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EXAMINING BANK SUPERVISION AND RISK MANAGEMENT IN LIGHT OF JPMORGAN CHASE'S TRADING LOSS

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

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EXAMINING BANK SUPERVISION AND RISK MANAGEMENT IN LIGHT OF JPMORGAN CHASE'S TRADING LOSS

Tuesday, June 19, 2012

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the committee] presiding.

Members present: Representatives Bachus, Hensarling, Royce, Lucas, Manzullo, Jones, Biggert, Capito, Garrett, Neugebauer, McHenry, Pearce, Posey, Fitzpatrick, Westmoreland, Luetkemeyer, Huizenga, Duffy, Hayworth, Renacci, Hurt, Dold, Schweikert, Grimm, Canseco, Stivers, Fincher; Frank, Waters, Maloney, Gutierrez, Velazquez, Watt, Ackerman, Sherman, Meeks, Capuano, Hinojosa, Clay, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Moore, Ellison, Perlmutter, Donnelly, Carson, Himes, Peters, and Carney.

Chairman BACHUS. The committee is called to order. This hearing will come to order.

Opening statements will be limited to 10 minutes on each side as previously agreed with the ranking minority member.

Today, the committee meets to examine bank supervision and risk management in light of the recent trading loss at JPMorgan Chase (JPMC). When America's largest bank reveals it has suffered an unexpected loss of more than $2 billion, that understandably generates concern and raises questions not only about the bank's risk management controls and corporate governance but also the action or inaction, as the case may be, of the regulators.

While the size of the reported loss is a small fraction, just one one-thousandth of JPMorgan's total assets, this episode serves as a reminder that no institution, no matter how well-managed, is immune from mistakes that are, to use Mr. Dimon's words, "stupid, sloppy, and the result of bad judgment." But, even more importantly, this should remind all of us about the importance of making sure it is the bank and the shareholders, not the taxpayers, who pay for such mistakes.

Fortunately, these losses are not being borne by the taxpayers or customers or clients of the bank, but by JPMorgan and the shareholders.

Since the losses were disclosed, the company has lost $23 billion in market capitalization and suffered reputational harm in the

marketplace; and employees involved in the problematic trades have lost their jobs, at least some of them.

This is how the system is supposed to work: Those who take the risk are the ones who suffer the loss or realize the gain. It stands in sharp contrast to the regime of taxpayer-funded bailouts with privatized profits and socialized losses we have experienced in the cases of AIG, GM, Fannie Mae, Freddie Mac, and Solyndra—could we have order among some of the staff and the audience? Thank you.

Because the bank has more than sufficient capital, taxpayers are protected from a bailout, and the overall financial system is protected from being brought down by the mistakes of an institution that is deemed too-big-to-fail. That is why the most important lesson to be learned from this incident has nothing to do with any the 400-plus rules found in the 2,300 page Dodd-Frank Act. The most important lesson is how central capital is to the safety and soundness of individual banks and our overall financial system. There is no capital or liquidity problem at JPMorgan, and I think that is a primary concern of the regulators. You are to be complimented that you have ensured that there is sufficient capital at that institution.

A bank with sufficient capital is able to absorb losses, whether the losses are caused by external factors beyond the institution's control or internal problems caused by poor risk management. A bank with sufficient capital is not a threat to the financial system even if regulators fail to do their jobs. And a bank with sufficient capital can take risks without putting taxpayers in jeopardy.

Just as JPMorgan should be and is being held accountable for its risk management failures, accountability must also be demanded of the Federal regulators who oversee the bank's activities. Unfortunately, because Dodd-Frank failed to consolidate and streamline the current convoluted and chaotic regulatory structure as House Republicans proposed, achieving regulator accountability is every bit as important now as during the height of the financial crisis.

How inefficient and fragmented is the current regulatory framework? Sitting before us today are five different regulators, all of whom have some supervisory responsibility over these trades and several of whom have examiners embedded in JPMorgan but none of whom, apparently, was either aware of the bank's hedging strategy or raised concerns.

Perhaps complexity of the trades of the regulatory structure and of the rules itself makes it impossible for any individual regulator to adequately do their job. After all, the Volcker Rule proposal is by itself staggering in its length and complexity. And more than a month after the loss was disclosed, the regulators cannot say whether the Volcker Rule would have prevented JPMorgan from making these trades.

Contrast this complexity with the simplicity of capital. Capital is our greatest protection against the systemic risk posed by institutions that are too-big-to-fail.

I'm pleased we will have the opportunity to discuss this today with our witnesses, and I thank each of them for being here.

Before closing, once again I want to emphasize the point that JPMorgan and its shareholders—not the bank's clients, not the depositors, and more importantly, not the taxpayers—are the ones

paying for the bank's mistakes. This is how the system is supposed to work, and it has.

I now recognize the ranking member for his opening statement.

Mr. FRANK. I will begin by confessing that my memory appears to have failed me with regard to the proposals from my Republican colleagues to supervisory consolidation. I do know that the structure we inherited when we took over in 2007 was a little bit more complex than the current one. We did in our legislation abolish the OTS—or, rather, merge it with the OCC. But I do not remember during the 12 years of Republican rule that any such consolidation proposal came forward. I apologize for the lapse in memory. I am sure they will remind me of it if one existed.

Nor do I remember a significant proposal to consolidate during the consideration of the bill.

I acknowledge there was a major problem here. The biggest problem is that we have a separate SEC and CFTC sharing jurisdiction over derivatives. I would like to have been able to get rid of that. I do not think it has ever been politically possible, given the cultural differences within our country that it reflects.

Now on to more serious subjects. To me, this is not a hearing about JPMorgan Chase. They are an example of the larger issue, which is the effort by my Republican colleagues, with help from some in the industry, to re-deregulate derivatives. That has been a drive that they have made.

Now they haven't done it head on, because they do believe there is some popularity in the country for the notion that there should be some regulation, that we should undo the error of 2000, when Senator Gramm led the charge for a total de-regulation.

But here is where we are today. As we sit here now, the Appropriations Committee will be voting shortly on the budget proposed for next year for the Commodities Futures Trading Commission (CFTC) which will, incredibly to me, reduce the amount they have from this year to next year. So while there was going to be criticism of the CFTC for not doing rules quickly enough, for not doing enough at MF Global, for not washing the windows of people's cars, and all other things, this Republican Majority is prepared to reduce their funding. They will be given by the Republicans $180 million—I stress "million" because with regard to derivatives, that is the only time it is "million" and not "billion." The Senate fortunately has acted to do the full funding, and that is one of the issues.

Secondly, as Mr. Gensler addresses in his testimony, this committee, over my objection and the objections of many of us, voted to exempt from regulation the derivatives transactions conducted by the foreign subsidiary and American institution, i.e., JPMorgan Chase's London operation, AIG, and others. So there were other bills that they have been trying to put forward, too. Some take small pieces and make some sense. Some try to lock in what could be done better, more flexibly administratively.

But let's be clear: This is the issue. And the relevance of JPMorgan Chase is that it shows this. JPMorgan Chase is considered to be a very well-run bank. If in a very well-run bank, you can get this loss of several billion dollars—$3 billion and counting, we are told—in a fairly short period of time, it is an indication of the problem with derivatives.

JPMorgan Chase, Mr. Dimon tells us, has a fortress balance sheet. But not every institution has a fortress balance sheet. Some institutions may have a picket fence balance sheet or a chain link balance sheet. And, yes, we would like all of them to get up there, but we are not all there yet.

So the notion that we should underfund the main regulator on derivatives, that we should exempt foreign subsidiaries from it, as Mr. Gensler has pointed out incentive for American institutions to move overseas, these are very grave errors. And that is the question.

And the very fact that JPMorgan Chase and Mr. Dimon, a very well-regarded chief executive, was taken by surprise on this, it got out of his control, I believe that if you look at the various lines of business of JPMorgan Chase and other banks, you would find it would be unlikely that this could happen in any other line of business, that derivatives are particularly complex, highly leveraged, and—until our legislation is fully implemented, if the CFTC is ever given the ability financially to do it—obscure.

And that is the point. This is an example and, yes, we are not micromanaging JPMorgan Chase. What we are saying is the fact that Mr. Dimon and this bank were taken by surprise and were not able—lost so much money so quickly in derivatives, didn't fully understand what they were doing—and I think it is relevant—and then made the choice when they were confronted with a problem not to try to wind the position down but in fact to expand the use of derivatives so that good derivatives would come to the aid of bad derivatives, multiplying the error, these are arguments for the kind of regulation we need.

As I said, it did not cause a systemic problem here, but waiting until it happens in an institution or in a pattern that causes systemic problems would be a very grave error. So I intend to focus on this, and I believe many on our side will.

The question is, does this not argue against the proposal to deregulate derivatives? And what we see on the part of our Republican colleagues is a systemic, piece-by-piece, bite-by-bite effort to render us unable to regulate derivatives, to go right back to where we were before the terrible crisis of 2008.

Chairman BACHUS. I thank the ranking member.

The chairwoman of the Subcommittee on Financial Institutions, Mrs. Capito is recognized for 1 minute.

Mrs. CAPITO. Thank you, Mr. Chairman.

We are here today to learn about how the risk management lapses at JPMorgan led to over $2 billion in losses. Normally, the losses of a private company would not be something that would come before congressional hearings. However, we know that Dodd-Frank failed to end too-big-to-fail and in fact codified it into law. Therefore, institutions like JPMorgan are still viewed by market participants as being systemically important firms that may be bailed out by taxpayers in times of extreme distress.

Although no taxpayer dollars were at risk in this case, as long as too-big-to-fail exists in our markets, this committee should be vigilant in oversight to ensure regulators and private firms are employing sufficient risk management models.

We know the $2 billion loss did not pose a threat to the system or the firm because as of March 31, 2012, they were holding $128 billion of Tier 1 Capital. The questions I have: A less-well-capitalized firm, could they survive the loss? Is there transparency in the system? As far as the regulators go, there are five regulators here to talk about this, but why was this not seen by all five? Why was it not shared if it was seen?

I yield back.

Chairman BACHUS. Thank you.

Ms. Waters, the ranking member of the Capital Markets Subcommittee.

Ms. WATERS. Thank you very much, Mr. Chairman. I thank you for this hearing.

I think that Mr. Frank has set the tone and direction for this hearing, and I would like to continue in that vein.

Before we get into the specifics of the circumstances surrounding JPMorgan Chase's trading loss, I think it is important to remember the context underlying this hearing. We are approaching the 4-year anniversary of the most significant financial crisis since the Great Depression. Millions of American families have lost their homes to foreclosures, many of which were completed with robo-signed or otherwise fraudulent paperwork. For those who remain in their homes, individuals have lost trillions of dollars in housing wealth, as well as losses to their retirement accounts and college funds. So it is within this context that we hold this hearing today.

Let's make no mistake. This is not just about a $2 billion or $3 billion dollar trading loss at JPMorgan Chase. It is about the $10 billion or the $15 billion or the $50 billion loss that could come next, either at JPMorgan or any other bank that is backed by the U.S. taxpayer, if we don't stand up for financial reform.

Fortunately, we passed Dodd-Frank to respond to this crisis. But, admittedly, nearly 2 years since the passage of the Act, we are still waiting for many of its provisions to be finalized.

Industry complains about all the lingering uncertainty over Dodd-Frank, but the truth is that the industry lobbying is a central reason for these delays. As I have said before, there is a death-by-a-thousand-cuts approach to undermining financial reform, which includes pushing bills to undermine Dodd-Frank right here in Congress, lobbying our agencies to weaken the rules, and suing our regulators when they don't like the rules they eventually do put forward.

Many of my Republican colleagues here at the House are complicit in this effort by failing to give the regulators the funding they need do their jobs. So I want to implore the regulators here today to resist the pressure they face to weaken the rules and get their work done and finish their rulemaking. Otherwise, we may sit here a year from now wishing that we would have acted just a bit faster to prevent the next financial blowup.

I yield back the balance of my time.

Chairman BACHUS. Thank you.

Next, the chairman of the Subcommittee on Capital Markets, Mr. Garrett, for 1 minute.

Mr. GARRETT. I thank the Chair.

The recent trading loss at JPMorgan is obviously regrettable, and our banking supervisors in charge should be examined themselves and asked what exactly happened. But, I am a little surprised still about the hemming and hawing that we have heard by my colleagues on the other side of the aisle. When a private business loses money, when the institution that we are all in right here is losing billions of dollars literally every day—there was no shortage of outrage from my friends on the other side of the aisle when the private sector loses money.

So it makes you wonder, where was the outrage when Bear Stearns was bailed out with billions of dollars, and Republicans asked the former chairman for a committee hearing to hold a discussion to look into it, and we never had the hearing.

Where is the outrage when Fannie Mae and Freddie Mac lose a billion dollars every quarter now, and there is still no outrage.

Where was the outrage from the other side of the aisle when over half a billion dollars of loss to the President's green energy tax policy like Solyndra, where is the outrage?

A $2 billion loss is certainly significant, but in a capital society, that sometimes happens. Unfortunately, my colleagues on the other side of the aisle continue to demonize losses in the private sector but fail to take a look inwardly at the losses sustained to the taxpayers every day here in Congress.

I yield back.

Chairman BACHUS. Thank you.

Mr. Frank, for 30 seconds.

Mr. FRANK. Yes. It is interesting that the previous speaker talked about Fannie and Freddie and started to say—I would like to listen to the tape; he didn't finish the sentence—we are no further then we were before. The gentleman is the chairman of the subcommittee that has jurisdiction over Fannie Mae and Freddie Mac and has been since January of last year, and nothing has come to the full committee to change that. So when the gentleman laments the problems in Fannie Mae and Freddie Mac as continuing, he is, I guess, confessing his inability to do anything about it.

In fact, when we were in power, we did accede to the wishes of the Bush Administration that put Fannie and Freddie in a conservatorship. That is as far as it went. And since January of last year, under the gentleman's chairmanship of the subcommittee, nothing has happened.

I yield back.

Chairman BACHUS. Mr. Neugebauer, for 1 minute.

Mr. NEUGEBAUER. I thank the chairman.

I think the point has been made that taxpayers didn't lose any money. The shareholders lost $23 billion in market value. A colleague from New Jersey pointed out that today, local taxpayers will go $3.6 billion in the hole.

I think the two items that I want to focus on during this hearing are, one, the regulatory issue, where we had embedded regulators in these entities and we didn't seem to catch this issue. And it is a point that I have been trying to make in a number of hearings we have had in my committee is that, when we have regulatory failure, it brings to question—a lot of people call for more regula-

tions and more regulators. The question is, don't we just need the regulators to do their job?

And I think the other issue that is concerning is the disclosure and transparency of some of these trades and what members of the executive management of these companies are saying. We had, just a few days before this problem became a real issue, the CEO saying this is like a tempest in a teapot. We also had the CFO of MF Global saying, just a few days before that company went bankrupt, that they have never been in better shape.

So I think these kind of issues are important issues that we need to discuss today.

Chairman BACHUS. Mrs. Maloney for 1 minute.

Mrs. MALONEY. Thank you, and welcome to the regulators.

Since the financial crisis, we have worked to improve regulation of the financial industry. The basic questions today are: Are we on the right track to prevent another 2008 from happening? Do regulators now have the tools to prevent another crisis? And are CEOs managing their institutions with the lessons they learned from 2008? Why were the losses incurred in the London unit? Could they have been incurred in New York as easily? By every indication, JPMorgan Chase is a well-managed firm. So if this trading loss could happen there, it could happen at another large financial institution.

Mr. Dimon testified last week that there were parts of Dodd-Frank he supported and parts that needed to be clarified, not overturned. I think the industry, regulators, and policymakers can agree that the Volcker Rule, including the market-making provision, needs to be as clear and straightforward as possible; and I believe it should be put in place as soon as possible.

Thank you.

Chairman BACHUS. Thank you.

Mr. Hensarling, vice chairman of the committee, for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman; and thank you for holding a very important hearing.

I would like to associate first my comments with that of the gentleman of New Jersey. I do find it somewhat interesting, in an institution that unfortunately now witnesses serial trillion dollar annual deficits, as an order of magnitude of $2 billion, although certainly a significant sum, seems to pale in comparison; and so I am somewhat curious about certain Members' levels of outrage.

When the news broke about the $2 billion trading loss at JPMorgan, many said, "I told you so. We needed the Volcker Rule." Some of us also may reflect, "I told you so." Maybe we don't need institutions in America that are too-big-to-fail.

But, unfortunately, Mr. Chairman, as you well know, Dodd-Frank has codified too-big-to-fail. With the ability to designate systemically important financial institutions, we codify too-big-to-fail into Federal law. Empowering the FDIC to wind down these institutions and allowing them to borrow the FDIC up to the book value of the institution from taxpayers, an amount that could be outstanding, in the trillions of dollars again, we have codified too-big-to-fail. And, Mr. Chairman, before we get too far down the Dodd-Frank road, it is time for this Nation to reexamine this.

In addition, I think we should be very careful about outlawing risk. Without risk, we do not have a rate of return. Without a rate of return, we do not have investment and we do not have jobs in an economy that 3½ years after the President has taken office still suffers and our constituents are still in search of jobs.

So I thank you for calling the hearing. I look forward to hearing the testimony of the witnesses. Thank you.

Chairman BACHUS. Thank you.

Mr. FRANK. How much time do we have remaining?

Chairman BACHUS. One minute.

Mr. FRANK. Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Chairman, I had a wonderful opening statement, but I guess I have been thrown off it.

If you keep saying the same thing over and over and over, regardless of whether it is true or not, apparently it will become fact. I want the Red Sox to win, so the Red Sox are going to win. But they are still in last place.

You can say it all day long, but Dodd-Frank did not codify too-big-to-fail. Just the opposite. It prevented it from happening in the future.

And it is amazing. Where was the outrage? You must have missed the hearings we had. It made me a movie star, Mr. Garrett. "Inside Job" made me a movie star by expressing the outrage of the American people when we were on that side of the aisle in the Majority passing the most important bill in a lifetime in the Dodd-Frank bill to express outrage the way we are supposed to through legislation. The legislation that you and your friends have decided to vote against, to try to kill at every opportunity, to underfund, to make sure that the regulators cannot do their job, and you won't even give them the time to put the regulations in place to see if they happen.

The truth is I am not outraged by this particular loss, because the numbers are relatively small in comparison to other things. However, I do think it is important to ask thoughtful, insightful questions about what happened—

Chairman BACHUS. Thank you.

Mr. CAPUANO. —why they happened, and how we can prevent them from happening in a bigger way in the future. That is the outrage.

Chairman BACHUS. Thank you.

I can see we are not quite ready to break into a "Kumbaya" moment. Welcome to the serenity of the Financial Services Committee.

This concludes our opening statements, and without objection, all Members' written statements will be made a part of the record.

The Chair wishes to remind our guests that the manifestation of approval or disapproval, including the use of signs and placards, is a violation of the rules which govern the committee; and the Chair wishes to thank our guests in advance for their cooperation in maintaining order and decorum.

Let me say that there is agreement, I think, among all the panel that your agencies are all functioning under an increased workload, a greatly increased workload, and that you are facing many chal-

lenges with not only the economy but with adopting new rules and increased supervision, and that you are functioning under budgetary restraints. Particularly, I think the SEC and the CFTC, your workload has greatly increased, and your budget doesn't reflect it.

Mr. FRANK. Mr. Chairman, parliamentary inquiry? Are we going to hear the opening statements?

Chairman BACHUS. Yes, we will do that right now.

Mr. FRANK. Is there time for opening statements?

Chairman BACHUS. Oh, right now would be great.

Mr. FRANK. Okay. I thought you seemed to be—

Chairman BACHUS. Oh, no, not at all. I was just introducing the first panel, thanking them for their attendance, and acknowledging that they—

Mr. FRANK. Yes, but that shows preferences.

Chairman BACHUS. Well, it is the prerogative of the Chair.

Mr. FRANK. Hold on, Mr. Chairman. The Chair is under the same time limits as any other Member.

Chairman BACHUS. I am saying if you introduce the panel—you wish to protest.

All right. We will go forward and remind the witnesses that, without objection, your written statements will be made a part of the record, and you will each be recognized for a 5-minute summary of your testimony.

Our first panelist is Thomas Curry, Comptroller of the Currency. This is your first appearance before our committee since you were sworn in as Comptroller in April, and we look forward to a productive working relationship with you, as we did at the FDIC, and we welcome your attendance.

Thank you, Mr. Curry.

STATEMENT OF THE HONORABLE THOMAS J. CURRY, COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

Mr. CURRY. Thank you, Chairman Bachus, Ranking Member Frank, and committee members. I appreciate this opportunity to discuss the OCC's perspectives on JPMorgan Chase's losses. My written testimony also includes background on our approach to supervising large banks and our efforts to raise supervisory expectations on these institutions. This material provides important context for understanding how we are increasing our awareness of risks facing banks and the banking system, ensuring these risks are understood and well-managed, and raising our expectations for governance and oversight, capital, reserves, and liquidity.

It will take some time to achieve these objectives, and we must be vigilant in maintaining our course. That course leads towards strong, effective supervision and towards improved soundness of our banking system so that it can fairly and effectively serve its customers and communities.

The OCC is the primary regulator of JPMC's national bank where the transactions leading to its losses occurred, and we are responsible for the prudential supervision of the bank. In early April, information became available indicating risks in certain activities conducted within its Chief Investment Office. In response, OCC examiners met with bank management to discuss the bank's

transactions and the current state of the position. OCC examiners directed the bank to provide additional details regarding the transactions, their scope, and risk.

Our examiners were in the process of evaluating the bank's current position and strategy for risk reduction when, at the end of April and during the first days of May, the value of the position deteriorated rapidly. As the positions deteriorated, discussions turned to corrective actions and steps necessary to mitigate and reduce the bank's position.

In response to these events, we have undertaken a two-pronged review of our supervisory activities. The first component focuses on evaluating the adequacy of current risk controls at the bank informed by their application to the positions at issue. We are actively assessing the quality of management and risk management, board oversight, the types and reasonableness of risk measurement metrics and limits, the model governance review process, and the quality of work by the independent risk management team and internal auditors.

We are also assessing the adequacy of the information and reporting provided to bank management and to the OCC. Quality supervision is dependent on the quality of information available to examiners. The second component evaluates the lessons learned from this episode that could enhance risk management processes at this and other banks. Consistent with our supervisory policy of heightened expectations for large banks, we are demanding that the bank adhere to the highest risk management standards.

We are not limiting our inquiry to the particular transactions at issue. We are assessing the adequacy of risk management throughout the bank. We are using these events to broadly evaluate the effectiveness of the bank's risk management within its CIO function and to identify ways to improve our supervision. If corrective action is warranted, we will pursue appropriate informal or formal remedial action.

While the losses raise serious questions and may affect the bank's earnings, these losses do not present a solvency issue. JPMC's national bank has approximately $1.8 trillion in assets and $101 billion in Tier 1 common capital. It has improved its capital reserves and liquidity since the financial crisis, and those levels are sufficient to absorb this loss.

It is also worth noting that this loss does not threaten the broader financial system.

There has been much discussion about whether these JPMC activities would be permissible under the proposed Volcker Rule. While it is premature to reach any conclusion before our review is complete, this episode will certainly help focus our thinking on these issues and help regulators ask fresh questions.

Before closing, I want to stress my commitment to strong supervision and to taking every opportunity to improve how we accomplish our mission. This commitment will be a theme that runs throughout my tenure as Comptroller of the Currency, and I look forward to answering your questions.

Thank you.

[The prepared statement of Comptroller Curry can be found on page 94 of the appendix.]

Chairman BACHUS. Thank you, Comptroller, for that excellent statement.

SEC Chairman Schapiro, you are recognized for your 5-minute statement. And happy birthday.

Ms. SCHAPIRO. Thank you.

Mr. FRANK. Mr. Chairman, I ask unanimous consent that we silently insert "Happy Birthday" into the record.

STATEMENT OF THE HONORABLE MARY L. SCHAPIRO, CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION (SEC)

Ms. SCHAPIRO. Thank you very much.

Chairman Bachus, Ranking Member Frank, and members of the committee, I appreciate the opportunity to testify on behalf of the Securities and Exchange Commission regarding the significant trading losses announced last month by JPMorgan Chase.

On May 10, 2012, JPMorgan Chase, a bank holding company with $2.3 trillion in consolidated assets, announced it had incurred a $2 billion loss stemming from trades executed by its Chief Investment Office. The company also stated that it could face additional losses.

The losses reported by JPMorgan appear to have occurred in the bank's London branch and perhaps in other affiliates, but not in the broker-dealer subsidiary that is directly supervised by the SEC. Nevertheless, as a publicly held company, JPMorgan is subject to SEC reporting requirements and must disclose certain market risks in its annual and quarterly reports. This report includes line-item requirements for disclosure of specific information about risk as well as principles-based disclosure about the risks and uncertainty companies face.

Although the Commission does not discuss investigations publicly, I can say that in cases of this nature, the SEC's primary authority relates to the appropriateness and completeness of the entity's financial reporting and other public disclosures and its financial accounting and internal controls over financial reporting.

Under an SEC rule that requires quantitative market risk disclosure, companies are permitted to use one of three alternatives to disclose these risks. One of those options is Value at Risk, or VaR, disclosure that expresses the potential loss in future earnings, fair values or cash flows of market-sensitive instruments over a selected period of time and the likelihood of losses resulting from changes in market factors.

Market risk must be disclosed annually as of the end of the company's fiscal year. In addition, on a quarterly basis, the company is required to provide discussion and analysis of the sources and effects of any material changes in the market risk reported at the close of the previous year.

If a company chooses to use VaR to comply with its market risk exposure requirement, it must also disclose any changes to key model characteristics and to the assumptions and parameters used as well as reasons for the change. Changes to the scope of the instruments included within the model and the reasons for those changes must be disclosed as well.

The company also must provide qualitative disclosure of primary market risk exposures and how it manages such risks. Like the

quantitative disclosure, qualitative disclosures are required annually, with material changes reported quarterly.

Generally Accepted Accounting Principles (GAAP) also necessitate detailed information about derivative instruments in the notes to the financial statements. The mandated disclosures include aggregating information regarding volume, fair value, maturity and credit risk, qualitative information about the entity's objective in holding the instruments, and a discussion of risk management.

If there are compensation policies and practices that create risk and are reasonably likely to have a material adverse affect on the company, the SEC's rules also call for disclosure of the policies or practices as they relate to risk management and risk-taking incentives in the company's annual proxy statement.

Our rules also require that the proxy statement contains specific disclosure of the board's role in risk oversight.

In addition, certain principles-based rules require disclosure of a broad range of risks, including a discussion of known trends, events, demands, commitments, and uncertainty that are reasonably likely to have a material effect on financial condition or operating performance.

This provision would mandate disclosure, for example, if a company was experiencing trading losses that are different from past experience and, as a result, its current year results are likely to be materially different from the past.

Similarly, SEC rules require companies to describe the material risks they face and how particular risks affect the company. All disclosures must be complete and not misleading.

In conclusion, although the trading losses of JPMorgan do not appear to have occurred in an entity directly supervised by the SEC, the examination and review of the causes and implications of the trading losses are ongoing. Once we have a fuller understanding of these issues, we will be in a better position to determine whether additional regulatory or legislative action is appropriate.

And I am, of course, pleased to answer your questions.

[The prepared statement of Chairman Schapiro can be found on page 133 of the appendix.]

Chairman BACHUS. Thank you, Chairman Schapiro, for that thoughtful and informative opening statement.

At this time, I recognize CFTC Chairman Gary Gensler, who has been before our committee many, many times, and we welcome you back.

Mr. GENSLER. I think it is my 8th time in this job, and maybe a half dozen times in my earlier job.

STATEMENT OF THE THE HONORABLE GARY F. GENSLER, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION (CFTC)

Mr. GENSLER. Thank you, Chairman Bachus, Ranking Member Frank, and members of the committee.

When I hand one of my three daughters the car keys, I sleep better knowing that there are common-sense rules of the road. There are stop signs, traffic lights, and speed limits. There are prohibi-

tions against drunk driving, and there are cops on the street to enforce all of these rules and keep my daughters safe.

Similarly, when my mom and dad, neither of whom worked in finance or even completed college, invested their savings, our family benefited from the securities markets common-sense rules of the road.

It was during the Great Depression that President Roosevelt asked Congress to put in place rules to bring transparency to the securities markets as well as the futures markets and protect investors against fraud, manipulation, and other abuses. I believe these critical reforms of the 1930s are at the foundation of our strong capital markets and many decades of economic growth.

Swaps subsequently emerged in the 1980s. They provide producers and merchants a means to lock in a price of a commodity, an interest rate, or a currency rate; and our economy benefits from a well-functioning swaps market, as it is essential that companies have the ability to manage their risk.

The swaps marketplace, however, lacked necessary street lamps to bring it out of the shadows or traffic signals to protect the public from a financial crash. In 2008, swaps, in a particular credit default, concentrated risk in the financial institutions and contributed to the financial crisis and the worst economic crisis Americans have experienced since the Great Depression.

Congress responded with the Dodd-Frank Act, bringing common-sense rules of the roads to the swaps marketplace.

With regard to the credit default swaps index products traded by JPMorgan Chase, the CFTC is currently midstream in standing up reforms that promote transparency and lower risk in this marketplace. The CFTC has made significant progress in implementing the law's historic reforms, completing 33 key roles. But 4 years after the financial crisis, and yes, 2 years since the passage of Dodd-Frank, I think it is time that we finish the job and complete the nearly 20 remaining rules.

And we must not forget the lessons of the 2008 crisis and earlier. Swaps executed offshore by U.S. financial institutions can send risk straight back to our shores. It was true with the London and Cayman Island affiliates of AIG, of Lehman Brothers, of Citigroup, and of Bear Stearns. Yes, they all were in London and the Cayman Islands. And, yes, a decade earlier, Long-Term Capital Management, which this committee had hearings on, that, too, was booking its $1.2 trillion in derivatives where? The Cayman Islands, offshore.

The recent events of JPMorgan Chase, where it executed swaps through its London branch, are a stark reminder of this reality of modern finance. For the public to be protected, swaps market reform should cover transactions with these overseas branches, overseas affiliates guaranteed here in the United States, or even something called a conduit affiliate.

I think failing to do so would mean American jobs and markets would likely move offshore. They would. They would go where there is lower cost, and lower regulation.

But, particularly in the crisis, where would the risk come? Right back to our shores. Right back to the American taxpayers.

Dodd-Frank was successful in closing one London loophole for exchanges. Why would we leave another loophole for the dealers behind?

Some in the financial community have suggested we retreat. Some in Congress even suggested cutting the funding of market oversight. But the ever-growing financial storm clouds hanging over Europe and lessons from the crisis should guide us. Now is the time to bring common-sense rules of the road to the swap market.

Eight million Americans lost their jobs, millions of families lost their homes, and small businesses across the country folded when financial institutions were permitted to drive on dimly-lit swaps roads which had no rules, no cops. I think we would all sleep better if the complex roads of the swaps market were well-lit with transparency, had rules to lower risk to the bystanders, the American public, and that the agency tasked with overseeing them had enough funding to police them. Otherwise, I would say, hold onto your car keys.

[The prepared statement of Chairman Gensler can be found on page 114 of the appendix.]

Chairman BACHUS. Thank you, Chairman Gensler.

At this time, I recognize Acting Chairman Martin Gruenberg, who most of us know did an excellent job as Chief Counsel for Senator Sarbanes and did excellent work on Sarbanes-Oxley. I think you have been with the FDIC for about 7 years, and Chairman since last year. So we welcome you back before the committee, and we always welcome your testimony.

STATEMENT OF THE THE HONORABLE MARTIN J. GRUENBERG, ACTING CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Mr. GRUENBERG. Thank you very much, Mr. Chairman.

Chairman Bachus, Ranking Member Frank, and members of the committee, thank you for the opportunity to testify this morning on behalf of the Federal Deposit Insurance Corporation on bank supervision and risk management as it concerns recent trading losses at JPMorgan Chase.

The recent losses at JPMorgan Chase revealed certain risks that reside within Large Complex Financial Institutions. They also highlighted the significance of effective risk controls and governance at these institutions.

The four FDIC-insured subsidiaries of the JPMorgan Chase firm have nearly $2 trillion in assets and $842 billion in domestic deposits. As the deposit insurer and backup supervisor of JPMorgan Chase, the FDIC staff works through the primary Federal regulators—the Comptroller of the Currency and the Federal Reserve System—to obtain information necessary to monitor the risk within the institution.

The FDIC maintains an on-site presence at the firm, which currently consists of a permanent staff of four professionals. The FDIC staff engages in risk monitoring of the firm through cooperation with the primary Federal regulators. Following the disclosure of JPMorgan Chase's losses, the FDIC has added temporary staff to assist in our current review. The team is working with the institution's primary Federal regulators to investigate both the cir-

cumstances that led to the losses and the institution's ongoing efforts to manage the risks at the firm. The agencies are conducting an in-depth review of both the risk measurement tools used by the firm and the governance and limit structures in place within the Chief Investment Office unit where the losses occurred. Following this review, we will work with the primary regulators to address any inadequate risk management practices that are identified.

Following the announcement of these losses in May, the FDIC joined the OCC and the New York Federal Reserve Bank in daily meetings with the firm. Initially, these meetings focused on getting an understanding of the events leading up to the escalating losses in the CIO synthetic credit portfolio. The FDIC has continued to participate in these daily meetings between the firm and its primary regulators. We are looking at the strength of the CIO's risk management, governance, and control frameworks, including the setting and monitoring of risk limits. The FDIC is also reviewing the quality of CIO risk reporting that has historically been made available to firm management and the regulators.

Our discussions have also focused on the quality and consistency of the models used in the CIO as well as the approval and validation processes surrounding them. Although the focus of this review is on the circumstances that led to the losses, the FDIC is also working with JPMorgan Chase's primary Federal regulators to assess any other potential gaps within the firm's overall risk management practices.

As a general matter, and apart from the specifics of this situation, evaluating the quality of financial institutions' risk management practices, internal controls, and governance is an important focus of safety and soundness examinations conducted by the Federal banking agencies. On-site examinations provide an opportunity for supervisors to evaluate the quality of the loan and securities portfolios, underwriting practices, credit review and administration, establishment of and adherence to risk limits, and other matters pertinent to the risk profile of an institution.

One important element of risk management is that senior management and the Board receives accurate and timely information about the risks to which a firm is exposed. Timely risk-related information is needed by institution management to support decision making and to satisfy the disclosure requirements and is an important element to supervisory review.

Without speaking to the specifics of the case for which a review is currently under way, the recent losses attest to the speed with which risks can materialize in a large complex derivative portfolio. The recent losses also highlight that it is important for financial regulatory agencies to have access to timely risk-related information about derivatives and other market-sensitive exposures, to analyze the data effectively, and to regularly share findings and observations.

Thank you, and I would be pleased to respond to your questions.

[The prepared statement of Acting Chairman Gruenberg can be found on page 129 of the appendix.]

Chairman BACHUS. Thank you, Chairman Gruenberg.

And, as he said, these are ongoing examinations and investigations, and there is some restraint on their part from giving conclusions.

Our next witness is Federal Reserve General Counsel Alvarez.

Before you begin, Mr. Alvarez, I want to thank you for being with us today. As many of the panel and our members know, the Federal Open Market Committee is meeting this morning. Normally, representatives of the Fed do not testify while the FOMC is meeting to discuss monetary policy. And we very much appreciate the Fed's willingness to accommodate the committee by making its General Counsel available to testify this morning.

But the Chair reminds Members that Mr. Alvarez is here to testify about the Fed's supervision of JPMorgan Chase, and he will not entertain questions on the monetary policy issues on which the FOMC is meeting today. Members will have a chance in the next few weeks to question Chairman Bernanke about monetary policy during our semiannual Humphrey Hawkins hearing.

Mr. FRANK. Mr. Chairman, let me just thank you for making that statement, and I would like to reinforce that and ask all the Members to please respect that.

Chairman BACHUS. Thank you. I thank the ranking member.

General Counsel Alvarez, you are now recognized.

STATEMENT OF SCOTT G. ALVAREZ, GENERAL COUNSEL, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (FED)

Mr. ALVAREZ. Chairman Bachus, Ranking Member Frank, and members of the committee, thank you for the opportunity to testify this morning.

Last month, JPMorgan Chase announced significant trading losses on credit derivative positions in its Chief Investment Office. These trading losses arose out of a complex synthetic credit portfolio that was primarily composed of long and short credit default swap positions on a number of different credit assets and indices. JPMC has stated that a combination of risk management failures and execution errors and the complexity and illiquidity of the positions led to the losses.

In response to these significant trading losses, the Federal Reserve has been assisting the OCC in the oversight of JPMC's efforts to manage and de-risk the CIO portfolio. We are also working closely with the OCC and the FDIC to help ensure that any risk management failures, governance weaknesses, or other potential problems that may have given rise to the CIO losses are promptly and appropriately addressed.

In addition, the Federal Reserve continues to evaluate whether any weaknesses exposed by this incident may be present in other parts of the firm engaged in similar activities. While we have to date found no evidence that they are, this work is not yet complete.

This incident is a strong remainder of the fundamental importance of capital requirements, especially for the largest banking firms. The purpose of capital is to absorb unanticipated as well as anticipated losses. With strong capital, business losses are borne by the firm's shareholders and not by depositors, customers, or tax-

payers; and the large and absolute dollar terms need not threaten the safety and soundness of the firm.

For precisely this reason, over the past several weeks the Federal Reserve, the Comptroller of the Currency, and the FDIC have jointly finalized reforms that will materially strengthen the market risk capital requirements applicable to the largest, most complicated banking firms.

We have also proposed changes to implement the Basel III capital reforms and the new capital requirements in the Dodd-Frank Act. Importantly, many of these reforms specifically address and strengthen the capital requirements applicable to trading activities and positions, including complex derivatives.

The stress tests are supervisory complements to these improvements to the regulatory capital framework. The most recent stress test conducted by the Federal Reserve demonstrated that 15 of the 19 largest banking firms in the United States would maintain capital above prescribed standards, even in a very stressed economic scenario. The Tier 1 common ratio for these firms, which compares high-quality capital to risk-weighted assets, has doubled during the past 3 years to a weighted average of 10.9 percent at the end of the first quarter of 2012, from 5.4 percent at the end of the first quarter of 2009.

The trading losses announced by JPMC have also focused attention on the Volcker Rule provision of the Dodd-Frank Act, which contains an exemption from the ban on proprietary trading to allow risk-mitigating hedging activities. The agencies have jointly proposed rules that would incorporate the terms of the statutory exemption.

Importantly, the agencies have also proposed to add requirements designed to enhance the risk management of hedging activities. Among these added restrictions are a requirement for formal policies and procedures governing hedging activities, hedging instruments, and hedging strategies, a formal governance process, documentation requirements, internal audits, and requirements that incentive compensation paid to traders engaged in hedging not reward proprietary trading.

The Federal Reserve has received many comments on this proposal, including comments informed by the trading losses occurring within JPMC's CIO. We will consider all of these comments carefully as we work with the other agencies to finalize the regulations implementing the Volcker Rule.

Thank you very much, and I would be pleased to answer your questions.

[The prepared statement of General Counsel Alvarez can be found on page 86 of the appendix.]

Chairman BACHUS. Thank you, Counsel.

Before I begin my 5 minutes, let me say to all Members, if you don't get your question completed before the 5 minutes is over, you will be stopped right there. Only if you have your question out and the witness is responding, will you be allowed to have an answer to that question.

Comptroller Curry, you testified before the Senate Banking Committee 2 weeks ago about the risk management deficiencies at JPMorgan Chase and your agency supervision of the institution. As

your review of this matter has continued, have you learned anything new over the last 2 weeks about what led to these losses? And, in your view, were there appropriate risk controls in place at the Chief Investment Office where the relevant trades took place?

Mr. CURRY. Thank you, Mr. Chairman.

We are continuing our review of the facts surrounding the trading loss at JPMC. However, we do believe as a preliminary matter that there are apparent serious risk-management weaknesses or failures at the bank. We are attempting, as I mentioned, to continue to examine the root causes for those failures and to determine whether or not there are other weaknesses elsewhere in the bank besides the Chief Investment Office.

Ultimately, we are looking to ensure that we also learn how to improve our supervisory processes and examination practices to make sure that we have a better handle on emerging or similar risks in the institutions that we supervise, particularly our large bank area of supervision.

Chairman BACHUS. Thank you.

During the April 13, 2012, analyst call during which JPMorgan Chase officials initially dismissed the significance of the London Whale trade, the firm's chief financial officer, Douglas Braunstein, stated, "We are very comfortable with our positions as they are held today, and I would add all of those positions are fully transparent to the regulators. They review them, have access to them at any point in time, and get the information on those positions on a regular and recurring basis as part of our normalized reporting."

Is Mr. Braunstein's description of the regulators' access to information about the positions being taken by the firm at any given time accurate?

Mr. CURRY. Generally, we have wide access to the management reports that the bank itself has given for a variety of its activities, including the activities of the CIO office. What we are looking at presently is whether or not that reporting was sufficiently granular or not to disclose both to us and to the bank itself the size and the complexity and the potential risk of the positions that they took with their synthetic credit book.

Chairman BACHUS. All right. So the OCC failed to identify the risk inherent in these positions until after the fact, although you did have access to the information, because the descriptions were not transparent?

Mr. CURRY. In hindsight, if the reporting were more robust or granular, we believe we may have had an inkling of the size and potential complexity and risk of the position. What we are looking at on a prospective basis is to ensure that there is a robustness to the risk management reporting within the CIO's office and throughout the bank. And that is one of the lessons learned here.

Chairman BACHUS. Thank you.

I guess if there is proprietary information, you have to guard that and make sure that there is no disclosure.

Mr. CURRY. Absolutely.

