For those who wonder whether JP Morgan made money on the "London whale"

Some regulators (also called financial markets watchdogs) and potentially hundreds of millions of savers felt misled by Jp Morgan statements at the time of events (the bank admitted it for part in September and October 2013 paying overall a fine of about $1 bln and settling many other pending litigations with the US government for $13 Bln more). Was it such a big deal for Jp Morgan now that the CIO and its "tranche book" were dismantled as planned since late 2010? No it was not a big deal for Jp Morgan ultimately once the CIO was dead for good in July 2012. Once they understood that the US bank had never been really endangered by the well publicized losses, some investors felt rightly so that they had been stolen some of their savings after they had felt compelled to engage in panicky trades that they would not have done otherwise. One may summarize their issue at the time as follows: this trading scandal in the making had sparked fears in the spring of 2012 that the bank may face a big loss because of some 'JP Morgan CIO oversized positions built on toxic credit derivative financial products'. Those credit derivatives were the ones that had been central in the last financial crisis to date in 2008. Some cautious investors therefore opted to sell JP Morgan shares at a depleted price and may even have traded further for fear their other market exposures might suffer from the suspected 'CIO positions'. This summary picture is supported by the many litigations that some investors tried to bring up against JP Morgan in the years following 2012 but with very little success overall. The causes for their very limited success are known. The fact is that the bank did not have to unwind much of the 'CIO trades' in question. The other fact is that the bank made record profits right at the time even with this 'massive trading loss' on the record. The last fact to bear in mind is that the CEO Jamie Dimon sent every assurance that the published earnings of the bank were NOT at risk. But he was far from being convincing through his other statements at the time and the share price dived anyway. He may have been quite a poor communicator for once….What makes matters really worse is that the actual events of the time have not come to light yet, 5 years later... A lot more than what has been exposed so far has to be said about the inner-workings of the bank that were uncovered through the subsequent procedures and investigations. Many of those internal procedures and decisions had been made unbeknownst to the man that was put "at the center" of all this scandal, "Iksil", particularly at the time when he still was an employee at the bank. The investigations were launched thereafter in connection with this case and revealed those peculiar facts only in 2013 and later. As a result it may appear to the reader of this website that the abuses and potential violations that occurred in 2012 are still unaddressed for most of them. As such the way this 'London Whale Saga' has been treated so far by the authorities may serve as a key jurisprudence and may impact later harmfully every single employee being instructed by an employer, while this employer is knowingly embarked in a potentially criminal behavior. This is here all about integrity of individuals at every rank be that at the employer or at the financial market watchdogs. This is about to know how an employee could ever be protected against a management line or a corporate entity which, unbeknownst to the employee in question, is secretly caught in conflicts that would induce criminal conduct ultimately at every rank. The 'london whale' saga may reveal very disturbing conclusions here especially with regards to how some authorities handled the matter. Some authorities deployed in the public arena a theory that is flawed in many aspects and it is hard to believe that they did their job here. Thus they saw a manipulation the wrong way round. They ignored the very genesis of CIO and its 'tranche book' that they had closely monitored for years before 2012. And they seemed to ignore the massive mismarking showing in the reserves of Jp Morgan. Not only the investors were taken away some of their savings but this occurred ultimately with the passive support of some of the market watchdogs involved. The parts that follow provide some more technical and background information before more detailed descriptions will be posted on this website….

Trading basics and financial performance ground data

When one party A loses on a derivative trade, its counterparty B wins… It cannot be otherwise

- Day 0 --Trade: party A buys at 100 to party B which therefore sells at 100.

(the item "P&L" stand for "Profit and Loss")

- Day 1—Price moves from 100 to 101---Party A wins “1” AND party B loses “1”--- Party A P&L is positive “+1” while party B P&L is negative “-1”. The sum of the 2 P&Ls is zero all the time ….
- Day 2,3,4,5 and next…..whatever the price is then, IF party A wins an amount “X” in P&L, then Party B loses by the same amount “X” on its own P&L.

And of course “X” + “-X” = 0. This looks quite obvious and simple….To bear in mind though…

Intermediate Conclusion: if one party wins, the other loses by the same token. It cannot be that both parties either lose or win together at the same time. The only case when they have the same P&L is when the price is at 100 again and their P&L is back to zero. Otherwise the signs of their P&L are opposite and sum to zero (or close) altogether.

Usually party A has many trades (alike party B), some of which offset the risks of some other trades with regards to the gyrations of the markets. The hedging book of CIO had generally a group of trades offsetting the IG9 10yr positions that made the total position “market neutral”. This means simply that many prices were needed altogether to compute the performance and that the ultimate P&L was disconnected from the market direction day to day.

The counterparties to CIO involved in the London Whale events allegedly had adopted deliberately a mirror exposure to the one of CIO on IG9 10yr. The explanation above works still for the “market neutral exposure on IG9 10yr” as a whole that CIO had in front of its own counterparties and other hedge funds involved. Thus whenever CIO lost money on this "market neutral IG9 10yr position", its counterparties taken altogether were making money as surely as CIO was losing and growingly so....This will be the case just every week of 2012, week after week, starting on January 4th 2012. Now one may still argue that CIO was countering a natural trend that was hammering specifically the IG9 10yr for good cause, due for example to a former overpriced position of this index versus the rest of the market….This argument will be dismantled in what follows. One can surely say that this not a “distortion” anyway. Indeed a ‘distortion’ would result in a visible gain obtained from a pressure put on prices that would induce immediate gains recorded on recent trades. That was for sure not the case on the CIO side of those trades. But was it still a “pressure” of some kind on the part of CIO? First some things have to be stressed out.

<u>What is a so called “market neutral” position?</u>

A “market neutral position” is a position consisting of at least 2 trades, one offsetting the other with regards to the general direction of the markets. For example, one could buy the IG9 10yr index in protection terms and at the same time sell another index, or group of indices, or group of CDS, or other financial products related to the IG9 10 yr index in proportions such that the P&L of the two trades should usually balance each other as the markets would fluctuate day to day. Yet, unlike the original case displayed above, because the instruments involved differed one from the others, one of the instruments being bundled together may face an underperformance versus the others irrespective of the direction of the markets. This could be "noise" that will mean revert one day. This could be a regime shift for the instrument considered that will be soon supported by new facts. This could also be a market manipulation….In any event the resulting P&L was not related to market directions day to day.

FACTS in 2012:

- the CIO had a market neutral position on the IG9 10 yr.
- the IG9 position lost value regularly versus all its peers, and less liquid comparables (since Mid December 2011)
- the CIO grew the position in a “market neutral” fashion all along the first quarter of 2012
- the CIO lost money every week if not day to day on its “market neutral” IG9 10 year position versus the rest of the market.

- the loss , as well as the dangers associated, were reported and understood fully as such inside CIO and JP Morgan since the beginning of 2012. They were elevated up the chain since March 2011 (yes 2011).

