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JPMorgan Chase London Whale F: Required Securities Disclosures[1]

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Abstract

On April 13, 2012, JPMorgan Chase (JPM) Chief Financial Officer Douglas Braunstein took part in a conference call to discuss the bank's first quarter 2012 earnings. Coming just a week after media reports first questioned the risks taken by JPM derivatives trader Bruno Iksil, Braunstein made a series of assertions about the trades. On May 10, JPM finalized its first quarter financial results, which included some disclosures regarding Iksil's trading that were substantially different from Braunstein's statements of April 13. At issue is whether the regulatory filings on April 13 and May 10, as well as verbal comments by Braunstein and Chief Executive Officer Jamie Dimon on those dates, were potentially misleading to investors and thus violated relevant securities laws enforced by the Securities and Exchange Commission.

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[1] This case study is one of nine produced by the Yale Program on Financial Stability (YPFS) examining issues related to the JPMorgan Chase London Whale. The following are the other case studies in this case series:

- *JPMorgan Chase London Whale A: Risky Business*
- *JPMorgan Chase London Whale B: Derivatives Valuation*
- *JPMorgan Chase London Whale C: Risk Limits, Metrics, and Models*
- *JPMorgan Chase London Whale D: Risk Management Practices*
- *JPMorgan Chase London Whale E: Supervisory Oversight*
- *JPMorgan Chase London Whale G: Hedging Versus Proprietary Trading*
- *JPMorgan Chase London Whale H: Cross-Border Regulation*
- *JPMorgan Chase London Whale Z: Background & Overview.*

Cases are available at the Journal of Financial Crises.

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1. Introduction

On April 13, 2012, Douglas Braunstein led off a conference call to discuss the first quarter 2012 earnings of JPMorgan Chase & Company (JPM) in his capacity as the bank's Chief Financial Officer. After discussing how the various lines of business contributed to the bank's quarterly net income of $5.4 billion, and before turning the call over to Chief Executive Officer Jamie Dimon, Braunstein addressed media stories that had recently swirled around the bank's Chief Investment Office (CIO).

Just a week earlier on April 6, *Bloomberg* and the *Wall Street Journal* published the first news stories about a JPM derivatives trader named Bruno Iksil, who worked in the CIO's London office. Iksil ran the Synthetic Credit Portfolio (SCP), buying and selling credit default swaps with the aim of hedging some of the default risk to which the bank was exposed. The media articles implied that Iksil was trading such large volumes of certain credit derivatives that his activity was single-handedly moving prices in the market to insure against company defaults and also exposing JPM to substantial additional risk instead of protecting the bank.

In his comments to analysts, investors, and members of the media participating on the April 13 earnings call, Braunstein commented that the purpose of Iksil's trading activity was to help JPM manage losses in a stressful credit environment, that trading decisions were made on a long-term basis, that SCP positions were transparent to banking regulators and also approved by the firm-wide risk management function, and that SCP's hedging function would be allowable under the Volcker Rule.

On May 10, JPM finalized its first quarter financial results in a Form 10-Q regulatory filing with the Securities and Exchange Commission and held a business update call in which the bank updated some of the statements made in its earlier earnings release and by Braunstein. Whereas the Form 10-Q disclosed that CIO was expected to lose $800 million in the second quarter instead of the $200 million profit previously anticipated, Dimon clarified in the business update call that the SCP had already lost $2 billion in the second quarter to be offset by $1 billion of gains elsewhere in the CIO. In addition, the Form 10-Q noted that a commonly used measure of CIO's risk was in fact double what was disclosed in the earnings report, and Dimon explained for the first time that the dramatic increase in reported CIO risk happened because the bank had switched to and then abandoned a new risk model that understated market risk and was later found to be inadequate.

At issue for purposes of this academic case study is whether JPM's regulatory filings on April 13 and May 10, as well as Braunstein's and Dimon's verbal disclosures on those dates, may have violated relevant securities laws.

The Securities and Exchange Commission (SEC) was established during the Great Depression to restore confidence in the capital markets by setting clear rules for honest dealing by market participants and by requiring securities issuers to provide reliable information about publicly offered stocks and bonds. The SEC imposes certain disclosure requirements on financial market participants to foster fair, orderly, and efficient markets. Section 17(a) of the Securities Act of 1933 and Rule 10(b)-5 of the Securities Exchange Act of 1934 make it illegal for an issuer to make false statements or to omit material facts in connection with the purchase or sale of securities.

The remainder of the case is organized as follows. Sections 2 and 3 provide a brief overview of the structure of the SEC and the disclosure requirements that the agency imposes on financial market participants. Sections 4 and 5 detail possible errors and omissions that JPM made in its first quarter 2012 earnings release and conference call on April 13, and later revisions to these disclosures in the final first quarter results and business update call on May 10. Section 6 discusses the impact of these disclosures on JPM's stock price during 2012. Section 7 concludes with the SEC enforcement actions against JPM and certain of its employees. See Appendix 1 for a timeline of key events pertinent to this case.

