB 07	JAN 07	DEC 06	NOV 06	12 Month Avg
Swaps	179.8	221.0	207.7	52.5	76.2	47.1	56.9	55.5	64.0	43.9	12.4	46.7	88.6
Options	16.3	39.2	14.6	24.1	21.9	21.4	20.6	1.5	11.1	16.5	1.8	18.4	17.3
Govt/Agency/Freq Borrowers	75.3	67.9	8.9	18.9	29.1	15.2	32.5	10.7	5.2	34.0	4.7	19.1	26.8
Financing/Trading	52.4	56.3	59.3	31.7	29.8	29.8	19.3	37.0	18.0	16.7	25.5	16.0	32.6
Global FX	89.9	102.3	142.6	89.7	73.7	71.2	79.1	67.8	68.8	87.9	67.7	76.7	84.8
Management	(12.6)	(12.1)	(1.4)	(2.9)	(10.1)	(4.5)	(3.6)	(6.1)	(3.0)	(3.1)	6.9	(0.6)	(4.4)
Global FX & Rates	401.0	474.6	431.7	213.9	220.6	180.0	204.7	166.5	164.0	195.7	118.9	176.4	245.7

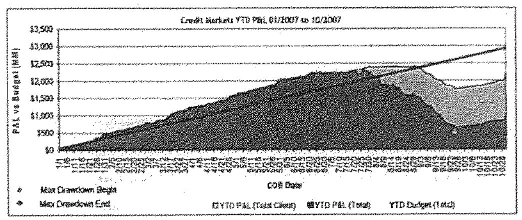
RISK REPORTS

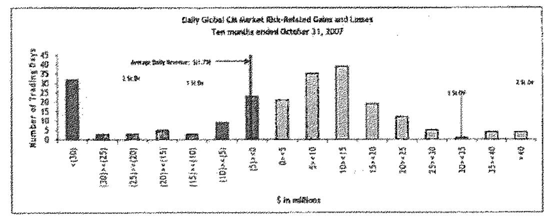
Market Risk

Investment Bank - Rate Risk Exposure

Risk Return Metrics

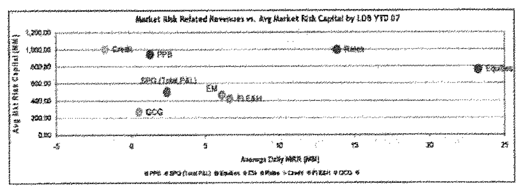
CREDIT MARKETS

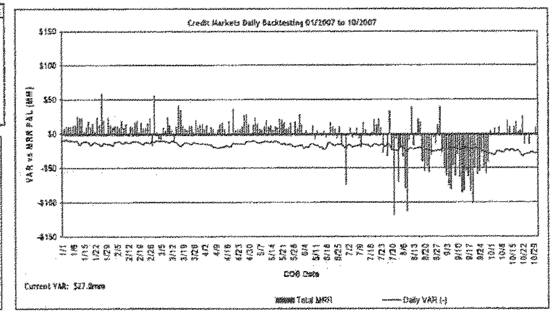




Total Revenue vs Budget	Revenue	Budget	Variance
YTD (MM)	949	2,919	(1,969)
Max Drawdown (Total P&L)	Start Date	End Date	Amount
YTD 2007	7/14	9/27	(1,730)
2006	2/14	3/15	(180)
2005	10/13	10/28	(37)
	FY2007	FY2006	FY2005
Drawdown Ratio	182%	8%	1%

Risk Return Metrics ($MM)	2007	2006	2005
Avg Daily Revenue	(1.75)	7.74	6.40
Avg. VAR (mm's)	17.9	33.9	27.6
Positive Days/Negative Days	146 / 78	227 / 33	203 / 57
Sharp Ratio	-0.8	15.4	9.8
Stress Ratio	39%	1%	1%
P&L Volatility	20.8	8.1	10.5
Return on MRC	-45%	251%	294%
MR Capital (mm's)	1,006	873	566





Reserves

Global IB Pricing & Fair Value Adjustments – October 2007 (in $ millions)

Business	Pricing Adjustment			Fair Value Adjustment					Credit / Debit Adjustment			
	Model Limitation	Price Testing	Pricing Adj Total	Concentration	Illiquidity	Early Unwind	Parameter Uncertainty	Fair Value Adj Total	CVA	DVA	DVA Illiquidity	Credit / Debit Adj Total
Fixed Income Exotics & Hybrids	285	21	306	37	141	9	534	720	91	(250)	32	(127)
Equities	412	19	431	71	37	0	254	363	54	(304)	49	(260)
Commodities	2	5	7	50	19		71	140	10	(142)	18	(117)
Currencies	(2)	0	(1)	1	3		12	17				
Credit Markets	0	10	10	26	86	0	32	144	3	0		3
Rates	(38)	20	(18)	3	25		31	59	12	0		12
Credit Portfolio	7	(0)	7	11	19		21	50	698	(481)	80	297
Emerging Markets	2	5	8	17	15		3	35	39	(133)	17	(77)
Securitized Products	0	(0)	(0)	0	52		47	99	0			0
Principal Investing		(0)	(0)		44		30	73				
Proprietary Positioning	(1)	3	2	0	1		1	3				
Chase Secured Loan Trust							3	3				
IB Management					23		100	123				
Total October	669	82	751	216	475	9	1,141	1,840	907	(1,350)	174	(270)

$2,591mm

1265

PSI-OCC-27-000152

Q&A

- ?

1266

- Can't think of any now, email me later.
- Mike.Kirk@occ.treas.gov
- 212-789-4764

PSI-OCC-27-000153

Attachments – Questions 2 & 3

- FFIEC Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities
- PPM 5310-10: Guidance to Examiners in Securing Access to Bank Books and Records
- Derivatives Basics and Bank Supervision

Attachments – Question 5C

- PPM 5310-3 (REV): Enforcement Action Policy
- PPM 5310-5 (REV): Securities Activities Enforcement Policy
- Matters Requiring Attention Memorandum

POLICIES & PROCEDURES MANUAL

Comptroller of the Currency
Administrator of National Banks

Section: Bank Supervision Operations | Subject: Enforcement Action Policy

TO: Deputy Comptrollers, Department and Division Heads, District Counsel and all Examining Personnel

PURPOSE AND SCOPE

This PPM describes the OCC's policy for taking appropriate enforcement action in response to violations of law, rules, regulations, final agency orders and/or unsafe and unsound practices or conditions. It revises PPM 5310-3 (REV) July 30, 2001, and supersedes Supplement 1 to PPM 5310-3(REV), November 10, 2004. This PPM also supersedes OTS Examination Handbook Section 080, Enforcement Actions, July 18, 2008, with respect to federal savings associations. This PPM is applicable to all types of national banks, federal branches and agencies of foreign banks, and federal savings associations (collectively, "banks"). This PPM is also applicable to enforcement actions that the OCC may take against bank service companies under 12 USC 1861 and service providers under 12 USC 1464(d)(7)(D). Actions may take the form of informal enforcement actions; formal enforcement actions under 12 USC 1818; prompt corrective action directives under 12 USC 1831o; safety and soundness orders under 12 USC 1831p-1; or some combination thereof. This PPM does not address civil money penalty actions against persons under 12 USC 1818(i) (*see* Civil Money Penalties Policy, PPM 5000-7, Revised, June 16, 1993); prohibition or removal actions, or personal cease and desist orders against individuals, under 12 USC 1818(e) or (b); actions taken to enforce the various securities laws and regulations (*see* OCC's Securities Activities Enforcement Policy, PPM 5310-5, Revised, February 8, 2001); or actions under the International Lending and Supervision Act (*see* 12 USC 3909).

These policies and procedures provide internal OCC guidance. They are not intended, do not, and may not be relied upon to create rights, substantive or procedural, enforceable at law or in any administrative proceeding.

This PPM also is not intended to supersede or limit the applicability of any other PPM that may provide more explicit guidance and direction, or establish supplemental procedures, applicable to compliance-related violations or treatment of supervisory issues arising from the various specialty areas (*i.e.*, compliance, fiduciary, and asset management, or information technology).

TABLE OF CONTENTS

OVERVIEW AND GENERAL POLICY

Effective bank supervision requires clear communications between the OCC and the bank's senior management and board of directors. The OCC uses a variety of enforcement actions to communicate problems or weaknesses and to require corrective measures by banks. Once problems or weaknesses are identified and communicated to the bank, the bank's senior management and board of directors are expected to promptly correct them. Whenever possible, OCC enforcement actions should deal with problems or weaknesses at an early stage, before they develop into more serious supervisory issues or adversely affect a bank's performance and viability. This may mean taking action well before problems or weaknesses are reflected in a bank's financial condition.

An OCC Report of Examination ("Report") documents the OCC's findings and conclusions with respect to its supervisory review of a bank. The actions a bank takes or agrees to take in response to its Report are important factors in determining whether the OCC will take enforcement action and the severity of that action. Although enforcement actions may be initiated as a result of findings contained in a Report, taking such actions are not necessarily correlated with the completion of the Report. In some cases, enforcement action may be warranted prior to the completion or transmittal of the Report to obtain correction of significant problems or weaknesses as quickly as possible. This policy provides guidance in selecting the action or combination of actions best suited to accomplish corrective or remedial measures. The policy also promotes consistency while preserving flexibility for specific circumstances.

