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Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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May 22, 2012

The Honorable Darrell E. Issa
Chairman
Committee on Oversight and Government Reform
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On May 10, 2012, JPMorgan Chase & Co. disclosed more than $2 billion in losses over a period of six weeks resulting from a trading strategy that its Chairman and Chief Executive Officer, Jamie Dimon, called "poorly constructed, poorly reviewed, poorly executed, and poorly monitored."[1] According to recent reports, JPMorgan's losses may have grown by an additional $1 billion since its original announcement.[2] Both the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) reportedly have initiated investigations.[3]

Because JPMorgan's activities have clear implications for the federal government's efforts to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act, we are writing to request that the Committee hold a hearing with Mr. Dimon, as well as Bruno Iksil, the trader who will be departing JPMorgan's London office as a result of his involvement in these

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[1] *JPMorgan Discloses $2B in Losses in 'Flawed' Hedging Strategy,* MSNBC (May 10, 2012) (online at marketday.msnbc.msn.com/_news/2012/05/10/11644161-jpmorgan-discloses-2b-in-losses-in-flawed-hedging-strategy?lite).

[2] *JPMorgan's Trading Loss Is Said to Rise at Least 50%,* New York Times (May 16, 2012) (online at dealbook.nytimes.com/2012/05/16/jpmorgans-trading-loss-is-said-to-rise-at-least-50/?hp).

[3] *SEC Opens Review of J.P. Morgan*, Wall Street Journal (May 11, 2012) (online at online.wsj.com/article/SB10001424052702304203604577397984205205446.html#id=I1_13368 47234481&parent=http%3A%2F%2Fonline.wsj.com&rpctoken=749320866&_methods=onPlus One%2C_ready%2C_close%2C_open%2C_resizeMe%2C_renderstart); *Justice Dept. Launches Criminal Probe Into JPMorgan's $2B Trading Loss,* Washington Post (May 15, 2012) (online at www.washingtonpost.com/business/economy/justice-dept-launches-criminal-probe-into-jpmorgans-2b-trading-loss/2012/05/15/gIQAFF7URU_story.html?wpisrc=al_comboNE).

recent losses, and Ina Drew, JPMorgan's former chief investment officer who headed the unit responsible for the bank's problematic trades.[4]

As you know, our Committee played a pivotal role in identifying the lessons of the 2008 financial crisis. In testimony before the Committee on October 23, 2008, the former Chairman of the Federal Reserve, Dr. Alan Greenspan, famously admitted:

> I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such as that they were best capable of protecting their own shareholders and their equity in the firms.[5]

JPMorgan's recent losses exemplify the risks that continue to threaten the stability of our financial system and highlight the critical importance of the Dodd-Frank legislation, which our Committee's previous investigation helped inform. Unfortunately, almost two full years after Dodd-Frank became law, many of its provisions have yet to be fully implemented. For example, the Volcker Rule appears to contemplate trades such as those that led to JPMorgan's recent losses. The Volcker Rule prohibits banking entities from engaging in speculative trading activities using deposits, referred to as "proprietary trading."[6] Banks are regulated more heavily

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[4] *Dimon Fortress Breached as Push From Hedges to Bets Blows Up,* Bloomberg (May 14, 2012) (online at www.bloomberg.com/news/2012-05-14/dimon-fortress-breached-as-push-from-hedging-to-betting-blows-up.html); *'London Whale' Said to Be Leaving JPMorgan,* New York Times (May 16, 2012) (online at dealbook.nytimes.com/2012/05/16/london-whale-said-to-leave-jpmorgan/); *J.P. Morgan's Drew Retires; Zames to Take CIO Post,* Wall Street Journal (May 14, 2012) (online at http://online.wsj.com/article/SB10001424052702304192704577403911410998528.html).

[5] House Committee on Oversight and Government Reform, *Hearing on the Financial Crisis and the Role of Federal Regulators* (Oct. 23, 2008).

[6] Congressional Research Service, *The "Volcker Rule": Proposals to Limit "Speculative" Proprietary Trading by Banks* (June 30, 2010) (online at www.crs.gov/pages/Reports.aspx?PRODCODE=R41298&Source=search). Under Section 619 of Dodd-Frank (Pub. L. No. 111-203 (2010)):

> [A] banking entity shall not … engage in proprietary trading, or … acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund.