Questions

1. What SEC disclosure obligations was JPM supposed to meet?
2. Did JPM's public statements about the CIO losses (particularly those made in connection with the 1st quarter 2012 earnings release) fulfill these obligations based on information available at the time?
3. What role can required securities disclosures play in reducing systemic risk?

2. Overview of the Securities and Exchange Commission

The SEC was established during the Great Depression by the Securities Exchange Act of 1934. This law, together with the Securities Act of 1933, was designed to restore investor confidence in the capital markets by setting clear rules for honest dealing by market participants and by requiring securities issuers to provide reliable information about publicly offered stocks and bonds. (SEC Annual Report 2011, 7). In 2010, the SEC published a strategic plan covering fiscal years 2010 through 2015, including the agency's mission and vision statements. (See Figure 1.).

Operationally, the SEC is an independent federal government agency that is run by 5 presidentially appointed commissioners, one of whom serves as Chairman. As of September 2011, the SEC had about 3,800 employees located either in its Washington DC headquarters or in one of 11 regional offices across the United States (US). Regional offices investigate and litigate potential violations of securities laws, as well as examine certain financial institutions (investment advisers, investment companies, and broker-dealers, among others). (SEC Annual Report 2011, 8-9) The SEC is organized into five main divisions:

1. Corporation Finance
2. Economic and Risk Analysis
3. Enforcement
4. Investment Management
5. Trading and Markets

3. Relevant Securities Laws

Consistent with its mission and vision, the SEC imposes certain disclosure requirements on financial market participants to foster fair, orderly, and efficient markets. Section 17(a) of the Securities Act of 1933 and Rule 10(b)-5 of the Securities Exchange Act of 1934 make it illegal for an issuer to make false statements or to omit material facts in connection with the purchase or sale of securities. (US Senate Report, 262)

Figure 1: Mission and Vision of the United States Securities and Exchange Commission (SEC)

Mission

The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

Vision

The SEC strives to promote a market environment that is worthy of the public's trust and characterized by transparency and integrity.

Source: SEC Strategic Plan, 1

Under Rule 10(b)-5, disclosures must comply with federal securities laws if they are [1] material, [2] made in connection with the buying or selling of securities, and [3] made by an issuer who has the requisite *scienter* (intent).

First, the US Supreme Court has ruled that information disclosed by an issuer is deemed "material" if there exists "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available". (US Senate Report, 263) The courts have concluded that information affecting an investor's decision to buy, hold, or sell a company's securities, including information about estimated earnings, is considered material.

Second, courts have ruled that a company statement is considered made "in connection with" the buying or selling of securities if the statement "is reasonably calculated to influence the average investor". (US Senate Report, 263). While SEC-registered issuers must make ongoing quarterly and annual public filings, the SEC deems a far broader array of corporate communications to satisfy the "in connection with" element, including statements made in press releases and even telephone calls made by company management to discuss major corporate events and actions.

Third, the US Supreme Court has ruled that "a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly". (US Senate Report, 264) Importantly, statements made by company management based on deficient corporate management systems are considered to be reckless in nature.

Courts have ruled that Section 17(a) "prohibit[s] essentially the same type of conduct" as Rule 10(b)-5. However, Section 17(a) is applicable in more situations, since it does not require a finding of *scienter*. (US Senate Report, 265)

4. Possible Errors and Omissions on April 13, 2012

On Friday, April 6, 2012, Bloomberg and the Wall Street Journal published the first reports about Bruno Iksil, a derivatives trader in the London office of JPMorgan Chase & Company (JPM). Together with a small team in the bank's Chief Investment Office (CIO), Iksil ran the Synthetic Credit Portfolio (SCP), which consisted of long and short positions in credit default swaps and other credit derivatives. As a lender, JPM is exposed to the risk that borrowers cannot or will not repay money borrowed from the bank, especially in a stress credit scenario such as the financial crisis of 2007-2009. SCP's main purpose was to partially hedge this default risk. (The characteristics of credit default swaps, as well as CIO's use of these credit derivatives in the failed SCP trading strategy, are explored in greater detail in Zeissler, et al. 2014A.)

