# 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. On June 19, 2012, Mr. Dimon appeared at a second hearing before the U.S. House Committee on Financial Services.

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, 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, 2013. 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

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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).
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.).
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.

(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

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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. 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. 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. 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.

The JPMorgan Chase & Co. of today began as JPMorgan, a commercial bank, in the 19th century. 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. In January 2013, JPMorgan Chase & Co. reported a 2012 record net income of $21.3 billion, on revenue of $99.9 billion.

JPMorgan Chase & Co. engages in a wide variety of financial services, including banking, mortgage lending, securities, credit card issuance, commodities trading, and asset management. It also serves as a primary dealer in U.S. Government securities.

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13 5/10/2012 JPMorgan Form 10-Q, at 4-5.
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. The firm’s principal non-bank subsidiary is JPMorgan Securities LLC. 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.

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. 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). JPMorgan Chase has highlighted its focus on risk management and often refers to its “fortress balance sheet.”

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. 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. JPMorgan Chase is the largest U.S. derivatives dealer in the credit markets.

James (Jamie) Dimon is Chairman of the Board of Directors and Chief Executive Officer (CEO) of JPMorgan Chase & Co. 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.

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15 Id.
16 Id., at 4-5.
17 Id., at 4-5.
18 Id., at 4.
22 Id., at 9, Graphs 3 and 4.
23 Id., at Tables 11 and 12.
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.
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.  

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. 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.

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. 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. In October 2012, Mr. Zubrow announced he would retire.

Stephen Cutler serves as JPMorgan Chase’s general counsel. Greg Baer is a managing director and deputy general counsel in charge of corporate and global regulatory affairs since September 2010. Prior to that, Mr. Baer worked in a similar position at Bank of America.

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. 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.

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.\(^{42}\)

**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

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\(^{38}\) 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.


\(^{40}\) 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).

\(^{43}\) 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.”).
By 2012, the CIO was managing a portfolio of approximately $350 billion, a historic high. According to the OCC, the enormous size of this $350 billion portfolio would make the CIO alone the seventh largest bank in the country.

The CIO was formerly part of the bank’s internal treasury function, but was split off into a stand-alone office in 2005. 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. In 2012, JPMorgan Chase’s proxy statement described the CIO and its Treasury office as 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.” 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.”

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. 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.” 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.” 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. 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.” A final component of the CIO’s longer term horizon was a portfolio of “Special Investments,” which

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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.
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).
consisted of stressed or distressed investment opportunities “related to undervalued or underperforming loans” on the bank’s balance sheet.  

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 which, in turn, was part of the International portfolio identified as having a shorter term investment horizon.

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.

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. Ms. Drew reported directly to Mr. Dimon and was a member of JPMorgan Chase’s Executive and Operating Committees. Prior to taking the helm at the CIO, Ms. Drew had headed the holding company’s Global Treasury office. 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. She was replaced initially by Matthew Zames, from May to September 2012, and then by Craig Delaney.

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. He was then replaced by Marie Nourie. 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. He was replaced by Chetan Bhargiri who now serves as

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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).

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).


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.
Chief Risk Officer for the CIO as well as the bank’s Treasury and Corporate offices. Since 2007, Patrick Hagan served as the CIO’s chief quantitative analyst.

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. 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. 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. He worked in the CIO’s London office, reported to Mr. Macris, and directly oversaw the Synthetic Credit Portfolio. He had earlier worked for Mr. Macris at Dresdner Kleinwort Wasserstein. Mr. Martin-Artajo is a Spanish national living in London.

Bruno Iksil was a trader in the CIO’s London office and reported to Mr. Martin-Artajo. Mr. Iksil joined the CIO in 2005, and served as the head trader managing the Synthetic Credit Portfolio from January 2007 until April 2012. 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. Mr. Iksil is a French national who lived outside of Paris.

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73 Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
79 JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
and commuted to his job in London. 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. He oversaw several other CIO traders including Julien Grout.

In July 2012, JPMorgan Chase fired Messrs. Macris, Martin-Artajo, and Iksil, and suspended Mr. Grout. 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.” 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. The bank indicated the recovered amounts were roughly equal to two years’ worth of the person’s total compensation. At the time of her departure, Ms. Drew forfeited approximately $21.5 million.

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. Under the Dodd-Frank Act, the OCC has also become the primary regulator of federally chartered thrift institutions. The OCC maintains

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.
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. 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. 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 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. The OCC maintains a continuous on-site presence at each of the 19 largest banks under its supervision. An Examiner-in-Charge (EIC) leads each bank’s on-site team of examiners. National banks and Federal savings associations must submit regular reports to the OCC covering a wide range of safety and soundness factors.

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

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subsidiaries, including the CIO. 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. Several OCC examiners were responsible for overseeing the CIO.

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.

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 individual bank. 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.

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. 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. Basel III

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103 Id., at 11.
104 For more information about OCC oversight of the CIO, see Chapter VI.
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.
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

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
due 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

“Progress report on Basel III implementation,” Basel Committee on Banking Supervision, Bank for

110 “International regulatory framework for banks (Basel III),” Basel Committee on Banking Supervision, Bank for
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

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 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,

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.”).
riskier activities than if capital were more expensive. 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.

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. Credit derivatives derive their value from the creditworthiness of a specified financial instrument such as a corporate bond or stock, or from the creditworthiness of a referenced entity such as a corporation or sovereign nation. 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. Parties taking the “long” side of the bet wager that no credit event will occur; parties taking the “short” side of the bet wager that the negative credit event will occur. 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.

Credit Default Swaps. The simplest type of credit derivative, which also dominates the credit derivative markets, is a credit default swap (CDS). 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.

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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 Id., at 37.
Traders often analogize credit default swaps to insurance contracts. The long party is essentially selling insurance, or “credit protection,” against the occurrence of a negative credit event, while the short party is essentially buying that insurance or credit protection. 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. Those periodic payments are sometimes referred to as “premiums,” “coupon” payments, or the “credit spread.” 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.

The value of a CDS is typically related to the premium amount or “credit spread” that the long party has to pay. 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. 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. 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. 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.

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. Each credit index references a basket of selected credit instruments, typically credit default swaps or other types of credit instruments. The value of the index is typically determined by calculating the value of each constituent credit instrument and using a mathematical formula to

\[ \text{Value of Credit Index} = \sum_{i=1}^{n} (\text{Value of Constituent Credit Instrument}_i \times \text{Weight}_i) \]

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127 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.
combine them into a single dollar value for the entire basket. Parties then enter into swaps that reference the index value. The long party bets the index value will increase; the short party bets it will fall.

Investing in a credit index, whose value reflects multiple credit instruments, can be analogized to investing in a portfolio of bonds or loans. 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. Those periodic payments are, again, typically referred to as premiums, coupon payments, or credit spreads. 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. 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. After the credit event, the defaulting credit instrument is effectively eliminated from the index.

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. 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. The parties holding a swap when the referenced index expires are typically required to make a final payment reflecting the value of the index at the time of expiration.

**IG9, HY, and iTraxx Indices.** The CIO traded a variety of credit indices. CIO profit-loss reports indicate that, by March 2012, the CIO held more than 100 different types of credit derivative instruments. Its largest holdings involved indices administered by the Markit Group, Ltd., a global financial information services company that administers multiple index products. 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.

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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 Id., Appendix 4, at 30.
145 Id., at 11.
146 Id., at 13.
147 Id., at 14.
148 Id., at 11.
149 Id.
150 Id.
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.
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. One key index traded by the CIO is the CDX.NA.IG.9. “CDX” refers to credit index. “NA” refers to North America. “IG” refers to “investment grade,” because the index tracks credit default swaps (CDS) for 125 investment grade companies in North America. Each year, Markit issues two series of this index, updating it every six months with a revised reference list of 125 constituent CDS. The number “9” in “IG9” denotes the relevant series of the index. The IG9 series was issued in 2007.

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 covered period, the long party will have to make a payment to the short party holding the credit protection.

The CIO also traded the CDX.NA.HY. “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. These companies are often rated as HY companies because they carry non-investment grade or “junk bond” ratings. 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. The iTraxx group of indices also had a high yield index known as

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.
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.
160 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.
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.
163 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.
the “XO” index. As with the CDX indices, Markit issues a new series of the iTraxx indices every six months, with revised reference lists and varying maturities.

When a new credit index series is issued, it is referred to as the “on-the-run” series. Earlier series of the index are then referred to as “off-the-run.” They continue to trade until their maturity dates, but are typically less actively traded.

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.

Credit Index Tranches. A third, still more complicated type of credit derivative involves credit tranches. The credit tranches that were traded by the CIO typically related to Markit credit indices. Each of the Markit credit indices tracked the value of a specified basket of credit instruments. 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 four tranches with different degrees of vulnerability to default. The riskiest tranche, called the “equity tranche,” was immediately affected by any default at any company in the basket. The next tranche, called the “mezzanine,” was affected only by losses that exceeded 15% of the loss distribution. 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. The last and most secure tranche, the “super senior tranche,” was affected only by losses that exceeded 35% of the loss distribution. 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 often did not require any premiums. These instruments also typically required the parties to make a final payment when the swap expired or the trade otherwise

167 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.
168 Id., at 9; see also 2013 JPMorgan Chase Task Force Report, at 24-25.
169 Id., at 9.
170 Id., at 9-11.
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 Id., at 15, Appendix 4, at 37.
173 Id., at 15, Appendix 4, at 37.
174 Id., at 15, Appendix 4, at 37.
175 Id.
176 Id.
177 Id.
178 Id., at 28.
CIO documents show that the CIO traded credit tranches as well as credit indices and credit default swaps. 179

**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 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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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.
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. Those instruments included, for example, U.S. treasury bonds, municipal bonds, corporate securities, high grade corporate bonds, and high grade mortgage-backed securities. At a Senate hearing, Mr. Dimon stated: “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+. 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. The CIO also diversified its portfolio with a mix of instruments to avoid concentrating its investments in one type of instrument.

In 2006, CIO hired a new trader, David Olson, to diversify the excess deposits investment portfolio by purchasing credit products. According to the OCC, purchasing synthetic credit derivatives was unusual for a CIO-type asset-liability management function. While banks

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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).
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).
often trade in credit derivatives, the OCC has testified that no other large bank uses them to hedge credit risk.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{194} The NBI generally authorized the CIO to trade in credit derivative indices and broad credit default swaps that were not limited to a single corporation.\textsuperscript{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.”\textsuperscript{196} In 2006, the portfolio was assigned an initial “Value-at-Risk” (VaR) limit of $5 million,\textsuperscript{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.\textsuperscript{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.”\textsuperscript{199} At that time, the ABX and TABX were new credit derivative indices that “serve[d] as liquid instruments for trading subprime credit risk.”\textsuperscript{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

\textsuperscript{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).
\textsuperscript{192} Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
\textsuperscript{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).
\textsuperscript{197} Id.; Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
\textsuperscript{198} See, e.g., 2011 JPMorgan Chase Annual Report, at 162.
\textsuperscript{199} 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, “Synthetic Credit Materials,” JPM-CIO-PSI 0001101.
\textsuperscript{200} 2/6/2009 presentation prepared by JPMorgan Chase in response to a Subcommittee request, “CDO Briefing,” at 21, PSI-JPM-30-000001.
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.

In July 2008, the CIO started a credit derivative trading program intended to “benefit from large defaults on High Yield names.” “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. 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. 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.

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. The OCC determined that the SCP acquired its current name in 2008.

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

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202 Id.
203 4/12/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, “Synthetic Credit Materials,” JPM-CIO-PSI 0001101.
205 For more information on the HY credit index, see Chapter 2.
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).
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 derivative products, such as credit index tranches, and engaging in larger volumes of trades.209

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, 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

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)

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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.
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.”).
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:

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\(^{217}\) 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).


\(^{223}\) Subcommittee interview of Ina Drew, CIO (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:

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.

“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 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 developments viewed as highly unlikely, but very

\(^{226}\) 2013 JPMorgan Chase Task Force Report, at 24, footnote 23.
\(^{227}\) 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”).
\(^{233}\) 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).
costly if they do occur. 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.

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. 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.”

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,” 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. 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.

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 a whole. Others explained that it was meant to mitigate losses on the firm’s balance sheet
as opposed to hedging the whole balance sheet. Still others stated that the SCP was meant to
hedge the CIO’s own $350 billion Available-For-Sale (AFS) book of assets. The head of

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
239 Subcommittee interview of John Wilmot, CIO (9/11/2012).
240 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Harry Weiss).
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
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. 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.

It is possible the SCP may have been meant to hedge all of the above at some point. Ms. Drew explained that the SCP originally hedged the bank’s entire balance sheet. 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. 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. 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. 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. In fact, he told the Subcommittee that he was never permitted to know any of the assets or positions held in other parts of the bank.

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” and “not linear.” According to Ms. Drew, it was a “guesstimate.” 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. According to the OCC, on April 16, 2012, JPMorgan Chase told the OCC that

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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).

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.
the SCP was expected to gain $1 billion to $1.5 billion in value to offset $5 to $8 billion in firm wide losses.  

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.  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. 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. 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. For example, the 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.

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, 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. 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. They also described it as hedging against a U.S. financial crisis. In his Senate testimony, Mr. Dimon pointed to both risks, saying the Synthetic Credit Portfolio’s “original intent was to protect or hedge the

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258 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
259 Id.
260 Id.
261 Id.
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 Gunesman).
266 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Gregg Gunesman).
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 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

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 (“we 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).
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 0001151 (“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.”).
bank in those scenarios. 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. 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. The MSR hedges appear to have been routinely documented. 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. 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. 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.”

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. At the time the instrument was issued, it was identified as a hedge, and recorded a notional amount and maturity date. 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. Ms. Drew told the Subcommittee that SCP performance was evaluated in relation to the underlying asset that it was trying to hedge, however, neither she nor the bank identified or produced any documentation supporting that assertion.