Chairman BACHUS. Counsel Alvarez, one of the things about the JPMorgan Chase loss that I am having difficulty with is which regulators are responsible for what. I know the OCC regulates the national bank where the chief investment officer is located, but the

Federal Reserve regulates the holding company. What specifically did the Federal Reserve do in supervising the holding company that could have prevented a sudden loss like this from happening? And particularly, what responsibility does the New York Fed have for supervising JPMorgan?

Mr. ALVAREZ. Mr. Chairman, it is true that the setup for regulation of these institutions is divided among different institutions and the Federal Reserve is the holding company supervisor. But I don't think that it was a result of—that the difference in point of views or the division of responsibility played a role in this particular case.

We have been working very closely with the other regulators to understand the risks here. I think what has happened here is actually more a breakdown in the risk management of the organization itself. The firm has acknowledged that. We are working with the firm and the other regulators to make sure they repair those risk-management problems.

As I mentioned before, one of the things the Federal Reserve has focused on a lot as the consolidated supervisor is making sure these institutions have adequate capital. That is the best backstop here to any supervisory or management failure, for that matter; and there is adequate capital in this case to absorb the losses and make sure the shareholders and not the taxpayers absorb those losses.

Chairman BACHUS. Thank you.

Mr. Frank, for 5 minutes.

Mr. FRANK. I will pick up on that point about the divided authority. Because I want to stress again, despite the opening statement comment by my colleague, the chairman, I am aware of no proposal that came from either side for a consolidation beyond where we already were.

We did put the OCC and the OTS together. But to go further would require—to take the example just given, you either take holding company supervision away from the Federal Reserve or put the Federal Reserve in charge of what the OCC now does. I don't remember anyone proposing that.

One of the things people need to remember is that we have a more complex structure in the banking area in part because you have the dual banking system, and we had State-chartered banks resistant to being regulated by the regulator of the Federal banks.

As to the SEC and the CFTC, I agree. It is because the Midwest hates the coast and the coast thinks they can put something over on the Midwest, and that is why we have two agencies where we ought to have one. And anybody who wants to propose to merge them, I am with you. Because I am leaving and don't have to deal with the flak.

And I appreciate what Mr. Alvarez said, that you have been able to work together. One of the things I know from Mr. Alvarez is, when he talks on page six about what they are doing in the Volcker Rule, in addition to is it in or out, one of the things that seems to be very useful are the rules you are proposing for hedging.

Because one of the debates here is, as I read some of what Mr. Dimon says, it seems to me he can be interpreted as saying that if the bank is afraid of losing money from a certain set of events in the world, anything they do to make money somewhere else

counts as a hedge because it would be an offset against that loss. And you talk in your testimony here about requiring more specific hedging activities that meet a more traditional definition of a hedge, and I think that would be useful.

But let me now just go to Mr. Gensler. If the legislation that passed this committee on extraterritoriality were to become law, and it went to the Agriculture Committee and they pulled it from the agenda, if that had become law, what would the effect have been on the transactions of JPMorgan Chase?

Mr. GENSLER. I think it would be a major retreat from reform. And, as I understand it, these trades were executed in London in a branch, and they would not be covered.

Mr. FRANK. So that if that bill became law, those trades in London would be totally outside the supervision insofar as derivatives? They presumably would be subject to some bank supervision, but they would be not subject to anything about derivatives?

Mr. GENSLER. I believe so. It depends on how one provision in that statute is interpreted. But, yes, I believe so.

Mr. FRANK. And if the provisions of the Reform Act were fully implemented—and they have been held up in part because you had that three-to-two situation, and that is what is there. You have comments. You have been sued a couple of times. People flood you with comments, threaten to sue you if you don't edit them carefully, and then don't give you enough people to read them. So it is a little hard for me to be upset at you.

Mr. GENSLER. Thank you.

Mr. FRANK. But if the provisions of the bill had been fully implemented, what would the impact of that have been on the trades? Leaving aside the Volcker Rule, and I want to stress the Volcker Rule is only a part of this. If all we did was enforce a tough Volcker Rule and drove derivatives out of banks in an unregulated fashion, that wouldn't make anybody any better off either.

So take the non-Volcker Rule derivative provisions of the bill. If they had been fully implemented, if you had been given the staff, or when they are fully implemented, would that have had any impact on these trades?

Mr. GENSLER. I think there would still be risk in the bank, but they would be more transparent to their managers up the stream.

The trades themselves, because they were largely in credit default swap indices, would be in central clearing, not only for the bank but for the hedge funds that were on the other side, and they would have transparent pricing out to the public.

So risk tends to be better managed when you have public market transparency. I think Chairman Neugebauer said that earlier, too. I think transparency helps a great deal.

Mr. FRANK. I am glad you mentioned that. Because it stresses that much of what we tried to do in the derivative field outside of the Volcker Rule was to bring more market activity there.

And I must say I have found that some of my friends in the financial community regard competition and openness as a great spectator sport; they like to see other people engage in it, but they often have reasons why their own business is too delicate and too complex and too obscure to survive it.

It does seem to me that if this was in effect, Mr. Dimon and his people might have learned about some of this earlier. Is that possible?

Mr. GENSLER. I think that is right, even because of an internal business conduct rule, risk management rule we passed earlier this year. It has to go up the chain, and they have to manage these. But I do think transparency would have lowered the risk and also central clearing for the hedge funds as well as the bank.

Mr. FRANK. Let me ask, finally, on the Volcker Rule, and I know it is still being considered, one of the things that I think Mr. Dimon acknowledges led to a problem here, when it turned out that some of the transactions in the hedge were going bad, rather than try to withdraw from them and diminish them to cut the losses, they expanded them and got themselves into more difficulty. To the extent that the Volcker Rule defines hedges more narrowly and more specifically and it doesn't become a license to just do all kinds of things because if they make money they have offset losses, I think we will be much better off.

But, Mr. Chairman, my time has expired; and I appreciate that.

Chairman BACHUS. Thank you.

I would like to ask unanimous consent to correct the record by submitting H.R. 3311, which House Republicans on the Financial Services Committee sponsored, which would have consolidated the bank supervisory responsibilities of the OTS, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve into a new agency, and also would have established a new Office of Consumer Protection within that agency.

Mr. FRANK. Reserving the right to object, Mr. Chairman, when was that introduced?

Chairman BACHUS. In March of 2009.

Mr. FRANK. Further inquiry: now that you are in the Majority, have we had a hearing on that? Are we moving on that?

Chairman BACHUS. Well, you were the chairman.

Mr. FRANK. No. But now, you are the chairman, and you have been for a year-and-a-half. Have we taken any action on that bill? Have you reintroduced it in this Congress?

Chairman BACHUS. No. We are having trouble enough dealing with Dodd-Frank.

Mr. FRANK. Well, but that deals with it. So you have not reintroduced it in this Congress.

Chairman BACHUS. Thank you.

Mr. Hensarling for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman; and I appreciate your comments on Dodd-Frank. During its passage, many of us were told it would end the specter of too-big-to-fail. Many of us thought, frankly, the opposite might be true, that the big would get bigger, the small would become fewer, and the taxpayer would get poorer.

Chairman Gruenberg, I have looked at the FDIC's Q-1 banking profile—not that I expect you to memorize this—and if I have my citation right, page 7, table 3(a) says that the cost of funding earning assets for institutions greater than $10 billion is 22 basis points less than institutions with between $1 billion and $10 billion in as-

sets. Are you familiar with this data? Does this sound about right to you?

Mr. GRUENBERG. In general, yes, sir.

Mr. HENSARLING. If I recall from memory—and I don't have the data at my fingertips—Fannie and Freddie, given their implicit government guarantee, enjoyed roughly a similar funding advantage. Maybe it was 30 basis points. So here we are almost 2 years after the passage of Dodd-Frank, and yet we see these larger banks still enjoying a funding differential advantage over their smaller competitors. If the legislation had ended the specter of too-big-to-fail, wouldn't we have expected this funding difference to narrow?

Mr. GRUENBERG. I think that is clearly an objective, Congressman. And we are seeing among some of the rating agencies downgrades of some of the large institutions because of the reduced expectation of public support in the event of failure, and actually we view that as a positive development and a core objective of the legislation.

Mr. HENSARLING. Isn't it true that since the passage of Dodd-Frank, the five largest banks have indeed grown larger? In fact, Mr. Alvarez, I am not sure you are familiar with the report, but the Dallas Fed in its recent annual report said, "For all its bluster, Dodd-Frank leaves too-big-to-fail entrenched."

I believe this is Federal Reserve data, and I will quote from a Bloomberg report quoting the data: "Two years after President Barack Obama vowed to eliminate the danger of financial institutions that are too-big-to-fail, the nation's largest banks are bigger than they were before the financial meltdown." It goes on to list them—JPMorgan, Bank of America—and says, "They held more than $8.5 trillion in assets at the end of 2011, equal to 56 percent of the U.S. economy, according to the Federal Reserve."

Mr. Alvarez, does that sound accurate to you?

Mr. ALVAREZ. Recall, Congressman, that during the financial crisis there were some mergers of troubled institutions. So JPMorgan, for example—

Mr. HENSARLING. Let's start out with the basic question. Is the data accurate or is it not accurate?

Mr. ALVAREZ. I don't know the data that you have. The general idea sounds right, but I am pointing out the reason I think that it sounds right is because there were some acquisitions of troubled firms. JPMorgan bought WaMu. Bank of America bought Merrill Lynch. And there were various mergers during the crisis to shore-up troubled firms.

Mr. HENSARLING. Back to you, Mr. Gruenberg, and my fear of the taxpayer potentially getting poorer. The Congressional Budget Office (CBO) has estimated that the Orderly Liquidation Authority contained within Dodd-Frank could weigh in at roughly $22 billion of taxpayer money. That is how they have scored it. Have you read CBO's report in this regard? Do you have a comment?

Mr. GRUENBERG. I am aware of it, Congressman. I guess the point I would make is that the assumption behind that report is that there would be large up-front borrowing in the event of the failure of a systemic institution borrowing from the Treasury.

I guess two points to make: One, the Dodd-Frank Act, as you know, prohibits the use of any taxpayer money in the event of a

failure of a systemic institution. Any use of Treasury funds would have to be paid for out of the assets of the failed company.

Mr. HENSARLING. I see I am out of time, but I believe that by definition, Treasury funds are taxpayer funds, and if you don't have a bailout, I don't think you need the taxpayer funds. Thank you.

Chairman BACHUS. Ms. Waters for 5 minutes.

Ms. WATERS. Thank you very much.

Continuing with questions about the foreign branches and the affiliates of U.S. banks and this attempt to basically exclude them from Dodd-Frank, when risk is taken in a London branch of a bank, does that risk stay in London, Mr. Gensler?

Mr. GENSLER. No, generally, it doesn't. It can in calm waters, but in crisis—AIG was in London. Citigroup set up their special purpose vehicles, called SPVs, in London. So, often, it comes right back here crashing to our shores.

And to Vice Chairman Hensarling, if the American taxpayer bails out JPMorgan, they would be bailing out that London entity as well. Let's hope that doesn't happen, but it would be London as well.

Ms. WATERS. This risk that was taken by the Whale in London, a $100 billion trade, could it effectively have the same kind of impact in the United States?

Mr. GENSLER. If it were so large to bring down that institution, yes. In a crisis, generally there is a run on the whole institution, and it is hard, it is almost impossible to sever off a limb—if I can use that expression—even if it is overseas.

Ms. WATERS. Chairman Schapiro, we have heard Chairman Gensler outline his approach to extraterritoriality. What can we expect from the SEC on this issue? Do you basically agree with him? And when can we expect it?

Ms. SCHAPIRO. Congresswoman, I do agree with respect to the potential reach of the rules to the London branch of a U.S. bank in this instance. I think he is right about that.

With respect to the extraterritoriality more broadly, the SEC has been working very closely with the CFTC staff, but our Commission has not yet approved anything, so I can't speak definitively about what we will do. But our plan is to issue a release that holistically looks at the extraterritorial application of each and every Dodd-Frank rule and allow commentors the opportunity to give us their views on the entire approach when all the rules have been proposed for comment. So we hope this will occur sometime later this summer.

Ms. WATERS. Additionally, how did JPMorgan Chase's compensation structure figure in this trading loss? Were traders incented to take inappropriate risk? Dodd-Frank Section 956 empowers the regulators to review compensation structures that encourage inappropriate risk-taking at financial institutions. This rule is currently a year overdue. When can we expect the SEC and other regulators to act on it?

Ms. SCHAPIRO. That is a joint rule among seven different agencies. And you are right. It has two general prohibitions: one is against excessive compensation; and the other is against compensation arrangements that incent employees to take risks that could

present material financial loss to the company. And, for companies over $50 billion in total consolidated assets, there is a proposed requirement for a deferral for 3 years of 50 percent of an executive officer's compensation and a requirement for the board's direct engagement in approving the compensation, policies, and plans with respect to risk-takers within the firm.

I would say we are working very closely together to try to finalize the rule among the seven agencies. We have received a lot of comment letters. I don't have for you a specific date when it will be done.

But I will also say that since I arrived, the SEC has put into place a set of rules that require disclosure about compensation plans that can expose a company to material adverse financial consequences by employees who are taking outsized risk, and that disclosure is already happening.

Ms. WATERS. So I guess I need to ask everyone, how long do we have to wait for the rule on this?

Mr. CURRY. I would hope, from the OCC's perspective, that we could accomplish a final rule as quickly as possible, Congresswoman.

Mr. GRUENBERG. Congresswoman, we strongly agree this rule should have a high priority, and we should try to move on it as quickly as we can.

Mr. ALVAREZ. We, too, are working on it, but the Federal Reserve also put in place guidance that was very much along the lines of this rule before the Dodd-Frank Act was passed, so we are working hard with the other agencies to turn it into a rule for all.

Ms. WATERS. Thank you very much, Mr. Chairman. I yield back.

Chairman BACHUS. Thank you.

Mr. Royce for 5 minutes.

Mr. ROYCE. Thank you.

Mr. Curry, as you know, my view in terms of the meltdown is that a big part of it was caused by the overleveraging of the GSEs, Fannie Mae and Freddie Mac, that was 100 to 1. When the housing market turned, that destroyed the GSEs. The investment banks being allowed to leverage at 30 to 1, they were doomed once the market turned. AIG was 170 to 1.

I think that this incident of the JPMorgan Chase trading losses really brings front and center this issue again that capital is king. Capital is the ultimate buffer to protect against those unforeseen losses. It protects against the flawed risk models that the bank might have. It also protects against the mistakes the regulatory community might make. It protects against the asset bubbles that might have been caused by the regulatory community setting—the Fed setting the interest rate too low for too long and helping to cause that bubble.

But the bottom line is, if you have the ratios right, you can survive the storm. And now that, in the view of a number of economists, we have institutionalized this too-big-to-fail problem with Dodd-Frank, the reality is that the only thing standing between the taxpayer and the failure of these institutions and the massive amounts of additional capital that would be required is the enforcement on these capital ratios.

And that is what I wanted to go to, because investors are losing confidence in major banks' risk-weighted asset models, if we believe the financial press on this. There is a recent study of 130 institutional investors that found that 63 percent have less faith in bank models than they did 1 year ago; 83 percent want to get rid of what they call "model discretion." That is what I want to go to here.

Because, as we move forward, the Basel Committee, prior to Basel III, made this observation that capital levels in American banks employing their own internal ratings approach would experience a capital reduction of 7 to 27 percent, while those adhering to the standardized approach would actually experience a 2 percent increase in capital demands.

So my question to you is, what is the benefit of continuing to rely on this internal approach as opposed to the standardized approach?

Mr. CURRY. To answer your question, Congressman, I agree with you wholeheartedly that the importance of capital—it is the cushion that protects against errors of risk management, which is the primary bulwark against loss, or of risk of insolvency with an institution.

In terms of—you have cited two issues: one issue with respect to the risk-weighting of assets; and one with respect to the use of models in setting capital levels.

The issue of models and their use in capital is a key component of the capital regulations, and it is also a focus of the OCC in terms of its review and approval of banks' internal models for capital purposes. We have formal guidance that we issued a year ago emphasizing the importance of making sure the models are appropriately designed, monitored, and updated; and that is essential if we are going to continue to rely on models as a key component of the capital ratios.

Mr. ROYCE. Here is my point: If institutional investors are demanding a move away from model discretion, and especially when you consider that the banks likely to use this less standardized model are the biggest banks, thus compounding their advantage out in the marketplace, it seems to me that during the crisis, we have seen where these models have failed, and it seems to me that it is pretty clear going forward that you have the discretion now to solve that problem, and while we are talking about the benefits of capital, the conversation shouldn't end there.

I would hope that this incident at JPMorgan reinforces the notion that internal risk models often fail, and that when it comes to mandating capital levels, we would be well-served to focus our efforts on a simpler metric like minimum leverage ratios. Think about that going forward, if you would, minimum leverage ratios as an answer to this problem.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mrs. Maloney?

Mrs. MALONEY. Thank you very much, Mr. Chairman.

Some financial institutions have told me that they have terminated their proprietary trading desks. I would like to ask Mr. Curry, to what extent have financial institutions already begun to spin-off their proprietary trading desks in advance of the Volcker

Rule becoming effective? How many have taken those steps and terminated it? And can you list those financial institutions?

Mr. CURRY. Thank you, Congresswoman.

I believe that is the practice among many banks, but the actual activities of engaging in the prohibited proprietary trading and private equity investments or investments in hedge funds are also done at the holding company, which we don't supervise at the OCC. So I believe that is the trend within the industry, to move away in advance of the effective date of the Volcker Rule.

Mrs. MALONEY. Is there added benefit to doing this because they are legally required to? What role is the OCC playing in this process?

Mr. CURRY. We are not directing institutions to take specific actions with respect to those activities. The Federal Reserve, I believe, has issued some guidance that we signed onto in terms of the conformance period in which they should take appropriate steps to conform with the Volcker Rule.

Mrs. MALONEY. Can you list those financial institutions that have terminated these activities?

Mr. CURRY. I would have to get back to you, Congresswoman.

Mrs. MALONEY. Okay, thank you.

I would like to ask the regulators about a disturbing pattern in the last few years of London literally becoming the center of financial trading disasters: AIG was bailed out, their financial products division, to the tune of $184 billion; the trade losses in Lehman are historical; the losses in UBS trading. It seems to be that every big trading disaster happens in London, and I would like to know why? Why is it happening in London and not the United States?

Mr. Gensler, and then Mr. Curry and Mr. Alvarez, if you could give us some insights. It is a pattern that is happening.

Mr. GENSLER. I think that, with all respect, because I worked in New York, in your great City, they do have some time zone advantages, that they are between Asia and the United States, that we can't repeal the globe.

But I also think that large financial institutions—and I used to do a little of this as a business matter—set up legal entities wherever they can. They set up hundreds if not thousands of legal entities to find the lower regulatory regimes or tax regimes to set up. And it is a disturbing pattern, but it is a very real pattern.

Mrs. MALONEY. So is there a lower regulatory regime? Is there a lower tax structure? I have asked others, and they have said there is not. So I would like to know, is there a lower standard for non-U.S. trading activities?

Mr. GENSLER. I would say, just in terms of the derivatives regime, that Europe has done an excellent job and just passed legislation similar to Dodd-Frank. But it is not up and running yet, and it does not yet have the pieces of transparency, public market transparency, that this Congress adopted. So there is still quite a debate.

And I think if we were to leave the London branches of the U.S. banks or even the guaranteed affiliates out, it would be, so to speak, another loophole and a retreat from reform, where risk would come crashing back to our taxpayers and our Federal Reserve.

This was a bank that has Federal Reserve discount window access and the FDIC insures its deposits. Why would we leave the branches out? I just don't understand why we would do that.

Mrs. MALONEY. Mr. Curry, how will Dodd-Frank allocate examiner resources? I read or heard in the last hearing with the Senate there were only five examiners from the OCC in London but hundreds in JPMorgan and other facilities. Basically, will this impact what happened and what is happening with other challenges? Will this impact how you allocate your examiner resources? And your comments on why London?

Mr. CURRY. In terms of our London presence of the OCC, we will use our experience here and our review of JPMorgan Chase to reevaluate the numbers and strength of the personnel in our London office. Our focus is really the London office is a branch of the bank, so that is our jurisdictional hook for the activity over there.

We do have 65 individuals in the headquarters of JPMorgan Chase to supervise that entity. We also bring to bear in our targeted examinations and overall supervision of the bank the entire strength of the OCC in terms of expertise and numbers of examiners, which is close to 2,500 individuals. Those are brought in as needed into any particular area. So the number five may be misleading as to our ability to leverage our activities.

We would also look to coordinate with the market regulators in terms of any issues that would affect both the branch and their jurisdiction.

Chairman BACHUS. Thank you, Comptroller.

Mrs. Capito for 5 minutes.

Mrs. CAPITO. Thank you, Mr. Chairman.

I would like to talk a little bit about the issue of transparency. We have just heard Comptroller Curry say that there are over 65 Federal examiners at JPMorgan. The Federal Reserve has examiners. Mr. Gruenberg has some folks there as well. With all these people there, I am wondering, how was this missed?

In the April 13, 2012, analyst call, the chief financial officer at JPMorgan said, "We are very comfortable with our positions. They are healthy. I would add all these positions are fully transparent to the regulators. They review them, have access to them at any point in time, can get information on these positions on a regular and recurring basis." Is that a true statement?

Mr. CURRY. We are in the process of reviewing what exactly happened. That is one of the prongs of our review, how that position within the Chief Investment Office developed and whether or not there were appropriate controls in place. Our understanding is that neither the management or the bank was fully aware of the scope of that investment and that we were initially relying upon the information that was available to the bank.

Mrs. CAPITO. Right. You are relying on the information available to the bank.

Mr. CURRY. Which is a critical component of risk management and the supervision of these institutions. There needs to be a strong architecture that has controls in place and vigorous and granular reporting, and that is really an area that we are looking into, is whether the reporting structure that was present in the

CIO office met the standards that we expect and that JPMorgan would have in other aspects or areas of its business.

Mrs. CAPITO. We would know that—the CIO, the office there, obviously has additional offices all throughout the country and the world who have additional offices all throughout the country and the world; and is the expectation that all the information is going to bleed up to—I suppose that is the system, but I think we see that is not exactly what was happening here.

Mr. CURRY. By way of background, the CIO office is centrally located within the New York headquarters of the bank.

Mrs. CAPITO. Right.

Mr. CURRY. There were trading activities that were conducted in other locations—a handful of locations, including London. But in terms of the management controls, recordkeeping, key personnel; they were predominantly within the New York office, and that is where our focus has been.

Mrs. CAPITO. Let me talk about communications between the five examiners in cases of these very large, and I am going to call them too-big-to-fail institutions. What kind of controls do you have for your communications? Do you regularly use the FSOC for communication? What are your protocols that you have put in place, since we know that was one of the major failures in 2008?

I will ask Mr. Alvarez if he has a comment on that.

Mr. ALVAREZ. Sure. We have set up a variety of ways of communicating with the other agencies. The FSOC is certainly one of the mechanisms.

But for large institutions, we have supervisory colleges that include all the relevant supervisors. We meet regularly to talk about issues of concern. The examiners in the field also talk with each other. We talk with the OCC examiners at the national bank, we talk with the FDIC, with the SEC when there is a broker-dealer involved in the organization. So, we have actually quite a matrix of communication.

Mrs. CAPITO. You have described a matrix of communication, but then I think it has come to light that, even with the matrix of communication, nobody was catching it. Nobody was seeing it. We know the hedge funders saw it eventually, because that is—at least the periphery that I read—that is the indicator. But, is the communication really working and are you communicating—is the information not as robust and as granular as it needs to be?

Mr. ALVAREZ. So to keep this a little bit in context, there were significant changes in the portfolio, the CIO portfolio, in the first quarter of 2012, and those changes were very significant contributors to this loss.

As the company itself has mentioned, the reports that the company generated, the kind of review and risk management it had in place had serious flaws to it. We had access to that information, but to the extent it was flawed and its own management didn't have a good handle on the information and understanding the risk, that would make it more difficult for us as well. So we have to rely on information that we get from the organization itself. If that is flawed, it is going to be a problem for us.

Mrs. CAPITO. So that is Mr. Gensler's three daughters with the keys to the car. Thank you.

Chairman BACHUS. Thank you.

Let me say this: Regular order will return when the second panel comes on. But in fairness to the Members who have been here the whole time, at least on the Republican side—I have no control over the Minority—we are going to continue down the row. We are not going to come back up, in fairness to all our members. So we will continue down the row.

Ms. Velazquez, I want to acknowledge the loss of your mother.

Ms. VELAZQUEZ. Thank you.

Chairman BACHUS. The members of the committee express our sympathy, and I recognize you for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman Schapiro, it has come to light that JPMorgan Chase changed its value-to-risk model a number of times over the past 6 months which led to its investments appearing less risky than they really were. Are there penalties for failing to disclose these changes to investors and the SEC?

Ms. SCHAPIRO. Thank you.

I think Mr. Dimon actually testified in the Senate that they change their Value at Risk models all the time. The area we are focused on and concerned about is a change with respect to the VaR model they used for their earnings release on April 13th that had the effect, yes, of understating the Value at Risk.

Our rules do require that changes to the Value at Risk model, the assumptions and parameters, have to be disclosed. So part of what we are investigating is the extent of that disclosure, whether it was adequate, among other things.

Ms. VELAZQUEZ. And if you conclude that basically the rules were broken—

Ms. SCHAPIRO. There could be, yes.

Ms. VELAZQUEZ. Okay. So let me ask you, these penalties apparently were not enough to prevent JPMorgan from such activities. So I just would like for you to explain to us how should these penalties be structured to deter such behavior going forward, if that was the case?

Ms. SCHAPIRO. I think first, we really need to finish the investigation and see the full scope of conduct, if any, that potentially violates the Federal securities laws; and then the Commission would make a determination about what the appropriate sanction is to deter such conduct in the future and to remediate the violations.

It is hard to say what that number would be as a penalty, whether there would be potentially a requirement that they bring in a special consultant to help them rework their financial reporting controls and whether there could be other sanctions. We have a pretty wide panoply of sanctions that are available to us, but until we have completed an investigation and understand whether we have simply a VaR model change that is not disclosed or we have risk-management issues or other disclosure shortcomings or failures, it is hard for me to guess where we might land.

Ms. VELAZQUEZ. Okay, thank you.

Chairman Gruenberg, proprietary trading was just one among many factors that contributed to the financial crisis in 2008, and opponents of the proposed Volcker Rule have argued that it will do

more harm than good. In light of JPMorgan's loss, if the proposed rule were delayed or otherwise scaled back, will other measures in Dodd-Frank such as increased capital requirements and new controls on derivatives be sufficient in themselves to mitigate the risks posed by proprietary trading?

Mr. GRUENBERG. In the first instance, Congresswoman, that is not a choice for us to make. The law is the law, and we have an obligation to implement it, both in regard to the capital requirements and in regard to the Volcker Rule. We certainly agree that capital requirements are very important, but the provisions of the Volcker Rule are also the law of the land, and we have an obligation to implement those as well.

Ms. VELAZQUEZ. So you believe that increased capital requirements and new controls on derivatives will be sufficient?

Mr. GRUENBERG. I think the provisions of the Volcker Rule, particularly requiring the reporting, the recordkeeping, the governance provisions relating to proprietary trading are really quite important in order to focus the attention of both management and the regulators on this activity; and I think that would be actually a valuable complement to the capital and other prudential requirements of Dodd-Frank.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Neugebauer for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Curry, the Bloomberg article came out on April 6th. When did you have knowledge that there was a problem with this portfolio?

Mr. CURRY. The size and complexity of the portfolio at JPMorgan Chase became clearer to us at that point in time. After that, we began to ramp up our discussions with bank management and our presence—

Mr. NEUGEBAUER. What day would that have been?

Mr. CURRY. I believe it was around the 9th, when I assumed office.

Mr. NEUGEBAUER. So April 9th you were having pretty extensive conversations with management about this position?

Mr. CURRY. That is when we became aware of the potential significance of the situation.

Mr. NEUGEBAUER. Ms. Schapiro, do you have any recollection of when your agency began to have some concern about this issue?

Ms. SCHAPIRO. It would have been around that same time when the articles began to appear.

But, again, because this was not in the broker-dealer, we wouldn't have had people focused particularly on that.

Mr. NEUGEBAUER. Mr. Gensler?

Mr. GENSLER. Again, when the articles about the London Whale started to run, as we are just midstream standing up our reforms for credit derivatives. But we do oversee and see daily the risk in the clearinghouse. ICE Clear Credit and ICE Clear Europe have some of these indices in there. Even this IG-9 one is in there.

Mr. NEUGEBAUER. Mr. Gruenberg?

Mr. GRUENBERG. In that same time period.

Mr. NEUGEBAUER. And Mr. Alvarez?

Mr. ALVAREZ. We were informed by the firm at the same time as they informed the OCC.

Mr. NEUGEBAUER. So, I want to fast-forward then to April 13th when Mr. Dimon said that, "This has been blown way out of proportion. This is a tempest in a teapot." Did you find that comment a little interesting, the fact that you were—I guess all of these regulators were activating some action that was stimulated—did you think that was an interesting—

Mr. CURRY. At that point in time, we were still trying to determine the underlying strategy and its ramifications to the bank's financial position.

Mr. NEUGEBAUER. But would you have called that a tempest in a teapot?

Mr. CURRY. I would not have had information at the time to make a conclusion one way or the other.

Mr. NEUGEBAUER. Ms. Schapiro, do you have a comment on that?

Ms. SCHAPIRO. It is part of the context, I think, for the review. If you look at the fact that the VaR number really didn't change for the earnings release—and, by the way, VaR is not required to be disclosed in the earnings release, but if you choose to speak to it you must speak truthfully and completely. The fact that the VaR number didn't change much at all from year end to the earnings release is part of the context of whether it truly was a tempest in a teapot or there was more there.

When the Q-1 statements came out on May 10th, we saw that VaR doubled because they reverted back to the old VaR model. Again, it is part of the context of how you view those statements.

Mr. NEUGEBAUER. I think particularly in your area of oversight, the statements CEOs make are relevant. Is that—

Ms. SCHAPIRO. They are always part of what we look at when we are looking at issues exactly like this, yes.

Mr. NEUGEBAUER. And so when—I can understand, if you are a CEO of a company and you have some bad news out there, you are trying to tamp that down. But there is also a fiduciary responsibility, I guess—if we are going to talk about disclosure and transparency—for whatever information and statements are coming out of that organization to be accurate or a fair reflection. Would you agree with that?

Ms. SCHAPIRO. That is right. If you choose to speak, you absolutely must speak truthfully and completely and not allow yourself to leave any kind of misleading impression from the information that you are putting out.

Mr. NEUGEBAUER. And is there a certain amount of duty, whoever the spokesman is, whether it is Mr. Dimon or the CFO, whoever is making the speech, to make sure that the team thinks this is an accurate statement?

Ms. SCHAPIRO. I don't know about their internal processes for preparing—

Mr. NEUGEBAUER. I am not asking about that. But if you are going to make a statement, say on behalf of the SEC, don't you ask your people, is this a fair representation?

Ms. SCHAPIRO. Yes, I do.

Mr. NEUGEBAUER. So there is a certain amount of duty to do that?

Ms. SCHAPIRO. Again, the duty under the Federal securities laws is to speak completely and truthfully. How people arrive at what they decide is a truthful and complete statement is a matter of their internal deliberations and discussions, I think.

Chairman BACHUS. Thank you.

Mr. Capuano for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Chairman, first, I would like to just point out that anybody who is interested in breaking up some of these large institutions should sign on to H.R. 1489, which would reinstitute the Glass-Steagall Act, which I voted against repealing in the first place. It was repealed by a bill called the Gramm-Leach-Bliley Act, and I recall there were three Republicans who sponsored that Act to repeal Glass-Steagall that allowed the beasts of Wall Street to come into existence. So anybody who has another idea on how to limit the size, I totally agree with that concern.

To the panel, I would just like to say the comments on transparency are appropriate, but in preparing for this hearing, this is very complicated stuff, very difficult stuff, and I try to read as much as I can. The problem is on this particular hearing, all I could get was news reports, and the only news reports I could get were all based on assumptions and educated guesses. Even the Congressional Research Service, which is very good on these things, had to piece it together. There is just not enough transparency from your agencies to allow outside people to make a comment on what might have happened.

I would encourage you to, if you can't come to conclusions—I am not suggesting you should do that rapidly—but at least whatever facts you unveil to yourself, make them public as soon as you can so that the greater public can engage in a discussion which will enlighten our thought as to what might happen.

I have so many questions in 5 minutes. I guess, Mr. Curry, I will start with you.

This is only a $2 billion item. Is there anything that you have learned thus far that would have limited it just to $2 billion? Could it not have been a $20 billion loss?

Mr. CURRY. Part of our review process now is to look at the unwinding of their position and our review process, along with the other Federal bank agencies—

Mr. CAPUANO. But could it have been $20 billion? Not necessarily this one, but is there anything that would have prevented it?

Mr. CURRY. No. That is the concern from a supervisory standpoint, is that this is the result of an apparent lapse in vigorous risk management.

Mr. CAPUANO. So it could have been $20 billion?

Mr. CURRY. And that is really the regulatory concern—

Mr. CAPUANO. And it could have been $200 billion.

Mr. CURRY. In another institution and under other circumstances, possibly.

Mr. CAPUANO. Is there anything in any of the regulations, anything you found thus far, that would limit this loss only to JPMorgan?

Mr. CURRY. We have surveyed the other large banks that we supervise, and we do not believe that any of those banks—

Mr. CAPUANO. But they could have?

Mr. CURRY. They do not—we believe they do not engage in similar—

Mr. CAPUANO. But they could have—

Mr. CURRY. That is really why—

Mr. CAPUANO. I don't know why you are being so resistant. I am not after you. You would know it if I were.

Mr. CURRY. We view that as being a very serious issue, and that is why it is the focus of our—

Mr. CAPUANO. So it could have been a $20 billion item, it could have been a $200 billion item, it could have been every other major large bank, and it could have been other counterparties, which is my concern.

I guess what I would like to find out—I read your testimony, and you did say that thus far you have found no one else engaging in this activity. But, again, for me, the biggest question here is not necessarily what happened in this instance, other than the way it might enlighten us or educate us as to what could happen.

And I guess what I am asking is to be sure that when everything is said and done, it is not just focused—and this is not just for you, Mr. Curry, I intend to ask the rest of the panel—on one instance, one event, that lost $2 billion for a bank that apparently could handle it. It is whether it could have shaken the system again.

Are you confident yet that what you have found, what your reaction might be, would be to tell us that the system is now sound?

Mr. CURRY. We do not believe that the system is at risk from this situation, and that is why, again, we are focusing on making sure that all of the institutions we supervise have rigorous—

Mr. CAPUANO. Thank you.

Ms. Schapiro, do you feel the same way? Is the system sound, based on what you have found thus far?

Ms. SCHAPIRO. I think the system is sounder than it was, but I think we really have to get the Title VII regulatory regime in place that will give us access to the kind of information we need and the public needs to impart some greater—

Mr. CAPUANO. Thank you.

Mr. Gensler?

Mr. GENSLER. I think the American public still isn't safe on these roads until we get the transparency and get the rules of the road in place, and that is why I made the analogy to my daughters and the keys to the car. I think the American public were bystanders to some taking on excess of risk in 2008, and we still haven't—

Mr. CAPUANO. But based on what you found in this instance, I understand, but in this instance, is there any indication that what happened here might expose—not necessarily by JPMorgan but by anybody else—a risk to the system?

Mr. GENSLER. I think it still exposes risks broadly in our regulatory system that we are not covering London and also in credit derivative products, that we have not yet finished the tasking.

Mr. CAPUANO. I actually want to jump to London, because I think your testimony was very important. On page 9, if I recall, I want to read back to you what you said, which I think is very good, because I want to follow up Mrs. Maloney. The whole London thing

has been bothering me. With Mr. Neugebauer, we have been chasing a lot of the MF Global stuff. It seems all about London, AIG—

Chairman BACHUS. Your time has expired, but you go ahead and read his statement.

Mr. CAPUANO. The statement was very simply that Section 722(d) of the Dodd-Frank says that if it has a direct and significant connection with activities in or an effect on the commerce of the United States that you do have oversight.

Would you agree that statement allows you to regulate some of the things that go on overseas?

Chairman BACHUS. Thank you.

Mr. Luetkemeyer for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

It is an interesting debate we are having here, the discussion this morning, from the standpoint that over the last 4 or 5 years, the American public has finally found out what actually goes on in banking and financial service institutions. They manage risk, and that is how the whole system works. A lot of folks just didn't know what went on behind the doors and in boardrooms and offices of banks and financial institutions, but now they do. Every day, they manage risk. They take risks. Sometimes, they win. Sometimes, they lose.

So today, we are discussing an entity that took a risk and lost, and I think that the things we are working on, and you, ladies and gentlemen of the panel here, have to find a way to walk that fine line to keep from taking all the risk away—the ability to take risk from these institutions—otherwise, perhaps they won't do any investing and, therefore, the whole system collapses and stops—or find a way to pass that risk on to other entities, in other words, the taxpayers, which is what the too-big-to-fail doctrine does, which is not the way to go either.

So it is interesting, the fine line you are trying to walk. I appreciate that, and I thank you for your service and for trying to do that.

Mr. Curry, to follow up on the gentleman from California's remarks earlier with regards to capital, you made some comments in your testimony here that the Tier I common capital of the larger banks has gone from 5.2 percent to 7 percent now; and in some rough figures that I got from, I think, your testimony or Mr. Alvarez here, it looks like Tier I capital for—in fact, it was your testimony—Tier I capital for JPMorgan is 5.7 percent. Is that probably accurate?

Mr. CURRY. Yes.

Mr. LUETKEMEYER. So, therefore, they are below average. Is that what you are saying?

Mr. CURRY. No. No, I am sorry. They meet existing minimum capital requirements for banks.

Mr. LUETKEMEYER. You said the Tier I capital average now is 7 percent for the same size, and they are only at—

Mr. CURRY. I think my testimony refers to bank level of capital and bank holding company capital, and that may be part of the confusion.

Mr. LEUTKEMEYER. Okay. All right.

Are they well-capitalized, in your judgment?

Mr. CURRY. Yes, they are.

Mr. LEUTKEMEYER. Okay. What was their capital account prior to—well, back in 2008?

Mr. CURRY. I can't recall offhand, but it has increased since then. That has been the overall objective of our heightened supervision program, is to increase the level of capital and put it in reserves.

Mr. LEUTKEMEYER. Okay. So by increasing their capital, they have made more money. Could they have done that by taking extraordinary risks or could they do that through the normal management practices of running their operation, in your judgment?

Mr. CURRY. No. We expect banks to be in the business of taking manageable risks and having effective internal controls over those material risks within their organization, and then ultimately we look to capital as being the cushion for those risks that occur.

Mr. LEUTKEMEYER. Okay. Mr. Gruenberg, right now, the investment banking portion of JPMorgan is underneath their main bank which would be covered by FDIC insurance, is that correct? Are they an FDIC-insured bank? First question.

Mr. GRUENBERG. JPMorgan is an FDIC-insured bank.

Mr. LEUTKEMEYER. Is their investment bank under their main bank umbrella so they would be part of—

Mr. GRUENBERG. They are a separate affiliate.

Mr. LUETKEMEYER. They are a separate affiliate. Their investment bank is separate, so therefore there are no FDIC insurance dollars at risk with this particular activity that took place?

Mr. GRUENBERG. I believe the activity in this case, Congressman, was in a branch of the bank itself, not in the affiliated investment company.

Mr. LEUTKEMEYER. A lot of banks have a lot of branches, and some of those branches are covered, and some of them aren't, based on their activities. And my question is, were the activities that were taking place in this situation part of the umbrella that was underneath the main bank and therefore deposit insurance exposed?

Mr. GRUENBERG. Yes.

Mr. LEUTKEMEYER. They were.

Mr. GRUENBERG. Yes, sir.

Mr. LEUTKEMEYER. So, in other words, the deposit insurance, if this had gone bad and caused a major problem with the bank, deposit insurance would have to kick in and take care of this?

Mr. GRUENBERG. If this activity did occur in the bank, yes.

Mr. LEUTKEMEYER. What is your opinion of that?

Mr. GRUENBERG. That is the issue, frankly, that is raised here.

Mr. LUETKEMEYER. Is that a grave concern to you?

Mr. GRUENBERG. I think it is a serious question that is raised. It is why this inquiry is going forward. I think we need to understand—

Mr. LUETKEMEYER. We have a situation with the banking structure that we have right now that is to me a real problem from the standpoint that you have these big entities that have this enormous exposure. Do you feel that they are paying their fair share based on the risks that they are taking and the exposure to the fund, compared to the rest of the banks which don't do this?

Mr. GRUENBERG. In terms of deposit insurance premiums? Is that the issue?

Mr. LUETKEMEYER. Right.

Mr. GRUENBERG. For these large institutions, we do have a risk-based deposit insurance system specifically targeted for the large institutions. It is true that the kind of trading activity that occurred here is taken into consideration in setting the deposit insurance premiums for these large institutions.

Mr. LUETKEMEYER. Okay, I see my time has expired. Thank you.

Chairman BACHUS. Thank you.

Mr. Lynch is recognized for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

Also, I want to thank the witnesses for attending and helping the committee with its work.

If not for the exposure to the taxpayer, we probably wouldn't be here, but I do want to note that, starting back in the fall of 2008, JPMorgan and a bunch of other Wall Street banks received about $700 billion from the American taxpayer. JPMorgan Chase itself received $25 billion in those TARP loans. All told, the amount of emergency Federal Reserve lending support to JPMorgan exceeded $456 billion, and I note that a November of 2011 Bloomberg article estimates that the bank made nearly $458 million in profit from those emergency loans from the Fed.

