

United States Senate

COMMITTEE ON

HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510-6250

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June 7, 2013

VIA ELECTRONIC SUBMISSION (regs.comments@federalreserve.gov)

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. 1457 and RIN 7100-AD-95 on Large Bank Assessments

Dear Mr. Frierson:

The purpose of this letter is to support the proposed rule seeking to implement Section 318 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The need for this provision, which authorizes assessments of fees on certain large financial institutions to support regulatory oversight, is well established. Prompt implementation of the rule is essential to give federal regulators of large banks and systemically important financial institutions the resources to keep pace with an industry that has grown in complexity and size.

The strained ability of federal regulators to stay informed of large bank activity, including derivatives trading, was exposed in a recent investigation by my Subcommittee of certain synthetic credit derivatives at JPMorgan Chase. Due to their enormous size, those trades became known as the "whale trades," and caused a loss of at least \$6.2 billion at the bank in 2012. In connection with that investigation, the Permanent Subcommittee on Investigations released a 300-page bipartisan report entitled, "JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses," and held a hearing on March 15, 2013.¹ The investigation uncovered conduct by JPMorgan Chase indicating that the bank had not been forthcoming with its primary federal regulator, the Office of the Comptroller of the Currency ("OCC"), and had at times even provided misinformation, none of which was detected by the OCC until months later.

The troubling conduct included the following:

- In the first quarter of 2012, without alerting its regulators, JPMorgan Chase's Chief Investment Office ("CIO") used bank deposits, including some that were federally insured, to triple the size of its Synthetic Credit Portfolio to \$157 billion. The CIO's high risk, complex, short term credit derivatives trading strategies were disclosed to regulators only after the portfolio attracted media attention.

¹ "JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses," U.S. Senate Permanent Subcommittee on Investigations (3/15/2013) (hereinafter "Levin-McCain Report").

- JPMorgan Chase also mischaracterized the Synthetic Credit Portfolio (“SCP”) as a risk-mitigating hedge, while failing to identify the assets or portfolios being hedged, test the size or effectiveness of the alleged hedging activity, or show how the SCP lowered rather than increased bank risk.
- In addition, JPMorgan Chase dodged regulatory oversight by 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.

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 level of serious problems besetting the portfolio. Given prior risk assessments, the OCC had assigned ten capital markets examiners to oversee JPMorgan Chase’s trading activity at both its Investment Bank and CIO; given the relatively low risk profile given for the CIO, the OCC had not assigned any staff with derivatives experience to oversee CIO trading. As a result, the OCC had been largely unaware of the Synthetic Credit Portfolio until its trades grew so large, they roiled world credit markets, and media reports dubbed the bank’s key trader as the “London Whale.”

Even then, the bank offered such vigorous reassurance to its regulators about its portfolio, that the OCC initially considered the matter closed. It was not until after the bank disclosed the CIO’s growing losses that the OCC added staff with derivatives expertise and engaged in two separate inquiries into the CIO’s Synthetic Credit Portfolio to uncover the history, extent, and risks associated with the CIO’s credit derivatives trading activity. The fact that JPMorgan was able to build a high risk credit derivatives trading portfolio for years within the bank with little notice to its primary regulator, and was able within months to triple its size and change its composition, while hiding massive, unexpected losses, provides solid evidence of the need for a higher level of regulatory attention, training, and expertise, in order to ensure effective oversight of large financial institutions. To ensure this evidence is considered during the course of the rulemaking process, this letter requests that the enclosed Levin-McCain report be included in the administrative record for the proposed rule.

Implementing Section 318 is an important step in providing financial regulators with the necessary resources to fulfill their mandate to ensure large financial institutions operate in a safe and sound manner. The proposed rule to implement Section 318 will provide for an annual assessment of bank holding companies and savings and loan holding companies with \$50 billion or more in total consolidated assets and for nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve. The assessment fees imposed on those financial institutions are reasonable given the intricacies involved in monitoring, analyzing, and ensuring the safety and soundness of such complex institutions. According the Federal Reserve’s methodology, approximately 70 financial institutions with aggregate total assessable assets of about \$20 trillion would pay a combined total of \$440 million per year in fees, an amount which represents about two-thousandth of one percent of the \$20 trillion in assets at issue. More specifically, financial institutions with the threshold \$50 billion

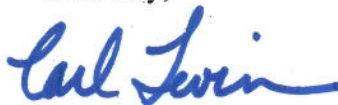
in assets would pay approximately \$1 million per year, while those with total assessable assets of \$1 trillion would pay approximately \$22 million.

The additional fees would provide regulatory supervisors with critically needed resources to identify higher risk investment portfolios and to carry out inspections of those portfolios on a transaction-by-transaction basis to ensure effective risk management, operational functions, and capital reserves. For instance, with asset-backed securities, Federal Reserve System's Trading and Capital Markets Activities Manual Section 4105.1 notes: "Although the basic elements of all asset-backed securities are similar, individual transactions can differ markedly in both structure and execution." Instead of relying solely on a bank's internal investment performance, risk management, or audit reports, additional resources could allow regulators to undertake independent sampling and analysis of individual portfolios and related transactions. Independent regulatory assessments would have been revealing in the case of the whale trades, where the OCC later criticized both the Risk Management and Audit functions.

As another example, when examiners review a community bank, they are likely to pull specific loan files to evaluate the supporting documentation, collateral, and payment history, and to look for any errors. They may also look for how the loan is being accounted for on the bank's books. That type of transaction-by-transaction scrutiny is currently performed, for example, for a \$40,000 line of credit between a community bank and a small manufacturer in Michigan. But if a big bank bets millions, or even billions of dollars through derivatives trades, their books and records apparently do not undergo a similar level of scrutiny by regulators. The Section 318 fees, as currently proposed, could help end that imbalance in oversight.

Thank you for this opportunity to comment on the Proposed Rule.

Sincerely,



Carl Levin
Chairman
Permanent Subcommittee on Investigations

Enclosures