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

MAJORITY AND MINORITY STAFF REPORT

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

UNITED STATES SENATE

RELEASED IN CONJUNCTION WITH THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS MARCH 15, 2013 HEARING
# JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES

## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. EXECUTIVE SUMMARY</td>
<td>2</td>
</tr>
<tr>
<td>A. Subcommittee Investigation</td>
<td>2</td>
</tr>
<tr>
<td>B. Overview</td>
<td>3</td>
</tr>
<tr>
<td>(1) Increasing Risk</td>
<td>3</td>
</tr>
<tr>
<td>(2) Hiding Losses</td>
<td>5</td>
</tr>
<tr>
<td>(3) Disregarding Risk</td>
<td>7</td>
</tr>
<tr>
<td>(4) Avoiding and Conducting OCC Oversight</td>
<td>8</td>
</tr>
<tr>
<td>(5) Misinforming Investors, Regulators, and the Public</td>
<td>10</td>
</tr>
<tr>
<td>C. Whale Trade Case History</td>
<td>14</td>
</tr>
<tr>
<td>D. Findings of Facts</td>
<td>15</td>
</tr>
<tr>
<td>(1) Increased Risk Without Notice to Regulators</td>
<td>15</td>
</tr>
<tr>
<td>(2) Mischaracterized High Risk Trading as Hedging</td>
<td>15</td>
</tr>
<tr>
<td>(3) Hid Massive Losses</td>
<td>15</td>
</tr>
<tr>
<td>(4) Disregarded Risk</td>
<td>15</td>
</tr>
<tr>
<td>(5) Dodged OCC Oversight</td>
<td>15</td>
</tr>
<tr>
<td>(6) Failed Regulatory Oversight</td>
<td>16</td>
</tr>
<tr>
<td>(7) Mischaracterized the Portfolio</td>
<td>16</td>
</tr>
<tr>
<td>E. Recommendations</td>
<td>16</td>
</tr>
<tr>
<td>(1) Require Derivatives Performance Data</td>
<td>16</td>
</tr>
<tr>
<td>(2) Require Contemporaneous Hedge Documentation</td>
<td>16</td>
</tr>
<tr>
<td>(3) Strengthen Credit Derivative Valuations</td>
<td>16</td>
</tr>
<tr>
<td>(4) Investigate Risk Limit Breaches</td>
<td>17</td>
</tr>
<tr>
<td>(5) Investigate Models That Substantially Lower Risk</td>
<td>17</td>
</tr>
<tr>
<td>(6) Implement Merkley-Levin Provisions</td>
<td>17</td>
</tr>
<tr>
<td>(7) Enhance Derivative Capital Charges</td>
<td>17</td>
</tr>
<tr>
<td>II. BACKGROUND</td>
<td>18</td>
</tr>
<tr>
<td>A. JPMorgan Chase &amp; Company</td>
<td>18</td>
</tr>
<tr>
<td>B. Chief Investment Office</td>
<td>21</td>
</tr>
<tr>
<td>C. Office of the Comptroller of the Currency</td>
<td>25</td>
</tr>
<tr>
<td>D. Capital Requirements</td>
<td>27</td>
</tr>
<tr>
<td>D. Credit Derivatives</td>
<td>29</td>
</tr>
<tr>
<td>III. INCREASING RISK</td>
<td>35</td>
</tr>
<tr>
<td>A. Origins of the Synthetic Credit Portfolio</td>
<td>36</td>
</tr>
<tr>
<td>B. Purpose of the Synthetic Credit Portfolio: Undocumented, Unclear, and Subject to Change</td>
<td>42</td>
</tr>
</tbody>
</table>
C. SCP Trading .......................................................... 49
   (1) The Early Years: 2006 to 2010 ........................................ 49
   (2) 2011 SCP Expansion ................................................ 50
   (3) 2011 SCP Profit From Bankruptcies .................................... 53
   (4) SCP Size and Revenues .............................................. 56
   (5) SCP Trader Compensation ............................................ 57
   (6) 2012 Opens with Order to Reduce RWA ............................. 60
   (7) Eastman Kodak Default .............................................. 64
   (8) Credit Market Rally Revalues SCP .................................... 65
   (9) Four Options to Reshape the SCP ...................................... 67
   (10) Decision to Go Long ................................................ 72
   (11) Adoption of 2012 Trading Strategy .................................. 73
D. SCP’s Increasing Risk and Losses ........................................ 75
   (1) January 2012 ...................................................... 76
   (2) February 2012 ..................................................... 78
   (3) March 2012 ....................................................... 81
   (4) Phones Down ....................................................... 85
E. Unmasking JPMorgan Chase ............................................ 90
F. Dismantling the SCP .................................................. 92
G. Analysis .............................................................. 94

