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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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Center for Nonlinear Science.[924] He then worked for several financial research firms and financial institutions.[925]

Increasingly, for regulators to evaluate the risks and quality of risk management at a financial institution, they have to understand the institution's risk metrics and models. Regulators also rely on mathematical models to help determine, among other matters, how much capital a financial institution must hold to mitigate its risks. Regulators' duties today include determining whether proposed models meet detailed regulatory requirements, overseeing model changes and variations, examining model implementation which can raise complex operational issues, and overseeing back-testing of the models to evaluate their accuracy.[926] These complex tasks are made more difficult if banks' quantitative experts are developing new or revised models to artificially lower the bank's risk ratings and capital requirements.

JPMorgan Chase uses a variety of models to track and measure risk for specific lines of business and business units as well as for the bank as a whole. At the CIO, during the first quarter of 2012, the CIO's risk limits were repeatedly breached by the Synthetic Credit Portfolio, even triggering a breach of a bank-wide limit. But instead of investigating and reducing the high risk trading activities that triggered the breaches, the CIO's traders, risk management personnel, and senior managers criticized the risk metrics as inaccurate and pushed for model changes that would portray credit derivative trading activities as less risky.

(1) Disregarding the VaR Limit

One of the early red flags about the risk being taken on by the Synthetic Credit Portfolio was the CIO's breach of the Value-at-Risk (VaR) limit. In January 2012, the CIO's SCP breached not only the CIO's individual VaR limit, but also the VaR limit for the bank as a whole. The breach continued for four days, and ended only after the bank temporarily increased the limit. The CIO's traders and quantitative analysts then rushed approval of a new CIO VaR model which, when it took effect, portrayed the Synthetic Credit Portfolio as 50% less risky than the prior VaR model. The new VaR model not only ended the SCP's breach, but also freed the CIO traders to add tens of billions of dollars in new credit derivatives to the SCP which, despite the supposedly lowered risk, led to additional massive losses. Those losses helped expose both substantive and serious operational flaws in the new VaR model. As a result, in May 2012, the bank backtracked, revoked the CIO's new VaR model, and restored the old one.

(a) Background

VaR models use historical profit and loss data to calculate a dollar figure that is supposed to represent the most money that a portfolio of assets could be expected to lose over a fixed

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[924] See 12/5/2012 biographical information on Patrick Hagan, course tutor for Incisive Training, "Patrick Hagan on Fixed Income," http://ev888.eventive.incisivecms.co.uk.
[925] Subcommittee interview of Patrick Hagan, CIO (2/7/2013).
[926] See, e.g., 12 C.F.R. Part 3, Appendix B. The OCC, Federal Reserve, and FDIC have also proposed new regulations to comply with new capital, risk, and liquidity standards issued by the Basel Committee on Banking Supervision. See 8/30/2012, Joint Final Rule, "Risk-Based Capital Guidelines: Market Risk," Federal Register, http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16759.pdf.

period of time to a certain degree of confidence.[927] The OCC provides detailed guidance on how regulatory VaR models should function, but allows individual banks to design their own models.[928] The OCC also requires all of the banks it oversees to obtain its approval of VaR models used to calculate regulatory capital.[929] Banks also use VaR models for internal risk management. While the OCC has broad authority to oversee the risk management and model development process, banks are not required to submit internal risk management VaR models for OCC approval.[930]

JPMorgan Chase defines VaR as a "measure of the dollar amount of potential loss from adverse market moves in an ordinary market environment."[931] JPMorgan Chase's 2011 Annual Report explained the bank's use of VaR as a risk metric as follows:

> "JPMorgan Chase utilizes VaR, a statistical risk measure, to estimate the potential loss from adverse market moves. Each business day, as part of its risk management activities, the Firm undertakes a comprehensive VaR calculation that includes the majority of its material market risks. VaR provides a consistent cross-business measure of risk profiles and levels of diversification and is used for comparing risks across businesses and monitoring limits. These VaR results are reported to senior management and regulators, and they are utilized in regulatory capital calculations."[932]

According to public filings, JPMorgan Chase "has one overarching VaR model framework used for risk management purposes across the Firm,"[933] but Mr. Dimon told the Subcommittee that the bank has hundreds of individual VaR models used by various lines of business and business segments.[934] For the purposes of this chapter, the relevant VaR is known as the "95%" or "10Q" VaR. The "95%" refers to the confidence level in the computation, and the "10Q" indicates it is the VaR that JPMorgan Chase reports in its 10-Q quarterly filings with the SEC. According to JPMorgan Chase's 2011 Annual Report:

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927 See OCC definition of VaR, 12 C.F.R. Part 3, Appendix B, Section 2 ("*Value-at-Risk (VaR)* means the estimate of the maximum amount that the value of one or more positions could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.").

928 See 12 C.F.R. Part 3, Appendix B, Sections 4 and 5; Subcommittee briefing by OCC (3/4/2012)

929 12 CFR Part 3, Appendix B, Section 3(c)(1) ("(c) Requirements for internal models. (1) A bank must obtain the prior written approval of the OCC before using any internal model to calculate its risk-based capital requirement under this appendix.")

930 See 12 CFR Part 3, Appendix B, Section 3(d) ("(2) The bank must validate its internal models initially and on an ongoing basis. The bank's validation process must be independent of the internal models' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness.").

931 3/30/2012, "2011 Annual Report," JPMorgan Chase publication, at 311, http://files.shareholder.com/downloads/ONE/1839748086x0x556139/75b4bd59-02e7-4495-a84c-06e0b19d6990/JPMC_2011_annual_report_complete.pdf.

932 Id. at 158.

933 JPMorgan Chase & Co. Form 10-Q (for period ending 9/30/2012), filed with the SEC (11/08/2012), at 96, http://files.shareholder.com/downloads/ONE/2252595197x0xS19617-12-308/19617/filing.pdf.

934 Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

> "The Firm calculates VaR to estimate possible economic outcomes for its current positions using historical simulation, which measures risk across instruments and portfolios in a consistent, comparable way. The simulation is based on data for the previous 12 months. This approach assumes that historical changes in market values are representative of the distribution of potential outcomes in the immediate future. VaR is calculated using a one day time horizon and an expected tail-loss methodology, and approximates a 95% confidence level. This means that, assuming current changes in the market are consistent with the historical changes used in the simulation, the Firm would expect to incur losses greater than that predicted by VaR estimates five times in every 100 trading days, or about 12 to 13 times a year. However, differences between current and historical market price volatility may result in fewer or greater VaR exceptions than the number indicated by the historical simulation. The firm's VaR calculation is highly granular and incorporates numerous risk factors, which are selected based on the risk profile of each portfolio."[935]

According to the OCC's Examiner-in-Charge at JPMorgan Chase, the bank's 10Q VaR estimated the potential loss to the bank's portfolio over the course of a day by looking at the previous 264 trading days and taking the average loss of the worst 33 days.[936]

At JPMorgan Chase, risk models, including VaR models, were normally developed or overseen by the Model Risk and Development (MRAD) group, also referred to as the Quantitative Research (QR) team within the bank's risk management division.[937] Some models required review and testing by MRAD before they were put into effect; tier two models were scheduled for periodic review and could be implemented by business units prior to approval by MRAD.[938] In addition, the Subcommittee was told that, normally, a new model is analyzed concurrently with an existing model for several months to evaluate how the new model performs and examine any diverging results between the two.[939]

(b) Developing a New VaR Model

JPMorgan Chase told the Subcommittee that the new VaR model adopted by the CIO in January 2012, was not produced at short notice, but was the product of more than a year of planning and development.

The bank told the Subcommittee that the CIO had embarked upon the project to reformulate the methodology for calculating its VaR results in 2011.[940] The CIO 10-Q VaR model then in effect had been designed by Keith Stephan, a member of the CIO's risk

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[935] 3/30/2012, "2011 Annual Report," JPMorgan Chase publication, at 158, http://files.shareholder.com/downloads/ONE/1839748086x0x556139/75b4bd59-02e7-4495-a84c-06e0b19d6990/JPMC_2011_annual_report_complete.pdf.
[936] Subcommittee interview of Scott Waterhouse, OCC (9/17/2012); see also Subcommittee briefing by JPMorgan Chase (8/15/2012).
[937] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
[938] Id.
[939] Id.
[940] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).

management team in London.[941] Although Mr. Stephan remained employed by the CIO in a risk management capacity, he was not the primary developer of the new VaR model; instead, that task was assigned to Patrick Hagan, the CIO's senior quantitative analyst who worked with the CIO traders.[942] Mr. Hagan had never previously designed a VaR model.[943] According to JP Morgan Chase, having an employee from a business unit design the unit's risk model was somewhat unusual,[944] but it did not violate bank policy.[945] The new VaR model, when finalized, indicated that it had been created by both Mr. Hagan and Mr. Stephan.[946]

Mr. Hagan told the Subcommittee that he initially began work on two other VaR models, a "stress VaR" model and then a "historical" VaR model with a 99% confidence level, both of which were intended to be used in a model designed to calculate Risk Weighted Assets (RWA) for the CIO.[947] Mr. Hagan told the Subcommittee that he was told the objective of his research was to design VaR models that, when fed into the RWA model, would produce lower RWA results for the CIO, since both he and the CIO traders viewed the bank's standard RWA model as overstating CIO risk.[948] Mr. Hagan said that he began work on the stress VaR and VaR-99 models in the early summer of 2011, wrote algorithms for them, and worked to refine the models over the next few months.

Mr. Hagan told the Subcommittee that his supervisor, Javier Martin-Artajo, then asked him to design a new 10-Q 95% VaR model for the CIO. Mr. Hagan explained that he was able to develop that model quickly, because he derived the VaR-95 model from the VaR-99 model he had already been working on. He explained that the VaR-99 and VaR-95 models were nearly identical, since they drew from the same historical data sets and used very similar mathematical functions. He said that he worked on the VaR-95 model for a two-month period, from October to November 2011, designing both the model and a computer program to run it during that time period.[949] Mr. Hagan said that he felt "rushed" and "under a lot of pressure" from Mr. Martin-Artajo to get the new VaR-95 model completed and implemented quickly.[950]

[941] Subcommittee interviews of Elwyn Wong, OCC (8/20/2012); Michael Kirk, OCC (8/22/2012); and C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

[942] Subcommittee interview of Patrick Hagan, CIO (2/7/2013); Levin Office briefing by JPMorgan Chase (7/5/2012).

[943] Subcommittee interview of Patrick Hagan, CIO (2/7/2013); Levin Office briefing by JPMorgan Chase (7/5/2012); 2013 JPMorgan Chase Task Force Report, at 104.

[944] Levin Office briefing by JPMorgan Chase (7/5/2012); Subcommittee briefing by JPMorgan Chase (8/15/2012).

[945] Levin Office briefing by JPMorgan Chase (7/5/2012).

[946] See 10/10/2011 memorandum by Patrick Hagan and Keith Stephan, CIO, "VAR METHODOLOGY," JPM-CIO-PSI 0000041-47.

[947] Subcommittee interview of Patrick Hagan, CIO (2/7/2013). A "stress VaR" is a VaR designed to reflect market conditions similar to the 2007-2008 financial crisis. The "historical VaR" for calculating RWA is based on a ten day time horizon and 99% confidence level.

[948] Id. Mr. Hagan explained that the bank's VaR-95 model was designed so that traders were expected to exceed the VaR total produced by the model on at least 5 days out of 100, but, in fact, the bank had not exceeded the total on a single day during the prior year, proving that the VaR-95 model "overstated the risk." Id.

[949] Id. See also 2013 JPMorgan Chase Task Force Report, at 122-123 (stating the CIO worked on the new VaR model from August to November 2011).

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

According to JPMorgan Chase, the impetus for the new VaR models was to render the CIO's VaR models compliant with Basel III requirements.[951] Basel III refers to a set of international banking standards issued by the Basel Committee on Banking Supervision addressing capital, risk, and liquidity issues; the new Basel III standards were intended to be phased in globally beginning in 2013, but according to the bank, the CIO wanted to "pre-adopt" them.[952]

In addition to citing compliance with Basel III as a motivation for changing the VaR models, JPMorgan Chase also told the Subcommittee that the CIO's old VaR-95 model was "too conservative."[953] That is, the old VaR model overstated risk.[954] As the 2013 JPMorgan Chase Task Force put it: "The trader who had instructed the modeler to develop the new VaR model, CIO Market Risk, and the modeler himself also believed that the [old] model was too conservative – that is, that it was producing a higher VaR than was appropriate."[955] Both JPMorgan Chase and Mr. Hagan informed the Subcommittee that the new model was designed to consider and reflect additional types of risks compared to the prior model, and would produce more accurate results.[956]

In a document authored by Mr. Hagan explaining his new VaR-99 model, which also formed the basis for the new VaR-95 model, he wrote that the new model was a "conservative" one that was expected to produce "higher" VaR results.[957] When asked about that description, Mr. Hagan told the Subcommittee that he had thought that might be the result, although in practice, the new VaR model typically produced lower results – generally 20% lower – than the prior model. He said that he never fully understood the prior VaR model and so did not know exactly why his model produced lower results.[958]

Bank documents, emails, and recorded telephone conversations are clear that a key motivation for developing the new VaR model was to produce lower VaR and Risk Weighted

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[951] Levin Office briefing by JPMorgan Chase (7/5/2012). For more information on Basel III, see Chapter II.