THEREFORE: any party facing CIO on the IG9 10yr "market neutral" trades, which were executed in a market neutral manner at CIO, was recording a gain, growing week after week since the 4th January 2012 onwards. (it does not matter at this stage to figure out whether it was either "noise" or " regime shift" or "manipulation")

CONCLUSION: In short, this was a blatant manipulation targeting CIO and conducted from within JP Morgan. As explained CIO trading activity, no matter how large it was, did NOT pressure the prices in its favor on its IG9 10yr exposure that was market neutral and remained market neutral all along. The prices quoted in the market said it. They even showed quite the opposite in fact…. The pressure on prices, witness the growing loss at CIO, was going the other way, namely against CIO recent trades. Once again, this ongoing pressure on prices going straight against the positions, old and new, of CIO may have been either a regime shift, or a "noise" (also called "mean reversion patterns"), or a manipulation. One may argue, as mentioned before, that without "pressuring" prices, CIO activity was slowing a market trend. That was not a "distortion" for sure but that could have felt as an indirect pressure in some cases. One may claim that this "influence" of CIO was little warranted. As far as CIO was concerned its trades were simply ordered by CIO management who saw this visible pressure as an opportunity to increase a strategic exposure at a price level that promised higher profits in an undefined future time at the immediate expense of a bigger loss for the present performance. Therefore, it is plain nonsense in practical terms to allege that CIO trades pressured the prices. However it is quite logical to allege that the parties facing CIO on its IG9 10yr "market neutral" trades likely were de facto pressuring the prices in their favor as they were recording instant gains precisely while increasing their positions where CIO recorded instant growing losses. The parties facing thus CIO kept growing their side of the IG9 10yr market neutral trades while recording growing immediate gains, therefore entering as a matter of fact in a relentless growing pressure on prices that went in their favor week after week if not every day. How did they expect to lock their gains? Either they saw a "natural price" for the IG9 10 yr that was trending lower versus just all the other indices being quoted then. Historical data could not provide such a "natural price" actually. They had a crystal ball of some sort here. Or they acted with the sole view to forcing CIO to capitulate soon since they allegedly had targeted CIO from the start. In any event this admitted "targeting" precluded the case of the "market noise". It was concerted. But it still could be a mere "mean reversion pattern" at play. One may speculate indeed that this ongoing well organized underperformance of the IG9 versus just all its peers was caused by an initial opposite move that occurred in the course of late 2011. One may then say that it was a sort of boomerang effect or a "mean reversion pattern" in jargon. The long term historical data shows that this is true but only in part as the IG9 even underperformed much less liquid CDS something which should not have happened anyway for long. As such this was not market "noise" but a weird reversion to mean including some absurd moves where the parties targeting CIO actually still pushed prices in a sort of forceful manner. This felt like a manipulation on their part but not easy to prove still. But in mid February 2012, as far as historical data was a guide, this mean reversion was almost done and the manipulative stance got more and more obvious through anecdotal evidence. What would follow on the side of those targeting the CIO was therefore sparked by other motivations for sure as they kept pressuring price more openly than ever as some trading chats of the time prove it. They had built a capitulation scenario for CIO where the IB of Jp Morgan was an active player behind the scenes. Most of this anecdotal evidence exists and Iksil would openly testify on that as he lived through these anecdotes and elevated them then (former talks between Guy America –JP IB- and Artajo at CIO ---weird calls from a headhunter starting in late February---February 29th NY close weird trading flows that were NOT triggered by CIO but by Boaz Weinstein alone--- March 1st call from Gabriel Roberts- Citigroup- to Bruno Iksil---Testimony of Ade Adetayo about Blue Mountain calling him on March 23rd 2012). The regular path of the growing loss of CIO starting on the 4th January 2012 is testimony that the trend, the pressure and the manipulation (reported at the time inside the firm) appeared 3 months before the articles and only increased after the articles. The latter simply turned out to be a catalyst for the capitulation of CIO to occur sooner than later. The data in market prices do exist and show the well coordinated loss that snowballed in the CIO book at certain specific dates of March 2012, dates which were all related to key meetings occurring inside JPMorgan involving Ashley Bacon in particular. The latter articles in April 2012 thus were just another catalyst to trigger this long awaited capitulation, perceived as a "cathartic outcome" which CIO Ina Drew and Achilles Macris had elevated all the way up inside Jp Morgan on 23rd March 2012 at the latest. This latter elevation was done in the follow up of many former alerts that had started inside CIO no later than the 10th January 2012. The Investment bank of JP morgan was quite active in articulating this capitulation of CIO but always behind the scenes….

What was the CIO role inside JP Morgan?

CIO was mandated to invest 'wisely' the 'excess liquidity' for the firm under supervision of the firm's treasury CEO (namely Mike Cavannagh) and the firm's Chief Finance Officer (CFO) (namely Doug Braunstein). The investments of CIO were ALSO monitored by risk management (headed by Barry Zubrow until 2011 and next by John Hogan in 2012 and his deputy Ashley Bacon) so that the firm could prepare at best for liquidity shortages in the markets. These rare but devastating stress scenarios- where banks run short of immediate liquidity- were called 'tail risk events' in Jargon inside JPMorgan CIO. Did the CIO unit charged with investing the firm's strategic liquidity reserve need a liquidity reserve itself? Well it should not in theory but it did need a massive reserve itself since 2007 in fact…The figure at stake had only kept growing since then until the "catharsis" arose in 2012 through the "London Whale" event from within Jp Morgan.

Here are some critical questions that will be addressed further in the future on this website and that can be sketched as follows….

Who pressured prices, why and when?....Why was CIO targeted in 2012?

There must have been a genesis to the ultimate "cathartic capitulation of CIO inside JP Morgan" that occurred through the "London Whale" event. This website will offer insight on the genesis in question that dates back to 2009. As described above, the case that has been pictured by the bank, the media and some authorities, does not hold even on the surface. It is for example technically impossible to 'pressure' prices for a market player by trading in a way that induces a loss on those new so-called "pressuring" trades given the market conditions in which they were executed. As one would expect instead, if one trades in a way that pressures prices through "market-neutral" strategies, those recent trades are going to be at a steady profit in the foreseeable future, not at a growing loss. Yet for the CIO all the new "market neutral" trades were only showing a growing loss week after week, almost day after day. The drift in value that was prompting those growing losses at CIO could not be justified by common sense, mean reversion from the past excesses, or even standard market activity and noise. However, if the articles are to be believed, one has to conclude that CIO traded and "pressured" prices in a way that only caused a bigger loss on those recent "market neutral" trades in particular. What kind of "pressure" could that be on the part of CIO then? Why would the CIO "double down" using in fact quite another trading strategy if it had just lost money on an on so far on the original "market neutral" trades? One "doubles down" on the same trading strategy, not another one…Otherwise this is just not "doubling down" at all. This is merely another trading strategy that is driven by ANOTHER kind of loss coming on OTHER trades….Thus there was neither "doubling down" nor "pressure" on CIO part…

What was the universe of comparison for the IG9 index in early 2012? What was its performance in this universe?

Since the IG9 10yr allegedly was 'pressured' due to CIO trades, it should have brought a gain for CIO at the time on the IG9 10 yr specifically so in some way of form anyway. The very opposite occurred all along the first and second quarters of 2012, week after week, before and after the articles that will be displayed. Monitored from a "market neutral" standpoint, there was actually no comparable index or comparable group of CDS that underperformed the IG9 10yr index during that period despite all the trades that CIO did that anticipated in pure theory an outperformance of the IG9 10yr versus its peers. The price levels from mid February 2012 onwards were unchartered in the 5 years of historical record about the IG9 index. It could be called a "wrong way trade" surely so since it lost money all along. But for the same reason it just cannot be the case of CIO "market neutral" trades that "pressured" prices in favor of CIO. Likewise the "double down" theory, for its mere existence, just confirms that fact: CIO kept losing money all the way into 2012…and actually altered radically its trading approach in the markets. Thus this "double down" theory that spread through the Congress in June 2012 and in many public reports issued by the authorities involved was misleading and going against the facts.

What is the short story of this "London Whale" genesis actually?

