

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 70458 / September 19, 2013**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3490 / September 19, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15507**

**In the Matter of**

**JPMorgan Chase & Co.,**

**Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTION 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934, MAKING  
FINDINGS, AND IMPOSING A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against JPMorgan Chase & Co. (“JPMorgan”).

**II.**

In anticipation of the institution of these proceedings, JPMorgan has submitted an Offer of Settlement (“Offer”) that the Commission has determined to accept. JPMorgan admits the facts contained in Annex A attached hereto, the Commission’s jurisdiction over it, and the subject matter of these proceedings; and consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order, the Offer, and the facts contained in Annex A attached hereto, the Commission finds<sup>1</sup> that:

1. Public companies are responsible for devising and maintaining a system of internal accounting controls sufficient to, among other things, provide reasonable assurances that transactions are recorded as necessary to permit preparation of reliable financial statements. In addition, the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) established important requirements for public companies and their management with respect to corporate governance and disclosure. For example, public companies are obligated to maintain disclosure controls and procedures that are designed to ensure that important information flows to the appropriate persons so that timely decisions can be made regarding disclosure in public filings. Commission regulations implementing Sarbanes-Oxley therefore require management to evaluate on a quarterly basis the effectiveness of the company’s disclosure controls and procedures and the company to disclose management’s conclusion regarding their effectiveness in its quarterly filings.

2. On an investor call conducted in connection with the filing of its quarterly report on May 10, 2012, JPMorgan publicly disclosed a trading loss of approximately \$2 billion since the start of the second quarter in a large portfolio of credit derivatives known as the Synthetic Credit Portfolio (“SCP”) held by the firm’s Chief Investment Office (“CIO”). In the quarterly report, JPMorgan stated that, based upon management’s evaluation at the time, its disclosure controls and procedures were effective as of the end of the quarter.

3. Over the next few months, as JPMorgan sought to bring down risk in the SCP, the losses in the SCP grew to nearly \$6 billion. Nevertheless, the full extent of the trading losses that had occurred during the first quarter was not detected and reported, in part, because of the ineffectiveness of an internal control function within CIO, known as the Valuation Control Group (“CIO-VCG”). Within JPMorgan and other financial institutions and investment firms, valuation control units frequently serve as an essential internal control by helping to ensure that traders and other market professionals record accurate valuations for trading positions. Valuation control units must be sufficiently independent from the trading desks, and clear and effective written policies are necessary in order to guard against the risk that a company’s investment assets will be improperly valued—and its public filings misstated.

4. In the case of CIO, its VCG unit was unequipped to cope with the increase in the size and complexity of the SCP in early 2012, and did not function as an effective internal control in the first quarter of the year. The unit was understaffed, insufficiently supervised, and did not adequately document its actual price-testing policies. Moreover, the actual price-testing methodology employed by CIO-VCG in the first quarter of 2012 was subjective and insufficiently independent from the SCP traders, which enabled the traders to improperly

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<sup>1</sup> The findings herein are made pursuant to JPMorgan’s Offer and are not binding on any other person or entity in this or any other proceeding.

influence the VCG process. In addition, during the first quarter of 2012, CIO-VCG failed to escalate to CIO and JPMorgan management significant information that management required in order to make informed decisions about disclosure of the firm's financial results for the first quarter of 2012. As a result, JPMorgan did not timely detect or effectively challenge questionable valuations by the SCP traders as the portfolio's losses accumulated in the first quarter of 2012 and publicly misstated its financial results for that period.

5. JPMorgan's response to the CIO trading losses also was affected by inadequate communication between JPMorgan's Senior Management and the Audit Committee of JPMorgan's Board of Directors (the "Audit Committee"). In April 2012, after learning of large counterparty valuation disputes relating to SCP positions, JPMorgan Senior Management initiated several reviews of the SCP marks and of CIO-VCG. By early May 2012, the various reviews had alerted JPMorgan Senior Management to serious issues about CIO-VCG's effectiveness in price-testing the values SCP traders had assigned to positions in the SCP during the first quarter of 2012. These issues, among others, prompted JPMorgan Senior Management to take several actions, including recommending delaying the filing of the firm's quarterly report with the Commission, and substantially revising CIO-VCG policies in early May 2012 to eliminate what Senior Management believed was an undue amount of subjectivity in a control function.

6. Consistent with Sarbanes-Oxley's emphasis on the role that the audit committee of a public company's board of directors should play in corporate governance, JPMorgan's internal controls include a requirement that its management keep the Audit Committee informed of, among other things, the identification of any significant deficiencies or material weaknesses in the firm's internal control over financial reporting. Such updates are necessary for the Audit Committee to fulfill its oversight role and help to assure the integrity and accuracy of information JPMorgan discloses in its public filings.

7. Before JPMorgan filed its quarterly report on May 10, 2012, however, JPMorgan Senior Management did not adequately update the Audit Committee concerning the facts learned during the reviews of CIO-VCG. Nor did it adequately update the Audit Committee on important observations made by the management-commissioned reviews of control breakdowns at CIO-VCG that amounted to, at a minimum, a significant deficiency. Three primary issues relating to the sharing and synthesis of relevant information contributed to the inadequate communications with the Audit Committee. First, several employees involved in conducting the reviews of CIO-VCG failed to timely escalate important facts regarding control deficiencies at CIO-VCG. Second, JPMorgan Senior Management was concerned about the market sensitivity of the SCP positions and the confidential nature of the review, and required that the review teams keep their work strictly confidential, which had the effect of impeding the exchange of information among the review teams and their ability to analyze collectively the information generated by these reviews. Third, despite learning of important information concerning control deficiencies at CIO-VCG, JPMorgan Senior Management did not make a considered assessment of the significance of that information to determine if it revealed a significant deficiency or material weakness at CIO-VCG that had to be disclosed to the Audit Committee.

8. On July 13, 2012, JPMorgan announced that it would restate its results for the first quarter of 2012 because it was no longer confident that the SCP marks used to prepare the

first quarter results, which CIO-VCG was responsible for price testing, “reflect good faith estimates of fair value at quarter end.” Also on this date, JPMorgan disclosed to investors that a material weakness in internal control over financial reporting had existed at CIO as of March 31, 2012 based on deficiencies in the CIO-VCG process.

9. On August 9, 2012, JPMorgan filed an amended Form 10-Q with restated results for the first quarter of 2012. The restatement had the effect of moving certain SCP losses from the second quarter to the first quarter. These misstated first quarter results were disclosed not only in the quarterly report filed on Form 10-Q on May 10, 2012, but also in JPMorgan’s earnings release for the first quarter, which was filed on Form 8-K with the Commission on April 13, 2012. Also on August 9, 2012, JPMorgan disclosed that its disclosure controls and procedures as of March 31, 2012 were not effective and that management’s prior conclusion in the firm’s May 10, 2012 quarterly report that they were effective was incorrect.

10. As a result of its failure to maintain effective internal control over financial reporting as of March 31, 2012, and disclosure controls and procedures, and as a result of its filing of inaccurate reports with the Commission (specifically, the Form 8-K filed on April 13, 2012, and the Form 10-Q filed on May 10, 2012), JPMorgan violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-11, 13a-13, and 13a-15 thereunder.

11. In response to the Commission’s investigation, JPMorgan provided substantial cooperation to Commission staff. JPMorgan has also voluntarily undertaken a comprehensive program of remediation to address, among other things, the internal control deficiencies that are the subject of this proceeding. Most notably, JPMorgan has substantially strengthened the valuation control function within CIO to ensure that price verification procedures are conducted with the appropriate degree of independence and supervision.

#### **IV.**

#### **RELEVANT ENTITIES AND PERSONS**

12. JPMorgan, a Delaware corporation headquartered in New York, New York, is a global banking and financial services firm whose common stock is registered with the Commission under Section 12(b) of the Exchange Act and traded on The New York Stock Exchange under the symbol “JPM.”