Bloomberg and the *Wall Street Journal* painted a picture of Iksil trading such large volumes that he was singlehandedly moving prices in the market to insure against company defaults. JPM was given a chance to respond before the news was published, and the articles included the bank's statements that CIO activities "hedge structural risks" and "bring the company's assets and liabilities into better alignment", and that the unit's results are "disclosed in our quarterly earnings reports" and are "fully transparent to our regulators". (US Senate Exhibits, 140-144)

JPM Chief Financial Officer Douglas Braunstein met the same day with Ina Drew, who served as JPM Chief Investment Officer as well as head of the CIO. Braunstein requested a detailed analysis of the SCP's positions and profit & loss potential under various scenarios to be completed by Monday, April 9. The SCP derivatives trader who presented the initial results of the analysis explained that the first quarter "attempt to neutralize [the risk exposure of] the book had been unsuccessful", but that the SCP was now "overall risk balanced" with expected second quarter results ranging from a $250 million profit to a $150 million loss, but with "significantly positive" upside potential if corporate defaults should increase materially. Braunstein continued to receive daily updates from Drew and other CIO employees about the SCP's function and composition. Though Jamie Dimon, the bank's Chairman and Chief Executive Officer, was out of the office from April 2 through April 12, he was kept abreast of the situation through e-mail. (JPM Task Force 2013, 61-62, 70).

On Friday, April 13, one week after the initial *Bloomberg* and *Wall Street Journal* articles, JPM filed a Form 8-K with the SEC that included the bank's quarterly earnings release and "reported 2012 first quarter net income of $5.4 billion, or $1.31 per share, compared with net income of $5.6 billion, or $1.28 per share, in the first quarter of 2011". (JPM 8-K 20120413, 2).

Although the Form 8-K did not address the media allegations, senior bank management commented about the SCP and the London Whale trades during their earnings conference call with analysts, investors, and the media that also took place on April 13. Dimon famously agreed with a Bank of America Merrill Lynch stock analyst who characterized the media's concern about the London Whale as a "tempest in a teapot". (US Senate Exhibits, 439).

However, Braunstein provided a more detailed response on the earnings call, including several statements that might be considered misleading in nature. (US Senate Exhibits, 436).

> We invest those [securities] in order to hedge the interest rate risk of the firm as a function of that liability and asset mismatch. We hedge basis risk, we hedge convexity risk, foreign exchange risk is managed through CIO, and [mortgage servicing rights] risk. We also do it to generate [net interest income], which we do with that portfolio.
>
> The result of all of that is we also need to manage the stress loss associated with that portfolio, and so we have put on positions to manage for a significant stress event in Credit. We have had that position on for many years and the activities that have been reported in the paper are basically part of managing that stress loss position, which we moderate and change over time depending upon our views as to what the risks are for stress loss from credit.

> All of those decisions are made on a very long-term basis. They are done to keep the Company effectively balanced from a risk standpoint. We are very comfortable with our positions as they are held today.
>
> And I would add that all those positions are fully transparent to the regulators. They review them, have access to them at any point in time, get the information on those positions on a regular and recurring basis as part of our normalized reporting. All of those positions are put on pursuant to the risk management at the firm-wide level.
>
> The last comment that I would make is that·based on, we believe, the spirit of the legislation as well as our reading of the legislation and consistent with this long-term investment philosophy we have in CIO we believe all of this is consistent with what we believe the ultimate outcome will be related to Volcker." (US Senate Exhibits, 436).

"[W]e also need to manage the stress loss associated with that portfolio, and so we have put on positions to manage for a significant stress event in credit."

The JPMorgan Chase & Company Management Task Force (JPM Task Force) conducted an internal investigation of the CIO losses. The Task Force report explained "The Synthetic Credit Portfolio managed by CIO was intended generally to offset some of the credit risk that JPMorgan faces, including in its CIO investment portfolio and in its capacity as a lender." (JPM Task Force 2013, 2). However, the SCP traders were never able to produce any documentation of what the specific credit risks were, what hedges would be used, how large the hedges should be, how to test if the hedges were effective, and so on. (US Senate Report, 273).

To function as a hedge, the SCP should have been profitable in a weak credit environment when the rest of JPM was experiencing losses from borrower defaults. However, CIO Chief Financial Officer John Wilmot sent an analysis to Dimon and Braunstein on April 11, just 2 days before the April 13 earnings call, showing that the SCP actually would lose money if credit spreads widened in anticipation of increased defaults, with the SCP suffering losses of $46 million, $163 million, and $918 million if credit spreads widened by 1 basis point, 10%, and 50%, respectively. (US Senate Report, 278).

"All of those decisions are made on a very long-term basis."

In 2010, Drew made a presentation to the Risk Policy Committee of the Board of Directors that included the mandate, approach, and investment horizon of CIO's various portfolios. The Tactical Asset Allocation portfolio, which included the SCP among its sub-portfolios, had the shortest investment horizon of all CIO portfolios. At a similar board presentation in March 2012, the SCP (now part of the International Mark-to-Market Overlay portfolio) was again classified as having a "shorter" investment horizon. (US Senate Report, 270).