In addition, JPMorgan Chase has access to the Fed discount window and its depository base, some of which funded these proprietary trades, which are FDIC- and taxpayer-insured.

So there is a lot of exposure here for the taxpayer, and that is why it defies logic that we would allow an institution with that type of support from the taxpayer to act in this way.

Mr. Gensler, I enjoyed your opening remarks. I thought your testimony was great. I have two girls myself, so I have empathy for you in giving your car keys out.

But I do note that in Mr. Dimon's testimony earlier in the previous hearings on the Senate side, he basically confirmed those reports that these trades, while they were managed I guess in the New York office, they were actually executed in JPMorgan's London office, and I guess you are saying some of these were executed in the Cayman Islands as well, is that correct?

Mr. GENSLER. I don't know about the Cayman Islands, except I know in other circumstances Bear Stearns was in the Cayman Islands, and Long-Term Capital Management was in the Cayman Islands. So there were other circumstances.

But the JPMorgan Chase Chief Investment Office trades, as I understand, executed or entered into out of London was in the branch. And to Representative Luetkemeyer's question, the deposit insurance fund, as we heard from Mr. Gruenberg, was at risk.

Mr. LYNCH. We also heard prior testimony that—and, actually, this was in discussions of legislation that would limit margin and clearing requirements for overseas derivatives trading—that a substantial percentage of JPMorgan Chase's derivatives business has moved to London or is in the process of moving to London. Is that correct?

Mr. GRUENBERG. They are a very significant operation out of London, and they operate as a branch in many countries, and they

have advocated to this Commission that it not be covered by Dodd-Frank reforms. I have a different view, and I hope that the Commission will vote to get public comment this Thursday, that we don't, in essence, create another London loophole.

Mr. LYNCH. Right. That is what I want to ask you about. How does your oversight toolbox differ when trades are executed through London, in this instance, as opposed to in the United States? What are those London loopholes that you have described?

Mr. GENSLER. Congress has given us some discretion to interpret a provision of the Act, Section 722(d), as to where is the reach of the Act. And if it has a direct and significant effect on the commerce or activities here in the United States, then it is covered. So that is the debate that is going on, is an interpretation of a very critical part of Dodd-Frank. I believe that, to answer the question, these would be under part of the direct and significant effect on U.S. commerce or activities.

Mr. LYNCH. One last question, I have about a minute left. On May 18, 2012, Morgan Stanley issued a research note estimating the JPMorgan Chase losses could reach as high as $5.2 billion, and the report also contains some analysis of how such trading losses might have occurred. This is assuming that they were right and there is a limited amount of information on this, but this is assuming that was a CDX IG 9 that you mentioned before, which is a more standardized derivative that is approved for clearing both in the United States and Europe.

There are estimates that the losses could reach as high as $5.2 billion. Do you think that is somewhat accurate or not?

Mr. CURRY. We are still reviewing with our examinations with the bank the scope of the potential losses, but our focus is to monitor the de-risking of their precision.

Chairman BACHUS. Thank you. Mr. Lynch?

Mr. LYNCH. I am just trying to get an estimate here whether $5.2 billion is accurate or not accurate. A simple yes or no?

Chairman BACHUS. Mr. Lynch, let me say this, no one knows.

Mr. LYNCH. That is why we have the witnesses, so they can testify, not so you can answer for them.

Chairman BACHUS. But your time is up.

Mr. Curry? If you know how much the loss will be?

Mr. CURRY. That is a matter we are still reviewing in our examination activity.

Chairman BACHUS. Thank you. Mr. Pearce?

Mr. PEARCE. Thank you, Mr. Chairman. Mr. Alvarez, if we are going to look at derivatives trading and especially overseas derivatives trading, and we are going to prioritize the risk that these major firms face, would that particular activity be in the middle or at the top? Is that a scary, risky thing or is it kind of not very risky? What priority should we be looking at when we consider derivatives trades?

Mr. ALVAREZ. I am not sure what priority Congress wants to—

Mr. PEARCE. No, I am saying, you are in charge of risk, that is what you say.

Mr. ALVAREZ. I think from the other perspective, we are taking two high-priority approaches. One is, we think it is important for firms to have good risk management around—

Mr. PEARCE. My question is not that. My question is, derivative trading itself, is it very high risk?

Mr. ALVAREZ. It can be if—

Mr. PEARCE. It can be a very high-risk item, that is all I am trying to establish.

Chairman BACHUS. Allow the witness to answer the question. You are sort of stepping on his answer.

Mr. PEARCE. Mr. Chairman, I have 5 minutes, if he is going to skew off to the side.

Chairman BACHUS. He is trying to answer your question.

Mr. PEARCE. My question wasn't what they are doing and what they are doing with risk relation, it was the priority-based, it is the difficulty of regulating derivatives, that was my question. What I am going to go to next is you guys are the supervisors in charge, that is, the consolidated supervisor in charge of all of the people who are regulating the activities. And so I see, Mr. Curry said that he has people, 65 people on location, these are not just regular people, these are people with 20 more years of experience, skills in key risk areas, teams of Ph.D. economists from the OCC.

He then identifies in the next paragraph that the examination teams have three objectives, one of which is the key risks. Derivatives would be a key risk; they are very problematic. So my question is, with the 65 regulators onsite, would you know the name of the one who monitors the trading of derivatives? You are the guy in charge, you, the Federal Reserve, you say so in your testimony.

Mr. ALVAREZ. No, we are not the ones in charge of the OCC, we are the consolidated supervisor—we supervise the unregulated portions of the holding company and its consolidated activities. But the specific activities in the national bank, those 65 examiners you are talking about, I am afraid—

Mr. PEARCE. Mr. Curry, would you have a name of whomever is in charge of the derivatives?

Mr. CURRY. We operate supervision policy where we have a resident examiner in charge of the institution. That individual allocates responsibility for individuals to examine into particular areas of the bank. That can change over time, it can also be the result of someone being brought in—

Mr. PEARCE. Do you have a name of who was in charge during that time in early April?

Mr. CURRY. Not at the moment of looking at the derivatives portfolio.

Mr. PEARCE. Mr. Chairman, my point is that we have 65 gee-whiz people, these are top-notch people according to your testimony. We have this stuff going on, they are onsite in order to pay attention, and yet I hear from Mr. Alvarez that we are concerned with the changes and the portfolio during that period of time.

What are they doing? Are they sitting there watching? That is what they were doing, the SEC and the CFTC were sitting with MF Global while they were taking money out of customer accounts. They weren't watching, they weren't saying a word, they weren't raising an alarm. And here you all are saying you are starting an investigation, I thought that was the reason you had people on location in order to watch what is going on.

You have 65 people. You say in your testimony the key risks are what you are monitoring, and yet, Mr. Alvarez finds out, whew, you all didn't call him and tell him. He is alarmed with the changes. And I am just thinking, what are we doing here? Why do you have these people on location? Mr. Gruenberg, he at least admits that at least we are finally worried about—we are seeing recent losses that reveal certain risks. The entire Nation is aware of those risks. I am sitting here saying, what were we doing if you are supposed to be regulating? We are all supposed to be out there. You have on-site teams and now we are starting investigations, the investigation should be that you are talking to your people who are on location and finding out if they are doing their job, or they are sitting there with their feet on the desk drinking coffee.

From this side of the table, we ask you all to do this, and yet I come here and read all this testimony and it is all kind of angling toward the same thing: Nobody is really in charge, nobody is really supervising. We are finding out after the fact through press releases or whatever. This gets very frustrating from our point of view.

Mr. CURRY. I understand that, Congressman. That is part of our review process is to do a postmortem to see what went wrong in this particular case and how the OCC can better perform its duties as a supervisor.

Mr. PEARCE. Thank you, Mr. Chairman. I yield back.

Chairman BACHUS. I thank you. The Chair thanks the panel for their testimony. The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

And as a witness noted, this is an ongoing investigation and that was one reason that we delayed our hearing until more information could be gathered. I think, as Mr. Curry has said, some of the reporting was granular, and it was not appreciated within the firm, and it would be pretty difficult to determine some of these things. The panel is dismissed.

And the first panel, if you wish to go out this way, you are welcome to go out through the side door.

Mr. FRANK. Mr. Chairman, could we ask people who are not needed to move? We are going to lose somebody getting a chance to question. If people would get outside the door, they are blocking the door. We have to get Mr. Dimon. Would the people at the door, the Treasury Department officials, please move outside?

Chairman BACHUS. Would you let Mr. Andrews maybe find a place to sit?

The Chair wishes to remind all our guests that the manifestation of approval or disapproval, including the use of signs and placards, is a violation of the rules which govern this committee. The Chair wishes to thank our guests in advance for their cooperation in maintaining order and decorum.

Our second panel is made up of one witness, Mr. Jamie Dimon, the CEO of JPMorgan Chase. And Mr. Dimon, you are recognized for 5 minutes. Maybe if the cameras will take a picture and then sort of exit?

Mr. Dimon, you are recognized for 5 minutes, and we welcome you to the committee.

STATEMENT OF JAMIE DIMON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, JPMORGAN CHASE & CO.

Mr. DIMON. Thank you, Mr. Chairman. Chairman Bachus, Ranking Member Frank, and members of the committee, I am appearing today to discuss recent losses in a portfolio held by JPMorgan Chase's Chief Investment Office. These losses have generated considerable attention, and while we are still reviewing the facts, I will explain everything I can to the extent possible.

JPMorgan Chase's six lines of business provide a broad array of financial products and services to individuals, small and large businesses, governments, and not-for-profits. These include deposit accounts, loans, credit cards, mortgages, capital markets advice, mutual funds, and other investments.

Let me start by explaining what the Chief Investment Office does. Like many banks, we have more deposits than loans. At quarter end, we hold approximately $1.1 trillion in deposits and $700 billion in loans. CIO, along with our Treasury unit, invests excess cash in a portfolio that includes Treasuries, agencies, mortgage-backed securities, high-quality securities, corporate debt, and other domestic and overseas assets. It also serves as an important vehicle for managing assets and liabilities of the consolidated company.

In short, the bulk of CIO's responsibilities is to manage an approximately $350 billion portfolio in a conservative manner.

While their primary purpose is to invest excess liabilities and manage long-term interest rate and currency exposure, it also maintains a smaller synthetic credit portfolio whose original intent was to protect or hedge the company against a systemic event like the financial crisis or the current Eurozone situation.

So what happened? In December 2011, as part of a firmwide effort, and in anticipation of new Basel capital requirements, we instructed the CIO to reduce risk rate assets and associated risk.

To achieve this in the synthetic credit portfolio, the CIO could simply have reduced its existing positions. Instead, starting in mid-January, it embarked on a complex strategy that entailed adding positions that it believed would offset the existing ones. This strategy, however, ended up creating a portfolio that was larger, and ultimately resulted in even more complex and hard-to-manage risk. This portfolio morphed into something that rather than protect the firm, created new and potentially larger risks. As a result, we let a lot of people down, and we are sorry for it.

Now, let me turn to what went wrong. We believe a series of events led to the difficulties in the synthetic credit portfolio. These are detailed in my written testimony, but I will highlight the following: The CIO's strategy for reducing the synthetic credit portfolio was poorly conceived and poorly vetted. In hindsight, the traders did not have the requisite understanding of the risk they took.

The risk limits for the synthetic credit portfolio should have been specific to the portfolio and much more granular, i.e., only allowing lower limits on each specific risk being taken. The CIO, particularly the synthetic credit portfolio should have gotten more scrutiny

from both senior management and the firmwide risk control function.

In response to this incident, we have already taken a number of important actions to guard against a recurrence. We have appointed an entirely new leadership for the CIO. Importantly, our team has made real progress in aggressively analyzing, managing, and significantly reducing our risk going forward. Although this does not reduce the losses already incurred, and it does not preclude future losses, it does reduce the probability and magnitude of future losses.

We are also conducting an extensive review of this incident which our board of directors is independently overseeing. When we make mistakes, we take them seriously, and often we are our own toughest critic. In the normal course of business, we apply lessons learned to the entire firm. So while we can never say we won't make mistakes—in fact, we know we will make mistakes—we do believe this to be an isolated event. We will not make light of these losses but they should be put into perspective. We will lose some of our shareholders' money, and for that we feel terrible, but no client, customer or taxpayer money was affected by the incident.

Our fortress balance sheet remains intact. As of quarter end, we held $190 billion in equity and well over $30 billion in loan loss reserves. We maintain extremely strong capital ratios far in excess of regulatory capital standards. As of March 31st, our Basel I, Tier 1 common ratio was 10.4 percent, and our estimated Basel III Tier 1 common ratio was 8.2 percent, both among the highest in the banking sector. We expect both of these numbers to be higher by the end of year.

All of our lines of businesses remain profitable and continue to serve consumers and businesses. And while there are still 2 weeks left in our second quarter, we expect our quarter to be solidly profitable. In short, our strong capital position and diversified business model did what they were supposed to do, cushion us against unexpected loss in one area of our business.

While this incident is embarrassing, it should not and will not detract our employees from our main mission: to serve clients, consumers, and companies and their communities around the globe.

During 2011, JPMorgan raised capital and provided credit of over $1.8 trillion for consumer and commercial clients, up 18 percent from the prior year. We provided more than $17 billion of credit to U.S. small businesses, up 52 percent over the prior year. And over the past 3 years, in the face of significant economic headwinds, we made the decision not to retrench but to step up as we did with markets in turmoil when we were only bank willing to commit to lend billions to the States of California, New Jersey, and Illinois.

All of these activities come with risk. And just as we remain focused on serving our clients, we also remain focused on managing the risk of our businesses, particularly given today's considerable global economic and financial volatility.

Finally, I would like to say that in the face of these recent losses, we have come together as a firm, acknowledged our mistakes, and committed ourselves to fixing them. We will learn from this inci-

dent, and my conviction is we will emerge from this moment a stronger, smarter, better company.

I also would like to speak directly for a moment to our 260,000 employees, many of whom are watching this hearing today. I want all of you to know how proud I am of JPMorgan Chase, the company, and how proud I am of what you do every day for your clients and communities around the world. Thank you. I welcome any questions you may have.

[The prepared statement of Mr. Dimon can be found on page 110 of the appendix.]

Chairman BACHUS. Thank you, Mr. Dimon.

And let me say that the first panel unanimously said that JPMorgan had sufficient capital, and that there were no liquidity problems, and that depositors' money, clients' money was certainly not at risk.

Mr. LYNCH. Mr. Chairman, a point of order, are we going to ask the witness to take an oath, to speak under oath or has that process been waived here?

Chairman BACHUS. We have never done that. I see no reason at this hearing to do what we have not done in several years.

Mr. LYNCH. I object to that, sir.

Chairman BACHUS. I see no reason to place this witness under—this is not a criminal proceeding, or even a civil proceeding, and he has voluntarily come before us.

At this time, Mr. Manzullo, for 5 minutes.

Mr. MANZULLO. Thank you, Mr. Chairman, for calling this hearing.

Mr. Dimon, on the third to last paragraph of your written testimony, you have written "all these activities come with a risk. Just as we have remained focused on serving our clients, we have also remained focused on managing the risk of our business, particularly given today's considerable global economic and financial volatility."

I just returned from a conference in Copenhagen with members of the EU Parliament discussing the tremendous crisis going on with the Eurozone countries. The IMF has estimated that the average debt of the 17 Eurozone countries is about 80 percent of GDP. But in the United States, the debt of this country, which includes State, local, and Federal, is 107 percent of GDP. And my question to you is, what do you think is going to be the bigger story 2 years from now in terms of the health and strength of the financial industry, trading losses at JPMorgan or the Eurozone?

Mr. DIMON. The Eurozone—I am sorry I take up so many people's time on this loss, because it is rather insignificant in the global scheme of things, and things that you ought to worry about as legislators, and what we need to worry about in Europe. Europe is a significant event. I am far more worried about Europe than I am about this trading position. And I hope the legislators over there can overcome their complications and keep the Eurozone alive.

Mr. MANZULLO. Can you give us a reading, in your opinion, as to the impact, for example, on the U.S. economy, should the Greeks decide to get out of the Eurozone, go back to the drachma, or should the entire Eurozone itself collapse?

Mr. DIMON. Unfortunately, as a bank, we have to prepare for all eventualities, so we are not guessing what might happen. I want to make sure we come forward to our shareholders and communities and say, whatever happens we can survive and thrive going forward.

Greece defaulting alone is not the issue; it is Greece leaving the Euro and the fallout effect of that might be a bank run in Italy and Spain. We see that they are trying to put firewalls in place to stop that from happening. If I had to guess at the outcome, I think that might work. I think it is important they do that, and hold back a crisis, and then they have to go about having a real fiscal treaty among the 17 nations of the Euro. So short-term solutions may stop a crisis, but it won't stop—they have to really fix the underlying problems.

Mr. MANZULLO. Italy has an economy that is 2½ times that of Ireland, Portugal, and Greece combined. The Italian banks don't have a liquidity problem, they have a big problem with debt. Could you address the impact of debt on nations as it relates to the ability—it as relates to liquidity but more importantly, the overall economy?

Mr. DIMON. The banking—Italy, surprisingly, is actually a very wealthy nation and they have the wherewithal to meet their debt, but they are having a crisis of confidence, which is damaging that. The banks there own a lot of sovereign debt. Banking systems don't function very well if the sovereign system is not functioning; they actually go hand-in-hand. You need to fix both to make the whole financial system strong there.

Mr. MANZULLO. The reason I ask that is that, as you know, the EU is our largest trading partner, and your bank is obviously involved in international finance, and it is always important for members to be able to glean from people who are on the inside seeing that happen. Can you give—I am not looking for a forecast, but how do you see the Eurozone issue as being resolved?

Mr. DIMON. In Europe, what we see is that the politicians have the will, they want to fix it, they talk about no plan B, there is only one plan, which is the keep the Euro alive. I think there the way is very hard, because you have 17 nations, and 17 parliaments, so what our economists think, and a lot of smart people I listen to, is that there will be a firewall for Italy and Spain, that you will have growth and austerity plans for the southern nations, and that the 17 nations will come up with a fiscal treaty which has more carrots and sticks in it, and that is believable by the world, and will show long-term progress of getting down the debts of Europe.

Chairman BACHUS. Thank you. Mr. Frank for 5 minutes.

Mr. FRANK. Mr. Dimon, you said that you want there to be smart regulation, as opposed to more regulation. The Commodities Futures Trading Commission's budget was $200 million for the year, and it has been proposed to cut it. The President is supposed to raise it to $308 million, not a huge sum. Do you think at the level of $180 million, that you can get smart regulation out of the CFTC?

Mr. DIMON. I have never looked at the CFTC's budgets, I don't know what they need, and so it would be almost impossible for me to comment on it.

Mr. FRANK. I am disappointed. By the way, the Appropriations Committee just voted 27–19 not to give them the additional funds. I am surprised because it did seem to me you are well-informed about other aspects of what the Federal Government does or doesn't do. And to talk about smart regulation, but in effect to give them a pass on the substantial reduction in the CFTC, seems to be a mistake. But you answered that.

The next question is, the legislation that would remove any application—I understand there was a Volcker Rule debate, but as you know, over and above the Volcker Rule, there are requirements we have put on derivatives trading which you have spoken of somewhat favorably. But there is legislation that would have exempted the transactions in question and any other transactions conducted overseas, not in this country, from the rules of clearing where possible about transparency. Do you believe that we should enact that and exempt the kinds of activities talked about here even when conducted by an American institution from these regulations?

Mr. DIMON. These trades are not exempt from regulations.

Mr. FRANK. No, I am talking about the regulation—you know what I mean, I am talking about the specific rules enacted in the financial reform bill that are about to be adopted regarding derivatives, transparency, et cetera. There is a bill, as you know, that would exempt derivatives trades overseas, over and above the Volcker Rule, whether in a bank or not; there are two sets of rules here. Do you believe and are you supportive of the bill that would exempt these trades from the rules on derivatives that we hope to have in place?

Mr. DIMON. Yes.

Mr. FRANK. Why do you think that they are adequately regulated elsewhere? Why would you not want the American regulators to have an ability to—for instance, transparency, and clearly where possible, I thought you were approving of those, why would we want to exempt these kind of activities from these rules?

Mr. DIMON. These trades are visible and regulated by the OCC and the Fed. Sixty percent of these trades were, in fact, cleared; all of them were fully collateralized. So we are not against rules that caused those things.

Mr. FRANK. Mr. Dimon, excuse me, then they would have met the rule. But it does seem to me there were problems with this in terms of your knowing about when they happened, about your being uninformed about them, or underinformed. But you are in favor of exempting these kinds of trades from any American derivatives regulation?

Mr. DIMON. Not any, prudential they should have, transparency they should have.

Mr. FRANK. Regulation derivatives. Transparency is part of the thing you would be exempted from, there is no legal requirement for transparency other than that—once again, I am disappointed.

Let me ask you—we have a time issue. You said because you have a fortress balance sheet, these were not a threat. What about institutions whose balance sheets are less impregnable, as I said, a couple chain link, maybe a picket fence or two. Should we have rules since we don't legislate just for JPMorgan Chase, is there a danger that this kind of activity in a financial institution and in-

sured institution with less in a strong balance sheet might cause some problems?

Mr. DIMON. I don't know, but I think you should all take comfort in the fact that all American banks are better capitalized. The system is far stronger today—

Mr. FRANK. I appreciate that, but that wasn't the question I asked. And we can't assume it will be that way forever, and there are some who are resisting the capitalization. So if you were not as well-capitalized, would this have had some problems in it that we didn't have because of your balance—you said you have a fortress balance sheet, which assumes there is something special about the way you are that made us have to worry about it. But we can't assume that is going to be the case for every financial institution.

Mr. DIMON. But I also said we would be solidly profitable this quarter, so relative to—

Mr. FRANK. That is not the question, Mr. Dimon. Please don't filibuster. Let me ask you now.

I am sorry, Mr. Chairman, I asked a specific questions. Mr. Dimon knows full well what we are talking about. You did say finally that there would be some clawbacks for compensation. You have also taken some responsibility here, will the clawbacks for compensation—is your compensation on the table for consideration of clawbacks?

Mr. DIMON. Yes, all of the—this whole action should be reviewed by the board.

Mr. FRANK. Yours is a specific question.

Mr. DIMON. My compensation is 100 percent up to my board.

Mr. FRANK. Mr. Dimon, you said there are going to be clawbacks for people responsible. Is your compensation in the pot that is going to be considered for that?

Mr. DIMON. They will do what they see as appropriate. I can't tell my board what to do.

Chairman BACHUS. Thank you. Mrs. Biggert for 5 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman. Mr. Dimon—

Chairman BACHUS. Let me explain to the witness, because it is a little bit of an unusual procedure. The Republican side elected to go in order and not to come back up to the top to allow all the Members to ask questions. The Democratic Members are starting over.

Mr. FRANK. Let me say, Mr. Chairman, not entirely, with modifications for people who were here and not here.

Chairman BACHUS. Yes, that is fine. Thank you. Mrs. Biggert for 5 minutes.

Mrs. BIGGERT. Thank you. Mr. Dimon, what went wrong with JPMorgan's Value at Risk model which is used to estimate losses that occur on a particular trade or in a portfolio? The press has reported that JPMorgan changed its model which allowed its London traders to take on more risk, and then JPMorgan changed its model again. And then to top it off, this change occurred in January, which seemed to be material in nature but was not included in its Value at Risk model. The SEC has said that when a public company changes its model, those changes must be disclosed. So why exactly were the risk models changed?

Mr. DIMON. We have hundreds, maybe a thousand models, which are periodically changed and updated. The intent is usually to make them better. Back in June of the prior year, the CIO and an independent model risk group were trying to update and improve a model. It was approved, and it was implemented in January. As of April 13th, we had no reason to think it wasn't a better model and didn't better reflect some of the risks that were being taken there. Clearly, when things started to go south several weeks later, we felt that the new model was not better, and went back to the old model which we thought was better. We disclosed that in our 10-Q, and we told our shareholders on May 10th.

Mrs. BIGGERT. So it was changed on May 10th, but was there approval?

Mr. DIMON. There is an independent model review group which approved it and we have a review taking place—this is one of the things we will go through in a lot of detail and make sure we know all the facts exactly as they happened. I should also point out that we don't run trading risk based on one model. There are a lot of other things that should determine your decisions.

Mrs. BIGGERT. Did you think that was adequate disclosure?

Mr. DIMON. We disclosed what we knew when we knew it.

Mrs. BIGGERT. Okay. So who was responsible for making the change?

Mr. DIMON. It was approved by an independent model review group. Whether it was implemented really well, I don't know, it is still part of the review.

Mrs. BIGGERT. You don't know who made the change within the company or decided there needed to be a change?

Mr. DIMON. There are constant changes, people asking for updates and adjustments based upon new facts and new history.

Mrs. BIGGERT. Do you think that regulators should have noticed whether there was adequacy in the reporting?

Mr. DIMON. Regulators periodically review models and model changes, and in this case, I wouldn't blame that. If we failed to pick up its inadequacy, I don't think we should expect the regulators to pick it up.

Mrs. BIGGERT. So you don't think these changes had anything to do with what happened?

Mr. DIMON. I think it may have aggravated what happened. I wouldn't say it was the cause of what happened.

Mrs. BIGGERT. All right. I yield back.

Chairman BACHUS. Ms. Waters for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. Mr. Dimon, I am trying to understand your position relative to Dodd-Frank and a number of other issues. I am not going to try to use this as a "gotcha" moment, and I don't want to you use this as a way or a time that you can basically just give us a lot of information that we don't need.

You said you support 75 percent of Dodd-Frank, but after your testimony last week, and after following your statements in the lobbying of some of the industry over the last 2 years, I really don't know what you really support. When it comes to the most important substantial elements of Dodd-Frank, I am afraid that we don't have your support, even when these reforms would actually benefit

your firm, your shareholders, and America's taxpayers by preventing another financial crisis.

Of the Volcker Rule, in testimony before the Senate last week, you called it unnecessary and you asserted that some banks like JPMorgan should be treated differently under the rule; they should have a higher speed limit. But at the same time, you also conceded that the Volcker Rule may have prevented the recent trading losses in the CIO. Of capital standards, you told the Senate last week that you support higher capital for larger banks, but your chief risk officer has testified here in this committee against a capital surcharge for the largest U.S. banks. On Title VII derivatives requirements in Dodd-Frank, you say that you want to work with us to implement those reforms, but you work for loopholes through bills here in Congress.

So I want to ask a few questions, and this one requires a simple yes-or-no answer. When we think about the losses coming out of the CIO in London, did those losses stay in London or did the $30 billion or more drop in your market value impact your shareholders here in the United States?

Mr. DIMON. Yes, it did affect our shareholders.

Ms. WATERS. But you have lobbied very strongly and you just answered Mr. Frank that you do believe that the foreign markets should be exempt from the extraterritorial regulations that we are proposing here. And if this impacted your shareholders here, why do you continue to take that position?

Mr. DIMON. I think I said the overseas operations are regulated by the Fed and the OCC, these things went to clearinghouses and they collateralized. The reason we are careful about overseas competition is if JPMorgan overseas operates under different rules than our foreign competitors, we can no longer provide the best products and services to our U.S. clients or our foreign clients. That is why we are concerned about extraterritoriality. It is not about the protection, but the ability for us to compete. And when we compete, we give our clients, which include major U.S. companies, better deals. They will go elsewhere if we cannot give them the best possible deal no matter how much they like us.

Ms. WATERS. So you take that position, despite the fact that the losses do not stay in London?

Mr. DIMON. Yes.

Ms. WATERS. And you continue to lobby for exemptions for the foreign trades?

Mr. DIMON. Lobbying is a constitutional right and we have the right to have our voice heard.

Ms. WATERS. I am not questioning your right to lobby. I am questioning what is in the best interest of the American public. While the public doesn't know the full details of this trade, it is clear that these trades were not subject to the full panoply of rules we crafted under Title VII. I think we all need to be just very, very clear about that. And I want to know whether or not you are aware of Mr. Gensler's testimony here today, and what he said about the risk that you take in having that kind of exemption, and whether or not you agree with Mr. Gensler and what he testified here today in any way, any shape, form, or fashion.

Mr. DIMON. I don't agree with him. I heard part of it, and I think the starting point should be that the United States is the best, widest, deepest, most transparent capital market in the world that has flaws. We should fix the flaws, we are concerned about some of these things making us not the best capital markets in the world. The best capital markets in the world in part is what made this the best business machine ever, the United States of America. We just want to get it right, it is not binary, it is not one thing, these are very complex rules. We want to get it right so it works for America.

Chairman BACHUS. Thank you. Mr. Duffy for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman. Mr. Dimon, good morning. I think it is clear that we are not here because a private firm lost $2 billion. I think it is clear that we are here because many of the American taxpayers are concerned when big banks go bad, and they are left holding the loss. It is one of these philosophies where we have capitalism on the way up, where you and your firm make a lot of money when you do well. And when you fail, we have socialism on the way down, and the taxpayers bear the brunt of that loss. That is why we sit here today to make sure that taxpayers in Wisconsin don't bear the loss of big banks on Wall Street. So when we look at what is going on, would you say that the regulators are capable of sufficiently regulating a bank the size of JPMorgan?

Mr. DIMON. First of all, I completely agree with the fact that taxpayers should never pay for a big bank failing, totally. So we should work on things to make sure that is true.

Mr. DUFFY. But we will agree, we were a little nervous about it when we had TARP and the taxpayers did it just a couple of years ago. We are a little gun shy with big bank losses. Are other regulators sufficiently staged to regulate a bank the size of JPMorgan?

Mr. DIMON. I think the regulators have been challenged with a lot of new rules and regulations. I think it's challenging them to get them all done on time.

Mr. DUFFY. Can they regulate a bank the size of JPMorgan?

Mr. DIMON. I believe they can, yes.

Mr. DUFFY. And so, I want to be clear on this, per your testimony, you said that as one of the best and brightest CEOs in this industry, held in high esteem, you didn't know about these trades, and you didn't know about these losses. How do you come forward today and say the regulators should have known what one of the best CEOs in the industry didn't know and couldn't have known?

Mr. DIMON. I didn't say that. Remember, we have high capital standards, high liquidity standards, far more rules, most banks are stronger, there are far more—boards are more engaged, risk management committees are engaged, there are no off-balance sheet vehicles, there are no more subprime mortgages.

Mr. DUFFY. Mr. Dimon, the system is far healthier, and you have to look at regulation in its whole, not the one thing that they might have missed. If one of the best CEOs in the industry doesn't know about these trades, how can we expect the regulators to know about these trades and protect the American taxpayers?

Mr. DIMON. I think it would be an unrealistic expectation that they would capture everything, some things will get through their

screen, like some things get through our screen. However, they can make it a better system by disseminating that kind of information to a lot of other companies, they audit us regularly, they constantly are criticizing some of the things we are doing, it makes us a better company. I just think we need realistic expectations for regulators.

Mr. DUFFY. And I would agree. But is it fair to say that a $2.3 trillion bank is too-big-to-manage? Too-big-to-regulate? Too-big-to-control? Is it too complex? Are you too-big-to-fail?

Mr. DIMON. No, we are not too-big-to-fail. We believe that a bank should be bankruptable, and that when the bank fails that the clawbacks should be invoked on management, the board should be fired, and the company should be slowly dismantled.

Mr. DUFFY. And who bears the losses?

Mr. DIMON. In a way, that doesn't cost the economy anything.

Mr. DUFFY. Who bears the losses?

Chairman BACHUS. Mr. Duffy, allow the witness to answer the question.

Mr. DIMON. They are charged back to the other big banks to survive, that is what I believe.

Mr. DUFFY. If JPMorgan fails, who picks up the tab?

Mr. DIMON. If JPMorgan fails, I don't think anyone is going to pick up any tab because we have $190 billion of equity, $290 billion of unsecured debt, so I don't think there is any chance we are going to fail. If we did, any losses the government would bear should go back, be charged to the banks. Just like the FDIC today is charged back the banks. JPMorgan is going to spend $5 billion of fees to the FDIC to pay for the failure of other banks.

Mr. DUFFY. So—

Mr. DIMON. I don't like the $5 billion, but I think it is appropriate that the American taxpayer doesn't pay for that guarantee.

Mr. DUFFY. I thought were you done. The Orderly Liquidation Authority would step in and bear the brunt of JP Morgan's loss should you fail, right?

Mr. DIMON. The loss would mostly be borne by equity and unsecured debt. They might provide temporary funds to keep the company functioning in the short run.

Mr. DUFFY. But is it fair to say that JPMorgan could have losses of a half trillion dollars or a trillion dollars?

Mr. DIMON. Not unless the Earth is hit by the Moon.

Mr. DUFFY. Okay. I want to go to your trades that brought us—brought you the $2 trillion—I am sorry, the $2 billion to $5 billion loss. The dollars that were used to trade, those were dollars that were backed up by the FDIC; is that right?

Mr. DIMON. I am sorry, say that again?

Mr. DUFFY. The $2 billion to $5 billion loss that you incurred, the dollars that were used to make those trades, those were dollars that were backed up by the FDIC?

Mr. DIMON. Yes.

Mr. DUFFY. Okay. And why then weren't you taking this excess deposit and investing those dollars here with American businesses, American consumers, instead of taking those excess dollars backed up by the American taxpayers, or the FDIC, and sending them over to London to make very complex—

Mr. DIMON. It is not either/or. We have $700 billion of loans, we have $200 billion of short-term investments in central banks around the world to handle cash flow for our clients, and we have a $350 billion, AA-plus securities portfolio. Any valid loan that comes in the door that we can make, small business, middle market where we are, we try to make those loans.

Chairman BACHUS. Thank you. And let me say, I am sure that somewhere in Dodd-Frank, there is a prohibition against the Moon striking the Earth.

Mrs. Maloney?

Mrs. MALONEY. Thank you, I would like to welcome Mr. Dimon, who resides in the district I am privileged to represent. I would like to note that he has been a major employer in a number of different financial institutions before joining JPMorgan Chase.

I would like to ask you, Mr. Dimon, I always thought that you loved New York. So why are all these jobs and all this activity taking place in London? I specifically would like to know why were the losses incurred in the London unit? They didn't take place in the New York unit. Could they have incurred in New York just as easily?

We learned in the prior regulatory panel that a substantial portion of the bank's Chief Investment Office's activities, including its credit derivatives trading, are conducted through the London branch, and that other large financial institutions likewise have London offices. And I certainly understand that we are in a global market and we have to be in global markets around the world, but what is it about the regulatory regime of the United Kingdom that encourages such a large portion of these activities to take place in London as opposed to the United States?

And I would also say that a large portion of the credit disasters have taken place in London: AIG, we bailed out $184 billion; Lehman; UBS; there is a whole series. And I want to understand why all this is taking place, why London?

Mr. DIMON. The predominant part of the CIO is done in New York, but we operate in 100 countries. We are on the ground in 60 countries, we take deposits in all of those countries, we have to invest in some of those countries, they all have laws, rules, and requirements. That operation could have been in London or somewhere else, sometimes the operation where we have the people, so—

Mrs. MALONEY. Is the regulatory regime lighter in London? Why is all the activity overwhelmingly, and all the problems appear to be in London?

Mr. DIMON. I don't think this activity was in London because regulatory activity is less in London. And most of what we do in London is serving European companies.

Mrs. MALONEY. What are the lessons that you have learned for large financial institutions going forward? Is there any way to ensure against this type of loss where a trader is forced to hedge the hedge and cover losses that led to more losses? Is it possible to ensure that legitimate hedges never morph into something else?

Mr. DIMON. It is not possible to ensure we will never make a mistake. Anyone who has ever been in business knows you make mistakes, hopefully they are small, hopefully they are few and far

between, and hopefully they are not life-threatening, and this is not life-threatening. We, in this one area, failed to have the granular limits and the rigorous review that we should have. We believe it is not true for the rest of the company. We try to be very, very disciplined, and we fixed this problem the second we found it.

Mrs. MALONEY. And were the risk limit rules raised while the loss-making position was on the books?

Mr. DIMON. No, they—sometimes limits hit triggers and it asks you for further focus and detail. I think some of the things you heard about were when some of these limits were hit, people did what they were supposed to do.

Mrs. MALONEY. Did they raise them?

Mr. DIMON. They do get raised sometimes, yes.

Mrs. MALONEY. Why were they raised again?

Mr. DIMON. I didn't say they were—I don't know if they were raised. I am saying sometimes they do get raised.

Mrs. MALONEY. So you don't know whether they were raised or not?

Mr. DIMON. They might have been, I don't recall.

Mrs. MALONEY. Was the loss-making position increased in size after it began generating losses?

Mr. DIMON. What I recall is that they weren't really increased in size after early April. At one point, they stopped taking positions. I think that was in late March.

Mrs. MALONEY. And what was the delay between the start of the losses and senior management action?

Mr. DIMON. Prior to April 13th, there had been some losses, and management was looking at it. People looked at stress testing, a lot of folks thought of it as an aberrational thing that would come back, which happens sometimes. The real losses started later in April, late April, like the last week of April. At that point, we brought in some top experts again, they dug deep, and we realized we had a much more severe problem and that we—that was late April that we started—

Mrs. MALONEY. And what was the delay between the start of the losses and disclosure of the losses to the Office of the Comptroller of the Currency on-site at JPMorgan Chase?

Mr. DIMON. I don't believe there was a delay in the disclosure of the losses. We run a regulatory—we try to run the company that—what I call open kimono with—the regulators to tell them what we know and when we know it. I don't know exactly what all reports they were looking at, but we don't hide reports from them. They do see P&L, so they saw the losses. I do know at one point our CO went to see them to explain what had happened prior to April 13th. We did not understand the seriousness of it until later in April, on April 13th.

Mrs. MALONEY. My time has expired.

Chairman BACHUS. Thank you.

Mr. Schweikert?

Mr. SCHWEIKERT. Thank you, Mr. Chairman. Forgive me, as I have been bouncing around, just so I can get my—put it on the record. What is the best model estimate of what the loss is?

Mr. DIMON. We have not disclosed that because when we make disclosures to shareholders, we will disclose the quarter on July

13th. At that point, we will give a full and fair explanation of what went on. I personally feel that this will never be life-threatening to the company, and we are going have a solidly profitable quarter, and more details to come when we report the quarter.

Mr. SCHWEIKERT. Mr. Chairman—

Chairman BACHUS. I will reserve your time, so we can stop the clock. I think we all need to realize, and I think if you have read the articles on this, the more disclosure that is made, the more those betting against the position of JPMorgan can use that to the disadvantage of JPMorgan. In fact, I think it is pretty well-established that part of the open disclosure and discussion has precipitated some of those losses. But it is not necessary for him to disclose proprietary information. I think if you read any of these articles, you see that they are managing this, and independent people have said the loss could be $6 billion, but that is just an estimate. It could be $2 billion, it could be—some estimated it could be less than that.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

Chairman BACHUS. Start the clock again.

Mr. SCHWEIKERT. Being respectful that you will be doing your quarterlies very shortly, sir, the second question I was going to ask is profit for the quarter, but I guess we will just wait on that one too.

Mr. DIMON. But there will be profits in the quarter.

Mr. SCHWEIKERT. That was basically the point I was trying to head towards is that at least as an institution this is—it is not happy that it is shareholders' money, but it is not devastating.

Mr. DIMON. Not devastating, not fun either.

Mr. SCHWEIKERT. And this is actually more of an offshoot, having read over some of the Senate testimony. I want to get my head around something that is actually all up and down both the financial, the fixed income and the banking community. We are all operating in an environment that literally is zero interest rates, you plug in interest rates today and plug in what real inflation, so slight movements whether it be caused by cascading Europe or Argentina or some pop Fed policy or fiscal policy here. My understanding is just little bit of movement would be devastating to your book of business if you have not hedged that. What scale are you hedged for the fear of movements and interest rates a couple of ticks up?

Mr. DIMON. Our biggest exposure is credit and interest rates. And we try to manage the portfolio and all interest rates such that rising rates don't hurt us because our biggest, what I call "fat tail risk" is rapidly rising rates. In fact, we are positioned today that if rates went up, we make more money. It does cost us to do that.

Mr. SCHWEIKERT. You are heading towards the ultimate question here. I am trying to get a sense of the cost to do that type of risk management, and that is one of the frustrations I hear lots of discussion going on about, are you doing risk management here or here? A lot of folks don't understand that it is expensive.

Mr. DIMON. It is expensive, yes. I am guessing now it costs us probably over $1 billion a year to be positioned where we are to benefit from rising rates as opposed to neutral to rising rates. But

I think it protects our company, which is why we are there. Again, we may be wrong.

Mr. SCHWEIKERT. And do you have to do excessive amounts of hedging in that fashion or buying, we will call it interest rate insurance, it might be an easier way to understand it, because of your imbalance in both deposits to the loan portfolio?

Mr. DIMON. Yes, so the investment portfolio is invested to help manage that exposure, which is why it is invested very, what I call shorter than most. The average maturity or duration is 3 years. If you invest that longer, you can earn more money; having it shorter is more conservative. It gives us the ability to reinvest like $40 billion a year at whatever the new current rates are. So that portfolio is one of the main things we use to manage interest rate exposure.

Mr. SCHWEIKERT. So, you were just saying what, 3 years?

Mr. DIMON. The duration is 3 years of the AFS portfolio, the $350 billion portfolio.

Mr. SCHWEIKERT. And that costs you almost $1 billion a year just to insure?

Mr. DIMON. Just to keep it positioned so that we benefit from rising rates.

Mr. SCHWEIKERT. In this type of environment—in your understanding, and I know we are all still all working on the mechanics of the Volcker Rule, what would have happened in these trades if the Volcker Rule was fully implemented as you understand it?

Mr. DIMON. The Volcker Rule specifically allows portfolio hedging, and I think initially the original intent, it would have been allowed because it was a hedge that would benefit the company in a terrible stress like Eurozone. What it morphed into I cannot defend. It violated common sense, and I don't know if the Volcker Rule could have or would have stopped that, if it did it wouldn't bother me. I wouldn't be sitting here.