The OCC's long-range strategy for a bank that is experiencing difficulties is an important factor in determining what enforcement action to take. Long-term strategy takes into consideration not only the measures needed to address the bank's problems currently but also what measures *will* be needed in the future *if* the bank's problems develop into serious supervisory issues threatening the bank's viability. Certain types of enforcement action also may provide better transitions to more severe supervisory responses later if the condition of the bank warrants, including requiring the bank to raise capital, or other resolution options such as requiring the sale, merger, dissolution, or liquidation of the bank, or appointing a receiver or conservator. This policy provides guidance on this aspect of selecting enforcement actions. It also provides guidance on the long-term strategy aspects of documentation for enforcement actions. The documentation of earlier enforcement actions, of failure to comply, and of the consequences for the bank of that failure is an important part of establishing the record for more severe subsequent action.

TYPES OF ENFORCEMENT ACTIONS

Enforcement actions fall into two broad categories: informal and formal. (*See* Appendix A for definitions of types of enforcement actions.)

A. *Informal Enforcement Actions*

When a bank's overall condition is sound, but it is necessary to obtain written commitments from a bank's board of directors to ensure that identified problems and weaknesses will be corrected, the OCC may use *informal* enforcement actions. These enforcement actions provide a bank with more explicit guidance and direction than is normally contained in a Report. Agreement to an informal action can be evidence of the board's commitment to correct identified problems before they adversely affect the bank's performance or cause further decline in the bank's condition.

Informal enforcement actions include commitment letters, memoranda of understanding, and approved safety and soundness plans submitted pursuant to the part 30 and part 170 safety and soundness process. (*See* Appendix A for a more complete description of informal enforcement actions.)

B. *Formal Enforcement Actions*

The OCC may use a wide variety of *formal* enforcement actions to support its supervisory objectives. Unlike most informal actions, formal enforcement actions are authorized by statute (mandated in some cases), are generally more severe, and are disclosed to the public. Also, formal actions are enforceable through the assessment of civil money penalties and, with the exception of formal agreements, through the federal court system.

For purposes of this PPM, formal actions against a bank include: orders and formal written agreements within the meaning of 12 USC 1818(b); capital directives under 12 USC 3907; Prompt Corrective Action (PCA) directives under 12 USC 1831o; and safety and soundness orders under 12 USC 1831p-1. (*See* Appendix A for a more complete description of formal enforcement actions, and Appendix B for a description of mandatory and discretionary actions under PCA. Also, refer to Banking Circular 268, Prompt Corrective Action, February 25, 1993).

1. *Enforcement Actions under 12 USC 1818(b)*

Formal enforcement actions under 12 USC 1818(b) include cease and desist orders and formal agreements. These types of actions are available when a bank violates a law, rule, or regulation; engages in an unsafe or unsound banking practice; or violates a written condition imposed by the OCC in connection with the granting of an application. A cease and desist order can also be issued, by consent of the bank[1] or following an administrative hearing, for violating the terms of a formal agreement. In addition to requiring a bank to take corrective measures to remedy a violation of law or an identified problem or weakness, formal enforcement actions under 12 USC 1818(b) include, under certain circumstances, the authority to require a bank to: (i) make restitution or provide reimbursement; (ii) restrict asset growth; (iii) dispose of a loan or other asset; (iv) rescind an agreement or contract; (v) employ qualified officers or employees; and (vi) take other action the OCC determines to be appropriate.

As discussed below, the presumption for formal action under 12 USC 1818 is particularly strong, regardless of a bank's composite CAMELS rating or capital levels, when it is experiencing significant problems or weaknesses in its systems and controls; serious insider abuse; substantial violations of law or serious compliance problems; material noncompliance with prior commitments to take corrective action; or failure to maintain satisfactory books and records or provide examiner access to books and records when, as a result, the OCC is unable to determine the bank's true financial condition.

2. *PCA Directives and Related Actions*

PCA actions are triggered by a bank's capital category as defined in 12 USC 1831o, 12 CFR 6, and 12 CFR 165 Depending on a bank's PCA capital category, certain restrictions and actions are automatically imposed by operation of law. Discretionary PCA actions include the issuance of directives that impose actions or restrictions permitted or otherwise required under 12 USC 1831o, 12 CFR 6, and 12 CFR 165. Except in rare instances, the OCC provides prior notice of intent to issue a PCA directive. Unlike some other enforcement actions, there is no provision for an administrative hearing prior to the issuance of PCA directives. (*See* Appendix B for a full description of PCA provisions.)

For banks that are in the *undercapitalized, significantly undercapitalized,* or *critically undercapitalized* categories, the supervisory office should consider using a PCA directive in preference to a section 1818 enforcement action. In particular, PCA directives are preferred when there are concerns that the bank's problems may develop into serious supervisory issues that threaten viability, and the supervisory office anticipates that it may be necessary to exercise an early resolution option in the future. A PCA directive can enhance the OCC's use of resolution options later because failure to submit or implement a capital restoration plan required in a PCA directive is a ground for receivership. Thus, a PCA directive should be used in such situations, unless action under section 1818 clearly would better achieve the purposes of prompt corrective action. Similarly, PCA directives may be appropriate in cases where the need for prompt action is present.

[1] A cease and desist order issued with consent of the bank through its board of directors is termed a "consent order." Cease and desist orders and consent orders are legally indistinguishable in their effects.

When an *undercapitalized, significantly undercapitalized*, or *critically undercapitalized* bank is already subject to a formal enforcement action under section 1818, the OCC may elect to: (i) modify the section 1818 document to reflect any additional requirements deemed necessary in view of the bank's condition and capital category; (ii) replace the document with a PCA directive; or (iii) impose a PCA directive while also maintaining the formal enforcement action against the bank. Whatever option is chosen, mandatory PCA restrictions applicable to such banks will apply automatically.

The OCC may also impose more severe limitations than a bank's PCA capital category would otherwise permit or require if it is determined that the bank is in an unsafe or unsound condition or engaging in an unsafe or unsound practice; or it is determined, with respect to *undercapitalized* or *significantly undercapitalized* banks that the use of more severe measures is necessary to carry out the purposes of PCA.

The OCC will consider imposing these discretionary PCA actions whenever it is consistent with the PCA's purpose, which is to "resolve the problems of problem institutions at the least possible long-term cost to the deposit insurance fund."

a. *More Stringent Treatment based on other Supervisory Criteria*

Under 12 USC 1831o(g), if the OCC determines, after written notice and an opportunity for an informal hearing (*See* 12 CFR 19.221 and 12 CFR 165.8), that a bank is in an unsafe or unsound condition or is engaging in an unsafe or unsound practice, the OCC may:

- reclassify a *well-capitalized* bank as an *adequately capitalized* bank;
- require an *adequately capitalized* bank to comply with one or more requirements applicable to an *undercapitalized* bank, except the requirement to have a capital restoration plan; or
- require an *undercapitalized* bank to take one or more actions applicable to *significantly undercapitalized* banks.

b. *Discretion to Impose Additional Restrictions*

The OCC may apply corrective measures to undercapitalized or significantly undercapitalized banks otherwise only available under the next lower PCA category if the OCC determines that such measures are necessary to carry out the purposes of prompt corrective action. *See* 12 USC 1831o(e)(5) and (f)(5). In addition, for significantly undercapitalized banks and undercapitalized banks that fail to submit and implement an acceptable capital restoration plan, the OCC may also require any other action the OCC determines will better carry out the purposes of prompt corrective action. *See* 12 USC 1831o(f)(2)(J). The actions required under the authority of section 1831o(f)(2)(J) should address the unsafe and unsound practices that are of concern and be commensurate with the bank's overall condition.

3. ***Orders Requiring Compliance with Safety and Soundness Standards***

Under 12 USC 1831p-1, when a bank fails to comply with any established safety and soundness standard (see 12 CFR 30 and 12 CFR 170) the OCC may issue a Notice of Deficiency. The Notice of Deficiency requires the bank to submit to the OCC a plan to correct the deficiency, and the OCC must approve the plan. If the bank does not file a timely, acceptable plan, or fails in any material respect to implement it, the OCC must issue an order requiring the bank to correct the deficiency cited in the notice. A determination that the bank is not in compliance with an approved plan should be based on a finding that the bank has failed in a material respect to implement the plan. This failure must be substantial enough to jeopardize or preclude achieving the objective of the plan. The OCC may also order the bank to take any additional action that the OCC determines will better carry out the purposes of 12 USC 1831o, provided such actions are consistent with deficiencies cited in the notice. The OCC must also take certain additional action against a bank that has not corrected a deficiency if the bank experienced extraordinary growth over the past 18 months, or commenced operations or underwent a change in control within the past 24 months.

Unlike PCA, which is triggered by capital categories, the safety and soundness process is designed so that the OCC can require banks to address problems in their operations regardless of the bank's capital levels.

DETERMINING SEVERITY OF ENFORCEMENT ACTIONS

A. *General*

Enforcement actions should be specifically tailored to the institution, and designed to correct deficiencies and return the bank to a safe and sound condition as soon as possible. The severity of the enforcement action is based on several factors.