In addition, SCP's trading activity was often inconsistent with "long-term" decision making. For example, beginning in summer 2011, Iksil bought credit protection on approximately $1 billion notional value of a specific high yield credit index. This trade netted between $400 million and $550 million, equal to CIO's full-year revenue, but only because 2 of the 100 high yield companies in the index filed for bankruptcy before the expiration of the contract just a few months later on December 20, 2011. (US Senate Report, 54).

Furthermore, Iksil and his team made over 4,300 separate trades during the first quarter of 2012, equal to an average of almost 70 trades per day and hardly reflective of a long-term investment strategy. (US Senate Report, 272).

"All those positions are fully transparent to the regulators."

Since CIO's primary purpose was to safely and profitably invest deposits generated by JPM's national bank subsidiaries that were not otherwise loaned, CIO was regulated by the Office of the Comptroller of the Currency (OCC). Even though CIO's use of credit default swaps to hedge the bank's credit risk had existed in one form or another since 2006-2007, the OCC only became aware of the SCP in January 2012, because CIO had previously aggregated SCP into broader portfolios for reporting purposes. From January 2012 (when Iksil began to greatly expand the volume and number of credit derivatives traded) through March (when the SCP trading strategy was halted due to continuing losses) and into early April, JPM did not provide the OCC with certain required monthly reports that included CIO performance data and the results of internal reviews of the fair values assigned by traders to their derivative positions, yet the OCC failed to request the missing information. (See also Zeissler, et al. 2014E for a discussion of the breakdown in the regulatory relationship between JPM and the OCC.)

"All of those positions are put on pursuant to the risk management at the firm-wide level."

JPM firm-wide risk management personnel had only limited knowledge about SCP's activities and had no role in trading the credit derivative positions held in the SCP book. John Hogan, who was promoted from the Chief Risk Officer of JPM's investment bank to firm-wide Chief Risk Officer in January 2012, acknowledged that the April 6 articles "surprised him" because he had previously been "unaware of the size and nature of the SCP, much less its mounting losses". (US Senate Report, 266). (See also Zeissler, et al. 2014D for an explanation of why shortcomings in CIO's risk management were given insufficient scrutiny by senior bank management.)

Consistent with other major financial institutions, JPM uses various risk limits and metrics to measure and monitor the risk of its lending and investing activities. The amount of risk taken is measured using various risk metrics, and these amounts are compared with relevant limits. By January 16, 2012, the large derivative positions in the SCP book caused the CIO to exceed not only its own Value at Risk (VaR) limit, but also the higher firm-wide VaR limit. These VaR breaches continued until January 19, and Dimon and the members of the JPM Operating Committee were notified each day that the firm-wide VaR limit was exceeded. By March 31, Iksil's trading had caused CIO to exceed all of the risk limits applicable to the line of business. (US Senate Report, 174-175 and 207). (See Zeissler, et al. 2014C for a detailed description of JPM's use of quantitative risk management tools.

"[W]e believe all of this is consistent with . . . Volcker."

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act is also known as the "Volcker Rule" after one of its principal advocates, former Federal Reserve Chairman Paul Volcker. The intent of the Volcker Rule is to reduce risk by prohibiting federally insured banks from using depositors' money to engage in proprietary trading and certain other high risk activities. However, hedging activities that decrease, rather than increase, a bank's risk of loss are permitted.

Although final Volcker Rule regulations had not been implemented by April 2012, the US Senate committee investigating the CIO losses asked JPM's legal counsel if the bank had obtained a legal opinion about how the Volcker Rule might possibly impact the bank's business. JPM's attorneys acknowledged that no such analysis had been performed. However, in a comment letter to the OCC and other bank regulators dated February 13, 2012, JPM had expressed concern that SCP's asset liability management activities "during the financial crisis would have been endangered by the proposed rule". (US Senate Report, 287). (See Zeissler, et al. 2014G for an assessment of the extent to which SCP's trading activities may have been construed as proprietary trading.)

5. Revisions on May 10, July 13, and August 9

JPM finalized its first quarter financial results on May 10 in a Form 10-Q filing with the SEC. The bank reported the same net income of $5.383 billion on total net revenue of $26.712 billion that it had announced in the Form 8-K of April 13. (JPM 10-Q 2012Q1, 85). However, JPM had made certain changes to the disclosures pertaining to CIO between the 8-K of April 13 and the 10-Q of May 10.

First, JPM acknowledged the increasing difficulties with the SCP, revising estimated second quarter earnings for its Corporate segment, which included the CIO, from a $200 million profit to an $800 million loss, and stating "Since March 31, 2012, CIO has had significant mark-to-market losses in its synthetic credit portfolio, and this portfolio has proven to be riskier, more volatile and less effective as an economic hedge than the Firm previously believed." (JPM 10-Q 2012Q1, 9).