No one really got to the bottom of why Dimon created this CIO and this "tranche tail hedging strategy" at CIO. It was not entirely the choice of the new CEO of Jp Morgan when he joined the group JP Morgan-Chase through the "merger of equals" with BankOne. The genesis of the "London Whale" is based on a series of older clashes between JPMorgan-Chase initially and the market watchdogs that dated back from 2006. The regulations that emerged from the 2008 crisis would only make matters worse for the proclaimed "Fortress Balance Sheet" had rather thin paper walls. The 'London Whale' event will act truly as a **catharsis** in that regard (Merriam Webster definition: "*a purification or purgation that brings about spiritual renewal or release from tension*"). The matter is complex and may require a larger report based on 10-Q and 10-K filings among other things like the correspondence letters between the bank and the SEC that one can find on EDGAR. Still one can monitor the "simplified" script of this genesis through the quarterly 10-Q and annual 10-K reports published by the bank since 1999. The bank Jp Morgan initially at the end of 1999 was quite profitable but had enormous leverage on its balance sheet, ie it produced its profits by piling up trades that would cost it a fortune to unwind in a forceful scenario. The examples of the bond market crash of 1994 and of the clash of LTCM demise in late 1998 were powerful warnings. If the bank wanted to avoid a forced unwind it had to keep a large reserve of cash. The issue would then be to invest "wisely" this "excess liquidity" as a sort of "rainy day fund". That was the Gordian Knot some would say. The future concept of CIO was already in the cards. But Jp Morgan could not afford such luxury as its funding and cash sources were limited. The JPM bank share price traded way above its book value in late 1999 and Jp Morgan was kindly invited to find a partnering bank to get bigger and hopefully safer, before it would be too late. And it was Chase Manhattan Bank the best candidate. But the talks dragged on likely because the JP Morgan share price looked too high versus the one of Chase. One year was lost in dead-end talks. The 2 banks married rather in haste towards the end of 2000 while they saw the dot.com bubble exploding and the recession looming. Share prices had surely hit their highs a couple of months ago. Time was running out for regulators. Chase officially took over Jp Morgan but while it brought a lot of cash to the new group it also brought a lot of off balance sheet exposures that required a lot of cash reserves anyway. It was all about risk management skills looking forward to make the best use of this dear "excess" cash at hands. A reverse take-over occurred on the follow as Jp Morgan risk management staff seemed much more able to handle the situation.

Came the year 2001 with the heavy implication of JPMorgan-Chase in the 'credit line options' and the scandal of ENRON. In 2002, the picture is clear and that looks bad. The operating costs of the new group in the market have only grown faster than the earnings. The reputation is tainted after Enron, and the shareholders have less and less tangible assets to rely on. They can only hope to get their money back based on what "other assets" are worth as displayed in the balance sheet. The year 2003 is a year of recovery across the economy and earnings are good. But the problems remain very acute looking forward. This is the year when JpMorgan-Chase organizes a “merger of equals” with BankOne. This is not really that, “a merger of equals”. The book value of BankOne was about $22 billion while the one of JPMorgan-Chase was rather $45-50 billion. To make good measure, the merger was announced on January 2004 with BankOne conveying on the way a $35 billion creation of Goodwill. All of a sudden BankOne was worth in the accounting ledgers not $22 bln but $57 billion. Adding other intangible capital “explained” by future expected synergies, it is a total of $42 billion of intangible capital that was created through this merger to engender a banking behemoth worth officially “only” $105 billion in total. Thus 40% of the book value of this huge bank was intangible and suddenly created. Size matters. With the advent of BankOne, JPMorgan-Chase-BankOne could have full access to all the government sponsored sources of cash. But there was also a humongous 40% of intangible capital.

All rested upon the fame of Jamie Dimon and his plain magic turnaround of BankOne since 2001. Jamie Dimon becomes CEO of JPM-Chase-BankOne in early 2006. And clashes start with the regulators….At the time, regulators require in public reports to disclose the ultimate Fair Value that the firm sets for its ‘total net derivatives receivables’. So far the bank only produced the ‘net receivable’ value and ‘net payable’ value that was obtained after routine collateral adjustments. That was NOT the ultimate fair value that would enter the accounting ledger and contribute to the reported earnings figures. Thus investors had no chance to see what the senior management had set through the ALCO stage for its final fair value adjustments. Dimon is in a hurry. He builds up the CIO, recruiting Macris and appointing Drew to report to Dimon straight. And Dimon prepares his strategic hedge on credit derivatives to go for early 2007. He then also becomes board chairman in early 2007. Then regulators require the bank to publicly report 4 new things:

- more details on what is called ‘time deposits’,
- more details in intangibles with a focus on “deposit intangibles”,
- a better description of the ‘trading revenue’ as the bank sees it through the label “Principal transaction”
- and details about the “fair value election” process inside the firm whereby the ALCO and risk management reallocate the derivative gross revenue to different businesses inside the group

The big “tranche tail hedge” of CIO is not enough by far. The subprime crisis is well started by June 2007. Dimon then starts a huge buying program of CLO and ABS tranches through the summer of 2007. The orders from Drew and Macris via Artajo are already about unwinding the ‘tranche strategic hedge’ with a view to reduce it at the maximum. Their focus is especially to unwind the protection on subprime and remove the protection on super-senior tranches. The theme conveyed within CIO at the time is that the subprime crisis is growing but irrelevant soon. People are scared and come to deposit their money with Jp Morgan. The bank is flushed with “excess liquidity” but not enough “Net Interest Income” is generated to pay the bills. The strategy at CIO is therefore to get rid of the “tranche tail hedging book” that mobilizes too much cash and capital and invest in AA-AAA tranches of CLOs which are “yieldy” but quite illiquid anyway. The target set by Dimon then is “Libor+70Bps” or “LIBOR+65Bps” or “even LIBOR+60bps” for AAAs…This is a project that Dimon personally monitored since July 2007 with the help of an accountant named Jon Masur at Jp Morgan. Maybe CIO will also buy single A CLO tranches if needed.

At the end of 2007 the earnings are at a record high but the tangible equity for shareholders lies within “other assets” still, the operating costs to refinance the debt or unwind the exposures have exploded and the share price starts declining due to the growing financial crisis. The yearly reporting rule known as SFAS 107 displays a relatively aggressive assessment of senior management on Fair Value.

This reporting of SFAS 107 has existed since 1999 at least. It requires the bank to report its final appreciation or depreciation of the bank assets and liability values. One has to understand that once the bank has run its models after finalizing the mark to market prices, the mathematical output value of the 'assets' does not match exactly the value of the 'liabilities' generally speaking. This is just a byproduct of the use of mathematical risk models to reallocate performances between units. Now, in order to present a sensible consolidated balance sheet, the ALCO has to adjust the fair value of the assets and/or the fair value of the liabilities one last time so that they fit one against the other. This is final adjustment is what the SFAS 107 rule requires to show. JpMorgan used to be conservative to the tune of $1 to 2 bln, underestimating the value of its assets or/and overestimating the value of its liabilities overall. But in late 2007 the bank only underestimates its balance sheet by a net $0.9 billion. No big deal so far but it adds to other lasting structural concerns being themselves aggravated by 40% intangible capital while an economic crisis is building up. What is the cushion of capital or liquidity that JpMorgan really has if its share price dives? There is no comforting answer.