Determining whether an informal action is the appropriate response, and deciding upon which informal action to use, will depend on: (i) the overall condition of the bank (both current and projected); (ii) the nature, extent, and severity of the bank's problems and weaknesses; and (iii) whether the bank's board and management demonstrate the commitment and ability to correct the identified problems and weaknesses within an appropriate time frame.

Unlike other informal enforcement actions, the safety and soundness order process provides the OCC with the ability to issue a formal action (safety and soundness order) based solely on the bank's failure to comply with the informal action (approved safety and soundness plan). However, like other informal enforcement actions, the safety and soundness order process should generally only be used when the problems or weaknesses are narrow in scope and correctable, and we are confident in the board and management's commitment and ability to correct the problems or weaknesses.

In situations where a bank fails to achieve compliance with an informal enforcement action within a reasonable period of time as defined in the action, absent strong justification, the supervisory office should promptly proceed with a formal enforcement action to address the outstanding deficiencies or concerns.

Formal enforcement actions may also be the appropriate initial action based on the rating of the bank and the severity of its problems. When deciding whether a formal enforcement action should be used and which one is appropriate, it is important to consider: (i) the bank's composite CAMELS rating; (ii) the severity of the bank's problems and weaknesses; (iii) the commitment and ability of management to correct the identified deficiencies; and (iv) the existence of previously identified, but unaddressed problems or weaknesses.

In situations where a bank has failed to achieve compliance with a formal enforcement action, there is a strong presumption for the use of additional enforcement actions, such as the assessment of civil money penalties against the board of directors and bank management, enforcement of the action in federal court, or commencement of a new enforcement action, including, in certain cases, a requirement for the sale, merger, or voluntary liquidation of the bank.

B. *1-Rated and 2-Rated Banks*

For banks with a composite rating of 1 or 2, examiners should obtain affirmative commitments from the bank's senior management and board of directors to correct problems and weaknesses. This includes commitments to address problems identified in Reports of Examination or otherwise brought to the bank's attention. Such commitments generally need not take the form of an enforcement action if the examiner-in-charge (EIC) and assistant deputy comptroller (ADC) consider other measures (*e.g.*, oral or written assurances, responses to Matters Requiring Attention (MRAs) and to Matters Requiring Board Attention (MRBAs), correspondence, or action already taken) adequate to address the OCC's criticisms. When confidence in the board or management is low, especially in situations where the risk profile is increasing, corrective measures generally should increase in scope and severity. The decision to recommend stronger action is the responsibility of the EIC and ADC and the type of action should be based on the seriousness of the deficiencies and the commitment and ability of the bank's management and board to correct them.

C. *3-Rated Banks*

When considering corrective measures for a 3-rated bank, the EIC and ADC need to assess the overall condition and outlook for the bank; risk profile trends; record of compliance with previous criticisms or supervisory actions; and the degree of confidence in the ability and willingness of management and the board to correct all identified deficiencies in a timely manner and return the bank to a safe and sound condition. A bank with strong management and a generally positive assessment can be considered for an informal enforcement action, if circumstances suggest that the remedial measures are immediately forthcoming. There is a presumption for use of a formal enforcement action for a bank with weak management or a less than satisfactory management rating, and where there is uncertainty as to whether management and the board have the ability or willingness to take appropriate corrective measures. In addition, if the 3 rating continues for two consecutive examinations following the bank entering into the informal enforcement action, a formal action normally should be taken unless the bank is in compliance with the informal enforcement action and no new grounds exist for taking a formal action.

D. ***4-Rated and 5-Rated Banks***

While the capability, cooperation, integrity, and commitment of management, the board of directors, or ownership are factors in deciding the content of an enforcement action, because a 4- or 5-rated bank has serious problems and is more likely to fail, there is a strong presumption in favor of using a cease and desist order, or PCA directive if legally supportable. Use of an informal enforcement action for a 4-rated bank, or an action other than a PCA directive or cease and desist order for a 5-rated bank, must be specifically approved by the appropriate senior deputy comptroller for Bank Supervision Operations.

E. ***Significant or Substantial Problems or Weaknesses***

Separate and apart from a bank's overall rating, financial condition, or past cooperativeness of management or their ability, there is a presumption in favor of formal enforcement action when:

- The bank is experiencing serious problems or weaknesses in its systems, controls, internal audit programs, operating policies, methods of operations, or management information systems (*i.e.*, operating in an unsafe or unsound manner), even if these problems have not yet resulted in a change of rating or have not been reflected in the bank's financial performance or condition;
- There is serious insider abuse involving members of senior management or the board, whether or not the bank is immediately harmed;
- There are serious compliance problems or substantial violations of law;
- The bank has disregarded, refused or been unable to appropriately respond to prior supervisory efforts to correct previously identified serious problems or weaknesses;
- The bank has failed, refused, or been unable to satisfactorily maintain its books and records, has attempted to place unreasonable limitations on how, when, or where the examination is conducted, or has imposed limits or restrictions on examiner access to bank personnel, books, and records, and as a result, OCC examiners are unable to determine the bank's true condition; or
- There is noncompliance with specific commitments received in response to serious problems or weaknesses identified in a Report of Examination, with an informal enforcement action, or with a less severe formal enforcement action.

EARLY RESOLUTION

The OCC has the authority to place a bank into receivership when the bank is insolvent or has tangible equity capital of less than 2 percent. Once a bank's tangible equity capital has dropped below 2 percent, the provisions of 12 USC 1831o(h) operate to subject the bank to all restrictions and limitations applicable to critically undercapitalized banks, including the provisions of 12 USC 1831o(h)(3) requiring that the bank be placed into receivership or conservatorship.

The OCC also has the authority to initiate an early resolution by placing a bank into receivership, conservatorship, or requiring its sale, merger, or liquidation while the bank still has tangible equity capital of more than 2 percent in certain circumstances. Such action may help resolve a problem bank at the least long-term cost to the deposit insurance funds. Early resolution can reduce or limit losses that might otherwise result if the bank is allowed to remain open until its tangible equity capital has dropped below 2 percent or has been exhausted. Early resolution can be considered, for example, when a bank: (i) is losing capital; (ii) has no realistic prospects for recapitalization; (iii) is engaging in practices likely to increase losses in the future; (iv) is engaging in unsafe and unsound practices that have a substantial negative effect on the bank; or (v) suffers from other critical management failures identified in the receivership statutes.

When a bank first becomes undercapitalized or when a bank begins to show substantial safety and soundness weaknesses or other critical management failings, even if the bank is not yet undercapitalized, supervisory offices should develop an early resolution contingency plan involving a merger, sale, voluntary liquidation, conservatorship, or receivership. Planning for these potential future developments is a factor in selecting which enforcement actions to use in the near-term. Although enforcement action is primarily aimed at rehabilitation of the bank, using particular enforcement tools at the rehabilitation stage can enhance the OCC's position for early resolution later, if the need arises. For example, for an undercapitalized bank, the failure to submit and implement an acceptable capital restoration plan when required under a PCA directive is a ground for receivership. It may also be a basis to require the bank to be sold or merged into another institution. Similarly, when addressing substantial safety and soundness weaknesses or other critical management failings, a section 1818 order might be preferred because a willful violation of a final section 1818 order is itself a ground for receivership. In addition, PCA, section 1818, and the safety and soundness order process all have provisions authorizing the OCC to require a bank to take any action the OCC determines will better resolve the bank's problems. In appropriate cases, this authority could be used to include a requirement that the bank have a contingency plan to sell itself or liquidate if it does not remedy its problems within a specified time period. Thus, supervisory offices must take into account the long-range strategy for the bank in deciding which enforcement action to use.

If the problems at the bank persist, then supervisory offices should consider whether early resolution action would be appropriate. This would be the case, for example, when a bank has reached the point beyond which additional enforcement action is not likely to prevent continued deterioration and failure or reduce costs associated with such failure. Once a decision is made to adopt an early resolution approach, OCC resources should be focused on the best available option at the least cost to the deposit insurance funds. All OCC offices with early resolution responsibilities, including bank supervision, licensing, and legal offices should be apprised of the possible need for an early resolution. Examiners should consult with these units regarding options available and what record is needed to support them.

The facts and reasons on which the receivership or other early resolution is based must be well supported and documented. In most instances, prior enforcement actions will have addressed these matters at an earlier stage (*e.g.*, when the bank first became undercapitalized or when the bank was required to remedy unsafe and unsound practices in an enforcement action). The record prepared for those actions will later be a part of documenting the receivership grounds. Additional documentation of the continuation and worsening of problems, and of a substantial negative impact on the bank's assets, earnings, and/or ability to conduct business, will be needed.

PROCEDURES FOR ALL ENFORCEMENT ACTIONS

A. *Responsibilities and Decision Authority*

The Senior Deputy Comptrollers for Midsize and Community Bank Supervision and for Large Bank Supervision ("Senior Deputy Comptrollers") have the primary responsibility to use the OCC's enforcement authority under 12 USC 1818, PCA authority under 12 USC 1831o, and safety and soundness authority under 12 USC 1831p-1 as necessary to accomplish the OCC's supervisory objectives. In many cases the authority to initiate, negotiate, execute, modify, and terminate enforcement actions covered by this PPM has been delegated. Current delegations of authority are maintained by the Special Supervision Division (SPSU) and are posted on the SPSU page in the OCCnet (UUUhttp://occnet.occ/2SpecialSupervisionOfficeView.asp). Any authority delegated by the appropriate Senior Deputy Comptroller may not be sub-delegated without that official's express written approval.

