United States Senate

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Committee on Homeland Security and Governmental Affairs

Carl Levin, Chairman

John McCain, Ranking Minority Member

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

MAJORITY AND MINORITY STAFF REPORT

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

UNITED STATES SENATE

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any diverging results between the two.[1020] When asked about testing, JPMorgan Chase responded that the question "touched a nerve," and the bank was "not proud" of the inadequate backtesting performed in this situation.[1021] The Subcommittee found no evidence that the Model Review Group expressed any concerns at the time about how and why the new model produced such dramatically lower VaR results for the SCP's trading activity compared to the prior model. Mr. Hagan told the Subcommittee that the 50% drop in the CIO's VaR results was surprising and "very significant," yet at the time the new VaR totals went unchallenged.[1022]

Despite the operational problems identified by the Model Review Group and the obvious questions raised by the new VaR model results, a lax approval process at the bank allowed the model to be put into effect immediately, prior to the specified corrective actions being completed. Bank and CIO personnel agreed in an email that "if [the] January tests look all right, we should go ahead and implement the new model even before the MRG [Model Review Group] review is completed."[1023] On January 30, 2012, Ashish Dev, a member of the Model Risk and Development Group reporting to Mr. Venkatakrishnan informed CIO Chief Market Risk Officer Peter Weiland that the new VaR model was approved.[1024]

Documents obtained by the Subcommittee show that the bank did send contemporaneous copies of its internal emails to the OCC about the proposed VaR model change. Despite those emails, the OCC asked no questions and took no steps to investigate the new model at the time it was approved by the bank for use by the CIO. A review conducted by the OCC subsequent to the SCP trading losses identified failures in the model review process. A November 6, 2012 OCC Supervisory Letter stated that one "Matter Requiring Attention" was that "[t]he bank was using several VAR models that were not properly reviewed internally and others did not receive required regulatory approval."[1025] The OCC concluded that JPMorgan Chase's "VaR Model risk management is weak and constitutes an unsafe and unsound banking practice."[1026]

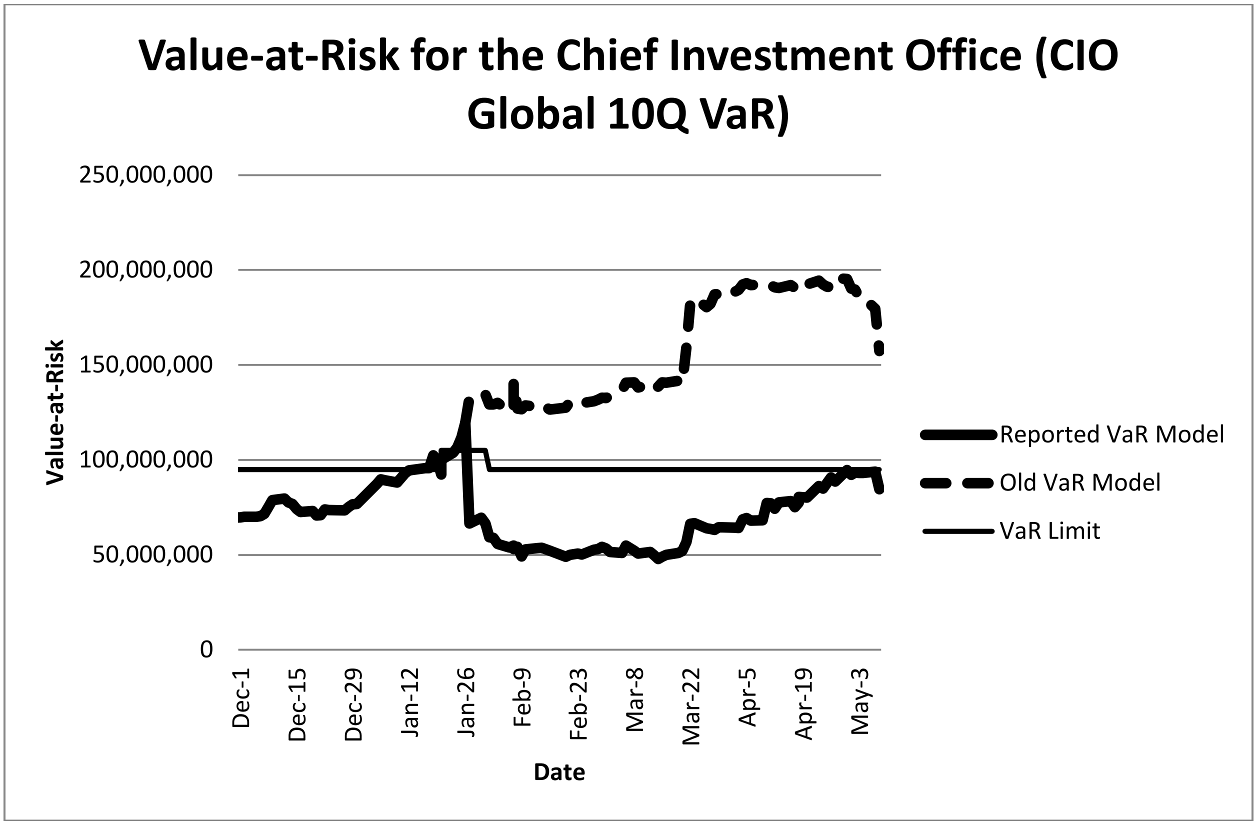
(f) Using the New VaR Model to Increase Risk