[952] Levin Office briefing by JPMorgan Chase (5/25/2012). See also 2013 JPMorgan Chase Task Force Report, at 121-122 (explaining that the new VaR model was developed to bring the CIO in compliance with Basel 2.5). Recently, the Basel Committee announced plans to delay implementation of the Basel III rules to January 1, 2019. See "Banks Win an Easing of Rules on Assets," New York Times, Jack Ewing (1/6/2013), http://www.nytimes.com/2013/01/07/business/global/07iht-banks07.html?src=twrhp. For more information about the Basel Accords generally, see Chapter II.

[953] Subcommittee briefing by JPMorgan Chase (8/15/2012). See also 2013 JPMorgan Chase Task Force Report, at 79, footnote 98 ("The previous model was viewed as too conservative and the VaR that it was producing thus was considered to be too high. The new model was thought to be a substantial improvement that would more accurately capture the risks in the portfolio.").

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

[955] 2013 JPMorgan Chase Task Force Report, at 122.

[956] Subcommittee interviews of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012) and Patrick Hagan, CIO (2/7/2013).

[957] See "VaR Methodology," prepared by Patrick Hagan and Keith Stephan, JPM-CIO-PSI 0000041, at 045 ("All the above problems with our methodology generally lead to higher VAR, which is unsurprising since VAR can be considered as a measure of noise. Accordingly, we believe that our VAR-99 calculation is decidedly conservative."). Mr. Hagan told the Subcommittee that it was his standard practice to prepare a written explanation of his models to communicate his reasoning. Subcommittee interview of Patrick Hagan, CIO (2/7/2013)

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

Assets (RWA) results for the CIO. Earlier in 2011, JPMorgan Chase had directed the CIO to reduce its RWA in order to lessen the bank's capital requirements under the upcoming Basel III rules.[959] Under those rules, a higher RWA required greater capital to protect against the higher risk; the bank wanted to minimize its mandatory capital requirements and so ordered the CIO to bring down its RWA. Normally, the most direct way to reduce a portfolio's RWA is to reduce the size and riskiness of its holdings, but key CIO personnel proposed another approach as well, modifying its VaR model and certain other risk related models used to calculate its RWA in order to produce lower results. This objective was not necessarily in conflict with the bank's stated goal of producing more accurate risk analysis, since the CIO personnel advocating the model changes viewed credit derivatives trading as less risky than portrayed by the existing models.

A key document providing insight into the thinking of the CIO traders and analysts is an internal presentation prepared for CIO head Ina Drew in late 2011. On December 22, 2011, Javier Martin-Artajo, head of the CIO's equity and credit trading operation and charged with overseeing SCP trading, sent an email to Ms. Drew laying out a plan for reducing the CIO's RWA by $13 billion by the end of the first quarter of 2012. The email recommended achieving that reduction in large part by modifying the VaR and other models and procedures used to calculate the CIO's RWA. Mr. Martin-Artajo wrote:

> "The estimates of reductions will be:
>
> Model reduction QR CRM (ackno[w]ledged already) 5 (Pat [Hagan] estimate)
> Model reduction QR VaR 0.5 (Pat estimate)
> Model Reduction QR Stress 1.5 (Pat estimate)
> Reduction for duration shortening 1 Actual
> Book optimization 3 Estimate
> Book reduction 2 Trading reduction
>
> TOTAL 13 Billion RWA end Q1 2012"[960]

The email indicates that Mr. Martin-Artajo estimated that $7 billion, or more than 50% of the total $13 billion RWA reduction, could be achieved by modifying risk related models.[961]

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[959] RWA is a dollar measure of a bank's assets, adjusted according to the assets' risk. For more information, see Chapters II and III.

[960] 12/22/2011 email from Javier Martin-Artajo, CIO, to Ina Drew and John Wilmot, CIO, "RWA – Tranche Book," JPM-CIO-PSI 0000032-034, at 033. See also 12/22/2012 email from Javier Martin-Artajo, CIO, to Bruno Iksil, Patrick Hagan, Julien Grout and Samir Ratel, CIO, "urgent ----- : Rwa," JPM-CIO-PSI 0001227 (requesting specific estimates for the amount of RWA reduction that could be achieved by each of the listed "model reduction[s]" by the end of the first quarter of 2012).

[961] The email estimated that a $5 billion reduction in the SCP's composite RWA could be achieved by modifying the QR model used to calculate the CIO's Comprehensive Risk Measurement (CRM), and another $500 million reduction could be achieved by modifying the QR model used to calculate its VaR. CRM and VaR are both key contributors to RWA calculations. The email also estimated that a $1.5 billion reduction in the SCP's composite RWA could be achieved by modifying the QR model used to calculate its "Stress" VaR, another key contributor to the RWA model. Mr. Hagan confirmed to the Subcommittee that he had provided all three of these estimates. Subcommittee interview of Patrick Hagan, CIO (2/7/2013). The recommended model changes, projected to reduce the CIO's RWA by $5 billion, $500 million, and $1.5 billion, added up to an RWA reduction of $7 billion. See also

While changing the VaR model was only one of the proposed changes and was estimated to have the smallest effect, it was nevertheless characterized as capable of producing half of a billion dollars in RWA reduction. That the Martin-Artajo email included specific estimates for RWA reductions from Mr. Hagan in connection with changing, not only the VaR model, but also other QR models that fed into the RWA calculation, shows that the CIO viewed Mr. Hagan's work, at least in part, as a way of producing lower – as opposed to simply more accurate – SCP risk results.[962]

Several weeks later, on January 18, 2012, Mr. Iksil provided Ms. Drew a written presentation that included a comparison of the CIO's RWA results using the bank's standard "QR" model versus results from using the CIO's own, newly developed model.[963] Mr. Hagan told the Subcommittee that he was not shown this document at the time, but observed that it used figures that had been developed by his staff.[964] Mr. Hagan told the Subcommittee that he had not developed a fully working RWA model for the CIO when the estimates were provided, but acknowledged that, while at the CIO, he worked on each of the key contributors to a RWA model.[965] The Iksil presentation stated that the CIO's "Core Credit Book RWA" under the bank's standard QR model was $40.3 billion, while under the CIO's model it would be about half that amount, at $20.9 billion.[966] The next day, January 19, Mr. Martin-Artajo sent Ms. Drew an email describing four scenarios for reducing the SCP's RWA.[967] The four options revolved in large part around whether the CIO could convince bank management to allow it to use its own "shadow" RWA model.[968] Changing the CIO's VaR model was one element in that larger plan.

(c) Breaching the VaR Limit

As explained earlier, during the first three weeks of January 2012, the CIO traders purchased a variety of short credit instruments in order to ensure that the Synthetic Credit

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5/3/2012 email from Irvin Goldman, CIO, to Douglas Braunstein, JPMorgan Chase, and others, "CSW 10%," with attached JPMorgan Chase presentation entitled "CIO Synthetic Credit: Risk background information for upcoming meetings," slide entitled "Capital Metrics History, chart entitled "Synthetic Credit RWA," at 8, JPM-CIO-PSI-H 000546-556, at 555 (identifying the key components in calculating the SCP's RWA as VaR, Stress Var, CRM, and IRC).

[962] See, e.g., 3/8/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000373 (indicating that the CIO traders had deliberately worked to change the VaR model: "We are not going to do with ... RWA yet what we have done with the VaR that is to challenge the current methodology and have the model changed.").

[963] 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," JPM-CIO-PSI 0000098-104, conveying presentation entitled, "Core Credit Book Highlights."

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

[965] Id. Mr. Hagan told the Subcommittee that, while at the CIO, he worked on models to produce Comprehensive Risk Measurement (CRM), stress VaR, VaR-99, and Incremental Risk Charge (IRC) results. Id.

[966] 1/18/2012 email from Bruno Iksil, CIO, to Julien Grout, CIO, "Meeting materials for 11am meeting," JPM-CIO-PSI 0000098-104, conveying presentation entitled, "Core Credit Book Highlights." Mr. Hagan told the Subcommittee that the $20.9 billion figure was "not realistic," because it was far from clear that the bank's QR group would adopt the model changes he was advocating. Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

[967] 1/19/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "Credit book Decision Table – Scenario Clarification," at JPM-CIO-PSI 0000106.

[968] The term "shadow model" was used by the CIO's senior market risk officer when describing the CIO model to the Subcommittee. Subcommittee interview of Peter Weiland, CIO (8/29/2012).

Portfolio "maintained its upside on defaults."[969] Those purchases pushed up the SCP's VaR total and eventually resulted in the four-day breach of not only the CIO's VaR limit, but also the VaR limit for the entire bank.

On January 10, 2012, the firmwide VaR daily update stated: "The Firm's 95% 10Q VaR as of cob [close of business] 01/09/2012 is $123mm [million] or 98% of the $125mm limit, an increase of $5mm from the prior day's revised VaR."[970] The daily update also reported that the CIO had utilized $88 million of its $95 million limit.[971] Later that day, apparently concerned with the CIO's approaching its 10Q VaR limit, Ms. Drew emailed Mr. Weiland the notification and asked: "This says cio var still 88? Can u give me breakdown tomorrow." Mr. Weiland responded:

> "Yes, I have details and can give you tomorrow. Short story is that the increase in VaR corresponds to increased credit protection on HY [High Yield credit index], in particular trades executed between Dec. 19 and January 6. … This has obviously been a significant increase and I sent Javier an email today to highlight the RWA implications."[972]

His email indicates that, while the CIO bought a variety of long and short positions in January, it was the short positions – the "increased credit protection" – that drove up the VaR.

The following day, January 11, 2012, Mr. Weiland forwarded the email exchange to Keith Stephan, the Chief Market Risk Officer for CIO International. Mr. Stephan responded by forwarding the explanation he had provided on January 10th to Messrs. Martin, Iksil, Grout, and others:

> "**[S]ince 21 December, the [Core Credit] book var has moved from $76mm [million] to $93mm,** nearly +25% increase driven by position changes and through the inclusion of m[ar]k[e]t data in the last week of 20[1]1 with rally in OTR [on-the-run] HY [High Yield] indicies. … The big drivers, are increases in notional of HY OTR short risk in indicies +2.6bio not'l [notional], +14MM VAR."[973]

In other words, Mr. Stephan explained that the increased credit derivative positions – specifically, the short positions – acquired by the SCP in December and January had caused the increase in VaR, which was quickly approaching its limit.

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[969] For more information, see Chapter III.
[970] 1/10/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI 0000095.
[971] Id.
[972] 1/10/2012 email from Peter Weiland, CIO, to Ina Drew, CIO, and others, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI 0000094. The email mentions RWA, because a version of the VaR is used, in part, to calculate RWA scores. Therefore, risks that increase the VaR also increase the RWA, and could potentially trigger increased capital reserve requirements.
[973] 1/10/2012 email from Keith Stephan, CIO, to Bruno Iksil, CIO, and others, "Core Credit Var Summary 06 January," JPM-CIO-PSI 0000093. [emphasis in original]

On January 12, 2012, Mr. Weiland emailed Mr. Martin-Artajo, head of the CIO's equities and credit trading operation, asking about Mr. Stephan's explanation: "Is this not correct?"[974] Mr. Martin-Artajo replied: "No, in terms of VAR." Mr. Martin-Artajo continued:

> "Will come back to you with a better explanation. From our point of view we did not have any P/L [profit/loss] vol[ume] to increase the overall VAR so much. Pat [Hagan]'s model is in line with the 70 VAR and has a much better explanation for these changes. Hopefully we get this [model] approved as we speak."[975]

Mr. Martin-Artajo essentially contended that the purchases made by the CIO traders had not been so voluminous that they would have increased the "overall VaR so much."[976] He also noted that the new VaR model being developed by Mr. Hagan would produce a lower VaR – which he predicted would be in the range of $70 million – and the CIO was attempting to finalize its approval "as we speak."[977]

Despite inquiring into the CIO's increasing VaR and noting that the CIO was approaching its limit, neither Ms. Drew nor Mr. Weiland instructed the CIO traders to stop trading or reduce the SCP holdings. Their inaction is especially puzzling since Mr. Dimon, Mr. Braunstein, and Ms. Drew all told the Subcommittee that, in December 2011, bank management had instructed the CIO to reduce its RWA, and had taken the view that in an improving macroeconomic environment less credit protection was necessary.[978] The CIO and bank's senior management nevertheless stood by and allowed the CIO traders to purchase additional short credit protection in such quantities that it would cause a VaR breach.