Generally, the EIC is responsible for initially recommending the use of an enforcement action to address problems and concerns identified in assigned banks. While ADCs may approve the use of certain informal enforcement actions on 1- and 2-rated banks, District, Midsize and Large Bank deputy comptrollers are responsible for deciding most enforcement action recommendations against banks under their supervision.

To assist with these decisions, the Senior Deputy Comptrollers will, on an annual basis, appoint a Washington Supervision Review Committee (WSRC) chaired by the deputy comptroller for Special Supervision and approve its written charter and operating procedures. In addition, each district and Midsize deputy comptroller will, on an annual basis, appoint a District/Midsize Supervision Review Committee (DSRC) and establish its written charter and operating procedures, subject to the review and approval of the Senior Deputy Comptroller for Midsize and Community Bank Supervision. The Washington or district/midsize supervision review committee's (SRC) role is to help ensure that OCC bank supervision and enforcement policies are applied effectively and consistently, and is to advise the Senior Deputy Comptrollers or the deputy comptrollers on bank supervision and enforcement cases by providing recommendations on supervisory strategies and enforcement actions. With a few exceptions as outlined in the delegations of authority matrix, SRC reviews and advises the decision maker on the initiation of all enforcement actions. WSRC reviews all nondelegated enforcement actions, all enforcement actions against bank service companies (12 USC 1861 et seq.) and all proposed referrals to FinCen, FEC, DOJ, HUD, CFPB, and SEC. WSRC may also be asked to advise on cases that are unique or highly visible.

B. ***Support for Decisions***

A person presenting a case to SRC will prepare a presentation package, which includes a memorandum summarizing the supervisory history, history of previous enforcement actions, the facts in the current case, an objective analysis of the facts, the recommended enforcement action, legal support for the recommended action, the supervisory strategy, and any other relevant issues. Minutes of the committee's deliberations, recommendations, and the final decision should be documented in the OCC's electronic supervisory databases.

C. ***Timeliness of Enforcement Actions***

The OCC will take enforcement actions as soon as practical once the need for such action has been identified, including during an examination when circumstances warrant. Enforcement actions should be taken within the following maximum time periods whenever possible.

The appropriate SRC should recommend and the decision maker should decide whether to initiate an enforcement action, or to change or modify an existing enforcement action, including the form and content of the action, within 15 calendar days following:

- A final Report of Examination or other written supervisory analysis that determines whether the bank is experiencing one or more of the significant or substantial problems or weaknesses listed in the Determining Severity of Enforcement Actions section above;

- A final decision to assign or retain a composite CAMELS rating of 3, 4, or 5;

- A final Report of Examination or other written supervisory analysis that determines whether a bank is undercapitalized, significantly undercapitalized, or critically undercapitalized;

- A final Report of Examination or other written supervisory analysis that determines whether an undercapitalized bank has failed to submit an acceptable capital restoration plan or has failed in some material respect to implement it; or

- A final Report of Examination or other written supervisory analysis that determines whether a bank has violated a safety and soundness standard (*See* 12 CFR 30 and 12 CFR 170)).

For nondelegated enforcement actions (see delegations matrix) involving delegated banks, the appropriate Washington legal division should present the case to WSRC no later than the third weekly WSRC meeting following the receipt of the recommendation from the DSRC.

Within 15 calendar days following the final decision to take an enforcement action that requires the signature of the bank's board of directors (commitment letter, memorandum of understanding, formal agreement, cease and desist order), a copy of the proposed action should be provided to the board, or its duly authorized representative, and a date established within the next three weeks for a meeting with the board of directors to present the document and obtain its execution. If the enforcement action is not executed by the board and a Notice of Charges for Issuance of a Cease and Desist Order is not served, the decision maker or authorized representatives shall have 30 days to negotiate the execution of the document or serve a Notice of Charges. Recommendations to use a less severe action require the same approval process as the initial action.

For enforcement actions that involve the service of a notice of intent (PCA Directive) or notice of deficiency (Safety and Soundness Order), such notice should be served within 15 calendar days following the final decision to take such action.

Any time frame exceptions should be documented in the OCC's electronic supervisory databases.

D. *Content of Enforcement Action Documents*

Enforcement action documents should address all substantive supervisory problems. Each action should clearly list any prohibited or restricted activities, prioritize remedial measures to be taken, and assign the time frames in which the board of directors or management must act. Enforcement action documents should also explicitly state what action is expected of those parties subject to the document.

Enforcement actions should be drafted using as guidance any standard language provided from time to time by the Director for Enforcement and Compliance, as well as articles used in previous enforcement actions that are tailored to the specific concerns to be addressed. Articles may be modified and new articles created, as necessary, to sufficiently address specific concerns in each individual bank. These articles should be drafted in consultation with, and input from, the District Counsel in the case of delegated banks and the Enforcement and Compliance Division in the case of nondelegated banks.

E. *OCC Responsibilities Following Completion of All Enforcement Actions*

Early assessment and written feedback on a bank's efforts to comply with a new enforcement action are critical to helping management and the board understand the requirements of the document, and achieve timely compliance. Therefore, the EIC and ADC are encouraged to perform an on-site assessment of the bank's compliance with the enforcement action shortly after the document has been entered into. In all cases they must perform an on-site assessment within 60 days of the latest due date in the action. Most articles in an enforcement action require corrective action within a specified time period after the effective date of the document. For example, if the latest due date is 90 days, then the on-site assessment of compliance with the document would commence within 60 days after the expiration of the 90-day period. Articles requiring cessation of specific activities usually require immediate action and should be assessed on-site shortly after the enforcement action becomes effective. If all articles in a document require immediate action, on-site assessment of compliance would commence shortly after the enforcement action becomes effective and no later than 60 days from the completed date of the enforcement action.

The success or failure of the bank in complying with the enforcement action, and the impact on the bank of the continuation of the problems should be thoroughly documented. Noncompliance with the enforcement action will be part of the support for a more severe enforcement action and, in appropriate cases, early resolution actions. The findings of this assessment and any recommendation to take further action, modify the document, or amend the supervisory strategy must be presented to WSRC or DSRC, which will advise the decision maker (see delegations matrix). Minutes of the deliberations, recommendations, and the decision maker's final decision should be documented in the OCC's electronic supervisory databases.

At least every six months thereafter, while the enforcement action remains outstanding, the EIC and ADC will assess the bank's compliance with the document and present the findings and any recommendation to take further action, modify the document, or amend the supervisory strategy, to WSRC or DSRC which will advise the decision maker (see delegations matrix). At least one assessment must be on-site as part of a full scope examination, the other assessment may involve on-site activities as deemed necessary by the EIC and ADC, consistent with the supervisory strategy for the bank. Minutes of the WSRC or DSRC deliberations, recommendations, and the decision maker's final decision should be documented in the OCC's electronic supervisory databases.

F. ***Assessing Compliance with Enforcement Actions***

A rating of *compliance* can be achieved on a particular article in an enforcement action only after the bank has adopted, implemented, and adhered to all of the corrective actions set forth in the article, the corrective actions are effective in addressing the bank's problems, and OCC examiners have verified through the examination process that this has been accomplished. A bank should not be considered in compliance with an article in an enforcement document simply because it has made progress or a good faith effort toward complying with the article.

Articles for which the bank has not achieved compliance fall into two categories:

- Those articles where the bank has adopted and begun the implementation of all of the corrective actions required by the article but sufficient time has not passed to verify that the actions have been fully implemented, are being adhered to, and are effective in addressing the bank's problems. In these situations management and the board must continue to monitor and test the bank's progress to ensure that corrective actions are fully implemented, adhered to, and are effective.

- Those articles where additional action on the part of the bank, its board, and management is required. This includes, but is not limited to: where the bank has failed to adopt policies, procedures, and systems within required time frames; where adopted policies, procedures, and systems fail to address all required items in the article; where the bank has failed to comply with immediately effective requirements; where the bank has failed to cease activities prohibited by the article; where the bank has failed to fully implement or adhere to corrective actions. *In these situations there is a strong presumption to take more severe action (i.e., formal action if the current action is informal; civil money penalties against the board or management if the current action is formal; or if the action is a formal agreement, the use of a stronger formal action).* The decision maker (see delegations matrix) may grant in writing reasonable extensions of time to comply with articles that require the development and implementation of policies, procedures, systems, and controls. Support for such extensions should be fully documented in writing.

For those articles with which the bank has not achieved compliance (both categories), the Report of Examination or other written communication to the bank must identify why the article is not in compliance, and what must be done to achieve compliance.

G. *Termination of Enforcement Actions*

The decision to terminate an enforcement action is the responsibility of the decision maker (see delegations matrix) and generally follows the same review process through SRC as is applicable to new enforcement actions. Usually the EIC or ADC recommends, through SRC, termination based on the assessment of compliance contained in a Report of Examination. An enforcement action should not be terminated until the bank has complied with all of the articles in the document. However, there may be some limited exceptions where termination of an enforcement action before the bank achieves compliance with all articles in the document may be appropriate. This may occur in cases where a bank has complied with all of the material requirements, and the articles in noncompliance have become outdated or irrelevant to the bank's current situation, or in cases where the current document is being replaced by a different enforcement action (*e.g.*, a Consent Order is replacing a Formal Agreement). Minutes of the committee's deliberations, recommendations, and the final decision should be documented in the OCC's electronic supervisory databases.