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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).
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 Gundersman).
285 Subcommittee interview of Ina Drew, CIO (9/7/2012).
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 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.”

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. 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. The bank also contended that regulators should not require a macro or portfolio hedge to have even a “reasonable correlation” with the risks associated with the portfolio of assets being hedged.

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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).
289 Id., at 25.
would not function as a hedge at all, since all hedges, by their nature, must offset a specified risk associated with a specified position. 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, 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.’”

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. 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. 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.

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.”
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).
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 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. According to Mr. Macris, Ms. Drew thought there would be more defaults. 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,” 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.

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. Greg Baer, a deputy general counsel at the bank, explained that the traders were essentially selling insurance on the lower risk investment grade indices and using the insurance premiums they received to buy insurance on the higher risk, high yield indices. 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. Some current and former JPMorgan Chase personnel referred to that strategy as the long positions “financing” the short positions.

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. Most of this growth occurred in the first half of 2011.

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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).
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.
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 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.\(^{327}\)

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\(^{317}\) 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, “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.
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.\textsuperscript{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 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.\textsuperscript{329} Mr. Macris also told the investigation that the traders – and he – knew they were using “dangerous” instruments.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.


\textsuperscript{329} JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012).

\textsuperscript{330} Id.

\textsuperscript{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 26.

\textsuperscript{332} For more information on credit index tranches, see Chapter II.
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.\footnote{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-13-000113 [Sealed Exhibit]; “From ‘Caveman’ to ‘Whale,’” \textit{Wall Street Journal}, Gregory Zuckerman (5/17/2012), http://online.wsj.com/article/SB100014240527023303879604577408621039204432.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).}

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.”\footnote{“From ‘Caveman’ to ‘Whale,’” \textit{Wall Street Journal}, Gregory Zuckerman (5/17/2012); Subcommittee interview of Doug McLaughlin, OCC (8/30/2012).} 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,”\footnote{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=.} 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,\footnote{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.”).} 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.\footnote{JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).} The CIO traders later claimed internally that they made $550 million,\footnote{JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).} but did not record the profits all on the same day.\footnote{Id.} The key CIO trader, Bruno Iksil, later described the gains as “massive,”\footnote{JPMorgan Corporate Sector Executive Management Report (Full Year 2011 Actuals), JPM-CIO-PSI 0018046 at 26.} while a JPMorgan Chase internal report characterized them as a “windfall.”\footnote{2011 CA Quarterly Summary: Global Chief Investment Office 4th Quarter CA summary,” OCC-SPI-00002483.} JPMorgan Chase’s internal auditors also referred to them as “windfall gains.”\footnote{See FDIC presentation, “JPMC & COMPANY CIO Synthetic Credit Portfolio,” at 11, FDICPROD-0001783.}

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.\footnote{Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).} JPMorgan Chase senior risk managers told the Subcommittee that they had been unaware of the 2011 trades involving the SCP at the time.\footnote{Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).}
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 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. According to the OCC, the SCP’s 2011 gain came from a concentrated position in illiquid credit derivatives, that had been “pretty risky” and was completely dependent upon timing. 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. 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. In fact, she told the CIO traders to try to repeat their performance in 2012. Mr. Macris told the JPMorgan Chase Task Force investigation that he viewed the 2011 gain as a great event for the CIO. Mr. Iksil told that investigation that kind of gain was “unprecedented” within the CIO, and that he had just “reset” the position the month before because it was “cheap." According to JPMorgan Chase but for that $400 million gain, the SCP would have lost money in 2011.

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 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

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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).
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).
American Airlines’ bankruptcy to any loan or credit loss suffered elsewhere in the bank, 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. 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, 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.” 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. 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.

<table>
<thead>
<tr>
<th>Year</th>
<th>SCP Revenue</th>
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<tbody>
<tr>
<td>2008</td>
<td>$170 million</td>
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<tr>
<td>2009</td>
<td>$1.05 billion</td>
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<tr>
<td>2010</td>
<td>$149 million</td>
</tr>
<tr>
<td>2011</td>
<td>$453 million</td>
</tr>
<tr>
<td>Total</td>
<td>$1.772 billion</td>
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</tbody>
</table>

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.

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355 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
357 Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
358 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
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
(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.” 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:

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## "Seat value" comparisons

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<tr>
<th>Role</th>
<th>Name</th>
<th>Total Compensation (Smm)</th>
<th>Ref Grp</th>
<th>2011</th>
<th>2010</th>
<th>Comments / Other</th>
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<td><strong>JPM CIO</strong></td>
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<td>$15</td>
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<td><strong>Bank CIOs</strong></td>
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<td>$9.7 - 10.1</td>
<td>$10 - 12</td>
<td>McLagen OC Market Survey*</td>
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<td>6.8 - 16.1</td>
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<td>McLagan Investor Survey*</td>
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<td>17.5</td>
<td>Internal comparisons FI Mgt (Top 2)</td>
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<td>MGMIC initial benchmarking: 20P - 25P</td>
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<td>$7 - $18</td>
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<td>Macris</td>
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<td>Avg. – High 5.9 - 12.8</td>
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<td>Avg. – High 6 - 15.0</td>
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<td>Internal – Sales &amp; Trading MDs in IB (n=60)</td>
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<td>Internal - IB Fixed Income (Top 3 below IBOC)</td>
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<td>Internal - AM Fixed Income Investment Head</td>
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<td></td>
<td>Martin-Artajo</td>
<td>10.98</td>
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<td>Avg. – High 4.9 - 10.5</td>
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<td>Avg. – High 6.0 - 13.3</td>
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<td>• Global FI – All Products MDs</td>
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<td>Buraya</td>
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<td><strong>SCB Traders</strong></td>
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<td>Avg. – 75P 1.0 - 1.95</td>
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<td>Avg. – 75P 1.2 - 2.2</td>
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<td>1.1 - 1.9 (MGMIC/McLaughan)</td>
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* Independent third party pay survey data used in direct job benchmarking

** Independent third party pay survey data used for comparable jobs in other LOBs that are referenced as part of internal comparisons
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. 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.

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.” 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.” 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.”

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. 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.”

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. 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 end of the range in 2010; and Mr. Iksil was at the top end of the range for 2011 (the only year available). 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.

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365 Id., at 92.
368 Id.
370 Id., at 754.
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, 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.

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.”

(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, including Jamie Dimon, and Ina Drew, had determined that the macroeconomic environment was improving and credit markets were expected to improve as well, with fewer defaults. 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. As Mr. Braunstein explained to the Subcommittee, there was also less of a need for

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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.

374 Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).

375 Id.

the CIO to protect its $350 billion Available-for-Sale portfolio.\textsuperscript{377} Together, this analysis suggested that the SCP should be reduced in size.\textsuperscript{378}

Another factor in favor of reducing the SCP was its high RWA.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{382} Similarly, Mr. Dimon told the Subcommittee that the SCP’s loss protection was becoming less relevant, since the bank was bigger and earning more money, and the SCP’s synthetic assets would require the use of a lot of capital under the upcoming Basel III standards.\textsuperscript{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.”\textsuperscript{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.\textsuperscript{385} Mr. Goldman also told the Subcommittee that, in December 2011, a decision was made to stop using the SCP as a hedge,\textsuperscript{386} which made its credit loss protection characteristics irrelevant to the decision to reduce its RWA.

\textsuperscript{377} Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
\textsuperscript{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.
\textsuperscript{379} See 2013 JPMorgan Chase Task Force Report, at 2, 26-27.
\textsuperscript{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.
\textsuperscript{381} Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
\textsuperscript{382} Id.
\textsuperscript{383} Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012). See also 2013 JPMorgan Chase Task Force Report, at 26-27.
\textsuperscript{384} Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
\textsuperscript{385} Subcommittee interview of John Wilmot, CIO (9/11/2012).
\textsuperscript{386} Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
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. 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. According to the traders, reducing the portfolio still more, and faster, would be more expensive because of execution costs. 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. Mr. Martin Artajo later told the JPMorgan Chase Task Force investigation that the CIO had not been given any budget to cover that cost to reduce the SCP. 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. 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.”

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.” 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. 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

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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).
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).
that CIO would exit the synthetic business as a hedging mechanism over the course of the next year.\textsuperscript{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.”\textsuperscript{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.\textsuperscript{399} Ms. Drew confirmed to the Subcommittee that she gave guidance to the traders to position the book for another gain like in late 2011.\textsuperscript{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.”\textsuperscript{401} That presentation estimated the execution cost for achieving a $10 billion reduction in RWA to be $516 million.\textsuperscript{402} The presentation also identified the possible lost profits from eliminating default protection if one or two corporations were to declare bankruptcy.\textsuperscript{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[ning]ding some of these pos[i]tions opportunistic[ally]. 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

\textsuperscript{397} Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
\textsuperscript{398} JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
\textsuperscript{399} Id.
\textsuperscript{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[ality]”). 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).
\textsuperscript{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.
\textsuperscript{402} Id., at 260.
\textsuperscript{403} Id.
SCP’s RWA total might be better – that is, lower – than anticipated. 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.

(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, 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. 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.”

While the CIO traders acquired the new short credit instruments in December and early January, they did not replace all of the expiring shorts due to the instruction to lower the SCP’s RWA and reduce its size 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, which meant that it was providing less credit protection.

On January 19, 2012, Eastman Kodak filed for bankruptcy, and the SCP book “suffered significant losses as a result.” 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. One internal CIO document estimated the CIO’s loss at $50 million.

According to one CIO trader, they were told not to let an Eastman Kodak-type loss happen again. In response, the CIO traders bought additional short credit protection on a variety of derivative indices.

(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, meaning that the value of long credit positions increased and the value of short credit positions fell. Since the value of short credit protection generally

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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.
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.
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).
417 Subcommittee interview of Peter Weiland, CIO (8/29/2012).
declined, the SCP book also lost value. As the OCC explained it to the Subcommittee, general market movements went against the CIO in January 2012.

The result was that the SCP experienced nine straight days of losses in the second half of January. 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. 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. 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.

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. Mr. Martin-Artajo later told the JPMorgan Chase Task Force investigation that, despite Mr. Macris’s comment, he still viewed the SCP book as a hedge. 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. According to Mr.

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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.
423 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”).
424 JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
425 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.
Martin-Artajo, Mr. Macris did not want to lose money and, in fact, would be “angry” to lose money. 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.” But according to Mr. Iksil, his supervisor Mr. Martin-Artajo disagreed and explicitly instructed him to stop losing money.

The second option, unwinding the book, had already been calculated to cost a minimum of $516 million. 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. In addition, Ms. Drew had already expressed concern about the high cost of unwinding the book.

(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.

In preparation for the meeting, Mr. Iksil provided Ms. Drew a written presentation with key information about the SCP. 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

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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).
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, 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).
$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 HY11 – $115 billion in gross notional value; and
- Main iTraxx S9 – $90 billion in gross notional value.\(^{438}\)

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:

“[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

\(^{435}\) 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 HY11 each tracked 100 companies at higher risk of default; the Main iTraxx S9 tracked 125 investment companies in Europe. For more information on credit indices, see Chapter II.
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 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.

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 engage in “opportunistic risk reduction” with respect to the SCP. 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.

Mr. Martin-Artajo attached to his email a “Decision Table” describing the four scenarios, a copy of which is reprinted below.

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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.

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

<table>
<thead>
<tr>
<th>Model</th>
<th>QR model prevails</th>
<th>CIO model prevails</th>
<th>CIO model prevails</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenarios and perceived feasibility as of today</td>
<td><strong>REDUCTION</strong> (as discussed at 7th December 2011 meeting London and follow up on Xmas)</td>
<td><strong>CENTRAL SCENARIO</strong> (possible with data from QR as discussed with John Wilmer)</td>
<td><strong>TARGET SCENARIO</strong> (to be confirmed once approved by QR)</td>
</tr>
<tr>
<td>Model applied and diversification</td>
<td>QR Model no diversification</td>
<td>QR Model no diversification</td>
<td>CIO Model no diversification</td>
</tr>
<tr>
<td>Data?</td>
<td>No detailed data</td>
<td>Data updates through the year</td>
<td>Data available</td>
</tr>
<tr>
<td>Reduction in RWA</td>
<td>RWA reduced from USD 43 Bln to USD 20 Bln</td>
<td>RWA reduced from USD 43 Bln to USD 20 Bln</td>
<td>RWA reduced from USD 21 Bln to USD 15 Bln</td>
</tr>
<tr>
<td>RWA target EDY (undiversified)</td>
<td>USD 20 Bln</td>
<td>USD 20 Bln</td>
<td>USD 15 Bln</td>
</tr>
<tr>
<td>Estimated Diversified RWA</td>
<td>USD 20 Bln</td>
<td>USD 20 Bln</td>
<td>USD 15 Bln</td>
</tr>
<tr>
<td>Risk management</td>
<td>Systematic reduction of the largest legs across the book</td>
<td>Opportunistic reduction of the critical legs identified from marginals</td>
<td>Opportunistic risk reduction and optimization towards upside in stress</td>
</tr>
<tr>
<td>Unwind of existing trades across the board</td>
<td>Buying protection on QR 10yr, MAIN 59, HY 10 7yr</td>
<td>Buying protection on IG 9 10yr, MAIN 59, HY 10 7yr</td>
<td>Roll the protection on short term tenors expiring</td>
</tr>
<tr>
<td>Trading cost</td>
<td>USD 590mm</td>
<td>USD 250mm</td>
<td>USD 100mm</td>
</tr>
<tr>
<td>Carry</td>
<td>USD 400-500mm</td>
<td>USD 200mm</td>
<td>USD 50mm</td>
</tr>
<tr>
<td>Optionality</td>
<td>USD 0-50mm</td>
<td>USD 0-150mm</td>
<td>USD 0-100mm</td>
</tr>
<tr>
<td>P/E range</td>
<td>USD 150mm to USD 50mm</td>
<td>USD 50mm to USD 150mm</td>
<td>USD 50mm to USD 250mm</td>
</tr>
<tr>
<td>Drawdown needed</td>
<td>USD 300mm</td>
<td>USD 200mm</td>
<td>USD 150mm</td>
</tr>
</tbody>
</table>
Of the four scenarios laid out in the Decision Table, the fourth, or “Target Scenario,” had the lowest “drawdown” or expected loss.\(^\text{444}\) 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.\(^\text{445}\) 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.\(^\text{446}\)

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.”\(^\text{447}\) 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.\(^\text{448}\)

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.\(^\text{449}\) 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.