As soon as it was approved internally, the new model produced a dramatically lower VaR for the CIO. On January 27, 2012, for example, the same day the new VaR model took effect, the CIO's VaR was $66 million, whereas under the prior model, its VaR was $132 million.[1027]

[1020] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
[1021] Levin Office briefing by JPMorgan Chase (6/26/2012) (Greg Baer). See also 2013 JPMorgan Chase Task Force Report, at 104 (stating that the MRG did not compare the two model results at all) and 123 (stating the Model Review Group "performed only limited back-testing of the model," because the CIO "lacked the data necessary for more extensive back-testing").
[1022] Subcommittee interview of Patrick Hagan. CIO (2/7/2013).
[1023] 1/27/2012 email from Ashish Dev, JPMorgan Chase, to Peter Weiland, CIO, and others, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM-CIO-PSI 0000187.
[1024] 1/30/2012 email from Ashish Dev, JPMorgan Chase, to Peter Weiland, CIO, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM-CIO-PSI 0000187. See also 2013 JPMorgan Chase Task Force Report, at 126 (stating new VaR model was authorized by the MRG on January 30, and received "[f]ormal approval" on February 1, 2012).
[1025] 11/6/2012 OCC Supervisory Letter to JPMorgan Chase, "Examination of VaR Model Risk Management," at 2, PSI-OCC-17-000019 [Sealed Exhibit].
[1026] Id.
[1027] See undated spreadsheet of CIO 10Q VaR from 12/1/2011 to 5/10/2012, JPMC-Senate/Levin 000155. This

Mr. Hagan told the Subcommittee, when shown emails predicting that his new VaR model would lower the CIO's VaR results by 44%, that the CIO traders were "dreaming."[1028] When informed that on the first day the model was implemented, it actually reduced the CIO's VaR results by 50%, he mouthed the word "wow," said he was "very surprised," and characterized it as a "very significant" reduction that he didn't know about at the time.[1029]

The sizeable difference between the two figures – the VaR remained between 30 and 50% lower than it would have been under the prior model[1030] – continued until the new VaR model was abandoned in May 2012.[1031] The following chart shows the calculations produced by the new VaR model compared to the previous model and the CIO VaR limit.[1032]



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

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spreedsheet also indicated that, on April 6, 2012, the new VaR was $68 million and the prior VaR was $192 million. Id.

[1028] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

[1029] Id.

[1030] Subcommittee chart created from data provided by JPMorgan Chase, JPMC-Senate/Levin 000155-6; Levin Office briefing by JPMorgan Chase (7/5/2012) (Greg Baer).

