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## JPMorgan Chase London Whale G: Hedging Versus Proprietary Trading

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# JPMorgan Chase London Whale G: Hedging Versus Proprietary Trading<sup>1</sup>

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Yale Program on Financial Stability Case Study 2014-2g-V1

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## Abstract

In December 2013, the primary United States financial regulatory agencies jointly adopted final rules to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which is often referred to as the “Volcker Rule”. Section 619 prohibits banks from engaging in activities considered to be particularly risky, including proprietary trading and owning hedge funds or private equity funds. Banking regulators designed the final rule against proprietary trading in part to prevent losses like the \$6 billion London Whale loss that took place in 2012 at JPMorgan Chase. Given the controversial nature of the Volcker Rule, it is not surprising that the regulatory agencies received 18,000 comment letters, including a 67-page letter from JPMorgan Chase.

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<sup>1</sup> 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 F: Required Securities Disclosures*
- *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 December 10, 2013, a handful of United States regulatory agencies jointly adopted final rules to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 619 is often referred to as the “Volcker Rule” after one of its principal supporters, former Federal Reserve Chairman Paul Volcker. This part of the Dodd-Frank Act is intended to make the banking system safer by prohibiting banks from engaging in activities considered to be particularly risky, including using the bank’s own money to generate trading profits (known as proprietary trading) and owning hedge funds or private equity funds.

The Volcker Rule is widely considered to be one of the most controversial aspects of the Dodd-Frank Act, as evidenced by the 18,000 comment letters that the regulatory agencies received and the three years that it took them to finalize the detailed rules. Banks were particularly concerned that activities prohibited by the Volcker Rule were so similar to existing core financial intermediation functions that the rule would have many unintended negative consequences for bank profitability and risk management. In its final form, banks are permitted by the Volcker Rule to hedge the specific, identifiable risks that they face, as well as to continue underwriting and market-making activities on behalf of their customers.

Though the Dodd-Frank Act was signed into law in 2010 in response to the financial crisis of 2007-2009, the negotiations over the Volcker Rule were greatly impacted by the fact that JPMorgan Chase & Company (JPM) lost over \$6 billion in 2012 because of complex credit derivatives trades made by Bruno Iksil, who came to be known as the “London Whale” because of the large size of his trades. Iksil worked for the bank’s Chief Investment Office (CIO) as senior trader for the Synthetic Credit Portfolio (SCP), which consisted of long and short positions in credit default swaps to help hedge the credit risk facing the bank. Though Iksil’s trading activity in 2012 preceded the completion of the Volcker Rule regulations in December 2013, banking regulators designed the prohibition against proprietary trading in part to prevent future trading losses like those at JPM.

CIO’s credit trading began in 2006, and an internal audit review a year later noted that this activity consisted of “proprietary position strategies”. In the aftermath of the revelation of the London Whale trading strategy, both senior bank management and the internal task force charged with investigating the loss consistently maintained that the SCP was intended to offset some of the credit risk that the bank faced. However, when questioned by the US Senate subcommittee investigating the matter, CIO leadership and other bank officials provided conflicting answers about which assets or portfolios the SCP was supposed to hedge, ranging from only part of another CIO portfolio to the entirety of JPM’s balance sheet.

SCP personnel could not produce documentation of what specific credit risks they were supposed to offset, how they decided which derivatives to use as hedges and in what quantity, and if they tested that the hedges in fact reduced risk as expected. Whereas CIO recorded, tracked, and regularly tested the effectiveness of its hedges against risks associated with interest rates and mortgage servicing rights to qualify for favorable accounting treatment, the SCP traders did not follow these procedures. Furthermore, an internal analysis prepared in 2012 showed that SCP personnel were compensated in 2010 and 2011 largely based on compensation paid to investment bank sales and trading staff, rather than to risk management staff.

The remainder of the case is organized as follows. Section 2 discusses the key provisions of the Volcker Rule, especially with respect to the ban on proprietary trading. Section 3

provides a brief overview of the history of the CIO and its SCP portfolio. Section 4 introduces evidence about SCP's purpose and related documentation. Section 5 describes how key CIO personnel were paid. Section 6 concludes with a brief summary of a study conducted by the US Government Accountability Office of possible risks posed by proprietary trading. See Appendix 1 for a timeline of key events pertinent to this case module.