I think the far more important think about the Volcker Rule is the ability to make active markets here which keep down spreads for everybody, for all investors, and that makes it easier for companies to raise money, and cheaper for investors to invest money. Those investors are veterans, retirees, and mothers; they are not just people like me. So that is why we think the Volcker Rule has to be written carefully to maintain the best capital markets in the world and not stifle them.

Mr. SCHWEIKERT. Okay, in 6 seconds, how do you, as an international organization, hedge against political risk, such as what is happening in Argentina, what is happening in Europe, and what is happening in other places? What do you have to do and what does it cost?

Mr. DIMON. Well, some places we don't do that much business in, so it is obviously an easy solution. In other places, you have conversations with the board about if you are wrong about a country, how much you might be willing to lose. So we do do investments in certain countries, but we don't want any one country or anything to damage JPMorgan if we are wrong about our view about that country.

Chairman BACHUS. Thank you.

Ms. Velazquez for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Mr. Dimon, although these trading laws cannot do substantial harm to Morgan Chase's capital position, it very well may have caused the collapse of a weaker bank. Do you think separating similar investment activities from traditional banking, taking deposits and making loans, is a reasonable approach to protecting the fragile economy from bank failures?

Mr. DIMON. I do not. If you look at most of—

Ms. VELAZQUEZ. I thought so.

Mr. DIMON. Let me give you some facts to support what I say. Early on, mortgage bankers went bankrupt, monoline investment banks, Bear Stearns and Lehman, a monoline insurance company AIG, WaMu, and IndyMac which were monoline thrift kind of savings companies. Fannie Mae and Freddie Mac, which were the biggest financial disasters of all time, were monoline mortgage insurance type companies. All of that happened and it had nothing to do with Glass-Steagall.

And in other parts of the world that didn't have Glass-Steagall, like Canada, they didn't have any problem at all because they had good banks and good regulations and proper capital levels, et cetera.

Ms. VELAZQUEZ. As you know, the rulemaking to implement the Volcker Rule is ongoing, and experts are still debating whether, in its current draft, the rule will have prohibited these trades. How should, given the lessons learned, the Volcker Rule be implemented to account for the complexity of trades like those that cost JPMorgan's loss, and the possibility that they move beyond purely hedging risk?

Mr. DIMON. Look, I am not writing the rules. That is other people's jobs. But I think I said it was a strategy that was badly vetted, badly implemented, and badly tested. And I would ask companies if you are going to do something like that, properly vet it, properly test it, so that it never morphs into something which isn't what it was really intended to do.

Ms. VELAZQUEZ. Where does the hedging risk stop and risky proprietary trading start?

Mr. DIMON. I can't define that for you. I am sorry.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Grimm for 5 minutes.

Mr. GRIMM. Thank you, Mr. Chairman.

Good afternoon, Mr. Dimon.

Just to continue with—we have been hearing a lot about this Volcker Rule. We heard before from Ms. Waters that if all of Dodd-Frank was implemented, it is possible that these trades wouldn't have occurred.

Would it be safe to say that if you didn't do any trading at all, you wouldn't have any losses. Is that true?

Mr. DIMON. Yes.

Mr. GRIMM. So if we made banks a utility and we couldn't compete with Europe, that would pretty much clear this up as well. Would that be one way to get rid of losses and take all the risk out?

Mr. DIMON. Yes, I think so.

Mr. GRIMM. Okay. So when we look at—before, we were talking about the regulators, and my colleague, Mr. Duffy, was saying—he asked you, do you think the regulators can regulate JPMorgan Chase? You said yes. And his argument was, why couldn't they find this one trade?

I think the point is that—again, my humble opinion—regulators are there to look overall at the major rules, such as maybe minimum capital requirements, maximum leverage ratios, maybe some concentration risk, some rules in place so you are not too concentrated in one area. And those three things combined, regardless of whether you have a bad trading day—is it safe to say that we could never expect regulators to be able to have foreseen this loss of JPMorgan Chase?

Mr. DIMON. Yes. But I think it is fair to say if regulators do their job, the system will be healthier, most banks will be healthier, and the chance of having a systemic collapse should be virtually zero.

Mr. GRIMM. Okay. But would you agree—

Mr. DIMON. But to expect them to capture any one trade, I just think is an unrealistic expectation.

Mr. GRIMM. Okay. I happen to agree with that. I don't think regulators will ever be set up to do that for the amount of institutions and the amount of trading. And the amount of metrics that would need to be put in place to figure out whether something is a proper trade or not is an unrealistic goal, and we are setting ourselves up for failure.

I think if we focus—and I want to ask you a question—on things like the capital requirements, leverage ratios, making sure there is not too much concentration, that is something that regulators can actually get their hands around and do a good job at. Would you agree with that?

Mr. DIMON. Yes.

Mr. GRIMM. Okay.

Now, if I can get into the weeds a little bit just to understand a little bit about your risk models, without divulging your proprietary information, could I just ask, your Value at Risk model, how did you calculate it? Was it daily, weekly, monthly?

Mr. DIMON. I believe it to be daily.

Mr. GRIMM. Daily. Do you know if it was at a 95 percent concentration, 95 percent confidence?

Mr. DIMON. I think we look at both 95 and 99 percent. I forget what the public disclosures are.

Mr. GRIMM. Okay. Because my question was going to be, a 95 percent confidence level is approximately 2 standard deviations. If you go to 3, 4, you are talking 98, 99 percent. Would that have helped your scenario? I am just curious. Would that have actually helped?

Mr. DIMON. VaR is just a basic statistical thing that shows how much volatility there is in a security or a basket of securities. There is nothing mystical about VaR.

The other things which normally help is having limits at a very granular level and doing what I would call real stress testing, like what happens if rates blow out, what happens if credit spreads blow out, what happens if the Eurozone has a crisis, what happens if you have a credit crisis in the United States.

So we do all of these serious things to manage risk. VaR is one measure and, in my opinion, not the best of them either.

Mr. GRIMM. Okay.

And I want to also go back to make a point. At any point—I know that the sums were technically insured by the FDIC—even now, having the benefit of having looked at these trades, were the taxpayers at risk?

Mr. DIMON. No. And I believe one of the Fed Governors here is saying that the bank can bear $80 billion of risk before the taxpayer might be at risk.

Mr. GRIMM. And, lastly, I just want to—because I am actually trying to get my hands around this—look at some areas of concentration risk. Because we hear a lot about—what I think we are doing is trying to turn banks into utilities, and I think there are better ways to do it, and maybe looking at concentration risk.

With the financial meltdown in 2008, much of the concentration was in loans. We know it was in subprime. Based on JPMorgan's size, just your size alone, other market participants were able to clearly notice your London desk's activity related to somewhat illiquid credit indexes.

Do you think reevaluating your concentration risk, especially in light of things that are liquid, is something that makes sense for the banking institutions overall, besides just JPMorgan?

Mr. DIMON. Yes, that was one of the flaws here. In this book we should have had more granular limits. I didn't mention this specifically, but one of them would have been specific limits on anything that might be illiquid, specific limits on credits, specific limits on counterparties. We had some but not all, and they all should have been in place.

Mr. GRIMM. Thank you, and I yield back.

Chairman BACHUS. Thank you.

Mr. Ackerman for 5 minutes.

Mr. ACKERMAN. Thank you.

If I may, I would like to get back to some very basic concepts. In your opinion, is gambling investing?

Mr. DIMON. No. No, it is not.

Mr. ACKERMAN. What is the difference between gambling and investing, briefly, if you can?

Mr. DIMON. I think when you gamble, on average, you lose. The house wins.

Mr. ACKERMAN. That has been my experience with investing.

Mr. DIMON. I would be happy to get you a better investment advisor and see if we can improve upon your experience.

Mr. ACKERMAN. You have, in general, except for recently, an excellent track record.

I would tend to agree with you, but we seem to be treating them quite the same. I used to think that all of Wall Street was on the level, that it facilitated investing, that it allowed people and institutions to put their money into something that they believed in and believed would be helpful and beneficial and grow and make money, and especially help the economy and, on the side, create a lot of jobs and be good for our country and good for America.

Now, a lot of what we are doing with this hedging—and you could call it protecting your investment or whatever, but it is basi-

cally gambling. You are just betting that you might have been wrong. It doesn't help anything succeed anymore. It doesn't encourage anything anymore. It creates the possibility that people are saying, do these guys really know what they are doing if they are now betting against their initial bet?

And then if you go and hedge against your hedge, which means you are betting against your bet against your first bet, it seems to me that you are throwing darts at a dartboard and putting a lot of money at risk just in case you were wrong the first time.

I don't see how that creates one job in America. I don't see how it helps the American economy. I don't see how it helps the housing market or the building market or the let's-make-steel-or-widgets market. One-tenth of a zillionth of a percent. What it helps is, if you were right a majority of the time, then it makes a bunch of money for the guys who did it, and doesn't help the company, the industry, the economy, or the country at all. And if you were wrong, it puts systemically everything at risk. And when I say everything, I mean the confidence that the American people, the public, the investing community, and everybody else has in the system. And that is a loss you can't hedge against, because the more you hedge, the more questions you raise in the confidence of what you are doing with your initial investment.

And the fact that you have chosen to do this overseas raises a lot of fuzziness. Maybe the businesses there—da-da-da-da-da-da-da-da-da. And it is not illegal to do it over there, it is just as good to do it over there. And, when you come back from an overseas trip, at customs there is always the question on the form, did you have any exposure to farm animals? And I am sure the nice people over in Europe and Africa and Asia, they have safety codes and enforce them, but they still ask the question because they are worried about the infiltration of the problem into the American system and putting us at risk. They ask that question.

How is this hedging and wedging thing any different than protecting yourself by taking the odds to Las Vegas?

Mr. DIMON. We don't gamble. We do make mistakes. The main mission of this company is to serve clients around the world.

Mr. ACKERMAN. But isn't it—

Mr. DIMON. Last quarter, we did $40 billion in mortgages. I assume you want us to do that. We are the biggest, or one of the biggest small-business lenders in the United States. We have raised $400 billion, $500 billion for the biggest American corporations. We bank some of those corporations in 20 countries around the world.

Our main mission is serving those clients, investors, capital issuers, small businesses, and consumers. That is what we do.

Mr. ACKERMAN. Granted, but when you—

Mr. DIMON. And we lost $2 billion on Chrysler. I assume you want us to continue lending to Chrysler.

Mr. ACKERMAN. I want all good things to happen. But wouldn't you be serving those clients better—and you have done a pretty adequate job, from what I can see—wouldn't you be serving them better if you spent more time and energy or that billion dollars in figuring out all these mathematical formulas, wouldn't you do a better job if you evaluated the investment a lot clearer with another billion dollars into that?

Mr. DIMON. In this case, yes.

Mr. ACKERMAN. Why shouldn't we apply that to the whole program? What I am doing is I am raising a question on what is the purpose of hedging. If you are right, you win; if you are wrong, the system loses. We all lose in that context. Because there is nothing more important than that confidence.

Chairman BACHUS. Thank you.

Mr. Fitzpatrick?

Mr. FITZPATRICK. Thank you, Mr. Chairman.

Much of the discussion regarding JPMorgan's trading loss is focused on whether the activity in question would have been prohibited if the so-called Volcker Rule had been in effect. What is your view on that?

Mr. DIMON. I have already said I don't know. The Volcker Rule isn't fully vetted yet, it is not fully written, and I just don't know.

The Volcker Rule specifically allows portfolio hedging, properly done, if properly vetted. What this became wasn't really that. So if it does or didn't prohibit it, it wouldn't bother me.

Mr. FITZPATRICK. Putting aside the question of whether it would have been prohibited under the Volcker Rule, since the regulators who wrote it can't seem to answer that question either, what is your view on whether it should be prohibited?

Mr. DIMON. I believe that portfolio hedging, properly done, should be allowed. It protects the companies, particularly in times of dramatic credit crisis or Eurozone crisis. I do believe it should be allowed, portfolio hedging.

Mr. FITZPATRICK. Mr. Dimon, some have suggested that your position as a board member on the New York Federal Reserve Board is a significant conflict of interest and have suggested that you and other bankers who sit on the board should resign your positions. How do you respond to that?

Mr. DIMON. The Federal Reserve rules are written by you all, and so—but I should tell you that I don't vote for the president, I don't get involved in supervisory, I can't serve on the Audit Committee. The board basically sits around and talks about the economy, what is going on. There are 12 Federal Reserve Boards. That information, I think, is put together and sent to Washington. It is more of an informational advisory group. And whatever the lawmakers write would be fine with me.

I, personally, if I was head of the board, I would want to hear from a lot of different types of people. It would be funny to be talking about global markets and not have someone involved in the global markets at the table. It surely does not have to be me.

Mr. FITZPATRICK. Nothing further.

Chairman BACHUS. Thank you.

Mr. Sherman for 5 minutes.

Mr. SHERMAN. Thank you.

Mr. Lynch wanted to swear you in. You have already said something that is false, that we all know is false—

Chairman BACHUS. Let me—

Mr. SHERMAN. Excuse me. Let me finish my statement.

Chairman BACHUS. No, I—

Mr. SHERMAN. Sir, I—

Chairman BACHUS. —want to clarify something about swearing people in.

Mr. SHERMAN. That is—

Chairman BACHUS. We had a hearing in September of 2009, when Mr. Frank was chairman. And Mr. Frank made a decision not to swear in any of the CEOs of the banks about what had gone on in September of 2009. I am following the protocol of the committee.

Mr. SHERMAN. Mr. Chairman—

Chairman BACHUS. If you want to continue to say he ought to be sworn in, that is fine.

Mr. SHERMAN. I wasn't saying that, Mr. Chairman. I was not criticizing you. But if I can't get to the end of the sentence—

Chairman BACHUS. I am saying the ranking member has said I am doing something unusual here. What I am doing is following the standard policy—

Mr. FRANK. Excuse me, Mr. Chairman. I didn't say you were doing anything unusual.

Chairman BACHUS. Well, I took it as saying that.

Mr. FRANK. What? I didn't—I made no comment.

Chairman BACHUS. I am sorry. I think it was Mr. Lynch.

Mr. FRANK. Not everybody from Boston talks the same.

Chairman BACHUS. That is right.

Mr. FRANK. But let me just say—

Chairman BACHUS. I am just saying this is normal, standard operating procedure.

Mr. FRANK. Mr. Chairman, I do want to take exception. I have made no comment on the swearing in. Let me just—if I could, just another 30 seconds. I am gratified that you are following my precedent. And I will have by tomorrow another list of precedents that you can also follow, and we would all benefit.

Chairman BACHUS. Don't be in any rush to give it to me.

Mr. SHERMAN. Mr. Dimon, had you been sworn in, you would face no legal liability for the comment that I think you have made that is erroneous, because we are here because we are in touch with Main Street in our districts. And you put forward the idea that there were $350 billion that you had given to your Chief Investment Office because there weren't small and medium-sized businesses in the United States that were creditworthy that wanted the money. And I assure you, there isn't a member of this panel who couldn't bring you 100 small and medium-sized businesses, creditworthy, in need of loans from you. And, instead, you took the $350 million to London.

That is why we are here. Because if you had made the small and medium-sized business loans, you wouldn't be here. And some of that money in London went to the gambling tables in London. And whether it was $2 billion lost or some multiple of that, that is why we are here.

I would hope that you would leave here dedicated to taking the money away from your London operations and lending it to small and medium-sized businesses. And if you can't find 100 in each one of our districts, we will do it for you.

Now, I would like to, without objection, put in the record an editorial by the wild socialists over at Bloomberg. I assume there is no objection.

Chairman BACHUS. Without objection, it is so ordered.

Mr. SHERMAN. They point to a study just published by the IMF that says that your bank enjoys a $14 billion subsidy, that its cost of funds is some 0.8 percent lower because of the implicit Federal guarantee.

What we saw in 2008 is a belief around the world that if a bank your size was going to go under, there would be a bailout not just of insured depositors but of all creditors. And that belief reduces your cost by 0.8 percent of your total funds, is responsible for $14 billion.

You are in a position where you are simply too-big-to-fail. And this raises—and I think the gentleman from Wisconsin made this point. You lost $2 billion or some multiple of that. You happen to be very well-financed. But you bet over $300 billion. You are lucky, and fortunate and wise that you didn't lose more.

Can you say on behalf of all the banks with over $100 billion in assets that all of them could have survived a mistake this size? I will ask you to answer that for the record.

The question is, why should we allow you to be so big that if you go under, we are going to have to bail out your creditors?

Mr. DIMON. Banks should take risks relative to their size and capability. So you can't compare all the banks. And I would venture—and I am not going to change what you believe—but a lot of banks were a port in the storm. I know it is convenient to blame them all for everything, but JPMorgan's size and capability and diversification in 2008, 2009, and 2010 allowed us to continue to do the things that you want us to do. We never stopped making loans. We bought Bear Stearns at the request of the United States Government. We helped the FDIC fund by buying WaMu. We lent money to California and New Jersey. It allowed us to do it.

So we try to be a conservative company that does the right thing. Every now and then, we make mistakes.

Mr. SHERMAN. And how can medium-sized banks compete against you when your cost of capital is reduced by 80 basis points, 0.8 percent, because of a belief that if they go under, we will let them go under, but if you go under, we will bail out your creditors?

Mr. DIMON. I don't believe that is true. I am going to give you two facts, if you don't mind.

Fact number one is we borrow in the marketplace, unsecured, with the smartest people in the world. It costs us 200 basis points over Treasury. It costs the average single A industrial, like, 100 basis points over Treasury. So we are—if everyone is so smart and knew that we are too-big-to-fail, we would be trading at 10 basis points over Treasury.

Mr. SHERMAN. After you lost all that money in London, I would expect that creditors would be reluctant to lend you money at less than that rate.

Mr. DIMON. Most of that $350 billion predominantly is in the United States. It is not in London. Most of it is here.

The second is the FDIC report, which looks at average funding costs, because we have studied this report a way back and all al-

most of it, if I remember correctly, was related to mix. We are a money center bank. We have a tremendous sum of money, which we keep very short term and overnight, which costs us very little right now because of the way the yield curve is. But we have to put out—we are the checking accounts for large corporations, including some nations, and so we invest that money very short and make almost no money on it. It shows up as a low funding cost, but our actual cost of funds for retail deposits, middle market deposits, and negotiated deposits is probably pretty much like everybody else.

Mr. SHERMAN. There isn't a small or medium-sized—

Chairman BACHUS. Thank you, Mr. Sherman.

Mr. SHERMAN. —banker who agrees with you.

I yield back.

Chairman BACHUS. Mr. Canseco for 5 minutes.

Mr. CANSECO. Thank you, Mr. Chairman.

I have spent a number of years in the banking sector, and I am approaching this hearing keeping in mind a primary truth about the banking industry, which is that the business of banking is inherently risky. Lending money is a risky proposition.

This was evident back in February when your firm disclosed in an investor presentation that it had set aside $27 billion, more than 10 times the amount of its recent trading losses, in loss reserves against its loan portfolio, providing that lending and exposure to credit was and is the largest risk facing America's banks today.

So we must keep this in mind as today's hearing has focused on whether it is appropriate or not, the Volcker Rule, and the attempt to keep banks from making so-called risky investments. Yet, in the years leading up to the financial crisis, there was hardly a riskier proposition than extending mortgage loans in the midst of an artificially inflated housing bubble. And if you want further proof of this, look no further than Fannie and Freddie, who didn't need to make proprietary trades with depositors' funds in order to lose $200 billion of taxpayer money.

The irony is, of course, that had the Volcker Rule been in effect prior to the crisis, it is likely that banks would have had even more exposure to the housing bubble and the crisis would have been far deeper and far worse.

Someone once said that, like energy, risk is not created or destroyed; it is simply transferred, passed on. And I feel the push for ever more regulation in your economy represents a continued misunderstanding of our banking system and the roots of the financial crisis and that this misunderstanding is, by itself, a great risk to our financial system and economy as we move forward.

So, with that said, Mr. Dimon, during your testimony in the Senate last week, you stated that we don't actually know who has jurisdiction over many issues we deal with anymore. Did Congress miss an opportunity with Dodd-Frank to simplify our regulatory structure and put an end to regulators passing the buck to one another?

Mr. DIMON. It would have been my preference that we simplify it. And we made it a little more complicated, yes.

Mr. CANSECO. Thank you.

So how do you respond to those who cite JPMorgan's recent trading loss as evidence that JPMorgan and other banks are simply too large and complex to manage?

Mr. DIMON. There are huge benefits to size, and you see them in the kinds of scale in aircraft and banking and diversification. I have already mentioned that we were a port in the storm because of our size and diversity.

The benefit of size has to eventually accrue to clients, not to us. That is the capitalist system, that you do things better, faster, and the client benefits. There are some negatives to size—lack of attention to detail, et cetera. So some of those lack of benefits of size happen to small firms too, and you have to weigh and balance.

So I think, on balance, the company has done a good job for its clients and its shareholders. And we continue to grow and expand and away from this problem. Our businesses are healthy and strong and serving more and more people, both in the United States and around the world. And we are helping a lot of American corporations travel around the world, helping them do a better job where they want to do business and do more exports.

Mr. CANSECO. So, Mr. Dimon, if the activities of the Chief Investment Office at JPMorgan were severely restricted under the Volcker Rule, especially to the point where portfolio hedging was disallowed, what would that do to the risk profile of the CIO portfolio?

Mr. DIMON. We would probably just modify the risk profile a little bit of the CIO portfolio and try to make sure we are not taking undue risks.

As I mentioned before, the AFS portfolio has an $8 billion unrealized profit. It is double-A-plus average rating. And it has invested rather shorter term, not short, but shorter term to protect us from rapidly rising interest rates. So I would call it a fairly conservative portfolio, and maybe would have changed the nature of it a little bit.

Mr. CANSECO. As I understand it, the CIO portfolio is around $400 billion of excess deposits that have not been lent out. Is that correct?

Mr. DIMON. $350 billion, I think.

Mr. CANSECO. It seems to me that if activities were restricted, JPMorgan would be left with the unappealing option of lowering underwriting standards or increasing risk somehow in a portfolio. Is that a fair assumption?

Mr. DIMON. It is possible, yes.

Mr. CANSECO. All right. So would you say that if the Volcker Rule were implemented, it is likely that overall risk in the financial system would actually be increased?

Mr. DIMON. I would love to answer the question. I don't know the answer to that.

Chairman BACHUS. All right. Thank you.

Mr. DIMON. Remember, it is one rule out of hundreds that are all being done together. So, I can't tell you the cumulative effect of all of them.

Mr. CANSECO. Thank you.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Meeks for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Dimon, I have been listening, and I think there is another reason why you are here. Some of it has to deal with the fact that—some of it has to deal with politics, to be quite honest with you. Some feel that Dodd-Frank has a role, and others feel that Dodd-Frank doesn't have a role. Some think regulations, others think no regulations. I think that we were at a point where we were talking about a lot of deregulation at one point, when I first came to Congress anyway, and we got into the problem that we are in. I remember the Secretary of the Treasury coming and saying, disaster was about to happen. And so Dodd-Frank came into existence because we wanted to fix the problem so that we would not be where we were when we had this terrible catastrophe that was facing our country.

And during that debate—and I want to pick up someplace around where I think Representative Maloney was talking about—there was concern about a lot of individuals doing business in London. That has been some of the questions that have been taking place. And I understand that you have to get the best deal for your investors, et cetera.

But I kept hearing about this London loophole. And from what I heard you answering to Representative Maloney, that there is no London loophole, it wasn't due to any regulations or lack of regulations in London. Yet when I talk to, not to you but a number of other financial institutions—I am from New York also, and I talk to them—and they tell me that if we put certain regulations in place, they will leave New York and they will go to London, because they will have less regulations in London.

So I don't understand if—isn't there something, some kind of loophole in London that other institutions, maybe not JPMorgan Chase—but they say that if we put these regulations in place, they will leave New York and take those jobs with them—that is what they tell me—to London. Why is that if there is no London loophole?

Mr. DIMON. Our problem has nothing to do with, as far as I know, any loopholes, going to London. It could happen in New York. So that is a separate issue.

If a U.S. company calls up JPMorgan and says, make me a bid on interest rate swap, and we can't give them the best deal and they are going to get the best deal out of Deutsche Bank in Europe, that is where they are going to go. The rules at the transaction level about margin, reporting, all those requirements may enable Deutsche Bank to make them a better deal.

Two things will happen. Caterpillar or whoever the big company is will get less bids; it won't be good for the American company. And the business will move to another bank overseas. You would see some—I don't know the head count numbers—some firms, if they can, put some people overseas to do the business in foreign subsidiaries with the same company that they were doing it within the United States.

If a U.S. bank can't do the business at all, at all, because the rules are written so broadly, then we will lose a lot of business, you will lose a lot of jobs here. They will not move to London. But I

assure you, they will one day be in Singapore, China, and other parts of the world.

Mr. MEEKS. Let me—time is so short. Last week, you referred to "big, dumb banks." In your opinion, could a big, dumb bank be successfully resolved under Title II of the Dodd-Frank Act without harming the American economy?

Mr. DIMON. Yes, but we all have work to do to harmonize that globally and get the exact rules in place, things that you all call living wills and resolutions, et cetera. But, yes, I believe it can be done. More work needs to be done to make it real. And people have to believe it is real. It is not just sufficient for us to say it is real. We need the regulators and the people, the countries to say we believe it is doable.

Remember, it was doable in the United States for years. The FDIC took down Continental Illinois, WaMu, American Savings Bank very successfully, all without damaging the American economy. So there are examples. It is just a bigger, more complex world. It is going to take a little more time.

Mr. MEEKS. But it could be done under Dodd-Frank?

Mr. DIMON. I think it could be done. But it is going to take foreign jurisdictions, particularly London, working out common sets of rules on how it would take place.

Mr. MEEKS. And, we also are concerned with reference to the American taxpayers being stuck. Last, in 2009, we wanted an ex ante fund to resolve big banks. And I think that a number of individuals—I forget, I think maybe JPMorgan Chase was against an ex ante fund—

Chairman BACHUS. The gentleman's time is up. Thank you.

Mr. Garrett for 5 minutes.

Mr. GARRETT. I thank the chairman.

Thanks, Mr. Dimon.

So, before you came here, the previous panel, I don't know if you were watching it in the back room. One of the cute little analogies that Mr. Gensler used was about, before he gives those keys to his daughter, he wanted to make sure that the rules and regulations were out there, and if not regulators, maybe a cop on the beat.

The only problem with that, to try to compare that to this analogy, was that there were—sitting right where you are—one, two, three, four, five regulators or cops on the beat, and each one of them gave basically the same answer, that they got to the accident scene afterwards. And in each case, they were going to tell us what they are going to do next time. So the analogy just really doesn't hold true, because we are trying to do, obviously, better than that.

I know you gave testimony here and back at the Senate. Your exact quote I had was, with regard to the role of the regulators and what they could and couldn't do, you said, "I think you have to give the regulators realistic objectives. I don't think realistically they can stop something like this from happening. It was purely management's mistake, and we were misinformed a little bit. We are not purposefully misinforming them too."

You had 100—there were 100 regulators, what, embedded, if you will, working full-time, getting up every day to go to your firm to work. So aren't we in a case where there is a little bit of a charade here with the American public with regard to what it is that the

regulators, even after 2,300 pages of Dodd-Frank, are able to do in these circumstances, that they are really not able to get into the detail, into the granular nature of things with or without modifications to the rules?

Mr. DIMON. I think I mentioned before—

Mr. GARRETT. Yes.

Mr. DIMON. —realistic assumptions help, realistic goals. I don't think that stopping one thing—but they could disseminate good information. They could demand best practices. They do have constant audits. They can make the system better in total so that there are fewer mistakes and farther between.

But I would never blame them for a mistake we made. Maybe what they learn from us will stop someone else from making a similar mistake.

Mr. GARRETT. I know that the ranking member and the ranking member of the full committee were somewhat taken aback maybe by some of your responses to Dodd-Frank and the legislation and how it is being implemented, and that is fine. And I concur and I commend you, as for your part. Your part is to lobby for, if you will, what, the position for your firm on positions of these issues and also something more than that, as far as what is best in the interest of your investors, too, I would presume. Correct?

Mr. DIMON. No. My highest, most important thing to me is the United States of America.

Mr. GARRETT. Actually, I was—

Mr. DIMON. I hope when I look back that anything I say was in the interest of the United States of America and not in the interest of JPMorgan Chase. And I feel that JPMorgan Chase will—

Mr. GARRETT. Will improve.

Mr. DIMON. —meet all the rules, meet all the regulations, we will continue to serve our clients. And that is what we are going to continue to try to do.

Mr. GARRETT. And I was going to lead there, if your answer to the first question was yes. So part of the reform of the reform that we may need in this area is, what, the extraterritorial effect of some of the rules that we have had so far. And we have done that in a bipartisan manner, right? So we had a Member, he is not here right now, but Mr. Himes from Connecticut has legislation with us to try to reform it, to limit it.

But you see at the same time, what, the previous panel, you had the CFTC Chair coming out with their proposed regulations—actually, not regulations, rules, but guidance in certain of these areas, in the areas of coming up with various standards, coming up with two separate standards for swap and security-based swap dealers.

Is that the appropriate manner that we should have, purely guidance rules coming out, where you don't do a cost-benefit analysis beforehand? Or should there actually be more of a close working relationship between the CFTC and the SEC when issuing and promulgating rules in this area?

Mr. DIMON. The CFTC and the SEC is a primary example where we should have one set of rules around derivatives and swaps. We have competing sets of rules. They haven't been defined yet. And, yes, of course, I think thinking through what makes sense and

cost-benefit always is the right way to do it. It is hard for me to imagine it is better to do something better than that.

Mr. GARRETT. You would agree that we haven't seen that, though, since Dodd-Frank has been passed into law.

Mr. DIMON. There may have been places where it was done, but I am unaware of it, yes.

Mr. GARRETT. Okay.

And just to close, then, I thought your answer was going to be slightly different with regard to the Volcker Rule when you said that things may not have been different had the Volcker Rule been fully implemented here. I thought the answer would be, had the Volcker Rule been law at the time, there simply would not have been trades going on because of the uncertainty, not only by the regulators, but the uncertainty by institutions such as yours as to how is it actually going to be implemented and what trade is permissible and what trade is not permissible.

I will close on that.

Mr. DIMON. Yes, no, I think the most important—we are really focusing on portfolio hedging, which I think is the minor part of Volcker.

Mr. GARRETT. Yes.

Mr. DIMON. I think it is the market making that allows these great capital markets in America to remain healthy, to finance companies at a very cheap cost to investors and issuers. That, to me, is the more important part.

And there are, if I remember correctly, like, 170 things written around that. And we are concerned that will stifle the capital markets here if they are not done right. They may very well end up being done right. The regulators, I think a lot of them want to get them to the right place. It is just very hard to do.

Mr. GARRETT. Very hard to do.

Thank you. I yield back.

Chairman BACHUS. Thank you.

Mr. Capuano for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

Thank you, Mr. Dimon, for being here.

First of all, I want to tell you that I have agreed with a lot of the statements that you have made. I know that may surprise some people, but it shouldn't. Because but I think, first of all, I welcome your voice in the discussion about what is appropriate regulation. There is no golden answer that any of us—at least, I don't come to the table thinking I know the answers. You think, you try, you talk to people like you. Does this work? Does that not work? So I welcome your voice, whether we agree or not in the final analysis.

I particularly welcome your comments on Title II of Dodd-Frank. You have clearly stated that you are not too-big-to-fail. Is that a misinterpretation?

Mr. DIMON. Nope.

Mr. CAPUANO. I agree with you, but I wish that some of my colleagues on the other side would finally hear that, because I think we handle that in Dodd-Frank. You have stated it. I agree with you.

I also fully agree with you on the simplification of regulators. I think we have too many regulators, as well. And I wish that some of the large institutions—I don't remember whether you personally, your institution was, but, in general, the larger institutions and the organizations were nowhere to be found when we were having this debate during Dodd-Frank. I was on the side of trying to simplify the number of regulators, not because of what they were going to regulate, because it is too many people doing the same thing. I totally agree. I would work with you or anyone else to try to reduce the number of voices at the table to make your job easier. That doesn't mean that I would reduce the regulation, just simplify it.

I do want to talk a little more about the extraterritoriality because, again, I don't think you have said anything here that I disagree with relative to competitiveness. We want to keep our financial institutions competitive. But I want to be clear, I want to make it clear that I am understanding you correctly.

You are not arguing that all financial institutions, U.S. or any others, should always seek the least regulated regime. That is not your argument, is it?

Mr. DIMON. That is not my argument, no.

Mr. CAPUANO. I didn't think so, but I wanted to be clear about that.

I would suggest very clearly that you are not wrong about competitiveness. It is nobody's goal, I hope, not my goal, to try to regulate you into a competitive disadvantage. And I think that is what the world is trying to accomplish now. Basel III is a classic example. It is not the answer, but it is a step in the direction of trying to get all the major different countries around to have similar approaches toward financial institutions.

There are still loopholes. Whether you take advantage of them or not, there are loopholes. They exist in London and elsewhere, which is why people are there. You may not be there for that reason. I don't know, and I don't really mind whether you are, because you are one institution. The institution of JPMorgan, in and of itself, is of little interest to me. What I am interested in is the entire system and the U.S. competitive advantages we might have. And when you have a loophole in London or anyplace else that people take advantage of through regulatory schemes, we need to talk about it openly to try to find out whether their regulation is better than ours, whether their regulations are worse than ours, and, regardless, how we can work them together so the loophole is not just for you but also for your competitors, don't give them an advantage.

And I would argue that, very clearly, when you say that you are looking at who offers the best deal, you are 100 percent right. You should. But the truth is, if it is only about the bottom-line best deal, you would be loaning your money on the corner of some street someplace because they get a better deal than you do. They loan out their money at much better rates than you get. The difference is, it is a little less secure.

So when you talk about best deal, it is not just bottom line, is it? It is also the ability to get those loans paid back and to make a profit. Is that an unfair—you are not just looking at the bottom line?

Mr. DIMON. I was referring to the best deal for the client. We are not going to win their business if we don't give them the best deal.

Mr. CAPUANO. Exactly right. But the best deal is more than just the lowest common denominator.

Mr. DIMON. Yes.

Mr. CAPUANO. It is also security, it is stability, it is operations under the rule of law, to know what those rules are so that you know the deal you are making is the deal you are going to be able to enforce. Is that a fair way to say it?

Mr. DIMON. That is true. Yes.

Mr. CAPUANO. Thank you. See, I told you, Mr. Dimon. We are not that far off from what we—we may have differences of opinion where we go.

But I do want to talk about one thing that is happening today. As we speak, there is another committee meeting that is about, at least the last I read, at least the news reports are reporting they are going to cut out $25 million from the CFTC's ability to pay their staff. Do you think that is a smart thing for us to be doing, to be cutting the ability of regulators to do their job?

Mr. DIMON. I have never looked at the CFTC budget. We have already said, by the way, that we have a CFTC and an SEC in duplication. I would prefer we fix the duplication before we throw more money at it, but that is what I do at my company. I can create a lot more staff tomorrow too, but it is not necessarily the right thing to do.

Mr. CAPUANO. And I agree with you on the analysis, but in the meantime, until we get there, do you really think it is a smart idea? With the regulatory regime that we have today—we both agree that it is not what we want, but it is what we have—do you really think it is a smart idea to be cutting the legs out of one of those major regulators? Do you think that is good for America?

Mr. DIMON. I have enough problems. I am going to leave that to you.

Mr. CAPUANO. Mr. Dimon, the only reason I ask is because you have had no hesitancy whatsoever in expressing opinions on other matters. I thought you might want to take an opportunity to express one today.

Mr. DIMON. I know nothing about their budget. I don't know how many employees they have. I really don't know. So it would be—I try not to have a comment if I know nothing.

Mr. CAPUANO. I would like you to learn it and maybe get back to us on the answer. Because the truth is, I would like to hear your answer before we actually vote on the Floor.

Thank you, Mr. Dimon.

Chairman BACHUS. Now, you do know that we are in serious trouble down here on our budget. I guess you would rather have your budget than ours, I am sure.

Mr. DIMON. No comment.

Chairman BACHUS. Ms. Hayworth?

Dr. HAYWORTH. Thank you, Mr. Chairman.

Mr. Dimon, I realize that the activity that we have talked about in terms of the loss for JPMorgan in April was bank hedging that was within the institution. But I have introduced legislation, in fact it passed unanimously through our subcommittee and com-

mittee, to repeal most of the swaps push-out, Section 716 of Dodd-Frank.

It strikes me that this example of the potential risk undertaken—and there is always risk involved, and there is going to be loss from time to time—but the potential risk undertaken in these sorts of activities does, it would seem, perhaps highlight the need for us to keep those activities within institutions where they are more regulated, if you will.

I would just appreciate your comments on that.

Mr. DIMON. I would agree with that. And the push-out, I never understood it. I thought it could make things riskier, not safer.

Dr. HAYWORTH. Right.

Mr. DIMON. I never understood why it was put in there at all.

Dr. HAYWORTH. Right. And, in fact, we have broad support for that, so I am hopeful that we will be able to move that through expeditiously.

With regard to the fact that derivatives activity seems to be concentrated in London, I get the sense that—I am a physician—I get the sense that it is because they are the specialist, so to speak. They do that kind of thing all the time. But Chairman Gensler implies that the rules are inadequate governing those activities. And yet, through the G-20, all regulators and extraterritorial regulators have coordinated fairly closely.

Do you feel that there is a need for us? The SEC is about to come out with its ruling on extraterritorial activity. Do you feel that we need to have some sort of regulation that we apply to our subsidiaries extraterritorially?

Mr. DIMON. No. I have been clear, I think the foreign laws should apply over there so we can compete fairly over there. And it is not—they were always regulated, the OCC and the Fed, so it is not true that there is no regulation. There is prudential regulation at the top. And the trades that I mentioned were collateralized, 60 percent cleared. So I think some of those rules wouldn't have mattered at all.

Dr. HAYWORTH. Right.

Mr. DIMON. And AIG, which I know keeps on coming up as an example, AIG was insured only. They weren't trying to hedge anything. AIG was an insurance company. AIG didn't have regulators who understood credit derivatives. And AIG, they accounted for them as insurance contracts.

Dr. HAYWORTH. Right.

Mr. DIMON. They were not mark-to-market and, for the most part, not collateralized. So a completely different example in a different industry.

Dr. HAYWORTH. Right. And yet an enormous level of risk, obviously, that had great implications. But you cannot map that situation onto the JPMorgan situation.

Now, clearly, sir, there have been questions about the activities of risk committees. Obviously, there are lessons that you have referred to that JPMorgan has learned. Are there lessons that we can apply to what our regulators use, the criteria they use when they look at how our institutions undertake risk?

Mr. DIMON. Yes. Risk committees—and, obviously, we have failed in this regard, but we have very strong risk committees. You need

properly staffed, properly reported, that everyone gets it, independent-minded. Their job is to challenge management, all the way to the CEO. Why are we doing that? Why don't we have more limits? What can go wrong? Let's stress test it. And that is what those committees are supposed to do. Proper reports, granular limits, constantly testing, and protecting the management from themselves sometimes.

And our risk committees do report independently. In this particular case, the risk committee made the same lack of oversight that I probably made a little bit down the line about this one activity. They had some pretty good disciplines in the other activities. It was in this synthetic credit activity that it should have been much tougher.

Dr. HAYWORTH. Yes, sir. And in terms of—obviously, JPMorgan has regulators inhouse who closely monitor your activities. Is there an element of human nature that makes us, to a certain extent, comfortable with each other and how we do things that may lend a certain amount of hazard to these relationships over time?

Mr. DIMON. No, they are not. They can be pretty tough on us. But I think what happens sometimes is—and it is just human nature—I say it is okay, the next person doesn't spend that much time on it, the next person doesn't spend that much time on it. You go around the table, everyone says it is okay.

Dr. HAYWORTH. Because you have a track record.

Mr. DIMON. Yes, all of us. So you can't be complacent about risk. It has to go through a rigor. It is not whether you trust the person, because I trust a lot of people. It is that it has to be independently verified.

Dr. HAYWORTH. Right. Trust but verify. Thank you, sir.

And thank you, Mr. Chairman. I yield back.

Chairman BACHUS. Thank you.

Mr. Hinojosa for 5 minutes.

Mr. HINOJOSA. Mr. Dimon, thank you for your testimony.

The recent JPMorgan loss comes at a time when we have many in your industry complaining about the new regulations that were put in place with the Dodd-Frank Wall Street Reform Act. For good reason, the $2-billion-plus loss has pressed the pause button on the constant stream of attempted rollbacks to Dodd-Frank. It seems to me that with the recent conviction of a prominent Wall Street corporate director, Wall Street firms do not seem to be going out of their way to restore trust with the American people.

I understand that JPMorgan will still turn a profit this year, but the size of the loss and the complexity of the trades and macro hedging that caused the loss still gives cause for concern. There needs to be an evaluation of not only prudent regulations but also the broken culture on Wall Street, a culture that some believe provides perverse incentives to play fast and loose with other people's money. After the crisis, there should have been major self-reflection and reevaluation of Wall Street.

Mr. Dimon, looking back at this loss, do you feel that the compensation structure at JPMorgan might have created incentives for excessive risk?

Mr. DIMON. I don't agree with what you said about Wall Street, so I will be direct about it. I think there are a lot of people you

can trust on Wall Street. And there are a lot of people you can trust anywhere, and I think when anyone blankets a whole industry with the same thing, I think we are making a mistake. It is like when people blanket all of Congress the same way. I just think it is not fair.

We try to have a culture at the company where people have long-term careers. They aren't paid just because of profits. They are paid because they are good managers. They are paid because they recruit, they retain, they are open-minded, they are independent on risk committees, they participate in the company, they mentor our younger people. That is what we do. It is not just financial results that drive people's compensation at JPMorgan. And no one in this area had formulas.