IV. HIDING LOSSES ........................................................ 96
   A. Background ........................................................... 99
      (1) Valuing Derivatives In General ..................................... 99
      (2) Valuing Derivatives at JPMorgan Chase ........................... 101
   B. Mismarking the CIO Credit Derivatives ............................. 106
      (1) Mismarking Begins ................................................ 106
      (2) Mismarking Peaks .................................................. 110
      (3) Increasing the Reported Losses ................................... 116
      (4) Trading Stopped ................................................... 123
      (5) Accusing the Investment Bank ..................................... 124
      (6) Mismarking Continued ............................................ 130
   C. Ending the Mismarking ................................................ 136
   D. Reviewing the SCP Valuations ........................................ 140
   E. Admitting the Mismarking ............................................. 151
   F. Analysis .............................................................. 153

V. DISREGARDING LIMITS ................................................ 154
   A. Background ........................................................... 155
   B. Risk Management Structure at CIO .................................... 158
   C. CIO Risk Management Personnel .................................... 160
   D. Disregarding CIO Risk Metrics ....................................... 165
      (1) Disregarding the VaR Limit ....................................... 166
VI. AVOIDING AND CONDUCTING OCC OVERSIGHT........................................... 216

A. Overview of OCC's Oversight Role ............................................................. 218

B. Pre-2012: Avoiding OCC Oversight As the SCP Develops .......................... 220
   (1) 2006-2009: Minimizing OCC Oversight As SCP Expands ....................... 221
   (2) 2010: Resisting OCC Examination Results ......................................... 222
   (3) 2011: Missing SCP Red Flags ............................................................ 225

C. 2012: Dodging OCC Oversight While SCP Losses Mount ........................... 227
   (1) Misinforming OCC that SCP Book to be Reduced ................................ 227
   (2) Failing to Provide OCC with CIO Data ............................................. 230
   (3) Failing to Investigate Risk Limit Breaches ....................................... 232
   (4) Miscasting Long Acquisitions As Risk Reducing ................................ 234

D. 2012: Resisting OCC Oversight Even After Whale Trades Became Public ....... 236
   (1) Providing OCC with Limited or Incorrect Information ............................ 237
   (2) Updating OCC Only When Losses About to Become Public .................... 241
   (3) Hiding Problems with the Marks ....................................................... 244

E. OCC Aftermath ......................................................................................... 246

F. Analysis .................................................................................................... 251

VII. MISINFORMING INVESTORS, REGULATORS AND THE PUBLIC ............ 252

A. Public Disclosure of Whale Trades and SCP ............................................ 255

B. Securities Laws .......................................................................................... 262
   (1) Rule 10b-5 ............................................................................................ 263
   (2) Section 17(a) of the Securities Act of 1933 ......................................... 265
C. Disclosures and Key Omissions Raising Concerns .............................. 265
   (1) Mischaracterizing the Involvement of Firmwide Risk Managers .... 265
   (2) Mischaracterizing SCP as "Fully Transparent to the Regulators" .... 269
   (3) Mischaracterizing SCP Decisions as "Made on a Very Long-Term Basis" .... 270
   (4) Mischaracterizing SCP Whale Trades As Hedges ....................... 273
   (5) Asserting SCP Trades Were Consistent With the Volcker Rule ........ 286
   (6) Omitting VaR Model Change ........................................... 289

D. Analysis ............................................................................................ 300

#  #  #
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

---

1197 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012); see also Subcommittee interview of Julie Williams, OCC (9/13/2012).
1198 Subcommittee briefing by OCC (7/30/2012).
1200 See 7/30/2012 OCC Large Bank Supervision presentation to Subcommittee re Chief Investment Office Discussion, PSI-OCC-06-000011.
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 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

1202 See 2012 OCC Organizational Chart, JPMC Resident Staff, OCC-00004227.
1203 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.
concluded, in particular, that the so-called “whale trades” had been conducted in an unsafe and unsound manner. 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.

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.

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, 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. That report identified the SCP for the first time as a distinct portfolio accounting for over 90% of the CIO’s VaR. The lack of bank disclosures essentially made it more difficult for OCC to effectively oversee this high risk portfolio in its early years.

1211 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.

1212 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–__, (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.”).

1213 See 12/31/2010 OCC Report of Examination, OCC-SPI-00036145, at 6163 [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.”).

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–__, (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 10/26/2012 Confidential Supervisory Report, OCC at PSI-OCC-13-000025 [Sealed Exhibit].