## Questions

1. Are the Volcker Rule prohibitions desirable and likely to be effective in reducing systemic risk?
2. Do the provisions of the Volcker Rule unwisely restrict bank profitability and risk management?
3. Would CIO's credit derivative trading activities (and documentation) have qualified as a permitted risk-mitigating hedging activity under the Volcker Rule?
4. How might the CIO compensation structure have contributed to the 2012 trading loss?

## 2. Overview of the Volcker Rule

The Dodd-Frank Act was signed into law on July 21, 2010. One of the most controversial provisions of the Dodd-Frank Act is contained in Section 619, which is often referred to as the "Volcker Rule" after one of its main advocates, former Federal Reserve Chairman Paul Volcker. Section 619 of the Dodd-Frank Act added a new section, section 13, to the Bank Holding Company Act of 1956 that, subject to certain exemptions, prohibits banking entities from engaging in proprietary trading and from owning, sponsoring, or having certain other relationships with hedge funds or private equity funds (termed "covered funds" by the rule).

The Federal Reserve Board, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission jointly proposed a common set of rules in 2011 and 2012 to implement Section 619 in an unusual display of interagency regulatory cooperation. As a sign of the importance of the Volcker Rule and of the controversy that the rule generated, the agencies collectively received over 18,000 comment letters in response to their proposals, including a 67-page letter from JPM. After reviewing the comment letters and making revisions, the agencies jointly adopted the final Volcker Rule on December 10, 2013.

Given the facts surrounding the London Whale trades at JPM, this module will focus on the Volcker Rule's ban on proprietary trading, rather than the rule's restriction on covered funds. Subject to certain exemptions, the Volcker Rule prohibits banking entities from engaging in "proprietary trading", which is defined as "engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments." (Volcker Attachment A, 6)

Whereas the US placed a ban on proprietary trading by any part of a bank holding company, the United Kingdom took a different approach with its banks by requiring the deposit-taking unit(s) of a bank holding company to be legally, economically, and operationally separate from the rest of the holding company (known as "ring-fencing"), but allowing proprietary trading in non-deposit-taking units. A 2014 proposal by the European Commission

combines elements of both approaches, banning proprietary trading by European Union banks and ring-fencing other high-risk trading activities. (Shearman & Sterling 2014, 9-15)

Whereas securities, derivatives, and commodity futures (and options on each) fall within the scope of the Volcker Rule, traditional bank loans are not considered financial instruments for purposes of the rule. Because proprietary trading is often short-term, the Volcker Rule includes a presumption that a financial instrument held for fewer than 60 days is held as part of a proprietary trading strategy, though a bank may rebut this presumption. (Volcker Attachment A, 7)

The final regulations specifically exclude some types of transactions from the definition of proprietary trading, while also permitting banks to continue certain activities that are part of their core operations. Proprietary trading specifically does not include purchases or sales of financial instruments under repurchase (or reverse repurchase) agreements, written securities lending agreements, documented liquidity management plans, and deferred compensation (and similar) plans. Purchases or sales by a bank to satisfy a legal or regulatory obligation or when the bank is acting solely as an agent, broker, or custodian are also specifically excluded.

Banks are permitted to continue underwriting and market-making activities on behalf of their customers. Underwriting activities are allowed as long as the bank acts as an underwriter to distribute (public or private) securities offerings and the trading desk's position in the securities being offered is solely for distribution purposes. Bank trading desks are also allowed to make markets in financial instruments by providing quotes and standing ready to buy and sell such instruments. For both underwriting and market-making, the amount and type of securities held by the trading desk in its inventory should not exceed the "reasonably expected near term demands of clients, customers, or counterparties." (Volcker Attachment A, 11, 13) Furthermore, the bank must maintain a compliance program (discussed below), and employees engaged in underwriting or market-making cannot be compensated "to reward or incentivize prohibited proprietary trading." (Volcker Attachment A, 12, 14-15)