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

\(^{444}\) 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.
tension." 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. 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. 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 allow the CIO to collect premiums, which they often referred to as “carry.” It could then use this carry both to finance other credit trades and offset losses. 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. Still another benefit was that the value of the long credit protection would increase

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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.
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
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. 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.

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 more long credit derivatives. 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. The ISMG participants were resident in the CIO’s London office, and Ms. Drew attended their meetings when she was in London. Ms. Drew told the Subcommittee that she considered the ISMG to be the appropriate level for an SCP strategy review.

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. 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).” It also stated that the SCP already included some long credit instruments which were providing “offsetting gains to the

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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 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).
458 1/26/2012 email from Bruno Iksil, CIO, to Andrew Perryman, CIO, “credit book last version,” JPM-CIO-PSI 0000159-176, 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.
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 not understand. Because the traders themselves 
disclosed 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

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464 Id.
465 Id.
466 Id.
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.
Buy protection on the tightening move: The presentation proposed essentially buying credit protection when it was less expensive. 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. Coupled with the purchase of protection “on the tightening move,” the presentation was essentially proposing to buy low and sell high.

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. The presentation appears to propose buying the long side of those credit instruments.

Use indices and add to existing position: The presentation noted that the SCP already had some long credit index positions on the books, 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. 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. This trading strategy would prove, however, in the words of Mr. Dimon, to have been “poorly conceived and vetted.”

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

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472 Id.
473 Id.
474 Id.
475 For more information on these credit index tranches, see Chapter II.
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).
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 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. 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”).

The Iksil presentation on January 26, 2012, proposed, not to unwind, but to increase the size of the SCP book of assets. 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. 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.

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. 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

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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).
investment-grade long positions gaining less value than expected. 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 stopped, rather than expanded its use. 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.

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 ....”

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.

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

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486 See 2013 JPMorgan Chase Task Force Report, at 33.
487 Subcommittee interview of Mike Sullivan, OCC (8/30/2012).
488 Subcommittee interview of Doug McLaughlin, OCC (8/30/2012).
larger and larger drawdown pressure versus the risk due to notional increase. Please let me know the course of action I should take here.”

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.”

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. 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. 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 prevented the book from being long risk enough.” 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

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490 Id.
493 JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 9/6/2012).
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.
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 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.

\(^{495}\) JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).


\(^{498}\) 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.

\(^{501}\) 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/8822900/88229001201400000001400001.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.
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.

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.

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.
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.
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.” 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. 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.” 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.

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.

(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.”

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.” 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. According to Mr. Martin-Artajo, the protection the traders bought continued to lose

514 JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
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).
519 JPMorgan Chase Task Force interview of Achilles Macris, CIO (partial readout to the Subcommittee on 8/28/2012).
520 Id.
money relative to the protection the traders sold.\textsuperscript{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.”\textsuperscript{522} Yet, on March 19, 2012, Mr.
Iksil wrote that perhaps they should increase the book’s long positions even more:

“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.”\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{526} On top of that, the CIO acquired a massive $18 billion long position in
the corresponding iTraxx series of credit indices.\textsuperscript{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

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\textsuperscript{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.
\textsuperscript{522} 3/15/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, “Update on Core,” JPM-CIO-PSI
0000386.
\textsuperscript{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.
\textsuperscript{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, “IQ2012,”
(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).
\textsuperscript{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).
\textsuperscript{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.
\textsuperscript{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).
He explained that he had sold so much protection in the IG9 index that he believed the other credit traders “knew” his position, and were taking advantage. 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.” 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.”

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. 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. Ms. Drew told the Subcommittee that she never read that email, 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. According to Ms. Drew, she was not informed at that meeting about the SCP’s recent acquisition of additional long positions, the $600 million to $800 million lag described in the

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528 JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
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.
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 increased position noted today after yesterday’s exhaustive meeting,” JPM-CIO 0003492. For more about this meeting, see Chapter IV.
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 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

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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).


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.

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,
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 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

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).


547 Subcommittee interview of Ina Drew, CIO (9/7/2012).

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.
staff. She explained that Mr. Martin-Artajo had told her that they were trading in the market to “defend” their positions. 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. Ms. Drew told the Subcommittee that, in her view, “you buy or sell something based on value, not to defend your position,” an approach that Mr. Iksil confirmed as reflective of her philosophy. 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.”

Another development occurring at the same time also signaled the increasing risk in the SCP book. On March 22, 2012, the SCP breached a key risk limit known as “CSW10.” Two other risk limits, VaR and CS01, had been breached earlier in the year, but Ms. Drew told the Subcommittee that she considered the CSW10 to be the “overriding” limit.

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.” 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.”

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.” The OCC also
said that the credit trades taken on were “risk additive” rather than “risk reducing.” One OCC regulator said that the trades had so many dimensions of risk that “no matter what happened, they would lose money.”

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. 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. Since JPMorgan Chase transferred many SCP index 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.

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.

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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 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.
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 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—an 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.
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.

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

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).
575 Recorded telephone conversation between Bruno Iksil, CIO, and Julien Grout, CIO (3/16/2012), JPM-CIO 0003474.
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.”).
in March. 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. 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. 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.”

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."

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.” 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.’” The article also said the size of the position could have been as large as $100 billion.

The Wall Street Journal article, entitled “London Whale Rattles Debt Market,” told a similar tale. 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

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578 1/31/2012 email from Bruno Iksil, CIO, to Javier Martin-Artao, 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).


583 Id.

584 Id.

585 Id.

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. The article 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. 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.”

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.

**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. 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.”

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 took far too much risk. That strategy we had was badly vetted. It was badly monitored. It should never have happened.”

Mr. Dimon directed his team of derivative experts to dismantle the CIO’s Synthetic Credit Portfolio. 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. Unwinding those positions led the CIO to report another $449 million loss.

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, with another $1 billion possible. 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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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).
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.
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 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

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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.
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.
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 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.” 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.” GAAP explains that deriving fair value “assumes a hypothetical transaction but is nonetheless a market-driven exercise using the best available information at hand.”

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. Level 1 consists of “quoted prices in active markets for identical assets or liabilities.” 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.” 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.

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.”

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.” 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

607 Accounting Standards Codification Topic 820-10-30, Fair Value Measurements and Disclosures (ASC 820).
608 Id.
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).
bid-ask spread and midpoint price for derivatives of interest. Some financial firms employ independent price reporting services to identify, for a fee, the bid-ask spread and midpoint prices of specified derivatives for use in their financial reporting. 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.”

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, or are part of a large holding whose size might affect the price. Parties with derivative portfolios 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

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616 JPMorgan Chase’s Investment Bank, for example, took this approach.
617 See 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.”).
which it holds a concentrated block of assets, and the uncertainties associated with its pricing methodology.\textsuperscript{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
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.”\textsuperscript{621}

\textsuperscript{620} Subcommittee briefing by Public Company Accounting Oversight Board (9/14/2012).
\textsuperscript{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).”).
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.”

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.”

**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. To identify the mid-price, the Investment Bank employed an independent pricing valuation service which provided pricing information on a number of derivatives for trading book valuations. 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

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622 2013 JPMorgan Chase Task Force Report, at 48-49.
624 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Olivier Vigneron).
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.
market making groups in the Investment Bank, that where CIO hold the same positions the adjustments are also discussed with/applied to CIO.”

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.” 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.”

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.

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. 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.”

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628 Id., at 3.
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.
By March 2012, when the SCP routinely encompassed over 100 different types of credit derivatives, this daily pricing effort required sustained effort. 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. 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.” He also often drafted a short explanation for the day’s gains or losses and included that explanation in the P&L Predict as well. 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.

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. 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. 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. 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 up into a bankwide, internal, cumulative, daily P&L statement.

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

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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.
635 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.
638 Id. (explaining that the bank’s internal database, “Monster Truck,” generated P&L data for both the CIO and firmwide P&L reports).
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.  

Valuation Control Group. Due to the importance of derivative valuations, which can
classify 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 values
reported internally. 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. 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.

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.” 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). 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. The extent of the permitted deviation varied
depending upon the type of credit index or tranche position at issue. 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.
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.” 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.

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. 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. In addition, the book lost money on nine business days in a row at the end of January, producing collective losses of $81 million. February was equally bleak, losing money on 15 of 21 business days, including on seven consecutive business days at the end of the month. 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

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.
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Source: OCC spreadsheet, OCC-SPI-00000298. Losses are indicated by figures in parentheses. Numbers do not


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.\footnote{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.} 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.”\footnote{See 3/9/2012 transcript of a recorded telephone conversation between Julien Grout, CIO, and Bruno Iksil, CIO, JPM-CIO 0003445-356, at 449. (“\textbf{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 big 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.”).} He also advocated analyzing “the lags we have in the core book.”\footnote{Id.} 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.”\footnote{“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.}

On March 9, 2012, in a recorded telephone conversation with Mr. Iksil, Mr. Grout expressed concern about how “we’re lagging,”\footnote{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.} 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.”\footnote{2/29/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, “Core credit book update”, JPM-CIO 0003443.} 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 cover this thing. … [W]e must be careful.”\footnote{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.} 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.”\footnote{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.} Month-end
is not as important as quarter-end.” 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. 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.

The OCC noticed the same trend when it examined the March marks. As one OCC examiner put it: “New marks increase loss [$472m] for March. … Instead of marking to mid, in most cases longs were marked at offer and shorts at bid.” 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.”

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.
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
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. 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 columns broke out the difference for each of the three credit indices, using both dollars and basis points.

<table>
<thead>
<tr>
<th>Date</th>
<th>Distance</th>
<th>iTraxx</th>
<th>CDX.IG</th>
<th>CDX.HY</th>
<th>iTraxx.Main</th>
<th>5S 10y</th>
<th>CDX.IG 10y</th>
<th>CDX.HY 10y</th>
</tr>
</thead>
<tbody>
<tr>
<td>12-Mar-12</td>
<td>(202,543.64)</td>
<td>(59,050.04)</td>
<td>(90,077.97)</td>
<td>(53,415.62)</td>
<td>3.0</td>
<td>2.0</td>
<td>0.17</td>
<td></td>
</tr>
<tr>
<td>13-Mar-12</td>
<td>(205,639.42)</td>
<td>(61,372.97)</td>
<td>(89,698.50)</td>
<td>(54,667.65)</td>
<td>3.5</td>
<td>2.0</td>
<td>0.18</td>
<td></td>
</tr>
<tr>
<td>14-Mar-12</td>
<td>(263,984.07)</td>
<td>(82,396.79)</td>
<td>(136,202.78)</td>
<td>(68,279.79)</td>
<td>4.0</td>
<td>3.0</td>
<td>0.18</td>
<td></td>
</tr>
<tr>
<td>15-Mar-12</td>
<td>(292,470.54)</td>
<td>(83,045.95)</td>
<td>(181,254.94)</td>
<td>(37,635.86)</td>
<td>4.0</td>
<td>4.0</td>
<td>0.12</td>
<td></td>
</tr>
<tr>
<td>16-Mar-12</td>
<td>(498,717.23)</td>
<td>(100,525.86)</td>
<td>(158,706.38)</td>
<td>(107,366,237)</td>
<td>5.0</td>
<td>3.0</td>
<td>0.34</td>
<td></td>
</tr>
<tr>
<td>15-Mar-12</td>
<td>(432,348.43)</td>
<td>(130,119.51)</td>
<td>(143,346.09)</td>
<td>(107,366,237)</td>
<td>5.0</td>
<td>3.0</td>
<td>0.34</td>
<td></td>
</tr>
</tbody>
</table>

Source: Spreadsheet prepared by Julien Grout, CIO, JPM-CIO-PSI-H 0002812. Losses are indicated by figures in parentheses.

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 please? … And send it to javier email … Put me in copy … I refer to the spreadsheet.”
Mr. Grout: “itraxx 83 (4bp) ig180 (4bp) hy 37) 0.12”

Mr. Iksil: “… So julien, basically [you] say the worsening is 1bp in ig9 …”

Mr. Grout: “correct bruno”

[Later that same day]

Mr. Iksil: “We have 6 bps in ig9 after all … 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 also: main s9 10y”

Mr. Iksil: “I am confused. I mean, [I’m]n trying to keep a relatively realistic picture here - ig9 10y put aside Because 7 bps in ig9 10yr makes up for 7x50 gives 350 …”

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 [you]u store the breakdown of the difference between our estimate and crude mids I will comment to javier”

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

003457-459. 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.

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.

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 spreadsheet recording the breakdown 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 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

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.
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 0001231-233, at 232 (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.”).


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 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

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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-PSI-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).
problems with the CIO’s marks.\textsuperscript{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.”\textsuperscript{692}

Three days after the spreadsheet was apparently discontinued, on March 19, 2012, the CIO traders appear to have calculated that, by mid-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).\textsuperscript{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.\textsuperscript{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 reflect the

\textsuperscript{691} Subcommittee interview of Ina Drew, CIO (12/21/2012).

\textsuperscript{692} Id.

\textsuperscript{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.]

\textsuperscript{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.
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

In addition, in the P&L email’s commentary explaining the CIO’s loss, Mr. Iksil699 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

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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.”).
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.”).
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).”

By way of context, a loss of $600 million, on top of the marked loss of $208 million, would more than extinguish all of the revenues produced by the Synthetic Credit Book in 2010 and 2011, combined.

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.

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. 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.