The year 2008 is the most tumultuous year in man's memory maybe since 1929-1930. Regulators will call Dimon to hastily absorb Bear Stearns for a dime in March 2008. Regulators again will call Dimon to become the global custodian of Lehman Brothers in May 2008. The regulators again call Dimon and Drew to work in the tri-partite repo issue in July 2008. The regulators once more rely on Dimon to to sail through the organized bankruptcy of Lehman in September 2008, and to absorb the largest surviving savings and loans bank "Washington mutual" in October 2008. Jp Morgan will be granted an exceptional discretion in booking acquisition reserves in connection with the recent operations with Bear Stearns and Washington Mutual. At the end of the year 2008 Jp Morgan is one of the very rare banks that could publish a profit, albeit small for the year 2008. Dimon stated $5 bln net profit. But as the SFAS 107 reporting rule showed, Dimon had overestimated the value in his balance sheet by some $15,5 bln. That is brand new! Had the senior executives (the ALCO) been applying the conservative stance they had had in say 2007, the bank would have actually printed a loss of some $10 bln for 2008, not a profit of $5 bln. This is the moment when the huge $50 bln Ponzi scheme of Bernard Madoff is uncovered publicly. Madoff too was overestimating his balance sheet somehow. Jp Morgan happened to be one of the main custodian of Madoff fraudulent funds, ie some deposits that Jp Morgan may have been using at his CIO that were in fact the non-existent ones of Madoff to the tune of $50 bln potentially! That mixture of "Dimon not having the excess liquidity while CIO allows the IB traders to take 25% more risks" is just a possibility but a scary one.

New reporting rules for the public are required: the bank will have to provide the SFAS 107 ultimate assessment every quarter looking forward. In Q1 2009, order at CIO is given to buy as many assets as possible at a distressed price and to position the 'tranche tail hedge' for a coming economic recovery. Is this really the "worse case scenario" for Jp Morgan, that the economy recovers fast and soon? The daily Var of the "tranche tail hedging" book will spike at around $160 million at the end of Q1 2009 with Ina Drew's full blessing. A tiny $30 million liquidity reserve is set for the "'tranche tail hedging book" then. For Q2 2009, the firm still overestimates the balance sheet by $10 billion as per the SFAS 107 reporting rule new guidance. Order is given at CIO to keep buying assets like CLOs and other illiquid bonds. Order is also given by Drew to now reduce the Var of the tranche book by taking profits only where profits can be realized. Drew also orders to leave the losing money positions for better days. Ina Drew coined it as "Let's not throw money out of the window ". At the end of Q2 2009, Dimon states that he wants to pay back the TARP money that had been lent by the US Government at the end of 2008. To do that Dimon issues shares and debt: he does not have extra cash at hand. The regulators in Q3 2009 request JpMorgan to include the CIO VAR in reports next to the IB VAR as the CIO "tranche tail hedging book" provides a massive 25% diversification benefit to the firm. In short, thanks to the "CIO tranche tail hedge" the Investment Bank traders can take about 25% more risks than they would without this "CIO tranche book". ! That mixture of "Dimon not having the excess liquidity while CIO allows the IB traders to take 25% more risks" is just another possibility but a scary one again.

This is especially the case on credit derivatives. Here the IB traders of Jp Morgan take the lion share in the CDS markets as the competitors operate in limbo. Jp Morgan is able to price at its convenience at the IB all the needs to unwind former CDOs that are expressed by its clients. This is as much additional real trading profits that the bank will make through its customers operations at the IB thanks to the CIO "tranche hedging book" diversification effect. Dimon said it on and on: size matters. At the end of 2009, the profits are comfortable but the bank still overvalues its balance sheet on paper by $7 bln. This is $8 bln less than at the end of 2008 but still it is an over-appreciation on the face of it that is unmatched in historical records at Jp morgan apart from 2008. As if by coincidence the reporting rules for the public change again for 2010 onwards: more details are required about credit derivatives fair value constituents while the provisions for credit losses grow and as the litigation reserves explode. The CIO is then embroiled in a toxic litigation with an SIV called SIGMA where John Hogan is involved too at the IB. More, for 2010 JpMorgan will have to disclose how the external auditors PWC analyze the actual balance sheet and the actual Net Interest Income (NII) of the bank. It turns out that PWC and Jp Morgan will not have the same size for the balance sheet and will not inventory in particular the same amount of "trading assets". There is a constant mismatch of around $30 to $50 billion between PWC and JPMorgan. What JP labels as "interest bearing trading assets" are rather labeled as "receivables" among "other assets" for PWC. On the liabilities side, where one can see how those "trading assets" are financed, it seems that Jp Morgan sees more "deposits" than PWC and some additional "other borrowed funds". Both labels suggest debt of a special nature that is not defined in time. All this, assets and liabilities, suggests some "basis or skew" exposures that are not valued running through standard collateral-clearing daily routines. To which extent are they consolidated? How is it done since this is "unaudited" actually by PWC? These strange "deposits" or "other borrowed funds" alternatively may well be some collateral postings that are here as "reserves" to offset market "noise".

The reserve figures and the actual "excess liquidity" available at the bank for CIO to invest must be reviewed. The bank is well aware that credit indices and tranches have become much more illiquid in the foreseeable future. The warnings were many. At the end of 2009, the CIO traders reported both to CIO management and financial officers that it cost about $300 million to unwind 20% of the positions in the markets in the very best conditions. A CDS expert, Evan Kalimtgis is recruited by Macris and Drew to scrutinize the liquidity risks at CIO. He will take over the analysis that will determine in the future the trades that will be done on the "CIO Tranche tail hedging book". This is his first mission at CIO as he explains it to Iksil face to face then. With Kalimtgis in the walls of CIO reporting straight to Macris, the CFO decides for 2009 year end to re-integrate this $300 million trading/execution "cushion-reserve" into the estimate P&L report despite the request of Iksil to roll this cushion into 2010. CFO and CIO management therefore know that unwinding the "CIO tranche tail" hedge would cost at least $1.5 bln at the end of 2009 in the best market conditions. Around March 2010 (see US Senate report), the CFO of Jp Morgan, Mike Cavannagh sets the "off the run rule" that applies already to the IG 9 index and associated tranche positions. This index is now deemed "less liquid" looking forward something which, as per the firm's valuation policy enacted in 2007, calls for a liquidity reserve. Assessments are made monthly by Jason Hugues about the amount of this reserve based on IB formula that wrongly so use "market volatility" while they should instead be based on "bid-offer" spreads. As a result any computation of Hugues vastly underestimates the actual reserve that is needed for “off the run” exposures. Hugues and CFO are aware of this since the end of 2009 through their decision to NOT roll the “$300 million cushion” into 2010. Right then in March 2010 also, Cavanagh comes to the CIO London office and meets with many executives and portfolio managers. He has just finalized the “off the run rule” that concerns the IG9 index and other indices present in this tranche book but he does not need to talk to “THE trader”. No, Cavanagh the CFO does not try to talk to Iksil at all even though the “CIO tranches tail hedge” weighs in VAR terms 40% of the whole VAR of JpMorgan in total. Cavanagh will meet with Artajo though.

Few days later Dimon pays a visit to CIO London. Here Iksil is invited to a round table along with a dozen people of CIO London. It is the only time Iksil and Dimon will talk together. Answering Dimon’s question about what Iksil did here at CIO, Iksil will reply that he is dealing day to day with the “nuclear wastes” of the markets in credit. Dimon will smile and move on… At the end of Q2 2010, Hugues have come monthly to enquire about the liquidity in the CDS markets. It is getting worse and worse as Hugues hears from Iksil and others. Iksil reports to Artajo and Macris that it is not any longer possible to unwind the positions, whichever “off the run” or “on the run” they are, at almost zero cost. It is going to cost a lot and once again the “$300 million cushion” of late 2009 serves as reminder. Meetings occur between Artajo, Macris and Drew without Iksil. Macris ultimately coins the new strategy adopted by CIO for its “Tranche tail hedging book”: they will “land the plane” which in practice for Iksil will be to let the legacy positions expire or be unwound only on opportunities as they show in the markets at times. These are the instructions of the time.