H. *Enforcement Action Tracking System and Decision Documentation*

The appropriate supervisory office is responsible for ensuring that the enforcement actions application in the OCC's electronic supervisory databases is current and accurately documents the enforcement action process from the date an enforcement action is recommended, presented to SRC, initiated, completed, and finally terminated.

PUBLIC DISCLOSURE OF ENFORCEMENT ACTIONS

A. *Disclosures Required by Law*

The OCC is required by 12 USC 1818(u) to publicly disclose certain types of agency actions. The OCC must publicly disclose all final orders entered into pursuant to 12 USC 1818(b), civil money penalties (including those for late or inaccurate call reports), removal orders, capital directives, and any modification and/or termination of such actions. The OCC must also publicly disclose all formal agreements under 12 USC 1818(b) and any conditions imposed in writing in connection with any application, notice, or other request, which are enforceable under section1818(b). The OCC must also disclose any final PCA directives under 12 USC 1831o or safety and soundness orders issued pursuant to 12 USC 1831p-1(e). Under certain very limited circumstances, the OCC may delay mandatory public disclosure for a reasonable period of time.

There is no legal requirement for the OCC to publicly disclose temporary orders to cease and desist or any informal enforcement actions.

Once a month, the OCC's Communications Division publishes a list of formal enforcement actions that includes the name of the person or bank involved, the type of action, and the date of the action. The enforcement actions are posted and available through the OCC's public

Internet Web site and may also be obtained in hard copy through the Communications Division upon request.

B. *Discretionary OCC Disclosure*

The OCC will consider public disclosures beyond those required by law on a case-by-case basis, where the OCC believes disclosure would be in the public interest.

The OCC will publicly disclose enforcement actions taken to remedy violations of the federal securities laws and/or related OCC regulations in accordance with provisions of PPM 5310-5, which sets out the Securities Activities Enforcement Policy.

C. *Requirements for Disclosure by Banks*

Disclosures described in paragraphs A and B above refer only to the OCC's required or discretionary disclosures. Nothing in either paragraph is intended to relieve any bank, or, where applicable, its holding company, of independent obligations to make required disclosures under the various securities laws and related regulations, or any other relevant statutes or obligations.

OVERSIGHT

On a monthly basis, the Special Supervision Division, under the supervision of the deputy comptroller for Special Supervision, prepares a Problem Bank Report (PBR) with input from the various district and field offices. The PBR includes all banks supervised by the Special Supervision Division and all other banks with a composite CAMELS rating of 3, 4, and 5. Quarterly, the final "Watch List" will be attached as part of the PBR (*see* PPM 5000-34). For each bank, current performance, rating and enforcement action information is identified. Narrative sections discuss problems, supervisory strategy, current status, and any necessary additional background information. The PBR also provides problem-bank trend information, lists all outstanding enforcement actions, and includes information on enforcement action trends and distribution by ratings and supervisory office.

The PBR is distributed to the Comptroller, all Executive Committee members, Midsize and Community Bank deputy comptrollers, and Large Bank deputy comptrollers, and other senior officials within the OCC. The Senior Deputy Comptrollers utilize the PBR as well as the quarterly National MIS Report prepared by the Supervisory Information Division to oversee and monitor compliance with the OCC's enforcement policy and this PPM.

Michael L. Brosnan
Senior Deputy Comptroller, Large Bank Supervision

Jennifer C. Kelly
Senior Deputy Comptroller, Midsize and Community Bank Supervision

Attachments
- Appendix A
- Appendix B
- Appendix C

Informal and Formal Enforcement Actions Against Banks

INFORMAL ACTIONS

Commitment Letter

A Commitment Letter is a document signed by the bank's board of directors on behalf of the bank and is acknowledged by an authorized OCC official, reflecting specific written commitments to take corrective actions in response to problems or concerns identified by the OCC in its supervision of the bank. The document may be drafted by either the OCC or the bank. A Commitment Letter is not a binding legal document. However, failure to honor the commitments provides strong evidence of the need for formal action.

Memorandum of Understanding

A Memorandum of Understanding (MOU) is also a bilateral document signed by the bank's board of directors on behalf of the bank and an authorized OCC representative. An MOU is drafted by the OCC and in form and content looks very much like a formal OCC enforcement action. It legally has the same force and effect as a Commitment Letter.

Safety and Soundness Plan

Under 12 USC 1831p-1, 12 CFR 30, and 12 CFR part 170, the OCC issues to the bank a determination and notification of failure to meet safety and soundness standards and requires the submission of a safety and soundness compliance plan (collectively called a Notice of Deficiency). At a minimum, the plan ("Safety and Soundness Plan") must include a description of the steps the bank will take to correct the deficiencies and the time within which these steps are to be taken. If the Safety and Soundness Plan is approved, it functions as an informal enforcement action. However, if the bank fails to submit an acceptable Safety and Soundness Plan or fails in any material respect to implement an approved Plan, the OCC must, by order (see Safety and Soundness Order under Formal Actions), require the bank to correct the deficiencies. The OCC may, by order, require the bank to take any other action that the OCC determines will better carry out the purposes of 12 USC 1831p-1.

FORMAL ACTIONS

Orders under 12 USC 1818:

a. **Consent Orders**

Consent Order is the title given by the OCC to an Order to Cease and Desist, which is entered into and becomes final through the board of directors' execution on behalf of the bank of a Stipulation and Consent document.[2] Consent Orders are also signed by an authorized OCC official. Like all Orders to Cease and Desist, the Consent Order is an order issued pursuant to 12 USC 1818(b). Its provisions are set out in article-by-article form and prescribe those

[2] Prior to July 21, 2011, orders issued by the OTS pursuant to 12 USC 1818(b) were generally titled Orders to Cease and Desist, regardless of whether the bank consented by stipulation.

restrictions, corrective and remedial measures necessary to correct deficiencies or violations in the bank and return it to a safe and sound condition. Violations of a Consent Order can provide the legal basis for assessing civil money penalties (CMPs) against directors, officers and other institution-affiliated parties. A Consent Order may also be enforced through application to a U.S. district court. Moreover, a willful violation of a final Consent Order is itself grounds for receivership under 12 USC 1821(c)(5)(D). In addition, violation of substantial safety and soundness articles in a Consent Order can help establish the unsafe or unsound practices or condition that is an element of several other receivership grounds under 12 USC 1821(c)(5)(B), (C) and (H).

b. Cease and Desist Orders

Aside from its title, a Cease and Desist Order is identical in form and legal effect to a Consent Order. However, a Cease and Desist Order is imposed on an involuntary basis after issuance of a Notice of Charges, hearing before an administrative law judge, and final decision and order issued by the Comptroller. Any such Cease and Desist Order is reviewable by a U.S. court of appeals. Cease and Desist Orders can be used to order affirmative corrective action including the power to order restrictions on the growth of the bank, disposal of assets, or the imposition of requirements or prohibition of payments on contracts that the bank has with third parties. Moreover, a willful violation of a final Cease and Desist Order is itself grounds for receivership under 12 USC 1821(c)(5)(D). In addition, violation of substantial safety and soundness articles in a Cease and Desist Order can help establish the unsafe or unsound practices or condition that is an element of several other receivership grounds under 12 USC 1821(c)(5)(B), (C) and (H).

c. Temporary Cease and Desist Orders

A Temporary Cease and Desist Order is an interim order issued by the OCC pursuant to its authority under 12 USC 1818(c) and is used to impose measures that are needed immediately pending resolution of a final Cease and Desist Order. Such orders are typically used only when immediately necessary to protect the bank against ongoing or expected harm. A Temporary Cease and Desist Order may be challenged in U.S. district court within 10 days of issuance, but is effective upon issuance and remains effective unless overturned by the court or until a final order is in place.

Formal Written Agreements:

A formal written agreement ("Formal Agreement") is a bilateral document signed by the board of directors on behalf of the bank and an authorized OCC official.[3] Like a Consent Order, its provisions are set out in article-by-article form and prescribe those restrictions, corrective and remedial measures necessary to correct deficiencies or violations in the bank and return it to a safe and sound condition. It is a legally recognized document issued pursuant to the OCC's enforcement authority under 12 USC 1818(b). Violations of a Formal Agreement can provide the legal basis for assessing civil money penalties (CMPs) against directors, officers and other institution-affiliated parties. However, unlike a Consent Order, Formal Agreements are not enforceable through the federal court system. Another important difference between a Formal

[3] Prior to July 21, 2011, the OTS generally used the title "Supervisory Agreement" for its formal written agreements with banks.

Agreement and a Consent Order is that willful violation of a Consent Order may be used as grounds for appointment of a receiver while a Formal Agreement may not. The decision to utilize a Formal Agreement instead of a Consent Order is largely driven by negotiation strategy and the discretion of the delegated decision-making official. Often the semantic title difference is significant to many boards of directors, who will agree to enter into a Formal Agreement where they would otherwise fight a Consent Order. However, in some cases, the OCC's long-term strategy for the bank may require use of a section 1818 order rather than a Formal Agreement.