Mr. Iksil: “Yea[h] so, yea[h] we sent an estimate down [$]40 million today. …”

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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.
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.”).
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 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

706 Id., at 394-395.
707 Id., at 396-397.
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 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.

Mr. Martin-Artajo: “Ok, Bruno, no, no, no, it’s fine, okay, I see what you’re going through. … 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 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.”

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). 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.”

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. 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. 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 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.

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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 increased 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).
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.
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; 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. 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.

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 “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.

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. The next day, March 22, 2012, the CIO reported a daily loss of $1.8 million.

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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.
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.
(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.\textsuperscript{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.”\textsuperscript{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:

\textbf{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 [$]600m[illion], BID ASK MID BID ASK YOU HAVE [$]300M[illion] AT LEAST … [I]t is everywhere/all over the place we are dead I tell you --”

[Later that day]

\textbf{Mr. Grout:} “[W]ill you give me the color please? [I]f there is some.”

\textbf{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]

\textbf{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 …”

\textbf{Mr. Grout:} “Did you talk to Javier?”

[5 minutes later]

\textsuperscript{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.”).

\textsuperscript{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.
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.”

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 happen [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”

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.

(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. 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.

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

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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 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).
disclosing information about the CIO’s positions to the marketplace at large. In response, a senior Investment Bank executive, Daniel Pinto, investigated the allegations and determined they were untrue.

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.

**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 billion 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 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.

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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 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 severely 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.
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.”

**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. 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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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.”

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 …?”

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.”

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

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734 Id.
735 Id.
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?”

**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 to take a look of the marks and see if there is anything that is being done inappropriate. What I was

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736 Jean Francois Bessin was the director and global head of valuation for the Investment Bank.
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.”

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. Mr. Pinto’s logic in identifying collateral disputes as a red flag of mismarking shows that the bank itself 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. 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.  JPMorgan Chase

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738 Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
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.
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 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.

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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 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 0001759-760, at 759 (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 1.8bln.”).
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-PSI-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-PSI-00071386 (“Real market marks were true by end of Mar and the large loss on 3/31/2012 was due to that one reason.”).
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?”

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.”

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. 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

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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.
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 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[en]t 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 an SCP P&L Predict projecting a daily loss

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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.
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.”).
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[en]t 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.”).
755 The markets were closed on Monday, April 9, due to Easter. See 2013 JPMorgan Chase Task Force Report, at 64, footnote 78.
of only about $6 million, 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. 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, 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, 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.” 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. 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 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. Trader interviews with the JPMorgan Chase Task Force
suggest that Mr. Martin-Artajo then directed the second SCP P&L Predict to be emailed.

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.
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).
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.” 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.”

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.

The final daily loss recorded internally for the SCP by the bank on April 10, 2012, was $415 million. That $415 million loss was the single largest daily loss for the book up to that point in the year. The cumulative year-to-date losses then jumped to $1.2 billion, the first time the cumulative SCP losses had crossed the $1 billion threshold.

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

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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.
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.
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

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

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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 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. …” Mr. Iksil: “…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.
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.” 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. The disputes apparently arose, in 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. At their peak in mid-April 2012, the CIO collateral disputes involved $690 million.

The collateral disputes were escalated to the attention of Ms. Drew. By April 20, 2012, the CIO had collateral disputes with 10 different counterparties, involving primarily differences over the prices assigned to credit tranche positions. On April 20, 2012, Daniel

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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 0000141-151, 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 0000141-151, at 141.
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.”).
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 0000141-151, at 142.
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.\textsuperscript{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.”\textsuperscript{780}

The largest single dispute involved Morgan Stanley which contested credit derivative valuations that it contended were overstated by more than $90 million.\textsuperscript{781} Morgan Stanley told the Subcommittee 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.\textsuperscript{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.”\textsuperscript{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.”\textsuperscript{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.

\textsuperscript{779} See 4/20/2012 email from Daniel Vaz, JPMorgan Chase, “URGENT ::: Huge Difference for iTraxx and CDX trades,” JPM-CIO 0003586-587.
\textsuperscript{780} 4/20/2012 email from John Hogan, JPMorgan Chase, to Douglas Braunstein, JPMorgan Chase, “Collateral Disputes,” JPM-CIO-PSI-H 0000108.
\textsuperscript{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 (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).
\textsuperscript{782} Subcommittee interview of Morgan Stanley (9/25/2012).
\textsuperscript{783} 4/20/2012 email from Morgan Stanley to JPMorgan Chase, JPM-CIO 0003603-605.
\textsuperscript{784} Subcommittee interview of Ina Drew, CIO (12/10/2012).
### Chief Investment Office Collateral Disputes - April 20-May 23, 2012

<table>
<thead>
<tr>
<th>Date</th>
<th>Total of CIO Collateral Disputes</th>
<th>Largest Counterparty Difference</th>
<th>Counterparty of Largest Dispute</th>
</tr>
</thead>
<tbody>
<tr>
<td>4/20/2012</td>
<td>$ 520 million</td>
<td>$ 115 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/02/2012</td>
<td>$ 182 million</td>
<td>$ 55 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/03/2012</td>
<td>$ 194 million</td>
<td>$ 57 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/04/2012</td>
<td>$ 203 million</td>
<td>$ 61 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/07/2012</td>
<td>$ 212 million</td>
<td>$ 61 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/08/2012</td>
<td>$ 144 million</td>
<td>$ 54 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/09/2012</td>
<td>$ 120 million</td>
<td>$ 58 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/10/2012</td>
<td>$ 66 million</td>
<td>$ 46 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/11/2012</td>
<td>$ 69 million</td>
<td>$ 27 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/14/2012</td>
<td>$ 156 million</td>
<td>$ 46 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/15/2012</td>
<td>$ 152 million</td>
<td>$ 110 million</td>
<td>DBKAG</td>
</tr>
<tr>
<td>05/17/2012</td>
<td>$ 42 million</td>
<td>$ 27 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/21/2012</td>
<td>$ 25 million</td>
<td>$ 32 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/23/2012</td>
<td>$(29) million</td>
<td>$ 17 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/24/2012</td>
<td>$(29) million</td>
<td>$ 17 million</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>05/25/2012</td>
<td>$ 25 million</td>
<td>$ 39 million</td>
<td>Morgan Stanley</td>
</tr>
</tbody>
</table>

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.
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.
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.
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.
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. 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.

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. 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.” The effort was headed by the bank’s Controller, Shannon Warren. 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 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

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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.
sources, and inadequate procedures for requiring reserves. For example, the internal audit report rated the following as “Needs Improvement”:

“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.”

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.”

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.

**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.

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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.
We had a small number of positions where they fell outside these tolerances and hence the adjustment that was passed."\textsuperscript{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.”\textsuperscript{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.

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.\textsuperscript{812} Excerpts from three of those charts are presented below, covering the 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

<table>
<thead>
<tr>
<th>Credit Default Swap Indices and Tranches</th>
<th>CIO Mark</th>
<th>Broker Bid</th>
<th>Broker Mid Price</th>
<th>Broker Offer</th>
<th>Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>CDX.NA.HY 10-15% S08 05Y</td>
<td>70.000</td>
<td>69.625</td>
<td>70.313</td>
<td>71.000</td>
<td>lower price</td>
</tr>
<tr>
<td>CDX.NA.HY 15-25% S10 05Y</td>
<td>93.375</td>
<td>92.875</td>
<td>93.313</td>
<td>93.750</td>
<td>higher price</td>
</tr>
<tr>
<td>CDX.NA.HY 15-25% S11 05Y</td>
<td>86.250</td>
<td>85.438</td>
<td>86.063</td>
<td>86.688</td>
<td>higher price</td>
</tr>
<tr>
<td>CDX.NA.HY 35-100% S10 05Y</td>
<td>106.313</td>
<td>106.170</td>
<td>106.315</td>
<td>106.460</td>
<td>higher price</td>
</tr>
<tr>
<td>CDX.NA.HY IDX S11 07Y</td>
<td>101.000</td>
<td>100.688</td>
<td>101.000</td>
<td>101.313</td>
<td>higher price</td>
</tr>
<tr>
<td>CDX.NA.HY IDX S14 05Y</td>
<td>100.625</td>
<td>100.375</td>
<td>100.625</td>
<td>100.875</td>
<td>lower price</td>
</tr>
<tr>
<td>CDX.NA.HY IDX S15 05Y</td>
<td>100.125</td>
<td>99.938</td>
<td>100.125</td>
<td>100.313</td>
<td>lower price</td>
</tr>
<tr>
<td>CDX.NA.IG 0-3% S09 05Y</td>
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<td>26.460</td>
<td>26.680</td>
<td>26.900</td>
<td>lower price</td>
</tr>
<tr>
<td>CDX.NA.IG 0-3% S09 10Y</td>
<td>60.750</td>
<td>60.563</td>
<td>60.813</td>
<td>61.063</td>
<td>higher price</td>
</tr>
</tbody>
</table>

\textsuperscript{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.

\textsuperscript{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.

\textsuperscript{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.
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

<table>
<thead>
<tr>
<th>Credit Default Swap Indices and Tranches</th>
<th>CIO Mark</th>
<th>Broker Bid</th>
<th>Broker Mid Price</th>
<th>Broker Offer</th>
<th>Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>CDX.NA.HY 10-15% S08 05Y</td>
<td>89.750</td>
<td>89.500</td>
<td>90.000</td>
<td>90.500</td>
<td>lower price</td>
</tr>
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<td>CDX.NA.HY 10-15% S10 07Y</td>
<td>17.000</td>
<td>15.160</td>
<td>16.245</td>
<td>17.330</td>
<td>higher price</td>
</tr>
<tr>
<td>CDX.NA.HY 15-25% S10 05Y</td>
<td>95.375</td>
<td>94.660</td>
<td>95.120</td>
<td>95.580</td>
<td>higher price</td>
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<tr>
<td>CDX.NA.HY 15-25% S11 05Y</td>
<td>86.250</td>
<td>85.660</td>
<td>86.330</td>
<td>87.000</td>
<td>higher price</td>
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<tr>
<td>CDX.NA.HY 35-100% S10 05Y</td>
<td>106.188</td>
<td>106.000</td>
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<td>106.290</td>
<td>higher price</td>
</tr>
<tr>
<td>CDX.NA.HY IDX S11 07Y</td>
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<td>101.063</td>
<td>101.563</td>
<td>102.063</td>
<td>lower price</td>
</tr>
<tr>
<td>CDX.NA.HY IDX S14 05Y</td>
<td>101.375</td>
<td>101.250</td>
<td>101.500</td>
<td>101.750</td>
<td>lower price</td>
</tr>
<tr>
<td>CDX.NA.HY IDX S15 05Y</td>
<td>100.563</td>
<td>100.313</td>
<td>100.500</td>
<td>100.688</td>
<td>lower price</td>
</tr>
<tr>
<td>CDX.NA.IG 0-3% S09 05Y</td>
<td>24.188</td>
<td>23.830</td>
<td>24.060</td>
<td>24.290</td>
<td>lower price</td>
</tr>
<tr>
<td>CDX.NA.IG 0-3% S09 10Y</td>
<td>59.875</td>
<td>59.625</td>
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<td>60.080</td>
<td>lower price</td>
</tr>
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<td>CDX.NA.IG IDX S09 07Y</td>
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<td>91.813</td>
<td>93.813</td>
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<tr>
<td>CDX.NA.IG IDX S09 10Y</td>
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<td>113.313</td>
<td>115.563</td>
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<tr>
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<td>65.875</td>
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<td>66.400</td>
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<td>iTraxx.Main 22-100% S09 07Y</td>
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<td>iTraxx.Main 22-100% S09 10Y</td>
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<td>126.000</td>
<td>128.250</td>
<td>128.500</td>
<td>lower spread</td>
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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

<table>
<thead>
<tr>
<th>Credit Default Swap Indices and Tranches</th>
<th>CIO Mark</th>
<th>Broker Bid</th>
<th>Broker Mid Price</th>
<th>Broker Offer</th>
<th>Benefit</th>
<th>Month-End CIO Trade (date and price)(^{813})</th>
</tr>
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<tbody>
<tr>
<td>CDX.NA.HY 10-15% S08 05Y</td>
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<td>91.500</td>
<td>92.000</td>
<td>92.500</td>
<td>lower price</td>
<td>Info not available.</td>
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<tr>
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<td>92.875</td>
<td>93.125</td>
<td>93.375</td>
<td>higher price</td>
<td>Info not available.</td>
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<tr>
<td>CDX.NA.HY 15-25% S11 05Y</td>
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<td>82.875</td>
<td>83.313</td>
<td>83.750</td>
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<tr>
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\(^{813}\) 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.”

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 the midpoint prices, the Controller then shaved off...

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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.).
$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. After changing those marks to reflect the extreme edge of the VCG’s allowed valuation range, 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.

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. 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…”

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.”

Mr. Webster: “But they were, none of them were actually at the boundaries of the bid or offer.”

Mr. Martin-Artajo: “Right.”

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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.

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.”

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.”

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 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.”

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.”

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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.

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.
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. 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. 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.

When later asked about the bank’s special assessment of the SCP marks, a senior OCC examiner told the Subcommittee that “it was garbage.” 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. The OCC told the Subcommittee that it was clear the CIO traders were “gaming the system.” 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.” 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.\textsuperscript{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.”\textsuperscript{831} At another point, he said that his supervisor would have to “decide[ ] what we show. [B]ecause me, I don’t know anymore.”\textsuperscript{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,\textsuperscript{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 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.\textsuperscript{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.\textsuperscript{835}

\textsuperscript{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.
\textsuperscript{831} 3/16/2012 transcript of a recorded telephone conversation between Julien Grout, CIO, and Bruno Iksil, CIO, JPM-CIO-PSI-A 0000162.
\textsuperscript{832} 3/23/2012 instant messaging session between Bruno Iksil, CIO, and Julien Grout, CIO, JPM-CIO 0003515-541, at 541.
\textsuperscript{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”).
\textsuperscript{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.
\textsuperscript{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
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. That $570 million was the largest single daily loss reported by the SCP up to that point in 2012. While it may have reflected 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,” 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. 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.”