Now, is it possible that someone here says, yes, I was driven a lot by money? Yes, people—it shouldn't be a great surprise to you or anybody else that some people are driven a lot by money. Some are not.

Mr. HINOJOSA. Next question: Do you feel there is a problem with Wall Street culture?

Mr. DIMON. I think there might be a problem with some people on Wall Street. And, Wall Street for the most part are honest, decent, hardworking people. Their clients trust them. And to the extent we lose it, we should earn it back. I think if you talk to most of our clients, they think that JPMorgan tries to do a very good job for them, including when we make a mistake, we admit it. We try to rectify it.

And all firms are different, so I can't speak for every firm while I am standing here.

Mr. HINOJOSA. Mr. Dimon, what would you personally recommend be done by Congress to strengthen the Dodd-Frank Act so that we can prevent actions with the complexity of trades and risky derivatives and macro hedging that caused the loss of at least $2 billion at JPMorgan which brought us to this congressional hearing? We want to ensure similar losses do not occur in other banks, and I would like to hear your recommendations.

Mr. DIMON. I have lost this argument publicly many times, but I will make it again. Regulation is not binary. It is not left or right. It is not Democrat or Republican. These are complex things that should be done the right way, in my opinion in closed rooms—I don't think you make a lot of progress in an open hearing like this—talking about what works, what doesn't work, and collaborating with the business which has to conduct it.

We want a safer system, too. We have as much a vested interest in having a safe and good financial system as anybody else. And we will do anything we can to be part of a process to make it healthy and safe.

I should point out, it is a lot healthier and safer today. The market did a lot of things, like I mentioned—no off-balance-sheet vehicles, no subprime mortgages, exotic derivatives are going away. Regulation has created more capital, more liquidity, standardized derivatives go to clearing houses. It is a much stronger system today. A lot has been accomplished.

Mr. HINOJOSA. My time has ended, and I yield back.

Chairman BACHUS. Thank you.

Mr. McHenry for 5 minutes.

Mr. MCHENRY. Thank you, Mr. Chairman.

Mr. Dimon, there is this discussion today, the distinction between hedging and proprietary trading. Can you define to us the difference, in your view, of hedging versus proprietary trading?

Mr. DIMON. I will tell you what I think. A hedge is meant to protect you if something goes wrong in a decision you make. Proprietary trading I think people mean is just making a bet that prices change and you can make money in a price change.

The problem with that is, every time we make a loan, it is proprietary. The riskiest thing we do is loans. They are all proprietary. If we lose money on them—and one of the Congressmen mentioned how much money we can lose on loans—that is to the house account. We still make them. We try to do the right thing to risk-manage it.

I understand and never disputed the intent of the Volcker Rule to make companies safer. I totally agree. I think we have made something very complex which is going to be very hard to legislate or put in regulatory terms that works.

Mr. MCHENRY. Is there a bright-line distinction between hedging and proprietary trading? Because don't they look similar unless there is a balanced trade on the other side that matches up?

Mr. DIMON. I think in some cases there is a bright line, yes.

Mr. MCHENRY. Okay. And how long have you been in finance, how many years?

Mr. DIMON. A long time, 30 years or so.

Mr. MCHENRY. Okay. We will just say a long time. And for a living, you are supposed to know the distinction between this. You are testifying before Congress. You have obviously spent a lot of time doing this. So is there a bright-line distinction between that? And if you can't determine what that is, how can a regulator determine that?

Mr. DIMON. Okay. I wouldn't have set it up proprietary versus hedging. That is not how I would have had the conversation. If you wanted to make the system safer, I would have said for trading, proper capital, proper liquidity, make sure it is largely done with clients, look at age inventory, you have proper risk reporting. You do have the ability to portfolio hedge and hedge because you need that in trading. And you could track all these things to say if you are running a good customer business or not. It does not eliminate risk; it will mitigate the risk.

Mr. MCHENRY. Okay. So did you support Dodd-Frank?

Mr. DIMON. That is a hard one to say. There are parts—we had a major crisis. We—

Mr. MCHENRY. Did you support Dodd-Frank in its conception?

Mr. DIMON. We had a major crisis, and we never denied that. And the crisis unveiled lots of flaws in our system—not one flaw, lots of flaws. So we understood the need for reform. There are parts of Dodd-Frank we supported; there are parts of Dodd-Frank we didn't.

Mr. MCHENRY. Okay. Suffice—

Mr. DIMON. If you do remember, there are lots of parts to Dodd-Frank, so it is not like we had the same vote—

Mr. MCHENRY. Suffice it to say, you have a little buyer's remorse. That is kind of what I am hearing. So, I understand, you are basically saying, yes, you understand the need for changes, you just don't like the results.

Mr. DIMON. Some of the results.

Mr. MCHENRY. Some.

Mr. DIMON. It should be modified.

Mr. MCHENRY. Okay. So with Volcker, as it is being written, the distinction between proprietary trading and hedging, that is a bit of the debate that is going on right now.

So, look, my concern is, in the post-TARP era, when we said we are going to end bailouts, we have actually codified it and institutionalized it. Therefore, when a company like yours that received extraordinary support from the government has a trading loss, the government gets very involved. Why is the government very involved? Because we have institutionalized "too-big-to-fail" and bailouts with Dodd-Frank.

Now, to that point, during your hearing last week with the Senate, you discussed the distinction between a resolution authority and bankruptcy. Would you touch on that? Would you explain your view on what is preferable, the resolution authority as written in Dodd-Frank or bankruptcy?

Mr. DIMON. You are asking for a lot of semantics. I would use the word "bankruptcy." A bankruptcy implies that the equity gets wiped out. The unsecured debt only recovers if there is some left over to recover. And a court manages the wind-down of the company.

You do need an expert like the FDIC to manage the process, that has the right people, the right structures, the right capabilities to manage the wind-down. And that it should be wound down, and all clawbacks invoked, the board of directors fired. The company should eventually be dismantled in a way that does not damage the economy. The name should be buried in disgrace. That is what should happen.

Mr. MCHENRY. Okay. So that is called bankruptcy, right?

Mr. DIMON. You guys can call it whatever you want. I am not going to get involved in the debate between bankruptcy and resolution.

Mr. MCHENRY. If you are involved in the debate, actually, sir, I don't know if you have been here for as long as—

Mr. DIMON. Yes.

Mr. MCHENRY. Anyway. But the distinction between resolution authority, which is in essence codifying "too-big-to-fail," in essence codifying the fact that the government will lift you up if you fail, therefore these trading risks can be as risky as possible—this is the crux of the debate and why you are here today.

Mr. DIMON. They won't lift you up. They will keep it going so that—but the equity is wiped out, management is wiped out, unsecured is wiped out. The company gets dismantled and eventually is not there, without damaging the economy.

Mr. MCHENRY. So we will put you on record in support of that.

Chairman BACHUS. Your time is up, Mr. McHenry. Thank you.

Mr. Miller for 5 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

Mr. Dimon, you were very dismissive last week with the Senate about a Bloomberg article—I think you told the Senate committee not to believe everything they read—that said that the CIO had really changed in the last few years from being a fairly sleepy, cautious risk mitigation unit and had become much more aggressive, much more risk-tolerant and profitable, and it was your intention that it become a profit center. And, in fact, more than a quarter of JPMC's profits for 2010 came from CIO's trading.

But there was a question that Senator Johnson asked you from that article about a—that there had been a limit, that traders had to liquidate, had to get out of any position that had lost $20 million. And you were very puzzled by that and said you knew nothing about it. Have you inquired since then if there was such a limit and it was changed?

Mr. DIMON. No.

Mr. MILLER OF NORTH CAROLINA. You have not asked within your organization?

Mr. DIMON. I think it referred to something back in 2007 or 2008, so I did not ask, no.

Mr. MILLER OF NORTH CAROLINA. All right. You did say last week that the failure with these trades was not that it was rogue traders; they weren't violating the risk controls. The risk controls were not sufficient. That is correct, right?

Mr. DIMON. They were too low—they were too high. There should have been much more lower limits that they had, yes.

Mr. MILLER OF NORTH CAROLINA. Did they have any limits? Last week, you seemed to indicate not.

Mr. DIMON. No, the CIO as a total had limits, but this unit didn't have its own. But they used the CIO's limits, which they eventually hit and stopped it at this level of loss.

Mr. MILLER OF NORTH CAROLINA. But a limit of $20 million in losses and then you close the position, that would be a fairly granular risk control, wouldn't it?

Mr. DIMON. If that were true, that would—it depends what the area is, but yes.

Mr. MILLER OF NORTH CAROLINA. All right. You have been very critical of JPMC in this matter, and you said that it was a significant risk management failure. You said it is flawed, complex, poorly reviewed, poorly executed, poorly managed. But on February 29th, you filed a certification required by law that you had adequate risk controls in place, that management's assessment of the firms determined that there were no material weaknesses in its internal controls over financial reporting as of December 31, 2011.

I know that you are entitled to rely upon your subordinates, and I am sure you have relied upon your subordinates in making that certification. But was that certification correct?

Mr. DIMON. I believe it to be, yes.

Mr. MILLER OF NORTH CAROLINA. It was correct?

Mr. DIMON. It was to my knowledge at the time. And—

Mr. MILLER OF NORTH CAROLINA. No, no. Not based upon your knowledge at the time, but based upon what you know now, was that certification correct?

Mr. DIMON. That is why we are having the review, to make sure that we have all the right things in place. That is what companies

do when they have problems. They analyze them, they review them, and they make determinations like that. And the review is not done yet.

Mr. MILLER OF NORTH CAROLINA. All right. Who is entitled to—it seems like that certification is intended for regulators, but it is also intended for investors, isn't it? Aren't they entitled to rely upon the representation that there are adequate risk controls?

Mr. DIMON. I don't know the thing you have in front of you, but—

Mr. MILLER OF NORTH CAROLINA. What is that?

Mr. DIMON. I don't know what you are referring to, but we try to give proper disclosures to our investors.

Mr. MILLER OF NORTH CAROLINA. I am referring, actually, to the certification about risk controls. That certification is required by law. And presumably it is for both regulators and also for investors, isn't it?

Mr. DIMON. Yes. We try to disclose what we are supposed to disclose.

Mr. MILLER OF NORTH CAROLINA. All right.

What inquiry did you make about risk controls at the CIO before you signed that certification?

Mr. DIMON. I believed at that time that the risk controls in the CIO were being done properly.

Mr. MILLER OF NORTH CAROLINA. You were surprised last week at the question about a $20 million limit. It appeared to be something you were hearing for the first time, and you haven't inquired in the 6 days since then whether that was true. I know that you rely upon—you are entitled to rely upon your subordinates, you said that last week, but there seems like there must be a limitation on that entitlement if you have noticed that there may be something wrong. One of the ways you might get other information would be from the financial press. Did you read the Bloomberg article?

Mr. DIMON. I don't remember if I read the Bloomberg article.

Mr. MILLER OF NORTH CAROLINA. It was an article that said there was a $100 billion limitation, that traders at the CIO had to close positions once they lost $20 million. That would seem like that would stick out as a pretty big deal.

Mr. DIMON. It wouldn't stick out to me. It happened many years ago. I would pay virtually no attention to it. I am sorry.

Chairman BACHUS. Mr. Miller, your time has expired.

Mr. Stivers for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman; and thanks for being here today, Mr. Dimon.

Before you were seated, we had a first panel where we had five regulators; and the two things that really struck me out of that panel was something Mr. Alvarez from the Federal Reserve said about capital. Obviously, that is a theme we have had here today, about how capital—your strong capital position saved this from causing JPMorgan from having a big problem and ensures that it won't cause the rest of the system a problem.

The other thing was Mr. Gruenberg from the FDIC talked about risk management. Your questions you got from Mr. Grimm and Ms. Hayworth centered around risk management. Is there anything in

your internal review other than capital and risk management that have come out that are lessons learned that other institutions should know?

Mr. DIMON. I agree. You all brought up some things a little bit about models and implementation of models, making sure the risk committee is independent minded and not just sitting around having a cup of coffee, all those kind of things. So there will be more than just that, but—

Mr. STIVERS. Mr. Frank talked a little bit about smart regulation that you had referred to earlier. We had those five regulators sitting in the seats before you. Not one of them really is in charge of the others. They don't really coordinate with a lot of questions about how they share communication. In fact, no questions came up from any of the previous panel about harmonizing the regulations between Europe that they passed in March—on March 29th with the U.S. regulations. And there don't appear to be any lessons learned that are shared with the other firms after what you go through to make sure that there is real shared knowledge. Do you want to comment any more about what smart regulation means to you?

Mr. DIMON. So when Dodd-Frank was done, one of the things it had was the FSOC, like an oversight committee to make sure there are no gaps in the system and that learnings are shared, and we kind of supported that. It was set up with I say virtually with no teeth, and the legislators would have to change it.

But someone should tell them who is responsible for mortgages, who is responsible for Volcker, as opposed to five people having jurisdiction. You see how complex it gets, how long it takes, how long it takes to work it out with foreign regulators. So I think simplifying it, clarifying it, adjudicating disputes, and giving authority and responsibility to the same people would be a good thing.

Mr. STIVERS. Do you want to comment a little bit about how the impact on a multinational financial firm like yourself with regulations in Europe and regulations here that are not harmonized?

Mr. DIMON. Yes, we talked about Dodd-Frank, which has 400 rules. We have to accommodate Basel, which has hundreds of different things. We are not against them all, but liquidity, capital, et cetera. But the rules coming out of Brussels FSA, which is in the U.K., and several others and the CFTC, the SEC. So we have to deal with a lot, and we are going to. We are going to. I just wish it was a little bit more coordinated, and we did the important ones first and not just treat everyone like they are all the same. Like they are equally important. To a hammer, everything is a nail; and that is kind of what we are doing.

Mr. STIVERS. Some questions have come up earlier today, and I am going make a statement instead of asking you this. There have been a lot of questions about too-big-to-fail, and I will just say as a policymaker, too-big-to-fail only happens when policymakers let it happen. So I am not asking you to comment on that, but that is a fact.

I do want to talk to you about the Volcker Rule a little bit. You had some questions about it before. But, really, the key thing on the Volcker Rule would be getting it right. I don't want financial institutions that can run to the Fed fund's window borrowing

money and then putting it in a trading account and then essentially gambling—

Mr. DIMON. And they don't.

Mr. STIVERS. But, at the same time, you have to be able to risk to hedge your positions. So I hope that we can work with the regulators as policymakers here and with the industry to craft something that makes sense. And if you have any ideas for us—I have a minute and 4 seconds—I will let you tell us if you have any ideas on how to make that happen.

Mr. DIMON. The only idea I have is people should actually get in a room, talk about what they are going to accomplish, go through the specifics, and not pretend they are either for Volcker or against Volcker. For us, it is the process of the law of the land. You all may want to get rid of it, but we have to deal with it, and it is a very detailed thing.

And I remind people we do have the best capital markets in the world. You should go home at night and say that we sit upon the best economy in the world, the best capital markets of the world, the best job creator of the world. We need to start doing jobs again, and we need to fix the mortgage market. We need to do a lot of things. If we do, I think it will help this economy recover quicker, not slower.

Mr. STIVERS. One of the things Mr. Gensler said earlier today—there weren't many things he said that I agreed with, but the one thing he did talk about is the advantage Europe has being in a time zone between Asia and the United States. There have been a lot of questions about why certain trades go to London, and I know you need to follow your customers who are global, too, but aren't there some advantages to that time zone?

Chairman BACHUS. Thank you. Mr. Stivers, your time is up. I think the answer was yes.

Mr. DIMON. Yes, sir.

Chairman BACHUS. Mr. Scott for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

Welcome, Mr. Dimon. It is good to have you here.

I want to start off by paying you and your operation down in Georgia a tremendous compliment. Georgia is number one in home foreclosures. We had a great foreclosure event down there, and I want you to say a good word for your folks down there in Georgia: Mr. David Balo and Todd Williams and Vanessa Williams—Vanessa Mims. Your Chase Home Ownership Center, good job. We saved over 1,785 homes, many of them yours. So good work.

I think it is very important for us to set the stage here. I think that we in the United States of America and probably the world economy dodged a bullet, and we dodged a bullet basically because of your size, because of your largeness. You were able to handle and absorb this loss. But there is much we can learn from it. And I think, if I get my hands around this correctly, one was not enough attention was paid early on in the game; is that correct? Would you say that is one of the major reasons why the loss was substantial?

Mr. DIMON. In hindsight, yes.

Mr. SCOTT. And your reporting was diluted in the aggregate, which caused a problem as well.

The fundamental issue here, so we can learn from the future, is your risk management tool is referred to as Value at Risk. That was your model. And it is one of the reasons it was used to effectiveness, but it is basically predicated on large financial institutions. You are the largest financial institution in the world, certainly in the United States of America, and that is why we are still profitable, taxpayers didn't lose anything on this, and it was effective.

But here is the question: Would smaller firms have been able to have those same protections, using the same Value at Risk model as Chase?

Mr. DIMON. We use lots of protections. VaR is one of many things we do to manage risk.

I should point out there are reasons for big banks. There are reasons for small banks. Community banks do a great job. JPMorgan Chase in fact is one of the biggest banker to banks. The history of JPMorgan, as a money center bank, was to bank banks; and I think some of them can, yes. I can't go through each one. They have different business models. But each one should do what they need for their own business, the ame business as we are in.

Mr. SCOTT. Let me ask you this, Mr. Dimon. As a result of this, should one of the things we do now—should banking entities like JPMorgan be allowed by our regulators to hedge only on positions specific basis, as opposed to on an aggregate or portfolio basis?

Mr. DIMON. If I were the regulator, I would allow portfolio aggregate. I will give you one example, because several people have mentioned Europe today. JPMorgan has been doing banking in Europe for 75 years. JPMorgan himself used to love Italy and would go there. We have exposures to Italian companies that you can't get out of tomorrow. So if you were on my board of directors and you said, I don't want Italian exposure, there is only one way to really do it, would be to go and do certain portfolio hedging, which would accomplish part or all of that. If you said do it by individual name, it would be impossible.

Mr. SCOTT. And, Mr. Dimon, I think the American people would want to know, when this happened, when you first got wind of this $2 billion loss, what was your initial reaction?

Mr. DIMON. When I fully realized it, I told our people that everything is going to happen, from coming down to Washington, to questioning Volcker, that I think we have hurt other bankers—it causes a lot of commotion inside the company, soul searching. But my attitude is let's admit our mistakes, and fix them. Let's put our jerseys on and fix it. That we would have to make changes. It would be a very tough time for us.

However, it didn't affect—it does affect it, but it shouldn't detract us from our mission of serving clients. We have 82 Chase home offices, we have opened them all in the last 3 or 4 years, and we will do all the things we have to serve the clients right. I don't want this detracting from what all of our 260,000 people do every day.

Mr. SCOTT. And I can't let you leave without this question. Because the fundamental question going forward is this whole issue of too-big-to-fail, how do you feel about that, especially since you are the biggest of the biggest?

Mr. DIMON. Our goal is not to be the biggest. It is to be the best. I think everyone kind of agrees we have to get rid of that in any incarnation.

Mr. SCOTT. You said get rid of too-big-to-fail?

Mr. DIMON. We cannot have too-big-to-fail. We have to eliminate too-big-to-fail, therefore allowing a big bank to fail in a way that doesn't damage the American economy and the taxpayer never pays. And I think we are on our way to working through the things that would allow that to take place.

Chairman BACHUS. Thank you.

Mr. Neugebauer for 2 minutes, and that will then conclude our hearing.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Dimon, I want to kind of just go through a little calendar here. On April 6th, Bloomberg had an article. You are familiar with that article.

Mr. DIMON. Yes.

Mr. NEUGEBAUER. And I think the Wall Street Journal had an article that same day. Are you aware that the regulators had come into your shop on April 9th and had expressed concerns about this article in the trades?

Mr. DIMON. I am aware that—I don't know if they came or we called them. Like I said, we share everything with them. So I do believe some of the people spoke to the regulators and described what they thought about it, yes.

Mr. NEUGEBAUER. It is reported on Tuesday, April the 10th, that particular position lost $300 million that day and I think subsequently on the next Tuesday and Wednesday with smaller losses. Were you familiar with those?

Mr. DIMON. Yes.

Mr. NEUGEBAUER. And so then on April 13th, you made a statement that it is no big deal; it is just a tempest in a teapot. Was that an accurate reflection of that transaction?

Mr. DIMON. It is totally a positive, accurate reflection of what I believed at the time. Because folks had done work to look at the additional stress. That day it lost $300 million was the first trading day after the article. So part of that was expected, since we just showed the world our hand a little bit. The stress tests showed that it could be that dramatic. Several people believed that, reported that back to me. So on April 13th, I believed it was a tempest in a teapot.

I obviously was dead wrong. It won't be the first time I have ever been wrong. It won't be the last. I obviously was dead wrong, and I deeply regret having said it.

Mr. NEUGEBAUER. I understand. We all—I think the concern I had was that was a couple of days after that $300 million pop, and that is a pretty big pop even in your organization, isn't it?

Mr. DIMON. Our folks have looked to reports after that about how bad it can get. We stress-tested it. Some of the stress reports, I may have seen them, but there were reports to me that doesn't show it could be that much worse. So, no, if that is what we believed, I would have considered that a small thing for JPMorgan. We had a very profitable quarter. You have to put things in relative size.

Mr. NEUGEBAUER. Thank you.

Chairman BACHUS. Thank you.

Mr. Green for 2 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I will be quick.

Mr. Dimon, thank you for appearing today.

Is it fair to say that you probably had more than 50 meetings concerning this issue that we are talking about today?

Mr. DIMON. Fifty what?

Mr. GREEN. Fifty meetings, meetings. Meeting with people, talking on the phone about this?

Mr. DIMON. Yes.

Mr. GREEN. Probably a hundred. More than a hundred.

And is it fair to say that you are amenable to meeting with and talking to various people about these things and other things associated with your business and that probably you meet with Members of Congress and talk to them about these issues?

Mr. DIMON. I talk to people if appropriate. We operate under a lot of rules and laws of what I can and can't say to certain people.

Mr. GREEN. If appropriate, do you meet with Members of Congress?

Mr. DIMON. On occasion, yes.

Mr. GREEN. I am asking this because I want to talk to you about a concept that is near and dear to my heart. We have been talking about too-big-to-fail. I want to talk to you about a concept that I have called "too-small-to-live-off." That concerns something that is happening in this country. We have in Houston, Texas, some persons who are janitors; and they are paid $8.35 an hour. Now I know this is very small compared to what we have been talking about. I think you made about $19 million in 2011, or thereabouts; is that right?

Mr. DIMON. Yes.

Mr. GREEN. And I understand that your 4th highest paid person made about $14 million in 2011. I won't mention the name, but there is a reason for picking the 4th highest. With persons making this kind of money—

By the way, I salute you for it. I am a capitalist. I commend people for making the money that they make, within the rules, of course.

But what I want to talk to you about is this: $47,000 is what it costs a family of 4 to live off in Houston. The poverty level is $23,000 a year. The average janitor working full time will make about $18,000 a year. That is working full time and living below the poverty line.

I would like to meet with you and talk to you about "too-small-to-live-off." And I will pay my way. I won't use congressional funds. I will be willing to do it anyplace that you would like. Can you and I meet and talk about "too-small-to-live-off," Mr. Dimon?

Mr. DIMON. Yes, we can.

Mr. GREEN. I will talk to you after the meeting.

Chairman BACHUS. Actually, maybe tomorrow or the next day.

Mr. GREEN. I am going to miss the vote.

Chairman BACHUS. Thank you.

This concludes the hearing. The Chair thanks our panelist for his testimony.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will be open for 30 days for Members to submit written questions to this witness and to place his responses in the record.

Mr. DIMON. Thank you very much, Mr. Chairman.

Chairman BACHUS. This hearing is now adjourned. Thank you.

[Whereupon, at 1:49 p.m., the hearing was adjourned.]

A P P E N D I X

June 19, 2012

Congressman Joe Baca
Opening Statement
Financial Services Committee Hearing – *Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss*
June 19, 2012

- I want to begin by thanking the Chair and Ranking Member for calling this hearing.
- Leading up to the collapse of 2008, we saw many of our country's biggest financial institutions over-extend themselves and engage in risky trades to pad the pockets of their investors.
- And they did so with little regard as to whether they could cover their losses if they needed to.
- Today, our economy is still paying for these mistakes, and Americans are still cautious of what happens on Wall Street and the regulation that is supposed to protect us.
- That is why what happened with JP Morgan is so troubling, because it continues to send the message that Wall Street still doesn't get it.
- Homeowners are still facing underwater mortgages; unemployment is still in double digits, and people are still trying to rebuild their savings for retirement, while executives on Wall Street are still being handed golden parachutes after being fired or let go.
- Yet our country's biggest financial institution argues, that even though this deal has already accounted for $4 billion in losses, stronger regulation is not needed.
- Maybe the only people who were hurt in the pocket were the shareholders of JP Morgan, but we should all be clear about the message that is being sent.
- I hope today we can discuss how we can fix this message and build back the confidence in our market that the American public deserves.
- Thank you and I yield back –

6/19/12

Mike Capuano

Thank you Mr. Chairman. I believe all of us here would agree that nothing is more important to our constituents than the health of our economy and the future we are going to leave the next generation. With the banking and financial services sector comprising a large portion of our economy, any major development, especially one regarding a $2 billion loss by the nation's largest private bank, is worth evaluating.

We are here today to examine and understand the supervision and risk management within the capital markets in light of JPMorgan Chase's recent loss. I appreciate the witnesses taking the time to provide their perspective on our regulatory system as it relates to large financial institutions.

Today, there will be very important questions to both panels evaluating the current situation at JP Morgan, whether there was a regulatory failure or a lack of oversight and what could or should have been prevented. We will be looking to understand what measures should be taken, moving forward, by regulators to protect investors and the economy. With regards to JP Morgan, were there compliance failings or simply poor business decisions?

The economic meltdown and a near collapse of our banking system is still fresh on everyone's minds and invites heightened scrutiny. We only seek to gauge the status of financial reforms and to understand what measures this committee and this Congress need to take to protect our citizens from another economic catastrophe.

Thank Mr. Chairman, and I yield back.

For release on delivery
9:30 a.m. EDT
June 19, 2012

Statement by

Scott G. Alvarez

General Counsel

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

June 19, 2012

Chairman Bachus, Ranking Member Frank, and members of the Committee, thank you for the opportunity to testify regarding bank supervision and risk management and the Federal Reserve's response to the trading losses recently announced by JPMorgan Chase & Co. (JPMorgan Chase).

Prudential Supervision of Large Financial Firms

Before discussing JPMorgan Chase's recent trading losses, it may be helpful first to discuss how the Federal Reserve and other supervisors oversee large financial institutions like JPMorgan Chase. The prudential supervision of the largest, most complex financial firms is a cooperative effort, in which the Federal Reserve acts as the regulator and supervisor of bank holding companies, but with most of the principal business activities of such firms typically conducted through subsidiaries supervised by other functional regulators, such as insured depository institutions, broker-dealers, and insurance companies. As the consolidated supervisor of holding companies, the Federal Reserve's supervisory program for such firms generally takes a broad view of the activities, risks, and management of those firms on a consolidated basis, with particular focus on financial strength, including the adequacy of capital and liquidity, corporate governance, and risk-management practices and competencies of a firm as a whole.

The Federal Reserve has taken a number of steps in recent years to reorient its supervisory structure and strengthen its supervision of the largest, most complex financial firms. Most importantly, we have established the Large Institution Supervision Coordinating Committee (LISCC), which is founded on the principles that large institution supervision should be more centralized; that it should conduct regular, simultaneous, horizontal (cross-firm) supervisory exercises; and that it should be more interdisciplinary than it has been in the past. Thus, the committee includes senior Federal Reserve staff from the research, legal, and other

divisions at the Board and from the markets and payment systems groups at the Federal Reserve Bank of New York, as well as senior bank supervisors from the Board and relevant reserve banks. Relative to previous practices, this approach to supervision relies more on quantitative methods for evaluating the performance and vulnerabilities of firms.

To date, the LISCC has developed and administered various horizontal supervisory exercises, notably the capital stress tests and related comprehensive capital reviews of the nation's largest bank holding companies, and is now extending its activities to coordinate other supervisory processes more effectively.

JPMorgan Chase's Trading Loss and the Federal Reserve's Response

Last month, JPMorgan Chase announced that it had suffered significant trading losses on credit derivative positions entered into by its Chief Investment Office (CIO). The CIO is an organizational unit of JPMorgan Chase that carries out, through the firm's subsidiary national bank, a variety of asset-liability management and other activities. The activities of the CIO are managed and controlled out of JPMorgan Chase's New York headquarters, with a substantial portion of the CIO's activities conducted through the bank's London branch and other overseas branches or offices.

The trading losses suffered by the CIO arose out of a complex synthetic credit portfolio that the CIO had developed over time, which was primarily composed of both long and short credit default swap positions on a number of different credit assets and indices. Trading in this synthetic credit portfolio was executed through the London branch of JPMorgan Chase's subsidiary national bank. JPMorgan Chase has stated that, because of a combination of risk-management failures and execution errors, and the complexity and illiquidity of the positions

involved, the CIO's synthetic credit portfolio gave rise to significant trading risks that resulted in the losses.

In response to these significant trading losses, the Federal Reserve--in its capacity as consolidated supervisor of the bank holding company--has been working closely with the Office of the Comptroller of the Currency (OCC), the regulator of the national bank, on a number of fronts. First, the Federal Reserve is assisting in the oversight of JPMorgan Chase's efforts to manage and de-risk the portfolio in question. Second, we are working closely with the OCC and Federal Deposit Insurance Corporation (FDIC) to fully assess any risk-management failures, governance weaknesses, or other potential problems that may have given rise to the CIO's losses, and to help ensure that any such shortcomings are promptly and appropriately addressed. This review includes scrutiny of risk-control practices surrounding the CIO's trading, hedging, and investment activities and strategies; in particular, those activities and strategies that led to the CIO's recent losses. Third, the Federal Reserve continues to evaluate whether the governance, risk management, and control weaknesses exposed by this incident may be present in other parts of the firm engaged in similar activities. To date, we have found no evidence that they are, but this work is not yet complete.

The Importance of Capital

The trading losses at JPMorgan Chase have served to remind us of the fundamental importance of capital regulation in our prudential oversight of the largest banking firms. Although the risk-management failures that led to JPMorgan Chase's recent trading losses are a cause for significant supervisory concern, it is important to note that these losses, though large in absolute dollar terms, are not a threat to the safety and soundness of the firm. Every dollar of

these losses will be borne by JPMorgan Chase's shareholders, and not by depositors or taxpayers, a result that is a function of the substantial amounts of high-quality capital that JPMorgan Chase holds.

While robust bank capital requirements alone cannot ensure the safety and soundness of the largest banking firms, and indeed should be buttressed by other effective regulatory tools, they are central to good financial regulation because they ensure that capital is available to absorb all kinds of losses, unanticipated as well as anticipated. For precisely this reason, the Federal Reserve and other federal banking regulators continue to take important steps to strengthen bank capital regulation, especially for the largest, most complex firms. Over the past several weeks, the Federal Reserve, OCC, and FDIC have acted jointly to finalize U.S. implementation of the so-called Basel 2.5 reforms that will materially strengthen the market risk capital requirements of Basel II. We have also requested public comment on changes to the U.S. regulatory capital rules to implement the Basel III reforms and the capital requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The proposed changes would improve the quality and quantity of regulatory capital held at our nation's banking organizations. Importantly, many of these regulatory reforms specifically address and strengthen the capital requirements applicable to trading activities and positions, including complex derivatives.

The Federal Reserve has also advocated internationally for capital surcharges on the world's largest, most interconnected banking organizations based on their global systemic importance. Last year, an international agreement was reached on a framework for such surcharges, to be implemented over a 2016–19 transition period. This initiative is consistent

with the Federal Reserve's obligation under section 165 of the Dodd-Frank Act to impose more stringent capital standards on systemically important financial institutions, including the requirement that these additional standards be graduated based on the systemic footprint of the institution.

The recent improvements to the regulatory capital framework have important supervisory complements in the Federal Reserve's development of firm-specific stress testing and capital planning requirements. These supervisory tools make capital regulation more forward-looking by testing whether firms would have enough capital to remain viable financial intermediaries if they sustained hypothetical losses in asset values and earnings in an adverse macroeconomic scenario. These tools also help to ensure that a firm's senior management and board of directors have put in place the appropriate processes and procedures to fully understand and manage the capital adequacy of the firm in a variety of economic environments. In this area, the Federal Reserve recently completed our second annual Comprehensive Capital Analysis and Review (CCAR). In the CCAR, the Federal Reserve assessed the internal capital planning processes of the 19 largest bank holding companies and evaluated their capital adequacy under a very severe hypothetical stress scenario that included a peak unemployment rate of 13 percent, a 50 percent drop in equity prices, and a further 21 percent decline in housing prices.

Notwithstanding the stringency of the stress test used in the 2012 CCAR, 15 of the 19 firms showed they would maintain capital above prescribed standards, even assuming that all proposed dividends and other capital actions went forward during the stress period. Furthermore, the results of the 2012 CCAR process demonstrated that most of the 19 bank holding companies have made considerable progress in their internal capital planning processes.

Crucially, the tier 1 common ratio for these firms, which compares high-quality capital to risk-weighted assets, has doubled during the past three years to a weighted average of 10.9 percent from 5.4 percent in the first quarter of 2009.

Implications for Implementation of the Volcker Rule and Other Regulatory Reforms

The trading losses announced by JPMorgan Chase have also focused attention on the regulation of trading activities by large, complex banking firms. In particular, there is considerable attention on the Volcker Rule provision of the Dodd-Frank Act banning proprietary trading. The statute provides an exemption from the general ban on proprietary trading for risk-mitigating hedging activities. The rulemaking agencies have jointly issued proposed rules to implement the Volcker Rule, and that proposal would implement that statutory exemption by incorporating the terms of the statutory exemption. Importantly, the agencies' proposal also adds requirements designed to enhance the risk-monitoring and -management of hedging activities and to ensure that these activities are risk-mitigating. Among the restrictions the agencies proposed to add include a requirement for formal policies and procedures governing hedging activities that includes approved hedging instruments and strategies, a formal governance process, documentation requirements explaining the hedging strategy, an internal audit for compliance with these approved hedging strategies, and requirements that incentive compensation paid to traders engaged in hedging not reward proprietary trading. This multi-faceted approach is intended to limit potential abuse of the hedging exemption and improve risk management of these activities, while not unduly constraining the important risk-management function that is served by a bank entity's hedging activities.

The Federal Reserve has received a significant number of comments on this aspect of the proposed rule, including a number of more recent comments informed by the trading losses that have occurred within JPMorgan Chase's CIO. We will consider all of these comments carefully as we work with the other rulewriting agencies to finalize the joint agency Volcker Rule proposal.

Thank you for inviting me to appear before you today. I would be pleased to answer any questions you may have.

For Release Upon Delivery
10:00 a.m., June 19, 2012

TESTIMONY OF

THOMAS J. CURRY
COMPTROLLER OF THE CURRENCY

before the

FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

June 19, 2012

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Bachus, Ranking Member Frank, and members of the Committee, it is a pleasure to testify before you as the 30th Comptroller of the Currency. Before beginning, I want to express my willingness and desire to work closely with the Members of this Committee during my tenure on the many issues under consideration that have an impact on the supervision of national banks and federal savings associations.

Strong supervision is a theme that will mark my tenure as Comptroller. The OCC supervises nearly 2,000 national banks and federal savings associations (collectively "banks"), which constitute approximately 26 percent of all federally insured banks and thrifts, holding more than 69 percent of all commercial bank and thrift assets. These institutions range in size from nearly 1,800 community banks with assets of $1 billion or less to the nation's largest and most complex financial institutions with assets exceeding $100 billion. To meet the supervisory needs of banks with such diversity, the OCC has structured its supervision activities into three lines of business: our Large Bank program, which typically covers banks with assets of $50 billion or more; our Midsize Bank program, which covers banks with assets generally ranging from $10 billion to $50 billion; and our Community Bank program, which is focused on banks under $10 billion in assets. We tailor our supervisory activities for these three groups of institutions to the challenges they face.

My testimony today will discuss the OCC's large bank supervisory program and our oversight and work currently underway at JPMorgan Chase (JPMC) related to their recently announced trading losses.

I. OCC Supervision of Large Banks

Overview of the OCC's Supervisory Program for Large Banks

The OCC's Large Bank supervision program is structured to promote consistent risk-based supervision. It is a centralized program headquartered in Washington with a national perspective that facilitates coordination across large institutions.

The foundation of the OCC's supervisory efforts is our continuous, onsite presence of examiners at each of the 19 largest banking companies. These onsite teams are led by an Examiner-In-Charge (EIC) who manages a staff of seasoned examiners, generally with 20 or more years of experience across numerous banks and multiple business cycles, and possessing advanced skills in key risk areas such as credit, capital markets, and compliance. In addition, certain supervisory activities are staffed by our team of PhD economists from the OCC's Economics Department. The examiners are also supplemented by lawyers, other economists, as well as policy and subject matter experts to support their ongoing supervision.

The onsite examination teams have three main objectives. The first is to know the objectives of the bank and its lines of business, the key risks, and the controls that are put in place to manage them. The second is to assess the levels of risk in the bank and the quality of risk management over the course of the examination cycle. Finally, examiners are charged with communicating examination findings, concerns, and ratings through our CAMELS and Risk Assessment System. Examiners communicate by meeting with bank management and the board of directors, and through written supervisory letters and reports of examination. They identify concerns and ensure that corrective actions are taken, through the supervisory process, or if needed, appropriate enforcement actions.

Resident examiners apply risk-based supervision to a broad array of issues and risks, including credit, liquidity, price, interest rate, compliance, and operational risks.

The primary focus of examiners is to determine whether banks have sound risk control processes commensurate with the nature of their risk-taking activities, capital, reserves, and liquidity. Given the millions of transactions that large banks conduct daily across varied product lines and businesses, examiners do not review every transaction in a bank. Our primary focus, rather, is on the bank's own risk management functions and governance. Our assessments in these areas guide where more detailed exam work may be needed. Our review of risk management controls at large banks starts at the top, with governance and oversight provided by the board of directors and senior management. We regularly meet with independent directors and the chairmen of the board's audit and risk committees to assess their understanding of key risks and emerging issues, along with their thinking on current and prospective matters. Through these meetings and our review of the board's actions and decisions, we assess their ability and willingness to effectively challenge management decisions, as well as their qualifications to serve in such a position. We also evaluate those functions via regular review of board and management information reports (executive and business level), as well as risk management reporting and audit reports.

OCC examiners probe to see where activities, earnings, or losses diverge from expectations to a degree indicative of a breach of approved parameters or breakdown of controls. For example, examiners look for lending or trading activities operating outside approved limits, especially where risk management activities did not identify or escalate such instances; and for models breaking or not going through proper validation. Risk management seeks to mitigate and control risk but not eliminate it entirely. Losses occur

even when all controls function properly. That is why banks are required to maintain capital, reserves, and liquidity to absorb adverse outcomes and unexpected losses.

When we find weaknesses or deficiencies, we communicate them to bank senior management and require corrective actions. Most often this is accomplished through "Matters Requiring Attention" (MRA) that are sent to the bank's senior management and board of directors. When needed, we take more formal enforcement actions.

To enhance our ability to identify key risks, as well as emerging issues, and share best practices across the large banks, we have examiner network groups across eight major disciplines: Commercial Credit, Retail Credit, Mortgage Banking, Capital Markets, Asset Management, Information Technology, Operational Risk, and Compliance. These groups share information, concerns, and policy application among examiners. They also identify areas of common interest, as well as risks that are elevated or emerging. The EICs and leadership teams of each of the network groups work closely with specialists in our Supervision Policy and Risk Analysis Divisions to promote consistent application of supervisory standards and coordinated responses to emerging issues.

Examinations are conducted pursuant to risk-based supervisory strategies that are developed for each institution. Although each strategy is tailored to the business model and risk profile of the individual institution, the strategy development process is governed by supervisory objectives established annually by our senior supervision management team. Through this planning process, the OCC identifies key risks and issues that cut across the industry and promotes consistency in areas of concern. Each strategy is reviewed and approved by the appropriate Large Bank Deputy Comptroller. In addition,

a Quality Assurance group within our Large Bank program reviews selected strategies as part of a structured process review to ensure that examination activities are executed consistently and in a quality manner.

It is important to remember that the job of risk management is not to eliminate losses. Rather, risk management ensures that risk exposures are fully identified and understood by bank management and directors to allow them to make informed business decisions about the firm's risks, and that the bank has sufficient capital, reserves, and liquidity to withstand a range of potentially adverse outcomes. Banks must manage their risks effectively to meet the credit and borrowing needs of the customers and communities they serve.

OCC's Heightened Expectations for Large Banks

We have raised the bar on our supervisory expectations for the largest banks we supervise. Large banks are critically important to the vitality of our economy and the orderly functioning of the capital markets. As a result, they must be managed and governed in a higher quality manner than less systemically important banks. Our experience in the recent crisis showed that we needed to elevate expectations with respect to balance sheets as well as governance and oversight processes.

Stronger Capital, Reserves, and Liquidity Standards

Since the onset of the financial crisis, we directed the largest institutions to strengthen their capital, reserves, and liquidity positions. As a result, the quality and level of capital at national banks and bank holding companies with total assets over $50 billion have improved significantly. The median percentage of Tier 1 common capital relative to total assets for bank holding companies increased from 5.2 percent to more

than 7 percent, while the comparable ratio for national banks and federal savings institutions rose from 6.4 percent to 8.7 percent over that same period.