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). Typically, 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

---

1218 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 3508 (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).
1219 Subcommittee briefing by the OCC (11/29/2012) (Scott Waterhouse).
1220 See Subcommittee interview of Doug McLaughlin and Mike Sullivan, OCC (8/30/2012).
1221 Id.
1222 Subcommittee interview of Fred Crumlish, OCC (8/28/2012). In addition, JPMorgan Chase has acknowledged to the Subcommittee that, despite years of operation, the CIO has never detailed the purpose or workings of the SCP in any document nor issued any specific policy or mandate for it. Levin Office briefing by JPMorgan Chase (Greg Baer) (8/15/2012).
1223 Subcommittee briefing by JPMorgan Chase (8/15/2012).
1224 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).
1225 Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
1226 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. 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. Ms. Drew said the frequent name changes and portfolio reconfigurations were made for business reasons and not to evade regulatory oversight.

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. JPMorgan Chase later claimed that the SCP represented a “successful” way to hedge the bank’s credit risks. The bank was unable to explain, however, why it 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. The bottom line is that the bank did not disclose and the OCC did not learn of the extent and associated risks of the CIO’s growing Synthetic Credit Portfolio until media reports on April 6, 2012 described the book’s outsized credit derivative holdings.

(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. 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.”\textsuperscript{1235} 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.\textsuperscript{1236} 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.\textsuperscript{1237}

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.”\textsuperscript{1238} 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.\textsuperscript{1239} Moreover, according to the Examiner-In-Charge’s email, Ms. Drew informed the OCC “that investment decisions are made with the full understanding of executive management including Jamie Dimon. She said that everyone knows that is going on and there is little need for more limits, controls, or reports.”\textsuperscript{1240}

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.”\textsuperscript{1241} 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.\textsuperscript{1242} 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.\textsuperscript{1243}

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.\textsuperscript{1244} Ms. Drew told

\begin{footnotesize}
\textsuperscript{1235} 12/8/2010 Supervisory Letter JPM-2010-80, OCC-SPI-00011201 [Sealed Exhibit].
\textsuperscript{1236} Id.
\textsuperscript{1237} Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
\textsuperscript{1239} Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
\textsuperscript{1240} 5/11/2012 email from Scott Waterhouse, OCC, to Mike Brosnan and Sally Belshaw, OCC, “J.P. Morgan Chase,” OCC-00001746; confirmed as an accurate description of the telephone call with Ms. Drew. See Subcommittee interviews of Fred Crumlish, OCC (8/28/2012) and James Hohl, OCC (9/6/2012).
\textsuperscript{1241} Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
\textsuperscript{1242} Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
\textsuperscript{1243} Subcommittee interview of Ina Drew, CIO (9/7/2012).
\textsuperscript{1244} 1/7/2011 letter from Ina Drew, CIO, to Scott Waterhouse, OCC, OCC-SPI-00011198 at 11199.
\end{footnotesize}
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 it 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 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

---

1245 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).
1246 Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).
1247 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
1248 Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).
1249 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
1250 Subcommittee interview of Ina Drew, CIO (9/7/2012).
1251 Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).
1252 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
1253 Id.
1255 Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
risk personnel criticized the OCC’s findings and recommendations,\textsuperscript{1256} and the meeting assumed a loud and “combative” tone.\textsuperscript{1257} 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.\textsuperscript{1258} 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.\textsuperscript{1259}

Still another instance involved profit and loss reports. In either late January or early February 2012, the OCC said that 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 informed it that Chief Executive Officer Jamie Dimon had ordered the bank to cease providing the Investment Bank’s daily P&L reports, because he believed it was too much information to provide to the OCC.\textsuperscript{1260} 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.\textsuperscript{1261} 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 in which both Mr. Braunstein and Mr. Dimon were present, according to the OCC, when Mr. Braunstein stated that he had ordered resumption of the reports, Mr. Dimon reportedly raised his voice in anger at Mr. Braunstein.\textsuperscript{1262} The OCC 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.\textsuperscript{1263} The OCC estimated that it was without the reports for less than a week 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.\textsuperscript{1264} As explained earlier, it

\textsuperscript{1256} Id.
\textsuperscript{1257} Id.
\textsuperscript{1258} Id.
\textsuperscript{1260} Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
\textsuperscript{1261} Id.
\textsuperscript{1262} Id.
\textsuperscript{1263} Id.
\textsuperscript{1264} See “Summary of Positions by Type,” prepared by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-PSI 0037609.
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.1265

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.”1266 The CIO’s stress limits were triggered eight times, sometimes for weeks at a stretch, from January to June 2011.1267 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.1268 In those reports, the CIO attributed all of the CIO’s stress limit breaches to changes in its “synthetic credit (tranche book).”1269 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.1270