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836 See OCC spreadsheet, OCC-SPI-00000298, printed as a Subcommittee chart earlier in this chapter. Numbers do not reflect restated P&L figures.


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.”).

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.”

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.” Mr. Braunstein, by virtue of his position as Chief Financial Officer, had the responsibility for approving the establishment and size of the reserves.

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. 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.

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. 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.

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.

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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).
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).
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).
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 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

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.
851 Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012).
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.
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.”

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 standard policies and procedures in the Book’s stated value.”

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. 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.

854 7/12/2012 letter from JPMorgan Chase to Javier Martin-Artajo, CIO, JPM-CIO-PSI-H 0002744-745, at 744.
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).
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. 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.”  

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. 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.”

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. 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.

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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.
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. Mr. Hogan said that the Synthetic Credit Portfolio was not on his radar in an “alarming way” prior to that date. It speaks volumes that the financial press became aware of the CIO’s risk problems before JPMorgan Chase’s Chief Risk Officer.

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,” and Mr. Braunstein stated that the bank was “very comfortable with our positions.” Those statements did not reflect the magnitude of the problems in the Synthetic Credit Portfolio. Mr. Dimon publicly withdrew his comment a month later.

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 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.”

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, and were regularly discussed with the Risk Policy Committee of the Board of Directors. The business unit risk limits were developed by each unit’s head and risk management personnel, in consultation with the bank’s Chief Risk Officer. The CIO’s limits depended on overall firm risk appetite as well as its own mandate, which required a dialogue between the CIO and firm managers. 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. 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.

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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.
873 Subcommittee interview of Peter Weiland, CIO (8/29/2012).
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).
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.” 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 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.”

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

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 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. 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.”).
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.”).
automatic freeze or unwinding of positions.\textsuperscript{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.\textsuperscript{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.\textsuperscript{885} Ms. Drew and Mr. Macris held Mr. Martin-Artajo in high regard, and put a great deal of confidence in his analysis.\textsuperscript{886} The CIO’s risk personnel did not express a countervailing view.\textsuperscript{887}

With hindsight, the JPMorgan Chase Task Force provided this negative assessment of the CIO’s risk management structure:

“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.”\textsuperscript{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.\textsuperscript{889} Yet the CIO did not have a Chief Risk Officer until 2012. The position of CIO Chief Risk Officer was vacant through 2011.\textsuperscript{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.\textsuperscript{891} When he was informed of limit

\textsuperscript{883} Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
\textsuperscript{884} Subcommittee interview of Ina Drew, CIO (12/11/2012).
\textsuperscript{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.
\textsuperscript{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).
\textsuperscript{887} See 2013 JPMorgan Chase Task Force Report, at 100, and discussion below.
\textsuperscript{888} 2013 JPMorgan Chase Task Force Report, at 94.
\textsuperscript{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.”).
\textsuperscript{890} Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
\textsuperscript{891} Subcommittee interview of Peter Weiland, CIO (8/29/2012).
breaches, bank documents indicate that his reaction was to challenge the metrics, not the CIO traders. The same was true of the CIO’s top risk quantitative analyst, Patrick Hagan.

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. 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. 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.”

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.”

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. 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

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893 Id.
895 Subcommittee interview of Peter Weiland, CIO (8/29/2012).
897 Subcommittee interview of Ina Drew, CIO (9/7/2012).
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 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. 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

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:

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 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).
905 Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
906 Id.
907 Id.
“[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.”

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. 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. Mr. Weiland, who remained the CIO’s Chief Market Risk Officer, began reporting to Mr. Goldman. 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.

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.

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. 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. In addition, unlike other JPMorgan Chase lines of

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).
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 20 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 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
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.”

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. At the CIO, in 2011 and early 2012, risk managers played no role in evaluating and approving trading strategies. Mr. Weiland explained to the Subcommittee that his role as a risk manager was descriptive, rather than prescriptive. 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 to Ms. Drew rather than to the risk personnel to enforce the risk limits.

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.

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. Mr. Hogan stated that until the stories broke, his first priority had been to understand the bank’s consumer...
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 effective or that the environment in CIO was conducive to their effectiveness.”

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

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923 Id.
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. These complex tasks are made more difficult if banks’ 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. The OCC provides detailed guidance on how regulatory VaR models should function, but allows individual banks to design their own models. The OCC also requires all of the banks it oversees to obtain its approval of VaR models used to calculate regulatory capital. 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.

JPMorgan Chase defines VaR as a “measure of the dollar amount of potential loss from adverse market moves in an ordinary market environment.” 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.”

According to public filings, JPMorgan Chase “has one overarching VaR model framework used for risk management purposes across the Firm,” but Mr. Dimon told the Subcommittee that the bank has hundreds of individual VaR models used by various lines of business and business segments. 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:

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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.”).
930 See 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.”).
933 Id., at 158.
935 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
“The Firm calculates VaR to estimate possible economic outcomes for its current positions using historical simulation, 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.”

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.

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. 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. 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.

(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. The CIO 10-Q VaR model then in effect had been designed by Keith Stephan, a member of the CIO’s risk

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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.
941 Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
management team in London. 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. Mr. Hagan had never previously designed a VaR model. According to JPMorgan Chase, having an employee from a business unit design the unit’s risk model was somewhat unusual, but it did not violate bank policy. The new VaR model, when finalized, indicated that it had been created by both Mr. Hagan and Mr. Stephan.

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. 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. 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.

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. 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.

According to JPMorgan Chase, the impetus for the new VaR models was to render the CIO’s VaR models compliant with Basel III requirements. Basel III refers to a set of

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).
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.
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.
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.\textsuperscript{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.”\textsuperscript{954} That is, the old VaR model overstated risk.\textsuperscript{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.”\textsuperscript{956} Both JPMorgan Chase and Mr. Hagan informed the Subcommittee that the new model was designed to consider and reflect additional types of risks compared to the prior model, and would produce more accurate results.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{960} Under those rules, a higher RWA required greater capital to protect against the higher

\textsuperscript{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.

\textsuperscript{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.”).

\textsuperscript{955} Subcommittee interview of Ina Drew, CIO (9/7/2012).

\textsuperscript{956} 2013 JPMorgan Chase Task Force Report, at 122.

\textsuperscript{957} Subcommittee interviews of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) and Patrick Hagan, CIO (2/7/2013).

\textsuperscript{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).

\textsuperscript{959} Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

\textsuperscript{960} RWA is a dollar measure of a bank’s assets, adjusted according to the assets’ risk. For more information, see
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 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 (acknowledged 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”

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.

Chapters II and III.


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).
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.¹⁶³

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.¹⁶⁴ 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.¹⁶⁵ 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.¹⁶⁶ 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.¹⁶⁷ The next day, January 19, Mr. Martin-Artajo sent Ms. Drew an email describing four scenarios for reducing the SCP’s RWA.¹⁶⁸ 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.¹⁶⁹ 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.”¹⁷⁰ 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.

¹⁶³ 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.”).
¹⁶⁴ 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.”
¹⁶⁵ Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
¹⁶⁶ 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.
¹⁶⁷ 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).
¹⁶⁸ 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.
¹⁶⁹ 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).
¹⁷⁰ For more information, see Chapter III.
On January 10, 2012, the firmwide VaR daily update stated: “The Firm’s 95% 1Q VaR as of cob [close of business] 01/09/2012 is $123mm [million] or 98% of the $125mm limit, an increase of $5mm 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 1Q 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.

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:

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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].
“Will come back to you with a better explanation. From our point of view we did not have any P/L [profit/loss] volume 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.”

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.” 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.”

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. 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. While several JPMorgan Chase officials minimized the relevance of VaR 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.

On January 16, 2012, the CIO’s purchases of additional short positions triggered not only a breach of the CIO VaR limit, but also a breach of the bankwide VaR limit, a breach that continued for the next three days. These VaR breaches caused real concern within the CIO.

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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 Excessed notification (COB 1/19/12),” JPM-CIO-PSI 0000150.
981 1/16/2012, JPMorgan Chase spreadsheet “Position Limit and Loss Advisory Summary Report,” JPM-CIO-PSI 0037534 (showing excess of the $95 million MTM 10Q VaR limit for close of business January 16, 2012).
982 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
983 Id.
984 1/16/2012, JPMorgan Chase spreadsheet “Position Limit and Loss Advisory Summary Report,” JPM-CIO-PSI 0037534 (showing excess of the $95 million MTM 10Q VaR limit for close of business January 16, 2012).
985 See 1/19/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan
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.”  

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.”

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. 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.”

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. 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].” 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.”

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.”

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.

987 Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
989 2013 JPMorgan Chase Task Force Report, at 125.
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 0000150.
(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.” 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 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 31\(^\text{st}\), 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 31\(^\text{st}\), 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.”

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. 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.”

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991 Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
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,
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 positions1000 were threatening yet another breach of the bankwide VaR 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:

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“APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval,” JPM-CIO-PSI 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-SP1 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-SP1 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.
"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\textsuperscript{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.\textsuperscript{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.”\textsuperscript{1003}

By the end of the day on January 27, the SCP’s VaR totaled $125.7 million,\textsuperscript{1004} breaching the CIO’s temporary VaR limit of $105 million\textsuperscript{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 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.\textsuperscript{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.\textsuperscript{1007} Ms. Drew conceded as much to the Subcommittee.\textsuperscript{1008}

\textsuperscript{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.

\textsuperscript{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].

\textsuperscript{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.

\textsuperscript{1004} See 5/2012 JPMorgan Chase spreadsheet of VaR levels in the Synthetic Credit Portfolio, FDICPROD-0024286.

\textsuperscript{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.


\textsuperscript{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.

\textsuperscript{1008} Subcommittee interview of Ina Drew, CIO (9/7/2012).
(e) Winning Approval of the New VaR Model

On January 30, 2012, the CIO won bank approval of its new VaR model.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{1013}

JPMorgan Chase has acknowledged to the Subcommittee that the internal approval process for the new CIO VaR model was “hurried.”\textsuperscript{1014} All of the bank’s VaR models were supposed to be reviewed and approved by its internal Model Review Group, which was part of its risk division.\textsuperscript{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.\textsuperscript{1016} No dates were set for completing the action plans, however,\textsuperscript{1017} and the action plans were, in fact, never completed.\textsuperscript{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.\textsuperscript{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

\begin{footnotesize}
\begin{itemize}
\item 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.
\item See undated spreadsheet of CIO 10Q VaR from 12/1/2011 to 5/10/2012, JPMC-Senate/Levin 000155.
\item Levin Office briefing by JPMorgan Chase (6/26/2012).
\item Subcommittee interview of Michael Sullivan, OCC (11/7/2012).
\item Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
\item Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
\item 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.
\item 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 0000190-191.
\item 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 0000190-191.
\item 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 0000190-191.
\item Subcommittee briefing by JPMorgan Chase (8/15/2012); 2013 JPMorgan Chase Task Force Report, at 127.
\item 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].
\end{itemize}
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any diverging results between the two.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{1023} On 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.\textsuperscript{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.”\textsuperscript{1025} The OCC concluded that JPMorgan Chase’s “VaR Model risk management is weak and constitutes an unsafe and unsound banking practice.”\textsuperscript{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.\textsuperscript{1027}

\begin{footnotes}
\item[1020] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
\item[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”).
\item[1022] Subcommittee interview of Patrick Hagan. CIO (2/7/2013).
\item[1023] 1/27/2012 email from Ashish Dev, JPMorgan Chase, to Peter Weiland, CIO, and others, “draft of the MRG review of the HVAR methodology for the CIO core credit books,” JPM-CIO-PSI 0000187.
\item[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).
\item[1025] 11/6/2012 OCC Supervisory Letter to JPMorgan Chase, “Examination of VaR Model Risk Management,” at 2, PSI-OCC-17-000019 [Sealed Exhibit].
\item[1026] Id.
\item[1027] See undated spreadsheet of CIO 10Q VaR from 12/1/2011 to 5/10/2012, JPMC-Senate/Levin 000155. This
\end{footnotes}
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.” 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.

The sizeable difference between the two figures – the VaR remained between 30 and 50% lower than it would have been under the prior model – continued until the new VaR model was abandoned in May 2012. The following chart shows the calculations produced by the new VaR model compared to the previous model and the CIO VaR limit.

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Source: Subcommittee chart created from data provided by JPMorgan Chase, JPMC-Senate/Levin 000155-6.

spreadsheet 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.  
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 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 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. When asked why not, Ms. Drew explained that “everything can’t happen at once,” and “models get changed all the time.”

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. 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. 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. Mr. Dimon told the Subcommittee that a discussion as to whether the VaR limit should have been lowered at the

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.
same time as the VaR model change should have taken place. The OCC Examiner-in-Charge at JPMorgan Chase told the Subcommittee that he would have expected the firm to “recalibrate” the VaR limit given the major decline in the VaR resulting from the model change. 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.” 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.”

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,” 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).”

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. 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

1038 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
1039 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
1041 1/31/2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, “hello, quick update in core credit,” JPM-CIO-PSI 0001229.
1043 4/18/2012 email from Keith Stephan, CIO, to Achilles Macris, CIO, and others, “CIO VaR,” JPM-CIO-PSI 0001205.
1044 Subcommittee interview of Michael Sullivan, OCC (8/30/2012).
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. …

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

1045 Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
1046 Id.
1047 2013 JPMorgan Chase Task Force Report, at 105.
Group, as well as calculation errors involving hazard rates and correlation estimates that improperly lowered the VaR results.

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.”

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. 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. Bank officials told the Subcommittee that the new VaR model had the effect of reducing the bank’s overall VaR by 20%. 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.

