



FedFin Client Report

Thursday, September 19, 2013

Regulators Make JPM Example, Redefine Enforcement Regime

Client Report: **REFORM100**

Executive Summary

Today, U.S. and U.K. regulators combined to impose \$920 million in fines against JPMorgan Chase (JPM), building on prior actions in the U.S. that were widely criticized for failing sufficiently to sanction the bank in the wake of the London Whale debacle. Although these actions are strong, public sanctions that forced JPM to admit culpability – unusual in most recent high-profile actions – more enforcement cases remain under way. JPM has signalled that the CFTC is contemplating action and reports signal similar work under way at the New York AG and Justice Department (stung deeply by AG Holder's prior statement that some banks are too big to fail). If these law-enforcement cases result in criminal charges against the bank or senior management, JPM's legal and reputational risk will spike from its already high level. This report analyzes each enforcement action and assesses their impact on other banking organizations. Indeed, the case has still broader impact, given that the SEC's action is based on its view of the responsibilities of public companies, sanctioning the BHC on grounds that it failed its legal duties properly to inform investors. The SEC has also signalled that it continues to pursue "individuals," not making clear how high this chase will go. The U.K. action appears based at least as much on the systemic risk potential of market surprises at so large a bank as on prudential worries, suggesting a new tack the U.K. will take in assessing the very largest firms. However, the OCC's case is notable for its unsparing description of how unsafe and unsound it found conditions at JPM's national bank. A critical failing at JPM running through all of the actions was management failure on the time schedules mandated by each agency to review internal controls related to valuation and risk management. The SEC takes particular issue with management statements in May of 2012 that internal controls were found appropriate, making it clear that in the future firms will need not only to ensure that senior management and the board is apprised of risk-management concerns and addresses them, but is also

Federal Financial Analytics, Inc.
1121 Fourteenth Street, N.W., Washington, D.C. 20005
Phone (202) 589-0880 Fax: (202) 589-0423
E-mail: info@fedfin.com www.fedfin.com

© 2013. Federal Financial Analytics, Inc. All rights reserved.

cautious with regard to public statements. Significant in all of these actions is reference to “senior management” without names. However, the SEC does detail “relevant entities and persons,” noting not only problematic units in the firm, but also actions by the CEO, CFO, CRO, controller and auditor.

In concert with the London Whale case, the CFPB and OCC levied surprisingly large fines against JPM related to its credit-card practices with regard to add-on products. The sum total here is \$369 million, combining CFPB consumer-protection fines with OCC penalties based on what it views as UDAP. Key to this case is the allegation that JPM billed customers for monitoring services they did not in fact receive. The fines come despite the fact that JPM ceased to offer the disputed services last year and itself refunded customers for certain fees, with remediation to date included in the CFPB total. It signals not only the strong stand now being taken against allegations at JPM, but also the continued willingness of the OCC to sanction actions many institutions think solely within the CFPB’s purview.

Analysis

OCC

The OCC’s enforcement action largely reiterates internal-control lapses included in its prior, public supervisory action, imposing a \$300 million civil money penalty in final settlement of the case. Key in the order is the characterization of the bank’s credit derivatives operations as “recklessly unsafe and unsound.”

SEC

The SEC’s case is based on the finding that JPM’s management failed properly to advise the board of control lapses related to the London Whale case. The key concern to the Commission is violation of Sarbanes-Oxley requirements related to public disclosures, resulting in material misstatements during the first quarter of 2012. Of particular concern is the finding that JPM senior management personally rewrote a key valuation policy to redress problems, but these reforms were not deployed to revalue prior failings, leading to a \$750 million restatement. The enforcement action includes:

- a \$200 million fine;
- admission of culpability;

- public admission of securities-law violations;
- a focus on poor communication between senior management and the board audit committee, including a failure by senior management to tell the board of failings it had already uncovered; and
- remediation now under way at JPM to address the SEC's conclusions.

FRB

The fine here is \$200 million, focusing again on significant internal-control lapses of which senior management failed to inform the board and the regulators.

U.K.

The U.K.'s Financial Conduct Authority tacked \$220 million to all of the U.S. fines, alleging as noted above that fraud "permeated" all levels of the firm, with the FCA saying this ranged from the portfolio level to senior management. The filing drew a link between the case and the shock it sent through the U.K. financial market, essentially linking its findings more to possible systemic risk than to any prudential concerns at JPM. Importantly, the bank agreed early to work with the FCA, resulting in a thirty percent discount to the ultimate fine.