13. CIO is a unit of JPMorgan and part of the firm’s Corporate/Private Equity reporting segment. Among other things, CIO is responsible for investing excess deposits from JPMorgan’s banking arm. CIO maintains offices in New York, New York and London, United Kingdom.

14. JPMorgan “Senior Management,” as that term is used herein, refers to one or more of the following individuals who held the listed positions as of May 10, 2012: the JPMorgan Chief Executive Officer, the JPMorgan Chief Financial Officer, the JPMorgan Chief Risk Officer, the JPMorgan Controller, and the JPMorgan General Auditor.

## THE MISMARKING OF JPMORGAN'S SYNTHETIC CREDIT PORTFOLIO

### JPMorgan, CIO, and the Synthetic Credit Portfolio

15. In 2007, CIO created an investment portfolio, the SCP, which was designed to provide a hedge against adverse credit events. It invested in derivatives that could be expected to generate profit during adverse credit events, such as widespread corporate defaults. The positions in the SCP consisted of credit derivative indices and portions (or “tranches”) of those indices, both of which were constructed to track a collection of credit default swaps (“CDS”) referencing the debt of corporate issuers.

16. The SCP was invested in two primary index groups: CDX, a group of North American and Emerging Markets indices, and iTraxx, a group of European and Asian indices. Some indices referenced companies considered to be investment grade and others referenced companies considered to be high-yield (which generally means that their credit risk is viewed as higher). Investors in CDX and iTraxx indices, including CIO, can be “long” risk, which is equivalent to being a seller of CDS protection, or “short” risk, which is equivalent to being a buyer of CDS protection.

17. Beginning in 2008, the SCP’s investment strategy generally consisted of holding a net short risk position in high-yield indices and tranches, which meant that the SCP was positioned to realize gains if high-yield companies were to default on their corporate debt. The composition of the book changed from time to time in response to CIO’s assessment of market conditions.

18. In December 2011, in preparation for complying with the capital adequacy standards of the Third Basel Accord, the SCP traders were instructed to reduce the SCP’s use of regulatory capital. To achieve this—and, in light of improving economic conditions, to reduce the SCP’s credit protection profile—CIO management and the traders in charge of the SCP considered reducing the size of the SCP’s short risk position in high-yield investments. There were substantial costs associated with this strategy. To avoid these costs, CIO management and traders therefore decided to add investments to the SCP’s existing long risk investment-grade positions to offset the short risk high-yield position. However, as CIO built its long risk investment-grade positions, which included a large investment in an index known as the CDX North American Investment Grade Index Series 9 10-year, it also added substantially to its existing high-yield short position. JPMorgan did not have risk limits restricting the notional size of the SCP, and CIO’s trading strategy led to a large increase in the notional size of the SCP. During the first quarter of 2012, CIO tripled the net notional amount of the SCP. As of March 31, 2012, the SCP contained 132 trading positions with a net notional amount of approximately \$157 billion.

### Traders Mismark the SCP as Losses Mount

19. Like many other public companies, JPMorgan reported its results, which incorporated the mark-to-market profit and loss of the SCP, at the end of each quarter in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”). Under JPMorgan

policy, the SCP traders were required to assign valuations (or “marks”) to the positions in the SCP at fair value. Both GAAP and JPMorgan’s accounting policy required that the SCP traders do so by making a good-faith estimate of the fair value of each SCP position based on information available in the marketplace. Under GAAP, the positions in the SCP had to be marked “within the bid-ask spread” at the point that is “most representative of fair value in the circumstances,” with a particular emphasis on the price where the traders could reasonably expect to transact. GAAP also allows for the use of mid-market pricing “as a practical expedient for fair value measurements within a bid-ask spread.”

20. At the end of each business day, the SCP traders had to mark the positions in the SCP and report to CIO management a summary of the portfolio’s mark-to-market profits and losses for the day. Additionally, the traders had to provide their valuations for the SCP to the middle office at CIO so that the information could be incorporated into the books and records of JPMorgan.

21. The SCP generated sizeable profits for JPMorgan over the period from 2007 to 2011. In the first quarter of 2012, however, it began experiencing substantial mark-to-market losses. By early March 2012, the most senior SCP trader, who was a managing director within CIO, instructed the other SCP traders to stop reporting losses to CIO management unless there was a market-moving event that could easily explain the losses. In response, a junior SCP trader changed his daily marking methodology for the SCP. Previously, he had derived for each SCP position a bid-offer spread from dealer quotes he had received and then assigned a mark that was generally equivalent to the mid-point in that spread. In response to the most senior trader’s instruction, the junior trader began to assign marks that often were at the most aggressive point in the bid-offer spread received that day (*i.e.*, the point that resulted in higher valuations of the SCP positions). For some SCP positions, the junior trader assigned marks in March that were altogether outside every dealer’s bid and offer received that day. As a result of these marking practices, the SCP traders intentionally understated mark-to-market losses in the SCP.

22. In March 2012, the junior trader began to maintain a spreadsheet which showed that, by March 15, 2012, the difference between the daily prices he had assigned to the SCP and the average mid-market point between the best bids and offers he had received from dealers had grown to \$292 million. Within a few days, the difference had grown further to \$432 million. The traders, however, revealed significantly smaller losses in daily reports to CIO management about the portfolio’s performance than were indicated by mid-market pricing.

23. On March 30, 2012, the last trading day in the first quarter of 2012, the SCP traders informed the most senior trader in the morning that losses for that day alone could reach \$250 million. In response, the most senior trader directed the junior trader not to mark the SCP at the close of business in London, as JPMorgan policy required, but instead to wait for the markets in New York to close because trading information from New York might support higher valuations for the SCP positions.

24. The most senior trader also instructed the junior trader to use the “best” prices (*i.e.*, the most advantageous prices within the bid-offer spread) in marking the SCP. On March 30, the junior trader marked the SCP positions in accordance with these instructions, and reported to CIO management an estimated loss of \$138 million. Over the next several weeks, the

traders continued to understate mark-to-market losses in the SCP until their authority over the portfolio was taken away from them on or around April 29, 2012, when JPMorgan Senior Management asked a senior Investment Bank (“IB”) trader and senior risk officer to take responsibility for the portfolio.

### **JPMorgan Issues Its First Quarter Results and Subsequently Issues a Restatement**

25. On April 13, 2012, JPMorgan issued its earnings release for the quarter ending March 31, 2012, which was filed on Form 8-K with the Commission. Also on April 13, JPMorgan Senior Management conducted an earnings call with analysts and investors. The earnings release disclosed that JPMorgan’s consolidated quarterly income before income tax expense was \$7.641 billion. These results included the understated losses for the SCP, which was based on the SCP traders’ marks as of March 30, 2012.

26. One month later, on May 10, 2012, JPMorgan filed on Form 10-Q its report for the first quarter, which ended on March 31, 2012, disclosing that CIO had experienced significant mark-to-market losses in the SCP during the second quarter to date. Also on May 10, 2012, JPMorgan Senior Management conducted a call with analysts, during which the firm disclosed that CIO had suffered losses of approximately \$2 billion during the second quarter to date and that there could be additional losses, that the trading strategy that resulted in the losses was “flawed, complex, poorly reviewed, poorly executed, and poorly monitored,” that “we’ve had teams from audit, legal, risk, and various control functions . . . involved in extensive review of what happened,” and that “[w]e have more work to do but it’s obvious at this point that there are many errors, sloppiness, and bad judgment.” The \$2 billion calculation was based on marks for positions in the SCP that were derived from independent pricing sources and not from the SCP traders; therefore, the full year-to-date loss figure was not affected by its subsequent conclusions concerning the integrity of the SCP traders’ marks.

27. Two months later, on July 13, 2012, JPMorgan announced that it would restate its results for the first quarter of 2012 because it had discovered “information that raises questions about the integrity of the [SCP] marks” and was no longer confident that the marks used to prepare the first quarter results “reflect good faith estimates of fair value at quarter end.” On August 9, 2012, JPMorgan filed an amended Form 10-Q with restated results for the first quarter. The restatement had the effect of moving certain SCP losses from the second quarter to the first quarter. Specifically, the restatement reduced the revenues of JPMorgan’s Corporate/Private Equity reporting segment in the first quarter by \$660 million, from \$1.689 billion to \$1.029 billion, and the firm’s consolidated quarterly income before income tax expense from the previously-reported \$7.641 billion to \$6.981 billion.