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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).
1052 Id., at 98.
1053 Subcommittee briefing by JPMorgan Chase (1/28/13) (Neila Radin).
(a) Background

CRM, like VaR, produces a dollar figure representing potential losses. While VaR quantifies possible losses over the course of a 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:

- “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

1055 Subcommittee briefing by JPMorgan Chase (8/15/2012).
1057 Id.
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).
At the CIO, CRM was used to measure risk and capital requirements related to credit tranche positions and their associated hedges. 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.

(b) Challenging the CRM Results

JPMorgan Chase applied the CRM risk metric to the Synthetic Credit Portfolio beginning in 2011. 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. In January 2012, however, the CIO’s CRM totals suddenly began to skyrocket. On January 4, CRM was calculated at $1.966 billion. On January 11, it was $2.344 billion. On January 18, it reached $3.154 billion.

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. 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.

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. 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.

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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.
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.
1070 Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
1071 Id.
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 words1072 – 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 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

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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.
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.”).
1079 Id.
Mr. Weiland expressed surprise at the huge CRM figure and questioned the results:

“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.”

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.” Mr. Weiland told the Subcommittee that by “garbage” he meant, not that the results were negative, but rather that they were unreliable. 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[illion] 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 $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.

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1081 3/2/2012 email from Kevin Krug, JPMorgan Chase, to Peter Weiland, CIO, and others, “CIO CRM Results,” JPM-CIO-PSI 0000338.
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).
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.”

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.” Expressing concern at the discrepancy, Mr. Macris forwarded the email exchange to Mr. Martin-Artajo appending the question: “what is going on here?”

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 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 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).”

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

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1085 3/7/2012 email from C.S. Venkatakrishnan, JPMorgan Chase, to Ina Drew, CIO, and others, “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.
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 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.

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).
1092 3/7/2012 email from Patrick Hagan, CIO, to Javier Martin-Artajo, CIO, and others, “New CRM numbers,” JPM-
CIO-E 00034181-182.
1094 Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
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 tranche 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 ….

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.”

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.

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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: “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 ….“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.”

1097 3/21/2012 recorded telephone conversation between Anil Bangia, JPMorgan Chase, and Patrick Hagan, CIO, JPM-CIO-PSI-A 0000089.
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.”

Mr. Bangia: “Yeah, yeah, it’s not clear.”

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 –“

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.”

1098 3/21/2012 recorded telephone conversation between Patrick Hagan, CIO, and Anil Bangia, JPMorgan Chase, JPM-CIO-PSI-A 0000090.
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.”

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. 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.

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 book and ways to bringing it lower.” 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.” Mr. Wilmot also wrote: “We haven’t made the case of how this book runs off and whether risk can be managed effectively.”

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.” It discussed a wide range of factors contributing to RWA

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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).
1102 4/3/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, no subject line, JPM-CIO-PSI 000497-498.
1103 4/3/2012 email from John Wilmot, CIO, to Ina Drew, CIO, no subject line, JPM-CIO-PSI 0000497.
1104 Id.
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.’”

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.

(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.

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106 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”).

107 Subcommittee interviews of Ina Drew, CIO (9/7/2012, 12/11/2012).
(a) Breaching CS01 Risk Limit

The Synthetic Credit Portfolio first breached the CS01 risk limit in January 2012. 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. 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.

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. 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.” 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.

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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.
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.”).
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.\footnote{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**

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.\footnote{5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, “Information Needed,” JPM-CIO-PSI-H 0000627, at 636.} 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.\footnote{Id.}

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.”\footnote{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.}

According to the JPMorgan Chase Task Force Report, “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. 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,” 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.”

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.”

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%.

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1117 2013 JPMorgan Chase Task Force Report, at 81.
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.
Ms. Drew was informed of the CIO Global Spread CSBPV limit breaches in an email from Mr. Goldman on February 13, 2012.\(^\text{1122}\) In the email Mr. Goldman wrote: “We will need a one off limit increase.”\(^\text{1123}\) 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.”\(^\text{1124}\)

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.

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

\(^{1123}\) Id.
\(^{1124}\) Id.
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.”

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. As the CIO’s longstanding risk manager, and as someone who previously had the authority to approve Level 2 limit exceptions, 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.” 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 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.”

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.’”

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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.
1130 2013 JPMorgan Chase Task Force Report, at 81.
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%. 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.”

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?” 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.”

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.

Prior to May 2011, JPMorgan Chase policy required its lines of business to conduct an annual review of their major risk limits. In May 2011, the policy was changed to require the reviews to be conducted semi-annually. Contrary to both policies, however, the CIO failed to conduct any review of the adequacy of its risk limits “between 2009 and 2011.” 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.

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

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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.
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.
CSBPV value had “increased dramatically as IG [Investment Grade credit index] positions were added.”

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. 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.

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. 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. 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, 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%. 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

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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).
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.
1145 2013 JPMorgan Chase Task Force Report, at 3, 82.
moves.” \(^{1146}\) Ms. Drew told the Subcommittee that she considered the CSW10% to be an “overriding” risk limit of key importance. \(^{1147}\)

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 agree that 10%CSW has been trending up for CIO, by either their model or ours.” \(^{1152}\)


\(^{1147}\) Subcommittee interview of Ina Drew, CIO (9/7/2012).

\(^{1148}\) 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).

\(^{1152}\) 3/30/2012 email from C.S. Venkatakrishnan, JPMorgan Chase, to Oliver Vigneron, JPMorgan Chase, “CIO 10%
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.”

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. 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.

![CIO Mark-to-Market CSW10% Breaches](image)


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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.\footnote{See 5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, “Information Needed,” JPM-CIO-PSI-H 0000627, at 636.} 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 ‘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.”\footnote{2013 JPMorgan Chase Task Force Report, at 82-83.}

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.\footnote{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.”).} 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 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.

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1159 05/04/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, “Information needed,” JPM-CIO-PSI-H 0000627-636.
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:

“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.”

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.”

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.”

Mr. Kamath also observed: “Incidentally, CIO does not have drawdown limits.” 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 Subcommittee that JPMorgan Chase had deliberately structured the stop loss algorithm in this way, and that it was not merely an error in

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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.
1165 Id. A drawdown is the measurement of the loss from a recent peak in the value of a position.
arithmetic. He said that the bank’s method of calculation didn’t make sense to anyone at the OCC.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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 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

\begin{footnotesize}
\textsuperscript{1166} Subcommittee interview of Jairam Kamath, OCC (8/24/2012).
\textsuperscript{1167} 5/4/2012 email from Irvin Goldman, CIO, to Peter Weiland, CIO, and others, “Information Needed,” JPM-CIO-PSI-H 0000627, at 636.
\textsuperscript{1168} “Position Limit and Loss Advisory Summary Report,” OCC-SPI-00134902.
\textsuperscript{1169} “Position Limit and Loss Advisory Summary Report,” OCC-SPI-00134902.
\textsuperscript{1170} 6/2012 FDIC presentation, “JPMC & COMPANY CIO Synthetic Credit Portfolio,” FDICPROD-0001783, at 33.
\textsuperscript{1171} 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).”).
\textsuperscript{1172} Subcommittee interview of Elwyn Wong, OCC (8/20/2012).
\textsuperscript{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).
\end{footnotesize}
exposures to specific credit instruments and counterparties. 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. 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.” 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 least the concentration limits would have ensured that the growing positions would have drawn scrutiny from the risk managers.

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.’” The article identified the “London whale” as Bruno Iksil, reporting that, “Mr. Iksil has done so much bullish trading that he has helped move the index, traders say.”

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. 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.”

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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).
1179 Id.
1181 4/11/2012 email from John Wilmot, CIO, to Jamie Dimon, JPMorgan Chase, and others, “synthetic credit information,” JPM-CIO-PSI 0001701.
The first page of the presentation was entitled, “Synthetic Credit Summary: Notional Exposure.” 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. 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 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.

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.”

Concentration limits are such a well-known, fundamental risk tool, that their absence at the CIO is one more inexplicable risk failure.

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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).
1184 Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
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. Processes were inadequate for the nature of the risks, and the limit structure was insufficient and not effectively enforced.”

In total, the OCC identified 20 Matters Requiring Attention (MRAs) which required the bank to address risk, valuation, and model failures, among other problems.

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.

One of the steps it took to address its shortcomings was to establish a suite of new risk measures and limits for the CIO. 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. In addition, “29 new limits specific to the Synthetic Credit Book have been implemented to create consistency with JPMC’s IB [Investment Bank] approach.” All of these new SCP limits focused on the risks inherent in

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1191 See 6/2012 FDIC presentation, “JPMC & COMPANY CIO Synthetic Credit Portfolio,” at 34, FDICPROD-
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.\textsuperscript{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.

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.”\textsuperscript{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.\textsuperscript{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.”\textsuperscript{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.\textsuperscript{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.

\textsuperscript{1192} Id., at 26.
\textsuperscript{1193} 2013 JPMorgan Chase Task Force Report, at 115.
\textsuperscript{1194} Id., at 116.
\textsuperscript{1195} Id., at 113.
\textsuperscript{1196} Id., at 116, 118-119.
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 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. 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.

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. The OCC has assigned approximately 65 OCC examiners and related personnel to JPMorgan Chase; all are physically located at the bank. 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.

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

1198 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012); see also Subcommittee interview of Julie Williams, OCC (9/13/2012).
1199 Subcommittee briefing by OCC (7/30/2012).
1201 See 7/30/2012 OCC Large Bank Supervision presentation to Subcommittee re Chief Investment Office Discussion, PSI-OCC-06-0000011.
experts. 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. 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 assets than the CIO. 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.

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. On April 9, 2012, the Senate confirmed a new Comptroller of the Currency, Thomas Curry. News of JPMorgan Chase’s whale trades broke three days before he took office. 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. That second review issued an internal report in late October 2012, with recommendations for improving the OCC’s supervisory efforts.

The OCC’s primary examination role is to ensure that banks operate in a safe and sound manner, 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

1203 See 2012 OCC Organizational Chart, JPMC Resident Staff, OCC-00004227.
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.
1210 10/26/2012 Confidential Supervisory Report, PSI-OCC-13-000014 [Sealed Exhibit].
concluded, in particular, that the so-called “whale trades” had been 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 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.

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.
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.”).
1217 Id.; Subcommittee interview of Doug McLaughlin and Michael Sullivan, OCC (8/30/2012) (Mr. McLaughlin).
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(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). The bank does not share NBIA 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. 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, 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. 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.

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. 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,” which was one part of the SCP.

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. 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. In addition, the CIO and OCC

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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 briefing by the OCC (11/29/2012) (Fred Crumlish). 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).
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
told the Subcommittee that a few years earlier, the TAA portfolio had been called the “Discretionary Trading” portfolio.\textsuperscript{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.\textsuperscript{1229} Ms. Drew said the frequent name changes and portfolio reconfigurations were made for business reasons and not to evade regulatory oversight.\textsuperscript{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.”\textsuperscript{1231} A second set of emails summarizing the bank’s weekly stress results contained one July 2011 email referencing the “synthetic tranche book”\textsuperscript{1232} and one November 2011 email referencing the “synthetics credit portfolio.”\textsuperscript{1233} These varying descriptions of the Synthetic Credit Portfolio provided multiple hints but, again, no straightforward, comprehensive disclosure of the SCP to the OCC.

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.\textsuperscript{1234} JPMorgan Chase claimed that the SCP represented a “successful” way to hedge the bank’s credit risks.\textsuperscript{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.\textsuperscript{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

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.

\textsuperscript{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.).

\textsuperscript{1229} Subcommittee interview of Ina Drew, CIO (9/7/2012).

\textsuperscript{1230} Id.


\textsuperscript{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.


\textsuperscript{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.


\textsuperscript{1236} For more information on the bank’s description of the SCP as a hedge, see Chapter III.
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 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

\(^{1237}\) 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.

\(^{1240}\) Id.

\(^{1241}\) Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).


\(^{1243}\) Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
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.”

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.” 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. 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.

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 mentioned the TAA portfolio in which the SCP was then located. 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. The OCC told the Subcommittee that it should have noticed at the time that the CIO’s response was limited to the SAA portfolio, but said it did not, characterizing its failure to notice as an “oversight” by the OCC.

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. 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. Ms. Drew, however, told Subcommittee staff that she believed the MRA had been closed out, 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

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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).
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).
examination that was overcome by events, it still viewed its mishandling of the 2010 MRA as a “fail from OCC.”

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. He recalled one instance in which bank executives even yelled at OCC examiners and called them “stupid.” 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 stress examination. 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. 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, and the meeting assumed a loud and “combative” tone. 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. 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.

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. 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. 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.

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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.
1259 Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
1260 Id.
1261 Id.
1262 Id.
1264 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
1265 Id.
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. Braunstein. 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. 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. 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.

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.” The CIO’s stress limits were triggered eight times, sometimes for weeks at a stretch, from January to June 2011. 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. In those reports, the CIO attributed all of the CIO’s stress limit breaches to changes in its “synthetic credit (tranche book).” In the first breach of the year, for example, which occurred on January 27, 2011, the CIO continued to breach the limit for seven weeks in a row, peaking at 50% over the limit.

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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. 1269
1272 Id.
1273 Id.
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 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

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].
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 Surrounding Losses at CIO and Lessons Learned,” PSI-OCC-13-000003 [Sealed Exhibit] (identifying the American Airlines gain as an “outsise gain” that OCC should have “investigate[d].”).
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.”

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. 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. 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. He said that the CIO’s “MTM” book was “decreasing in size in 2012. It’s expected that RWA [Risk Weighted Assets] will decrease from $70B [billion] to $40B.”

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. Another OCC examiner who

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1283 10/26/2012 OCC Confidential Supervisory Report, PSI-OCC-13-000020 [Sealed Exhibit].
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).
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 notional. 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 notional 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 the
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. 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 notional positions – would be “very unusual.” The CIO’s counterintuitive strategy prompted even Mr. Dimon to ask later on: “Why didn’t they just sell vs offset[?]” 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 RWA down. My understanding, in my mind, they were going to reduce the book.” 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.