Second, the CIO received approval in late January 2012 to implement a new VaR model (see YPFS case Zeissler, et al. 2014C for more detail). The new model seemingly indicated that CIO's market risk, most of which stemmed from Iksil and the SCP, was only half the amount previously estimated by the old model. (US Senate Report, 165-185).

Included in the Form 8-K of April 13 was a table appearing to show that average CIO VaR was $69 million in the fourth quarter of 2011 and $67 million in the first quarter of 2012, giving the impression that CIO's market risk exposure at the start of 2012 was about the same as at the end of 2011. (see Figure 2). However, the earnings release did not mention that CIO changed its VaR model during the quarter, thereby hiding the fact that CIO market risk had nearly doubled.

After JPM discovered operational and calculation errors in the new CIO VaR model, the bank went back to using the previous model. (US Senate Report, 184-185). JPM revised average first quarter CIO VaR from $67 million in the Form 8-K of April 13 to $129 million in the Form 10-Q of May 10, noting that the higher revised amount "supersedes the Firm's VaR disclosures included in its Form 8-K filed on April 13, 2012" and emphasizing that the revised amount "was calculated using a methodology consistent with the methodology used to calculate CIO's VaR in 2011", but making no mention of the reason for the doubling of risk. (JPM 10-Q 2012Q1, 73). (See Figure 3).

Just as JPM accompanied its April 13 Form 8-K with an earnings conference call, the bank also followed its May 10 Form 10-Q with a business update call. Dimon was the sole JPM participant on the latter call, and he used the occasion to amplify and clarify certain aspects of the Form 10-Q. He disclosed that SCP was in much worse shape than had been disclosed a month earlier, referring to the new trading strategy as "flawed, complex, poorly reviewed, poorly executed, and poorly monitored." Dimon also clarified that the $1 billion decrease in estimated CIO income for the second quarter (from a $200 million profit to an $800 million loss) resulted from $2 billion of SCP market-to-market losses thus far in the quarter, offset by $1 billion of realized gains on the sale of fixed income securities in CIO's primary portfolio. Furthermore, Dimon explained that JPM had implemented a new VaR model during the first quarter that the firm now "deemed inadequate", leading the bank to go "back to the old one". (JPM Business Update Call, 2)

However, Dimon also used the call to defend JPM's disclosure of CIO's problems to banking regulators and analysts, stating that "you should assume that we keep our regulators up-to-date" and that "we try to keep our readers update[d] about what we know and when we know it." (JPM Business Update Call, 12) Dimon also reiterated eight times that the SCP functioned as a "hedge."

Soon after May 10, the bank formed the internal JPMorgan Chase & Company Management Task Force (JPM Task Force) to investigate the CIO losses, specifically what happened, how it happened, and what remedial measures needed to be taken. The JPM Task Force, which was led by Michael Cavanagh (co-Chief Executive Officer of the Corporate and Investment Bank), released its findings in January 2013. (JPM Task Force 2013, 1)

Figure 2: JPM Value at Risk (in millions), as Reported on Form 8-K of April 13, 2012

	QUARTERLY TRENDS						
						1Q12 Change	
	1Q12	4Q11	3Q11	2Q11	1Q11	4Q11	1Q11
95% CONFIDENCE LEVEL- AVERAGE IB TRADING VAR, CREDIT PORTFOLIO VAR AND OTHER VAR							
IB VaR by risk type:							
Fixed income	$ 60	$ 56	$ 48	$ 45	$ 49	7%	22%
Foreign exchange	11	12	10	9	11	(8)	—
Equities	17	19	19	25	29	(11)	(41)
Commodities and other	21	20	15	16	13	5	62
Diversification benefit to IB trading VaR (a)	(46)	(50)	(39)	(37)	(38)	8	(21)
IB trading VaR (b)	63	57	53	58	64	11	(2)
Credit portfolio VaR (c)	32	39	38	27	26	(18)	23
Diversification benefit to IB trading and credit portfolio VaR (a)	(14)	(21)	(21)	(8)	(7)	33	(100)
Total IB trading and credit portfolio VaR	81	75	70	77	83	8	(2)
Other VaR:							
Mortgage Production and Servicing VaR (d)	11	44	40	20	16	(75)	(31)
Chief Investment Office VaR (e)	67	69	48	51	60	(3)	12
Diversification benefit to other VaR (a)	(6)	(30)	(15)	(10)	(14)	80	57
Total other VaR	72	83	73	61	62	(13)	16
Diversification benefit to total IB and other VaR (a)	(37)	(45)	(35)	(44)	(57)	18	35
Total IB and other VaR (f)	$ 116	$ 113	$ 108	$ 94	$ 88	3	32