Iksil must report to Artajo on weekly basis and risk management upon what he has been able to reduce and how much it has cost. This book is thus already in what is called a “run off” mode. In Q3 2010, Ina Drew and Artajo decide to launch in September in the “tranche tail hedging book” an investment based in equity derivatives expressing the future dividends of the main stock indices like the S&P500 and the EuroStoxx50. Hugues stops asking traders about their observation of the liquidity in the markets, especially on the IG9 index. Apparently Hugues simply stopped estimating the liquidity reserve associated with the “off the run” rule instaured by Cavanagh. As the US Senate report (march 2013), the final notice of “Macris Vs FCA” (February 2016) and the OIG report of October 2014 mentioned, Jp Morgan may be quite complacent about this ‘CIO tranche book’ but the watchdogs are quite worried, intrusive and demanding. The OCC meets several times about the CIO and ultimately issues an MRA bearing, among other topics, on the valuation practices in force at CIO. The FCA issues in November 2010 a “close and continuous supervision” requirement with regards to CIO, highlighting among other things this “correlation book” that is “concentrated”. The Federal Reserve has in store 2 investigations bearing on the CIO activities that it plans to launch in 2011.

In 2010 the profits will hit new highs and the ALCO will stop overestimating its balance sheet as the SFAS 107 reporting rule shows. However, the operating costs keep growing and so is the financial leverage of the balance sheet that itself it huge. More, as it turns out in the annual reports of 2010 and 2011 the stated “excess liquidity” of Jp Morgan is “only” of $262 bln while CIO investments based on this “excess liquidity” amounted to about $310 bln, ie $50 bln too much. This concept of “excess liquidity” or “global liquidity reserve”, supervised by Mike Cavanagh, treasury chief in late 2010, appeared in the annual report of 2010 and 2011. This is just by coincidence since the concept will vanish for good in the annual report of 2012, replaced by the concept of “HQLA” or “High Quality Liquid Assets”. How then, being so specifically focused on those figures at the time, could Cavanagh and CIO be so wrong on the “excess liquidity” available at the firm back in 2010 when he allocated the proceeds to be invested by CIO on behalf of the whole firm? The Task Force Report of the same Mike Cavannagh will totally omit the issue in January 2013. Mike Cavannagh shall not mention once his “off the run rule” when he was the firm’s CFO. Mike Cavanagh will also omit in his Task Force

Report to explain how the collateral was managed inside Jp Morgan on behalf of the "CIO tranche tail hedge" book that weighed regularly 40% of the firm's VAR since 2007. The worse issue for Dimon in late 2010 is that the share price trades below the book value a sign which can be interpreted as "the business model of Jp Morgan is obsolete". Size matters and the bank is among the too big too fail ones then while the US economy only starts recovering. Dimon starts a massive share buyback program: is it a face saving move only? Iksil is promoted although his role does not change by an inch as Artajo coined it: "Don't get over it! it is a chocolate medal. We don't want you to leave. That's all."…Not yet, indeed…It is another coincidence that in December 2010 the Federal Reserve runs its stress tests and that in January 2011 the bank reports to the OCC that CIO had breached its stress limits due to trading activity attributed to changes occurring in the "tranche tail hedge" book. Too bad as the book was in "land the plane" mode, ie NOT trading. The Task Force Report of Cavanagh will have to admit that indeed this breach was due to activity that was NOT related to the "Tranche tail hedge" book. So what? The bank made a false report in January 2011 admittedly so, but who knows that today and who among the regulators publicly blamed the bank for that? It is another coincidence if in January 2011, reportedly from OCC staff, Ina Drew "sternly" replied to the MRA issued by the OCC. As the US Senate report describes without providing neither the MRA nor the reply of Drew, the CIO chief committed to make improvements for the investment books of CIO but not for the 'Tranche tail hedging' book. The CIO stress test breach, attributed to the 'tranche book', most likely was caused in fact by the decision of Drew to sell almost all of the US Treasury holdings that the CIO had had for years in the Past. As it will turn out, as per Kalimtgis account in 2012, this decision of Drew was fully endorsed by Dimon at the time. Back in January 2011, Drew will sternly remind the OCC that they should really turn to Dimon himself if they want more details from CIO. The OCC would not come back until late 2012 actually explaining that they had had "other priorities". Likewise, in February 2011 (see the IOG October 2014 report), the Federal reserve will drop its plans of investigation about the CIO of Jp Morgan. The change appears to have been decided by the LISCC committee. It was not due to "staffing problems" or even less due to "CCAR capital" priorities. The change though was driven by "other priorities" too. One will never know what those priorities were….In March 2011 the Federal Reserve will publish the results of its stress tests analysis and praise Jp Morgan. It is only by chance then that Ina Drew will come to CIO London Office in March 2011 to pressure Iksil to resume trading in order to reduce the RWA as computed under un-finalized and undisclosed Basel-III internal models of Jp Morgan. It felt like the "land the plane" strategy was somewhat over…There is a lot more to say about that. It is enough to know that Iksil then said that it was impossible to unwind the positions as the markets were more and more illiquid and inactive looking forward. This is when a project started around the future "strategy 27" to split the book into one "buy-and-hold" investment that would simply expire over time (90% of the book) and a remnant that would be unwound opportunistically if possible. The "run-off" mode took a more formal face then. This will be approved by Drew in June 2011 in a meeting where Iksil did NOT attend. **As it will turn out, had the bank simply finalized the projected and approved split of June 2011 and had the bank applied its own modeling internal arbitrage between the "CRM" and the "IRC" models, Jp Morgan would have achieved at the end of June 2011 a 40-50% instant reduction of the RWA-Basel III figure. As the book would have expired next, this reduction would have simply increased naturally at zero cost and without any need for additional trading. The "London Whale" scandal would never have seen the light of day and Iksil would not have been ordered to trade again and again.** At any point in time since March 2011, the senior executive could stop their orders and proceed with the planned split mentioned above. They never tried that or even suggested trying that after July 2011. This would have been costless for the bank and was precisely what Artajo ordered Iksil to work on in Q2 2011. This is how the "forward spread trades" would be designed and grown tehreafter. They were first suggested by Iksil for the split and subsequent run-off plan in March 2011. But next Kalimtgis, Stephan and Artajo would meet with Macris and Drew. They would change the initial risk profile proposed by Iksil and decide on the final proportions to be executed in the markets from July 2011 onwards. This was still just meant to operate an optimal split of the book at the start. It would become a scandal. This is mostly because Drew ordered to grow those legacy illiquid positions as early as July 2011. As per Artajo instructions conveyed to Iksil, she first wanted to grow the future investment in High Yield markets in 2011. Next she would want to grow the future investments in the IG9 markets in 2012. At the end of 2011, the picture on JP Morgan earnings looked quite "rosy" on the surface. But the share price closed at a 20% discount to the book value. Dimon had to do something here and fast!