Under scrutiny of our examiners, the largest banks have more than doubled their loan loss reserves as a percentage of gross loans since the end of 2007, from 1.4 percent to 2.9 percent. Similarly, the largest banks have materially strengthened their liquidity buffers through increases in short-term liquid assets that can be used to meet unanticipated liquidity demands and through a decreased reliance on short-term, volatile funding. In concert with the Basel III Capital rulemakings recently approved for public comment, we also are raising both the quality and quantity of regulatory capital that banks generally must hold. Under the proposed rules, large banks will face additional capital requirements, including a countercyclical capital charge, which banking supervisors can activate to curb excessive credit growth, and a supplemental leverage ratio that will capture off-balance-sheet exposures. Basel III also introduces two explicit quantitative minimum liquidity ratios to assist a bank in maintaining sufficient liquidity during periods of financial distress: the Liquidity Coverage Ratio to ensure a bank has sufficient high quality liquid resources to offset cash outflows under acute short-term stresses, and the Net Stable Funding Ratio, which creates additional incentives for a bank to fund ongoing activities with stable sources of funding. While these are all positive developments, we are taking actions to ensure that these are permanent and not just temporary improvements.

Heightened Expectations for Strong Corporate Governance and Oversight

Higher supervisory expectations, along with sharper execution by bank management and independent directors in fundamental areas, will go a long way toward

maintaining the improvements achieved since the financial crisis and minimizing the probability and impact of future crises. We set higher expectations for large banks in five specific areas.

Board willingness to provide credible challenge. A key element in corporate governance is a strong, knowledgeable board with independent directors who provide a credible challenge to bank management. The capacity to dedicate sufficient time and energy in reviewing information and developing an understanding of the key issues related to bank activities are critical to being an effective director. Informed directors are well positioned to engage in value-added discussions that provide knowledgeable approvals and guidance. Effective directors prudently question the propriety of strategic initiatives, talent decisions, and the balance between risk taking and reward. And obviously, it is essential to the ability of directors to perform this role to have effective information flow and risk identification within the organization.

Talent management and compensation. Human capital is a key asset in any organization, and we expect large banks to have a well-defined personnel management process that ensures appropriate, quality staffing levels and provides for orderly succession. Large bank management processes are typically extensive. OCC EICs are enhancing their knowledge in this area and incorporating their assessments into the "management" rating in CAMELS, with particular focus on the adequacy of current staffing levels, the ability to provide for orderly succession, the proactive identification of staffing gaps that require external hires, and appropriate compensation tools to motivate and retain talent. Of particular importance is the need to ensure that incentive compensation structures balance risk and financial rewards and are compatible with

effective controls and risk management. This is a key objective of the interagency guidance on sound incentive compensation that the OCC, FRB, and FDIC issued in June 2010, and the proposed rulemaking that the federal banking agencies, the National Credit Union Administration, the SEC, and the Federal Housing Finance Agency have issued to implement the incentive-based compensation provisions in the Dodd-Frank Act.

Defining and communicating risk tolerance expectations across the company. Consistent with prudent governance practices, banks must define and communicate acceptable risk tolerance, and results need to be visible and periodically compared to pre-defined limits. As banks have grown, the process of defining and measuring risk tolerance has typically been confined to the business unit and more micro levels. While these lower level risk limits can generally control individual areas of risk taking, they do not enable senior management or board members to monitor or evaluate concentrations or risk levels at the broader firm level. Examiners are directing banks to complement existing risk tolerance structures with measures and limits of risk addressing the amount of capital or earnings that may be at risk on a firm-wide basis, the amount of risk that may be taken in each line of business, and the amount of risk that may be taken in each of the key risk categories monitored by the banks. This process will result in better identification and measurement of concentrations, with attendant monitoring and controls.

Development and maintenance of strong audit and risk management functions. The recent crisis reinforced the importance of quality audit and risk management functions. The scale and breadth of large banks present added challenges to the roles of executive management and directors in knowing the risk profile and whether pre-defined

policies and procedures are being followed appropriately. While regulators operated for many years with the premise that *satisfactory*[1] oversight functions were generally sufficient, the financial crisis has led us to conclude that large banks should not operate with anything less than *strong* audit and risk management functions. To meet this higher standard, we have directed bank audit and risk management committees to perform gap analyses relative to OCC's standards and industry practices and to take appropriate action to improve their audit and risk management functions. We expect members of the bank's board and its executive management team to ensure audit and risk management teams are visibly and substantively supported. As part of their ongoing supervision, OCC examiners are evaluating the state of these key oversight functions and identifying areas that require strengthening.

Sanctity of the charter. While holding companies of large banks are typically managed on a line of business basis, directors at the bank level are responsible for oversight of the bank's charter—the legal entity. Such responsibility requires separate and focused governance. We have reminded the boards of banks that their primary fiduciary duty is to ensure the safety and soundness of the national bank or federal savings association. Execution of this responsibility involves focus on the risk and control infrastructure necessary to maintain it. Directors must be certain that appropriate personnel, strategic planning, risk tolerance, operating processes, delegations of authority, controls, and reports are in place to effectively oversee the performance of the bank. The bank should not simply function as a booking entity for the holding company.

[1] OCC examiners rate the quality of the bank's audit function and the quality of risk management as weak, satisfactory, or strong.

It is incumbent upon bank directors to be mindful of this primary fiduciary duty as they execute their responsibilities.

II. JPMorgan Chase Loss and OCC's Role and Responsibilities

With this background, let me turn to the recently announced losses at JPMC. This event raises questions about the adequacy and rigor of JPMC's risk management practices that we are actively investigating.

JPMC is a $2.3 trillion bank holding company with approximately $128 billion in Tier 1 common capital as of March 31, 2012. The FRB oversees the holding company and its affiliates. The OCC oversees JPMC's national banks and various subsidiaries. The lead national bank has approximately $1.8 trillion in total consolidated assets and $101 billion in Tier 1 common capital. The OCC's supervisory team includes approximately 65 onsite examiners who are responsible for reviewing nearly all facets of the bank's activities and operations, including commercial and retail credit, mortgage banking, trading and other capital markets activities, asset liability management, bank technology and other aspects of operational risk, audit and internal controls, and compliance with the Bank Secrecy Act, anti-money laundering laws, and the Community Reinvestment Act. These onsite examiners are supported by additional subject matter experts from across the OCC.

Given the scale of the bank, the loss by JPMC affects its earnings, but does not present a solvency issue. JPMC, like other large banks, has improved its capital, reserves, and liquidity since the financial crisis, and its levels are sufficient to absorb this loss. The Basel III rulemakings will further increase the required level of high-quality

capital for all U.S. banks, and work underway by the Financial Stability Board will further increase capital requirements for systemically significant firms, like JPMC.

Similarly, the events at JPMC do not threaten the broader financial system. Under current market conditions, the JPMC effort to manage its positions is not creating an unusual risk of contagion to other banks. Beyond JPMC, we have directed OCC examiners to evaluate the risk management strategies and practices in place at other large banks, and examiners have reported that there is no activity similar to the scale or complexity of JPMC. However, this is a continuing focus of our supervision.

The activities that generated the reported $2 billion loss were conducted in the national bank by JPMC's Chief Investment Office (CIO), which is responsible for the bank's asset-liability management activities. This asset-liability management function is separate from JPMC's investment banking business, where most trading and market making takes place. The CIO reports to the Chief Executive Officer of JPMC. Its activities are conducted globally but managed and controlled out of JPMC's New York offices. These activities are supervised by OCC staff assigned to the JPMC headquarters in New York. Part of our ongoing review includes an evaluation of this structure, its oversight, controls, and the adequacy of risk reporting.

In 2007 and 2008, the bank constructed a portfolio designed to partially offset credit risk using credit default swaps to help protect the company from potential credit losses in a stressed global economy. This strategy was reflected in reports received by OCC examiners. The OCC focused on the risk management systems and controls that the bank employed to mitigate credit risk in its portfolio.

In late 2011 and early 2012, bank management revised its strategy and decided to offset its original position and reduce the amount of stress loss protection. The instruments chosen by the bank to execute the strategy were not identical to the instruments used in the original position, which introduced basis, liquidity, and other risks. As the new strategy was executed in the first quarter, actual performance deviated from expectations, and resulted in substantial losses in the second quarter. Whether risk management controls and procedures were properly structured, reviewed, approved, and acted upon in the execution of this strategy, and risk reporting was sufficiently granular and appropriately escalated, are areas of focus of our ongoing examination.

In April 2012, as part of our supervisory activities, OCC examiners met with bank management to discuss the bank's transaction activity and the current state of the position. OCC examiners directed the bank to provide additional details regarding the transactions, their scope, and risk. Our examiners were in the process of evaluating the bank's current position and strategy when, at the end of April and during the first days of May, the value of the position deteriorated rapidly.

Since that time, the OCC has been meeting daily with bank management with respect to the bank's response to this situation, to re-evaluate the risk management activities and controls of the bank and how they applied to its CIO function, and to determine what additional action is necessary. This includes the ongoing daily oversight of the bank's actions to mitigate and reduce the risk of the positions at issue. We and the Federal Reserve are conducting reviews in the bank and are sharing information with other regulators.

We are also undertaking a two-pronged review of our supervisory activities and response. The first component is focused on evaluating the adequacy of current risk controls and risk governance at the bank, informed by their application to the positions at issue. The second component evaluates the lessons learned from this episode that could enhance risk control and risk management processes at this and other banks and improve OCC supervisory approaches. Consistent with our supervisory policy of heightened expectations for large banks, we will require that the bank adhere to the highest risk management standards.

We are not limiting our inquiry just to the particular transactions at issue. We will assess not just the adequacy of risk management, controls, and reports for the positions now spotlighted, but also activities in comparable bank operations. We will use these events to more broadly evaluate the effectiveness of the bank's risk management throughout the firm and to identify ways to improve our supervision.

The first prong of our approach involves our onsite exam team focusing on three broad areas. To begin with, we are actively assessing the quality of management and risk management in the CIO function, including decision making; board oversight, including whether the risk committee is appropriately informed and engaged; the types and reasonableness of risk measurement metrics and limits; the model governance review process; and the quality of work by the independent risk management team, as well as internal audit. We are also assessing the adequacy of the information provided within the bank and made available to the OCC to evaluate the risks and risk controls associated with the positions undertaken by the CIO. Finally, we are evaluating the compensation process of the CIO and will assess the bank's determination on "claw backs" as part of

that analysis. If corrective action is warranted, we will pursue and implement appropriate informal and/or formal remedial measures.

Working on a parallel track, as part of the second prong of our supervisory response, we are evaluating the events leading up to and through the bank announcement of losses associated with the CIO, and what these events teach us to improve risk management and to enhance our supervisory activity. Particular attention is being directed to the rationale for the transactions and how they fit within the framework of the bank's risk management processes; the quality and extent of information provided to the OCC; and consistency of the bank's activities with OCC supervisory guidance.

We are reviewing the bank's management information systems, committee minutes, audit reports, and conducting discussions with examiners to establish a detailed chronology of events surrounding the CIO decision-making and the resulting losses. Our analysis will focus on where breakdowns or failures occurred. This will include assessments of senior management communication and monitoring of strategies; business judgment and execution; the articulation of risk tolerance relative to strategy; risk measurement (including models, limits, stress scenarios, and changes to those tools during the period in question); flow of information, proper authority, and approvals; and the appropriateness and timeliness of particular actions.

As part of this second prong of our supervisory response, we are also assessing relevant audit or examination findings and whether they were addressed; how the risks associated with the strategy were recognized and evaluated; whether there was an effective exchange of views among the business unit and control groups; whether incentives were properly aligned with desired behaviors; and whether the bank's actions

were consistent with OCC supervisory guidance and expectations. Again, if corrective action is warranted, we will pursue and implement appropriate informal and/or formal remedial measures.

Finally, a vital part of this second component of our supervisory effort is identifying the lessons learned for improving the effectiveness of our supervision. The areas that we will explore here include whether the quality and extent of information available to OCC examiners was sufficient to permit an understanding of the risk and management processes in place to govern it. We will also determine what, in retrospect, the OCC could have done differently, and how to ensure that the risk management processes of this bank—and others—are effective.

I should also note that the OCC is not drawing any conclusion about whether the activities of JPMC's CIO would be subject to the Volcker Rule. It is premature to reach any conclusion based upon the facts and information as they currently exist, however, this experience is an opportunity to inform our views on the final rulemaking.

III. Conclusion

The recent events at JPMC confirm the need for strong capital, liquidity and reserves in the banking sector, and reaffirm the need for regulators to carefully and continuously scrutinize bank risk management policies, procedures, and practices, as well as to assess the OCC's supervisory processes. I look forward to continuing to share how we are meeting my commitment to strong, effective, fair, and balanced supervision of the national banks and federal savings associations that we supervise.

Testimony of Jamie Dimon

Chairman & CEO, JPMorgan Chase & Co.

Before the House Financial Services Committee

Washington, D.C.

June 19, 2012

Chairman Bachus, Ranking Member Frank, and Members of the Committee, I am appearing today to discuss recent losses in a portfolio held by JPMorgan Chase's Chief Investment Office (CIO). These losses have generated considerable attention, and while we are still reviewing the facts, I will explain everything I can to the extent possible.

JPMorgan Chase's six lines of business provide a broad array of financial products and services to individuals, small and large businesses, governments and non-profits. These include deposit accounts, loans, credit cards, mortgages, capital markets advice, mutual funds and other investments.

What does the Chief Investment Office do?

Like many banks, we have more deposits than loans – at quarter end, we held approximately $1.1 trillion in deposits and $700 billion in loans. CIO, along with our Treasury unit, invests excess cash in a portfolio that includes Treasuries, agencies, mortgage-backed securities, high quality securities, corporate debt and other domestic and overseas assets. This portfolio serves as an important source of liquidity and maintains an average rating of AA+. It also serves as an important vehicle for managing the assets and liabilities of the consolidated company. In short, the bulk of CIO's responsibility is to manage an approximately $350 billion portfolio in a conservative manner.

While CIO's primary purpose is to invest excess liabilities and manage long-term interest rate and currency exposure, it also maintains a smaller synthetic credit portfolio whose original intent was to protect – or "hedge" – the company against a systemic event, like the financial crisis or Eurozone situation. Among the largest risks we have as a bank are the potential credit losses we could incur from the loans we make. The recent problems in CIO occurred in this separate area of CIO's responsibility: the synthetic credit portfolio. This portfolio was designed to generate modest returns in a benign credit environment and more substantial returns in a stressed environment. And as the financial crisis unfolded, the portfolio performed as expected, producing income and gains to offset some of the credit losses we were experiencing.

What Happened?

In December 2011, as part of a firmwide effort in anticipation of new Basel capital requirements, we instructed CIO to reduce risk-weighted assets and associated risk. To achieve this in the synthetic credit portfolio, the CIO could have simply reduced its existing positions; instead, starting in mid-January, it embarked on a complex strategy that entailed adding positions that it believed would offset the existing

ones. This strategy, however, ended up creating a portfolio that was larger and ultimately resulted in even more complex and hard-to-manage risks.

This portfolio morphed into something that, rather than protect the Firm, created new and potentially larger risks. As a result, we have let a lot of people down, and we are sorry for it.

What Went Wrong?

We believe now that a series of events led to the difficulties in the synthetic credit portfolio. Among them:

- CIO's strategy for reducing the synthetic credit portfolio was poorly conceived and vetted. The strategy was not carefully analyzed or subjected to rigorous stress testing within CIO and was not reviewed outside CIO.
- In hindsight, CIO's traders did not have the requisite understanding of the risks they took. When the positions began to experience losses in March and early April, they incorrectly concluded that those losses were the result of anomalous and temporary market movements, and therefore were likely to reverse themselves.
- The risk limits for the synthetic credit portfolio should have been specific to the portfolio and much more granular, *i.e.*, only allowing lower limits on each specific risk being taken.
- Personnel in key control roles in CIO were in transition and risk control functions were generally ineffective in challenging the judgment of CIO's trading personnel. Risk committee structures and processes in CIO were not as formal or robust as they should have been.
- CIO, particularly the synthetic credit portfolio, should have gotten more scrutiny from both senior management and the firmwide risk control function.

Steps Taken

In response to this incident, we have taken a number of important actions to guard against any recurrence.

- We have appointed new leadership for CIO, including Matt Zames, a world class risk manager, as the Head of CIO. We have also installed a new CIO Chief Risk Officer, Chief Financial Officer, Global Controller and head of Europe. This new team has already revamped CIO risk governance, instituted more granular limits across CIO and ensured that appropriate risk parameters are in place.

- Importantly, our team has made real progress in aggressively analyzing, managing and reducing our risk going forward. While this does not reduce the losses already incurred and does not preclude future losses, it does reduce the probability and magnitude of future losses.

- We also have established a new risk committee structure for CIO and our corporate sector.

- We are also conducting an extensive review of this incident, led by Mike Cavanagh, who served as the company's Chief Financial Officer during the financial crisis and is currently CEO of our Treasury

& Securities Services business. The review, which is being assisted by our Legal Department and outside counsel, also includes the heads of our Risk, Finance, Human Resources and Audit groups. Our Board of Directors is independently overseeing and guiding these efforts, including any additional corrective actions.

- When we make mistakes, we take them seriously and often are our own toughest critic. In the normal course of business, we apply lessons learned to the entire Firm. While we can never say we won't make mistakes – in fact, we know we will – we do believe this to be an isolated event.

Perspective

We will not make light of these losses, but they should be put into perspective. We will lose some of our shareholders' money – and for that, we feel terrible – but no client, customer or taxpayer money was impacted by this incident.

Our fortress balance sheet remains intact: as of quarter end, we held $190 billion in equity and well over $30 billion in reserves. We maintain extremely strong capital ratios which remain far in excess of regulatory capital standards. As of March 31, 2012, our Basel I Tier 1 common ratio was 10.4%; our estimated Basel III Tier 1 common ratio is at 8.2% – both among the highest levels in the banking sector.[1] We expect both of these numbers to be higher by the end of the year.

All of our lines of business remain profitable and continue to serve consumers and businesses. While there are still two weeks left in our second quarter, we expect our quarter to be solidly profitable.

In short, our strong capital position and diversified business model did what they were supposed to do: cushion us against an unexpected loss in one area of our business.

While this incident is embarrassing, it should not and will not detract our employees from our main mission: to serve clients – consumers and companies – and communities around the globe.

- In just the first quarter of this year, we provided $62 billion of credit to consumers.
- Over the same period we provided $116 billion of credit to mid-sized companies that are the engine of growth for our economy, up 16% year on year.
- For America's largest companies, we raised or lent $368 billion of capital in the first quarter to help them build and expand around the world.
- We are one of the largest small business lenders and the leading Small Business Administration lender in America, providing $17 billion in credit to small businesses in 2011, up 52% year on year. In the first quarter, we provided over $4 billion of credit to small businesses, up 35% year on year.
- Even in this difficult economy, we have hired thousands of new employees across the country—over 61,000 since January 2008. We also have hired nearly 4,000 veterans over the past two years, in

[1] On June 7th, the Federal Reserve Board issued proposed Basel III rules, and we will be reviewing these ratios under the proposal.

addition to the thousands of veterans who already worked at our Firm. We founded the "100,000 Jobs Mission" – a partnership with 45 other companies to hire 100,000 veterans by the year 2020.

- Recently, we launched a groundbreaking and consumer-friendly reloadable card – Chase Liquid -- that offers customers financial control and flexibility.
- And over the past three years, in the face of significant economic headwinds, we made the decision not to retrench – but to step up – as we did with markets in turmoil when we were the only bank willing to commit to lend $4 billion to the state of California, $2 billion to the state of New Jersey and $1 billion to the state of Illinois.

All of these activities come with risk. And just as we have remained focused on serving our clients, we have also remained focused on managing the risks of our business, particularly given today's considerable global economic and financial volatility.

Last, I would like to say that in the face of these recent losses, we have come together as a Firm, acknowledged our mistakes, and committed ourselves to fixing them. We will learn from this incident and my conviction is that we will emerge from this moment a stronger, smarter, better company.

Thank you, and I'd welcome any questions you might have.

TESTIMONY OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

BEFORE THE

U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

WASHINGTON, DC

June 19, 2012

Good morning Chairman Bachus, Ranking Member Frank and members of the Committee. I thank you for inviting me to testify at today's hearing. I'm pleased to be on a panel along with my fellow regulators. I appreciate the opportunity to discuss the Commodity Futures Trading Commission's (CFTC) ongoing efforts to implement swaps market reforms, including for the credit default swap (CDS) index products traded by JPMorgan Chase's Chief Investment Office (CIO).

The CFTC's Division of Enforcement has opened an investigation related to credit derivative products traded by JPMorgan Chase's CIO. Although I am unable to provide any specific information about a pending investigation, I will, however, describe generally the Commission's oversight of the markets for CDS index products.

Following Congress' direction, the CFTC has made significant progress on bringing reform to the swaps market, as mandated in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). With regard to the CDS index products traded by JPMorgan

Chase's CIO, the agency is currently midstream in standing up reforms that promote transparency and lower risk to the market.

Dodd-Frank Swaps Market Reforms and CDS Indices

Swaps were developed to help manage and lower risk for commercial companies. But they also concentrate and heighten risk in international financial institutions. When these entities fail, as they have and surely will again, swaps can quickly spread risk across borders.

In 2008, AIG's subsidiary, AIG Financial Products, brought down the company and nearly toppled the U.S. economy. It was run out of London – actually as a branch of a French-registered bank – though technically organized in the United States.

The 2008 crisis – caused in part by swaps – was the worst financial and economic crisis Americans have experienced since the Great Depression. Eight million Americans lost their jobs, and millions of families lost their homes.

Following the crisis, when the President convened the G-20 leaders in Pittsburgh in 2009, a new consensus formed internationally. Swaps, which were basically not regulated in the United States, Asia or Europe, should now be brought into the light of regulation.

In 2010, Congress and the President came together and passed the historic Dodd-Frank Act. To date, the CFTC has completed 33 rules to implement the law's reforms with just fewer than 20 to go.

The goal of the law is to:

- Bring public market transparency and the benefits of competition to the swaps marketplace;
- Protect against Wall Street's risks by bringing standardized swaps into centralized clearing; and
- Ensure that swap dealers and major swap participants are specifically regulated for their swaps activity.

I am going to discuss each of these areas and how they relate to CDS indices, as well as how reform promotes market integrity.

Transparency

Dodd-Frank financial reform shines bright lights of transparency – to the public and to regulators – on the swaps market for the benefit of investors, consumers, retirees and businesses in America. Transparency is critical to both lowering the risk of the financial system, as well as reducing costs to end-users. The more transparent a marketplace is to the public, the more efficient it is, the more liquid it is, and the more competitive it is.

Once complete, the swaps market transparency reforms Congress mandated would mean prices and volume for all CDS index transactions would be reported to the public. Detailed transaction information would be available to regulators. In addition, the market for standard CDS indices would benefit, as many of them likely would be traded on transparent exchanges and swap execution facilities.

The Commission has adopted final rules establishing registration and regulatory requirements for swap data repositories (SDRs), which will gather data on all swaps transactions, including for CDS indices. Through SDRs, timely and accurate data on all swaps will be available to the CFTC and other regulators.

As soon as September, in conformance with already finalized rules, real-time reporting to the public will begin for CDS indices and interest rate swaps, with similar reporting on other swaps later this year.

By contrast, in the fall of 2008, there was no required reporting about swaps trading.

Clearing

For over a century, through good times and bad, central clearing in the futures market has lowered risk to the broader public. Dodd-Frank financial reform brings this effective model to the swaps market. Standard swaps between financial firms, including for CDS indices, will

move into central clearing, which will significantly lower the risks of the highly interconnected financial system.

The CFTC has made significant progress on central clearing for the swaps market. We have completed rules establishing new derivatives clearing organization risk management requirements. In addition, we finished rules on client clearing documentation, clearing member risk management, and so-called "straight-through processing," or sending transactions immediately to the clearinghouse upon execution.

Commissioners are now reviewing staff recommendations on the first clearing requirement determinations, which include a number of CDS indices. I expect these recommendations will be put out for public comment this summer and hopefully completed this fall. The requirement likely will cover certain North American investment grade and high yield CDX indices, as well as certain European iTraxx, high volatility, and crossover iTraxx indices.

Currently, voluntary clearing exists between dealers for many CDS indices, as well as standardized interest rate swaps transactions. The major clearinghouses, including Ice Clear Credit, Ice Clear Europe, LCH.Clearnet and the CME Group, providing clearing of these products are registered with the CFTC.

Per data that is publicly available, Ice Clear Credit has 27 clearing members and clears $18.3 trillion gross notional of CDS, of which approximately 90 percent are indices. It clears 46 different indices, including those on CDX North American Investment Grade and CDX North

American High Yield. Ice Clear Europe has 16 clearing members and clears 9.7 trillion Euro, of which approximately 85 percent are indices. It clears 42 different indices. The JPMorgan Chase bank is a clearing member of both houses.

With reform, clearing will expand to include transactions between dealers and hedge funds, as well as other financial entities, thus lowering the risk of the interconnected financial system.

Swap Dealers

Regulating banks and other firms that deal in derivatives is central to financial reform. Prior to 2008, it was claimed that swap dealers did not need to be specifically regulated for their swaps activity, as they or their affiliates already were generally regulated as banks, investment banks, or insurance companies. The crisis revealed the inadequacy of relying on this claim. While banks were regulated for safety and soundness, including their lending activities, there was no comprehensive regulation specific to their swap dealing activity. Similarly, bank affiliates dealing in swaps, and subsidiaries of insurance and investment bank holding companies dealing in swaps, were not subject to specific regulation of their swap dealing activities. AIG, Lehman Brothers and other failures of 2008 demonstrate what happens with such limited oversight.

The CFTC is well on the way to implementing reforms Congress mandated in Dodd-Frank to regulate dealers and help prevent another AIG. We finalized internal business conduct

rules to require swap dealers to establish policies to manage risk, as well as put in place firewalls between a dealer's trading, and clearing and research operations.

Among the risk management requirements are:

- Ensuring the risk management program takes into account market risk, credit risk, liquidity risk, foreign currency risk, legal risk, operational risk, settlement risk, and risk posed by traders;
- Establishing a system of diligent supervision by qualified personnel over the swap dealing activities; and
- Ensuring risk management issues are elevated within management.

We finished in April a joint rule with the SEC further defining the terms "swap dealer" and "securities-based swap dealer." Based on completed registration rules, dealers will register two months after we finalize the second major definition rule with the SEC: the further definition of the terms "swap" and "securities-based swap." Swap dealers who make markets in CDS indices would be amongst those dealers who may have to register with the CFTC. The further definition rule is now before Commissioners at both agencies. The CFTC and SEC are working together on the rule, and I believe we should consider it expeditiously.

Consistent with the provisions of the Dodd-Frank Act, the further definition proposal provided for CFTC regulation of CDS on broad-based security indices, and SEC regulation of narrow-based security indices (as well as CDS on single name securities or loans). Many of the

CDS indices compiled by the index provider, Markit, would be broad-based indices, including Markit's CDX North American Investment Grade, and its CDX North American High Yield. While the CDS based on these indices would be swaps under CFTC jurisdiction, both the CFTC and the SEC would have anti-fraud and anti-manipulation enforcement authorities over these products.

Following Congress' mandate, the CFTC also is working with our fellow financial regulators to complete the Volcker Rule. In adopting the Volcker Rule, Congress prohibited banking entities from engaging in proprietary trading, an activity that may put taxpayers at risk. At the same time, Congress permitted banking entities to engage in certain activities, such as market making and risk mitigating hedging. One of the challenges in finalizing a rule is achieving these multiple objectives.

The CFTC's role is primarily with regard to derivatives traded by swap dealers and futures commission merchants within banking entities. Last month, CFTC staff held a roundtable on this rule, and the discussion will be taken into account as we finalize the rule.

The CFTC is carefully considering public comments and is working with our fellow financial regulators to complete the Volcker Rule, which is among the remaining Dodd-Frank reforms we must finish to protect the public.

Market Integrity

Congress also provided the CFTC with new tools in Dodd-Frank to enhance market integrity and ensure the public has confidence in swaps markets.

Rules the CFTC completed last summer close a significant gap in the agency's enforcement authorities. These rules implement the Commission's new enforcement authority for swaps and prohibit the reckless use of manipulative or deceptive schemes. Thus, for example, the CFTC has clear anti-fraud and anti-manipulation authority regarding the trading of CDS indices.

Cross-border Application of Dodd-Frank's Swaps Reforms

Recent events at JPMorgan Chase are a stark reminder of how trades executed by traders located overseas can quickly reverberate with losses coming back into the United States.

Section 722(d) of the Dodd-Frank Act states that swaps reforms shall not apply to activities outside the United States unless those activities have "a direct and significant connection with activities in, or effect on, commerce of the United States."

The CFTC plans to soon put out to public comment our interpretation and related guidance on this provision to get public feedback.

The nature of modern finance is that financial institutions set up hundreds, if not thousands of legal entities around the globe. During a default or crisis, risk of overseas branches and affiliates inevitably flows back into the United States.

This was true with AIG. It was also true with Lehman Brothers. Among Lehman Brothers' complex web of affiliates was Lehman Brothers International (Europe) in London. When Lehman failed, this London affiliate, with more than 130,000 outstanding swaps contracts, failed as well. The U.S. mother ship, Lehman Brothers Holdings, had guaranteed many of the contracts.

Another example was Citigroup, which set up numerous structured investment vehicles (SIVs) to move positions off its balance sheet for accounting purposes, as well as to lower its regulatory capital requirements. Yet, Citigroup had guaranteed the funding of these SIVs through a mechanism called a liquidity put. When the SIVs were about to fail, Citigroup in the United States assumed the huge debt, and taxpayers later bore the brunt with two multi-billion dollar infusions. The SIVs were launched out of London and incorporated in the Cayman Islands.

Bear Stearns is yet another case. Bear Stearns' two sinking hedge funds it bailed out in 2007 were incorporated in the Cayman Islands. Yet again, the public assumed part of the burden when Bear Stearns itself collapsed nine months later.

A decade earlier, the same was true for Long-Term Capital Management. When the hedge fund failed in 1998, its swaps book totaled in excess of $1.2 trillion notional. The vast majority were booked in its affiliated partnership in the Cayman Islands.

Balanced implementation of regulatory reform requires an acknowledgment that the activities of financial institutions engaging in transactions or setting up operations abroad can pose a profound threat to U.S. taxpayers and the economy.

As the JPMorgan Chase CIO trades were executed by traders located abroad, I would like to provide for the Committee a description of the CFTC staff recommendation that has been before Commissioners.

First, it provides the guidance that when a foreign entity transacts in more than a de minimis level of U.S. swap dealing activity, the entity would register under the Dodd-Frank Act swap dealer registration requirements.

Second, it includes a tiered approach for overseas swap dealer requirements. This is largely consistent with comments received from major international swap dealers. Some requirements would be considered entity-level, such as for capital, risk management, recordkeeping and reporting to SDRs. Some requirements would be considered transaction-level, such as clearing, margin, real-time public reporting, trade execution and sales practices.

Third, entity-level requirements would apply to all registered swap dealers, but in certain circumstances, overseas swap dealers could meet these requirements by complying with comparable and comprehensive foreign regulatory requirements, or what we call "substituted compliance."

Fourth, transaction-level requirements would apply to all U.S. facing transactions. For these requirements, U.S. facing transactions would include not only transactions with persons or entities operating or incorporated in the United States, but also transactions with their overseas branches. Likewise, this would include transactions with overseas affiliates that are guaranteed by a U.S. entity, as well as the overseas affiliates operating as conduits for a U.S. entity's swap activity.

Fifth, for certain transactions between an overseas swap dealer (including a foreign swap dealer that is an affiliate of a U.S. person) and counterparties not guaranteed by or operating as conduits for U.S. entities, Dodd-Frank transaction-level requirements may not apply. For example, this would be the case for a transaction between a foreign swap dealer and a foreign insurance company not guaranteed by a U.S. person.

This means if a legal entity has over $8 billion in U.S. swap dealing activity, it should be preparing to register as a swap dealer. For foreign financial institutions, swaps with U.S. persons or their overseas branches would count toward the de minimis threshold. In the midst of a default or a crisis, there is no satisfactory way to really separate the risk posed to a branch from being transmitted to its parent bank.

As a swap dealer, the entity would have to comply with the various Dodd-Frank provisions applicable to swap dealers, though in certain cases, this may be done through substituted compliance.

In addition to the interpretive guidance, the CFTC also is considering a release on phased compliance for foreign swap dealers. The separate release addresses comments from U.S. and international market participants. For overseas swap dealers, the staff recommendation provides for phased compliance in the following manner:

- Foreign swap dealers would be required to register with the CFTC upon the compliance date of the registration requirement;
- Compliance with transaction-level requirements with U.S. persons and branches of U.S. persons would be required;
- Entity-level requirements (other than reporting to SDRs) that might come under substituted compliance may be delayed for up to one year. During that time, the CFTC would be moving to complete the cross-border interpretive guidance and would work with market participants and foreign regulators on plans for substituted compliance; and
- For overseas swap dealers, swap transactions with U.S. persons and branches of U.S. persons would be required to be reported to a SDR (or the CFTC).

Resources

Confidence in the futures and swaps markets is dependent upon a well-funded regulator. The CFTC is a good investment of taxpayer dollars. This hardworking staff of 710 is just 10 percent more than what we had at our peak in the 1990s though the futures market has grown fivefold. The CFTC also will soon be responsible for the swaps market – eight times bigger than the futures market.

Picture the NFL expanding eightfold to play more than 100 football games in a weekend, leaving just one referee per game, and, in some cases, no referee. Imagine the mayhem on the field, the resulting injuries to players, and the loss of confidence fans would have in the integrity of the game.

Market participants depend on the credibility and transparency of well-regulated U.S. futures and swaps markets. Without sufficient funding for the CFTC, the nation cannot be assured that the agency can adequately oversee these markets.

Conclusion

Nearly four years after the financial crisis and two years since the passage of Dodd-Frank, it's critical that we fully implement the historic reforms of the law.

It's critical that we do not retreat from reforms that will bring greater transparency and competition to the swaps market, lower costs for companies and their customers, and protect the public from the risks of these international markets.

The financial storms of 2008 continue to reverberate with the debt crisis in Europe affecting the economic prospects of people around the globe.

The CFTC has made significant progress implementing reform having largely finished the rule proposals, and now having completed well over half of the final rules.

We are on schedule to complete the remaining reforms this year, but until we do, the public is not fully protected.

STATEMENT OF

MARTIN J. GRUENBERG
ACTING CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

"EXAMINING BANK SUPERVISION AND RISK MANAGEMENT IN LIGHT OF JPMORGAN CHASE'S TRADING LOSS"

before the

COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

June 19, 2012
2128 Rayburn House Office Building

Chairman Bachus, Representative Frank and members of the Committee, thank you for the opportunity to testify this morning on behalf of the Federal Deposit Insurance Corporation on bank supervision and risk management as it concerns recent trading losses at JPMorgan Chase.

The recent losses at JPMorgan Chase revealed certain risks that reside within large, complex financial institutions. They also highlighted the significance of effective risk controls and governance at these institutions.

The four FDIC-insured subsidiaries of JPMorgan Chase firm have nearly $2 trillion in assets and $842 billion in domestic deposits. As the deposit insurer and backup supervisor of JPMorgan Chase, the FDIC staff works through the primary federal regulators, the Comptroller of the Currency and the Federal Reserve System, to obtain information necessary to monitor the risk within the institution.

The FDIC maintains an onsite presence at the firm, which currently consists of a permanent staff of four professionals. The FDIC staff engages in risk monitoring of the firm through cooperation with the primary federal regulators. Following the disclosure of JPMorgan Chase's losses, the FDIC has added temporary staff to assist in our current review. The team is working with the institution's primary federal regulators to investigate both the circumstances that led to the losses and the institution's ongoing efforts to manage the risks at the firm. The agencies are conducting an in-depth review of both the risk measurement tools used by the firm and the governance and limit

structures in place within the Chief Investment Office (CIO) unit where the losses occurred. Following this review, we will work with the primary regulators to address any inadequate risk management practices that are identified.

Following the announcement of these losses in May, the FDIC joined the OCC and the New York Federal Reserve Bank in daily meetings with the firm. Initially, these meetings focused on gaining an understanding of the events leading up to the escalating losses in the CIO synthetic credit portfolio. The FDIC has continued to participate in these daily meetings between the firm and its primary regulators. We are looking at the strength of CIO's risk management, governance and control frameworks, including the setting and monitoring of risk limits. The FDIC is also reviewing the quality of CIO risk reporting that has historically been made available to firm management and the regulators. Our discussions have also focused on the quality and consistency of the models used in the CIO as well as the approval and validation processes surrounding them. Although the focus of this review is on the circumstances that led to the losses, the FDIC is also working with JPMorgan Chase's primary federal regulators to assess any other potential gaps within the firm's overall risk management practices.

As a general matter, and apart from the specifics of this situation, evaluating the quality of financial institutions' risk management practices, internal controls and governance is an important focus of safety-and-soundness examinations conducted by the federal banking agencies. Onsite examinations provide an opportunity for supervisors to evaluate the quality of the loan and securities portfolios, underwriting practices, credit

review and administration, establishment of and adherence to risk limits, and other matters pertinent to the risk profile of an institution. One important element of risk management is that senior management and the board receives accurate and timely information about the risks to which a firm is exposed. Timely risk-related information is needed by institution management to support decision making and to satisfy disclosure requirements -- and it is an important element of supervisory review.

Without speaking to the specifics of the case for which a review is underway, the recent losses attest to the speed with which risks can materialize in a large, complex derivatives portfolio. The recent losses also highlight that it is important for financial regulatory agencies to have access to timely risk-related information about derivatives and other market-sensitive exposures, to analyze the data effectively, and to regularly share findings and observations.

Testimony on "Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss"
by
Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission
Before the
Committee on Financial Services
United States House of Representatives
Tuesday, June 19, 2012

Chairman Bachus, Ranking Member Frank, and members of the Committee: I appreciate the opportunity to testify on behalf of the Securities and Exchange Commission regarding the significant trading losses announced last month by JPMorgan Chase.

JPMorgan Chase & Co. (JPMC) is a bank holding company with $2.3 trillion in consolidated assets. The Federal Reserve Bank of New York is JPMC's regulator. JPMC has a number of affiliates, including several bank subsidiaries. The largest such subsidiary, JPMorgan Chase Bank, N.A. (Chase) is a national bank supervised by the Office of the Comptroller of the Currency (OCC). Additionally, JPMC's material broker-dealer subsidiary registered in the United States is JP Morgan Securities LLC, which is subject to oversight by the U.S. Securities and Exchange Commission (SEC), including compliance with its financial responsibility and customer protection rules.

On May 10, 2012, the company announced that JPMC incurred $2 billion in trading losses stemming from activities conducted by JPMC's Chief Investment Office (CIO). JPMC's Chairman and CEO, James Dimon, publicly stated that the company could face additional losses due to market volatility. The CIO is functionally responsible for the bank's asset-liability management activities.

The trading losses reported by JPMC appear to have occurred in the bank in London and perhaps in other affiliates – but not in the broker-dealer that is directly supervised by the SEC. Although the Commission does not discuss investigations publicly, I can say that in circumstances of this nature, the SEC's primary authority relates to the appropriateness and completeness of the entity's financial reporting and other public disclosures, as well as its financial accounting and internal control over financial reporting.

As a publicly-held company, JPMC is subject to the reporting requirements of the Securities Exchange Act of 1934 (Exchange Act) and must provide disclosures about market risks in its annual and quarterly reports. During a conference call with analysts on May 10, Mr. Dimon stated that JPMC was estimating a net $800 million loss in the CIO for the second quarter as detailed in the company's Form 10-Q. He further stated that the company had implemented a new value-at-risk[1] (VaR) model for usage by the CIO in the first quarter of 2012, which the company had determined was inadequate. Mr. Dimon also noted that the strategy that gave rise to the loss was "flawed, complex, poorly reviewed, poorly executed, and poorly monitored." JPMC's quarterly report – its Form 10-Q – filed on the same day also provided updated guidance for the CIO and included VaR estimates for the CIO that were revised from those reported in its first quarter earnings release supplement, which had been filed with the SEC on Form 8-K on April 13, 2012. The Form 10-Q indicated that the revised VaR estimate superseded the previous number included in the April 13 Form 8-K and was calculated using a methodology consistent with the methodologies used to calculate the CIO's VaR in 2011. The Form 10-Q also noted that

[1] Value-at-risk estimates, at a given confidence level, typically 95% or 99%, the potential decline in the value of a position or a portfolio under normal market conditions.

since March 31, the CIO had significant mark-to-market losses in its synthetic credit portfolio, and that the plan it had been using to hedge risks "has proven to be riskier, more volatile and less effective as an economic hedge" than the company previously believed.

The SEC's rules require comprehensive disclosure about the risks faced by a public company, including line item requirements for disclosure of specific information about risk, as well as principles-based disclosure requirements for companies to address the risks and uncertainties they face. For example, Item 305 of Regulation S-K requires quantitative disclosure of a company's market risk exposures, which includes exposures related to derivatives and other financial instruments.[2] Under the rules, companies are permitted to use one of three alternatives to disclose this information:

- tabular presentation of information related to market sensitive instruments;
- sensitivity analysis disclosure that expresses the potential loss in future earnings, fair values or cash flows of market sensitive instruments resulting from one or more selected hypothetical changes over a selected period of time from changes in market factors; or
- VaR disclosures that express the potential loss in future earnings, fair values or cash flows of market sensitive instruments over a selected period of time, with a selected likelihood of occurrence from changes in market factors.