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. 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. 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. 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. 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

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).
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).
losses for the book would have “moved around.”

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 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. 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. The OCC explained that it was concerned because “less information mean[t] less questions” that regulators could pose. 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. 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. 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, it promptly received a copy. 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.

1298 Subcommittee interview of John Wilmot, CIO (9/11/2012).
1299 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
1300 Id.
1301 Id.
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.
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. 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. 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. 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.

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.

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 comment” about it in a public filing due in a few days. The OCC examiners then made multiple requests to the bank for SCP-level profit and loss data to monitor SCP performance going forward. At the time, the OCC head capital markets examiner told

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1307 For more information about the mismarking that took place during these months, see Chapter 4.
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-00035273 (“Just received a revised CIO March 2012 Valuation Summary …. Appears they are revised 1Q12 results?”).
1310 Subcommittee interview of Scott Waterhouse, OCC (9/17/2013).
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,
his colleagues, “[the] Bank will likely object to this.”\footnote{Subcommittee interview of Jairam Kamath, OCC (8/24/2012).} 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.\footnote{See Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). For more information about this mismarking, see Chapter IV.}

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.\footnote{Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).} 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.\footnote{See Subcommittee interview of Jairam Kamath, OCC (8/24/2012).}

Late, missing, and misleading CIO information in the EMR, VCG, and P&L reports sent to the OCC meant that the OCC was supervising the CIO using incomplete and inaccurate information.\footnote{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.} 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. For example, the Market Risk Reporting System (MaRRS) report provided the OCC with weekly stress loss data for different scenarios, and Market Risk Management (MRM) Reporting emails provided notice of risk limit breaches. 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.

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. 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

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1320 See, e.g., 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000069 [Sealed Exhibit].
new model would significantly reduce the CIO’s VaR results. 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 bank reports about it and no indication that the OCC asked any questions about the model change, lower VaR, or earlier breach.

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. 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. 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. While OCC has internally concluded that the bank’s risk reports were “poor and non-transparent,” it needs to rectify its own approach to be more responsive to red flags where they do exist.

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.

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 27”). 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.
(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 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

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

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[.]”).
yield shorts and offset SCP reported losses. 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.

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. 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.” 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.”

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.” 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.

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. 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

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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).
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.
received such limited information about the trades and such blanket reassurances from the bank that it actually considered the matter closed in late April.\textsuperscript{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.

\textbf{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.\textsuperscript{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 by notional amount.\textsuperscript{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”\textsuperscript{1343} and in a Subcommittee interview as “absolutely unhelpful” and seemingly designed to make regulators “go away.”\textsuperscript{1344}

\textbf{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.”\textsuperscript{1345} On its face, however, calling the SCP book a “dedicated

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\item Subcommitte interview of Scott Waterhouse, OCC (9/17/2012).
\item 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.”).
\item 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.
\item 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.”).
\item Subcommittee interview of Fred Crumlish, OCC (8/29/2012).
\item 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
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. The Chief Financial Officer of the CIO confirmed that the book was in a net long position. 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, but the bank did not provide the requested data. 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.

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 ….”

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,” though it did not describe the particular credit exposures being offset or the risks or vulnerabilities involved in the whale

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.”).

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.).


See 4/14/2012 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-0009712, at 716.

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 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.”).

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).

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.


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. 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. The OCC was unable to 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,” including a misrepresentation that the 2012 first quarter SCP losses totaled $580 million, when first quarter losses had actually been internally reported as $719 million. 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. 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. 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.”

**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:

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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).
1357 Subcommittee interview of Michael Kirk, OCC (9/22/2012).
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).
“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.

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

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).
tolerating that and the other ongoing breaches, accepting the bank’s 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. 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. 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.”

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.).
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).
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, 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. In addition, the bank did not update the OCC, as it should have, on then-$500 million in CIO collateral disputes indicating

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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.
that the CIO may have been overvaluing SCP assets and understating its losses. According to the OCC, for nearly three weeks, the bank did not call, email, or otherwise update the OCC about any aspect of the SCP’s worsening status.

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.” 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,” 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. 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.

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.”

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. The OCC told the Subcommittee that amount of loss was “material” and should have prompted an immediate OCC communication to the CIO. While the OCC examiner who normally

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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 0000141-151, 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.
1377 5/4/2012 email from Scott Waterhouse, OCC, to Fred Crumlish, OCC, and others, “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-0000298, 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).
1383 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
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.\footnote{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.\footnote{1385} The OCC told the Subcommittee that, even then, the bank often provided limited information, with one OCC examiner characterizing the reporting as “terrible.”\footnote{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.\footnote{1387} The OCC told the Subcommittee that the bank responded by providing a long list of 60,000 positions\footnote{1388} in a format useless for data analysis purposes, frustrating the OCC’s efforts to understand the portfolio.\footnote{1389} Ultimately, after repeated requests, the OCC told the Subcommittee it believed it received the necessary information.\footnote{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.\footnote{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 more favorable asset valuations than its usual practice and understating its losses.\footnote{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.

\footnote{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).
\footnote{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.”).
\footnote{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.”).
\footnote{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.)
\footnote{1388} Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
\footnote{1390} Subcommittee interview of Elwyn Wong, OCC (8/20/2012).
\footnote{1391} See 12/12/2012 OCC Supervisory Letter JPM-2012-66, at PSI-OCC-18-000001, at 003 [Sealed Exhibit].
\footnote{1392} For more information about the mismarking, see Chapter IV.
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. 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. The OCC told the Subcommittee that it was not satisfied that his response was accurate. The bank later conceded that the SCP positions were mismarked.

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 and OCC 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. As one OCC examiner said at the time, “Does not add up.” Either the CIO’s counterparties in the collateral dispute were wrong, or the CIO’s pricing was wrong, and its reserves were inadequate. Not more than a week later, the CIO began to

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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).

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.").

Subcommittee interview of Michael Kirk, OCC (8/22/2012).

See 2013 JPMorgan Chase Task Force Report, at 89.

See March 2012, 2012 Continuous Audit Quarterly Summary of Global Chief Investment Office, OCC-SPI-00004614, at 618 (identifying as a problem “CIO VCG practices where 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.”).

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].

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.


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.

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 …”).
settle its collateral disputes by agreeing to the prices demanded by its counterparties, 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. 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.

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.

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.” The new Comptroller replied: “Isn’t it a little more than an embarrassment issue?” 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

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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.
losses, litigation etc.).” 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.” The bank later proved him wrong by publicly admitting a “material weakness” in its “internal control over financial reporting,” and stating that “CIO Risk Management was ineffective.”

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 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. 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. 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, the OCC had to backtrack, stating it was “premature to conclude” whether or not the Volcker Rule would allow such activity.

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1410 Id.
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/jun-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 Prostess, 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
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.”

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 Rule.” 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. 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. 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.  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.


1417 5/18/2012 handwritten notes of Julie Williams, OCC, “SBC Staff Briefing,” PSI-OCC-10-000001.
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).
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. As a result, in July 2012, OCC downgraded the bank’s CAMELS management rating for its “lax governance and oversight in the Chief Investment Office,” as well as other “oversight deficiencies.” 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.”

Altogether, the OCC issued six Supervisory Letters related to the problems detected in connection with the whale trades. 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.” 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. 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.” The OCC also explicitly criticized the bank for providing inadequate information about the whale trades. Outside the CIO, OCC criticized JPMorgan Chase’s audit coverage and practices for failing to “identify unsafe and unsound practices in the CIO.”

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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. The OCC is authorized to issue 
Cease and Desist orders 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. 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,” 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.” 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. 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.

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. The internal report’s analysis and 
recommendations have been the subject of presentations by the OCC to both U.S. and 
international regulators in addition to internal OCC groups of examination staff.

1436 2013 JPMorgan Chase Task Force Report, at 111.
1438 Id.
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 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 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

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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 “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.” The Subcommittee 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:

- 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.

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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. 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.” Secondly, he changed the statement, “We cooperate closely with our regulators, who are fully aware of our hedging activities,” by removing the word “fully.” Mr. Dimon responded to Mr. Evangelisti’s proposed talking points with “Ok.”

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 Market”; the Wall Street Journal’s article was entitled, “London Whale Rattles Debt Market.” 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. 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

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1443 Id., at JPM-CIO-PSI 0000543-544.
1444 Id.
1445 Id.
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.”

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, a research analyst at Fidelity, a JPMorgan Chase shareholder. 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.” 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. JPMorgan Chase 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.

On the same day as the loss, April 10, Messrs. Braunstein and Hogan were scheduled to provide a “backgrounder” with the Wall Street Journal. 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.” 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.”

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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, JPMorgan Chase, and others, “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 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 Sarah Youngwood, 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.
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.”

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, 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 written materials did not address the SCP or the whale trades directly, 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.” 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

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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.


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).
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.”

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 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.”

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.” Later that evening, she emailed them that there were “[v]ery few questions on CIO” on the “[l]ast batch of calls.” 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.”

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. Mr. Dimon, Mr. Braunstein, and other

1462 Id., at 7.
1463 Id., at 10.
1464 4/13/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon and Douglas Braunstein, JPMorgan Chase, “I/Q 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, “I/Q 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 00017022, 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
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. Messrs. Dimon, Braunstein, and other executives were also informed that the SCP had switched its overall position from short to long, 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. In addition, by that date, all of the risk limits governing the SCP had been breached. 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.” 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. 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 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 analyst meeting and the

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. Macris 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 Achilles Macris, CIO, to Douglas Braunstein, JPMorgan Chase, and Ina Drew, CIO, “Synthetic Credit Presentation,” JPM-CIO-PSI-H 0002204, 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.

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.


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).


See Chapter V, describing the breaches of CIO VaR, CS01, and CSW10%, among other risk limits.
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. …

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. …

[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

¹⁴⁷⁴ 5/2/2012 email from Ina Drew, CIO, to Ina Drew, CIO, [no subject], JPM-CIO-PSI 0001212-214, at 214.
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.”

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.”

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.

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 and Section 17(a) of the Securities Act of 1933, 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.

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1478 Id., at 4.
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).
(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.”\footnote{Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).} 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.’”\footnote{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)).} Courts have found that information about earnings estimates is generally material,\footnote{In re J. Douglas Elliott, Securities Exchange Act Rel. No. 34-40043 (May 29, 1998).} including any misrepresentation of a company’s earnings.\footnote{SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).} Changes in share price are also relevant to a materiality inquiry.\footnote{Crowell v. Ionics, Inc., 343 F. Supp. 2d 1 (D. Mass. 2004).} “[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.’”\footnote{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[.]”\footnote{SEC v. Rana Research, Inc., 8 F.3d 1358, 1362 (9th Cir. 1993) (annual reports, public statements, SEC filings).} 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.”\footnote{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)).} 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.\footnote{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).} 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. 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.”\footnote{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).}
**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. The Supreme Court has ruled that the scienter requirement can be met “by showing that the defendant acted intentionally or recklessly.” 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 sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.” 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.”

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.”

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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.”)
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. Telllabs 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
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 conduct.” 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.”

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.” 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.” Unlike Rule 10b-5, however, Sections 17(a)(2) and 17(a)(3) do not require a finding of scienter.

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.

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

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.”


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).”).
pursuant to the risk management at the firm-wide level."\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{1505} Mr. Hogan told the Subcommittee that the articles about the “London Whale,” which first appeared on April 6, 2012, surprised him.\textsuperscript{1506} Mr. Hogan said that the SCP was not on his radar in an “alarming way” prior to that date.\textsuperscript{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.\textsuperscript{1508} Mr. Goldman had no risk management experience and was still learning the job during the first quarter of 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,\textsuperscript{1509} CIO risk management had failed to review the CIO’s risk limits for three years.\textsuperscript{1510}

\textsuperscript{1502} 4/13/2012 “Edited Transcript JPM - Q1 JPMorgan Chase & Co. Earnings Conference Call,” at 7, JPM-CIO-PSI 0001151 (stated by Douglas Braunstein).
\textsuperscript{1503} Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
\textsuperscript{1504} Id.
\textsuperscript{1505} 3/20/2012 presentation for JPMorgan Chase Directors Risk Policy Committee meeting, JPM-CIO-PSI 0013890.
\textsuperscript{1506} Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
\textsuperscript{1507} Id.
\textsuperscript{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.
\textsuperscript{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.’.”).
\textsuperscript{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.”.”).
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. 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.

In addition to problems with its risk limits and metrics, the CIO had an overdue Matter Requiring Attention from the OCC from 2010, regarding its need to document its portfolio decisionmaking process, and had recently been told in an Internal Audit report that its asset valuation practices “need[ed] improvement.” 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.”

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. 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.

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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.
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
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?” Another analyst commented: “Pretty big confidence blow for best risk manager; very puzzling.”

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.

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.” By telling investors that its credit 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

\[\text{comments (3)}, \text{JPM-CIO-PSI 0017712} \] (“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 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.”).
on those positions on a regular and recurring basis as part of our normalized reporting.”

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.

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. At the end of January 2012, CIO executives told OCC examiners that the Synthetic Credit Portfolio was being reduced in size, 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. 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.

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

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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).

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.


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.”).
media had characterized as large enough to “driv[e] prices in the $10 trillion market.”

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.

(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.”

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. One of those presentations by Ms. Drew, reprinted below, took place in March 2012, just a month before the earnings call.

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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.”).


## Mandate and Approach

**KEY MANDATE:** Optimize and protect the Firm’s balance sheet from potential losses, and create and preserve value over the longer-term.