On January 16, 2012, CIO exceeded its VaR limit.[979] While several JPMorgan Chase officials minimized the relevance of VaR breaches in interviews with the Subcommittee, VaR measurements are considered significant enough within the bank that the bank's Operating Committee received daily VaR updates from the firm's Market Risk Management (MRM) Reporting group detailing the VaR levels for various business lines and business segments and explaining the basis for any significant changes. In addition, a breach of the firmwide VaR was treated within the bank as a "Level 1" notification, and was reported to the highest levels of bank management, including to CEO Jamie Dimon and the rest of the Operating Committee.[980]

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[974] 1/12/2012 email from Peter Weiland, CIO, to Javier Martin-Artajo, CIO, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI 0000093.
[975] 1/12/2012 email from Javier Martin-Artajo, CIO, to Peter Weiland, CIO, and others, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-PSI 0000093.
[976] Id.
[977] Id.
[978] Subcommittee interviews of Jamie Dimon, JPMorgan Chase (9/19/2012), Douglas Braunstein, JPMorgan Chase (9/12/2012), and Ina Drew, CIO (9/7/2012). For more information, see Chapter III.
[979] 1/20/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% 10Q – VaR – Limit Excession Notification (COB 1/19/12)," JPM-CIO-PSI 0000150; 1/16/2012, JPMorgan Chase spreadsheet "Position Limit and Loss Advisory Summary Report," JPM-CIO-PSI 0037534 (showing excession of the $95 million MTM 10Q VaR limit for close of business January 16, 2012).
[979] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).
[980] Id.

On January 16, 2012, the CIO's purchases of additional short positions triggered not only a breach of the CIO VaR limit,[981] but also a breach of the bankwide VaR limit, a breach that continued for the next three days.[982] These VaR breaches caused real concern within the CIO. On January 20, 2012, the CIO Chief Risk Officer, Irvin Goldman, emailed two of his subordinates with this instruction:

> "This is the third consecutive breach notice ... that has gone to Jamie [Dimon] and [Operating Committee] members. We need to get Ina [Drew] specific answers to the cause of the breach, how it will be resolved, and by when."[983]

One of Mr. Goldman's subordinates, Mr. Stephan – the chief market risk officer in London and designer of the VaR model then in use – responded:

> "The VaR increase is driven by Core Credit (tranche) …. We are in late stages of model approval … which will have the effect [of] reducing the standalone VaR for Core Credit from circa $96MM [million] to approx[imately] $70MM .... My recommendation therefore is that we continue to manage to the current ... limit ... and that we discuss further with the model review group (MRG) today the schedule for completion of approval of the new model with a view toward implementation next week if possible."[984]

Once again, changing the model – not modifying the risky positions – was presented as the solution to the VaR breach.

Mr. Goldman conveyed the same argument to his boss, Chief Risk Officer John Hogan:

> "Two important remedies are being take[n] to reduce VaR …. 1. Position offsets to reduce VaR are happening daily. 2. Most importantly, a new improved VaR model that CIO has been developing is in the near term process of getting approved by MRG and is expected to be implemented by the end of January. <u>The estimated impact of the new VaR model based on Jan 18 data will be a CIO VaR reduction in the tranche book by 44% to [$]57mm [million], with CIO being well under its overall limits</u>."[985]

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[981] 1/16/2012, JPMorgan Chase spreadsheet "Position Limit and Loss Advisory Summary Report," JPM-CIO-PSI 0037534 (showing excession of the $95 million MTM 10Q VaR limit for close of business January 16, 2012).
[982] See 1/19/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% VaR – Limit Excession Notification (COBs 1/16/12 and 1/17/12)," JPM-CIO-PSI 0005264; 1/23/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI 0001337; 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Breach of firm var," JPM-CIO-PSI 0000141.
[983] 1/20/2012 email from Irvin Goldman, CIO, to Keith Stephan, CIO, and others, "Breach of firm var," JPM-CIO-PSI 0000149.
[984] 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, "Breach of firm var," JPM-CIO-PSI 0000147.
[985] 1/20/2012 email from Irvin Goldman, CIO, to John Hogan, JPMorgan Chase, "CIO VaR," JPM-CIO-PSI 0000151. [Emphasis in original.] Mr. Goldman's prediction of a $57 million VaR for the SCP was even lower than the $70 million VaR that had been predicted by Mr. Martin-Artajo and Mr. Stephan. See 1/12/2012 email from Peter Weiland, CIO, to Javier Martin-Artajo, CIO, "JPMC Firmwide VaR – Daily Updated – COB 1/09/2012," JPM-CIO-

This email repeats Mr. Martin's previously-stated hierarchy for addressing risk reduction in the Synthetic Credit Portfolio: changing the model was "most" important, while position "offsets" were secondary. Moreover, it was not clear what Mr. Goldman meant by position offsets. Mr. Hogan told the Subcommittee that position "offsets" could involve either disposing of positions or adding new positions designed to offset the risk of other positions.[986] In either case, it was clear that having a new model that produced a lower VaR value was viewed as key.

After receiving Mr. Goldman's email, Mr. Martin-Artajo forwarded it to Patrick Hagan, the CIO VaR model developer, and said: "Dual plan ... as discussed keep the pressure on our friends in Model Validation and QR [Quantitative Research]."[987] JPMorgan Chase has since indicated: "There is some evidence that the Model Review Group accelerated its review as a result of this pressure, and in so doing it may have been more willing to overlook the operational flaws apparent during the approval process."[988]

On January 20, 2012, the Market Risk Management Reporting group notified the Operating Committee of the CIO's ongoing breach of the firmwide 10Q VaR limit. The notification stated:

> "The Firm's 95% 10Q VaR breached its $125mm [million] limit for the fourth consecutive day on January 19th, 2012, primarily driven by CIO.
>
> CIO 95% VaR has become elevated as CIO balances credit protection and management of its Basel III RWA. In so doing, CIO has increased its overall credit spread protection (the action taken thus far has further contributed to the positive stress benefit in the Credit Crisis (Large Flattening Sell-Off) for this portfolio which has increased from +$1.4bn to +$1.6bn) while increasing VaR during the breach period.
>
> Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model for synthetic credit and has been working with MRG [Model Review Group] to gain approval, which is expected to be implemented by the end of January.
>
> The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm."[989]

PSI-93; 1/20/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, "Breach of firm var," JPM-CIO-PSI 0000147.

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

987 1/23/2012 email from Javier Martin-Artajo, CIO, to Patrick Hagan, "CIO VaR," JPM-CIO-PSI 0000151. "QR" refers to Quantitative Research, a part of the bank's risk division that worked on model development. Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

988 2013 JPMorgan Chase Task Force Report at 125.

989 1/20/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "JPMC 95% 10Q – VaR – Limit Excession Notification (COB 1/19/12)," JPM-CIO-PSI 0000150.

The Subcommittee could identify no significant action taken by the bank to reduce the VaR other than by changing the model.

A four-day breach of the firm's 10Q VaR – the VaR that JPMorgan Chase reported in its SEC filings – driven by trades in the CIO's Synthetic Credit Portfolio ought to have been enough to trigger an intensive internal review of the SCP trading strategy, but it did not.

(d) Raising the VaR Limit Temporarily

Ashley Bacon, John Hogan's deputy in risk management, told the Subcommittee that, on some occasions when a firmwide limit is breached, "people were told to get back under their limit."[990] The CIO's breach of the firmwide VaR limit in January 2012, however, was not such an occasion. If JPMorgan Chase had ordered the CIO to reduce the Synthetic Credit Portfolio to get back under its VaR limit, the bank would have limited – and perhaps prevented – the whale trade losses. Instead, the bank elected to raise the bankwide VaR limit on a temporary basis to buy the CIO enough time to get a new VaR model in place to produce a more favorable risk analysis.

On January 23, 2012, the Market Risk Management Reporting group sent an email to Mr. Dimon and Mr. Hogan asking them to approve a temporary increase in the firmwide VaR limit from $125 million to $140 million, an increase of more than 10%. The group proposed increasing the firmwide limit for a little over a week, until the end of the month, predicting that, by then, the CIO's new VaR model would be approved, would dramatically reduce the CIO's VaR, and would end the breach.

> "This email is to request your approval to implement the temporary increase of the Firm's 95% 10Q VaR limit from $125mm [million] to $140mm, expiring on January 31st, 2012. There is a pending approval for a new model for the CIO Intl Credit Tranche book. If the new model is approved and implemented prior to January 31st, the Firm's 95% 10Q VaR limit will revert back to the original $125mm level …. CIO has increased its overall credit spread protection …. Action has been taken to reduce the VaR and will continue. In addition, CIO has developed an improved VaR model …. The impact of the new VaR model based on Jan. 18 data will be a reduction of CIO VaR by 44% to $57mm."[991]

This email shows that Mr. Dimon was informed about the new VaR model and the expectation that it would have the effect of lowering the apparent risk of the CIO's portfolio by a dramatic amount.

When asked about this email, Mr. Dimon told the Subcommittee that he did not recall whether he was required to approve a temporary increase in the bankwide VaR limit or approve a request by a business segment to exceed an existing bankwide VaR limit.[992] He indicated that he

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[990] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase, (9/4/2012).
[991] 1/23/2012 email from Market Risk Management Reporting, JPMorgan Chase, to Jamie Dimon, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI 0001337-338.
[992] Subcommittee interview of Jamie Dimon, JPMorgan Chase (9/19/2012).

did not view raising the bankwide VaR limit as a decision that required his personal attention and analysis, but as one which he could normally make in a matter of "seconds" relying on the recommendation of his risk management team. He also told the Subcommittee that he could not recall any details in connection with approving the VaR limit increase in January 2012. However, an email dated January 23, 2012, shows that both he and Mr. Hogan replied to the email requesting the limit increase by writing simply: "I approve."[993]

The temporary limit increase in the bankwide VaR limit provided immediate relief to the CIO by enabling its traders to take on more risk in their gamble to overcome an unprecedented cascade of losses in the SCP which had begun earlier in January.[994] On January 23, 2012, the same day the VaR limit was raised, the SCP recorded a loss of $15 million.[995] The next day, the CIO trader charged with managing the Synthetic Credit Portfolio, Bruno Iksil, wrote in an internal document that by January 24th the book had begun to "lose money in an uncontrollable way."[996] Altogether, during the last nine days in January, the SCP incurred losses every day, totaling in excess of $75 million.[997]

Mr. Weiland, the CIO Chief Market Risk Officer, told the Subcommittee that the CIO traders responded to the SCP losses by making a decision to purchase the long side of a variety of credit derivatives, collecting the equivalent of insurance premiums from their short counterparties, and using those incoming cash premiums – which they called "carry" – to offset some of the losses.[998] In addition, just as short positions decline in value during a market rally, long positions increase in value during a market rally. Thus, there was a dual benefit to going long: generating carry, but also allowing the CIO to post mark-to-market profits on the long positions, both of which the CIO could use to offset the mark-to-market losses on the SCP's short positions. The CIO traders were able to carry out that trading strategy – go long – because Mr. Dimon and Mr. Hogan had temporarily increased the VaR limit and allowed the additional credit derivative purchases.

By January 27, 2012, the SCP's rapid purchase of long positions[999] were threatening yet another breach of the bankwide VaR limit, despite the temporarily higher limit. Mr. Stephan,

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993 1/23/2012 email from Jamie Dimon, JPMorgan Chase, to John Hogan, JPMorgan Chase, and others, "APPROVAL NEEDED: JPMC 95% 10Q VaR One-Off Limit Approval," JPM-CIO-PSI 0001337. See also 1/25/2012 email from Ina Drew, CIO, to MRM Reporting and others, "ACTION NEEDED: CIO International-One-off Limits Approval, JPM-CIO-PSI 0000157-158 (containing Ms. Drew's approval of the temporary increase in the CIO's VaR limit); 2013 JPMorgan Task Force Report, at 79 ("Messrs. Dimon and Hogan approved the temporary increase in the Firm-wide VaR limit, and Ms. Drew approved a temporary increase in CIO's 10-Q VaR limit.").
994 For more information about these losses, see Chapter IV.
995 See chart, prepared by the Subcommittee and printed in Chapter IV, tracking SCP's daily reported profit and loss (P&L) from January to May 15, 2012, derived from an OCC spreadsheet, OCC-SPI 00000299. Numbers do not reflect restated P&L figures after JPMorgan Chase's restatement in July 2012. See also JPMorgan Chase & Co. Form 10-Q (for period ending 9/30/2012), filed with the SEC (11/08/2012), at 10, 220, http://files.shareholder.com/downloads/ONE/2252595197x0xS19617-12-308/19617/filing.pdf.
996 Undated internal document authored by Bruno Iksil with his personal notes and comments on SCP trading activities from January to March 2012, JPM-CIO-PSI 0021879-917, at 882.
997 See chart, prepared by the Subcommittee and printed in Chapter IV, tracking SCP's daily reported profit and loss (P&L) from January to May 15, 2012, derived from an OCC spreadsheet, OCC-SPI-00000298-299. Numbers do not reflect restated P&L figures.
998 Subcommittee interview of Peter Weiland, CIO (8/29/2012).
999 Undated spreadsheet of trades produced by JPMorgan Chase in response to a Subcommittee request, JPM-CIO-

chief market risk officer in London, informed the CIO's Chief Risk Officer, Irvin Goldman, about what was happening:

> "CIO is over its temporary limit, and could cause the Firm to do the same. ... VaR has increased by +3mm [million], to $107.6mm driven by increase in CDX IG S9 10Y index long risk[1000] .... This is consistent w/ the VaR increases of the last several days ... wherein the VaR increases approx 1mm per billion of notional in IG9 10y. ... We anticipate approval on Monday [January 30], and that the ***new methodology *should* become the official firm submission from Monday, for 27 Jan COB [close of business].*** Limit issues should therefore cease beginning from Monday."[1001]

In his email, Mr. Stephan explained that for every billion-dollar increase in the size of the SCP's notional holdings of the IG9 long positions, its VaR score was increasing by $1 million. He also disclosed that the SCP's long purchases had already caused a breach of the CIO's temporarily increased VaR limit and was threatening to breach the new bankwide VaR limit as well. In addition, Mr. Stephan explained that the anticipated approval of the CIO's new VaR model on Monday, January 30, which was intended to apply to the most recent trading day, January 27, should put an end to the VaR "limit issues."[1002]

By the end of the day on January 27, the SCP's VaR totaled $125.7 million,[1003] breaching the CIO's temporary VaR limit of $105 million[1004] but not yet the bankwide limit of $140 million. The CIO traders continued their trading spree, expanding the size of the SCP and CIO's VaR. As the CIO's VaR continued to climb, the documentation produced to the Subcommittee contains few emails, messages, or telephone calls asking whether the CIO's trading strategy made sense. On January 28, 2012, Barry Zubrow, former Chief Risk Officer for JPMorgan Chase, did send an email to the CIO Chief Risk Officer Irvin Goldman and the bank Chief Risk Officer John Hogan asking: "Why is the CIO VAR so elevated?" but took no further action to evaluate the CIO trading strategy causing the VaR increase.[1005] Even if the existing VaR model was viewed as overstating the risk, at a minimum the precipitous upward trend in the CIO's VaR

PSI 0037501. See also 1/27/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Update on *old/current methodology VaR* increase for COB 27 Jan," JPM-CIO-PSI 0000177.