Looking at the consolidated statement of cash-flows that the bank reports one notices that a $30 bln cash amount pops up at the bank in Q3 2011. As such the event is remarkable because since 1999, the JP morgan group had quite small net cash balances. Only in 2004 (BankOne Merger) and in 2008 (historic financial crisis) Jp Morgan had had a cash flow imbalance of about $15 bln. Compared to 2004 and 2008, this year 2011 instead looked pretty benign on the face of it. But surely this $30 billion announced in Q3 2011 that something big was in the making at Jp Morgan. This is NOT a profit yet though. It must back some sort of pending liability but the bank would not disclose what this was. At the end of September 2011 the controllers likely noticed that there was some $300 million of price difference between CIO and the IB about this "tranche book". Why is that? Because, in September 2011, the crisis in Europe had almost killed the liquidity in the IG9 index and the skew in particular. But if the $30 billion cash reserve is precisely here in anticipation of the coming collapse of "synthetic tranche" position across the firm, who is going to step in and complain? This is a $300 million mismatch in a context of $30 billion operation in cash that is about to close soon…. Well the problem is that the $30 billion operation had not closed yet by the end of 2011. The NY Federal Reserve in late December 2011 will express some concerns through its CCAR program as it runs its stress tests again. Surely it was told to drop its longstanding projects of investigation of CIO (OIG Oct 2014) in February 2011. It had ignored about this weird and misreported stress test limit breach of CIO that lasted through Q1 2011. It had dropped its 2 pending investigations on CIO and had praised publicly Jp Morgan in mid March 2011. But on 22nd December 2011 (see email of Drew in the US Senate report exhibits) the FED was concerned by the unwinding costs associated to the CIO "tranche tail hedging" book still. Internal estimates reached many $billion already (around $4-5 billion). The same difference of about $300 million will appear again at the start of December 2011, prompting Artajo to order Iksil to try unwind he "CIO tranche book" directly with the Credit Hybrids IB traders. They will turn Iksil down not even volunteering a price where they would care within the quoted bid-offer prices of the time. The reason why they turned Iksil down so stubbornly was as they said on a bloomberg chat: the market prices are not close enough to where they marked their books. Artajo would say that this is because the IB is sending bad collateral marks to CIO that caused several hundreds of million losses in $ for CIO. The same $300 million price difference will stick around at the end of December 2011 unbeknownst to Iksil at the time. He indeed was told otherwise by all his colleagues. And this price difference shall appear again but twice larger at the end of March 2012 actually and will become the alleged cause for the restatement of July 2012. And still in December 2011, despite the FED, despite the internal collateral issues, despite the need to urgently collapse positions of dead businesses looking forward, no one would step in at Jp Morgan to clean up the records, if one is to believe the legend…. Instead Iksil shall be instructed by Drew, Macris, Artajo to trade again and again… The senior management will thus cause massive risk limit violations as a result and vote for itself unlimited extensions against all the alerts of Iksil. It could thus only be a mere mischievous coincidence that the tranche market making business (lodged at "credit hybrids" also labeled "CH" by OCC staff in their May 2012 memo) had been closed at the IB in November 2011 and that the coming "take-down" of the "CIO tranche tail hedging book" would be announced to the OCC in December 2011 (see the US

Senate report account on the matter). To be sure "to take down" means "to dismantle"…. The curious reader could search the US Senate report account here and read about quite interpretative new definitions from John Wilmot or the OCC on this specific matter "in hindsight"…It remains that this was a long planned dismantlement that was reaching its final stage whatever the orders were in early 2012. This sudden $30 bln cash is testimony that something huge was about to occur at Jp Morgan at the end of Q3 2011. The tensions grew high in a project that was commanded by Dimon and no one stepped in to correct this price difference. The first part of the collapse was done with "credit Hybrids" in Q4 2011, the second part with the CIO "tranche book" would happen in early 2012. It would be delayed one wonders why really. Ultimately Dimon would step in through the media in April 2012 onwards with quite ambiguous characterizations. The success of it all depended upon where the IG9 skew would be priced. The IG9 skew, thanks to the media legend, went to zero exceptionally so. As it would turn out, those $30 billion of cash would then become a minimum of $25 billion gain of tangible capital after Q2 2012 and some other profits as will be shortly explained below in the following section….

Did Jp Morgan lose money on the back of the $5.5 to $6.3 billion sure loss recorded at its CIO?

The short answer is : "The bank probably made an extra net gain of $1 billion in the first 2 quarters of 2012 thanks to the media event". It matters to remind that JP Morgan reported ultimately the earnings figures for Q2 2012 at the very level that the bank had pre-announced before the "London Whale" scandal emerged. Yet there was a massive loss inside JpMorgan. This unquestionable huge loss occurred at CIO. Where was the balancing gain coming from within the bank then? There surely was a gain. Dimon provided his own "interpretation" of this gain at the time…. A finer scrutiny would show that this "interpretation" is mostly made of smokes and mirrors, decoys or diversions: most of it was made of quite partial descriptions that did not provide the real picture described above…. There is more than meets the eye here, beyond the headline earnings figure that printed exactly as expected despite the scandal, and the subsequent "explanations" of the firm's CEO…. As sure as the CIO did record-report-elevate a massive loss inside the firm, growing relentlessly starting from January 4th 2012 and onwards all along until June 2012, this reported loss was based on observed market prices and their changes over time. However the bank itself did NOT record such a loss ultimately as the 10-Q filings of the firm show actually when only the market "mid prices" are considered. The loss that the firm stated as "a credit derivatives trading loss" was no such thing as far as the net bank exposure was concerned, if one only considers the recorded consensus market "mid prices". It is easy to check since the initial impact of those "mid prices" is actually reported in the 10-Q filings of Jp Morgan under the labels "Gross derivative receivables" or "gross derivative payables" (search 10-Q PDF for "not designated as hedges" to retrieve the table and remember that CDS "designated as hedges" are typically not netted through ISDA agreements since they are associated with a specific asset to hedge- CIO trades were NOT "designated as hedges" and therefore were netted through standard ISDA procedures all run from within the Investment Bank of Jp Morgan. This netting mandated an agreement on the "mid price" and a centralized process for the adjustments running at the IB through the whole firm). To be sure, the firm had a "benign" net gross loss of about $1.5 bln before the firm's internal risk model operated their performance attributions. More, by comparing the Q1 2012 original 10-Q report and the "restated" 10-Q for Q1 2012 one can verify that the alleged faulty price difference only caused a change in the bank reports for the "gross netted derivatives" figures. Looking at those "gross figures" , "not designated as hedges", netting them with "enforceable collateral agreements", one will find out that the ultimate $5-6 bln loss reported in the 10-Q reports was only the result of a 'last minute' senior management attribution that was done in the very end of the valuation process. This $6bln loss came up indeed within the valuation process of JpMorgan at the very end of it, AFTER "mid prices" had been collected and applied, AFTER collateral adjustment had been made through ISDA netting rules, AFTER the internal risk models had re-allocated the performance across the business lines, AFTER the reserves had been reviewed. At this latter stage it turns out that the firm was in fact recording a profit on derivatives taken as a whole. It can be tracked through the key word 'fair value' in the PDF 10-Q filings. There is no mystery made about those many valuation stages that Jp Morgan follows to reach to the ultimate "fair value". This 'fair value measurement' process is described in every contemporaneous 10-Q filing of Jp Morgan. One cannot retrieve all the stages involved of course but one can definitely obtain an accurate fair value estimate based on market "mid prices" and basic routine collateral operations. One can also access the 'estimated fair value' computed by the risk controllers that still is not the 'carrying value' which is the one that the bank Jp Morgan ultimately will report on the consolidated balance sheet and uses for the net income. And this 'carrying value' is NOT necessarily in line with the 'principal transactions' figures that the firm based its statements upon for the "London whale" trading loss case. Thus, as a way of summarizing it, AFTER all the stages mentioned above indeed, including the 'fair value adjustments', the bank runs a last analysis and one last performance attribution under the oversight of a committee of senior bank managers (called the ALCO by the regulators in some of their emails- see the OCC emails exhibited with the US Senate report). This ALCO committee sets the final fair value figures across the board for the firm as a whole. Looking at the 10-Q figures provided by JP Morgan and its credit derivative receivables and payables, one can see that this is only at the last ALCO stage that the $6 bln loss was allocated to the 'tranche book of CIO' at the full discretion of the bank senior management. Neither the actual market prices applied to the net bank exposures, nor the mathematical and planned risk attribution run through the existing models in force at Jp Morgan indicated such a loss in fact. To show this, one simply has to gather the data provided by JPMorgan in its 10-Q reports about the credit derivative notional exposures, netting exposure (FIN39 for the experts) and follow the track down to the ultimate reported 'fair value' that the firm conveys through its 'level 3' analysis part as the "carrying value" reported on the "consolidated Balance sheet".