### **JPMORGAN’S INEFFECTIVE INTERNAL ACCOUNTING CONTROLS AND DISCLOSURE CONTROLS AND PROCEDURES**

28. JPMorgan’s May 10, 2012 quarterly report on Form 10-Q contained its financial statements for the first quarter of the year, management’s discussion of the firm’s various businesses, and other information. In addition, the report stated that JPMorgan’s management

evaluated the effectiveness of its disclosure controls and procedures and concluded that they were effective.

29. As discussed below, between late April and May 10, 2012, JPMorgan engaged in an extensive process involving work performed by the Controller's office, the Internal Audit department ("Internal Audit"), valuation experts from the Investment Banking Division ("IB"), and in-house and outside counsel in an effort to evaluate the SCP's quarter-end marks and to understand the CIO valuation control process and the differences between that process and the valuation control process of the IB. As a result, by May 10, various executives and employees of the firm had learned of deficiencies as of March 31, 2012 in CIO's internal controls. Due to failures to timely escalate information and instructions that had the effect of hindering the sharing of information, not all of these deficiencies had been escalated to JPMorgan Senior Management prior to May 10, 2012. And, as to the information that was escalated, JPMorgan Senior Management did not make a considered assessment as to whether critical facts existed—including any significant deficiency or material weakness in internal controls—that had to be disclosed to the Audit Committee. Consequently, JPMorgan Senior Management did not disclose the existence of any significant deficiencies or material weaknesses to the Audit Committee before JPMorgan filed its quarterly report on May 10, 2012.

30. On July 13, 2012, at the same time JPMorgan disclosed to investors that it would restate its results for the first quarter of 2012, the firm announced that a material weakness in internal control over financial reporting had existed at CIO as of March 31, 2012. As a result of the material weakness, JPMorgan also announced that its management had concluded that JPMorgan's disclosure controls and procedures were not effective as of March 31, 2012.

### **CIO Internal Controls in the First Quarter of 2012**

31. As part of fulfilling the requirements to devise and maintain systems of internal accounting controls, financial institutions such as JPMorgan need to have internal controls that adequately monitor and test the accuracy and integrity of, among other things, the valuations of the firm's trading portfolios such as the SCP. CIO-VCG served as a significant control for ensuring that certain assets and liabilities of CIO, including the positions in the SCP, were measured at fair value in accordance with GAAP in JPMorgan's books and records and in the quarterly and annual reports the firm filed with the Commission.

32. For the SCP, CIO-VCG carried out its responsibility by price-testing the marks that the SCP traders assigned to the portfolio's positions on the last business day of every month. Under firm policy applicable during the first quarter of 2012, CIO-VCG performed this price-testing function by undertaking the following steps:

- a. First, CIO-VCG had to calculate, as a benchmark, an independent price for each of the SCP positions. A CIO-VCG policy and procedure document indicates that, for index positions, these independent prices were to be obtained from Markit Limited Group ("Markit"), a service that provides consensus-based prices for indices. For tranches, CIO-VCG obtained independent prices from dealer quotes, which it checked against Totem,



another consensus pricing service offered by Markit, for any significant discrepancies.

- b. After calculating an independent price for each SCP position, CIO-VCG had to establish and apply a threshold (or tolerance) around each price that represented the average bid-offer spread for the security based on quotes received from dealers. While it had authority to make an adjustment to trader marks that fell within these thresholds, CIO-VCG considered such marks to be presumptively marked at fair value and would not make any adjustment to those marks.
- c. If the SCP traders' mark for a given position fell outside of the threshold, CIO-VCG would record the excess as a loss (or profit) and make a corresponding adjustment to the mark-to-market profit and loss for the SCP.
- d. Finally, if CIO-VCG determined that the market for a particular position had become illiquid, CIO-VCG applied a pre-established formula to calculate and record a liquidity reserve to account for the risk that certain SCP positions could not be sold at fair value due to reduced liquidity in the marketplace.

33. The CIO-VCG staff actively involved in price-testing the SCP's 132 positions at the end of the first quarter of 2012 consisted of one person, who worked at CIO's London office. That person was also responsible for price testing all of CIO's other London-based portfolios.

34. On April 4, 2012, CIO-VCG completed its price-testing process for the SCP for the end of March 2012. It applied the relevant thresholds to adjust downward the fair value of the SCP by approximately \$17 million compared to the traders' marks and maintained the previous month's liquidity reserve of approximately \$31 million.

35. During its price-testing process for quarter-end marks, CIO-VCG observed that most of the SCP traders' marks migrated to the aggressive end of the bid/offer spread. CIO-VCG questioned one of the SCP traders about this shift. The trader did not explain the shift but merely stated, "Talk to management." CIO-VCG did not disclose to anyone its observations concerning the shift in the SCP traders' marking methodology until questions were being raised about a collateral dispute, which is summarized below, on April 20, 2012. CIO-VCG also did not share the details of its exchange with the SCP trader.

36. CIO-VCG calculated a significant difference between its independent prices and the SCP traders' marks. During its price-testing process, it calculated that the mid-market value of the SCP based on its independent prices was approximately \$192 million less than the value based on the SCP traders' marks. It subsequently identified an error in its calculations, which increased the difference from \$192 million to approximately \$275 million. A March 30, 2012 Internal Audit report on CIO-VCG contained an Action Plan under which CIO-VCG should disclose this discrepancy to CIO management. However, that action plan was not required to be fully implemented until June 30, 2012, and CIO-VCG only disclosed the \$17 million fair value

adjustment based on marks that fell outside of its thresholds. Consequently, CIO management was not alerted to the significant difference between the SCP traders' marks and the CIO-VCG calculated mid-market valuations, which warranted further analysis.

37. Shortly after April 4, 2012, CIO Finance, with the approval of CIO management and JPMorgan Senior Management, increased the existing \$31 million liquidity reserve by \$155 million, based on a determination that certain tranches in the SCP portfolio had become illiquid as of March 30. The traders' marks, as adjusted by CIO-VCG, were then incorporated in the financial information provided for CIO in JPMorgan's earnings release on April 13, 2012 and in the firm's May 10, 2012 report for the first quarter of 2012.

### **Large Collateral Calls and Increasing Losses Prompt Multiple Reviews of CIO-VCG and the Traders' Marks**

38. On April 20, 2012, JPMorgan Senior Management was informed that the firm had received several collateral calls—requests from trading counterparties for payment or the posting of collateral based on their differing views of the fair value—concerning positions in the SCP. The total amount in dispute was approximately \$520 million.

39. A collateral dispute with a CDS counterparty can sometimes be an indication that a firm's internal price for an instrument does not accurately reflect its fair value. Accordingly, in April 2012, the size of the collateral disputes over the SCP raised concerns by JPMorgan Senior Management about the pricing of the SCP positions. In an April 20, 2012 email, a member of JPMorgan Senior Management observed that the collateral disputes were not “a good sign on our valuation process” in the SCP.

40. At the same time that the collateral disputes were being escalated to JPMorgan Senior Management, the SCP was also sustaining large daily losses. This development was inconsistent with what CIO had told JPMorgan Senior Management to expect prior to the April 13 earnings release, and JPMorgan Senior Management was concerned about the losses and the traders' explanations of what was happening to the SCP positions and their strategy for dealing with the risks to the SCP. On or about April 27, JPMorgan Senior Management asked a senior trader from the IB and a senior risk officer to evaluate the portfolio on an urgent basis. Shortly afterwards, the IB trader and risk officer were put in charge of managing and reducing the risk in the SCP, and the SCP traders were relieved of all trading and pricing responsibilities. Additionally, on a going-forward basis, positions in the SCP were to be marked to consensus mid-market prices published by Markit.