[1000] "CDX IG S9 10Y" and "IG9 10y" refer to credit derivative indices in which the SCP was invested. For more information about these indices, see Chapter II.

[1001] 1/27/2012 email from Keith Stephan, CIO, to Irvin Goldman, CIO, and others, "Update on *old/current methodology VaR* increase for COB 27 Jan," JPM-CIO-PSI 0000177, at 178. [emphasis in the original]

[1002] JPMorgan Chase has explained that the purpose of the long positions was to offset the shorts and thereby reduce risk, in lieu of unwinding the short positions. However, according to JPMorgan Chase's own internal documents, the purchases of the long positions at the end of January themselves *raised* the VaR instead of lowering it. Therefore, it is difficult to see how JPMorgan Chase could have believed the long positions were in fact able to offset the risk associated with the short positions.

[1003] See 5/2012 JPMorgan Chase spreadsheet of VaR levels in the Synthetic Credit Portfolio, FDICPROD-0024286.

[1004] 1/23/2012 email from Ina Drew to MRM Reporting, and others, "ACTION NEEDED: CIO Global 10Q VaR Limit One-off Limit Approval," JPM-CIO-PSI-H 0002880.

[1005] 1/28/2012 email from Barry Zubrow, JPMorgan Chase, to John Hogan, JPMorgan Chase and Irvin Goldman, CIO, "JPMC Firmwide VaR – Daily Update – COB 01/26/2012," JPM-CIO-PSI-H 0002897.

should have given bank management pause.[1006] Ms. Drew conceded as much to the Subcommittee.[1007]

(e) Winning Approval of the New VaR Model

On January 30, 2012, the CIO won bank approval of its new VaR model.[1008] The impact of the new model was even greater than the 44% described in the emails to firm management: it immediately reduced the CIO's VaR by 50%, from $132 million to $66 million.[1009]

JPMorgan Chase told the Subcommittee that the change in the CIO VaR model was not motivated by a desire to give the CIO traders more room to take risk.[1010] However, the evidence is clear that the January 2012 pressure to expedite approval of the model change was motivated by the CIO traders' desire to end the CIO's VaR breach and produce a much lower VaR, which then enabled them to take on more risk. An OCC model expert told the Subcommittee that it was "no coincidence" that the CIO's new VaR model was implemented at the same time the CIO traders were increasing their acquisitions; rather, instituting the new VaR model was part of the trading strategy.[1011] Mr. Dimon acknowledged as much during his testimony before Congress when, in discussing the SCP losses, he stated: "In January, the new model was put in place that allowed them to take more risk and it contributed to what happened."[1012]

JPMorgan Chase has acknowledged to the Subcommittee that the internal approval process for the new CIO VaR model was "hurried."[1013] All of the bank's VaR models were supposed to be reviewed and approved by its internal Model Review Group, which was part of its risk division.[1014] When the bank's Model Review Group undertook its evaluation of the CIO's new VaR model, it found a number of operational and mathematical problems and asked the developers to provide action plans to address the problems as well as provide dates for when the actions plans would be completed.[1015] No dates were set for completing the action plans, however,[1016] and the action plans were, in fact, never completed.[1017] A later OCC internal review described the action plans as identifying essential requirements that should have been completed before the model was placed into use.[1018]

[1006] This trend was not visible to investors, because the change in the VaR model was not disclosed in JPMorgan Chase's April 8-k filing. For more information, see Chapter VII.
[1007] Subcommittee interview of Ina Drew, CIO (9/7/2012).
[1008] See 1/30/2012 email from Ashish Dev, JPMorgan Chase, to Peter Weiland, CIO, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM-CIO-PSI 0000187.
[1009] Undated spreadsheet of CIO 10Q VaR from 12/1/2011 to 5/10/2012, JPMC-Senate/Levin 000155.
[1010] Levin Office briefing by JPMorgan Chase (6/26/2012).
[1011] Subcommittee interview of Michael Sullivan, OCC (11/7/2012).
[1012] Testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, S.Hrg. 112-715 (June 13, 2012), http://www.cq.com/doc/congressionaltranscripts-4105471.
[1013] Subcommittee briefing by JPMorgan Chase (8/15/2012) (Greg Baer).
[1014] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).
[1015] See, e.g., 1/25/2012 email from Dan Pirjol, JPMorgan Chase, to Patrick Hagan, CIO, and others, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM CIO-PSI 0000190-191.
[1016] See 1/27/2012 email from Keith Stephan, CIO, to Dan Pirjol, JPMorgan Chase, and others, "draft of the MRG review of the HVAR methodology for the CIO core credit books," JPM CIO-PSI 0000189.
[1017] Subcommittee briefing by JPMorgan Chase (8/15/2012); 2013 JPMorgan Chase Task Force Report, at 127.
[1018] Subcommittee interview of Michael Sullivan, OCC (8/20/2012); 12/12/2012 OCC Supervisory Letter to

In addition, the Subcommittee was told that, normally, a new model is run concurrently with an existing model for several months to evaluate how the new model performs and examine any diverging results between the two.[1019] 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.[1020] 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.[1021]

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."[1022] 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.[1023]

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."[1024] The OCC concluded that JPMorgan Chase's "VaR Model risk management is weak and constitutes an unsafe and unsound banking practice."[1025]

JPMorgan Chase, "CIO Oversight and Governance Examination," PSI-OCC-18-000001.

[1019] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

[1020] 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").

[1021] Subcommittee interview of Patrick Hagan. CIO (2/7/2013).

[1022] 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.

[1023] 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).

[1024] 11/6/2012 OCC Supervisory Letter to JPMorgan Chase, "Examination of VaR Model Risk Management," at 2, PSI-OCC-17-000019.

[1025] Id.

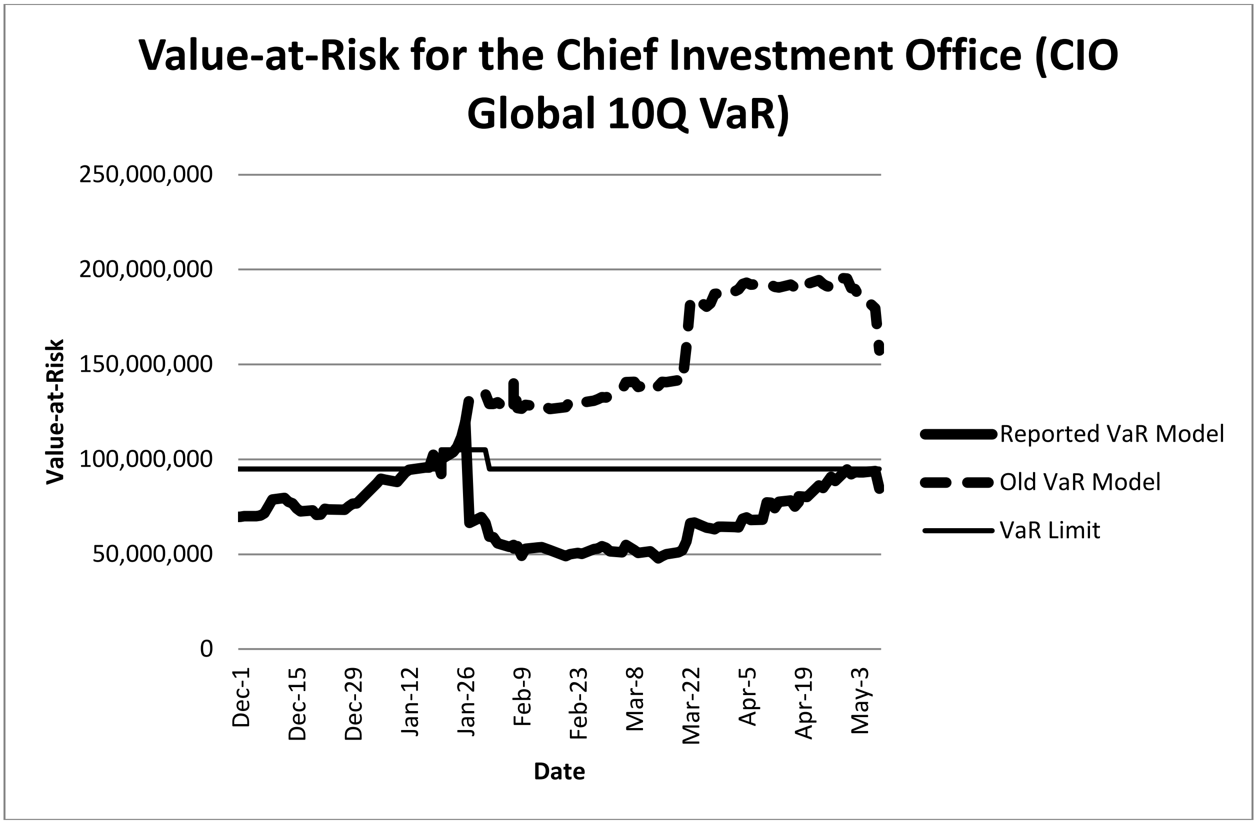
(f) Using the New VaR Model to Increase Risk

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.[1026]

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."[1027] 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.[1028]

The sizeable difference between the two figures – the VaR remained between 30 and 50% lower than it would have been under the prior model[1029] – continued until the new VaR model was abandoned in May 2012.[1030] The following chart shows the calculations produced by the new VaR model compared to the previous model and the CIO VaR limit.[1031]

[1026] Undated spreadsheet of CIO 10Q VaR from 12/1/2011 to 5/10/2012, JPMC-Senate/Levin 000155. This briefing also indicated that, on April 6, 2012, the new VaR was $68 million and the prior VaR was $192 million. Id.
[1027] Subcommittee interview of Patrick Hagan. CIO (2/7/2013).
[1028] Id.
[1029] 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).
[1030] 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.
[1031] This chart was prepared by the Subcommittee using data provided by JPMorgan Chase, JPMC-Senate/Levin 000155-6.



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

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

(g) Failing to Lower the VaR Limit

When JPMorgan Chase approved the CIO's new VaR model on January 30, 2012, it should have acted at the same time, but did not, to lower the CIO's VaR limit. As a consequence, the new model enabled 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.[1032] When asked why not, Ms. Drew explained that "everything can't happen at once," and "models get changed all the time."[1033]

[1032] Subcommittee briefing by JPMorgan Chase (8/15/2012); 3/8/2012 email from Ashley Bacon, JPMorgan Chase, "The change in notional is not correct and the CRM is therefore too high. We need to understand better the way they are looking at the scenario that creates the CRM and we also disagree with them on this. More work in progress until we can understand how to improve the number[1087] but if the result of an increase is due to an increase in the long index but not on the tranches this makes no sense since this is not part of the CRM measure and once we reconcile the portfolio this should be very clear of what we would do. First, go back to the results of end of year so that we go to a more neutral position before trying to do what we have done with the reduction of RWA due to VAR and StressVAR. (We are getting positive results here in line with expectations)."[1088]

This exchange reveals that when confronted with a metric signaling a huge increase in risk, the CIO manager responsible for the Synthetic Credit Portfolio not only disputed the metric, but also, as with the VaR results in January, questioned the model itself.

The CRM results signaling increasing risk in the SCP throughout January and February weren't circulated within the bank until early March. But, even then, had the CIO heeded them, it would have been in time to prevent the disastrously large synthetic credit trades made in the second half of March which increased the portfolio's risk and subsequent losses. But the CIO traders, risk personnel, and management discounted the CRM's warning. They simply did not believe that the SCP could be risking a $6.3 billion loss. By the time Mr. Venkatakrishnan prevailed upon Ms. Drew to accept the accuracy of the bank's CRM model, it was too late.