Banks also expressed concern in their comment letters that the Volcker Rule would prohibit risk management activities in which banks have long engaged, such as asset-liability management (ALM). In its comment letter, JPM noted that whereas ALM is "one of the foundations of bank safety and soundness and is integral to the stability of the U.S. and global financial systems," the proposed rule could prohibit or restrict certain sound risk reduction strategies. (JPM Comment Letter, 50) JPM spent three pages describing "several examples of asset-liability hedging strategies employed by JPMorgan during the crisis that enabled it to successfully deal with market, credit, interest rate, and liquidity risks that arose during the period." One of the examples that JPM gave was "[m]anaging credit risk by use of credit derivatives." (JPM Comment Letter, 56-59)

One area of concern expressed by JPM was that certain "traditional and long-established ALM activities" use financial instruments that must be accounted for in the market risk capital trading account and would thus be deemed proprietary in nature under the proposed rule. In addition, JPM commented that the dynamic nature of financial markets and bank-specific asset and liability cash flows may require a bank to exit a position in less than 60 days to effectively hedge its risks, even though such a short holding period is presumed to be proprietary. Another of JPM's concerns was the restriction that banks could only hedge against those risks to which they were already exposed or would become exposed in the very near future, whereas JPM noted that banks should prudently hedge against possible future risks as revealed by a stress test. (JPM Comment Letter, 52-54)

However, the final regulations do permit “risk-mitigating hedging activity” as long as such activity “is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks” [emphasis added]. (Volcker Attachment A, 16) Not only must a bank identify the specific risk being hedged, but a bank must also conduct a correlation analysis and independent testing to support the assertion that the proposed hedging strategy will in fact reduce risk. The effectiveness of the hedges must be monitored on an ongoing basis and recalibrated as necessary. Furthermore, the bank must document which trading desk establishes and maintains the hedge, which specific identifiable risk is being hedged, and what strategy is being used to mitigate the risk. (Volcker Fact Sheet, 2)

The Volcker Rule requires banks to add to their existing internal control processes a “compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments.” The compliance program must include written policies and procedures, a management framework and system of internal controls, training for affected personnel, independent testing of the effectiveness of the compliance program, and record-keeping sufficient to demonstrate compliance to the bank’s regulator. (Volcker Attachment A, 48-49).

In addition, large banks with total consolidated assets of \$50 billion or more must also “establish, maintain, and enforce an enhanced compliance program”. A large bank’s Chief Executive Officer must annually attest in writing to the bank’s regulator that the bank has processes in place to “establish, maintain, enforce, review, test, and modify” the program to achieve compliance with the Volcker Rule. (Volcker Attachment A, 62, 70-71)

In addition, the Volcker Rule requires banks with significant trading operations to continuously record and periodically report to their regulator certain quantitative measurements pertaining to their trading activities. Those banks with trading assets and liabilities equal to or greater than \$50 billion must report the items listed below at the individual trading desk level within 10 days of the end of each calendar month beginning June 30, 2014. Smaller banks will report quarterly beginning in 2016. (Volcker Attachment A, 50, 55)

1. Risk and Position Limits and Usage
2. Risk Factor Sensitivities
3. Value at Risk and Stress VaR
4. Comprehensive Profit and Loss Attribution
5. Inventory Turnover
6. Inventory Aging
7. Customer-Facing Trade Ratio

(See Davis Polk 2013 for an extensive series of flowcharts “designed to assist banking entities in identifying permissible and impermissible proprietary trading activities” under the final Volcker Rule regulations.)

### 3. The Chief Investment Office and Synthetic Credit Portfolio

JPM provides a wide variety of financial services, yet its commercial bank subsidiaries still engage in the basic banking functions of taking deposits from and making loans to customers. Over many years, the amount of deposits held by JPM on behalf of its customers was consistently greater than the amount of money that the bank loaned.

As a result, JPM needed a way to profitably and safely invest these excess deposits, and this task was assigned to and became the primary responsibility of the bank's Chief Investment Office (CIO). With \$521 million of deposits but only \$402 million of loans receivable at December 31, 2004, JPM separated the CIO from the internal treasury department in 2005. Ina Drew, who was JPM's Chief Investment Officer, was appointed to lead the CIO.