"Proprietary trading" is defined by Dodd-Frank as:

> [E]ngaging as a principal for the trading account of the banking entity or nonbank financial company…in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may … determine.

than securities firms because banks have the benefit of Federal Deposit Insurance Corporation (FDIC) deposit insurance and access to the Federal Reserve's discount window lending facility.[7]

Since the passage of Dodd-Frank, regulators, including the Federal Reserve, FDIC, the Office of the Comptroller of the Currency, the SEC, and the Commodity Futures Trading Commission, have been engaged in a coordinated effort to implement the Volcker Rule.[8] On November 7, 2011, a proposed rule was published in the Federal Register.[9] On April 19, 2012, the Federal Reserve issued a statement clarifying that entities subject to the Volcker Rule would have until July 21, 2014, to "fully conform their activities and investments" to the rule.[10]

JPMorgan has strongly opposed implementation of the Volcker Rule and has sought to create a loophole allowing the bank to engage in proprietary trading practices under the guise of hedging risk.[11] JPMorgan claims that the transactions generating the recent $2 billion losses were hedging activities that would not have violated the Volcker Rule.[12] However, the difference between "profit-seeking" and hedging activities is "tied up in the still-incomplete Volcker rule."[13] Press reports indicate that JPMorgan executives, including the head of its investment office that suffered the $2 billion loss, "met with Federal Reserve officials and warned that anything but a loose interpretation of the trading ban would hurt the bank's hedging activities."[14]

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[7] *Id.*

[8] Board of Governors of the Federal Reserve System, *Volcker Rule Activity Restrictions* (Oct. 11, 2011) (online at www.federalreserve.gov/newsevents/press/bcreg/20111011a.htm).

[9] Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; and Securities and Exchange Commission, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds,* 76 Fed. Reg. 215 (Nov. 7, 2011) (Notice of Proposed Rulemaking) (online at www.gpo.gov/fdsys/pkg/FR-2011-11-07/pdf/2011-27184.pdf).

[10] Board of Governors of the Federal Reserve System, Volcker Rule Conformance Period Clarified (Apr. 19, 2012) (online at www.federalreserve.gov/newsevents/press/bcreg/20120419a.htm).

[11] *JPMorgan Sought Loophole on Risky Trading,* New York Times (May 12, 2012) (online at www.nytimes.com/2012/05/12/business/jpmorgan-chase-fought-rule-on-risky-trading.html?pagewanted=1&_r=1).

[12] *A Hedge or a Bet? Trade Highlights Ambiguity in Volcker Rule*, Wall Street Journal (May 11, 2012) (online at online.wsj.com/article/SB10001424052702304543904577398524164756112.html?mod=googlenews_wsj).

[13] *Id.*

[14] *JPMorgan Sought Loophole on Risky Trading,* New York Times (May 12, 2012) (online at www.nytimes.com/2012/05/12/business/jpmorgan-chase-fought-rule-on-risky-trading.html?pagewanted=1&_r=1).

JPMorgan's characterization of these transactions as hedging activities raises serious questions. As a former employee in JPMorgan's corporate risk management department asked in a May 14, 2012, article in *American Banker*:

> [H]ow does a long credit position result in a hedge? The press reports suggest that it was offsetting a hedge against the loan book, but if that were true the gains and losses on one side should offset those on the other side. Since that has not happened on a mark-to-market basis, something needs to be explained.[15]

Since JPMorgan is the nation's largest bank holding company, it is important for us to understand the true nature of this trade, as well as the potential for the bank's losses to grow. We also need to understand the impact of this specific incident on the financial market and the prevalence of similar trades, as well as its significance for the ongoing implementation of Dodd-Frank and the Volcker Rule.

On February 9, 2011, you issued a staff report listing a number of regulations you believe "merit additional scrutiny, including the "Dodd-Frank Volker Rule."[16] We believe an examination of JPMorgan's recent activities would be beneficial to determining whether the Volcker Rule is being developed consistent with Congress' intent.

Thank you for your consideration of this request.

Sincerely,

Elijah E. Cummings
Ranking Member

Peter Welch
Member

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[15] *What JPMorgan Still Needs to Explain,* American Banker (May 14, 2012) (online at www.americanbanker.com/bankthink/JPM-Risk-Management-CIO-VaR-hedging-1049268-1.html)

[16] Majority Staff, House Committee on Oversight and Government Reform, *Assessing Regulatory Impediments to Job Creation* (Feb. 9, 2012) (online at oversight.house.gov/wp-content/uploads/2012/02/Preliminary_Staff_Report__Regulatory_Impediments_to_Job_Creation.pdf).