(c) Gaming the CRM Model

The CIO's efforts to question the CRM results were not limited to challenging the accuracy of the $6.3 billion risk projection. The CIO also sought to game the method used to determine which assets in the Synthetic Credit Portfolio would be subjected to CRM analysis as well as to analysis using another key risk measure known as the Incremental Risk Charge or IRC. Like CRM, the IRC risk metric is used to calculate a bank's Risk Weighted Assets (RWA) and its capital requirements.[1089]

As mentioned earlier, all three of these risk metrics were relatively new. The bank's Quantitative Research (QR) personnel completed work on new models to calculate CRM and IRC, as well as revised RWA outcomes in 2011, rolled them out bankwide that year, and were still fielding questions about the models and testing their accuracy.[1090]

On March 7, 2012, when the adverse CRM results for the SCP were first circulated, Patrick Hagan, the CIO's head of quantitative analytics, sent an aggressive email to the QR criticizing the structure, mathematics, and merits of the new, bankwide CRM risk model.

[1087] Four months earlier, in December 2011, Mr. Martin-Artajo had advocated taking steps to change the model used to calculate CRM to produce a $5 billion reduction in the CIO's RWA. See 12/22/2011 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "RWA – Tranche Book," JPM-CIO-PSI 0000032.

[1088] 3/8/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, and others, "CIO CRM Results," JPM-CIO-PSI 0000371.

[1089] See, e.g., 12 C.F.R. Part 3, Appendix B (discussing calculation of both CRM and IRC).

[1090] Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).

"Hoping that the model is somehow valid for extrapolating down to the 0.001 level risks is madness," Mr. Hagan wrote, "the only conceivable excuse for it is institutional inertia."[1091]

After meeting with the QR analysts who defended the model as accurate,[1092] Mr. Hagan changed his tactics. On March 14, he began a campaign to convince the QR to reduce the CIO's CRM and IRC totals, not by modifying its models, but by establishing a system for "optimizing" which of the CIO's credit derivative positions would be subject to the CRM calculation and which positions would be subject to the IRC calculation.

While federal regulators have allowed banks leeway in determining whether specific trading positions should be subject to the CRM or IRC calculation, the appropriate calculation to apply depends largely on the nature of the trades. According to Mr. Venkatakrishnan, credit tranche positions and their associated hedges should be subjected to the CRM calculation.[1093] He indicated that other, more liquid, credit derivative positions could appropriately undergo the IRC calculation. In practice, the CIO maintained two books, or "buckets," inside the Synthetic Credit Portfolio: a tranche book that was subject to CRM, and an index book that was subject to IRC.

Mr. Hagan sought to apply the CRM or IRC models to individual positions, not on the basis of which book they were in, or the nature of the trades, but rather on the basis of what arrangement would result in the lowest CRM and IRC totals and, therefore, the lowest RWA and the lowest capital charge for the bank.

On March 21, 2012, Mr. Hagan outlined his approach in an email he sent to Mr. Goldman, Mr. Venkatakrishnan, and others, copying Mr. Martin-Artajo and Mr. Weiland. Under the subject heading, "Optimizing regulatory capital," Mr. Hagan wrote:

> "To optimize the firm-wide capital charge, I believe we should optimize the split between the tranche and index books. The bank may be leaving $6.3bn [billion] on the table, much of which may be recoverable ….
>
> Here's what I think can be done …. The split between the index book (subject to IRC) and the tranch[e] book (subject to CRM) should be a theoretical split, a matter of labeling for the capital calculations. If there is a natural split which helps us think about the positions, that's different, but for the purposes of the capital calculation, the books should be combined and split on the optimal basis ….
>
> But the idea would be for QR [Quantitative Research] to find the value … which results in the minimum post-diversification capital charge for the bank as a whole ….

[1091] 3/7/2012 email from Patrick Hagan, CIO, to Javier Martin-Artajo, CIO, and others, "New CRM numbers," JPM-CIO-E 00034181-82.
[1092] See 3/7/2012 emails among QR personnel, "New CRM numbers," JPM-CIO-E-00034180-182.
[1093] Subcommittee interview of C.S. Venkatakrishnan, JPMorgan Chase (10/25/2012).

> The new rules have too many arbitrary factors of three for the regulatory capital to rationally reflect our risks. I don't think we should treat this as a regulatory arbitrage. Instead we should treat the regulatory capital calculation as an exercise of automatically finding the best results of an immensely arbitrary and complicated formula."[1094]

Mr. Hagan's email expressed the concern, pervasive at the CIO, that the regulatory capital models overstated the risks in the SCP, that they produced arbitrarily high results, and that the traders knew better. Mr. Hagan sought to engineer a way to get the capital calculations to better reflect the opinion of the traders.

Some recipients of Mr. Hagan's email were apparently uncomfortable seeing in writing a strategy that depended in part on manipulating the grouping of trades to produce the lowest possible RWA and capital charges. That discomfort was expressed in recorded phone conversations with Mr. Hagan later that same day. Anil Bangia, a subordinate of Mr. Venkatakrishnan, called Mr. Hagan in London and warned him about sending the type of email he did:[1095]

> **Mr. Bangia:** I think, the, the email that you sent out, I think there is a, just FYI, there is a bit of sensitivity around this topic. So –
>
> **Mr. Hagan:** There, there is a lot of sensitivity.
>
> **Mr. Bangia:** Exactly, so I think what I would do is not put these things in email.
>
> **Mr. Hagan:** That's exactly what I was told. Javier, Javier is the guy that asked me to send out the email this morning. And then he found out from, from Pete and – yeah, and he found out from some – and Irv that this is …
>
> **Mr. Bangia:** Yeah, yeah, I wouldn't put this you know in ….[1096]

Later that day, despite Mr. Bangia's qualms about sending written communications on optimizing the CRM/IRC split, he nonetheless discussed pursuing the issue with Mr. Hagan:

> **Mr. Hagan:** Hi Anil, this is Pat.
>
> **Mr. Bangia**: Hi Pat.
>
> **Mr. Hagan:** Um, you know that email that I should not have sent?

[1094] 3/21/2012 email from Patrick Hagan CIO, to Irvin Goldman, CIO, and others, "Optimizing regulatory capital," JPM-CIO-E 00033994-95.
[1095] The call was at 10:42 Eastern Daylight Savings Time, because UK daylight savings time didn't start until March 25, 2012. It was 2:42 Greenwich Mean Time, only four hours ahead, in London.
[1096] 3/21/2012 recorded telephone conversation between Anil Bangia, JPMorgan Chase, and Patrick Hagan, CIO, JPM-CIO-PSI-A 0000089.

Mr. Bangia: Um hum.

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

Mr. Bangia: Well it's, in some ways it's somewhat feasible, once we have a bit more of [indecipherable] development. So, a lot of the IRC tools that I was showing you are really based on a new model that is not in production yet. There is an old model that Bruce [Broder] has run, so that's the official model. So that has a very different offline manual process that complicates things.

Mr. Hagan: I see.

Mr. Bangia: And beyond that it's a matter of also, how much you guys should do it independently versus what, how much we can actually do on optimizing it, right, so, there's that side of that as well.

Mr. Hagan: Yeah, I mean, the feeling from the risk managers was that … treating the capital charge is this incredibly complicated mathematical function that we're, of course, going to optimize. And uh, they were less concerned about physically moving things from one physical book to another physical book.

Mr. Bangia: Yeah. Yeah. I think we should also make sure we don't oversell this in the sense that the stability of this, we have to see over time. So I, I would also not quote any numbers on how much we think we can save, right?

Mr. Hagan: Yeah, the thing is I was hoping we could save about half that and that's got to be split between the investment bank and us, so …

Mr. Bangia: Hmm.

Mr. Hagan: It's not clear, it's not clear.

Mr. Bangia: Yeah, yeah, it's not clear.[1097]

The CIO's Chief Market Risk Officer Peter Weiland also called Mr. Hagan:

Mr. Weiland: I keep getting banged up …. I know you've had some emails back and forth with Venkat and Anil or whoever on the optimization of the IRC and CRM and everything else. Everyone is very, very – I told this to Javier the other day but maybe he didn't mention it to you – everyone is very, very sensitive about the idea – writing emails about the idea of optimizing –

[1097] 3/21/2012 recorded telephone conversation between Patrick Hagan, CIO, and Anil Bangia, JPMorgan Chase, JPM-CIO-PSI-A 0000090.

Mr. Hagan: I got that sort of mentioned. I'd say it was mentioned to me [laughter].

Mr. Weiland: OK, so, I don't know, Irv just came by again and said, "Oh, Venkat was telling me he got another email from Pat you know –"

Mr. Hagan: From me?

Mr. Weiland: Maybe it's from a couple of days ago, I don't know, but .... if you're sensitive to it, that's all I wanted to know.

Mr. Hagan: Okay.

Mr. Weiland: So I think we can talk about, you know, allocation –

Mr. Hagan: Okay, so nothing about allocation. I understand –

Mr. Weiland: Uh, you see, the work of the risk manager has very broad and unclear borders sometimes. Anyway –

Mr. Hagan: Okay. I did write an email message. I didn't realize it was sensitive to that extent …. Ah, it's all mathematics.

Mr. Weiland: – Yeah, well that's, you know, the funniest thing is, the first time that someone mentioned it to me I said, you know, 'I'm sure that Pat just sees this as like a math problem, an interesting and a complicated math problem. And all this other crap that goes on about, like, the implications of regulatory arbitrage and stuff like that is like, completely boring' [laughter].

Mr. Hagan: – No it's not that. I just get annoyed when I see us creating risks when there were no risks ––

Mr. Weiland: Yeah, I know.

Mr. Hagan: – that's annoying. Ok, I understand the sensitivity. Tell Irv I'm sorry.[1098]

Over the next two weeks, Mr. Hagan worked with the QR analysts to come up with a way to categorize the CIO's trades in a way that would reduce its CRM and IRC results. Ultimately, the bank reached a compromise with Mr. Hagan over how to split the portfolio between the tranche and index books. At the end of March, Mr. Hagan was allowed to design the initial split of the portfolio as it existed in order to optimize RWA, but once a trade was placed in either the tranche or index book, it had to stay there.[1099] As new trades were made, the CIO would be

[1098] 3/21/2012 recorded telephone conversation between Peter Weiland, CIO, and Patrick Hagan, CIO, JPM-CIO-PSI-A 0000091.

[1099] Subcommittee interview of Patrick Hagan, CIO (2/7/2013). See also, 2/4/2012 email exchanges among QR allowed to categorize them in order to optimize RWA, but existing trades could not be re-categorized.[1100]

The CIO's efforts to understand and influence the CRM, IRC, and RWA models continued into April 2012. In an email dated April 3, 2012, Achilles Macris informed Ina Drew that a QR analyst "is now in our office and he is 100% involved with the RWA projections of our book and ways to bringing it lower."[1101] Ms. Drew forwarded the email to the CIO's Chief Financial Officer John Wilmot who responded: "I don't get the sense of clarity that we know what is driving the RWA (economic risk versus VaR, stress VaR, CRM and IRC) or the p&l [profit and loss] – or more importantly that either will be manageable going forward."[1102] Mr. Wilmot also wrote: "We haven't made the case of how this book runs off and whether risk can be managed effectively."[1103]

A recent article sponsored by the International Monetary Fund on why RWA totals differ across countries and banks observed that, due to the great variance in RWA totals, "Confidence in reported RWAs is ebbing."[1104] It discussed a wide range of factors contributing to RWA variances, mentioning near the end of the article, almost in passing, allegations that financial institutions might be "gaming the system":

> "The current set-up for RWA calculation leaves considerable scope for subjectivity and interpretation. Most banks rely on a combination of approaches to calculate RWAs, which inevitably brings complexity and opacity. Pillar 3 individual reports often refer to 'model changes,' 'data cleansing,' 'RWA optimization,' 'parameter update' or other techniques that could suggest that banks may be 'tampering' with their RWAs in order to lower capital requirements. However, it is prudent to guard against any simplistic conclusion, and against inferring that any bank with a low RWA density is necessarily 'gaming the system.'"[1105]

At JPMorgan Chase, however, emails, telephone conversations, and internal presentations offer evidence that efforts to manipulate RWA results to artificially lower the bank's capital requirements were both discussed and pursued by the bank's quantitative experts.

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personnel, CIO personnel, and Mr. Hagan, CIO, "Final split?" JPM-CIO-E 00033939-41. ("For perfect clarity, I am forwarding back what I understand has been selected as the final split. Please let me know if this is not the correct one. Otherwise, this is what we'll proceed with.")

1100 Subcommittee interview of Patrick Hagan, CIO (2/7/2013).

1101 4/3/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, no subject line, JPM-CIO-PSI 0000497-498.

1102 4/3/2012 email from John Wilmot, CIO, to Ina Drew, CIO, no subject line, JPM-CIO-PSI 0000497.

1103 Id.

1104 3/2012 "Revisiting Risk-Weighted Assets," IMF Working Paper No. WP/12/90, Vanessa Le Leslé and Sofiya Avramova, at 4, http://www.imf.org/external/pubs/ft/wp/2012/wp1290.pdf.

1105 Id. at 26. See also January 2013 "Regulatory consistency assessment programme (RCAP) – Analysis of risk-weighted assets for market risk," Basel Committee on Banking Supervision (documenting wide RWA variances across banks and countries); "Banks' Risk Measurements Rarely Off By Much More Than A Factor Of Ten," Dealbreaker.com, Matt Levine (1/31/2013), http://dealbreaker.com/2013/01/banks-risk-measurements-rarely-off-by-much-more-than-a-factor-of-ten/, (discussing evidence that banks are "optimizing" their RWA models to artificially lower their RWA results and that each bank's model is designed "to require as little capital as possible for its particular portfolio of assets").