CIO had various additional responsibilities, including funding JPM's retirement plans, as well as hedging risks associated with interest rates and mortgage servicing rights on behalf of other units within the bank. An important secondary function of CIO was to help JPM reduce its credit risk. As a bank, a major risk facing JPM is credit risk, also known as default risk, which is the possibility that someone who had borrowed from the bank (either directly in the form of a loan, or indirectly via the fixed income securities owned by CIO or other units of the bank) is unwilling and/or unable to repay the money that they owe.

In May 2006, CIO approved a proposal by Achilles Macris, the International Chief Investment Officer and Drew's subordinate, to begin trading credit derivatives, such as credit default swaps, as a business hedge to "effectively manage residual exposures created by [JPM's] operating businesses". (US Senate Exhibits, 36-37)

Thus, in addition to investing excess deposits in low-risk high-quality bond holdings, CIO purchased default protection using credit derivatives to partially hedge JPM's exposure to credit risk that arose from the bank's lending activities. At what point in time this strategy acquired the name Synthetic Credit Portfolio (SCP) remains unclear, but certainly was the case by 2008.

Three London-based CIO employees were responsible for the SCP on a daily basis. Javier Martin-Artajo, the head of credit and equity trading, reported to Macris and directly oversaw the SCP. Bruno Iksil, who would come to be known as the "London Whale", reported to Martin-Artajo and was the head trader for the SCP. Julien Grout was a junior trader and reported to Mr. Iksil. (See Zeissler, et al. 2014A for a definition of credit default swaps and related terminology, as well as a detailed description of the trading strategies pursued by the SCP team.)

### 4. Hedging or Proprietary Trading?

While the CIO was in charge of a number of different portfolios, one important issue surrounding the SCP specifically was whether the portfolio evolved over time from a purely hedging function to also incorporate proprietary trading.

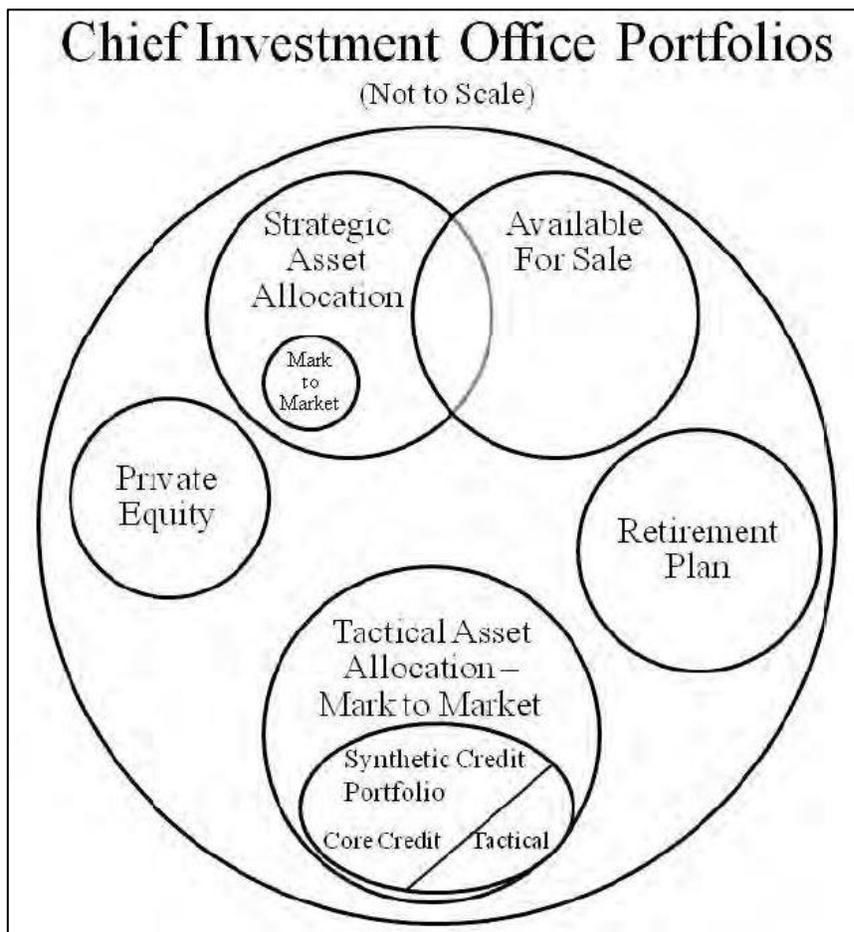
As discussed in Section 3, Macris received approval in May 2006 to begin trading credit derivatives. The CIO approval document to commence credit trading stated that JPM's largest concentration of risk from its operating businesses was "cyclical exposure to credit" and that CIO wanted the capability to "manage corporate credit exposures and diversify its asset classes." (US Senate Exhibits, 36-37)