41. In late April and early May, JPMorgan Senior Management mobilized resources from various parts of the firm—the IB's valuation experts, Internal Audit, which had prior experience with CIO-VCG's price-testing process, and the Controller's office, which included JPMorgan's fair value accounting experts—as well as the Legal Department and an outside law firm to conduct reviews of the SCP traders' marks and CIO-VCG's price-testing process. At the time, JPMorgan was planning to file with the Commission its report for the first quarter of 2012 in early May 2012. In part due to the questions being raised about the valuation of the SCP, JPMorgan Senior Management, with approval of the Audit Committee, decided to postpone the filing to May 10. JPMorgan Senior Management delayed the filing so that it had additional time

to assess whether CIO's first quarter results, which had been publicly released on April 13, were in fact compliant with GAAP and should be disclosed again in the quarterly report.

### *The Investment Bank's Review*

42. On April 25, 2012, a member of JPMorgan Senior Management asked the Valuation Control Group in the firm's IB ("IB-VCG") to price-test the SCP traders' marks for March 30, 2012 as if the positions had been held by the IB. IB-VCG also reviewed the price-testing work that had been done by CIO-VCG at the end of March 2012. The IB-VCG review was conducted under the supervision of the IB's Chief Financial Officer.

#### *IB-VCG Valuation "In Line with the Counterparties"*

43. The next day, IB-VCG performed a preliminary analysis of the SCP traders' marks. On a conference call that day, IB-VCG staff informed CIO management and CIO-VCG that "[t]he rough initial result [of its analysis] . . . seems to, to be in line with the mark-to-market differences you see on the collateral calls. . . . In terms of dollar value, the number seems pretty much in line . . . with the counterparties." In other words, IB-VCG's preliminary valuation of the SCP positions was in line with those of CIO's trading counterparties, who had valued the SCP at several hundreds of millions of dollars less than the SCP traders did.

44. During the conference call, CIO-VCG explained to IB-VCG staff that in setting thresholds around independent prices during its month-end price-testing process, it often consulted with the SCP traders—whose valuations it was supposed to validate—"to see if they have any market input to decide whether, you know, if it's, that's wrong, that's correct, et cetera." CIO-VCG also informed IB-VCG that, when completing its price-testing process, it used dealer quotes selected by SCP traders. IB-VCG staff believed that this process of consulting the traders had the potential to significantly impair the independence and effectiveness of the CIO-VCG process.

45. On Saturday, April 28, 2012, at a meeting with members of JPMorgan Senior Management and CIO management, the IB's CFO presented IB-VCG's analysis of the SCP traders' marks. He reviewed with the attendees a spreadsheet that detailed IB-VCG's work to date ("IB-VCG Spreadsheet"). At that meeting, at least one of the positions in the IB-VCG Spreadsheet was reviewed on a column-by-column basis in order to describe the data included in each individual column.

46. As of this time, JPMorgan Senior Management and CIO management knew that the SCP traders' marks were \$275 million greater than independent mid-market prices computed by CIO-VCG based on a combination of broker quotes and data from consensus pricing services. IB-VCG relied exclusively upon consensus pricing services, and the IB-VCG Spreadsheet calculated that the SCP traders' marks were approximately \$767 million greater than the values placed on the SCP positions by consensus mid-market prices published by Markit and Totem.

47. As part of its analysis, IB-VCG staff calculated an approximate bid-offer spread, based on market information from March 30, 2012, for six SCP positions, including several of the largest positions and some with the greatest total dollar value differences between trader marks and IB-VCG's consensus pricing. The IB-VCG Spreadsheet contained data regarding 133

positions and reflected, among other things, that for the six positions for which it calculated an approximate bid-offer spread, the traders' quarter-end marks were outside the bid-offer spreads that IB-VCG had approximated.

48. After presenting IB-VCG's analysis, the IB's CFO began to calculate the profit-and-loss impact if CIO marked the SCP to the conservative end of the bid-offer spread, rather than to mid-market prices, as a price-taker would have done (since price-takers often buy and sell at prices that are inferior to the consensus, mid-market Markit or Totem prices). This analysis showed that adjusting marks to the conservative end of the bid-offer spread would have further reduced the value of the SCP by approximately \$250 million, resulting in an over \$1 billion difference between the traders' marks and a price-taker's marks at the conservative end of the bid-offer spread. JPMorgan Senior Management elected not to pursue this marking methodology with respect to the March 2012 quarter-end marks because, among other reasons, it understood that using mid-market prices was acceptable under GAAP.

#### *Spreadsheet Errors*

49. IB-VCG also reviewed the process that CIO-VCG had applied to the traders' quarter-end marks. During this review, IB-VCG learned that in March 2012 CIO-VCG used a spreadsheet in its price-testing process into which data had been manually entered, and that this spreadsheet contained certain errors and reflected differences from the IB-VCG methodology that may have had the effect of understating the difference between the traders' marks and the independent mid-market prices derived by CIO-VCG. On May 8, 2012, IB-VCG forwarded an email to one member of JPMorgan Senior Management explaining these issues. IB-VCG and CIO-VCG were instructed to work together to address the errors and other issues.

50. The next day, IB-VCG corrected one such error, which involved the calculation of the difference between the value of the SCP based on the traders' marks and CIO-VCG's independent prices. Before the correction, the difference was believed to be approximately \$275 million. After the correction, the difference increased to \$512 million. IB-VCG informed JPMorgan Senior Management of the correction and the quantitative impact it had.

51. Based on the price-testing work of IB-VCG and other information, the management of the IB expressed concerns to JPMorgan Senior Management about the potential for mismarking of the SCP and whether CIO VCG was an effective control over the SCP. On May 6, 2012, for example, a senior IB executive explained to a member of JPMorgan Senior Management that the securities in the SCP had "very good price discovery mechanisms" (*i.e.*, could effectively be priced in the marketplace) and that he could not recall a variance between trader marks and independent prices in the IB "greater than \$50mm that remained at any month end across the ENTIRE IB's positions."

52. In light of their concerns relating to CIO, two senior IB executives initially expressed some reservations regarding the scope of their sub-certifications that JPMorgan required officers in the various business lines to provide in connection with its quarterly and annual filings. One of the executives apprised JPMorgan Senior Management that in light of the CIO related information to which he was privy, he had a conversation with an outside lawyer concerning the scope of his certification obligations. After relaying that conversation to the

other Investment Bank executive with certification obligations, both executives signed their sub-certifications.

### ***The Internal Audit Review***

53. In addition to the IB-VCG review, on or around May 2, 2012, JPMorgan Senior Management instructed Internal Audit to review the CIO-VCG process, including whether it had been applied consistently over past quarters. Also on May 2, at the end of a meeting of the Audit Committee of JPMorgan's Board of Directors, the Audit Committee, having just been informed of the losses recently suffered, separately requested that Internal Audit review CIO.

54. The Internal Audit team discovered deficiencies with the thresholds CIO-VCG had applied at March 30. As noted above, JPMorgan policy required that CIO-VCG set a threshold around its independent price for each SCP position that was representative of the average spread between the bids and the offers received from dealers for the position. Because the threshold was applied on each side of the independent price, in order to reflect the bid-offer spread the threshold on each side would be one-half of the entire spread.

55. By May 9, 2012, the Internal Audit team learned that in validating the SCP traders' quarter-end marks in March 2012, CIO-VCG had in some cases applied the entire bid-offer spread (rather than one half of the spread) on each side of its independent prices. The result was a threshold that was twice the size of the bid-offer spread and beyond the range of reasonable fair value estimates. The Internal Audit team calculated that, had CIO-VCG applied the thresholds appropriately, it would have adjusted the traders' quarter-end marks downward by \$307 million—\$290 million more than the \$17 million adjustment CIO-VCG had actually made at month end.

56. On May 10, the Internal Audit team collected its work in a draft memo ("Internal Audit Draft Memo"), which stated, among other things, that CIO-VCG was "inconsistent in the application of [its] own thresholds."