(3) Increasing the Reported Losses

His telephone calls, instant messages, and emails show that Mr. Iksil, who was charged with managing the SCP book, was becoming increasingly concerned about the growing difference between the SCP losses that the CIO was reporting to the bank versus the losses that would have been reported by marking at the midpoint. When on March 19, 2012, the unreported losses reached half a billion dollars, Mr. Iksil decided not to wait until the end of the month, as his supervisor had requested, but to begin reporting larger losses immediately to better reflect the actual market prices. On March 20, 2012, Mr. Iksil directed Mr. Grout to report a much larger SCP loss than had been reported previously during the year.[694]

While Mr. Grout was preparing the SCP P&L Predict email that would report the larger daily loss, Mr. Martin-Artajo met briefly with Ms. Drew about the SCP. In a March 20, 2012 email sent by Ms. Drew to Mr. Martin-Artajo's supervisor, Achilles Macris, Ms. Drew wrote:

> "Javier briefed me this morning on the credit book. He sounded quite nervous. Let's discuss on our weekly call. The full briefing is later in the morning but I want to understand the course of action from you."[695]

Mr. Macris, Ms. Drew, Mr. Martin-Artajo, and Chief Risk Officer Irvin Goldman arranged a meeting for the next day, Wednesday, March 21, to discuss the SCP.

In the meantime, Mr. Grout worked with Mr. Iksil to complete the daily SCP P&L Predict email to report a sizeable SCP loss, together with a brief explanation. Prior to its being sent, Mr. Iksil left a telephone message and an electronic message with Mr. Martin-Artajo to obtain his approval, but received no response. In his telephone message, Mr. Iksil said that the CIO needed to start showing losses: "[W]e would show a loss of 40 million core and 3 million in, in tactical …. I think we should, we should start, start showing it."[696]

The largest daily loss reported for the SCP book, up to that point in 2012, was a $24 million loss on February 8. On March 20, Mr. Iksil instructed Mr. Grout to report an estimated

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the $3 million loss to determine the extent to which those marks reflected prices within the daily bid-ask spread. In its 2013 report, the JPMorgan Chase Task Force stated that, by March 19, the CIO had reported only a small SCP daily loss for each of the prior seven consecutive days. 2013 JPMorgan Chase Task Force Report, at 50. It also wrote that the CIO trader recording the SCP marks "told another trader that a more senior trader had pressured him throughout this period not to show large losses in the Synthetic Credit Portfolio." Id.

694 See 3/20/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, "CIO Core Credit P&L Predict [20 Mar]: -$39,686k (dly) -$275,424k (ytd)," JPM-CIO-PSI 0016487-489.

695 3/20/2012 email from Ina Drew to Achilles Macris, CIO, "Wed call," JPM-CIO-PSI 0001236.

696 3/20/2012 audio file of recorded telephone message left by Bruno Iksil, CIO, for Javier Martin-Artajo, CIO, JPM-CIO-A 0000054 ("Hello Javier, it's Bruno. Again, you know, we can't try to be close to the market prices and we, we would show a loss of 40 million core and 3 million in, in tactical and I wanted to know if that was okay with you. I'm going to send you an SMS, to get your, your approval. We're still in the range but it's a 3 everywhere so, as I try to get closer to, to the target and I don't want to make it last, you know? I think we should, we should start, start showing it. Please call me back if you can or just reply to my SMS please."); see also written transcript of the recorded telephone message, at JPM-CIO 0003481. The reference to "SMS" is to an instant messaging service.

daily loss of $43 million and a year-to-date cumulative loss of $207 million, which he believed would get the immediate attention of CIO management, including Ina Drew.[697]

In addition, in the P&L email's commentary explaining the CIO's loss, Mr. Iksil[698] told senior CIO management that the IG9 was "underperform[ing]" by $450 to $500 million; the iTRAXX Main credit index was "lagging" by another $60 to $80 million; and the High Yield index had a $100 million "loss" plus another "lag" of $100 to $200 million, concluding that the total "lag in P&L" is "material" and in the range of $600 to $800 million:

> "As of today, reconstructing the CDX.IG9 10yr performance from the on the run indices and the 4 widest names in CDX.IG9 (Radian, MBIA, Istar, Sprint), the underperformance of the CDX.IG9 curves is between 6bps [basis points] to 13bps, which amount approximately to $450-500M[illion] for the sole CDX.IG9 series. iTraxx.Main S9 is also lagging by 3-4 bps or another $60-80M. Added to this the CDX.HY loss of $100M for Kodak and Rescap, plus the lag of CDX.HY10-CDX.HY11 series versus on-the-runs that is also $100-200M, **the lag in P&L is material ($600-800M)**."[699]

By way of context, a loss of $600 million, on top of the marked loss of $208 million,[700] would more than extinguish all of the revenues produced by the Synthetic Credit Book in 2010 and 2011, combined.[701]

Mr. Grout emailed the SCP P&L Predict, with the $43 million loss and the commentary discussing a "material" P&L "lag" of $600 to $800 million, to the designated list of CIO personnel who routinely received the SCP P&L Predict. The same information was also included in the CIO's End of Day (EOD) P&L report, which was sent at the close of the business day in New York to about 20 designated CIO personnel, including Ina Drew, John Wilmot, Achilles Macris, Javier Martin-Artajo, Irvin Goldman, Peter Weiland, Keith Stephan, Patrick Hagan, and Jason Hughes.[702]

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[697] See JPMorgan Chase Task Force interview of Javier Martin-Artajo, CIO (partial readout to Subcommittee on 9/6/2012) ("A $5 million loss? Ok. But this $43 million would cause issues with Ina.").

[698] See 3/20/2012 transcript of recorded telephone conversation between Bruno Iksil and Javier Martin-Artajo, CIO, JPM-CIO-PSI-A 0000055, JPM-CIO-PSI-H 0006392, at 394 (**Mr. Iksil**: "But that's why I tried sending this P&L, I sent also the comments it came from Julien but I wrote it, where I said okay you know we take this loss, we are maintaining long risk where we have to be, the rally is on IG but guess what you know it's lagging so much that actually we have to show loss.).

[699] 3/20/2012 email from Julien Grout, CIO, to the CIO Estimated P&L mailing list, "CIO Core Credit P&L Predict [20 Mar]: -$39,686k (dly) -$275,424k (ytd)," JPM-CIO-PSI 0016487-489, at 489. [Emphasis added.] For more information about the referenced credit indices and such terms as "on the run" and "basis points," see Chapter II.

[700] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above (showing a cumulative loss of $207,991,125 as of March 20, 2012). Numbers do not reflect restated P&L figures.

[701] See 5/3/2012 email from Irvin Goldman, CIO, to Douglas Braunstein, John Hogan, and Ashley Bacon, JPMorgan Chase, "CSW 10%," JPM-CIO-PSI-H 0000546-556, at 552.

[702] See 3/20/2012 email from Isi Oaikhiena, JPMorgan Chase, to "EOD Credit estimate" mail list, copy to "CIO P&L Team" mail list, "International Credit Consolidated P&L 20-Mar-2012," JPM-CIO-PSI 0019484-487, at 486; 12/12/2012 distribution list document, "Distribution List Membership Around March 2012," provided to Subcommittee by JPMorgan Chase legal counsel, JPM-CIO-PSI-H 0002815.

Soon after the SCP P&L Predict email went out at the end of the business day in London, Mr. Martin-Artajo telephoned Mr. Iksil.[703] In a lengthy conversation, Mr. Martin-Artajo repeatedly expressed dismay at the action taken by Mr. Iksil and indicated that neither he nor his supervisor, Achilles Macris, had wanted to report increased SCP losses until they received guidance from Ina Drew at the meeting that was scheduled for the next day.[704] Mr. Martin-Artajo also acknowledged that Mr. Iksil had been placed in a difficult position.

> **Mr. Iksil:** "Yeah, so, yeah we sent, we sent an estimate - down $40 million today. …"
>
> **Mr. Martin-Artajo:** "Ok, ok. I just don't want you to do this. I don't know why you've done it anyway, you've done it. . . . You should have told me this because it doesn't help us for the conversation for tomorrow."
>
> **Mr. Iksil:** "… [Y]ou know I thought we should, actually, you know, not do like minus, minus five every day but say ok, boom, you know, there is something happening, [indecipherable], we take a hit --
>
> **Mr. Martin-Artajo:** "… You think this is right. This is not what I would have done but you've done it. So I, I, I am ok with this. I've already said what the problem is. So, ok, they know. They are not going to be surprised. We have a meeting tomorrow. It's just that -- "
>
> **Mr. Iksil:** "I know it's embarrassing but --"
>
> **Mr. Martin-Artajo:** "Yeah, I don't understand your logic, mate. I just don't understand. I've told Achilles. He told me that he didn't want to show the loss until we know what we are going to do tomorrow. But it doesn't matter. I know that you have a problem; you want to be at peace with yourself. It's ok, Bruno, ok, it's alright. I know that you are in a hard position here."
>
> **Mr. Iksil:** "Yeah, I can't tell you I like it. I work with, with Julien [indecipherable] and you know, what we've tried to do is, to say ok, four months in, you know, we want to fight? Where are we, you know? So, and really, really, if we wanted just to be realistic as to what we can expect to do, I wanted to show like, up front, precisely before we discuss, you know, what it was going to look like. That, you know, if we expect potentially to lose 100, 200 million, it's because from where we are today, right? We will fail to bring back one basis point here, a quarter of a point in high yield there. It's just that, it's just, you see, just basic --"
>
> **Mr. Martin-Artajo:** "No, no, no, no, it's ok, it's everywhere. I know."

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[703] See 3/20/2012 transcript of recorded telephone conversation between Bruno Iksil, CIO, and Javier Martin-Artajo, CIO, JPM-CIO-PSI-H 0006392.
[704] Id. at 398 (**Mr. Martin-Artajo**: "I wish I could discuss it with you, because, um, I didn't, I didn't want to show the P&L and Achilles told me yesterday not to do it.").

On the same call, Mr. Martin-Artajo expressed displeasure at Mr. Iksil's disclosing in the daily SCP P&L Predict that the "lag" in the SCP book could approach $800 million ("800 bucks"). In addition, Mr. Martin-Artajo expressed concern over what would happen if Ms. Drew were to instruct them to stop "going long," which would likely intensify the book's losses.

> **Mr. Iksil:** "[W]e take this loss, we are maintaining long risk where we have to be, rally is the on IG but guess what you know, it's lagging so much that actually we have to show loss, andI explained that this is a lag that keeps going, that amounts to a potential of 800 bucks, right? …"
>
> **Mr. Martin-Artajo:** "What are you saying, Bruno? What are you talking about? What is,, you are losing your mind here, man, why did, you re sending an email that you would get, what is the 800 bucks?"
>
> **Mr. Iksil:** "It's just the lag that we have in IG, in High Yield, in Main, that is all over the book that makes that this book is just bleeding the money but it's just the lag. That's just the lag.
>
> **Mr. Martin-Artajo:** "Ok but this is what we need to explain tomorrow you don't need to explain in the email man."
>
> **Mr. Iksil:** "Yea, but I had to put the comment on this big move, I thought, I thought that was, that was a way to, to, to show what's happening on a day like --"
>
> **Mr. Martin-Artajo:** "Yea but why do you do it today when we are going to explain it tomorrow? …"
>
> **Mr. Iksil:** "Because, because that, that's, that's what we saw today, you know we've tried everything. …"
>
> **Mr. Martin-Artajo:** "Why don't you explain it tomorrow when Ina is there and we have, because this only, this only creates, it just creates more tension, you understand? ... What happens if she tells me that, that, that we cannot keep going long?"[705]

Continuing the conversation, Mr. Iksil indicated that the divergence between the reported and unreported losses, which then approached four basis points, or as much as $200 million, in two credit indices, were too large for him to ignore. He expressed the hope that Ms. Drew would read the SCP P&L commentary which would give her additional time before the meeting the next day to think about what the CIO should do, especially as the quarter-end approached. Mr. Iksil also commented that he had been forced to choose between "one bad thing and one thing that I think was worse" – perhaps referring to admitting increased SCP losses versus hiding losses that were rapidly escalating.

> **Mr. Iksil:** "[I]t's like there were 4 basis points missing on IG9, or 4 basis points missing on S9 …"

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[705] Id. at 394-395.

Mr. Martin-Artajo: [interrupting] "Ok, ok, ok…."

Mr. Iksil: "… [Y]ou know, it's just that, I have to, I don't know, I thought, I thought that was, that was not realistic, you know, what we were doing, and I said probably I was wrong, you know, I thought that it was this estimate before tomorrow, you know, was the way to, because I know Ina is going to read the comments, so,maybe it will leave some time and she will have different questions, or, I don't know. ... [I]t's one mistake for another here, because if I don't --"

Mr. Martin-Artajo: "No, no, man, no man."

Mr. Iksil: "I think I do a worst one, you know. It's sort of my logic is strange but, in fact I have to choose between one bad thing and one thing that I think was worse."[706]

Mr. Martin-Artajo responded that he had already informed Ms. Drew that the SCP was experiencing problems, which was why he and Mr. Macris had a meeting scheduled to seek her guidance on how to proceed.