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.1271 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.”1272 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.1273

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.1274 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

---

1265 Stress loss limits are dollar amounts representing plausible 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.
1268 Id.
1269 Id.
1272 Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012) (Doug McLaughlin).
1273 Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).
1274 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 3.
In hindsight, the OCC characterized the trading profits as “outsized”\(^{1276}\) 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.\(^{1277}\) Given that the bank admitted that the “CDX[.]HY positions were set up to take advantage of [a] key bankruptcy credit related event[]”,\(^{1278}\) 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 written document for the first time to the OCC, only to inform the OCC that it was planning to reduce the portfolio. Despite that representation, in the first three months of the year, the CIO tripled the size of the SCP, buying tens of billions of dollars of a high-risk mix of short and long credit derivatives in credit derivatives, only to see their value crash, resulting in mounting losses. As the OCC later described it: “SCP was obscure but not hidden as it went from operating outside of control limits in 2011 to operating out of control in 2012.”\(^{1279}\) 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.\(^{1280}\) One of the OCC examiners who attended the meeting prepared notes summarizing what was discussed and circulated them among OCC staff with CIO

---

\(^{1275}\) 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-13-0000113 [Sealed Exhibit].


\(^{1277}\) 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 “outsize gain” that OCC should have “investigate[d].”).


\(^{1279}\) 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000020 [Sealed Exhibit].

\(^{1280}\) See 1/24/3012 email from James Hohl, OCC, to Jaymin Berg, OCC, “CIO meeting,” OCC-00004746; Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
supervision responsibility.\textsuperscript{1281} 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.\textsuperscript{1282} 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.”\textsuperscript{1283}

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.\textsuperscript{1284} Another OCC examiner who attended the meeting with Mr. Wilmot told the Subcommittee that Mr. Wilmot conveyed the CIO’s plan to reduce its MTM positions and decrease the volume of its trading.\textsuperscript{1285} 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.”\textsuperscript{1286} The CIO’s counterintuitive strategy prompted even Mr. Dimon to ask later on: “Why didn’t they just sell vs offset[?]”\textsuperscript{1287}

\textsuperscript{1281} See 1/31/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, “CIO Quarterly Meeting,” OCC-SPI-00004695.

\textsuperscript{1282} 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).

\textsuperscript{1283} 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, at 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 positions. 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 positions because Mr. Wilmot had already told him differently at the end of January 2012. Subcommittee interview of James Hohl, OCC (9/6/2012).

\textsuperscript{1284} 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 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 1260. The notes of the quarterly meeting do not contain any reference to that expense.

\textsuperscript{1285} Subcommittee interview of James Hohl, OCC (9/6/2012).

\textsuperscript{1286} See 1/31/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, “CIO Quarterly Meeting,” OCC-SPI-00004695.

\textsuperscript{1287} 4/13/2012 email from Jamie Dimon, JPMorgan Chase, to John Hogan, JPMorgan Chase, “CIO,” JPM-CIO-PSI 0001753.
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.

Yet, 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 losses for the book would have “moved around.” It was the first of many SCP losses that the bank did not disclose to the OCC, but should have.

The bottom line is that the OCC’s quarterly meeting with the CIO took place at a critical time. Had the CIO disclosed the size, risk profile, losses, and plans for the SCP to its regulator during the January 2012 meeting – rather than downplayed the portfolio by saying the CIO planned to reduce it – the OCC could have evaluated the trading strategy 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.

---

1288 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
1289 Subcommittee interview of John Wilmot, CIO (9/11/2012).
1290 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.
1292 1/26/2012 email from Bruno Iksil, JPMorgan Chase, to Julien Grout, JPMorgan Chase, “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.
1293 Subcommittee interview of Jaymin Berg, OCC (8/31/2012).
1294 Subcommittee interview of John Wilmot, CIO (9/11/2012).
(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 (EMR). 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.

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 missing VCG reports, which were provided on the same day. Again, it is difficult to understand how the bank could have failed to provide those

1295 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
1296 Id.
1297 Id.
1298 4/19/2012 email from John Wilmot, CIO, to James Hohl, OCC, “CIO EMR?,” OCC-00004723.
1301 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
1303 For more information about the mismarking that took place during these months, see Chapter 4.
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,
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
his colleagues, “[the] Bank will likely object to this.” 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.