57. Although Internal Audit completed this work in the days prior to May 10, it did not fully share this information with JPMorgan Senior Management and did not circulate the Internal Audit Draft Memo to JPMorgan Senior Management or the Audit Committee.

### ***The Controller's Review***

58. On April 28, 2012, JPMorgan Senior Management asked the Controller's staff to assess whether the traders' quarter-end marks complied with GAAP and to review the effectiveness of CIO-VCG's quarter-end internal control process.

59. The Controller's staff made several significant observations. One was that, as losses in the SCP increased in March 2012, the traders departed from their historical practice of marking the positions close to the mid-point between the bids and offers received from dealers. Instead, they marked many positions at the aggressive end of the bid-offer spreads, *i.e.*, they marked the positions in a manner that resulted in smaller mark-to-market losses. JPMorgan Senior Management was informed of this fact in late April 2012. The traders justified their marks to the Controller's staff by explaining that the market had become volatile and dislocated.

This volatility, the SCP traders claimed, caused significant intraday price movements that may help explain the difference between the SCP traders' marks and consensus pricing services. To test the volatility explanation, the Controller's staff analyzed intraday pricing information, and determined that the difference between the SCP traders' marks and the mid-market prices was less than the average daily price movement. While accepting the SCP traders' justification, however, the Controller's staff failed to adequately assess whether CIO could transact at the price where the SCP was marked.

60. For two quarter end marks assigned by the SCP traders, the Controller's staff also detected significant differences from mid-market consensus pricing that were not supported by pricing data received by the SCP traders on the date that the mark was assigned. When the Controller's staff questioned these marks, one of the SCP traders agreed that they were too wide as compared to the mid-market price. This fact had not been adequately considered by CIO-VCG during its actual price testing process in connection with the first quarter of 2012, nor was this fact given appropriate scrutiny by the Controller's staff. Consequently, the Controller's staff did not escalate this information to JPMorgan Senior Management.

### *The Special Review by Outside Counsel*

61. In addition to the foregoing reviews, on or around May 1, 2012, JPMorgan retained an outside law firm to provide advice regarding disclosure and to review, among other things, whether the independence of the CIO-VCG process had been improperly compromised by the involvement of the SCP traders. By May 10, 2012, when JPMorgan filed its first quarter report, the law firm had interviewed the employee of CIO-VCG who had price-tested the SCP marks, the executive to whom he reported, and other members of CIO management. The law firm also had collected and reviewed a limited number of the relevant emails and Bloomberg chats from the first quarter of 2012.

### **The Process for Synthesizing and Escalating Information from the Various Reviews**

62. JPMorgan Senior Management led a process that involved daily—sometimes twice daily—meetings and calls in which participants involved in the different reviews discussed what they and their teams were doing and learning. Despite that process, a number of significant facts learned in the course of the various reviews were not shared in these group meetings and calls and were not otherwise escalated to JPMorgan Senior Management. This in turn led to JPMorgan's incomplete understanding of deficiencies relating to the CIO-VCG process in March 2012.

63. JPMorgan Senior Management's emphasis on confidentiality and sharing information on a need-to-know basis contributed to this incomplete understanding. JPMorgan Senior Management was concerned about sensitive information relating to CIO's positions being widely distributed and imposed restrictions on the creation and sharing of work product relating to those positions. These instructions affected the ability of those conducting the reviews to share, learn from, and build upon each other's work.

64. On April 29, 2012, the Controller's staff was instructed not to "discuss [its work] with people outside the immediate group" and to exercise caution in committing its findings to writing.

65. A member of JPMorgan Senior Management also instructed IB-VCG to "keep [its] analysis in a relatively tight group." On April 29, 2012, an IB executive confirmed to the member of JPMorgan Senior Management that IB-VCG "speaks to no one," including the Controller's staff, "without getting my express approval first."

66. Finally, the Internal Audit team was instructed to maintain strict confidentiality in connection with its review.

67. JPMorgan Senior Management did not receive all relevant information for another reason: some employees conducting the reviews failed to appreciate the significance of certain of the facts they had learned and their relevance to the quarterly report that was about to be filed. For example, in looking back on his work after learning in late June that the integrity of the traders' marks was in question, a London-based employee primarily responsible for the Controller's review conducted an after-the-fact assessment, noting that he "[s]hould have better understood the \$767 [million] diff.," *i.e.*, IB-VCG's calculation of the disparity between the SCP traders' quarter-end marks and Markit and Totem consensus, mid-market prices. The employee further noted that he "[s]hould have pressed [CIO-VCG] more on how the tolerances (thresholds) were determined" and "should have picked up that the tolerances determined by adding whole bid-offer," a fact already known to members of the Internal Audit team prior to May 10, 2012. Although executives were in contact with those responsible for the various reviews, some of those employees failed to timely analyze and escalate to JPMorgan Senior Management important facts that they had discovered.

#### **JPMorgan Senior Management's Response to the Information It Received**

68. Despite the inadequate information sharing and escalation described above, significant information learned in the management-commissioned reviews was escalated to JPMorgan Senior Management. This information, which related to the adequacy of the CIO-VCG process that produced the \$17 million fair value adjustment to the traders' quarter-end marks, included the following:

- a. As losses began to mount, SCP traders began consistently marking at or near the very edge of the advantageous side of the bid-offer spread.
- b. There was a collateral dispute of over \$500 million.
- c. Independent analysis by IB-VCG of the SCP traders' quarter-end marks was "in line with . . . the counterparties." Specifically, the value of the SCP based on trader marks was approximately \$767 million more than the value based on mid-point consensus pricing.

69. Management also learned of the following facts that directly related to CIO-VCG and the processes it was using in March 2012:

- a. The CIO-VCG process relied on manual spreadsheets that contained errors, one of which caused CIO-VCG to understate the disparity between its independent prices and the traders' marks by \$237 million.
- b. The SCP traders provided some of the quotes that were used in CIO-VCG's price-testing process and this process "need[ed] to be enhanced to ensure independence."

70. In response to what it was learning prior to May 10, JPMorgan Senior Management decided to enhance CIO-VCG's valuation policies. To assist with this task, the persons conducting the reviews recommended certain changes, and a member of JPMorgan Senior Management drafted revisions to CIO-VCG procedures, which were shared with JPMorgan Senior Management and CIO management on May 5, 2012. On May 7, 2012, a senior CIO executive circulated a "proposed operational approach to VCG price testing" that contained additional policy revisions. Both sets of changes were implemented before May 10, 2012.

71. Collectively, the new policies were intended to remediate several of the issues discovered by the management-commissioned reviews of CIO-VCG and the traders' marks:

- a. Disparity between CIO-VCG independent prices and traders' marks. The revised policies significantly curtailed the size of thresholds that CIO-VCG could apply, directing that the difference between a trader's mark and CIO-VCG's independent price could not exceed \$500,000 for an index position and \$2,000,000 for a tranche position.
- b. Trader involvement in the VCG process. The revised policies required CIO-VCG to "source broker quotes independently from the market," rather than through the traders, thereby "eliminating any reliance on [the traders] for sourcing of market data."
- c. Variance between Markit and CIO-VCG's independent prices. The revised policies stated that, for positions where CIO-VCG could rely on dealer quotes in calculating independent prices, CIO-VCG must obtain at least two quotes and, if two are not available, it must use Markit or Totem as an input. The revised policies also provided that, even when dealer quotes are obtained, "mid prices derived from selected dealer quotes should be compared . . . to Markit/Totem sourced data and any material differences . . . must be reported to the CFO of CIO and must be reconciled."
- d. Inadequate oversight over sole CIO-VCG price-tester. The revised policies introduced a new protocol for escalating to management valuation disputes between CIO-VCG and the traders, requiring the involvement of JPMorgan risk personnel and the Chief Financial Officer of CIO.

72. In addition to these policy changes, in early May the staff of IB-VCG prepared a remedial plan to address the spreadsheet errors it had identified in CIO-VCG's price-testing process, and to ensure proper review of the spreadsheets. On May 8, 2012, after CIO finance



management and CIO-VCG concurred in the remedial plan, IB-VCG described it to JPMorgan Senior Management.

