Testimony on "Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss"
by
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U.S. Securities and Exchange Commission
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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.