PCA Directives:

Under 12 USC 1831o, 12 CFR 6, and 12 CFR 165 (Prompt Corrective Action or PCA) insured banks are subject to various mandatory and discretionary restrictions and actions depending upon the bank's PCA capital category. Mandatory restrictions and actions are effective upon the bank being noticed that it is in a particular PCA capital category. Discretionary restrictions and actions are imposed on the bank through the issuance of a PCA Directive. If circumstances warrant, the OCC may issue a PCA Directive that is immediately effective. Otherwise, the normal process for issuing such a PCA Directive begins with the issuance of a Notice of Intent to Issue a Directive. The Notice identifies the bank's PCA capital category and various capital measures, describes the proposed actions, which would be included in the directive and the time frame for complying with the proposed actions. The bank is given an opportunity to respond to the Notice of Intent, explaining why the proposed directive is not necessary or offering suggested modifications to the proposed directive. After considering the response, the OCC may issue a PCA Directive, or determine that no action is necessary. A PCA Directive essentially has the same force and effect as a Cease and Desist Order. If a bank is undercapitalized (or lower), a PCA Directive is preferred when the supervisory office anticipates the bank may become an early resolution candidate in the future. A PCA directive can enhance the OCC's use of resolution options later because, *e.g.,* failure to submit or implement a capital restoration plan required in a PCA directive is a grounds for receivership.

Safety and Soundness Orders:

Under 12 USC 1831p-1, 12 CFR 30, and 12 CFR 170, the OCC issues to the bank a determination and notification of failure to meet safety and soundness standards and requires the submission of a safety and soundness compliance plan (collectively called a Notice of Deficiency). If the bank fails to submit an acceptable plan or fails in any material respect to implement an approved plan, the OCC must, by order, require the bank to correct the deficiencies, and the OCC may, by order, require the bank to take any other action that the OCC determines will better carry out the purposes of 12 USC 1831p-1. The OCC must also take certain additional action against a bank that has not corrected a deficiency if the bank has experienced either extraordinary growth over the past 18 months, or within the past 24 months commenced operations or underwent a change in control. If circumstances warrant, the OCC may issue an order that is immediately effective. Otherwise, the normal process for issuing such an order begins with the issuance of a Notice of Intent to issue an order. The notice identifies the safety and soundness deficiencies, describes the proposed actions which would be included in the order and the time frame for complying with the proposed actions. The bank is given an opportunity to respond to the Notice of Intent, explaining why the proposed order is not necessary or offering suggested modifications to the proposed order. After considering the response, the OCC may issue a Safety and Soundness Order, or determine that no action is necessary. A Safety and Soundness Order has essentially the same force and effect as a Cease and Desist Order. However, unlike Cease and Desist Orders, a willful violation of a Safety and Soundness Order is not itself grounds for receivership. But violation of substantial safety and soundness articles in a Safety and Soundness Order can help establish the unsafe or unsound practices or condition that is an element of several receivership grounds under 12 USC 1821(c)(5)(B), (C) and (H).

Capital Directives:

A Capital Directive is an order issued under the OCC's capital regulations, 12 CFR 3, and 12 CFR 167. Under these procedures, Capital Directives may be issued without a hearing before an administrative law judge. However, such directives are exclusively designed for establishing and enforcing capital levels for a given bank and for taking certain actions relating to capital. Since most banks with deficient capital have other problems that are normally dealt with through other formal enforcement actions, Capital Directives are rarely used. However, where capital adequacy is the overriding consideration and other problems do not rise to the level where a formal enforcement action is needed, imposing a Capital Directive can be a useful alternative. A Capital Directive, once issued, has essentially the same effect and legal status as a final Cease and Desist Order. However, unlike Cease and Desist Orders or failure to submit and implement an acceptable capital restoration plan under PCA, a willful violation of, or other failure to meet, a Capital Directive is not itself grounds for receivership.

Mandatory And Discretionary Provisions Under PCA

ALL INSURED INSTITUTIONS

No Capital Distribution

All banks are prohibited from making any "capital distribution" (cash or dividends), if after making the distribution the bank would be undercapitalized. However, the OCC may permit a bank to repurchase shares if the repurchase is made in connection with an offering of equal value, and if it will reduce the bank's obligations or otherwise improve its financial condition.

Management Fees Restricted

All banks are prohibited from paying management fees to any person having control of the bank for provision of management services or advice to the bank or related overhead expenses, including payments related to supervisory, executive, managerial, or policy making functions, other than compensation to an officer or employee of the bank, if after making the payment the bank would be undercapitalized. This restriction does not apply to payments for data processing, trust activities, mortgage servicing, audit, or property management.

ADEQUATELY CAPITALIZED BANKS

Brokered Deposits Restriction

Under 12 CFR 337.6 (Brokered Deposits), adequately capitalized banks are prohibited from accepting or renewing brokered deposits unless the bank obtains a waiver from the Federal Deposit Insurance Corporation (FDIC). The prohibition also includes the payment of excessive interest rates on deposits.

UNDERCAPITALIZED BANKS

Close Monitoring/Capital Restoration Plan (CRP) Required

Any bank determined to be undercapitalized will be subject to close monitoring and will be required to submit a capital restoration plan within 45 days specifying:

- How it will restore capital to adequate levels within certain statutorily prescribed time limits.
- The levels of capital to be attained during each year of the plan.
- How the bank will comply with the statutory restrictions against asset growth and acquisitions.
- The types and levels of activities in which the institution will engage.
- Any other information the OCC may require.

Holding Company Guarantee

In addition, the OCC may not approve a capital restoration plan submitted by a bank unless each company that controls the bank provides a guarantee that the bank will comply with the plan. (This guarantee is limited by statute to the lesser of 5 percent of the bank's total assets at the time it became undercapitalized or the amount which is necessary to bring the bank into capital compliance.) The guarantee must be in writing and provide adequate assurance of performance.

Asset Growth Restrictions

Undercapitalized institutions are also subject to asset growth restrictions unless the OCC has accepted the bank's capital plan and has determined that the growth will not impair the bank's ability to become adequately capitalized.

No Acquisitions, No New Branches, No New Lines of Business

Moreover, undercapitalized institutions may not make any acquisition of any bank or company, establish or acquire a branch or engage in any new line of business unless the bank is implementing an approved capital plan and the OCC determines the proposed action will further the achievement of the plan, or the FDIC board determines that the proposed action will further the purposes of PCA.

Discretionary Application of Certain Restrictions Otherwise Only Available for Significantly Undercapitalized Banks

Pursuant to the provisions of 12 USC 1831o(e)(5), the OCC may also apply any of the restrictions available under 12 USC 1831o(f)(2) applicable to significantly undercapitalized banks, if necessary to carry out the purposes of PCA.

Brokered Deposits Prohibited

Under 12 CFR 337.6 (Brokered Deposits) undercapitalized or worse banks are prohibited from accepting or renewing brokered deposits. The prohibition also includes the payment of excessive interest rates on deposits.

SIGNIFICANTLY UNDERCAPITALIZED BANKS
(And Undercapitalized Banks that have failed to submit or implement an Acceptable CRP)

Requiring recapitalization by one or more of the following:

- Requiring the bank to sell shares sufficient to make the institution adequately capitalized.
- Requiring that the shares be voting shares.
- Requiring the bank to be acquired by a holding company or to combine with another insured bank if one or more grounds exist for appointment of a conservator or receiver of the undercapitalized or significantly undercapitalized bank.

Restricting affiliate transactions between banks that are 80 percent or more controlled by the same company, notwithstanding 12 USC 371c(d)(1).

Restricting interest rates a bank pays on deposits to the prevailing rate paid in the region where the bank is located.

NOTE: The statute sets up a presumption that the OCC will take the above actions unless the OCC determines that the actions would not further the purposes of prompt corrective action.

Restricting asset growth or requiring the bank to reduce its total assets.

Restricting risky activities by the bank or its subsidiaries; requiring the bank to alter, reduce or terminate any activity that the OCC determines to pose excessive risk to the bank.

Improving management and the board by ordering a new election for the bank's board of directors; requiring the bank to dismiss directors or senior executive officers (**dismissal is not a section 1818 removal action**); or requiring the bank to hire qualified senior executive officers (who may be subject to approval by the OCC).

Prohibiting the acceptance of deposits from correspondent banks.

Restricting capital distributions by prohibiting any bank holding company from making any capital distribution without the prior approval of the FRB.

Requiring divestiture through one or more of the following actions:

- Requiring the bank to divest its interest in or to liquidate a subsidiary if it is determined that the subsidiary is in danger of becoming insolvent and poses a significant risk to the institution, or is likely to cause a significant dissipation of the bank's assets or earnings.

- Requiring the company that controls the bank to divest itself of or to liquidate any nonbank affiliate of the bank if it is determined that the affiliate is in danger of becoming insolvent and poses a risk to the bank or is likely to cause a significant dissipation of the institution's assets or earnings.

- Requiring the company that controls the bank to divest itself of the bank if it is determined that divestiture would improve the bank's financial condition and future prospects.

Restrictions on Senior Executive Officer Compensation

Significantly undercapitalized banks and undercapitalized banks that fail to submit or implement an acceptable capital restoration plan are required to obtain prior written approval by the OCC before paying any bonus or increasing the compensation of a senior executive officer. The OCC may not grant approval to any bank that has failed to submit an acceptable CRP.