---

1305 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?”).
1306 Id.
1307 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.
1308 See 5/16/2012 email from Elwyn Wong, OCC, to Scott Waterhouse, OCC and others, “CSO1,” OCC-SPI-
00023929; 5/14/2012 email from James Hohl, OCC, to John Wilmot, CIO, “CIO P&L Reporting,” OCC-00004759
(stating that an OCC request for SCP P&L for prior five weeks was made on May 7, 2012 and repeated on May 14,
2012); 5/17/2012 email from James Hohl, OCC, to Fred Crumlish, OCC, “Not Getting CIO Daily P&L after only one
day,” OCC-00004540 (Mr. Hohl: “I got one CIO daily P&L distribution and then didn’t yesterday. I inquired
about this morning, but haven’t heard back.”).
1309 5/7/2012 OCC email from Fred Crumlish, OCC, to Scott Waterhouse and others, OCC, “CIO information for
Wednesday,” OCC-SPI-00013737, (“[W]e haven’t historically gotten P&L from them [CIO] as we do the IB
[Investment Bank] … However, I asked James [Hohl] to first, put in a request for more granular daily P&L on the
synthetic credit to help us prepare for Wednesday’s meeting, and, more generally, put out the request that going
forward we get daily P&L in a form such as they provide to (say) Ina Drew. Bank will likely object to this.”).
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.  

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. 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.  

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. 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)

---

1311 See Subcommittee interview of Scott Waterhouse, OCC (9/17/2012). For more information about this mismarking, see Chapter IV.
1312 Subcommittee interview of Michael Sullivan and Doug McLaughlin, OCC (8/30/2012).
1313 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 p. 11.
report provided the OCC with weekly stress loss data for different scenarios, \(^{1315}\) and Market Risk Management (MRM) Reporting emails provided notice of risk limit breaches. \(^{1316}\) 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. \(^{1317}\)

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. Given that the OCC did not appear to notice when other regular CIO reports stopped arriving until press articles on April 6 drew attention to the CIO, as detailed above, it is possible that the OCC examiners were not even reviewing the regular MaRRS and MRM reports during the first quarter of 2012.

The OCC also failed to inquire into the CIO’s implementation in January 2012, of a new VaR model that, overnight, lowered the CIO’s VaR by 50%. The bank’s regular MRM report emails, which OCC received contemporaneously, provided the OCC with timely notice of three significant facts: that the CIO had breached the bankwide VaR limit for four days running in January; that the CIO was poised to implement a new VaR model on January 27; and that the new model would significantly reduce the CIO’s VaR results. \(^{1318}\) 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

---


\(^{1316}\) See, e.g., 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000069 [Sealed Exhibit].

\(^{1317}\) See, e.g., 4/4/2012 email from MRM Firmwide Reporting, JPMorgan Chase, to Fred Crumlish, OCC, and others, “Firmwide Risk Daily: Market Risk Limits and VAR Reports – Regulators (COB 4/3/2012),” at OCC-SPI-00132363 (see tab: CIO_Global_Credit, listing VaR Limits, 10% Credit Spread Widening, Credit Spread BPV, and Stop Loss Advisory Limits for MTM One Day, Five Day, and Twenty Day, among other listed risk limits). For more information about the breaches of the CIO risk limits, see Chapter V.

\(^{1318}\) See 10/26/2012 OCC Confidential Supervisory Report, at PSI-OCC-13-000042 [Sealed Exhibit] (“The change in the VaR model and its large reduction in measured risk was noted in reports received by the OCC.”); 5/21/2012 email from Jairam Kamath, OCC, to Fred Crumlish, OCC, and others, “cio var change,” OCC-SPI-00021932 (“Here are a few comments from the days preceding the synthetic credit VaR model change that became effective 1/27/12. Note the reduction of CIO VaR by 44% to $57mm,”), citing to MRM Reporting emails from JPMorgan Chase, e.g., 1/25/2012 email from MRM Reporting, JPMorgan Chase, to Peter Weiland, CIO, and others, “ACTION NEEDED: CIO International-One-Off Limits Approval,” JPM-CIO-PSI 0000157.
bank reports about it and no indication that the OCC asked any questions about the model change, lower VaR, or earlier breach.\textsuperscript{1319} 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.\textsuperscript{1320} 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.\textsuperscript{1321} 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.\textsuperscript{1322} While OCC has internally concluded that the bank’s risk reports were “poor and non-transparent,”\textsuperscript{1323} it needs to rectify its own approach to be more responsive to red flags where they do exist.