Source: JPM 8-K 20120413, 42

Figure 3: JPM Value at Risk (in millions), as Reported on Form 10-Q of May 10, 2012

	Three months ended March 31,							
	2012			2011			At March 31,	
(in millions)	Avg.	Min	Max	Avg.	Min	Max	2012	2011
IB VaR by risk type								
Fixed income	$ 60	$ 47	$ 73	$ 49	$ 44	$ 56	$ 69	$ 55
Foreign exchange	11	8	22	11	9	17	14	11
Equities	17	12	25	29	19	42	17	22
Commodities and other	21	16	27	13	8	20	16	10
Diversification benefit to IB trading VaR	(46) [a]	NM [b]	NM [b]	(38) [a]	NM [b]	NM [b]	(62) [a]	(37) [a]
IB trading VaR	63	50	79	64	40	80	54	61
Credit portfolio VaR	32	26	42	26	22	33	30	28
Diversification benefit to IB trading and credit portfolio VaR	(14) [a]	NM [b]	NM [b]	(7) [a]	NM [b]	NM [b]	(13) [a]	(7) [a]
Total IB trading and credit portfolio VaR	81	70	99	83	53	102	71	82
Other VaR								
Mortgage Production and Servicing VaR	11	8	16	16	10	32	11	18
Chief Investment Office ("CIO") VaR[c]	129	85	187	60	55	64	186	55
Diversification benefit to total other VaR	(4) [a]	NM [b]	NM [b]	(14) [a]	NM [b]	NM [b]	(6) [a]	(13) [a]
Total other VaR[c]	136	89	197	62	55	69	191	60
Diversification benefit to total IB and other VaR	(47) [a]	NM [b]	NM [b]	(57) [a]	NM [b]	NM [b]	(61) [a]	(56) [a]
Total IB and other VaR[c]	$ 170	$ 111	$ 232	$ 88	$ 67	$ 104	$ 201	$ 86

(a) Average VaR and period-end VaR were less than the sum of the VaR of the components described above, which is due to portfolio diversification. The diversification effect reflects the fact that the risks were not perfectly correlated. The risk of a portfolio of positions is therefore usually less than the sum of the risks of the positions themselves.

(b) Designated as not meaningful ("NM"), because the minimum and maximum may occur on different days for different risk components, and hence it is not meaningful to compute a portfolio-diversification effect.

(c) CIO VaR presented above for the period ended March 31, 2012 supersedes the Firm's VaR disclosures included in its Form 8-K filed on April 13, 2012 and was calculated using a methodology consistent with the methodology used to calculate CIO's VaR in 2011, including the first quarter of 2011 reflected above.

Emphasis added by author
Source: JPM 10-Q 2012Q1, 73

The JPM Task Force uncovered evidence that the SCP traders may not have been accurately marking their derivative positions at fair value as required by US Generally Accepted Accounting Principles (GAAP) (see Zeissler, et al 2019B for further detail). Unlike exchange-traded securities, credit derivatives trade in a smaller, less liquid dealer market, which introduces greater uncertainty and discretion into the valuation process. The SCP traders exploited this uncertainty and discretion to attempt to hide some portion of the losses that they incurred during the first quarter. (US Senate Report, 96-153).

After interviewing the traders involved, the JPM Task Force doubted "the integrity of the trader marks", and senior bank management decided that they "were no longer confident that the trader marks reflected good faith estimates of fair value at quarter end". (JPM 8-K 20120713, Exhibit 99.1). As a result, JPM management terminated the employment of Iksil, his superior Javier Martin-Artajo, and Martin-Artajo's superior Achilles Macris on July 12. (Drew had previously resigned on May 13.)

Management reviewed the valuation concerns with the Audit Committee of the Board of Directors the same day and concluded that JPM would have to amend its earnings as a result. One day later, JPM announced on July 13 that it was restating its first quarter earnings, reducing consolidated total net revenue by $660 million from $26.712 billion to $26.052

billion, which in turn reduced after-tax net income by $459 million from $5.383 billion to $4.924 billion. (JPM 8-K 20120713, 2)

JPM also announced in the same press release that the first quarter financial statements previously filed in the May 10 Form 10-Q "should no longer be relied upon" and that the bank suffered a "material weakness in our internal control over financial reporting at March 31, 2012 related to CIO's internal controls over valuation of the synthetic credit portfolio". (JPM 8-K 20120713, Exhibit 99.1) JPM filed an amended first quarter Form 10-Q/A on August 9. (JPM 10-Q/A 2012Q1)