Some facts corroborate this conclusion…One has to notice for example that JPMorgan would have unwound almost nothing of the CIO 'tranche book' in the markets themselves while quite officially getting rid of some 80% of the position before the end of June 2012. JP Morgan reportedly got rid of the exposure of CIO but DID NOT unwind it in the markets….And subsequently Jp Morgan produced record earnings in 2012 under the watchful eye of all the authorities being highly concerned in this scandal. More the bank recorded close to $25 bln of increase in tangible capital that directly benefited the shareholders of the bank in 2012 while the CIO would be dismantled. For the first time in 2012 since the record bonanza year of 1999, the tangible common equity of the firm was not entirely dependent upon the fair value of what Jp Morgan labeled as "Other asset" in its consolidated balance sheet…. This may be a coincidence although Ina Drew explained face to face to Iksil and others in London in March 2011 (yes in the year 2011, not the year 2012) that this was precisely one of the goals that Jamie Dimon had set for himself since late 2010 actually…She had then this expression: " Jamie wants to return money to shareholders. Priority No 1"... Which employee would dare fight such an endeavor? Which employee would thereafter doubt that all the orders he would receive, no matter how counter-intuitive they would appear to be, were going in that direction? As to the late restatement of some $500 million for Q1 2012 (first quarter), one should carefully search the 10-Q for Q2 2012 (second quarter) in PDF format for the P&L that the bank recorded on 'Maiden Lane'. The Federal Reserve of New York was heavily involved in that "maiden lane" transaction since 2008. The Federal Reserve was even trying to trade in the notoriously illiquid credit markets since 2011 on behalf of the "Maiden Lane" schemes. The NY Federal Reserve staff came across big execution issues then. The fact is that the bank Jp morgan reported a gain of some $545 million on "Maiden Lane" that it recognized in Q2 2012 as balancing the "CIO loss for Q2 2012". But in fact this gain, see the Q2 2012 10-Q filing of Jp Morgan, was actually recorded in Q1 2012. Thus, had the bank simply reported the $545 million recorded in Q1 2012 for Q1 2012 and not in Q2 2012, there was no need for a restatement as such, even though a liquidity reserve had been missing anyway for existing price differences persisting inside the firm. More, one will see that in the "deferred Tax Benefit" line on the "consolidated statement of cash flows" table, the bank reported a $1.47 Bln EXPENSE that it labeled mistakenly in August 2012 as a "benefit". For those who are curious Jp Morgan had reported a real $444 million "deferred tax BENEFIT" for Q1 2012, an outstanding $1470 million "deferred tax EXPENSE" for Q2 2012 and a more nimble $755 million "deferred tax EXPENSE" for Q3 2012. One has here figures that were provided on a "year to date" basis. If one tries to figure what the number for Q2 2012 could have been "in hindsight" using Q1 and Q3 figures, one would arrive at (-444+755 divided by 2, or a $155 million deferred tax EXPENSE for Q2), one understands that the firm overestimated possibly the expense at the time by some $1.3 bln. This is as much that the firm may have been able to report through its earnings for Q1 and Q2 2012 "in hindsight" altogether without doing anything crazy. This $1.3 bln amount sounds like a gain that went unreported at the time. The labeling mistake, printing a "benefit" while it was an outstanding "expense" actually is unique in the 10 year record of reporting of Jp Morgan…. Was it another coincidence after the $25 Bln gain in tangible capital or else? Thus, here Jp Morgan apparently inflated its actual "deferred tax expense" by some $1.3 bln since it will revise down the "expense" in Q3 2012 while printing even more profits for the year 2012 going forward. Thus, had the bank simply reported say a $150-250 million "expense" correctly labeled rather than a $1.47 bln so called "benefit" and reported the Q1 2012 $545 gain of Maiden lane in Q1 2012, no restatement would have occurred. More the bank would have even beaten its own initial earnings forecasts of the time both for Q1 (by say $100 million since the ultimate restatement was about $450 million only) and Q2 2012 (by about $1.2-1.3 million)! This result only required that JP Morgan allocated a Q1 2012 gain in Q1 2012 and that Jp Morgan did not overestimate an expense that it labeled mistakenly and uniquely as a "benefit". This "London whale" loss at CIO would have looked then for what it was: a bonanza gain for Jp Morgan. The subsequent 10-Q and 10-K reports will only confirm this gain as will be shown in detail in this website later on.

The year 2012, far from being a catastrophe, was quite a unique successful vintage for JpMorgan since 1999 and would still look like the best one year on the record in 2017 when the tangible capital generation is considered. One would then better understand why, back in 2012, the bank simply did NOT plan to unwind the position of the 'CIO hedge' in the markets…It was already positioned to make a profit on the long planned "CIO tranche book" transfer to the IB and to hedge funds. This sheds quite a different light upon the events that are described through the media coverage part before. This implies for example that the positions offsetting those of CIO were already present in the firm, valued by the IB (the Investment Bank of JpMorgan). And this suggests that the loss at CIO was not such a worry as far as the bank earnings were concerned throughout the period covering Q1 and Q2 2012. One may then rightly conclude that the losses at CIO were balanced everyday by quite equivalent known gains somewhere else inside JpMorgan. Hence nothing had been left to chance way before the rumor and the articles got to press in April 2012.

As to the mismarking and the actual accounting fraud a lot has to be said. Irrespective of the fact that JP Morgan made a lot of money even at the time of the "London Whale" event, a mismarking of some $500 million allegedly occurred in March 2012 for month end. It is not at all about arguing that there was no mismarking. There had been a big one mismarking in the books of the bank but not the one that the bank has portrayed so far. Some facts need be put into plain light on this matter. They will be further developed but here are the cornerstones already:

1- **The CIO 'tranche book' c**ontained either credit index positions (of which the famous IG9 10 yr index) or index based tranche positions. To process an estimate P&L daily the CIO had to pick about 100 prices spread between credit indices and index tranches that all used to be quoted by JP Morgan Investment Bank (IB) traders day to day. The IB of JPMorgan was one of the world's top dealer on those products since 2004 quoting those instruments to its many clients worldwide. CIO notoriously differed from the IB in its processes for structural, known and visible reasons (search for "GCB", "Treasury", "liquidity reserve" or "excess liquidity" in the PDF annual reports of the time). The fact is that JpMorgan had no need for CIO to select 'mid prices' for the purpose of valuing the "CIO tranche book" that was at the center of the "London Whale" case. All those prices were provided by the IB daily anyway and were applied mechanically across the firm if only for collateral management purposes (see the DCM platform). But things changed at the roots in Q4 2011. The IB tranche dealing business closed its activity in November 2011 and moved its legacy exposures to hedge funds like Blue Mountain in early 2012. The same kind of transfer was spontaneously organized by Ashley Bacon (deputy firm wide Chief Risk Officer), and finalized no later than the 12th March 2012. The projected transfer of the CIO tranche book was operated in part by Olivier Vigneron (former co-head of the tranche dealing business of the IB until late 2011 when it closed down). Thus between December 2011 and March 12th 2012, the question inside Jp Morgan already was only to know at which price the CIO "tranche book" would be transferred: CIO price or IB price…..The difference was known and actively debated then.
2- **The March 20th estimate P&L report**, the call of Martin-Artajo that day to Iksil and the famous **'distance spreadsheet'** were quite significant alerts regarding these price differences. They were by far not the first ones. **The US Senate report account** of Ina Drew "emotional statements" and reversals on the matter is worth a read. **The April 17th call** of Ina Drew to Javier Martin-Artajo shows the decision process that was in force in valuation terms at CIO (US Senate report exhibit). All this was "cathartic" but not so much "emotional"….All this called for liquidity or/and concentration reserves to be taken. They were missing since 2009. **The internal audit report of JpMorgan** (drafted in December 2011) would usefully confirm this blatant absence of reserves (US Senate report exhibits), irrespective of the price differences being actually observed. An action plan was undertaken by CFO with continuous monitoring (RAG process in JP Morgan jargon) since January 2012 on those well flagged matters relating directly to CIO mandate in the firm and investments made in the markets.
3- The CIO did not manage its day to day operations on collateral and margin calls. The Investment Bank (the IB) was in charge of the job on behalf of CIO. CIO elevated its potential P&L difference with the IB quite loudly as **of 23rd March 2012**, ie way before the month had closed. The evidence of this is present in the exhibits of the US Senate report (search for Daniel Vaz, Mark Demo and Collateral dated around April 20th. See also the key email chains on **the 23rd March and the key conference call between Daniel Pinto, Achilles Macris,** and Javier Martin-Artajo). In front of potential but toxic dangers, Pinto was assertive from his IB chief role and his JP morgan UK CEO position: the books were NOT mismarked in March as far as market prices and routine collateral management procedures were concerned…..He had many reasons to be so assertive. They come right below….
4- **The CIO used "ICE" as a clearing agent daily for most of its credit index trades**, as per the firm policy in place since 2011. This means that ICE set the price for the recorded CIO exposures day to day and conveyed this price to the bank for generic application. **Most of the ultimate restatement was based on internal price differences existing on credit index positions that were actually cleared by ICE daily**. Thus ICE was reconciling the differences of CIO versus the market players at least, including the IB of JPMorgan which was the main market counterparty of CIO on many large exposures. The ICE reports as a routine therefore supported the elevations of CIO staff towards the Bank's top. The bank officially participated in ICE and therefore had committed to apply ICE prices across its books. This was the very reason of being for this clearing house as wanted by the regulators. This was the very

commitment of Jp Morgan when it had opted to participate in ICE processes. As to the CIO, it had to step through the IB teams to feed ICE with CIO's trades. The IB thus had the full picture of the clearing process that ICE did on CIO recorded exposures and recorded instruments.

5- **The CIO had open trades in front of the Investment Bank of Jp Morgan on a vast majority of instruments** to be valued each day by the bank as a whole (likely 90% or more). Here, irrespective of ICE reports, the bank could have only one price so that no fictitious gain would be created between the 2 entities of the same firm inside the firm itself. This is basic standard control practice, irrespective of whether each business unit keeps its price on its side. The overarching firm had to process the adjustment when consolidating businesses like CIO and the IB on its balance sheet. There is just no need for ICE check here as this is one key requirement meant to avoid basic "Ponzi Scheme" frauds. Thus combining this point with the scrutiny of ICE only a very small part of the CIO tranche book exposure could have escaped the routine reconciliation and adjustments operated by the IB on behalf of CIO inside Jp Morgan for valuation purposes. Jp Morgan since 1993 has been the well recognized one leader in the banking industry in setting the valuation practice standards to avoid this kind of loopholes (see the 1993 "group of 30" report chaired by Paul Volcker and the JP Morgan CEO Denis Weatherstone for reference). This explains why Pinto sounded so ironic in front of CIO managers on this March 23rd 2012 call. CIO chiefs would complain as much as they wanted but IB was in agreement with ICE and with market counterparties on behalf of CIO. There is even more as shows next….

6- **The CIO did NOT apply "standard industry practices". The fact was notorious inside Jp Morgan on index tranches and on the absence of a defined closing time**. Thus CIO had just no ground to question the validity of the IB job that was done by the IB on behalf of CIO. The latter point, the closing time, though is one salient requirement of US GAAP standards and firm policy standards. This is one more compelling argument to show that JpMorgan had to reconcile CIO practices and US GAAP standards anyway. Yet CIO practice in itself was the simplest one that one could figure about the index tranches. The adjustment was thus mandatory and straightforward since CIO had a simple, transparent but non-standard process. This "non compliance" with regards to US GAAP and firm policy was known to the bank since 2010 at least and internal auditors did NOT request a change on those aspects in late 2011 while noticing them still. This "non compliance" was NOT part of the CFO RAG action plan. There was no intent at Jp Morgan to stop this "non standard" aspect about the missing "closing time" or the pricing of index tranche positions (for sure when it is about the estimate P&L report produced by the "traders" of CIO). The May 10th 2012 report of the controllers of JPMorgan was therefore alleging things that were not correct in that regard (the report is to be found in the US Senate report exhibits through a search on "Allistair Webster"). This "non compliance" would also show that the collateral dispute that the IB staff elevated as of April 19th 2012 has been quite misleadingly portrayed so far since it was solely based on this notorious "non compliance" of the CIO in the bank with standard practices of the industry. As such the IB collateral teams should never have elevated the dispute in the form they elevated it basing here the issue on the tranche pricing of CIO. They knew CIO did NOT apply the appropriate industry practices. They instead should have merely done THEIR job as they used to since 2007 until April 18th 2012.

7- The price differences were captured and reconciled each day numerically by the collateral IB teams (see for indication the DCM platform process in force at JpMorgan which Mark Demo was taking care of). **Based on the different events between late November 2011 and early January 2012 one would come to the conclusion that this $300-500 million internal difference in P&L for the CIO tranche book (depending on whether the P&L was estimated with CIO prices or with IB prices on the same instruments) existed in November 2011 already**, ie 4 to 5 months before the alleged mismarking date based on this P&L difference here.. The year 2011 therefore closed with a similar magnitude of known mismatch. **<u>Yet no known fair value adjustment was added to the "CIO tranche book" in either November 2011, December 2011, or in the months that followed until July 2012….</u>** Why is it that it is for March 2012 only that it is alleged in the accusations that the mismatch was allegedly NOT adjusted as it should have been? Was the December 2011 valuation simply right in fact since the price difference was there already? Given that the same difference likely existed since September 2011, was the Q3 2011 10-Q report accurate despite the net $30 cash-flow ?

CONCLUSION: All the elements above were known to many of the market watchdogs before the 'London whale" emerged. Jp Morgan, its CIO, and its "tranche book" were all the more so under close scrutiny as the authorities were very suspicious since 2008. But neither the employer Jp Morgan nor the authorities felt the need to talk to Iksil all those years. Jp Morgan made a fake promotion for Iksil to fall more easily and for the senior management to make some huge questionable gains. At the end of the day the markets were manipulated in such a way through the media that Jp Morgan maximized its profits on its skew exposures and therefore maximized the tangible capital generation that Dimon had orchestrated since late 2010 across the bank. In that the CEO succeeded after a decade of frustrating former attempts. In return for regulators truce, Dimon paid fines that some would call 'historic'. But, as the Economist rightly titled "When the fine is a crime", there is a lot more to say on that outcome….. This "London whale" case will likely serve as jurisprudence in the future. And as of now the bank top executives feel they have a free pass to do it again whenever needed since the watchdogs are unlikely to condemn them. They just need a "fit for all" name to placate in the media actually.