### **The Reviews of CIO-VCG Are Not Addressed with the Audit Committee**

73. The responsibility for overseeing JPMorgan’s management on behalf of the firm’s stockholders—including oversight of management’s responsibilities for internal controls—ultimately rests with JPMorgan’s Board of Directors. The Board, in turn, discharges its oversight function through several Board committees. One of the principal committees is the Audit Committee, which is charged with overseeing JPMorgan’s efforts to assure that it has effective internal controls, which are critical to the integrity of the firm’s financial reports and compliance with applicable policies and laws.

74. To assist the Audit Committee in carrying out its responsibility, the Audit Committee’s Charter requires JPMorgan management to provide updates to the Committee on all “significant operating and control issues in internal audit reports,” the “initiation and status of significant special investigations,” the “identification and resolution status of material weaknesses” in controls, and any “reportable conditions in the internal control environment, including any significant deficiencies.” These updates serve an important internal control function, allowing the Audit Committee to fulfill its oversight role by, among other things, keeping the Board up-to-date on significant matters, assessing whether to approve the filing of quarterly and annual reports, and evaluating whether the Committee should conduct its own independent investigation of any issues raised with it.

75. In late April and early May 2012, while JPMorgan’s Senior Management was devoting daily attention to CIO-VCG and the SCP traders’ quarter-end marks—in large measure to ensure that CIO results reported in its upcoming quarterly report would be accurate—it also was in contact with members of the Audit Committee.

76. However, while JPMorgan Senior Management was informed of, and was addressing, various issues with internal controls at CIO-VCG, JPMorgan Senior Management did not engage in a considered assessment, before the firm filed its first quarter report on May 10, 2012, to determine if these matters constituted a significant deficiency or material weakness in the firm’s internal control over financial reporting and therefore had to be disclosed to the firm’s Audit Committee. Nor, more broadly, did JPMorgan Senior Management disclose to the Audit Committee its concerns regarding the operation of CIO-VCG.

77. On May 2, 2012, the Audit Committee met with some members of JPMorgan Senior Management. The focus of the meeting was on the mounting losses in the SCP portfolio. Despite the requirement to keep the Audit Committee apprised of the significant control issues that were under review, there was no discussion of the IB-VCG or Controller reviews related to CIO-VCG and the traders’ marks, although that work was underway. There was also no discussion of the fact that an outside law firm had been retained to advise on disclosures to be made in the first quarter Form 10-Q that related to CIO and to assess certain aspects of the CIO-VCG process, including whether the SCP traders exercised undue influence on the process.

78. During a full meeting of the Board of Directors hours before the filing of JPMorgan's first quarter report on May 10, 2012, JPMorgan Senior Management mentioned that reviews of what occurred in CIO were underway, including by Internal Audit, legal, the Controller's staff, and risk management. But, JPMorgan Senior Management did not discuss the details of or facts learned in the IB-VCG, Controller, or Internal Audit reviews.

79. Because the Audit Committee was not apprised of the initiation of the reviews or facts learned as a result of those reviews, it was unable to provide input on the issues before the filing of JPMorgan's first quarter report, and was unable to engage with those doing the work to ensure that it was sufficient from the perspective of the Audit Committee.

80. As noted above, the Audit Committee was not made aware before JPMorgan filed its first quarter report of the facts learned by various members of the review teams, including that CIO-VCG's March 2012 price-testing process was compromised by spreadsheet errors, that SCP traders may have exerted influence over that process, or that CIO-VCG applied valuation thresholds that were in some instances twice the applicable spread.

81. Other information learned by various members of the review teams that further called into question CIO-VCG's March 2012 quarter-end valuation process was not shared with the Audit Committee. At the end of the first quarter, CIO-VCG made a fair value adjustment of \$17 million to the traders' marks. However, certain facts raised issues as to the adequacy of this adjustment and the process through which it was made, including the \$520 million in collateral disputes over SCP positions, the \$767 million disparity between the SCP traders' marks and consensus, mid-market prices, the fact that the traders marked some of the largest notional SCP positions outside the bid-offer spread approximated by IB-VCG, and the fact that the traders began to mark the SCP at the aggressive end of the bid-offer spread when losses began to mount.

82. Finally, the Audit Committee was not apprised of, or included in, JPMorgan Senior Management's efforts to remedy the control issues at CIO-VCG by revising valuation policies to ensure proper oversight by CIO management. As a result, the Audit Committee did not have any input into the proposed changes or an understanding of the reasons that motivated them.

### **Subsequent Disclosures by JPMorgan**

83. Based on the information available to it, the Audit Committee approved of the content of JPMorgan's quarterly report on Form 10-Q that was filed on May 10, 2012. On July 13, 2012, JPMorgan disclosed that a material weakness existed in its internal control over financial reporting stemming from the "effectiveness of CIO's internal controls over valuation of the synthetic credit portfolio." In its amended Form 10-Q for the first quarter of 2012 filed on August 9, 2012, JPMorgan disclosed that this material weakness finding "was the result of issues in certain interrelated and interdependent control elements comprising that process, including insufficient engagement of CIO senior finance management in the valuation control process in light of the increased size and heightened risk profile of the synthetic credit portfolio during the first quarter of 2012, and in the effectiveness of certain procedures employed during the first quarter of 2012 by the CIO Valuation Control Group in performing the price verifications."

84. JPMorgan also corrected prior statements concerning its disclosure controls and procedures. In its May 10 Form 10-Q, JPMorgan stated, “As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Firm’s management, including its Chairman and Chief Executive Officer and its Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the Chairman and Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective.” On August 9, 2012, when JPMorgan disclosed that it had determined that a material weakness existed at CIO as of March 31, 2012, it also disclosed that, “[a]s a result of that determination, the Firm’s Chairman and Chief Executive Officer and Chief Financial Officer also concluded that the Firm’s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) were not effective at March 31, 2012.”

## V.

As a result of the conduct described above, JPMorgan violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-11, 13a-13, and 13a-15 thereunder.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in JPMorgan’s Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. JPMorgan cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-11, 13a-13, and 13a-15 thereunder.

B. JPMorgan shall, within ten (10) business days of the entry of this Order, pay a civil money penalty in the amount of \$200,000,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) JPMorgan may transmit payment electronically to the Commission, which will provide detailed ACH transfer/ Fedwire instructions upon request;
- (2) JPMorgan may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) JPMorgan may pay by certified check, bank cashier’s check, or United States postal money order, made payable to the Securities and Exchange Commission and hand- delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying JPMorgan Chase & Co. as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Regional Director – New York Regional Office, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281.

C. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended (“Fair Fund distribution”). Regardless of whether any Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, JPMorgan agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of JPMorgan’s payment of a civil penalty in this action (“Penalty Offset”). If the court in any Related Investor Action grants such a Penalty Offset, JPMorgan agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a “Related Investor Action” means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

D. JPMorgan shall pay all reasonable administrative costs and expenses of any distribution, including the fees and expenses of a tax administrator, within thirty (30) days after receipt of an invoice for such services.

By the Commission.

Elizabeth M. Murphy  
Secretary

## **ANNEX A**

JPMorgan Chase & Co. (“JPMorgan”) admits to the facts set forth below and acknowledges that its conduct violated the federal securities laws:

### **RELEVANT ENTITIES AND PERSONS**

1. JPMorgan, a Delaware corporation headquartered in New York, New York, is a global banking and financial services firm whose common stock is registered with the Commission under Section 12(b) of the Exchange Act and traded on The New York Stock Exchange under the symbol “JPM.”

2. CIO is a unit of JPMorgan and part of the firm’s Corporate/Private Equity reporting segment. Among other things, CIO is responsible for investing excess deposits from JPMorgan’s banking arm. CIO maintains offices in New York, New York and London, United Kingdom.