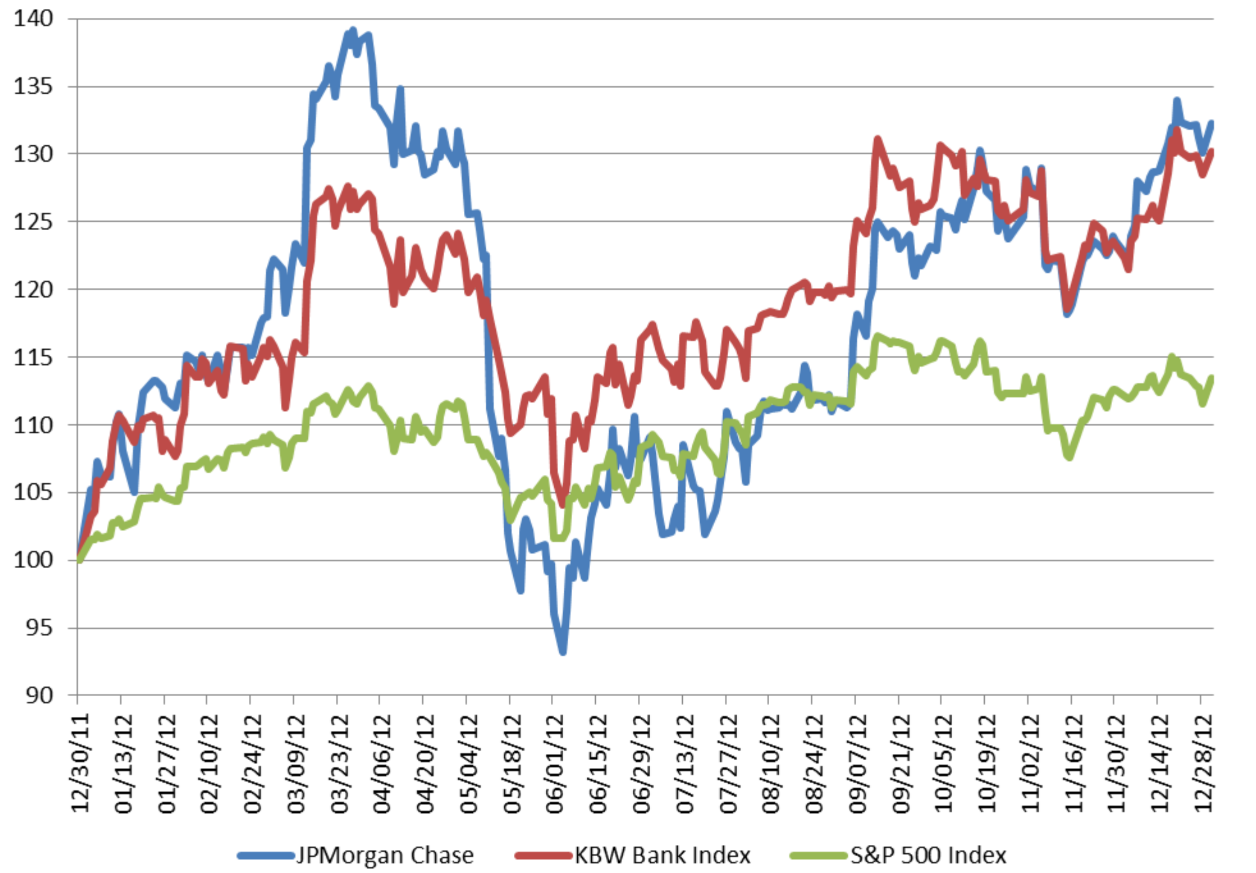
6. Stock Price Impact

One way to assess the impact of JPM and media disclosures about the London Whale events is by looking at the performance of the bank's stock during the relevant time period, especially compared with the performance of the KBW Bank Index of 24 large-cap banks (including JPM) and of the S&P 500 Index (see Figure 4).

From a price of $33.25 per share at December 31, 2011, JPM stock increased almost 40% during the first quarter of 2012, reaching $46.27 on March 28 (and paying a dividend of $0.25 on January 4), its highest closing price for the year. This gain outpaced the increase in the KBW Bank Index, which in turn grew faster than the broad S&P 500 Index.

The initial *Bloomberg* and *Wall Street Journal* news stories about Iksil came on April 6, when the stock market was closed for the Good Friday holiday. When the market reopened April 9, JPM stock fell by only 1%, less than the drop in the KBW Bank and S&P 500 indices on that day. JPM's Form 8-K filing and associated earnings conference call on the morning of April 13 had a greater impact, as JPM's stock price dropped 4%. Interestingly, the KBW Bank Index also fell 3% on April 13.