JPM completed the initial internal audit review of what it termed “CIO Global Credit Trading” in November 2007. In the final audit report, the business overview began by noting that CIO “credit trading activities commenced in 2006 and are proprietary position strategies executed on credit and asset back indices.” (US Senate Exhibits, 57-58)

During Drew’s interview with the US Senate subcommittee investigating the CIO losses, she approved a drawing indicating that, at the beginning of 2012, SCP was part of the larger “Tactical Asset Allocation” portfolio, which itself was formerly known as the “Discretionary Trading Book” (see Figure 1). A former co-head of JPM’s investment bank stated to the US Senate subcommittee that discretionary trading is in fact synonymous with proprietary trading.

A report issued January 2013 by the internal JPMorgan Chase Management Task Force (JPM Task Force) that investigated the London Whale losses stated “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 could produce no documentation of what these credit risks were, what hedges would be used, or how to test hedge effectiveness. (US Senate Report, 4) In other US Senate testimony, JPM officials acknowledged that the CIO never documented SCP’s purpose or intended manner of working, nor did the CIO ever issue a policy delineating SCP hedging parameters or strategies.

Figure 1: US Senate Drawing Approved by Ina Drew



Source: US Senate Report, 41

Credit default swaps and other derivatives can be used to hedge a specific asset or transaction, or to provide protection in a more general way. In a dedicated hedge, position ABC specifically hedges position XYZ, and both positions are recorded accordingly with offsetting gains and losses. (US Senate Report, 45) For example, a farmer obligated to deliver 1,000 bushels of corn may enter into a futures contract with the opposite exposure to offset future changes in corn prices.

However, CIO and other bank officials gave inconsistent answers to the US Senate subcommittee about which assets or portfolios the SCP was supposed to hedge, ranging from a portion of CIO's own portfolio of fixed income securities to the firm's balance sheet as a whole (what is referred to as a "top of the house" hedge). John Wilmot, who was CIO Chief Financial Officer from January 2011 until the immediate aftermath of the CIO losses in May 2012, stated that assets to be hedged by the SCP were not specifically defined in writing. Ms. Drew admitted that determining the size and nature of the hedge was therefore a "guesstimate". (US Senate Report, 44)

JPM's corporate counsel told the US Senate subcommittee that the SCP was not supposed to function as a dedicated hedge of a specific asset or transaction, but was rather intended to

protect against “tail risks” facing the bank, meaning risks characterized by low frequency yet high severity (i.e., unlikely, but costly). However, bank officials again gave conflicting descriptions of the types of tail risks the SCP was expected to mitigate.

In addition to investing excess deposits, the CIO would also hedge risks related to interest rates and mortgage servicing rights for other groups within JPM, with data about these hedges given to JPM Chief Financial Officer Douglas Braunstein on a weekly basis. While these particular CIO hedges were recorded, tracked, and regularly tested for hedge effectiveness (to qualify for favorable accounting treatment), the SCP hedges were not. JPM’s 2011 annual report filed on Form 10-K with the Securities and Exchange Commission described the detailed procedures that the bank used to track those derivatives designated as hedges:

... for a derivative to be designated as a hedge, the risk management objective and strategy must be documented. Hedge documentation must identify the derivative hedging instrument, the asset or liability or forecasted transaction and type of risk to be hedged, and how the effectiveness of the derivative is assessed prospectively and retrospectively. . . . The extent to which a derivative has been, and is expected to continue to be, effective at offsetting changes in the fair value or cash flows of the hedged item must be assessed and documented at least quarterly. (JPM 10-K 2011, 202-203)