Mr. Martin-Artajo: "I'm trying to get all the facts in front of Achilles and Ina, the fact that we show a loss here, it's ok, it's not, it is a problem, you know, I've already told her that there's a problem, so, you know, I've already told her, so, you know we're going to sit down tomorrow and talk about the CRM[707] we're going to talk about the problems. You know I've sent you an email on what she wants to discuss tomorrow she wants to see the changes in the book, okay So you need to make sure that Julien does that."

Mr. Iksil: "It, I was working on it."[708]

Finally, Mr. Iksil apologized to Mr. Martin-Artajo for creating more work for him with Ms. Drew, but also reaffirmed his belief that the CIO needed to get its marks closer to market value, stating: "we had to get closer to where the market is even if the market is wrong."

Mr. Martin-Artajo: "I didn't want to show the P&L and Achilles told me yesterday not to do it. So, okay, so we're just going to have to explain that this is getting worse, that's it. …"

Mr. Iksil: "… Sorry for that …. in any case, I feel bad. If I do that I know I'm not making your life easier, and if --"

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[706] Id. at 366-367.
[707] "CRM" refers to the "Comprehensive Risk Measure," which JPMorgan used to measure portfolio risk in the context of calculating its capital requirements; generally, federal regulators require banks to acquire more capital when engaging in higher risk activities. For more information on CRM, see Chapter V.
[708] 3/20/2012 transcript of recorded telephone conversation between Bruno Iksil, CIO, and Javier Martin-Artajo, CIO , JPM-CIO-PSI-H 006392, at 397.

Mr. Martin-Artajo: "No, no, no, you know I think that you're an honest guy. … I did not want you to do this way, but you know you feel that the bidoffer spreads are giving you a headache, and you want to release it this way, which is your own way of doing it. ... "

Mr. Iksil: "The thing is you know today, I said I told Julien you know okay let's try to frame this P&L estimate whatever it's going to be, right?, So that, with tomorrow, whatever the decision made, right, whether we settle or we decide to fight, you know like we go long and then we are going to defend the position on IG, on 9, on High Yield, you know, try to to do the minimum size everywhere you know so that the book grows a little bit but not too much, so that we are you know we, we maintain knowledge the level where we are, and we aren't too far off. I thought that tomorrow, at one stage, after or before at one stage later, I would show you, you know what, what the plan can be, where, how many basis points here and there we are chasing, and what size we can expect to do, right? And I realized we were, we were, we had to get closer to where the market is, even if the market is wrong, you see? …"

Mr. Martin-Artajo: "Ok, Bruno, no, no, no,. it's fine, ok, I see what you're going through. … [W]e'll sit down tomorrow and we'll look at the spreadsheet. I'm sure you've done some numbers that make sense, and you think this is part of something you can't recover, therefore you've released, and, you know, I know what you're doing and you're signaling here that there is a problem. I've already said it, Achilles knows it, and Ina knows it, and you're saying it now, so ok. I truly don't have a lot to say now because we have so much to speak tomorrow, I mean, We have a long day tomorrow."[709]

The next day, on March 21, 2012, Mr. Martin-Artajo sent an email to Ms. Drew, Mr. Macris, and Irvin Goldman, then the CIO's Chief Risk Officer, confirming that the purpose of the meeting to take place later that day was to discuss issues related to the Synthetic Credit Portfolio's "underperformance" and Risk Weighted Assets (RWA).[710] The meeting on March 21 took place, as confirmed in an email the next day from Ms. Drew to Mr. Martin-Artajo and Mr. Macris in which she described the meeting as "exhaustive."[711]

When asked about the March 20 SCP P&L report, Ms. Drew told the Subcommittee that, while she routinely received the CIO's daily EOD P&L emails and was meeting the next day to discuss the SCP, she did not open or read that particular email. When shown the text, Ms. Drew told the Subcommittee that she interpreted it as disclosing potential SCP losses and said, had she seen the $800 million figure at the time, it would have been a "game changer" in how she viewed the SCP book.[712] A week after her interview, Ms. Drew's legal counsel contacted the

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[709] Id. at 398-399.
[710] See 3/21/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, with copies to Achilles Macris, CIO, and Irvin Goldman, CIO, "Synthetic Book," JPM-CIO 0003489-490 ("The fact that the increase that we have seen in the book has not materialized in our performance has raised the following issues : 1. Our current underperformance in the Synthetic Book is large compared to our estimates given the changes in the profile of the book .").
[711] See 3/22/2012 email from Ina Drew, CIO, to Achilles Macris and Javier Martin-Artajo, CIO, "I was confused by the inc[re]ased position noted today after yesterday's exhaustive meeting," JPM-CIO 0003492.
[712] Subcommittee interview of Ina Drew, CIO (12/11/2012). See also March 2012 presentation, CIO Synthetic Credit Update, JPM-CIO-PSI 0021953-974, at 970 ("the realistic P&L miss is rather 800M USD").

Subcommittee to indicate that Ms. Drew had changed her interpretation of the email.[713] He told the Subcommittee that Ms. Drew had become "emotional" when listening to the recording of the conversation between Mr. Iksil and Mr. Martin-Artajo in preparation for her second Subcommittee interview and had become "emotional" again when seeing the transcript of the call during the interview. The legal counsel said that, upon reflection, Ms. Drew decided she had been too quick to interpret the $600 to $800 million figure in the email as referring to unreported losses, and that upon reading the email again, it appeared the traders were trying to reassure her by writing about a lag in market performance and predicting the SCP would regain $600 to $800 million in value. This telephone call took place after the Subcommittee's interview of Michael Cavanagh, head of the bank's internal investigation of the SCP losses, in which he and the bank's general counsel, Stephen Cutler, told the Subcommittee that they viewed the March 20 email, not as disclosing unreported losses, but as predicting that the market would rebound and add $600 to $800 million to the value of the SCP holdings.[714]

This interpretation of the March 20 email as conveying a positive message about future market performance is difficult to reconcile with the email's generally negative tone regarding the SCP. The purpose of the email's commentary was to explain a $43 million loss, which was the largest of the year and followed two straight months of losses. The email described problems with three key credit index positions held by the SCP;[715] used the words "underperformance," "lagging" and "loss" to describe those problems; attached a monetary figure to each described problem; then added up the figures and concluded that the "lag in P&L" was "material" and in the range of $600 to $800 million. The email also referred to the Eastman Kodak and Rescap bankruptcies, which cannot be interpreted as any type of prediction of better market performance. In addition, predictions about future market performance are rarely described as "material," and the email contains no positive descriptors of the $600 to $800 million figure.[716] Moreover, those figures did, in fact, reflect the ballpark amount of unreported losses then at stake, given the CIO's valuation practices; the bank's subsequent restatement put the first quarter's unreported losses at $660 million.[717]

In any event, whether or not the March 20 email was intended to or did disclose the extent of the unreported CIO losses to CIO management, Ms. Drew told the Subcommittee that she did not see the email at the time it was sent to her. In addition, despite her "exhaustive" meeting on March 21 regarding the SCP and evidence that Mr. Iksil and Mr. Grout viewed the mismarking as having reached "idiotic" and "monstrous" proportions and wanted to start

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[713] Ina Drew's legal counsel to the Subcommittee, (12/18/2012) (Lee Richards).
[714] Subcommittee interview of Michael Cavanagh, JPMorgan Chase (12/12/2012). Counsel for Ms. Drew told the Subcommittee that she was not aware of the explanation of Mr. Cutler and Mr. Cavanagh.
[715] The same three credit index positions were the subject of the Grout spreadsheet from the prior week. See undated spreadsheet referencing 3/16/2012, JPM-CIO-PSI-H 0002812.
[716] The email also described $100 million in losses caused by Eastman Kodak and Rescap bankruptcies that had already taken place.
[717] See also prior communications involving Mr. Grout or Mr. Iksil, CIO, cited earlier in this section, using the word "lag" to refer to unreported losses. See also March 29, 2012 email from Bruno Iksil, CIO, to Javier Martin-Artajo, CIO, "first draft of the presentation," JPM-CIO 0003543-554, at 545 ("the book is huge : 96Bln IG9 and 38Bln S9 fwds. … Series 9 lag is overwhelming : total loss YTD is 1.5bln."). See also 2013 JPMorgan Chase Task Force Report, at 47.

showing the losses, Ms. Drew told the Subcommittee that no one informed her at the time about the mismarking.[718]

On the same day, March 21, 2012, that Mr. Martin-Artajo and Mr. Macris met with Ms. Drew to discuss the synthetic credit book, the CIO reported its only profitable day during the second half of March. Its internal daily P&L statement reported a gain of over $700,000.[719] The next day, March 22, 2012, the CIO reported a daily loss of $1.8 million.[720]

(4) Trading Stopped

On Friday, March 23, 2012, Ina Drew ordered Mr. Martin and Mr. Iksil to "put phones down" and stop trading credit derivatives related to the SCP book.[721] The halt in trading did not, however, produce a halt in the mismarking.

The SCP book, which was essentially frozen in place on March 23, continued to incur losses throughout the trading day. Mr. Iksil informed Mr. Martin-Artajo that the SCP losses that day were huge, between $300 and $600 million, depending upon whether the CIO used the midpoint or "best" prices available in the daily price range (bid-ask spread): "I reckon we have today a loss of 300M USING THE BEST BID ASKS and approximately 600m from the mids."[722]

Using instant messaging, Mr. Iksil asked Mr. Grout to find out from Mr. Martin-Artajo what level of losses to report for the day. Mr. Iksil characterized the huge losses as "hopeless," predicted "they are going to trash/destroy us," and "you don't lose 500 M[illion] without consequences," concluding that he no longer knew what marks to use:

> **Mr. Iksil:** "It is over/it is hopeless now. … I tell you, they are going to trash/destroy us. … [T]onight you'll have at least [$]600m[illion], BID ASK, MID. BID ASK, YOU HAVE [$]300M[illion] AT LEAST… it is everywhere/all over the place. we are dead i tell you."
>
> [Later that day]
>
> **Mr. Grout:** "will you give me the color please? if there is some."

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

[719] See OCC spreadsheet, OCC-SPI-00000298. Numbers do not reflect restated P&L figures. The Subcommittee is unaware of any analysis of the derivative marks underlying the $700,000 to determine the extent to which those marks reflected prices within the daily bid-ask spread.

[720] Id. The Subcommittee is unaware of any analysis of the derivative marks underlying the $1.8 million loss to determine the extent to which those marks reflected prices within the daily bid-ask spread.

[721] Subcommittee interview of Ina Drew, CIO (9/7/2012). See also 5/5/2012 email from Achilles Macris to Ina Drew, CIO, "per the last call, here are the facts," JPM-CIO-E 00013052 ("Jamie asked if the position was increased after you ordered to stop trading. I think that your instruction came on March 23 following the SAA meeting in the previous day in which Bruno presented the book.").

[722] See 3/23/2012 instant messaging session between Bruno Iksil and Javier Martin-Artajo, CIO, JPM-CIO 0003507-508, at 508. See also 2013 JPMorgan Chase Task Force Report, at 51.

Mr. Iksil: "nothing for now… it will be negotiated with the IB [Investment Bank] at the top and I am going to be hauled over the coals. … you don't lose 500M without consequences. … ask javier what pnl [profit and loss] we print today. … please, go see javier. i don't know which pnl i should send."

Mr. Grout: "did you talk to javier?"

[5 minutes later]

Mr. Iksil: "yes. we show -3 [basis points] until month end on this one. … all that I am asking you is to tell Javier what you see. that's it and he decides what we show. because me, i don't know anymore."[723]

Less than an hour later, Mr. Iksil repeated many of the same complaints to a CIO colleague, stating that the crux of the problem was that the CIO had become "too big for the market."

Mr. Iksil: "[I]t had to happe[n]. [I]t started back in 2008 you see. [I] survived pretty well until [I] was alone to be the target. [Y]es [I] mean the guys know my position because [I] am too big for the market. … [B]ut here is the loss and it becomes too large and this is it. [W]e realize that [I] am too visible."[724]

Despite the emails predicting losses of between $300 million and $600 million, at the end of the day on March 23, 2012, the CIO reported internally a daily loss of only $12.5 million."[725]

(5) Accusing the Investment Bank

In the second half of March as the SCP losses continued to pile up, CIO management began to suspect and then blame the JPMorgan Chase Investment Bank for some of its trading problems. The Investment Bank, like the CIO, managed a large portfolio of derivatives and was active in the credit derivative markets. In fact, the original authorization for the CIO to trade in credit derivatives indicated that the CIO should use the Investment Bank's marks, because the Investment Banker was a market maker in the product.[726] However, by 2012, the CIO was not using the Investment Bank's marks (if it ever did), leading to a growing valuation discrepancy between the two entities within JPMorgan Chase. This discrepancy not only drew the SCP valuations into question overall, they also caused problems because the CIO and Investment Bank were sometimes on opposite sides of the same credit derivative trade, and settling those

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[723] 3/23/2012 instant messaging session between Bruno Iksil and Julien Grout, CIO, JPM-CIO 0003515-541, at 528-541

[724] 3/23/2012 instant messaging session between Bruno Iksil, CIO, and Ade Adetayo, JPMorgan Chase, JPM-CIO-PSI 0001240-246, at 244-245.