Figure 4: JPMorgan, KBW Bank Index, S&P 500 Index Closing Price/Level (December 31, 2011 = 100)



Source: Yahoo! Finance

As can be seen in Figure 4, the steepest drop in JPM's stock price came in May, especially the period surrounding the first quarter Form 10-Q filing and business update call on the afternoon of May 10 and the announcement on May 15 that Drew was leaving JPM. The bank's stock decreased 17% during the week that encapsulated these events, from $40.74 per share on May 10 to $33.93 on May 17. JPM stock continued to decline, reaching its low point for 2012 on June 4 at $31.00, a decrease of 24% since May 10. (US Senate Report, 252)

Nevertheless, the impact of the London Whale incident on JPM was not permanent, as the bank's stock rose for the remainder of 2012, reaching $43.97 per share by December 31. This represented an increase of 32% during the year, slightly ahead of the rise in the KBW Bank Index and more than double the 13% gain in the S&P 500 Index. In addition, JPM paid dividends totaling $1.15 per share during 2012.

7. Aftermath

On August 14, 2013, the SEC charged Martin-Artajo and Julien Grout (a junior SCP trader who reported to Mr. Iksil) with fraud for failing to mark SCP's investments at fair value as required by GAAP in an effort to hide losses in the SCP book. (SEC Press Release 2013-154)

The Department of Justice announced criminal charges against Martin-Artajo and Grout the same day. Iksil had entered into a non-prosecution agreement with the US government and accordingly was not charged.

One month later on September 19, banking regulators in the US and the United Kingdom (UK) announced a settlement with JPM. The Federal Reserve Board, the OCC, the SEC, and the UK Financial Conduct Authority penalized JPM a total of $920 million. JPM was also required to admit wrongdoing in certain instances, a rare occurrence in such settlements. The Commodity Futures Trading Commission then settled with JPM in October for a penalty of $100 million.

In its part of the global settlement, the SEC charged JPM with misstating financial results in SEC filings and with failing to have an internal control system that would have prevented the firm's traders from fraudulently valuing investments and detected such mismarking if it occurred. JPM agreed to certain findings of fact, to cease and desist from future violations of the securities laws, and to pay a $200 million penalty. (SEC Press Release 2013-187)

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Appendix 1: Timeline of Key Events

2005		JPMorgan Chase & Company (JPM) spun off the Chief Investment Office (CIO) as a separate unit to invest the bank's excess deposits. Ina Drew, JPM's Chief Investment Officer, was appointed head of CIO.
2012	January 16-19	CIO's Synthetic Credit Portfolio (SCP) breached the Value at Risk limit for both CIO and JPM for 4 days. This fact was reported to Chief Executive Officer Jamie Dimon.
	February 13	JPM sent a letter to the Office of the Comptroller of the Currency (OCC) and other bank regulators, expressing concern that SCP's asset liability management activities "during the financial crisis would have been endangered by the proposed [Volcker] rule".
	March 23	Drew ordered the CIO traders to stop trading the SCP.
	First Quarter	Bruno Iksil and his team of SCP traders executed over 4,300 trades, an average of almost 70 trades per day.
	April 6	*Bloomberg* and the *Wall Street Journal* published the first news stories about the "London Whale".
	April 11	CIO Chief Financial Officer John Wilmot sent an analysis to Dimon and JPM Chief Financial Officer Douglas Braunstein showing that SCP actually would lose money if credit spreads widened in anticipation of increased defaults.
	April 13	JPM filed a Form 8-K with the Securities and Exchange Commission (SEC) that included the bank's quarterly earnings release. On the earnings call, Dimon referred to the incident as a "tempest in a teapot", and Braunstein made several possibly misleading statements.
	May 10	JPM finalized its first quarter financial results in a Form 10-Q filing with the SEC. The bank reported the same net income of $5.383 billion on total net revenue of $26.712 billion that it had released in the Form 8-K of April 13. However, JPM did make certain significant changes to the disclosures pertaining to CIO between the 8-K and the 10-Q.
	May 13	Drew resigned.
	June	JPM officials began doubting SCP marks, when the JPM Task Force uncovered evidence that traders were criticizing their reported marks.
	July 12	JPM terminated the employment of Iksil, his superior Javier Martin-Artajo, and Martin-Artajo's superior Achilles Macris. Julien Grout was suspended (and later resigned).

	July 13	JPM restated Q1 earnings, reporting additional pre-tax losses of $660 million due to SCP ($459 million after tax).
	December 31	Year-to-date SCP losses = $6.2 billion.
2013	January	The JPM Task Force issued its report.
	August 14	The SEC charged Martin-Artajo (who directly oversaw Iksil) and Julien Grout (a junior SCP trader who reported to Iksil) with fraud for failing to mark SCP's investments at fair value as required by generally accepted accounting principles in an effort to hide losses.
	September-October	Four regulators in the US and one in the UK reached settlement agreements with JPM, totaling $1.020 billion in penalties.