Senior JPM executives have stated that the SCP would not have required such procedures and documents, since it was not intended as a dedicated hedge, but rather as a macro hedge to protect the bank as a whole against credit risk during another financial crisis or other stress event. Nevertheless, sensible risk management would dictate that the bank have some means to size the SCP and to gauge its effectiveness as a macro hedge. (US Senate Report, 48)

The first news stories about Iksil and his large credit derivatives trades appeared in *Bloomberg* and the *Wall Street Journal* on April 6, 2012. Braunstein addressed some of the concerns in a conference call on April 13 to announce the bank’s first quarter earnings. On the call, Braunstein stated “we have put on [the credit derivative] positions to manage for a significant stress event in credit.” (US Senate Exhibits, 437)

To properly function as a hedge, SCP should have been profitable in a weak credit environment when the rest of JPM was experiencing losses from borrower defaults. However, Wilmot sent an analysis to Chief Executive Officer Jamie Dimon and to Braunstein on April 11, just two days before the earnings call, showing that SCP would in fact lose money if credit spreads widened in anticipation of increased defaults. (US Senate Report, 278) (See also Zeissler, et al. 2014F for a discussion of whether Braunstein’s comments on the earnings call may have violated securities laws that make it illegal for an issuer to make false statements or to omit material facts in connection with the purchase or sale of securities.)

## 5. CIO Compensation

Like other financial firms, JPM used an incentive-based compensation system “premised on the basic assumption that one of the factors that influence individuals’ performance and conduct is financial reward”. (JPM Task Force 2013, 91)

CIO did not have its own incentive compensation system, but instead participated in the bank-wide incentive compensation system overseen by the JPM Board of Directors. As such,

CIO personnel were compensated by reference to how employees in other lines of business at JPM were paid, in addition to independent third party compensation survey data.

In June 2012, after the London Whale trades were public, the JPM Task Force prepared an analysis of the total compensation received in 2010 and 2011 by the key participants in the SCP trades: Drew, Macris,

Figure 2: Seat Value Comparisons Chart

Role	Total Compensation (\$mm)			Ref Grp	References		Comments / Other
	Name	2011	2010		2011	2010	
JPM CIO	Drew	\$14	\$15	Bank CIOs	\$9.7 – \$10.1	\$10 – \$12	McLagan OC Market Survey <sup>a</sup>
				Inv Mgt. CIO	6.8 – 16.1		McLagan Investor Survey <sup>a</sup>
				IB Fixed Income	16.5	17.5	Internal comparisons FI Mgt (Top 2) (10 Mkt Survey Range - \$13 - \$25)
				Chf. Inv. Head Blend	9.5	10.0	Internal comparison AM Head  MGMC initial benchmarking: <sup>a</sup> 25P – 75P \$7 - \$18
International CIO	Macris	14.5	17.25	JPM Top Paid	Avg. – High 5.9 – 12.8	Avg. – High 6 – 15.0	Internal – Sales & Trading MDs in IB (n=60)
				Top Paid Fixed Income	10-12.75	10.6 – 15	Internal - IE Fixed Income (Top 3 below IBOC)
				AM Fixed Income Inv.	8.0	8.0	Internal - AM Fixed Income Investment Head
EMEA CIO Mgt	Martin-Artajo Iksil	10.98 6.76	12.75 7.32	EMEA IB MDs	Avg. – High 5.9 – 10.5	Avg. – High 6.0 – 13.3	Internal - EMEA Sales & Trading (n=25)
				IB Fixed Income	Avg. – 75P 4.4 – 9.8 2.7 – 5.0		MGMC Market Survey <sup>b</sup> • Global FI – Trading Products MDs • Global FI – All Products MDs
SCB Traders	Buraya Grout de Sanguies	1.3 1.0 1.25	1.46 .76 .77	Wholesale Front Office	Avg. – 75P 1.0 – 1.95	Avg. – 75P 1.2 – 2.2	Market <sup>b</sup> 1.1 – 1.9 (MGMC/McLagan)
				IM Fixed Income PMs	9 – 1.5		McLagan Survey <sup>a</sup>
				CPG	Avg. = 2.18 Avg. = .6	Avg. = 2.23 Avg. = .63	Internal – IB MDs IB ED/VPs