[1031] See 5/10/2012 "Business Update Call," JPMorgan Chase transcript, at 2, http://i.mktw.net/_newsimages/pdf/jpm-conference-call.pdf (Mr. Dimon: "In the first quarter, we implemented a new VAR model, which we now deemed inadequate. And we went back to the old one, which had been used for the prior several years, which we deemed to be more adequate."); 5/12/2012 email from Peter Weiland, CIO, to John Hogan, CIO, and others, "NON IB VaR Bandbreak Summary Report – CIB 4/30/2012," JPM-CIO-PSI 0007884.

[1032] This chart was prepared by the Subcommittee using data provided by JPMorgan Chase, JPMC-Senate/Levin 000155-6.

The chart shows, not only the wide discrepancy between the two VaR models, but also that the old model produced much higher VaR numbers for the CIO than the new model. The chart also shows that, beginning in mid-January, the old VaR model would have shown the CIO as consistently and continuously in breach of its VaR limit, while the new model showed no breach at all through May 2012. In addition, the old VaR model would have shown the CIO in breach of the bankwide VaR limit in February, March, April, and May.

(g) Failing to Lower the VaR Limit

When JPMorgan Chase approved the CIO's new VaR model on January 30, 2012, it should have acted at the same time, but did not, to lower the CIO's VaR limit. As a consequence, the new model enabled the CIO to engage in substantial additional risky trading without violating its own or the bankwide VaR limit. The end result was that, when the CIO triggered the VaR limit breaches in January, rather than remove the offending credit derivative positions to reduce the amount of risk in the SCP, JPMorgan Chase removed the brakes instead.

JPMorgan Chase told the Subcommittee that a "recommendation" had been made to lower the CIO's VaR limit from $95 million to $70 million at the time the new model was approved, but that limit change was not made.[1033] When asked why not, Ms. Drew explained that "everything can't happen at once," and "models get changed all the time."[1034]

As Mr. Dimon acknowledged during his Congressional testimony, the change in the VaR model allowed the CIO traders to take on more risk. However, the model change is not alone responsible for the SCP's growing risk: the bank's failure to adopt a limit appropriate to the model change represents an additional failure in its risk management.

JPMorgan Chase told the Subcommittee that the failure to impose a new VaR limit in January was a consequence of the fact that the CIO was then in the process of reconsidering all of its limits across its entire complement of risk metrics, and that its VaR limit was already due to be considered in March.[1035] In addition, Mr. Goldman told the Subcommittee that when he assumed the role of Chief Risk Officer of the CIO in January, he initiated a review of all of the CIO's risk metrics at that time, but did not implement new risk limits due to the ongoing process to review them.[1036] At the end of March, the CIO's Risk Operating Committee received a presentation regarding a new "proposed limits framework," but planned additional weeks of review, leaving both the new VaR model and the old VaR limit in place.[1037] Mr. Dimon told the Subcommittee that a discussion as to whether the VaR limit should have been lowered at the

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[1033] Subcommittee briefing by JPMorgan Chase (8/15/2012); 3/8/2012 email from Ashley Bacon, JPMorgan Chase, to John Hogan, JPMorgan Chase, Peter Weiland, CIO, and others, "Firmwide VaR overlimit," JPM-CIO-PSI 0000379 ("Also CIO is contemplating a possible reduction in VaR limit to $70 mil (factored in here but not yet agreed.)").

[1034] Subcommittee interview of Ina Drew, CIO (9/7/2012).

[1035] Subcommittee briefing by JPMorgan Chase (8/15/2012).

[1036] Subcommittee interview of Irvin Goldman, CIO (9/15/2012).

[1037] The CIO Risk Operating Committee Minutes noted that the "proposed limits framework was presented to the committee noting that a full overhaul of all limits is underway. Over the next few weeks the limits will be discussed with the individual regions and presented back to the group for approval." See 3/28/2012, "CIO Risk Operating Committee Minutes – March 28th, 2012," JPMorgan Chase document produced to the OCC, OCC-SPI-00004734.