3. JPMorgan “Senior Management,” as that term is used herein, refers to one or more of the following individuals who held the listed positions as of May 10, 2012: the JPMorgan Chief Executive Officer, the JPMorgan Chief Financial Officer, the JPMorgan Chief Risk Officer, the JPMorgan Controller, and the JPMorgan General Auditor.

### **THE MISMARKING OF JPMORGAN’S SYNTHETIC CREDIT PORTFOLIO**

#### **JPMorgan, CIO, and the Synthetic Credit Portfolio**

4. In 2007, CIO created an investment portfolio, the SCP, which was designed to provide a hedge against adverse credit events. It invested in derivatives that could be expected to generate profit during adverse credit events, such as widespread corporate defaults. The positions in the SCP consisted of credit derivative indices and portions (or “tranches”) of those indices, both of which were constructed to track a collection of credit default swaps (“CDS”) referencing the debt of corporate issuers.

5. The SCP was invested in two primary index groups: CDX, a group of North American and Emerging Markets indices, and iTraxx, a group of European and Asian indices. Some indices referenced companies considered to be investment grade and others referenced companies considered to be high-yield (which generally means that their credit risk is viewed as higher). Investors in CDX and iTraxx indices, including CIO, can be “long” risk, which is equivalent to being a seller of CDS protection, or “short” risk, which is equivalent to being a buyer of CDS protection.

6. Beginning in 2008, the SCP’s investment strategy generally consisted of holding a net short risk position in high-yield indices and tranches, which meant that the SCP was positioned to realize gains if high-yield companies were to default on their corporate debt. The composition of the book changed from time to time in response to CIO’s assessment of market conditions.

7. In December 2011, in preparation for complying with the capital adequacy standards of the Third Basel Accord, the SCP traders were instructed to reduce the SCP's use of regulatory capital. To achieve this—and, in light of improving economic conditions, to reduce the SCP's credit protection profile—CIO management and the traders in charge of the SCP considered reducing the size of the SCP's short risk position in high-yield investments. There were substantial costs associated with this strategy. To avoid these costs, CIO management and traders therefore decided to add investments to the SCP's existing long risk investment-grade positions to offset the short risk high-yield position. However, as CIO built its long risk investment-grade positions, which included a large investment in an index known as the CDX North American Investment Grade Index Series 9 10-year, it also added substantially to its existing high-yield short position. JPMorgan did not have risk limits restricting the notional size of the SCP, and CIO's trading strategy led to a large increase in the notional size of the SCP. During the first quarter of 2012, CIO tripled the net notional amount of the SCP. As of March 31, 2012, the SCP contained 132 trading positions with a net notional amount of approximately \$157 billion.

### **Traders Mismark the SCP as Losses Mount**

8. Like many other public companies, JPMorgan reported its results, which incorporated the mark-to-market profit and loss of the SCP, at the end of each quarter in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). Under JPMorgan policy, the SCP traders were required to assign valuations (or "marks") to the positions in the SCP at fair value. Both GAAP and JPMorgan's accounting policy required that the SCP traders do so by making a good-faith estimate of the fair value of each SCP position based on information available in the marketplace. Under GAAP, the positions in the SCP had to be marked "within the bid-ask spread" at the point that is "most representative of fair value in the circumstances," with a particular emphasis on the price where the traders could reasonably expect to transact. GAAP also allows for the use of mid-market pricing "as a practical expedient for fair value measurements within a bid-ask spread."

9. At the end of each business day, the SCP traders had to mark the positions in the SCP and report to CIO management a summary of the portfolio's mark-to-market profits and losses for the day. Additionally, the traders had to provide their valuations for the SCP to the middle office at CIO so that the information could be incorporated into the books and records of JPMorgan.

10. The SCP generated sizeable profits for JPMorgan over the period from 2007 to 2011. In the first quarter of 2012, however, it began experiencing substantial mark-to-market losses. By early March 2012, the most senior SCP trader, who was a managing director within CIO, instructed the other SCP traders to stop reporting losses to CIO management unless there was a market-moving event that could easily explain the losses. In response, a junior SCP trader changed his daily marking methodology for the SCP. Previously, he had derived for each SCP position a bid-offer spread from dealer quotes he had received and then assigned a mark that was generally equivalent to the mid-point in that spread. In response to the most senior trader's instruction, the junior trader began to assign marks that often were at the most aggressive point in the bid-offer spread received that day (*i.e.*, the point that resulted in higher valuations of the SCP positions). For some SCP positions, the junior trader assigned marks in March that were

altogether outside every dealer's bid and offer received that day. As a result of these marking practices, the SCP traders intentionally understated mark-to-market losses in the SCP.

11. In March 2012, the junior trader began to maintain a spreadsheet which showed that, by March 15, 2012, the difference between the daily prices he had assigned to the SCP and the average mid-market point between the best bids and offers he had received from dealers had grown to \$292 million. Within a few days, the difference had grown further to \$432 million. The traders, however, revealed significantly smaller losses in daily reports to CIO management about the portfolio's performance than were indicated by mid-market pricing.

12. On March 30, 2012, the last trading day in the first quarter of 2012, the SCP traders informed the most senior trader in the morning that losses for that day alone could reach \$250 million. In response, the most senior trader directed the junior trader not to mark the SCP at the close of business in London, as JPMorgan policy required, but instead to wait for the markets in New York to close because trading information from New York might support higher valuations for the SCP positions.

13. The most senior trader also instructed the junior trader to use the "best" prices (*i.e.*, the most advantageous prices within the bid-offer spread) in marking the SCP. On March 30, the junior trader marked the SCP positions in accordance with these instructions, and reported to CIO management an estimated loss of \$138 million. Over the next several weeks, the traders continued to understate mark-to-market losses in the SCP until their authority over the portfolio was taken away from them on or around April 29, 2012, when JPMorgan Senior Management asked a senior Investment Bank ("IB") trader and senior risk officer to take responsibility for the portfolio.

### **JPMorgan Issues Its First Quarter Results and Subsequently Issues a Restatement**

14. On April 13, 2012, JPMorgan issued its earnings release for the quarter ending March 31, 2012, which was filed on Form 8-K with the Commission. Also on April 13, JPMorgan Senior Management conducted an earnings call with analysts and investors. The earnings release disclosed that JPMorgan's consolidated quarterly income before income tax expense was \$7.641 billion. These results included the understated losses for the SCP, which was based on the SCP traders' marks as of March 30, 2012.

15. One month later, on May 10, 2012, JPMorgan filed on Form 10-Q its report for the first quarter, which ended on March 31, 2012, disclosing that CIO had experienced significant mark-to-market losses in the SCP during the second quarter to date. Also on May 10, 2012, JPMorgan Senior Management conducted a call with analysts, during which the firm disclosed that CIO had suffered losses of approximately \$2 billion during the second quarter to date and that there could be additional losses, that the trading strategy that resulted in the losses was "flawed, complex, poorly reviewed, poorly executed, and poorly monitored," that "we've had teams from audit, legal, risk, and various control functions . . . involved in extensive review of what happened," and that "[w]e have more work to do but it's obvious at this point that there are many errors, sloppiness, and bad judgment." The \$2 billion calculation was based on marks for positions in the SCP that were derived from independent pricing sources and not from the

SCP traders; therefore, the full year-to-date loss figure was not affected by its subsequent conclusions concerning the integrity of the SCP traders' marks.

16. Two months later, on July 13, 2012, JPMorgan announced that it would restate its results for the first quarter of 2012 because it had discovered "information that raises questions about the integrity of the [SCP] marks" and was no longer confident that the marks used to prepare the first quarter results "reflect good faith estimates of fair value at quarter end." On August 9, 2012, JPMorgan filed an amended Form 10-Q with restated results for the first quarter. The restatement had the effect of moving certain SCP losses from the second quarter to the first quarter. Specifically, the restatement reduced the revenues of JPMorgan's Corporate/Private Equity reporting segment in the first quarter by \$660 million, from \$1.689 billion to \$1.029 billion, and the firm's consolidated quarterly income before income tax expense from the previously-reported \$7.641 billion to \$6.981 billion.