Additional Restrictions

Under 12 USC 1831o(f)(2)(J) and (f)(5), the OCC has the discretion to impose any other action including the additional restrictions otherwise available only for critically undercapitalized banks under section 1831o(i), if the OCC determines that this would better carry out the purpose of PCA.

CRITICALLY UNDERCAPITALIZED BANKS

Receivership or Conservatorship in 90 Days

The OCC is required to place a critically undercapitalized bank in receivership or, with the concurrence of the FDIC, conservatorship within 90 days after the bank becomes critically undercapitalized.

> **Exceptions:** The OCC may take some other action in lieu of conservatorship or receivership, but only if it determines, in writing, with the concurrence of the FDIC, the action would "better achieve" the purposes of this section. The decision to take some action other than appointment of a conservator or receiver ceases to be effective after 90 days and a new determination is required.

Limits on Other Actions

If other actions (including conservatorship) fail to restore capital within 270 days after the bank became critically undercapitalized, the OCC is required to appoint a receiver, unless it determines, with the concurrence of FDIC, that:

- The bank has positive net worth;
- The bank has been in substantial compliance with its capital plan;
- The bank is profitable or has an upward trend in earnings;
- The bank is reducing the ratio of nonperforming loans to total assets; and
- The Comptroller of the Currency and the Chairperson of the FDIC certify in writing that the bank is viable and is not expected to fail.

Critically Undercapitalized Banks must obtain FDIC's Prior Written Approval before:

- Entering into any material transaction;
- Extending credit for highly leveraged transactions;
- Amending bank charter or bylaws;
- Materially changing accounting methods;
- Engaging in covered transactions;
- Paying excessive compensation or bonuses;
- Paying high interest rates on deposits; or
- Making payments on subordinated debt (generally prohibited

Specific Actions Required by Statute or Other Legal Source

Monetary Transaction Record Keeping and Reporting

Whenever a bank fails to establish and maintain a Bank Secrecy Act (BSA) compliance program, as required by 12 CFR 21.21, or 12 CFR 163.177or fails to correct any problem with its BSA compliance program that was previously cited in a report of examination (ROE) or other supervisory correspondence, the OCC must issue an order to cease and desist requiring the bank to correct the violation or program deficiencies (12 USC 1818(s)(3)). Also, the OCC will report such actions to the Financial Crimes Enforcement Network (FinCEN).

(For further information, refer to bulletin OCC 2004-50, "Enforcement Guidance for BSA/Anti-Money Laundering (AML) Program Deficiencies," dated November 10, 2004.)

Equal Credit Opportunity Act (ECOA)

If the OCC has reason to believe that a creditor has engaged in a pattern or practice of discouraging or denying applications for credit in violation of ECOA, the OCC must refer the matter to the Attorney General (Department of Justice (DOJ)) (15 USC 1691e(g)).

If the OCC has reason to believe (does not require a pattern or practice determination) that an ECOA violation has occurred that also would be a violation of the Fair Housing Act (FH Act) (42 USC 3601 *et seq.*) and does not refer the matter to the Attorney General, the OCC must:

- Notify the Secretary of Housing and Urban Development (HUD) of the violation, and
- Notify the applicant that the Secretary has been notified of the alleged violation and that remedies for the violation may be available under the FH Act (15 USC 1691e(k)).

Fair Housing Act (FH Act)

If the OCC has information "suggesting a violation" of the FH Act, the OCC must:

- Notify HUD, and
- Forward the information to DOJ if it indicates a possible pattern or practice of discrimination (Executive Order No. 12892).

Flood Insurance Requirements

If the OCC finds that a lender has engaged in a pattern or practice of violations of certain requirements under the Flood Disaster Protection Act (FDPA), the OCC must assess civil money penalties against the lender in an amount not to exceed $385 per violation and $135,000 per calendar year (42 USC 4012a(f)).

PPM 5310-5 (REV)

POLICIES & PROCEDURES MANUAL

Comptroller of the Currency
Administrator of National Banks

Section: Bank Supervision **Subject:** Securities Activities Enforcement Policy

TO: Deputy Comptrollers, Department and Division Heads, District Counsel, and all Examining Personnel.

PURPOSE

This issuance discusses the OCC's use of administrative enforcement authority in securities enforcement actions. It replaces PPM 5310-5 (REV), dated February 8, 2001. This PPM is applicable to all types of national banks, federal branches and agencies of foreign banks, and federal savings associations (collectively, "banks"). This policy is designed to provide firm, prompt, and fair action on matters involving use of OCC enforcement authority. The policy serves the additional function of ensuring protection of the investing public, compliance with applicable laws, and the safety and soundness of the national banking system. The OCC's securities activities enforcement policy is separate from the agency's general enforcement policy contained in PPM 5310-3.

This policy and these procedures are internal guidelines for the use of the OCC and do not create any substantive or procedural rights enforceable at law or in any administrative proceeding, or affect the authority of other governmental agencies.

REFERENCES

- National Bank Act, 12 USC 1, *et. seq.*
- Enforcement Action Policy, PPM 5310-3 (REV), dated September 9, 2011
- Securities Activities Enforcement Policy, PPM 5310-5 (REV), dated February 8, 2001
- Securities Exchange Act of 1934 (Exchange Act), 15 USC 78a, *et. seq.*
- Gramm-Leach-Bliley Act (Pub. L. No. 106-102, 113 Stat. 1338 (1999))
- Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203, 124 Stat. 1376 (2010)
- 12 CFR Chapter I
- Prompt Corrective Action, 12 USC 1831o

PSI-OCC-27-000182

POLICY AND SCOPE

Authority

The OCC uses a number of tools to carry out its obligations to enforce the federal securities laws as they apply to banks and individuals who are subject to the jurisdiction of the OCC.[1] The OCC has the power to institute enforcement proceedings under the federal securities and banking laws for violations of law, including violations of federal securities laws. The OCC may bring actions for violations of the Securities Exchange Act of 1934 (Exchange Act) registration, reporting, and disclosure provisions, and provisions governing (i) bank municipal securities dealers, (ii) bank government securities brokers and dealers, and (iii) bank transfer agents, and (iv) other applicable provisions of the Exchange Act. Actions also may be based on violations of the OCC's securities offering disclosure rules, 12 CFR part 16 and part 197, and other laws and regulations governing the securities activities of banks.

Policy

The OCC's securities enforcement policy is designed to serve the following purposes: 1) to respond appropriately to violations of law, 2) to be a deterrent, 3) to be remedial/corrective, and 4) to be disciplinary. These purposes are often related and are not meant to be mutually exclusive. The OCC uses a range of enforcement remedies, including civil money penalties, cease and desist orders, injunctions, censures, suspensions, bars, removals, limitations, and a variety of other remedies depending on the nature of the violation. Depending upon the particular circumstances, one or more of the purposes listed above may be more significant than others.

The OCC will respond promptly and firmly to actual or potential violations of law by an individual bank or group of banks, or by persons associated with the institution (associated person) or an institution-affiliated party or parties. (An "associated person" is not necessarily the same as an "institution-affiliated party," although some overlap may exist. An "institution-affiliated party" generally encompasses a wider range of individuals.)

The OCC enforces the federal securities laws as they relate to the securities activities of banks in a manner generally consistent with the discipline and treatment accorded similarly situated nonbank entities and their associated persons. The OCC consults, as appropriate, with other securities regulators (such as the Securities and Exchange Commission (SEC) and state securities regulatory authorities), as well as self-regulatory organizations (such as the Financial Industry Regulatory Authority) in instances in which administrative enforcement action is being considered. Consultation concerning the appropriateness of bringing an action and the severity of proposed sanctions is intended to ensure that remedies sought by the OCC generally are consistent with those required by other securities regulators in like circumstances, unless alternate remedies are more appropriate. The OCC may pursue enforcement actions available

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[1] The OCC conducts its securities enforcement activities with respect to functionally regulated entities consistent with the provisions of the Gramm-Leach-Bliley Act (Pub. L. No. 106-102, 113 Stat. 1338 (1999)) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203, 124 Stat. 1376 (2010)).

under federal banking laws for securities law violations, when such actions better achieve the purposes of the OCC's securities enforcement policy.

Formal Enforcement Actions

The OCC pursues formal securities enforcement actions in cases involving:

- violations of the antifraud provisions of the federal securities laws, and rules promulgated thereunder;[2]
- misuse of customer funds or securities;
- customer abuse;
- other deceptive or unfair practices;
- serious and/or repetitive violations of law;
- significant internal controls breakdowns; or
- the existence of a likelihood of future violations, if formal enforcement action is not taken.

Formal enforcement actions may be initiated based on the above factors, even where corrective action already has been taken, is being taken, or can be reasonably expected to be taken. Formal enforcement actions also may be initiated to address other situations involving violations of the federal securities laws. In all cases, the purposes underlying the OCC's securities enforcement policy will guide the response undertaken by the OCC.

The OCC has the discretion to seek remedies for securities law violations under either the federal securities laws or federal banking laws depending on the circumstances of a particular case.[3] The OCC recognizes the desirability of equality of securities law enforcement among securities regulators, but also remains mindful that, in certain circumstances, banking law may provide the most efficient and effective avenue to address securities law violations.