[725] See OCC spreadsheet, OCC-SPI-00000298, printed in a chart prepared by the Subcommittee above. Numbers do not reflect restated P&L figures. The Subcommittee is unaware of any analysis of the derivative marks underlying the $12.5 million loss to determine the extent to which those marks reflected prices within the daily bid-ask spread.

[726] See "Chief Investment Office New Business Initiative Approval," prepared by CIO, on "Credit and Equity Capability" (undated, but in 2006), at 11, OCC-SPI-00081631.

trades using the Investment Bank marks would result in much larger losses for the SCP than it would otherwise record using its own, more favorable marks.[727]

Mr. Macris and Mr. Martin-Artajo communicated a variety of concerns in emails and telephone conversations, including that the Investment Bank was competing with the CIO, assigning unfavorable marks to positions where the SCP held the opposite side of the trade, and disclosing information about the CIO's positions to the marketplace at large.[728] In response, a senior Investment Bank executive, Daniel Pinto,[729] investigated the allegations and determined they were untrue.

On March 23, 2012, the same day that Ms. Drew ordered a halt in the SCP derivatives trading, the allegations were discussed in a telephone conversation between Mr. Martin-Artajo and Keith Stephan, the market risk officer in the CIO's London office.[730]

> **Mr. Martin-Artajo:** "Hey Keith, man. Having a lot of headaches here."
>
> **Mr. Stephan:** "… I mean, I've been through the book before with Pete [Weiland] as you're aware. I talk to him every day about it. So I have some patience to take Irv though it. But then it seems like there is a breakdown in the link of communication here because I, I was under the impression that everybody was very clear that … what we were doing was adding sort of another 20 to 25 [b]illion dollars of risk in one sense, right,

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[727] See, e.g., 3/23/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, copy to Achilles Macris, CIO, "Synthetic Book – URGENT," JPM-CIO-PSI 0000416 (discussing whether to "settle" SCP trades with the Investment Bank and noting that settling them could lead to a "permanent loss" for the SCP book as large as $350 million).

[728] See, e.g., 3/23/2012 email from Achilles Macris, CIO, to Ina Drew, CIO, "This is not 'normal'….," JPM-CIO-PSI 0000415 (**Mr. Macris:** "Javier and team here feel 'surrounded' and blindsided in terms of methodology etc. I think that we will need to intervene and somehow mediate this issue with the IB and insure the unbiased role of Ashley and Risk management. Let's please decide and coordinate on our exact course of action, as this issue is really taking a worrisome direction that could be embarrassing to the firm. Clearly, the IB knows our positions as well as the 'checkmate' in terms of Capital treatment. They will certainly like to settle with CIO and close their short position in IG. … The problem with 'settling' with the IB and help closing their shorts, is that CIO will be substantially short the market, post settlement. This is not where we [sic] I would like us to be in the middle of this strong market."); 3/23/2012 email from Javier Martin-Artajo, CIO, to Ina Drew, CIO, copy to Achilles Macris, CIO, "Synthetic Book – URGENT," JPM-CIO-PSI 0000416 (**Mr. Martin-Artajo:** "[D]uring the last week we have been trying to work on our best path for the Synthetic Book trying to both to reduce our overall RWAs and get the book in a balanced way. The problem with this has been that we have engaged in a dialogue with Risk Management (Ashley Bacon), QR (Venkat) and the IB (Guy America and Daniel Pinto) and this has resulted in a heightened alert about our positions in the IB and is really hurting us in various ways. … and also we have worse marks against our current book. … In any case it is very important that we need to let the IB know that we need to talk to them to stop this negative [s]piral that we are seeing in the market because we have disclosed too much information to them and we are sever[e]y affected by this. Specifically on the long IG9 position that is getting the attention of the market." **Ms. Drew**: "You guys need to get irv [Goldman] and call [CRO John] hogan and explain. I can give him a heads up.").

[729] At the time, Mr. Pinto was co-head of fixed income and CEO of the bank's Europe, Middle East and Africa (EMEA) region. Mr. Pinto is now the co-head of Corporate and Investment Banking, a position shared with Michael Cavanagh, JPMorgan Chase.

[730] 3/23/2012 recorded telephone conversation between Keith Stephan, JPMorgan Chase, and Javier Martin-Artajo, CIO, JPM-CIO-PSI-A 0000060. See also, partial transcript of this conversation at JPM-CIO 0003493.

you know, on the run? And now it seems like everybody says no we don't, we didn't know what we were doing .…"

Mr. Martin-Artajo: "No, no, no. I spoke with Ina. The reason I told her, the reason I'm doing that is to defend the position, okay? We can reduce that [RWA]. I just didn't want the investment bank to roll over us, okay? This[731] has increased the book by 25 or 26 billion of RWA which is freaking them out. … So this is going all the way up, man, just, just for you to know. Achilles and I, we've raised this issue to Ashley Bacon and he's going to talk to [Chief Risk Officer John] Hogan and he's going to talk to Daniel Pinto and he's going to talk to Guy America, okay? So we're escalating the problem here, all the way up, okay?"

Mr. Stephan: "Okay."

Mr. Martin-Artajo: "The issue here is that the investment bank is manipulating the prices. They want us out of – you know how valuable the IG9 position is, right?"

Mr. Stephan: "I know."

Mr. Martin-Artajo: "And we have a lot of it, okay? So it's almost they are trying to squeeze us out. … We have a good position, it's not performing and we are getting paranoid here, okay? … But this is out of my control or Achilles' control now. This is Ina. Ina has to decide this with, with, with whoever it is."

Mr. Stephan: "Jes Staley."

Mr. Martin-Artajo: "With Jes, basically. … They [the Investment Bank] are not trading volume. They are just avoiding us, okay? They are just giving us bad marks. So they are manipulating the market and we have to stop it because now it's coming to me from the market. The market is asking us what … are we doing? Okay? They think that we have a large position. Okay? And, you know, that's the last thing you want."

That same day, March 23, Mr. Pinto spoke with Achilles Macris about the accusations against the Investment Bank.[732] During the conversation, Mr. Macris began to retreat.

Mr. Macris: "So we are acting after Ina's instruction, you know, who, you know, wants to talk to [John] Hogan about it …."

Mr. Pinto: "Ok, well then I need to talk to Hogan too. … [W]e don't have any collateral, significant collateral disputes with anyone. I will, I'm trying to … really check on all of the valuations of the positions. …"

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[731] Mr. Martin-Artajo was referring to several recent large trades by the CIO, including a $9 billion purchase of one credit index and a $14 billion purchase of another, for a total of $23 billion.

[732] 3/23/2012 Subcommittee transcription of recorded telephone conversation among Achilles Macris and Javier Martin-Artajo, CIO, and Daniel Pinto, Investment Bank, JPM-CIO-PSI-A 0000140.

Mr. Macris: "… Javier has, like, you know, sort of, you know, some, you know, feedback, and you know, issues, you know, with the dealers. …"

Mr. Pinto: "I should say that it's a situation where I need to do a formal investigation. And, really, if Javier is fantasizing about this, he's going to really, he will, he will have a ba-, a hard time here. I mean, if he's right, I need to fire a lot of people. …"

Mr. Macris: "Yeah, exactly, you know, I mean, I'm not on that page so much. Like, I don't disagree with you. You know, this elevation is not my style, right?"

Mr. Pinto: "From what I understand, how we got here, honestly, I don't care. What I see, is that it is an accusation that the investment bank, with someone leaking the position of CIO, is acting against CIO on mismarking the books to damage CIO. …."

Mr. Macris: "No, it's not, that is not to my understanding. My understanding is, listen, I, yeah, I don't know. These are very aggressive comments. … I don't know how … this has become ... an issue of disciplinary action …."

Mr. Pinto: Yeah, that's fine. But that, at the moment what it is, is a real accusation. It's not that a concern that you may have for the future. And the way that the people think, over this side, is someone in my group, did something wrong. Either mismarked the books or used information that they should have not used to trade against your position and acted against the benefit of the, to harm the bank. So that is what is floating around."[733]

Mr. Pinto then questioned Mr. Martin about the accusations against the Investment Bank.

Mr. Pinto: "So my question is, there is something that DID happen, that in any shape or form, you think that our investment bank is trading against your position, because the position was leaked in some weird form to them?"

Mr. Martin-Artajo: "Ok, I don't think that there is anything here that has happened that is of, of a serious nature. What I think is happening here, that is of a serious nature, is that what can happen with the marks that we get from the investment bank. Ok?"

Mr. Pinto: (laughs) "… So now we go to the marks. Have you got any, we don't have any collateral disputes, so, or very little ones. Have you, have you, can you see, any of the marks, that they are deliberately un-, mismarked to hurt your position? ..."

Mr. Martin-Artajo: "Ok, what happens is that, every time we put a trade on, I get, you know, I get, sort of like an immediate ask from, from the dealer into the position that we just traded, right? So, I get evidence that they have access either to ICE or to some other way to look at what we do and you know, I am concerned about that …?"

[733] 3/23/2012 Subcommittee transcription of recorded telephone conversation between Achilles Macris and Javier Martin-Artajo, CIO, and Daniel Pinto, Investment Bank, JPM-CIO-PSI-A 0000140.

Mr. Pinto: "Honestly, I don't, I, I don't know. Is that the case? That someone is accessing your, your position? Because Olivier gave it to them or someone? So I need to fire that person."

Mr. Martin-Artajo: "Ok."

Mr. Pinto: "So we need to be extremely careful."[734]

Ultimately, Mr. Pinto pointed out that the market had likely become aware of the CIO's positions, because the CIO's positions at the time were enormous and the market had a limited number of participants. He also promised to examine the issue of how the positions were being marked, since the CIO and Investment Bank had different values on their books for the same credit derivatives.

Mr. Martin-Artajo: "[R]isk management knows that we have large, large, concentrations, ok? Now, I, I, I am hearing in the market that, you know, some of the guys in the company are talking to them and wondering what we are going to do with the positions. Now, I, I just want to stop that …yeah?"

Mr. Pinto: "But Javier, Javier, Javier, Javier, my friend. You know that over these days, because of the difference in performance, everyone is stating that. So that it's very likely --."

Mr. Martin-Artajo: "But I want it to be inside the company. I don't want it to be, known out there. …"

Mr. Pinto: "But … obviously, you bought those positions in the market so it is very likely that some of the market people can put two and two together. … That someone is trading against you, knowing your position, is something that I will be extremely surprised that is going on but we'll take a look and see if that is coming up and that's it."

Mr. Martin-Artajo: "Ok, thank you. Thank you for that Daniel. Thank you for that."

Mr. Pinto: "And if you could, so how much do you think is [the] damage?"

Mr. Martin-Artajo: "It's a few basis points but it's in a large position so that's the issue."

Mr. Pinto: "So it's not many millions of dollars?"

Mr. Martin-Artajo: "I don't know like, maybe 250?"

Mr. Pinto: "Two hundred and fifty million dollars?"

Mr. Martin-Artajo: "Yeah."

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[734] Id.

Mr. Pinto: "Ok. And you think that the fact that we marked the book that way, so we are benefitting with that amount and you are having a loss of that amount?"

Mr. Martin-Artajo: "Well, I, I just, I'm just concerned that the bid/offer spread is wide, and I don't know where the, the, the prices are when we trade. That's basically what it is, really."

Mr. Pinto: "Ok, so then, then, I think that we need to get Jean Francois[735] to take a look of the marks and see if there is anything that is being done inappropriate. What I was telling Achilles is that we haven't … had recently, any substantial … discrepancies in the valuations with clients, or any market disputes."

Mr. Martin-Artajo: "Ok."

Mr. Pinto: "So, if we would have something of that nature, we would have substantial market disputes. But in any case, so I'll take a look and then we'll take it from there. …

Mr. Pinto: "But, but, yeah but to think, to think, that someone from us … went and openly in the market, talked about your positions? Really? I would be extremely surprised."

Mr. Macris: "Ok."

Mr. Pinto: "That the market knows that, what your positions are? That may be, because you bought tons of it."

Mr. Macris: "Yeah."[736]

According to JPMorgan Chase, the Investment Bank reviewed its books, determined it had not traded in size against the CIO, had correctly marked its positions, and had no material collateral disputes indicating a problem with its marks.[737] Mr. Pinto's logic in identifying collateral disputes as a red flag of mismarking shows that the bank itself should have focused on the CIO's growing collateral disputes in March and April as evidence of a mismarking problem. JPMorgan Chase also told the Subcommittee "there was no evidence that the Investment Bank was leaking" information about the CIO's positions to the market at large.[738] Instead, as Mr. Pinto pointed out and as Mr. Macris admitted, the market's awareness of the CIO's positions was attributable to the CIO's voluminous trading.

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735 Jean Francois Bessin was the director and global head of valuation for the Investment Bank.
736 3/23/2012 Subcommittee transcription of recorded telephone conversation between Achilles Macris, Javier Martin-Artajo, CIO, and Daniel Pinto, Investment Bank, JPM-CIO-PSI-A 0000140.
737 Subcommittee interview of John Hogan and Ashley Bacon, JPMorgan Chase (9/4/2012).
738 Id. (noting that that the bank's compliance group had come to that conclusion, which Mr. Martin-Artajo accepted).