(4) Miscasting Long Acquisitions As Risk Reducing

Contemporaneous OCC documentation indicates that many senior OCC personnel initially accepted the bank’s characterization of the SCP as a hedging mechanism intended to reduce bank risk. When questions 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.\textsuperscript{1324} What was not offered as an explanation at the time, but which has become

---

\textsuperscript{1319} See 3/1/2012 Memo from Jaymin Berg, OCC, to OCC File, “Market Risk Reporting,” OCC-SPI-00035322, at 323 (memo from meeting with bank noted that “Firmwide VaR averaged $109mm in February versus $126mm in January. The decrease is due to CIO credit tranche methodology changes, which were implemented on January 27th.”); meeting minutes were circulated in 3/6/2012 email from Jaymin Berg, OCC, to Fred Crumlish, OCC, James Hohl, OCC, and others, “Market Risk Minutes,” OCC-SPI-00035319-321.

\textsuperscript{1320} Subcommittee interviews of Fred Crumlish, OCC (8/28/2012) and Jairam Kamath, OCC (8/24/2012). For more information, see Chapter V.

\textsuperscript{1321} Subcommittee interview of Jairam Kamath, OCC (8/24/2012); see also Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

\textsuperscript{1322} 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.”).

\textsuperscript{1323} Id.

\textsuperscript{1324} See, e.g., 4/17/2012 email from Fred Crumlish, OCC, to Mike Brosnan, OCC, and others, “JPM/CIO / IG 9 ‘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
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. 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.

The OCC told the Subcommittee that its examination team was not aware that the CIO was purchasing IG longs, in part, to produce carry that could be used to purchase additional high yield shorts and offset SCP reported losses. 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...”

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). “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.

1325 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).

1326 See discussion in Chapter III; JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (9/6/2012) (partial readout) (“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[,]”).

1327 Subcommittee interview of Mike Sullivan, OCC (11/7/2012).

1328 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).

1329 Subcommittee interview of Julie Williams, OCC (9/17/2012).
to hedge market risks arising in connection with and related to the HY trades.”1330 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.”1331

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.”1332 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.1333

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.1334 The OCC told the Subcommittee that it was surprised by the stories and immediately directed inquiries to the bank to obtain more information. The OCC initially received such limited information about the trades and such blanket reassurances from the bank that it actually considered the matter closed in late April.1335 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.

1330 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.
1331 Subcommittee interview of Julie Williams, OCC (9/17/2012).
1333 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.
1335 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
(1) Providing OCC with Limited or Incorrect Information

After the media began to report on the whale trades in early April 2012, the OCC and Federal Reserve sought additional information about those trades from the bank, but were provided with inadequate information that delayed effective oversight.

**Positions Table.** According to the OCC, on Monday, April 9, 2012, in the regulators’ first meeting 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.\(^{1336}\) The next day, April 10, 2012, 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.\(^{1337}\) 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”\(^{1338}\) and in a Subcommittee interview as “absolutely unhelpful” and seemingly designed to make regulators “go away.”\(^{1339}\)

**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.”\(^{1340}\) On its face, however, calling the SCP book a “dedicated hedge” contradicted the Summary of Positions table which showed that the portfolio held an overall net long position, the opposite of what would be expected for a hedge.\(^{1341}\) Nearly one week later, when the bank was explaining in an email a nearly identical table in a more

---

\(^{1336}\) 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.”).

\(^{1337}\) 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.

\(^{1338}\) 5/18/2012 email from Michael Kirk, OCC, to Elwyn Wong, OCC, “CIO Call With Mike Brosnan,” OCC-SPI-00021628 at 21630 (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.”).

\(^{1339}\) Subcommittee interview of Fred Crumlish, OCC (8/29/2012).

\(^{1340}\) 4/10/2012 email from Joe Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, and others, “Background and Supporting Data for CIO Discussion of April 9, 2012,” OCC-SPI-00004312. See also 4/10/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, “JPM CIO Trades—JPMorgan’s Iksil May Spur Regulators to Dissect Trading – Bloomberg News- 4/9/12,” OCC-00004087 (“As you know we had a call with Chief Investment Officer Ina Drew and others in JPM yesterday. … JPMC’s credit stress hedge is again where they want it. … We asked the bank for a number of items yesterday that reflect details on the trades and support the stress loss hedge rationale associated with this specific strategy. We expect this sometime today.”).

\(^{1341}\) 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.).
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 trades themselves. This representation, which, again, portrayed the SCP book as designed to lower bank risk, was, again, inconsistent with the SCP book itself, since it continued to hold a net long position, meaning it was exposed to credit risk, just as the CIO’s portfolio and the bank as a whole were exposed to credit risk.