Mitigating Factors

The presence of mitigating factors is not a defense against any enforcement action, but may be considered in determining appropriate sanctions. However, the OCC intends to pursue a vigorous securities enforcement policy to safeguard the investing public. Among the mitigating factors the OCC may consider in determining the appropriate sanction are:

- the willingness and commitment of bank management, the board of directors, and/or ownership to correct the problems, including the extent to which meaningful corrective action has been or will be taken;
- the absence of fraud, scienter,[4] or deliberate deception of the public;

[2] For example, the OCC has authority to initiate an action to remove an institution-affiliated party pursuant to 12 USC 1818(e) for violations of the antifraud provisions of the federal securities laws.

[3] Most enforcement actions under the federal banking laws will be taken pursuant to 12 USC 1818.

[4] The Supreme Court defines "scienter" as "a mental state embracing intent to deceive, manipulate or defraud." Courts of appeals have concluded that scienter includes some degree of recklessness.

- the limited extent or gravity of violations;
- the lack of public exposure to risk or harm, and;
- a bank's or individual's favorable record of compliance.

PROCEDURES

Authority for Initiating Enforcement Actions

The Senior Deputy Comptrollers for Midsize and Community Bank Supervision and for Large Bank Supervision ("Senior Deputy Comptrollers") are primarily responsible for authorizing administrative actions necessary to accomplish supervisory objectives. They retain for all banks or individuals the authority to initiate, negotiate, execute, modify, or terminate enforcement actions undertaken to enforce the securities laws.

To carry out this responsibility, the Senior Deputy Comptrollers appoint a Washington Supervisory Review Committee (WSRC). The WSRC will consider referrals made by supervisory or enforcement staff and recommend appropriate securities enforcement action to the appropriate Senior Deputy Comptroller. The director of the Securities and Corporate Practices Division (SCP) is a member of the WSRC for purposes of voting on securities enforcement actions.

Support for Decision

Decisions about whether to proceed with an enforcement action, and about the nature and severity of the action should be fully supported in decision memoranda by the agency's enforcement staff or designee, and made a part of the bank's permanent file. Individuals presenting cases to WSRC are responsible for preparing a presentation package that includes a memorandum summarizing the supervisory history, the facts in the current case, an objective analysis of the facts, enforcement action recommendations, and any other relevant issues. In addition, enforcement documents should contain clear statements regarding any prohibited or restricted activities, remedial measures to be taken, and the time in which the bank, its board of directors, or management must act. The documents should clearly state what action is expected of those parties subject to the terms of the document. If a decision to initiate a formal enforcement action is made, the appropriate supervisory office is responsible for reporting the action in Examiner View (EV).

Each party or individual charged with responsibility under this policy shall ensure that appropriate procedures are established to ensure that the OCC's enforcement policies are applied promptly, fairly, and consistently.

Termination of Enforcement Actions

The OCC may terminate or modify a securities enforcement action brought under the federal securities laws or the federal banking laws, if, in the judgment of the appropriate Senior Deputy Comptroller such action is deemed appropriate. The decision to terminate or modify an action must be supported by full and sustained compliance with the enforcement action in place. In addition, such actions should be fully supported in decision memoranda prepared by the agency's enforcement staff or designee and made a part of the bank's permanent file. The appropriate supervisory office is responsible for reporting the decision to terminate or modify an action in EV.

Securities enforcement actions brought under the federal securities laws or the banking laws result either in sanctions that are self-executing, such as censures, are of a limited duration, such as suspensions for periods of less than one year, or are of an ongoing nature, such as the imposition of continuing obligations to institute affirmative remedial or corrective measures, or obligations to refrain from certain activities. In cases resulting in ongoing sanctions or limitations of activities, the OCC may provide relief from certain continuing obligations (e.g., by granting permission to re-enter the securities business, with certain conditions, to persons previously barred), if requested. The OCC will consider such requests on a case-by-case basis, in light of all relevant circumstances. Termination of actions resulting in self-executing sanctions, however, is not appropriate.

Referrals to Other Agencies

The OCC makes referrals as appropriate to the SEC and other regulatory agencies, and cooperates with such agency's investigation and prosecution. The OCC will also provide the SEC or other regulatory agency with access to relevant information collected and maintained by the OCC in appropriate situations, provided that such agency agrees to maintain appropriate confidentiality with regard to any relevant OCC information.

Similarly, the OCC receives referrals from the SEC and other federal authorities of possible violations of the federal securities laws that fall under the OCC's jurisdiction. In the event of such a referral, the OCC shall take all necessary steps to maintain appropriate confidentiality with regard to the information forwarded.

PUBLIC DISCLOSURE OF ENFORCEMENT ACTIONS

Administrative enforcement actions initiated in accordance with this issuance are made public at their inception, unless the Comptroller, in his or her discretion, determines it is in the public interest that such proceeding be private. Thus, a Notice of Charges or a Notice of Assessment of Civil Money Penalty with respect to a securities violation is public as of its filing. This approach is consistent with the practice of other agencies charged with enforcing federal securities laws.

Pursuant to 12 USC 1818(u), hearings on the record with respect to a notice of charges issued by the OCC in a banking enforcement action pursuant to 12 USC 1818 shall be open to the public, unless the Comptroller, in his or her discretion, determines that holding an open hearing would be contrary to the public interest. In addition, the OCC is required to publicize and make available to the public any final order or formal agreement issued with respect to any administrative enforcement proceeding initiated under 12 USC 1818 or any other provision of law, as well as any modification and/or termination of such orders or formal agreements. The

OCC must also disclose any final Prompt Corrective Action directives under 12 USC 1831o or safety and soundness orders issued pursuant to 12 USC 1831p-1. Under certain very limited circumstances, mandatory disclosure may be delayed for a reasonable period of time.

The OCC's Communications Division publishes a list of enforcement actions monthly that includes the name of the individual or bank involved, the type of action, and the date of the action. The Communications Division maintains a file of all final formal enforcement actions and provides copies of these documents upon request.

Nothing contained above is intended to relieve a bank of its independent obligations to make required disclosures under the various securities laws and related regulations.

Please direct questions or comments to the director for Securities and Corporate Practices Division at (202) 874-5210, or to Large Bank Supervision at (202) 874-4890, or to Midsize and Community Bank Supervision at (202) 874-5020.

Michael L. Brosnan
Senior Deputy Comptroller, Large Bank Supervision

Jennifer C. Kelly
Senior Deputy Comptroller, Midsize and Community Bank Supervision

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

LBS 2005 - 01

Large Bank Supervision
Washington, DC 20219

To: Large Bank Examiners

From: Grace E. Dailey, Joseph H. Evers, Delora Ng Jee
Deputy Comptrollers, Large Bank Supervision

Date: August 8, 2005

Subject: Matters Requiring Attention (MRAs)

This memorandum is to ensure our philosophy and practices with respect to Matters Requiring Attention (MRAs) are understood and consistent. MRA's are conditions or issues that we expect management to change or correct. To be consistent with principles contained in the Large Bank Supervision Handbook, MRAs include practices that:

- Deviate from sound governance, internal control and risk management principles which may adversely impact the bank's earnings or capital, risk profile, or reputation if not addressed.

  Or

- Result in substantive noncompliance with:
  - laws and regulations
  - internal policies, controls or processes
  - OCC supervisory guidance, or
  - supervisory conditions imposed in interpretive letter or licensing approvals

Going forward, it is our practice to include weaknesses meeting the above criteria as a MRA in a Report of Examination or other supervisory communication to a large bank when discovered. This includes documenting MRAs in Supervisory Information Systems for Large Banks (SIS LB). Examiners should not defer listing these weaknesses as MRAs, pending bank management's effort to address such. Nor should we employ a graduated process where we first address an issue meeting the MRA criteria as a recommendation, then, if not addressed, as a MRA.

Going forward, examiner recommendations should be clearly distinguished from MRAs. In this regard, recommendations do not require follow-up by OCC examiners or specific action by bank management, whereas MRAs are issues that require action by bank management. As recommendations do not require specific action and follow-up by bank management or examiners, they should not be included in SIS LB.

When composing, documenting and tracking MRAs in SIS LB the examiner should provide specific details regarding:

- description of MRA
- contributing factors or root cause to the MRA
- description of management actions taken and/or planned to correct or address the MRA
- time frame and person(s) responsible for corrective action
- final resolution of MRA including date cleared

To be preventative and effective in our supervision, it is important when discussing MRAs that we are very clear with bank management and, as necessary, the Board of Directors as to our supervisory concerns and expectations. You should impress upon large banks that it is their responsibility to ensure remedial actions with regard to MRAs are effective and implemented within a reasonable period of time. This means that each large bank should have a process for following up on MRAs. Likewise, we should include in individual large bank strategies plans to follow up on MRAs.

Please contact the Large Bank Deputy Comptrollers with any questions pertaining to MRAs.

APPENDIX

December 15, 2005

LBEICs,

This is to provide clarification on the MRA guidance (LBS 2005-01). The correct interpretation of the guidance is as follows: MRA's are the only items that should **require bank follow-up actions** and should be communicated to the bank via supervisory letter or ROE. These issues should be included and **tracked in SIS-LB** until they are resolved. Under this interpretation Recommendations, if any, **may still be included in an official communication** to the bank but EIC **should not require the bank to respond** with corrective action **nor should the issues be included/tracked in SIS-LB.**

Thanks,

Delora, Grace and Joe