### Longer-term Investing
- **Private Equity**
  - Oversight of legacy investments
  - Management of US defined benefit pension investments and oversight of 401k
- **Retirement Plan**
- **Special Investments**
- **COLI BOLI**
  - Investment is stressed and distressed opportunities related to undervalued or under-performing JPMC loans

### Strategic Investing & Risk Management
- **Strategic Asset Allocation**
  - Maximization of tax-advantaged investments of life insurance premiums
- **FX Hedging**
  - Core investment and derivatives portfolio used to manage the Firm’s structural risk exposures
  - Mainly available for sale
- **MSR Hedging**
  - Management of Firm’s foreign currency exposure from non-USD capital, revenues, and expenses
  - Management of home Lending’s MSR asset

### MTM Overlay & Risk Management
- **North America**
- **International**
  - Complement central core investment decisions and are mainly in mark-to-market accounts

### Position
- **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**
- **Reducing capital intensive credit securities positions**

### AUM
- **$3.5bn AUM**
- **$11.0bn AUM**
- **$8.8bn AUM**
- **$113bn BPV structural risk**
- **$1.0bn nominal structural risk**
- **$21bn BPV structural risk**
- **Position size varies**
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. 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. 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 the first quarter of 2012, traders executed over 4,300 trades. 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. 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.

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. Another was to enter into trades that would substantially lower the SCP’s Risk Weighted Assets. 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.” Turning over a position to “monetize” volatility meant that the trading strategy was to flip the position, that is, buy low, and sell high. 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

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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.
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.
had increased in size since January and had changed from a net short to a net long posture, signaling short-term changes in the portfolio’s size and strategy. In addition, Achilles Macris, who oversaw the SCP trading, emailed Mr. Braunstein on April 8, 2012 that: “the most rewarding, short-term catalyst for CIO would be an MBIA related default event[.]” 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.”

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, 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

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].
standpoint. We are very comfortable with our positions as they are held today.”

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.”

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.”

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. 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.” 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. Mr. Dimon told the Subcommittee that he did not recall if he received a response. Ms. Drew, who had told her colleagues she was “working on Jamie’s request for correlation,” 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. The Subcommittee found no evidence that it was. Mr. Hogan also requested a correlation analysis to

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1545 Id., at 10.
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”).
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).
respond to regulators’ questions about the SCP, and included Mr. Braunstein on his email, but JPMorgan Chase never produced it.\footnote{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.}

**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.\footnote{ 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.”).} 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,\footnote{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.”)} 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.”\footnote{Id.}

Mr. Braunstein told the Subcommittee that he was sure he read the email, though he was not aware of this particular sentence.\footnote{Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).}

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 offsetting 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.\footnote{Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).} Similarly, John Wilmot, the Chief Financial Officer of the CIO, was unable to do so.\footnote{Subcommittee interview of John Wilmot, CIO (9/11/2012).} 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.\footnote{Subcommittee interview of Joseph Bonocore, CIO (9/11/2012).}
be long in order to be stable, but recognized that having the book be long was inconsistent with its mission.\textsuperscript{1562}

In contrast, Mr. Braunstein told the Subcommittee that the SCP book could both be long and provide a “fat tail hedge.”\textsuperscript{1563} Mr. Dimon concurred.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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 risk and that it did not need to provide a “payout.”\textsuperscript{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.\textsuperscript{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.”\textsuperscript{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.\textsuperscript{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.’”\textsuperscript{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

\textsuperscript{1562} JPMorgan Chase Task Force interview of Bruno Iksil, CIO (partial readout to the Subcommittee on 8/27/2012).
\textsuperscript{1563} Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
\textsuperscript{1564} Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
\textsuperscript{1565} Id.
\textsuperscript{1566} Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
\textsuperscript{1567} Subcommittee interview of Irvin Goldman, CIO (9/15/2012).
\textsuperscript{1568} JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to the Subcommittee on 9/6/2012).
\textsuperscript{1569} Subcommittee interview of Ina Drew, CIO (9/7/2012).
\textsuperscript{1571} Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
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 which credit deteriorated and the risk of default increased—the SCP would lose money.\(^{1575}\)

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\(^{1573}\) 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”).

\(^{1575}\) 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.
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 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

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-600mm 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
As the February chart above 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%.

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. He referred the Subcommittee staff to page 7 of the April 11 presentation, reprinted below, and stated that he relied on the three scenarios that, collectively, were projected to have an “80% likelihood” of occurring.

1578 Subcommittee interview of Douglas Braunstein, JPMorgan Chase (9/12/2012).
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).
Synthetic Credit Summary: Risk & P/L Scenarios

- **Q1 P&L Estimate**: 
  - Realised P&L in Q1
  - Q2 P&L Estimates: these scenarios do not include 19 April P&L, which would accrete back into each scenario +$400MM if re-calibrated for today’s market moves

- **Q2 P&L Estimates**: these scenarios do not include 19 April P&L, which would accrete back into each scenario +$400MM if re-calibrated for today’s market moves

- **Q3 P&L Estimate**: these scenarios do not include 19 April P&L, which would accrete back into each scenario +$400MM if re-calibrated for today’s market moves

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.
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.\textsuperscript{1580} Mr. Dimon explained that it was the original purpose of the hedge,\textsuperscript{1581} and that the SCP had made money for JPMorgan Chase during the 2008 financial crisis as a hedge against credit widening.\textsuperscript{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.\textsuperscript{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 hedge, the book provided protection against credit spread widening events.\textsuperscript{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.

\textsuperscript{1580} Subcommittee briefing by JPMorgan Chase (8/15/2012) (stated by Gregg Guncelman).
\textsuperscript{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.”).
\textsuperscript{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.
\textsuperscript{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”).
\textsuperscript{1584} 4/5/2012 email from Ina Drew, CIO, to Jamie Dimon, JPMorgan Chase, and others, “CIO,” JPM-CIO-PSI 0000539.
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 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

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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).
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).
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[.]”

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.”

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. In fact, even one month later, on May 10, Mr. Dimon continued to mischaracterize the SCP as a “hedge.”

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. 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.” 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:

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: “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.
“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.”

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.

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. 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.” Ms. Drew also informed both Mr. Braunstein and Mr. Dimon that the “Investment Grade strategies” were to provide “some carry.”

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

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].
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.
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).
counterbalanced. If the presentation were analyzing a hedging 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,” however, Mr. Venkatakrishnan told the Subcommittee that he did not know what, if anything, the SCP was hedging.

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.”

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 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)?

[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

\(^{1608}\) 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).


\(^{1612}\) 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.”).
been drafted with trading desks in mind, where both sides of a hedge are marked to market. It is a poor fit with Asset Liability Management.”  

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.”

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 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.

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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].
(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. 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,” including disclosure when banks change a VaR “model characteristics, assumptions, and parameters.” In June 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.

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[.]” The report also explained the VaRs for the different lines of business, including the CIO: “CIO VaR includes positions, primarily in debt securities and

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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).
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 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.”).
credit products, used to manage structural and other risks including interest rate, credit and mortgage risks arising from the Firm’s ongoing business activities.\textsuperscript{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 table below shows the results of the Firm’s VaR measure using a 95% confidence level.

<table>
<thead>
<tr>
<th>Total IB trading VaR by risk type, Credit portfolio VaR and other VaR</th>
<th>2011</th>
<th>2010</th>
<th>At December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Avg</td>
<td>Min</td>
<td>Max</td>
</tr>
<tr>
<td>IB VaR by risk type</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed income</td>
<td>$50</td>
<td>$31</td>
<td>$68</td>
</tr>
<tr>
<td>Foreign exchange</td>
<td>11</td>
<td>6</td>
<td>19</td>
</tr>
<tr>
<td>Equities</td>
<td>23</td>
<td>15</td>
<td>42</td>
</tr>
<tr>
<td>Commodity and other</td>
<td>16</td>
<td>8</td>
<td>24</td>
</tr>
<tr>
<td>Diversification benefit to IB trading VaR</td>
<td>(42)</td>
<td>NM</td>
<td>NM</td>
</tr>
<tr>
<td>IB trading VaR</td>
<td>58</td>
<td>34</td>
<td>80</td>
</tr>
<tr>
<td>Credit portfolio VaR</td>
<td>33</td>
<td>19</td>
<td>55</td>
</tr>
<tr>
<td>Diversification benefit to IB trading and credit portfolio VaR</td>
<td>(15)</td>
<td>NM</td>
<td>NM</td>
</tr>
<tr>
<td>Total IB trading and credit portfolio VaR</td>
<td>76</td>
<td>42</td>
<td>102</td>
</tr>
<tr>
<td>Other VaR</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chief Investment Office (&quot;CIO&quot;) VaR</td>
<td>57</td>
<td>30</td>
<td>80</td>
</tr>
<tr>
<td>Diversification benefit to total other VaR</td>
<td>(127)</td>
<td>NM</td>
<td>NM</td>
</tr>
<tr>
<td>Total other VaR</td>
<td>70</td>
<td>46</td>
<td>110</td>
</tr>
<tr>
<td>Diversification benefit to total IB and other VaR</td>
<td>(45)</td>
<td>NM</td>
<td>NM</td>
</tr>
<tr>
<td>Total IB and other VaR</td>
<td>$101</td>
<td>$67</td>
<td>$147</td>
</tr>
</tbody>
</table>

(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].

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.”\textsuperscript{1621}

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,\textsuperscript{1622} to end a four-day breach of the bankwide VaR limit that was caused by the CIO. The new model immediately

\textsuperscript{1620} Id., at 159.
\textsuperscript{1621} Id., at 160.
\textsuperscript{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.
recast the CIO’s VaR-95 total, dropping it by 50% on the day it was put into place.\textsuperscript{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.\textsuperscript{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 . . . .”\textsuperscript{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.\textsuperscript{1626} In its 8-K filing, JPMorgan Chase included another chart, reprinted below, reporting the VaR results for the CIO and Investment Bank.\textsuperscript{1627}

\textsuperscript{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).


\textsuperscript{1625} 4/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon and others, JPMorgan Chase, “CIO articles – Calls (9),” JPM-CIO-PS1 0001093.


\textsuperscript{1627} Id., at 42.
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.\footnote{1628} Again, by comparison, the Investment Bank’s VaR was larger at $81 million.\footnote{1629}

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

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\footnote{1628}{Id.}
\footnote{1629}{Id.}
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. Under JPMorgan Chase policy, Mr. Dimon had to personally respond to breaches of the 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%. Despite having received multiple emails and having approved a

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 0000150; 1/20/2012 email from Market Risk Management – Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, Douglas Braunstein, JPMorgan Chase, and others, “JPMC 95% 10Q 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 0000289, at 290 (“Today’s Attendees, Operating Committee, Jamie Dimon, Doug Braunstein,” and others.).

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 Exception 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 Exception Notification (COB 1/19/12),” JPM-CIO-PSI 0000150 (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, John Hogan, 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 –
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.” 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.

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. 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.

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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 0000289, at 290 (“Today’s Attendees, Operating Committee, Jamie Dimon, Doug Braunstein,” and others.).
**CIO Summary Risk Metrics**

<table>
<thead>
<tr>
<th>Risk Category</th>
<th>Description</th>
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<tbody>
<tr>
<td>Structural Risk</td>
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<tr>
<td>Firm D/E (excl. credit spread)</td>
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<tr>
<td>Credit spread investments</td>
<td>2.9</td>
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<tr>
<td>Firm D/E (incl. credit)</td>
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</table>

**Risk Overview**
- Integration of SAA into Firmwide Stress reflected: includes GCI impact as well as structural liability (see table below).
- Full limits framework under review.
- VaR for limits and disclosure would include all CIO Trading Book assets.
- Assets moved to Banking Book (e.g., bank preferreds and CLOs) not included in VaR for limited disclosure.
- Consider removal of MSR VaR from 10-Q disclosure.
- Regulators have recently moved MSR and hedges to Banking Book.
- Compositions have not followed JPM in disclosure of MSR VaR.

<table>
<thead>
<tr>
<th>Credit VaR</th>
<th>USD netted</th>
<th>Dates valid</th>
<th>Drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIO MTM</td>
<td>520</td>
<td></td>
<td>Positive benefit from tranche book offset by bank preferreds and CLOs.</td>
</tr>
<tr>
<td>CIO SAA AFS</td>
<td>(7,182)</td>
<td></td>
<td>Driven by bank debt, UK &amp; Neth. RMBS, CMBS.</td>
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<tr>
<td>CIO SAA Liabilities</td>
<td>(4,108)</td>
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<td>Rates rally drives reduced PV of liabilities.</td>
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<tr>
<td>FX Capital Hedging</td>
<td>(256)</td>
<td></td>
<td>Open FM currency positions $3.6% relief.</td>
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<tr>
<td>CRP</td>
<td>(146)</td>
<td></td>
<td>Driven by whole loans and CLOs.</td>
</tr>
<tr>
<td>TOTAL</td>
<td>(13,232)</td>
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</tbody>
</table>

**VaR Highlights**
- Enhanced VaR methodology for tranche book, reviewed and approved by MRC, helping to reduce VaR and RWA usage.
- Reduced MSR VaR reflects deepened sensitivity profile based on model improvements.
- VaR limit reductions are in the pipeline for MSR (from $800mm to $550mm) and CIO (reduction from $160mm under review).

**CIO Summary**
- CIO International: 48.3
- CIO North America: 6.6
- MSR: 4.9

**10Q VaR**

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*Source: 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 JPM-CIO-PSI 000241 [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. 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. 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. 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. 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.

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. 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.

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1636 Id.
1637 Id.
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 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.” 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.

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.”

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.

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.” 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 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.”

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.” 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

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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.”).
1647 Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
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-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. 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?,” “What would have happened if we [the bank] had not changed the VaR model?,” “How long was the 2012 model data tested?”, 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

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1649 See, e.g., 5/11/2012 email from Sarah Youngwood, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, “10-Q call - Buy-side and sell-side 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 - Buy-side and sell-side 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 - Buy-side and sell-side 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 - Buy-side and sell-side 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?”).


1651 Id.

models." 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.” 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?”

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.

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. 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. 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. 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.

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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).
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 untranche 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
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 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.

rebound. See, e.g., undated chart entitled, “Credit Spreads on IG9 Index,” prepared by JPMorgan Chase, JPM-CIO-PSI 0002062, reprinted in Chapter III.