The OCC told the Subcommittee that its examiners knew at this point that, given the book’s long risk posture, the SCP was not performing a hedging function. The OCC told the

---

1343 See 4/17/2012 email from John Wilmot, CIO, to James Hohl, OCC, “Quick questions on pp 4 and 5,” OCC-SPI-00023815 (“I believe there is a modest long credit risk sensitivity to the portfolio now.”). This email referenced “pp 4 and 5” of the above presentation: 4/16/2012 email from Joseph Sabatini, JPMorgan Chase, to Anna Iacucci, Federal Reserve, “materials for Fed/OCC/FDIC call at noon today,” OCC-SPI-00009712, at 9716.
1344 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.”).
1345 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).
1346 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.
1349 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.”).
1350 Subcommittee interview of James Hohl, OCC (9/6/2012).
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.\textsuperscript{1351} 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,”\textsuperscript{1352} including a misrepresentation that the 2012 first quarter SCP losses totaled $580 million,\textsuperscript{1353} when first quarter losses had actually been internally reported as $719 million.\textsuperscript{1354} 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.\textsuperscript{1355} 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.\textsuperscript{1356} 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.”\textsuperscript{1357}

**Risk and Stress Limit Breaches.** A few days later, on April 19, the OCC asked the bank, for what appears to be the first time since the beginning of 2012, about the significance of information that the SCP had breached several risk and stress loss limits. After receiving reassurances from the bank regarding these breaches, the OCC let the matter drop instead of investigating the trading activities that caused the breaches.

In the OCC’s initial inquiry on April 19, 2012, an OCC examiner asked the CIO Market Risk Officer for additional information about data indicating that the CIO had breached three of the bank’s primary risk limits:

“Would you have any color around some observations about the CIO VaR [Value-at-Risk], CSBPV [Credit Spread Basis Point Value, also known as the CS01 risk limit] and stress results? I received the following from another examiner this morning. Thanks.

[‘]The increase in the Firm’s Var is primarily driven by CIO Synthetic Credit portfolio.

\textsuperscript{1351} Subcommittee interview of Fred Crumlish, OCC (8/28/3012).
\textsuperscript{1352} Subcommittee interview of Michael Kirk, OCC (9/22/2012).
\textsuperscript{1354} See OCC spreadsheet, OCC-SPI-00000298, printed as a Subcommittee chart in Chapter IV. Numbers do not reflect restated P&L figures.
\textsuperscript{1355} 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.
\textsuperscript{1356} Subcommittee interview of Michael Kirk, OCC (9/22/2012).
\textsuperscript{1357} Subcommittee interview of Fred Crumlish, OCC (8/28/3012).
CIO aggregate stress is over 23% of its $15B [billion] limit. Also MtM [mark-to-market] cs bpv limit is in excessing by 1074% and has been in excessing for 71 days.\textsuperscript{1358}

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.\textsuperscript{1359}

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 that 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,\textsuperscript{1360} 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.\textsuperscript{1361} 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.”\textsuperscript{1362} 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,”\textsuperscript{1363} and “egregious,”\textsuperscript{1364} but acknowledged that, at the time, the OCC reacted by 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

\textsuperscript{1358} 4/19/2012 email from James Hohl, OCC, to Peter Weiland, CIO, “Info on VaR, CSBPV, and stress status and limits,” OCC-SPI-00022340.

\textsuperscript{1359} 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.

\textsuperscript{1360} 4/19/2012 email from Peter Weiland, CIO, to James Hohl, OCC, Info on VaR, CSBPV, and stress status and limits, OCC-SPI-00022340.

\textsuperscript{1361} Subcommittee interview of James Hohl, OCC (9/6/2012).

\textsuperscript{1362} 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).

\textsuperscript{1363} Subcommittee interview of Jairam Kamath, OCC (8/24/2012).

\textsuperscript{1364} 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.).
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.”

---

1366 7/31/2012 chart included in a presentation prepared by the OCC for a Subcommittee briefing, at 8, PSI-OCC-06-000026.
1367 Subcommittee interview of Ashley Bacon, JPMorgan Chase (9/5/2012).
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

---

1368 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
1369 See 3/30/2012 email from Achilles Macris, CIO, to John Hogan, JPMorgan Chase, “synthetic credit- crisis action plan,” JPM-CIO 0000434. Mr. Macris’ request was granted.
that the CIO may have been overvaluing SCP assets and understating its losses.\textsuperscript{1370} 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.\textsuperscript{1371}

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.”\textsuperscript{1372} 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,”\textsuperscript{1373} 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.\textsuperscript{1374} 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.\textsuperscript{1375}

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.”\textsuperscript{1376}

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.\textsuperscript{1377} The
OCC told the Subcommittee that amount of loss was “material” and should have prompted an
immediate OCC communication to the CIO.\textsuperscript{1378} While the OCC examiner who normally