<sup>a</sup> Independent third party pay survey data used in direct job benchmarking

<sup>b</sup> Independent third party pay survey data used for comparable jobs in other LOBs that are referenced as part of internal comparisons

Source: US Senate Report, 58

Martin-Artajo, Iksil, Grout, and two other traders (see Figure 2). Of interest is whether the compensation of these individuals was set relative to risk managers (i.e., SCP as hedging operation) or relative to traders (i.e., SCP as proprietary trading operation).

The primary internal reference groups for setting compensation were employees in the Investment Bank (considered to be a profit center) and in certain Sales & Trading units. The analysis makes no mention of risk management compensation, a cost center within the bank. Also noteworthy is that 2011 compensation for Drew, Macris, Martin-Artajo, and Iksil were all higher than comparable positions within the Investment Bank. (US Senate Exhibits, 22)

Nevertheless, the JPM Task Force concluded that “there does not appear to be any fundamental flaw in the way compensation was and is structured for CIO personnel”, albeit acknowledging that the bank must make front office staff who are assigned to tasks not expected to generate profits aware that they will “nonetheless be compensated fairly for the achievement of the Firm’s objectives, including effective risk management.” (US Senate Exhibits, 22)

## 6. Does It Matter?

Despite the efforts described in Section 2 to implement the Volcker Rule in the US and similar rules in other countries, the extent of the role played by proprietary trading in the financial crisis of 2007-2009, if any, remains open to debate. As required by the Dodd-Frank Act, the US Government Accountability Office (GAO) conducted a study in 2010-2011 of the “risks and conflicts of interest associated with proprietary trading by and within covered entities”. (GAO 2011, 2)

GAO analyzed data from stand-alone proprietary trading desks of the six largest US bank holding companies, including JPM, for the 18 quarterly periods from the third quarter of 2006 through the fourth quarter of 2010. Interestingly, GAO was not able to collect information about the proprietary activities of non-stand-alone trading desks because the banks did not separately break out this activity at the time of the study.

GAO found that these stand-alone proprietary trading desks were collectively profitable in 13 quarters, in which they generated total revenue of \$15.6 billion. However, this sum represented only about 3% of the average revenues from all sources of the banks involved. In the other 5 quarters, the stand-alone proprietary trading desks lost a combined \$15.8 billion, likewise about 3% of revenue from all sources. This data lead the GAO to conclude that “stand-alone proprietary trading generally produced small revenues in most quarters and some larger losses during the financial crisis”. Bank hedge fund and private equity fund investments showed a similar pattern. (GAO 2011, Preface)

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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.
2006		CIO approved a proposal by Achilles Macris to trade credit derivatives.
2007		JPM conducted the first internal audit review of "CIO Global Credit Trading". The final audit report noted that CIO "credit trading activities commenced in 2006 and are proprietary position strategies".
2010	July 21	The Dodd-Frank Act was signed into law.
2012	First Quarter	Bruno Iksil and the Synthetic Credit Portfolio (SCP) team make the credit derivatives trades that are the source of the "London Whale" losses.
	January	SCP was part of the larger "Tactical Asset Allocation" portfolio, which itself was formerly known as the "Discretionary Trading Book", based on an interview of Drew by the US Senate subcommittee investigating the CIO losses.
	February 13	JPM sent a comment letter to the Office of the Comptroller of the Currency 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.
	April 6	<i>Bloomberg</i> and the <i>Wall Street Journal</i> published the first news stories about the "London Whale".
	April 11	CIO Chief Financial Officer John Wilmot sent an analysis to JPM Chief Executive Officer Jamie Dimon and JPM Chief Financial Officer Douglas Braunstein showing that SCP actually would lose money if credit spreads widened in anticipation of increased defaults.
	December 31	Year-to-date SCP losses = \$6.2 billion.
2013	September-October	Four regulators in the US and one in the UK reached settlement agreements with JPM, totaling \$1.020 billion in penalties.

December  
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The Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Securities and Exchange Commission issued the final Volcker Rule.

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