Disclosure is required on an annual basis about market risk as of the end of the company's fiscal year. In addition, on a quarterly basis, the company is required to provide

[2] 17 CFR 229.305.

discussion and analysis to enable a reader to assess the sources and effects of material changes in information that would be provided under this item from the end of the preceding fiscal year to the date of the most recent balance sheet. If a company chooses to use the VaR disclosure alternative to comply with this market risk exposure requirement, it must disclose changes to key model characteristics, assumptions and parameters used in providing the quantitative information about market risk, including the reasons for the changes. Disclosure is also required if the company changes the scope of the instruments included within the model, along with the reasons for the change. Item 305 of Regulation S-K also calls for qualitative disclosure about the company's primary market risk exposures and how the company manages such market risks. Like the quantitative disclosure, this disclosure is required annually, with material changes reported quarterly.

Generally accepted accounting principles also necessitate detailed information about derivatives instruments in the notes to the financial statements. The mandated disclosures include information regarding volume, fair values, maturity information and indication of credit risk, as well as qualitative information about the entity's objective for holding the instruments and how the risks are managed.[3]

In addition, in cases in which a company has compensation policies and practices for employees that are reasonably likely to have a material adverse effect on the company, the SEC's rules call for disclosure in a company's annual proxy statement of the policies or practices as

[3] *See* U.S. GAAP Accounting Standards Codification Topic 815-10-50.

they relate to risk management and risk-taking incentives.[4] Our rules also require specific disclosure in the company's annual proxy statement about the board's role in oversight of risk at the company.[5]

In addition, certain principles-based rules require disclosure about a broad range of risks. For example, Item 303 of Regulation S-K, Management's Discussion and Analysis of Financial Condition and Results of Operations, requires a discussion of known trends, events, demands, commitments, and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance.[6] This disclosure should highlight issues that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating performance or of future financial condition. This provision would mandate disclosure, for example, if a company was experiencing trading losses that are different from past experience, and, as a result, its current year results are likely to be materially adversely impacted compared to prior years.

Similarly, the Risk Factors disclosure requirement in Item 503 of Regulation S-K requires companies to describe the material risks they face and how particular risks affect the company.[7] Further, under the SEC's rules, disclosures must be complete and not misleading. Specifically, Rule 12b-20 under the Exchange Act provides that "in addition to the information expressly required to be included in a statement or report, there shall be added such further

[4] 17 CFR 229.402(s).

[5] 17 CFR 229.407(h).

[6] 17 CFR 229.303.

[7] 17 CFR 229.503(c).

material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made not misleading."[8]

In conclusion, the examination and review of the causes and implications of the JPMC trading losses are ongoing. Once we have a fuller understanding of these issues, we will be in a better position to determine whether additional regulatory or legislative action is appropriate.

I would be pleased to answer any questions you may have.

[8] 17 CFR 240.12b-20.

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I

111TH CONGRESS
1ST SESSION

H. R. 3310

To reform the financial regulatory system of the United States, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JULY 23, 2009

Mr. BACHUS (for himself, Mr. BOEHNER, Mr. CANTOR, Mr. PENCE, Mr. SMITH of Texas, Mr. FRANKS of Arizona, Mr. ISSA, Mr. NEUGEBAUER, Mr. GARRETT of New Jersey, Mr. HENSARLING, Mr. PRICE of Georgia, Mrs. BIGGERT, Mrs. CAPITO, Mr. JONES, Mr. POSEY, Mr. LANCE, Mr. MARCHANT, Mr. ROYCE, Mr. LEE of New York, Mr. LUCAS, Mr. ROSKAM, Mrs. BACHMANN, Ms. JENKINS, Mr. BARRETT of South Carolina, Mr. SCALISE, Mr. GOODLATTE, Mr. GERLACH, and Mr. RYAN of Wisconsin) introduced the following bill; which was referred to the Committee on Financial Services, and in addition to the Committees on Education and Labor, Transportation and Infrastructure, the Judiciary, Agriculture, Oversight and Government Reform, the Budget, Rules, and Energy and Commerce, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

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A BILL

To reform the financial regulatory system of the United States, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

1 **SECTION 1. SHORT TITLE.**

2 This Act may be cited as the "Consumer Protection

3 and Regulatory Enhancement Act".

4 **SEC. 2. TABLE OF CONTENTS.**

Sec. 1. Short title.
Sec. 2. Table of contents.

TITLE I—RESOLUTION OF NON-BANK FINANCIAL INSTITUTIONS

Sec. 101. Amendments to title 28 of the United States Code.
Sec. 102. Amendments to title 11 of the United States Code.
Sec. 103. Effective date; application of amendments.

TITLE II—MARKET STABILITY AND CAPITAL ADEQUACY

Sec. 201. Establishment of Market Stability and Capital Adequacy Board.
Sec. 202. Functions of Board.
Sec. 203. Powers of Board.
Sec. 204. Responsibilities of Federal functional regulators.
Sec. 205. Staff of Board.
Sec. 206. Compensation and travel expenses.

TITLE III—REGULATORY CONSOLIDATION AND CONSUMER PROTECTION

Sec. 301. Establishment.
Sec. 302. Board of Directors.
Sec. 303. Powers and duties of the FIR.
Sec. 304. Allocation of responsibility among FIR divisions.
Sec. 305. Technical and conforming amendments relating to transfers of functions to the FIR.
Sec. 306. Office of Comptroller of the Currency and position of Comptroller of the Currency abolished.
Sec. 307. Office of Thrift Supervision and position of Director of the Office of Thrift Supervision abolished.
Sec. 308. Savings provisions.
Sec. 309. References in Federal law to Federal banking agencies.
Sec. 310. National Credit Union Administration moved within the FIR.
Sec. 311. Office of Consumer Protection.

TITLE IV—FEDERAL RESERVE REFORM

Sec. 401. GAO authority to audit the Federal Reserve System.
Sec. 402. Monetary policy and inflation targets.
Sec. 403. Reforms of section 13 emergency powers.

TITLE V—GOVERNMENT-SPONSORED ENTERPRISES REFORM

Sec. 501. Short title.
Sec. 502. Definitions.
Sec. 503. Termination of current conservatorship.
Sec. 504. Limitation of enterprise authority upon emergence from conservatorship.

TITLE III—REGULATORY CONSOLIDATION AND CONSUMER PROTECTION

SEC. 301. ESTABLISHMENT.

(a) IN GENERAL.—There is hereby established in the executive branch of the Government an independent agency to be known as the Financial Institutions Regulator (hereafter in this title referred to as the "FIR").

(b) DIVISIONS OF THE FIR.—There are hereby established within the FIR—

(1) a division to be known as the Federal Banking Division; and

(2) a division to be known as the State Banking Division;

(c) INSURED DEPOSITORY INSTITUTION DEFINED.—For purposes of this title, the term "insured depository institution" has the meaning given to such term in section 3(c) of the Federal Deposit Insurance Act.

SEC. 302. BOARD OF DIRECTORS.

(a) IN GENERAL.—The management of the FIR shall be vested in a Board of Directors consisting of 5 members—

1 (1) 1 of whom shall be the Chairman of the
2 FIR and who shall be appointed by the President,
3 by and with the advice and consent of the Senate;
4 (2) 1 of whom shall be the head of the Federal
5 Banking Division and who shall be appointed by the
6 President, by and with the advice and consent of the
7 Senate;
8 (3) 1 of whom shall be the head of the State
9 Banking Division and who shall be appointed by the
10 President, by and with the advice and consent of the
11 Senate;
12 (4) 1 of whom shall be the Chairman of the Na-
13 tional Credit Union Administration; and
14 (5) 1 of whom shall be the Chairperson of the
15 Board of Directors of the Federal Deposit Insurance
16 Corporation.
17 (b) TERMS.—
18 (1) 5–YEAR TERMS.—Each member appointed
19 under paragraphs (1), (2), and (3) of subsection (a)
20 shall be appointed for a term of 5 years.
21 (2) INTERIM APPOINTMENTS.—Any member ap-
22 pointed to fill a vacancy occurring before the end of
23 the term to which such member's predecessor was
24 appointed shall be appointed only for the remainder
25 of such term.

1 (3) CONTINUATION OF SERVICE.—Any member
2 may continue to serve after the expiration of the
3 term of office to which such member was appointed
4 until a successor has been appointed and confirmed.
5 (c) VACANCY.—Any vacancy on the Board of Direc-
6 tors shall be filled in the manner in which the original
7 appointment was made.
8 (d) INELIGIBILITY FOR OTHER OFFICES.—
9 (1) RESTRICTIONS ON EMPLOYMENT BY DEPOS-
10 ITORY INSTITUTIONS.—No member of the Board of
11 Directors may hold any office, position, or employ-
12 ment in any insured depository institution or any af-
13 filiate (as defined in section 2(k) of the Bank Hold-
14 ing Company Act of 1956) of an insured depository
15 institution during—
16 (A) the time such member is in office; and
17 (B) the 2-year period beginning on the
18 date such member ceases to serve on the Board
19 of Directors.
20 (2) OTHER RESTRICTIONS DURING SERVICE AS
21 MEMBER.—No member of the Board of Directors
22 may—
23 (A) be an officer or director of any Federal
24 Reserve bank or Federal home loan bank; or

1 (B) hold any stock in any insured deposi-
2 tory institution or any affiliate (as defined in
3 section 2(k) of the Bank Holding Company Act
4 of 1956) of an insured depository institution.
5 (3) CERTIFICATION.—Upon taking office, each
6 member of the Board of Directors shall file a certifi-
7 cation under oath with the secretary of the Board of
8 Directors that such member has complied with the
9 requirements of this subsection.

10 **SEC. 303. POWERS AND DUTIES OF THE FIR.**

11 (a) REGULATION OF NATIONAL BANKS.—
12 (1) TRANSFER TO THE FIR.—All functions of
13 the Comptroller of the Currency are hereby trans-
14 ferred to the FIR.
15 (2) FIR POWERS.—The FIR shall have all pow-
16 ers, duties, and authority which, before the date of
17 the enactment of this Act, were vested in the Comp-
18 troller of the Currency under any provision of Fed-
19 eral law to the extent such provision applies to na-
20 tional banks or the office, officers, or employees of
21 the Comptroller of the Currency.
22 (b) REGULATION OF MEMBER BANKS, BANK HOLD-
23 ING COMPANIES AND AFFILIATES, AND VARIOUS INTER-
24 NATIONAL BANKING ENTITIES.—

1 (1) TRANSFER TO THE FIR.—All functions of
2 the Board of Governors of the Federal Reserve Sys-
3 tem (and any Federal reserve bank) relating to—
4 (A) the supervision and regulation of
5 banks which are members of the Federal Re-
6 serve System,
7 (B) the supervision and regulation of bank
8 holding companies and any subsidiary or affil-
9 iate of a bank holding company which is not a
10 depository institution,
11 (C) the supervision and regulation of com-
12 panies operating under section 25 or 25A of the
13 Federal Reserve Act or the International Bank-
14 ing Act of 1978,
15 (D) the supervision and regulation of any
16 company which is subject to supervision and
17 regulation by the Board of Governors under any
18 title of the Consumer Credit Protection Act,
19 and
20 (E) the supervision and regulation of any
21 foreign bank, any branch or agency of a foreign
22 bank, and any commercial lending company
23 controlled by a foreign bank,
24 are hereby transferred to the FIR.

1 (2) FIR POWERS.—The FIR shall have all pow-
2 ers, duties, and authority which, before the date of
3 the enactment of this Act, were vested in the Board
4 of Governors of the Federal Reserve System under
5 any provision of Federal law to the extent such pro-
6 visions apply to banks or other companies described
7 in any subparagraph of paragraph (1).
8 (c) REGULATION OF SAVINGS ASSOCIATIONS AND
9 SAVINGS AND LOAN HOLDING COMPANIES.—
10 (1) TRANSFER TO THE FEDERAL BANKING DI-
11 VISION.—All functions of the Director of the Office
12 of Thrift Supervision are hereby transferred to the
13 FIR.
14 (2) FIR POWERS.—The FIR shall have all pow-
15 ers, duties, and authority which, before the date of
16 the enactment of this Act, were vested in the Direc-
17 tor of the Office of Thrift Supervision under any
18 provision of Federal law to the extent such provision
19 applies to savings associations, savings and loan
20 holding companies, or the office, officers, or employ-
21 ees of the Director.
22 (d) REGULATION OF STATE NONMEMBER BANKS.—
23 (1) TRANSFER TO THE FIR.—All functions of
24 the Federal Deposit Insurance Corporation relating
25 to the supervision and regulation of State non-

1 member banks, including savings banks, (other than
2 insurance, conservatorship, or receivership functions)
3 and foreign banks with insured branches (as defined
4 in section 3(s)(3) of the Federal Deposit Insurance
5 Act) are hereby transferred to the FIR.

6 (2) FIR POWERS.—The FIR shall have all pow-
7 ers, duties, and authority which, before the date of
8 the enactment of this Act, were vested in the Fed-
9 eral Deposit Insurance Corporation under any provi-
10 sion of Federal law to the extent such provisions
11 apply to the supervision and regulation of State non-
12 member banks, including savings banks, (other than
13 insurance, conservatorship, or receivership functions)
14 and foreign banks with insured branches (as defined
15 in section 3(s)(3) of the Federal Deposit Insurance
16 Act).

17 (e) REGULATIONS AND ORDERS.—In addition to any
18 authority under any provision referred to in subsection
19 (a), (b), (c), or (d), the FIR may prescribe such regula-
20 tions and issue such orders as the FIR may determine
21 to be appropriate to carry out the purposes of this title
22 and the powers and duties of the FIR under this title and
23 any provision referred to in any such subsection.

1 (f) NO INTENDED IMPACT ON EXISTING RIGHTS AND
2 JUDICIAL PRECEDENT.—Nothing in this section shall be
3 construed—
4 (1) to impact any existing right or obligation
5 under any function or power transferred to the FIR,
6 solely by reason of such transfer; or
7 (2) to impact any judicial precedent established
8 with respect to any function or power transferred to
9 the FIR, solely by reason of such transfer.
10 (g) EFFECTIVE DATE.—The provisions of this sec-
11 tion shall take effect after the end of the 90-day period
12 beginning on the date of the enactment of this Act.

13 **SEC. 304. ALLOCATION OF RESPONSIBILITY AMONG FIR DI-**
14 **VISIONS.**

15 (a) FEDERAL BANKING DIVISION.—The Federal
16 Banking Division shall have the primary responsibility for
17 carrying out the FIR's authority with respect to—
18 (1) national banking associations;
19 (2) foreign banks and Federal branches or
20 agencies of a foreign bank;
21 (3) bank holding companies and any subsidiary
22 or affiliate of a bank holding company which is not
23 a depository institution, other than a bank holding
24 company, subsidiary, or affiliate that consists solely
25 of State banks that are insured banks (as such

1 terms is defined in section 3(h) of the Federal De-
2 posit Insurance Act (12 U.S.C. 1813(h));
3 (4) companies operating under section 25 or
4 25A of the Federal Reserve Act or the International
5 Banking Act of 1978;
6 (5) commercial lending companies, other than a
7 Federal agency;
8 (6) savings associations;
9 (7) savings and loan holding companies; and
10 (8) such additional areas as the Board of Direc-
11 tors may prescribe.
12 (b) STATE BANKING DIVISION.—The State Banking
13 Division shall have the primary responsibility for carrying
14 out the FIR's authority with respect to—
15 (1) any State bank that is an insured bank (as
16 such terms is defined in section 3(h) of the Federal
17 Deposit Insurance Act (12 U.S.C. 1813(h)));
18 (2) any bank holding company or subsidiary or
19 affiliate of a bank holding company, if such bank
20 holding company, subsidiary, or affiliate consists
21 solely of State banks described in paragraph (1);
22 and
23 (3) such additional areas as the Board of Direc-
24 tors may prescribe.

1 **SEC. 305. TECHNICAL AND CONFORMING AMENDMENTS RE-**
2 **LATING TO TRANSFERS OF FUNCTIONS TO**
3 **THE FIR.**

4 (a) APPROPRIATE FEDERAL BANKING AGENCY RE-
5 DEFINED.—Section 3(q) of the Federal Deposit Insurance
6 Act (12 U.S.C. 1813(q)) is amended to read as follows:
7 "(q) APPROPRIATE FEDERAL BANKING AGENCY.—
8 The term 'appropriate Federal banking agency' means the
9 Financial Institutions Regulator.".

10 (b) MEMBERS OF FDIC BOARD.—Section 2(a)(1) of
11 the Federal Deposit Insurance Act (12 U.S.C. 1812(a)(1))
12 is amended—

13 (1) by striking subparagraph (A) and redesig-
14 nating subparagraphs (B) and (C) as subparagraphs
15 (A) and (B), respectively;

16 (2) in subparagraph (A) (as so redesignated by
17 paragraph (1)), by striking "Director of the Office
18 of Thrift Supervision" and inserting "Chairman of
19 the Financial Institutions Regulator"; and

20 (3) in subparagraph (B) (as so redesignated by
21 paragraph (1)), by striking "3" and inserting "4".

22 (c) EFFECTIVE DATE.—The provisions of this section
23 shall take effect after the end of the 90-day period begin-
24 ning on the date of the enactment of this Act.

1 **SEC. 306. OFFICE OF COMPTROLLER OF THE CURRENCY**
2 **AND POSITION OF COMPTROLLER OF THE**
3 **CURRENCY ABOLISHED.**

4 (a) IN GENERAL.—Effective at the end of the 180-
5 day period beginning on the date of the enactment of this
6 Act, the Office of the Comptroller of the Currency and
7 the position of Comptroller of the Currency are hereby
8 abolished.

9 (b) TECHNICAL AND CONFORMING AMENDMENTS.—
10 Effective at the end of the 180-day period beginning on
11 the date of the enactment of this Act:

12 (1) Chapter nine of title VII of the Revised
13 Statutes is amended by striking sections 324, 325,
14 and 326.

15 (2) Subchapter I of chapter 3 of title 31,
16 United States Code, is amended by striking section
17 307.

18 **SEC. 307. OFFICE OF THRIFT SUPERVISION AND POSITION**
19 **OF DIRECTOR OF THE OFFICE OF THRIFT SU-**
20 **PERVISION ABOLISHED.**

21 (a) IN GENERAL.—Effective at the end of the 180-
22 day period beginning on the date of the enactment of this
23 Act, the Office of Thrift Supervision and the position of
24 Director of the Office of Thrift Supervision are hereby
25 abolished.

1 (b) TECHNICAL AND CONFORMING AMENDMENTS.—
2 Effective at the end of the 180-day period beginning on
3 the date of the enactment of this Act:
4 (1) Section 3 of the Home Owners' Loan Act
5 (12 U.S.C. 1462a) is amended by striking sub-
6 sections (a) and (b).
7 (2) Subchapter I of chapter 3 of title 31,
8 United States Code, is amended by striking section
9 309.

10 **SEC. 308. SAVINGS PROVISIONS.**

11 (a) SAVINGS PROVISIONS RELATING TO THE COMP-
12 TROLLER OF THE CURRENCY.—
13 (1) EXISTING RIGHTS, DUTIES, AND OBLIGA-
14 TIONS NOT AFFECTED.—Sections 303(a)(1) and 306
15 shall not affect the validity of any right, duty, or ob-
16 ligation of the United States, the Comptroller of the
17 Currency, the Office of the Comptroller of the Cur-
18 rency, or any other person, which—
19 (A) arises under or pursuant to any provi-
20 sion of law referred to in section 303(a)(2); and
21 (B) existed on the day before the date of
22 the enactment of this Act.
23 (2) CONTINUATION OF SUITS.—No action or
24 other proceeding commenced by or against the
25 Comptroller of the Currency or the Office of the

1 Comptroller of the Currency shall abate by reason of
2 the enactment of this Act, except that the FIR shall
3 be substituted for the Comptroller or Office as a
4 party to any such action or proceeding.
5 (b) SAVINGS PROVISIONS RELATING TO THE BOARD
6 OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.—
7 (1) EXISTING RIGHTS, DUTIES, AND OBLIGA-
8 TIONS NOT AFFECTED.—Section 303(b)(1) shall not
9 affect the validity of any right, duty, or obligation of
10 the United States, the Board of Governors of the
11 Federal Reserve System, or any other person,
12 which—
13 (A) arises under or pursuant to any provi-
14 sion of law referred to in section 303(b)(2); and
15 (B) existed on the day before the date of
16 the enactment of this Act.
17 (2) CONTINUATION OF SUITS.—No action or
18 other proceeding commenced by or against the
19 Board of Governors of the Federal Reserve System
20 with respect to any function transferred to the FIR
21 shall abate by reason of the enactment of this Act,
22 except that the FIR shall be substituted for the
23 Board of Governors as a party to any such action
24 or proceeding.

1 (c) SAVINGS PROVISIONS RELATING TO THE DIREC-
2 TOR OF THE OFFICE OF THRIFT SUPERVISION.—
3 (1) EXISTING RIGHTS, DUTIES, AND OBLIGA-
4 TIONS NOT AFFECTED.—Sections 303(c)(1) and 307
5 shall not affect the validity of any right, duty, or ob-
6 ligation of the United States, the Director of the Of-
7 fice of Thrift Supervision, the Office of Thrift Su-
8 pervision, or any other person, which—
9 (A) arises under or pursuant to any provi-
10 sion of law referred to in section 303(c)(2); and
11 (B) existed on the day before the date of
12 the enactment of this Act.
13 (2) CONTINUATION OF SUITS.—No action or
14 other proceeding commenced by or against the Di-
15 rector of the Office of Thrift Supervision or the Of-
16 fice of Thrift Supervision shall abate by reason of
17 the enactment of this Act, except that the FIR shall
18 be substituted for the Director or Office as a party
19 to any such action or proceeding.
20 (d) SAVINGS PROVISIONS RELATING TO THE FED-
21 ERAL DEPOSIT INSURANCE CORPORATION.—
22 (1) EXISTING RIGHTS, DUTIES, AND OBLIGA-
23 TIONS NOT AFFECTED.—Section 303(d)(1) shall not
24 affect the validity of any right, duty, or obligation of
25 the United States, the Federal Deposit Insurance

1 Corporation, the Board of Directors of such Cor-
2 poration, or any other person, which—
3 (A) arises under or pursuant to any provi-
4 sion of law referred to in section 303(d)(2); and
5 (B) existed on the day before the date of
6 the enactment of this Act.
7 (2) CONTINUATION OF SUITS.—No action or
8 other proceeding commenced by or against the Fed-
9 eral Deposit Insurance Corporation or the Board of
10 Directors of such Corporation with respect to any
11 function transferred to the FIR shall abate by rea-
12 son of the enactment of this Act, except that the
13 FIR may be substituted for the Corporation or
14 Board of Directors, as the case may be, as a party
15 to any such action or proceeding.
16 (e) CONTINUATION OF ORDERS, RESOLUTIONS, DE-
17 TERMINATIONS, AND REGULATIONS.—All orders, resolu-
18 tions, determinations, and regulations, which—
19 (1) have been issued, made, prescribed, or al-
20 lowed to become effective by the Director of the Of-
21 fice of Thrift Supervision, the Comptroller of the
22 Currency, the Federal Deposit Insurance Corpora-
23 tion, or the Board of Governors of the Federal Re-
24 serve System (including orders, resolutions, deter-
25 minations, and regulations which relate to the con-

1 duct of conservatorships and receiverships), or by a
2 court of competent jurisdiction, in the performance
3 of functions which are transferred by this Act, and
4 (2) are in effect on the date this Act takes ef-
5 fect (or become effective after such date pursuant to
6 the terms of the order, resolution, determination or
7 regulation, as in effect on such date),
8 shall continue in effect according to the terms of such or-
9 ders, resolutions, determinations, and regulations and
10 shall be enforceable by or against the FIR until modified,
11 terminated, set aside, or superseded in accordance with
12 applicable law by the FIR, by any court of competent ju-
13 risdiction, or by operation of law.
14 (f) EFFECTIVE DATE.—The provisions of this section
15 shall take effect after the end of the 90-day period begin-
16 ning on the date of the enactment of this Act.

17 **SEC. 309. REFERENCES IN FEDERAL LAW TO FEDERAL**
18 **BANKING AGENCIES.**

19 (a) COMPTROLLER OF THE CURRENCY AND DIREC-
20 TOR OF THE OFFICE OF THRIFT SUPERVISION.—Any ref-
21 erence in any Federal law to the Comptroller of the Cur-
22 rency, the Office of the Comptroller of the Currency, the
23 Director of the Office of Thrift Supervision, or the Office
24 of Thrift Supervision shall be deemed to be a reference
25 to the FIR.

1 (b) BOARD OF GOVERNORS OF THE FEDERAL RE-
2 SERVE SYSTEM.—Any reference in any Federal law to the
3 Board of Governors of the Federal Reserve System in con-
4 nection with any function of the Board under any provi-
5 sion of law referred to in section 304(b)(2) shall be
6 deemed to be a reference to the FIR.

7 (c) FEDERAL DEPOSIT INSURANCE CORPORATION.—
8 Any reference in any Federal law to the Federal Deposit
9 Insurance Corporation or the Board of Directors of such
10 Corporation in connection with any function of the Cor-
11 poration or Board of Directors under any provision of law
12 referred to in section 303(d)(2) shall be deemed to be a
13 reference to the FIR.

14 (d) EFFECTIVE DATE.—The provisions of this sec-
15 tion shall take effect after the end of the 90-day period
16 beginning on the date of the enactment of this Act.

17 **SEC. 310. NATIONAL CREDIT UNION ADMINISTRATION**
18 **MOVED WITHIN THE FIR.**

19 (a) IN GENERAL.—The Nation Credit Union Admin-
20 istration is hereby moved within the FIR and shall be
21 maintained as a distinct entity within the FIR.

22 (b) EFFECTIVE DATE.—The provisions of this sec-
23 tion shall take effect after the end of the 90-day period
24 beginning on the date of the enactment of this Act.

1 **SEC. 311. OFFICE OF CONSUMER PROTECTION.**

2 (a) OFFICE OF CONSUMER PROTECTION.—There is
3 hereby established within the FIR an Office of Consumer
4 Protection (hereinafter in this section referred to as the
5 "Office").

6 (b) DELEGATION OF AUTHORITY TO THE OFFICE.—
7 The Office shall have the primary responsibility for car-
8 rying out the FIR's authority with respect to laws and
9 regulations relating to consumer protection, including the
10 authority of the FIR under the Consumer Credit Protec-
11 tion Act.

12 (c) RULEMAKING APPROVAL.—No rule or regulation
13 issued by the Office shall take effect unless the Board of
14 Directors of the FIR approves such rule or regulation.

15 (d) CONSUMER COMPLAINT HOTLINE AND
16 WEBSITE.—The Office shall establish a toll-free hotline
17 and a website for consumers to contact regarding inquiries
18 or complaints related to insured depository institutions.
19 Such hotline and website shall then refer such inquiries
20 or complaints to the appropriate FIR division, which will
21 then respond to the inquiry or complaint.

22 (e) DISCLOSURE REVIEW.—Not less than once every
23 7 years, the Office shall undertake a comprehensive review
24 of all public disclosures (including policies, procedures,
25 guidelines, standards, and regulatory filings) made by the
26 FIR and each division of the FIR. In making such review

1 the Office shall perform a cost and benefit analysis of each
2 such disclosure and determine if the policy of the FIR to-
3 wards such disclosure should remain the same or be re-
4 vised.

5 (f) CONSUMER TESTING REQUIREMENT.—Before
6 prescribing any regulation pursuant to the authority of the
7 FIR under the Consumer Credit Protection Act, the Office
8 shall carry out consumer testing with respect to such regu-
9 lation.

10 (g) PERIODIC REVIEW OF REGULATIONS.—

11 (1) REVIEW.—Not less than once every 7 years,
12 the Office shall undertake a comprehensive review of
13 all regulations issued by the Office, the FIR, or any
14 entity preceding the FIR, with respect to the author-
15 ity of the FIR under the Consumer Credit Protec-
16 tion Act. In making such review, the Office shall
17 perform a cost and benefit analysis of each regula-
18 tion and determine if such regulation should remain
19 the same or if such regulation should be revised.

20 (2) REPORT.—After performing a review re-
21 quired by paragraph (1), the Office shall issue a re-
22 port to the Congress describing the review process,
23 any determinations made by the Office, and any re-
24 visions to regulations that the Office determined
25 were needed.

Bloomberg

Dear Mr. Dimon, Is Your Bank Getting Corporate Welfare?

By the Editors - Jun 18, 2012

When JPMorgan Chase & Co. Chief Executive Officer Jamie Dimon testifies in the U.S. House today, he will present himself as a champion of free-market capitalism in opposition to an overweening government. His position would be more convincing if his bank weren't such a beneficiary of corporate welfare.

To be precise, JPMorgan receives a government subsidy worth about $14 billion a year, according to research published by the International Monetary Fund and our own analysis of bank balance sheets. The money helps the bank pay big salaries and bonuses. More important, it distorts markets, fueling crises such as the recent subprime-lending disaster and the sovereign-debt debacle that is now threatening to destroy the euro and sink the global economy.

How can all this be? Let's take it step by step.

In recent decades, governments and central banks around the world have developed a consistent pattern of behavior when trouble strikes banks that are large or interconnected enough to threaten the broader economy: They step in to ensure that all the bank's creditors, not just depositors, are paid in full. Although typically necessary to prevent permanent economic damage, such bailouts encourage a reckless confidence among creditors. They assume the government will always make them whole, so they become willing to lend at lower rates, particularly to systemically important banks.

Implicit Subsidy

With each new banking crisis, the value of the implicit subsidy grows. In a recent paper, two economists -- Kenichi Ueda of the IMF and Beatrice Weder Di Mauro of the University of Mainz -- estimated that as of 2009 the expectation of government support was shaving about 0.8 percentage point off large banks' borrowing costs. That's up from 0.6 percentage point in 2007, before the financial crisis prompted a global round of bank bailouts.

To estimate the dollar value of the subsidy in the U.S., we multiplied it by the debt and deposits of 18 of the country's largest banks, including JPMorgan, Bank of America Corp. and Citigroup Inc. The result: about $76 billion a year. The number is roughly equivalent to the banks' total profits over the

past 12 months, or more than the federal government spends every year on education.

JPMorgan's share of the subsidy is $14 billion a year, or about 77 percent of its net income for the past four quarters. In other words, U.S. taxpayers helped foot the bill for the multibillion-dollar trading loss that is the focus of today's hearing. They've also provided more direct support: Dimon noted in a recent conference call that the Home Affordable Refinancing Program, which allows banks to generate income by modifying government-guaranteed mortgages, made a significant contribution to JPMorgan's earnings in the first three months of 2012.

Like all subsidies, the taxpayer largesse distorts supply. If the government supports corn farmers, you get too much corn. If the government subsidizes banks, you get too much credit. As of March, households, companies and government in the U.S. had amassed debts of $38.6 trillion, or 2.5 times the country's gross domestic product. That's up from 1.3 times in 1980. The picture is similar in the euro area, where debt outstanding is 1.8 times GDP, double the level of 1995.

The oversupply of credit -- also supported in the U.S. by government-backed lenders Fannie Mae and Freddie Mac, and by tax breaks on mortgage interest -- encourages risky behavior. People buy houses they can't afford, companies borrow too much for acquisitions, and banks employ excessive leverage to boost the returns they can offer their shareholders. The result is a bloated finance industry: As of 2011, the sector accounted for 8.3 percent of the U.S. economy, compared with 4.9 percent in 1980.

Costly Cycle

Inevitably, the debt burden becomes overwhelming, precipitating crises in which banks suffer losses, private credit dries up, and people cut back on spending to pay down their debts. The onus then shifts to central banks and governments as they engineer bailouts and boost their spending to prevent economic collapse -- a pattern that has repeated itself throughout the developed world, according to research by economists Carmen Reinhart and Kenneth Rogoff. This costly cycle has helped increase sovereign debts to the point where they now threaten the solvency of governments.

The solution: Minimize the subsidy. Require banks' shareholders to put up enough capital to make bailouts highly unlikely (we advocate 20 percent of assets). Allow some creditors to take losses when a bank gets into trouble, so they won't assume they're safe (an approach regulators in the U.S. and Europe are considering). Cut off subsidies to traders, such as the folks in London who lost billions for JPMorgan, by forbidding speculative trading activity at banks (the goal of the Volcker rule in the U.S. and financial ring-fencing in the U.K.).

Why hasn't this been done? One partial explanation can be found in the amount of money banks put into election campaigns and into lobbying, which has recently included efforts to water down the Dodd-Frank financial-reform legislation. According to the nonprofit Center for Responsive Politics,

the broad financial industry -- a category that includes real estate companies and insurers -- has spent $285 million on political giving in the 2012 election cycle. That's much more than any other industry spends.

Lawmakers and regulators need to recognize just how costly business as usual will be. When Dimon pushes back against capital requirements or the Volcker rule, it's worth remembering that he's pushing for a form of corporate welfare that, left unchecked, could lead to a crisis too big for the government to contain.

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Questions for Mr. Scott Alvarez, General Council, Board of Governors of the Federal Reserve System, from Representative Spencer Bachus:

1. One of the things about the JPMorgan loss that I can't figure out is which regulator is responsible for what. The OCC regulated JPMorgan's national bank, where the Chief Investment Office was located. But the Federal Reserve regulated the holding company. What, specifically, did the Federal Reserve do in supervising the holding company that could have prevented a sudden loss like this from happening? In particular, what responsibility did the New York Federal Reserve Bank have for supervising JPMorgan? Given the multiplicity of regulators that have some responsibility for JPMorgan, wouldn't it have been better had we consolidated regulators in the Dodd-Frank Act? Or do you believe that the fragmented structure we had before and decided to keep really works?

Our financial regulatory system relies on a variety of federal and state supervisors to execute particular supervisory and examination responsibilities for certain parts of a firm. This multi-agency approach was intended to allow the separate focus on different activities within financial conglomerates and to make use of different skills at different agencies throughout the government. It was also designed to provide for the consistent regulation of firms engaged in regulated activity regardless of their affiliation with an insured depository institution.

As the regulator and supervisor of bank holding companies, the Federal Reserve's role in this statutory arrangement is typically that of consolidated regulator and supervisor of the parent holding company. Accordingly, our supervisory program for such firms generally takes a broad view of the activities, risks, and management of the consolidated firm, with a particular focus on the capital adequacy, governance, and risk-management practices and competencies of the firm as a whole. However, many of the principal business activities of the largest financial firms are conducted through the functionally regulated subsidiaries of those firms, such as insured depository institutions, broker-dealers, and insurance companies.

In the specific case of JPMorgan Chase & Co. (JPMorgan), the Federal Reserve is the supervisor of JPMC (the holding company), the Office of the Comptroller of the Currency (OCC) is the supervisor of JPMorgan's national bank, and the Securities and Exchange Commission is the supervisor of JPMC's U.S. securities broker/dealer. By law, the Federal Reserve must defer to the fullest extent possible on examinations conducted by these other U.S. regulators that supervise various parts of the bank holding company. Operations outside the United States, such as JPMorgan's securities broker/dealer chartered and operating in London, are also subject to supervision by other authorities, such as the UK Financial Services Authority.

In response to the significant trading losses that were announced earlier this year by JPMorgan as a result of trading operations at the London branch of its national bank, the Federal Reserve--in its capacity as consolidated supervisor of the bank holding company--is working with the OCC, the regulator of the national bank, to review the firm's response and remedial actions. In particular, the Federal Reserve has been assisting in the oversight of JPMorgan's efforts to manage and de-risk the portfolio in question. We also have been working with the OCC and Federal Deposit Insurance Corporation (FDIC) to identify the changes in risk measurement, management and governance that will be necessary to improve risk-control practices surrounding

the firm's trading activities across the organization and to address the trading strategies that led to these losses.

The Federal Reserve has a history of working cooperatively with other federal and state regulators. Together, the Federal Reserve and other functional regulators work to discharge the supervisory and examination responsibility given to each agency for particular parts of a large financial firm in a way that maximizes the expertise and resources of each agency and best ensures the safety and soundness of the consolidated firm and each of its constituent parts.

2. Several presidents of the regional Federal Reserve Banks as well as at least one prominent former regulator have called for breaking up those institutions that have become known as "Too Big to Fail." The Dodd-Frank Act did not do that; in fact, the institutions that were "Too Big to Fail" before the financial crisis are even bigger now than they were then. Should these institutions be broken up into smaller units so they can be more effectively supervised and so their failure wouldn't jeopardize the financial system? Is it the intention of the Federal Reserve to break up or shrink these institutions using its authority to set enhanced prudential standards under the Dodd-Frank Act for those institutions designated by the Financial Stability Oversight Council for regulation by the Federal Reserve?

A major objective of the Dodd-Frank Act is to mitigate the threats to financial stability posed by the too-big-to-fail problem. The too-big-to-fail problem is a pernicious one that has a number of substantial harmful effects. Critically, it reduces the incentives of shareholders, creditors, and counterparties of such firms to discipline excessive risk-taking. And it produces competitive distortions by enabling firms with large systemic footprints to fund themselves more cheaply than other firms because of the perception that these large firms will not be allowed to fail. This competitive distortion is not only unfair to smaller firms and damaging to competition today, but it also spurs further growth by the largest firms and more consolidation and concentration in the financial industry.

The Dodd-Frank Act takes a two-pronged approach in addressing the too-big-to-fail problem. The first prong empowers the Federal Reserve to reduce the probability of failure of a large, complex financial firm through tougher prudential regulation and supervision, including enhanced risk-based capital and leverage requirements, liquidity requirements, single-counterparty credit limits, stress testing, an early remediation regime, and activities restrictions. Ending the perception that some firms are too-big-to-fail also requires allowing a large, complex financial firm to fail if it cannot meet its obligations--and to do so without inflicting serious damage on the broader financial system. Importantly, the Dodd-Frank Act provides a mechanism for the FDIC, the Federal Reserve and the Treasury to jointly place any large financial firm that is in distress into liquidation. In addition the Dodd-Frank Act empowers the Federal Reserve and the FDIC to require large firms to conduct annual resolution planning. In particular, the Federal Reserve is working with the FDIC to require large, complex financial firms to better prepare for their own resolution by adopting so-called living wills.

In addition to stricter regulation and supervision of large, complex financial firms, the Dodd-Frank Act places new checks on the growth by acquisition of our major financial firms. It expands current restraints on acquisitions by bank holding companies to include a broader range of acquired firms (not just banks) and a broader range of liabilities (not just deposits). This expansion reflects a financial system that has changed in important ways since 1994, when the Congress first adopted concentration limits for banks and bank holding companies. The act also imposes new restrictions on the capital markets activities of banking firms--restrictions that will disproportionately affect the structure and profitability of the largest banking firms. For example, the so-called Volcker rule will restrict the ability of banking firms to engage in proprietary trading of securities and derivatives and to invest in or sponsor private investment funds.

The Federal Reserve's goal in designing enhanced prudential standards for large bank holding companies is to produce a well-integrated set of rules that meaningfully reduces the probability of failure of our largest, most complex financial firms and that minimizes the losses to the financial system and the economy if such a firm should fail. In doing so, we aim to require these firms to take into account the costs that they impose on the broader financial system, soak up the implicit subsidy these firms enjoy due to market perceptions of their systemic importance, and give these firms regulatory incentives to shrink their systemic footprint.

3. Jamie Dimon has used words like "sloppy," "stupid" and "bad judgment" to describe his firm's actions in this matter. Yet it is also the case that due to JPMorgan's "fortress balance sheet," the losses are eminently manageable, and do not in way jeopardize the firm's solvency or pose any threat to taxpayers. Are there lessons there for financial regulation? Does it seem to be the case that if an institution is well capitalized, most of what is in the Dodd-Frank Act that is intended to make the system safer is unnecessary, and if an institution is poorly capitalized, much of what is in the Dodd-Frank act is irrelevant?

Among the core objectives of the Dodd-Frank Act are enhancing regulators' ability to monitor and address threats to financial stability, strengthening both the prudential oversight (including capital regulation) and resolvability of large, complex financial firms, and improving the capacity of financial markets and infrastructures to absorb shocks. Achieving each of these objectives is important to enhancing the safety and soundness of the financial system.

The trading losses at JPMorgan have served to remind us of the fundamental importance of capital regulation in our prudential oversight of the largest banking firms. Although the risk-management failures that led to JPMorgan's recent trading losses are a cause for significant supervisory concern, it is important to note that these losses, though large in absolute dollar terms, are not a threat to the safety and soundness of the firm. Every dollar of these losses will be borne by JPMorgan's shareholders, and not by depositors or taxpayers, a result that is a function of the substantial amounts of high-quality capital that JPMorgan holds.

While robust bank capital requirements alone cannot ensure the safety and soundness of the largest banking firms, and indeed should be buttressed by other effective regulatory tools, they are central to good financial regulation because they ensure that capital is available to absorb all kinds of losses, unanticipated as well as anticipated. For precisely this reason, the Federal Reserve and other federal banking regulators continue to take important steps to strengthen bank capital regulation, especially for the largest, most complex firms.

4. Why do you believe that the best way to avoid future bailouts of financial institutions is by requiring higher capital cushions? How do you ensure that the capital requirements are commensurate with the risks posed by that institution to itself as well to the financial system more broadly?

While robust bank capital requirements alone cannot ensure the safety and soundness of our financial system, they are central to good financial regulation precisely because capital is available to absorb all kinds of potential losses and make taxpayer-funded bailouts less likely. Ensuring the capital adequacy of financial firms requires both improvement of the traditional, firm-based approach to capital regulation and the creation of a more systemic, or macroprudential, component of capital regulation.

With respect to improving the traditional approach to capital regulation, the Federal Reserve's work has principally involved the development of stronger regulatory capital standards in cooperation with other supervisors in the Basel Committee on Banking Supervision. This work includes the Basel 2.5 reforms that strengthened the market-risk capital requirements of Basel II. This work also includes the Basel III reforms, which improve the quality of regulatory capital, increase the quantity of required minimum regulatory capital, require banks to maintain a capital conservation buffer and, for the first time internationally, introduce a minimum leverage ratio. The Federal Reserve and other U.S. banking agencies recently issued final regulations to implement Basel 2.5 in the United States and proposed regulations to implement Basel III. (See 77 Federal Register 53060, August 30, 2012; 77 Federal Register 52792, August 30, 2012; 77 Federal Register 52888, August 30, 2012; and 77 Federal Register 52978, August 30, 2012.)