\textsuperscript{1370} See, e.g., 4/20/2012 email from Mark Demo to John Wilmot, CIO, and others, “Largest OTC Collateral Call
Dispute Report plus Update on Collateral Disputes Reported to Supervisors,” JPM-CIO-PSI-H 0000141-0151, at
0142 (reporting that the CIO collateral disputes involving the London trades were over $500 million.”). This email
was forwarded to Ina Drew and Irvin Goldman, CIO, on 4/23/2012. Id. at 141.
\textsuperscript{1371} See 5/6/2012 email from Fred Crumlish, OCC, to James Hohl, OCC, and others, “CIO Synthetic Position,”
OCC-SPI-00021853; Subcommittee interview of Fred Crumlish, OCC (8/28/2012).
\textsuperscript{1372} 5/4/2012 Email from Scott Waterhouse, OCC, to Fred Crumlish, OCC, CIO Synthetic Position, OCC-SPI-
00021853 (“Doug Braunstein and John Hogan called to provide an update on the CIO position ... Current losses are
approximately $1.6 billion.”). In fact, according to SCP profit-loss reports, as of the day 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.
\textsuperscript{1373} 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,
\textsuperscript{1374} Subcommittee interview of James Hohl, OCC (9/6/2012).
\textsuperscript{1375} Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
\textsuperscript{1376} 5/17/2012 email from Fred Crumlish, OCC, to Scott Waterhouse, OCC, “Your request of last night, re OCC
response on cio” OCC-00005554.
\textsuperscript{1377} 4/25/2012 email from Geralynn Batista, OCC, to Fred Crumlish, OCC, and others, “Weekly Market Summary
\textsuperscript{1378} 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.1379

After the bank’s telephone call on May 4 disclosed that the additional SCP losses exceeded $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.1380 The OCC told the Subcommittee that, even then, the bank often provided limited information, with one OCC examiner characterizing the reporting as “terrible.”1381 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.1382 The OCC told the Subcommittee that the bank responded by providing a long list of 60,000 positions1383 in a format useless for data analysis purposes, frustrating the OCC’s efforts to understand the portfolio.1384 Ultimately, after repeated requests, the OCC told the Subcommittee it believed it received the necessary information.1385 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 2012.1386

(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.1387 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.

---

1379 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).
1380 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.”).
1381 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.”).
1382 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.)
1383 Subcommittee interview of Scott Waterhouse, OCC (9/17/2012).
1385 Subcommittee interview of Elwyn Wong, OCC (8/20/2012).
1386 See 12/12/2012 OCC Supervisory Letter JPM-2012-66, at PSI-OCC-000001, at 003. [Sealed Exhibit.]
1387 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...

---

1388 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).
1389 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-00071386, at 386 (“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.”).
1390 Subcommittee interview of Michael Kirk, OCC (8/22/2012).
1391 2013 JPMorgan Chase Task Force Report, at 89.
1392 See March 2012, 2012 Continuous Audit Quarterly Summary of Global Chief Investment Office, OCC-SPI-00004614, at 4168 (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.”).
1393 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].
1394 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.
1396 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.
1397 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

---

1398 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.”).

1399 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.

1400 Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012). For more information, see Chapter IV.

1401 See also 5/11/2012 email from Senior Deputy Comptroller for Large Bank Supervision Mike Brosnan, OCC, to Thomas Curry, OCC, “J.P. Morgan Chase,” OCC-SPI-00000031, at 032.

1402 Subcommittee interview of Michael Kirk, OCC (8/22/2012).

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 Robert 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.

---

1405 Id.
1409 See 5/12/2012 email from Carrie Moore, OCC, to Michael Bright, Sen. 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.”).
1410 See, e.g., “JPMorgan Losses: Sens. Levin, Corker Debate Implementing Financial Regulation,” PBS News Hour (5/14/2012), at http://www.pbs.org/newshour/bb/politics/jan-june12/wallstreet_05-14.html (Senator Corker: “We have been in conversations all weekend with the OCC, the Office of [the Comptroller of the] Currency, and ... they have been very adamant that even if the Volcker rule, which the senator was referring to, was fully implemented, that this would have been permitted activity. During the course of the day, we were just talking, they have altered their position and said that this is more complex than they thought and they really want to hold off.”).
1411 See 5/14/2012 email from Bryan Hubbard, OCC, to Al Zibel, Dow Jones, Ben Prost, 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 General 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.
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 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.”

---

On January 14, 2012, 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.

---

1431 2013 JPMorgan Chase Task Force Report, at 111.
1433 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.1434 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.

1434 Subcommittee interview of Fred Crumlish, OCC (8/28/2012).