The recent financial crisis also made clear that the existing international regulatory capital framework was not sufficiently responsive to macroprudential concerns, such as the threat to financial stability posed by systemically important financial institutions. Accordingly, in Basel Committee deliberations, the Federal Reserve advocated for capital surcharges on the world's largest, most interconnected banking organizations based on their global systemic importance. Last year, an international agreement was reached on a framework for such surcharges, to be implemented during the same 2016-2019 transition period for the capital conservation buffers in Basel III. This initiative is consistent with the Federal Reserve's obligation under section 165 of the Dodd-Frank Act to impose more stringent capital standards on systemically important financial institutions, including the requirement that these additional standards be graduated based on the systemic footprint of the institution.

Both the Dodd-Frank Act provision and the Basel framework are motivated by the fact that the failure of a systemically important firm would have dramatically greater negative consequences on the financial system and the economy than the failure of other firms. Stricter capital requirements on systemically important firms should also help offset any funding advantage these firms derive from any remaining perceived status as too-big-to-fail and provide an incentive for such firms to reduce their systemic footprint.

The Federal Reserve has also sought to enhance the resiliency of the capital position of banking organizations through the development of firm-specific stress testing and capital planning requirements. These supervisory tools serve two related functions. They make capital regulation more forward-looking by testing whether firms would have enough capital to remain viable financial intermediaries if in an adverse macroeconomic scenario. They also contribute to the macroprudential dimension of supervision by enabling simultaneous examination of the risks faced by all large financial institutions during the hypothetical adverse economic scenario.

The Dodd-Frank Act also requires stress-testing requirements, which has been implemented through a final rule (77 Federal Register 62378, October 12, 2012). Pursuant to the rule, the Federal Reserve conducts annual stress tests on all bank holding companies with $50 billion or more in assets to determine whether they have the capital needed to absorb losses in hypothetical baseline, adverse, and severely adverse economic conditions. In addition, the rule requires that these companies and certain other regulated financial firms with assets between $10 billion and $50 billion to conduct internal stress tests. The Federal Reserve must publish a summary of results of the supervisory stress tests and issue regulations requiring firms to publish a summary of the company-run stress tests. Firm-specific capital planning has also become an important supervisory tool. In November 2011, the Federal Reserve issued a new regulation requiring large banking organizations to submit an annual capital plan. This tool serves multiple purposes. First, it provides a regular, structured, and comparative way to promote and assess the capacity of large bank holding companies to understand and manage their capital positions. Second, it provides supervisors with an opportunity to evaluate any capital distribution plans against the backdrop of the firm's overall capital position, a matter of considerable importance given the significant distributions that some firms made in 2007 even as the financial crisis gathered momentum. Third, at least for the next few years, it will provide a regular assessment of whether large bank holding companies will readily meet the Basel 2.5 and Basel III capital requirements as they take effect in the United States.

A stress test is a critical part of the annual capital plan review. But, as these three different purposes indicate, the capital plan review is about more than using a stress test to determine whether a firm's capital distribution plans are consistent with remaining a viable financial intermediary in adverse economic conditions. As indicated during our capital plan reviews in both 2011 and 2012, the Federal Reserve may object to a capital plan because of significant deficiencies in a firm's capital planning process, as well as because one or more relevant capital ratios would fall below required levels under the assumptions of stress and planned capital distributions. Likewise, the stress test is relevant not only for its role in the capital planning process. As noted earlier, it also serves other important purposes, not least of which is increased

transparency of both bank holding company balance sheets and the supervisory process of the Federal Reserve.

5. There is an obvious trade-off between safety and economic growth. Higher capital standards may mean safer banks, but the price is that there will be less credit and that credit will be more expensive. Can you tell us the price we will pay for Basel III? How much more capital will banks need to meet the new standards? Have we sacrificed economic growth in the name of safety?

The Board and other agencies recently sought comment on proposed revisions to the banking agencies' capital rules that would, among other things, incorporate new international standards established by Basel III. (See 77 Federal Register 52792, August 30, 2012; 77 Federal Register 52888, August 30, 2012; and 77 Federal Register 52978, August 30, 2012, collectively, the "NPRs"). The proposed revisions would result in capital requirements that better reflect banking organizations' risk profiles and, combined with other requirements of the Dodd-Frank Act, should enhance their ability to continue to function as financial intermediaries particularly during stressful periods. Over the medium- and long-term, this should improve the overall resiliency of the banking system and increase economic growth. It is expected that a more stable financial system will result in lower long-term costs of credit for consumers and small businesses and a more consistent supply of credit to consumers and small businesses.

Based on the analysis conducted by the Board and our international colleagues, stronger capital requirements could help reduce the likelihood of banking crises while yielding positive net economic benefits. Moreover, this analysis found that the requirements would only have a modest negative impact on the gross domestic product of member countries, and that any such negative impact could be significantly mitigated by phasing in the proposed requirements over time.[1]

The Board along with the other banking agencies considered the potential impact of the proposed requirements on banking organizations using regulatory reporting data, supplemented by certain assumptions where data needed to calculate the capital requirements was not reported (the Board's analyses, related assumptions, and descriptions of methodologies used for the analyses are included as Attachment B). The general conclusion of the Board as well as the other agencies was that the vast majority of banking organizations, including community banks, already would meet the proposed minimum requirements on a fully phased-in basis and would also have capital sufficient to exceed the proposed capital buffer threshold for restrictions on capital distributions and certain discretionary payments to executive officers.

In addition, the Board and the other banking agencies sought public comment on the proposed requirements in the NPRs to better understand their potential costs and benefits. The agencies asked several specific questions in the NPRs about potential costs related to the proposals, and

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[1] *See* "An assessment of the long-term economic impact of stronger capital and liquidity requirements" (August 2010), available at http://www.bis.org/publ/bcbs173.pdf. (Attachment A).

are considering all comments carefully. During the comment period, the agencies also participated in various outreach efforts, such as engaging community banking organizations and trade associations, among others, to better understand industry participants' concerns about the NPRs and to gather information on their potential effects. These efforts have provided valuable additional information to assist the agencies as they determine how to proceed with the proposed rulemakings. The comment period on the NPRs ended on October 22, 2012, and more than 1,000 public comments have been submitted to the banking agencies.

The Board believes that an appropriately structured, robust and comprehensive regulatory capital framework will be essential to increasing the resiliency of U.S. banking organizations and the financial system. As the Board and the other banking agencies work toward this goal, all the comments received on the proposed changes to the U.S. regulatory framework will be carefully considered.

6. Has the Fed discovered any of the governance, risk management or control weaknesses that characterized JP Morgan's Chief Investment Office in any other parts of the holding company?

JPMorgan Chase has admitted that it did not have appropriate risk management processes in place to monitor the risk of trading activities in its CIO. The Federal Reserve is working with JPMorgan Chase and the OCC to address these risk management failures and ensure that JPMorgan has appropriate risk management for its trading activities across the organization. Confidential information regarding examinations of bank holding companies, such as JPMorgan Chase, are protected by law.

7. In your view, do the types of synthetic derivatives used by JPMorgan Chase's Chief Investment Office in this case serve any beneficial purpose from a safety and soundness standpoint? Or should they just be banned?

Credit derivatives can be used by regulated financial institutions to hedge existing exposures, to create new exposures, or to make two-way markets for other derivatives users such as asset managers (thus earning a "bid-ask spread"). Thus, credit derivatives can serve the purpose of allowing a bank to manage its exposure to clients as well as to service clients. However, these transactions entail significant embedded leverage and can involve imperfectly offsetting long and short positions in similar – but not perfectly correlated – reference assets. Derivatives trading therefore must occur within a well-controlled environment in order to ensure that risk is appropriately measured and that positions do not grow too large in size.

8. The fact that the Federal Reserve and the OCC have over a hundred examiners combined on-site at JPMorgan Chase and yet failed to appreciate the risks being undertaken by the firm's Chief Investment Office has caused some to question the wisdom of having regulators "embedded" at our nation's largest financial firms. Under this view, those examiners are at such high risk of becoming "captured" by the firms whose offices they report to every day that we would actually be better off if they performed their duties

off-site. What is your view? Is it time for a fundamental rethinking of some of our basic assumptions about how best to supervise our nation's largest financial institutions?

In order to supervise these large banks, supervisors must spend significant amounts of time at the firms interacting with firm personnel. However, Federal Reserve examiners should also regularly spend time off site interacting with management as well as peers responsible for supervising other institutions. We will continue to evaluate and explore the optimal balance.

9. Press reports suggest that JPMorgan Chase's peer institutions were less aggressive in their strategies for investing the huge "excess deposits" that have built up on their balance sheets due to the Fed's highly accommodative monetary policy, choosing to invest those funds largely in Treasuries and other forms of government-guaranteed debt rather than the more speculative instruments that Chase's Chief Investment Office traded. Is that an accurate characterization? Should we be worried that there are other "London Whale"-type trades at other large financial institutions yet to be uncovered, or is that fear largely unfounded?

Based on the work undertaken since the risk management failures at CIO surfaced, the Federal Reserve has no reason to believe that similar outsized positions exists elsewhere. However, this incident highlights the challenge that supervisors face in monitoring evolving risk profiles when a bank's internal risk reporting and risk limits are deficient, rendering the firm itself unable to identify and escalate emerging risks and vulnerabilities.

10. Martin Wolf has asked the following question that I now ask you: "Suppose there were no lenders of last resort, no government deposit insurance, no government regulation of financial intermediaries, and no government bailouts. Would the financial world be more or less dangerous than it is?"

Those were the conditions prior to the establishment of the Federal Reserve System, which was founded to help offset the cyclical panics that followed highs in the business cycle. They were also largely the conditions that existed at the time of the financial crisis that became the Great Depression. The creation of a lender of last resort, federal deposit insurance, regulation of financial intermediaries and, now, a framework for placing into resolution any systemically important firm in distress were all intended to reduce the likelihood and depth of future financial crises, which, history has demonstrated, impose high costs on broad numbers of consumers, households and businesses small and big.

The recent trading losses at JPMorgan Chase have also served to remind us of the fundamental importance of capital regulation in our prudential oversight of the largest financial firms. While robust bank capital requirements cannot alone ensure the safety and soundness of the financial system, they are central to appropriate financial regulation precisely because a company with adequate capital will be able to absorb a variety of losses, including those that are unanticipated.

Questions for Mr. Scott Alvarez, General Counsel, Board of Governors of the Federal Reserve System, from Representative Luetkemeyer:

1. Are you making any recommendations on investing in European government bonds?

See response for question 2.

2. Are you classifying investments in European government bonds?

The Federal Reserve does not make investment recommendations on European government bonds or any other type of instrument. The Federal Reserve and the other banking regulatory agencies continuously monitor developments in country risk and their possible effect on regulated institutions. Agency staff regularly coordinate on an inter-agency basis their reviews of the transfer and country risk of countries to which U.S. regulated institutions have exposure, including the appropriate treatment and reserve requirements for sovereign and commercial exposures in default. As part of this review, the agencies assess all pertinent quantitative factors, such as debt burden as percent of GDP, balance of payment, current account measures and many other measures, as well as qualitative factors, such as a sovereign obligor's commitment to internationally sponsored repayment plans.

Questions for the Record from Congressman Bachus

The Honorable Thomas Curry, Comptroller, Office of the Comptroller of the Currency

1. Mr. Curry, one of the issues this episode raises is the effective supervision of large institutions that do business in financial centers around the world. Although this loss--and the risk to the financial system--was nothing like that of AIG's London-based Financial Products Group, this appears to be yet another example of a U.S.-based institution whose foreign activities were beyond the effective supervision of its U.S. regulators, with unexpected and unpleasantly surprising results. The AIG catastrophe and this much smaller loss both raise the question of who is overseeing the London-based activities of U.S. financial institutions, and whether U.S. and U.K. regulators are cooperating and coordinating supervision. We invited the U.K. Financial Services Authority to this hearing, but they unfortunately could not attend. Yet this question is an important one, and so I ask you, Mr. Curry:

   a. **Are U.S. regulators able to effectively oversee the foreign activities of U.S. financial institutions?**

      The foreign activities of U.S. financial institutions are often extensions of their domestic activities and are typically managed on a global basis. In most cases, an institution's process for measuring, communicating and controlling risks is part of an enterprise-wide corporate governance process. Management information systems are global in nature allowing for positions to be viewed and managed anywhere. The OCC's supervision-by-risk approach takes a holistic view at firm-wide risks regardless of where the activities are managed or booked. We seek to understand the breadth and nature of foreign activities, and ensure that risk measures and controls are appropriate and integrated into the institution's overall corporate governance process. We perform periodic examinations of areas of higher risk or weaker management. We also rely upon the work of the bank's internal audit and compliance functions when we believe these functions operate effectively.

   b. **What are U.S. regulators doing to coordinate the supervision of these institutions with foreign regulators, such as the U.K.'s Financial Services Authority?**

      We have information sharing agreements with many regulators around the world, including the U.K.'s FSA. The U.K.'s FSA is a member of the JPMC Supervisory College, through which we have quarterly conference calls to discuss supervisory issues and concerns and annual in-person meetings to explore relevant issues in more depth.

We have been working very closely with the U.K. FSA on issues of mutual interest such as foreign subsidiary and branch liquidity.

The OCC has an office in London to help supervise the U.K. and European-based activities of national banks and federal savings associations. This team facilitates communication with the U.K.'s FSA and other foreign regulators. The London staff is an extension of our large bank staff and provides on-the-ground support to our U.S. teams. Most of our exam strategies and priorities are planned and managed by New York-based resident staff. However, we use the London team to help scope and examine European-based activities.

c. **Are you concerned that the London-based activities of U.S. financial institutions are falling into a regulatory gap between U.S. and U.K. regulators?**

The OCC does not consider nor place reliance on the U.K. regulators' activities when developing the scope of our London-based activities. Where supervisory interests overlap, we occasionally participate in each other's reviews and continuous supervision activities.

We are concerned about any instances where activities could fall into a regulatory gap. With respect to the U.K., we communicate regularly with the U.K. regulators regarding risks and issues in order to minimize the potential for such gaps. We also perform periodic examinations to test and verify our understanding of the bank's activities. We review audit and compliance reviews of U.S. branches overseas and follow up on important findings.

2. **To the best of your understanding, were the JPMorgan trades compliant with the current version of the Volcker Rule? Does the fact that you and other regulators are unable to provide a definitive answer to that question suggest that the Volcker Rule is far too complex to be implemented in a rational, effective way? And if that is the case, aren't we better off scrapping the Rule entirely?**

If the question is directed to the statutory Volcker Rule provisions, the key question would be whether the transactions at issue were entered into with the intent to benefit from short-term price movements. The final rule is still in development by the agencies.

3. During the April 13, 2012 analyst call during which JPMorgan Chase officials initially dismissed the significance of the "London Whale" trade, the firm's Chief Financial Officer, Douglas Braunstein, stated, "We are very comfortable with our positions as they are held today, and I would add that all of those positions are fully transparent to the regulators. They review them, have access to them at any point in time [and] get the information on those positions on a regular and recurring basis as part of our normalized reporting."

a. **Is Mr. Braunstein's description of the regulators' access to information about the positions being taken by the firm at any given time accurate?**

Further investigation by JPMC and the OCC found that this statement was incorrect. JPMC itself, through its CEO Jamie Dimon admitted before Congress that the MIS used for the CIO did not provide adequate information and that because the examiners use the same information that management does, they were also misinformed.

OCC and JPMC executive management did receive summary information, and OCC had access to various other reports, but this information did not adequately convey the complexity of the positions or the risk profile. The complexities became apparent during the second half of April, when the position deteriorated further.

b. **If so, how is it that the OCC failed to identify the risks inherent in those positions until after the fact?**

The size and complexity of the synthetic credit book changed very rapidly in the first quarter of 2012, particularly in the last weeks of the quarter, when trading patterns resulted in unusual exposures. Until the first quarter of 2012, we considered the risk in the CIO to be moderate and focused our supervisory attention on higher risk activities elsewhere in the bank. Moreover, we subsequently learned that the existing risk reports did not sufficiently convey the nature of the risk.

4. JPMorgan's loss raises what may be the fundamental dilemma of banking regulation: on the one hand, there are those who think that it is the function of the regulators to prevent banks from losing any money ever; on the other hand, there are those who think that banking is an inherently risky business in which some failures are inevitable. In fact, this latter group believes that without risk, there can be no growth, and the point of banking regulation is to make it possible for lending and investment decisions to go sour and for institutions to fail without taking the financial system down. **What light does JPMorgan's loss shed, if any, on this dilemma?**

The OCC's supervisory philosophy and approach are grounded in the premise that banks are in the business to take risks, but in doing so, those risks must be effectively identified, managed, and controlled, and that banks must hold adequate capital to absorb unexpected losses. We do not believe that it is possible or desirable to establish an expectation that banks will never lose money or that bank failures will never occur. Banks are in the business of managing financial risk. Indeed, in the core business of banking—lending—banks expect to incur losses on some percentage of the loans they make, and we require them to

establish and maintain reserves for such losses. While we work hard to ensure that banks have adequate risk management systems and capital to withstand losses, there will be times when a bank's losses are such that its financial condition is no longer viable. In such cases, it is essential that we have the means to resolve the bank in a manner that does not place our financial system or U.S. taxpayers at risk and that no bank, regardless of size, is viewed as "too big to fail." The orderly resolution provisions of the Dodd-Frank Act are an important component to ensuring this outcome.

The recent events at JPMorgan underscore and reinforce our core premise that large banks must have strong, not just adequate, risk management practices and systems. In this respect, I would stress that the job of risk management is not to eliminate losses or risk, but rather to ensure that risk exposures are fully identified and understood so that bank management and directors can make informed business decisions about the bank's overall level of risk and ensure that adequate capital is maintained. As I noted in my testimony, the adequacy of JPMorgan's risk management processes over the CIO office and its activities is a focus of our ongoing investigation. The fact that the large losses at JPMorgan do not present a solvency issue also underscores the importance of robust capital levels as a backstop against unforeseen losses and risk management failures.

5. You have testified that "the OCC focused on the risk management systems and controls that the bank employed to mitigate credit risk in its portfolio. For several years ... risk levels operated within bank-approved stress and other limits. In late 2011 and early 2012, bank management revised its strategy and decided to offset its original position and reduce the amount of stress loss protection."

   a. **Can you describe the changes?**

   The OCC continues to evaluate the trading patterns and risk management practices of the CIO. As part of our work, we can provide the following basic information: As part of its annual budgeting process, the bank found that the synthetic credit position in the CIO was generating a large Risk-Weighted Asset (RWA) number and thus had a high capital charge. JPMC's CEO asked the CIO head to reduce the RWA in the synthetic credit book. This message was communicated to the desk head for execution. As we have since learned, rather than simply terminating the existing positions, the synthetic credit desk undertook a strategy to reduce the risks by adding to the positions through offsetting transactions. This resulted in the desk building a large and complex portfolio that actually increased RWA. We are continuing to review the facts and circumstances behind these events.

b. What was the OCC's initial response to the changes?

Bank management intended to reduce the synthetic credit risk and reduce RWA. Such a decision, taken alone, was reasonable and not something requiring direct supervisory attention. It was the unusual way in which that decision was executed that caused the large losses. As soon as OCC learned of the risks in the portfolio, OCC examiners immediately began reviewing the bank's actions.

6. **Why, if the approved strategies were so deficient, did the OCC examiners in New York not speak up when they noticed that the actual performance deviated from expectations?**

Risk information received by the OCC during the first quarter of 2012 did not signal any significant issues. Moreover, at our quarterly meeting with the CEO of the CIO, there was no mention of the building risks in the synthetic credit book. At our quarterly meeting with the bank's CFO on April 12, 2012, the day before the earnings announcement, there was no mention of the issues. Similarly, information provided to the board of directors in advance of first quarter earnings results also lacked mention of any problems or concerns with the synthetic credit book.

The risk positions on the synthetic credit desk ramped up very rapidly in the first quarter 2012 (particularly in the late March time frame). Information we received did not effectively capture the rapidly changing risk profile. We learned subsequently, that the risk reports were not sufficiently granular to manage and control the risks that the synthetic credit desk acquired. This behavior was also out of character for the CIO's business based on our prior understanding of the unit.

Questions for the Record from Rep. Blaine Luetkemeyer (M0-9)

Questions for Panel One

1. Are you making any recommendations on investing in European government bonds?

No, the OCC does not make investment recommendations. Our role as supervisor involves examining investment portfolios for compliance with applicable laws and regulations and overall safety and soundness criteria.

2. Are you classifying investments in European government bonds?

No, the OCC follows Interagency Country Exposure Review Committee (ICERC) guidelines with respect to sovereign credit risk and ICERC only classifies debt that is in default. European government bonds do not meet that criteria.

Questions for the Record from Congressman Bachus

Mr. Jamie Dimon, Chairman and Chief Executive Officer, JPMorgan Chase & Co.

1. **Much of the discussion of JPMorgan's trading loss has focused on whether the activity in question would have been prohibited if the so-called Volcker Rule had been in effect. What is you view? Putting aside whether such trades *would* be prohibited under the Volcker Rule – since nobody including the regulators who wrote it seem able to answer that question – *should* they be prohibited?**

   As reflected in our comment letter on the Volcker proposed rule, we believe that the proposal was not clear with respect to whether trading of the type done by our CIO was permissible. Different agencies and different examiners within agencies may well read it differently and reach different conclusions. We continue to believe that it is important for any bank to be able to hedge against potential stress events – a worsening economic climate, political instability, regional or sectoral downturns. Such hedging allows banks to avoid withdrawing or increasing the price of credit or other financial products, while still protecting their safety and soundness. We have concluded that the strategies adopted by the London traders in early 2012 were unwise, and did not achieve a hedging benefit to offset their risk. We will not use such strategies in the future. As a practical matter, we note that pending capital rules would likely make such a strategy uneconomic in any event, and that the banking regulators have safety and soundness authority to prohibit unsafe and unsound practices. The Volcker rule could prohibit such activity by labeling it proprietary as well; the problem, however, is that such a rule would likely prohibit benign and even beneficial activity as well.

2. **During your testimony before the Senate Banking Committee, you stated that "we don't actually know who has jurisdiction over many issues we deal with anymore. I would prefer a simple, clean regulatory system with real intelligent design, and that's not what we did." Your comment goes to the heart of what many of us view as one of the central shortcomings of Dodd-Frank – its failure to do anything to rationalize our chaotic financial regulatory structure, in which firms like yours are overseen by the five regulators who appeared on the first panel, as well as brand-new agencies like the Consumer Financial Protection Bureau, the Financial Stability Oversight Council, and the Office of Financial Research. Only in Washington could we conclude that the proper policy response to a massive failure of government bureaucrats to do their jobs is more bureaucracy. Don't we need to consolidate and streamline our regulatory structure if we are to have any hope of eliminating regulatory arbitrage and putting an end to regulatory buck-passing?**

   We continue to believe that regulatory streamlining is necessary. With respect to the Volcker rule, for example, we will face examination and enforcement by at least four different U.S. regulators, and the standards they impose are likely to be inconsistent. In other areas, we face supervision and enforcement by additional federal regulators, as well as state regulators. This arrangement, and an increasingly subjective approach to supervision and enforcement, makes it very difficult for financial institutions to know what standards are applicable to their conduct. This increases costs for consumers and clients.

3. **The fact that the losses in question here occurred in a London-based office have caused some to draw a historical parallel to the activities of AIG's Financial Products Group, which was also based in London and whose disastrous one-way directional bet on the U.S. housing market was one of the key triggers of the financial crisis. Recognizing that JPMorgan's trading loss here was a mere fraction of the losses that helped bring AIG down before it was bailed out by taxpayers, should we nevertheless draw any conclusions from the fact that in both circumstances, the derivatives trades that led to the losses took place overseas? Does this suggest that efforts to exempt trades made through foreign branches or affiliates from the reach of title VII of the Dodd-Frank Act are misguided?**

   The location of these trades in London did not diminish the authority of federal banking regulators to supervise them, and their London locus therefore was not any sort of regulatory arbitrage. We do have concerns about U.S. regulatory requirements being imposed on our overseas operations when those requirements put us at a competitive disadvantage with foreign banks operating in the same jurisdiction. The general approach of U.S. law has been to allow U.S. branches and subsidiaries of U.S. banks to operate under the laws of foreign jurisdictions, while still remaining subject to the safety and soundness authority of U.S. banking supervisors.

   Importantly, these activities remain subject to capital requirements at the holding company and bank level, and we had sufficient capital to absorb this loss without a significant reduction in our capital levels.

4. **It is easy to second guess and "Monday Morning Quarterback" after someone has made a mistake. But why did JPMorgan take such a big position in an illiquid market? Is this a common strategy? What is the rationale behind taking such positions? To your knowledge, do other banks employ similar "dynamic macro-hedges"?**

   We conducted a thorough management review to determine why we suffered these losses. As with any major loss, there were a variety of mistakes made. As we have stated publicly, these mistakes included the following:

   - CIO judgment, execution and escalation in the first quarter of 2012 were poor.
   - Level of scrutiny did not evolve commensurate with increasing complexity of CIO activities.
   - CIO Risk Management was ineffective in dealing with Synthetic Credit Portfolio.
   - Risk limits for CIO were not sufficiently granular.
   - Approval and implementation of Synthetic Credit VaR model were inadequate.

5. **How do you respond to those who cite your firm's recent trading loss as evidence that JPMorgan and other mega-banks like it are simply too large and complex to manage, and because they benefit from a federal safety net, are therefore, too big to exist?**

   Trading losses have occurred at small banks and large ones. As noted, our size – our fortress balance sheet, our diverse sources of revenue – allowed us to weather this loss while continuing to serve our clients.

6. **You seem to be "damned if you and damned if you don't." It seems like when you make money, you and your institution are vilified as examples of a capitalist system in which the one percent benefit at the expense of the 99 percent. When you lose money, as was the case here, you are hauled before Congress to atone for your sins. What can business leaders and elected officials do to promote a climate in which we avoid these kinds of hysterical extremes and achieve a greater sense of balance in our public debate?**

   Americans and their elected representatives are justifiably frustrated with the slow pace of economic recovery, and still apprehensive in the wake of a major financial crisis. We have to assume that banks will face extraordinary scrutiny in such an environment. We hope that economic recovery, in addition to having far more important benefits, will allow the debate about financial services regulation to admit the benefits as well as the costs of a modern, sophisticated bank.

Response to questions from the Honorable Spencer Baucus
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Q1: Does the Dodd-Frank Act end "Too Big to Fail"? If so, why could former Kansas City Federal Reserve President and current FDIC Acting Vice Chairman Thomas Hoenig say in December 2010 that "the five largest financial institutions are 20 percent larger than they were before the crisis. They control $8.6 trillion in financial assets — the equivalent of nearly 60 percent of gross domestic product. Like it or not, these firms remain too big to fail?"

A1: The absence of effective alternatives to merging large, failing firms with other large financial organizations during a financial crisis created a system with more asset concentration and larger banking and other financial companies. In March 2007, the 10 largest insured depository institutions (IDIs) and their affiliates had about 49 percent of total IDI assets – this has grown to 52 percent today. Further, the four largest IDIs and their affiliates had about 38 percent of industry assets in 2007, as compared with 45 percent today.

The *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) provides tools and powers that were not available during the crisis to end too-big-to-fail. Specifically, the Dodd-Frank Act:

- Requires large bank holding companies to prepare resolution plans or living wills that would allow for the orderly resolution of the company under the bankruptcy code; and

- Provides the FDIC new authority to place a bank, its holding company, and affiliates into an orderly resolution process if it is determined that the company cannot be resolved under the bankruptcy code without severe disruption to the financial system.

The FDIC will use these newly-available tools as necessary to ensure that the largest financial companies can successfully be resolved without significant adverse effects on the financial stability of the U.S.

Q2: Some have used JPMorgan's trading loss to argue that we should not permit insured depository institutions to engage in the kinds of activities that produced that loss, such as the purchase and sale of credit derivatives, on the grounds that such activity is "too risky." Yet there is also general consensus that the recent financial crisis was largely caused by poor underwriting of residential and commercial real estate loans – banks' "bread-and-butter" business – which suggests that focusing banks on their traditional lines of activity would not necessarily make them safer. Don't we need banks to take risks if we are going to have a dynamic market economy in which job creators can access the capital they need to establish and grow their businesses? In light of that, what do you make of calls to "de-risk" the banking system?

A2: As financial intermediaries, banks need to effectively manage risk to operate successfully and serve the needs of businesses and consumers. Banks support our economy with credit and depository services and play a critical role in the expansion of commercial enterprises that create jobs. Financial institutions facilitate economic growth and commerce by lending to creditworthy borrowers, providing payment systems and deposit services, and properly managing on- and off-balance sheet positions.

The federal banking supervisors have long supported strong risk management processes that enable financial institutions to better manage their organizations and mitigate unexpected losses. As you point out, myriad causes were behind the recent financial crisis. A central theme was the lack of effective risk management at many insured institutions and unregulated non-bank entities. Poor credit underwriting and outsized concentrations of real estate loans precipitated numerous bank failures and a rapid weakening of the economy and financial system generally. Furthermore, losses related to trading and hedging positions reinforced the need for careful risk taking, implementation of effective policies and exposure limits, strong controls and management information systems, and appropriate capital support. Since the crisis began, the FDIC has worked closely with banks to improve risk selection and management processes, address concentrations of risk, and strengthen earnings, capital, and liquidity.

In response to your question about "de-risking" the banking system, we believe that prudently controlled risk taking is an integral part of financial intermediation. Financial institutions, which are vital to our economy, should fully understand and control various exposures while minimizing undue concentrations that can cause significant losses. Regardless of an institution's size or business strategy, risk taking must be well managed within a robust policy and risk management framework that promotes safe-and-sound operation.

Q3: There is general agreement that our financial system was far too complex in the years leading up to the financial crisis, which led to risks being hidden from the view of the regulators and even from the boards of directors and management of the firms taking the risks. Yet the policy response to the crisis – the 2,300-page Dodd-Frank Act with its 400 new Federal regulations – has only made the system more complex and provided more opportunities for clever industry lawyers to game the system. Wasn't Dodd-Frank a missed opportunity to simplify our system and rationalize our financial regulatory structure? How would you recommend we go about creating a system that is less complex?

A3: The Dodd-Frank Act enacted reforms intended to address the causes of the recent financial crisis. Foremost among these reforms were measures to curb excessive risk taking at large, complex banks and non-bank financial companies where the crisis began. Title I of the Dodd-Frank Act includes new provisions that enhance prudential supervision and capital requirements for systemically important financial institutions (SIFIs), while Title II authorizes a new orderly liquidation authority that significantly enhances the ability to resolve a failed SIFI without contributing to additional financial market distress.

The FDIC is aware of concerns that the complexity of banking statutes and associated oversight processes are having an unintended effect on financial institutions.

The FDIC is committed to an effective regulatory process that is not needlessly complex and will support efforts to address the appropriateness of current requirements. As part of our implementation of the Dodd-Frank Act, we are updating, streamlining, or rescinding certain rules to comply with the statute. We also are sponsoring a Community Bank Initiative during 2012 to further our understanding of the challenges and opportunities for community banks and to review our examination and rulemaking process to ensure any unnecessary processes or requirements are eliminated. This will include an evaluation of our own risk-management and compliance supervision practices to determine if there are ways to make the process more efficient without sacrificing supervisory standards. We have engaged in a dialog with community bankers by holding a series of regional roundtables to solicit their input on these and other matters.

Further, we have taken steps to reduce complexity and increase transparency in rulemaking. In response to input from members of the FDIC's Advisory Committee on Community Banking on ways to streamline the regulatory process, we conducted a review of the materials that banks file with us and made changes to improve the process through greater use of technology and automation. Also, to make it easier for smaller institutions to understand the impact of new regulatory changes or guidance, we are now including a statement in our Financial Institution Letters (the communication that alerts banks to any regulatory changes or new guidance) as to whether the change applies to institutions with assets less than $1 billion.

Finally, the FDIC will perform a comprehensive review of its regulations to identify any outdated, unnecessary, or unduly burdensome regulations pursuant to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). This well-established process requires the FDIC to conduct a complete review of our regulations at least once every ten years. To prepare for the upcoming EGRPRA review, the FDIC published for public comment, earlier this year, a plan outlining this process.

Q4: It is my understanding that the FDIC has been working with JPMorgan's primary federal regulators, the OCC and the Fed, as well as the institution itself, to investigate both the circumstances that led to the losses and the institution's ongoing efforts to manage the risks at the firm. What have you discovered so far?

A4: Along with the Comptroller of the Currency and the Federal Reserve Board, the FDIC continues its evaluation of the CIO portfolio, its governance structure and the results of the work performed as part of JPMorgan's internal investigation. Further, the FDIC continues to work with both OCC and Federal Reserve staff to review the models used in JPMorgan's CIO unit for the assessment of risk associated with that unit's credit hybrid business. This review has focused on an assessment of JPMorgan's value at risk (VaR) methodology and the identification of any weaknesses in the firm's processes and procedures for model governance, validation, and controls.

The firm has identified major gaps in several areas within the CIO business line that contributed to the losses incurred. The primary areas of focus for the firm include the CIO trading strategy, VaR methodology and model governance, strength of risk management, and the CIO limit

structure/escalation process. While the FDIC has been focused on a variety of issues and risk areas, we cannot publicly disclose supervisory findings.

Q5: Basel III's new capital requirements will make banks less profitable, and we have discovered – thanks to the law of unintended consequences – that any time government tries to thwart profitable enterprises, profitable enterprises find new ways to make money. Does Basel III encourage banks to make up lost profits by chasing riskier, more speculative activities? By encouraging them to raise the fees they charge individual consumers? Small business? Large firms? Who ultimately pays the price for Basel III – the big banks, or the American consumer?

A5: The new capital requirements reflect lessons learned during the recent financial crisis and improve and strengthen the overall quality and quantity of capital. This builds additional capacity into the banking system to absorb losses in times of economic and financial stress.

We do not believe that Basel III would encourage banks to engage in excessive risk taking. The core of the agencies' Notice of Proposed Rulemaking to implement Basel III is to increase the overall minimum requirements for the quality and quantity of bank capital. Over 90 percent of banks already meet the proposed standards even if they were put in place immediately (the NPR proposes a multi-year phase-in of the standards).

With respect to the costs of Basel III, the Financial Stability Board and the Basel Committee on Banking Supervision undertook studies of the potential economic impact of transitioning to the proposed new capital requirements. The studies concluded there would be considerable economic benefits from stronger capital requirements. The reason for this conclusion is that banking and financial crises have had significant negative effects on economic growth. By reducing the frequency and severity of banking crises, the new capital standards should make economic growth higher and more sustainable over time.

Q6: Can you explain how higher capital requirements would have guarded against some of the spectacularly bad decisions that led to the financial crisis? Would higher capital requirements have mitigated or blunted government housing goals, which put people in houses they couldn't afford? Would higher capital requirements have prevented Lehman from doubling down on a housing market that was about to collapse? In other words, are higher capital requirements a cure for bad business decisions?

A6: Capital requirements, by themselves, are not a sufficient safeguard against speculative behavior and poor decision making. Capital is, however, the shock absorber that allows banks to absorb losses and continue to act as financial intermediaries during periods of financial stress. Adequate bank capital promotes a stronger and more resilient financial system and protects the FDIC Deposit Insurance Fund from loss, minimizing the likelihood that the banking industry's premiums will need to be raised and, ultimately, the federal full faith and credit guarantee of insured deposits would need to be exercised.

Response to questions from the Honorable Blaine Leutkemeyer
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Q1: Are you making any recommendations on investing in European government bonds?

A1: The federal bank regulatory agencies do not make investment recommendations. However, the agencies have issued investment permissibility regulations and guidance articulating the expectation that appropriate due diligence should be performed on the suitability of individual investments before purchase. Under the investment permissibility regulations, foreign sovereign debt must meet certain requirements before a bank is permitted to invest. For example, the debt instruments should be marketable obligations that are not predominantly speculative in nature. Furthermore, as a result of statutory lending limits, banks are subject to limitations on the investment that they can make in the securities of any one foreign government. For example, a National Bank must limit the investment in the securities of any one foreign government to no more than 10 percent of that National Bank's capital and surplus. The laws of most states contain similar limits.

Q2: Are you classifying investments in European government bonds?

A2: Overall, U.S. banks are not large buyers of European government bonds. Additionally, European government bonds held for trading are marked-to-market daily and, as such, are not classified. To the extent U.S. banks hold European government bonds for investment purposes, classification decisions are made on a case-by-case basis. If a particular European country misses payments or defaults, the bonds would be classified based on our classification standards.

Questions for the Record from
Congressman Bachus
Committee on Financial Services, U.S. House of Representatives

Hearing held on June 19, 2012, entitled
"Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss"

The Honorable Mary Schapiro, Chairman, U.S. Securities and Exchange Commission

Does the SEC have embedded staff at JPMorgan's broker-dealer? If so, how many SEC staff examine the broker-dealer? If the JPMorgan trading strategy at issue here had occurred in its U.S. broker-dealer, please describe how the SEC's examination process would have worked and what the Commission's response to the trading strategy and the loss would have been?

The Commission does not embed staff at broker-dealers, including JPMorgan Chase. If the JPMorgan trading strategy had occurred at its U.S. broker-dealer, I believe the Commission's Office of Compliance Inspections and Examinations ("OCIE") would have opened an examination to get a full understanding of the nature of the trading loss and validate the accuracy of the loss reported. I believe the examination staff also would have reviewed the broker-dealer's internal controls, including controls over model validation, valuation, market risk and relevant operational procedures. As part of an examination such as this, OCIE would have consulted and coordinated with other Commission divisions such as the Divisions of Trading and Markets and would have referred the matter to Enforcement as appropriate.

Some commentators have raised concerns that the threat of Sarbanes-Oxley civil and criminal penalties has made it more difficult to attract qualified individuals to serve on corporate boards. Do you share that concern? Do you believe the JPMorgan trading loss reflects a failure by the firm's board to adequately monitor and fully understand the risks being taken by the CIO?

It is critical that companies have well qualified boards to represent the interests of its shareholders and oversee management in the performance of the company's business activities, including oversight of the risk management process. The Sarbanes-Oxley Act and the related changes to the stock exchange listing standards placed greater responsibility on directors, particularly independent directors and audit committee members. I am not personally aware of a diminution in the caliber of board members serving on public company boards since the enactment of the Sarbanes-Oxley Act. I understand companies have implemented important practices to carry out the requirements of the Act, and management has taken on further responsibilities on which boards rely, including certifications of periodic reports and annual management reports on internal controls over financial reporting.

With respect to the JP Morgan trading loss, as I stated during my June 19 testimony, I cannot discuss investigations publicly. However, I can say that as a general matter, the Commission does have authority relating to the appropriateness and completeness of an entity's financial reporting and other public disclosures. In such cases, investigations may include

consideration of the board's obligations to oversee the risks the company is undertaking, and whether those risks are being adequately disclosed to investors.

While Sarbanes-Oxley requires external auditors to only examine controls around financial reporting, does the JPMorgan trading loss raise concerns about the effectiveness of JPMorgan's external auditor, PWC, and their ability to identify control weaknesses throughout the organization?

While the Commission does not discuss investigations publicly, I can say that in circumstances of this nature, Commission staff generally review a company's internal controls and the role of a company's auditor in any false financial reporting or internal controls matter.

One of the keys to well-functioning, orderly, liquid capital markets is the presence of counterparties who are able to assist companies, large and small, with financing. If the regulators finalize extremely rigid rules to implement the Volcker Rule, single counterparty credit limits, and the derivatives provisions of the Dodd-Frank Act, could this hamper or limit the ability of companies to manage their balance sheets effectively?

As you know, Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly referred to as the "Volcker Rule," prohibits banking entities from engaging in proprietary trading, subject to certain exceptions. The statute provides exceptions to this prohibition for underwriting and market making-related activity, among other things. Financial entities that are not banking entities, such as registered broker-dealers that are not affiliated with a bank, will not be subject to the trading restrictions of the statute and any final rules adopted thereunder.

I recognize it is important for companies to be able to access underwriting and market making services for a variety of reasons, including raising capital and hedging risks. The Commission has received comment letters on its proposed implementation of the Volcker Rule with respect to these issues, and the Commission and its staff are currently considering such comments.

With respect to the derivatives provisions of the Dodd-Frank Act, as the Commission moves forward with the task of implementation, the Commission is taking the time necessary to thoughtfully consider various issues before adopting specific rules. This process includes considering issues related to the use of security-based swaps, such as single-name credit default swaps, to hedge various risks faced by companies. Given the complex issues raised by the regulation of security-based swaps, and the wide-ranging effects these reforms will have on financial institutions and market participants, developing the appropriate regulatory approach is a very challenging task. We believe the Commission's deliberative process will help ensure that, when adopted, these rules reflect thoughtful consideration of comments from interested parties and provide a workable framework that allows the security-based swap market to continue to develop in a more transparent, efficient, accessible, and competitive manner.

Questions for the Record from
Rep. Blaine Luetkemeyer (MO-9)
Committee on Financial Services, U.S. House of Representatives

Hearing held on June 19, 2012, entitled
"Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss"

Questions for Panel One

The Honorable Mary Schapiro, Chairman, U.S. Securities and Exchange Commission

1. ***Are you making any recommendations on investing in European government bonds?***

As a general matter, the Commission does not make recommendations about investing in individual securities.

2. ***Are you classifying investments in European government bonds?***

The Commission does not classify investments but does require that investors be given accurate and complete information about investments.

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