### **JPMORGAN'S INEFFECTIVE INTERNAL ACCOUNTING CONTROLS AND DISCLOSURE CONTROLS AND PROCEDURES**

17. JPMorgan's May 10, 2012 quarterly report on Form 10-Q contained its financial statements for the first quarter of the year, management's discussion of the firm's various businesses, and other information. In addition, the report stated that JPMorgan's management evaluated the effectiveness of its disclosure controls and procedures and concluded that they were effective.

18. As discussed below, between late April and May 10, 2012, JPMorgan engaged in an extensive process involving work performed by the Controller's office, the Internal Audit department ("Internal Audit"), valuation experts from the Investment Banking Division ("IB"), and in-house and outside counsel in an effort to evaluate the SCP's quarter-end marks and to understand the CIO valuation control process and the differences between that process and the valuation control process of the IB. As a result, by May 10, various executives and employees of the firm had learned of deficiencies as of March 31, 2012 in CIO's internal controls. Due to failures to timely escalate information and instructions that had the effect of hindering the sharing of information, not all of these deficiencies had been escalated to JPMorgan Senior Management prior to May 10, 2012. And, as to the information that was escalated, JPMorgan Senior Management did not make a considered assessment as to whether critical facts existed—including any significant deficiency or material weakness in internal controls—that had to be disclosed to the Audit Committee. Consequently, JPMorgan Senior Management did not disclose the existence of any significant deficiencies or material weaknesses to the Audit Committee before JPMorgan filed its quarterly report on May 10, 2012.

19. On July 13, 2012, at the same time JPMorgan disclosed to investors that it would restate its results for the first quarter of 2012, the firm announced that a material weakness in internal control over financial reporting had existed at CIO as of March 31, 2012. As a result of the material weakness, JPMorgan also announced that its management had concluded that JPMorgan's disclosure controls and procedures were not effective as of March 31, 2012.



## **CIO Internal Controls in the First Quarter of 2012**

20. As part of fulfilling the requirements to devise and maintain systems of internal accounting controls, financial institutions such as JPMorgan need to have internal controls that adequately monitor and test the accuracy and integrity of, among other things, the valuations of the firm's trading portfolios such as the SCP. CIO-VCG served as a significant control for ensuring that certain assets and liabilities of CIO, including the positions in the SCP, were measured at fair value in accordance with GAAP in JPMorgan's books and records and in the quarterly and annual reports the firm filed with the Commission.

21. For the SCP, CIO-VCG carried out its responsibility by price-testing the marks that the SCP traders assigned to the portfolio's positions on the last business day of every month. Under firm policy applicable during the first quarter of 2012, CIO-VCG performed this price-testing function by undertaking the following steps:

- a. First, CIO-VCG had to calculate, as a benchmark, an independent price for each of the SCP positions. A CIO-VCG policy and procedure document indicates that, for index positions, these independent prices were to be obtained from Markit Limited Group ("Markit"), a service that provides consensus-based prices for indices. For tranches, CIO-VCG obtained independent prices from dealer quotes, which it checked against Totem, another consensus pricing service offered by Markit, for any significant discrepancies.
- b. After calculating an independent price for each SCP position, CIO-VCG had to establish and apply a threshold (or tolerance) around each price that represented the average bid-offer spread for the security based on quotes received from dealers. While it had authority to make an adjustment to trader marks that fell within these thresholds, CIO-VCG considered such marks to be presumptively marked at fair value and would not make any adjustment to those marks.
- c. If the SCP traders' mark for a given position fell outside of the threshold, CIO-VCG would record the excess as a loss (or profit) and make a corresponding adjustment to the mark-to-market profit and loss for the SCP.
- d. Finally, if CIO-VCG determined that the market for a particular position had become illiquid, CIO-VCG applied a pre-established formula to calculate and record a liquidity reserve to account for the risk that certain SCP positions could not be sold at fair value due to reduced liquidity in the marketplace.

22. The CIO-VCG staff actively involved in price-testing the SCP's 132 positions at the end of the first quarter of 2012 consisted of one person, who worked at CIO's London office. That person was also responsible for price testing all of CIO's other London-based portfolios.

23. On April 4, 2012, CIO-VCG completed its price-testing process for the SCP for the end of March 2012. It applied the relevant thresholds to adjust downward the fair value of the SCP by approximately \$17 million compared to the traders' marks and maintained the previous month's liquidity reserve of approximately \$31 million.

24. During its price-testing process for quarter-end marks, CIO-VCG observed that most of the SCP traders' marks migrated to the aggressive end of the bid/offer spread. CIO-VCG questioned one of the SCP traders about this shift. The trader did not explain the shift but merely stated, "Talk to management." CIO-VCG did not disclose to anyone its observations concerning the shift in the SCP traders' marking methodology until questions were being raised about a collateral dispute, which is summarized below, on April 20, 2012. CIO-VCG also did not share the details of its exchange with the SCP trader.

25. CIO-VCG calculated a significant difference between its independent prices and the SCP traders' marks. During its price-testing process, it calculated that the mid-market value of the SCP based on its independent prices was approximately \$192 million less than the value based on the SCP traders' marks. It subsequently identified an error in its calculations, which increased the difference from \$192 million to approximately \$275 million. A March 30, 2012 Internal Audit report on CIO-VCG contained an Action Plan under which CIO-VCG should disclose this discrepancy to CIO management. However, that action plan was not required to be fully implemented until June 30, 2012, and CIO-VCG only disclosed the \$17 million fair value adjustment based on marks that fell outside of its thresholds. Consequently, CIO management was not alerted to the significant difference between the SCP traders' marks and the CIO-VCG calculated mid-market valuations, which warranted further analysis.

26. Shortly after April 4, 2012, CIO Finance, with the approval of CIO management and JPMorgan Senior Management, increased the existing \$31 million liquidity reserve by \$155 million, based on a determination that certain tranches in the SCP portfolio had become illiquid as of March 30. The traders' marks, as adjusted by CIO-VCG, were then incorporated in the financial information provided for CIO in JPMorgan's earnings release on April 13, 2012 and in the firm's May 10, 2012 report for the first quarter of 2012.

### **Large Collateral Calls and Increasing Losses Prompt Multiple Reviews of CIO-VCG and the Traders' Marks**

27. On April 20, 2012, JPMorgan Senior Management was informed that the firm had received several collateral calls—requests from trading counterparties for payment or the posting of collateral based on their differing views of the fair value—concerning positions in the SCP. The total amount in dispute was approximately \$520 million.

28. A collateral dispute with a CDS counterparty can sometimes be an indication that a firm's internal price for an instrument does not accurately reflect its fair value. Accordingly, in April 2012, the size of the collateral disputes over the SCP raised concerns by JPMorgan Senior Management about the pricing of the SCP positions. In an April 20, 2012 email, a member of JPMorgan Senior Management observed that the collateral disputes were not "a good sign on our valuation process" in the SCP.

29. At the same time that the collateral disputes were being escalated to JPMorgan Senior Management, the SCP was also sustaining large daily losses. This development was inconsistent with what CIO had told JPMorgan Senior Management to expect prior to the April 13 earnings release, and JPMorgan Senior Management was concerned about the losses and the traders' explanations of what was happening to the SCP positions and their strategy for dealing with the risks to the SCP. On or about April 27, JPMorgan Senior Management asked a senior trader from the IB and a senior risk officer to evaluate the portfolio on an urgent basis. Shortly afterwards, the IB trader and risk officer were put in charge of managing and reducing the risk in the SCP, and the SCP traders were relieved of all trading and pricing responsibilities. Additionally, on a going-forward basis, positions in the SCP were to be marked to consensus mid-market prices published by Markit.

30. In late April and early May, JPMorgan Senior Management mobilized resources from various parts of the firm—the IB's valuation experts, Internal Audit, which had prior experience with CIO-VCG's price-testing process, and the Controller's office, which included JPMorgan's fair value accounting experts—as well as the Legal Department and an outside law firm to conduct reviews of the SCP traders' marks and CIO-VCG's price-testing process. At the time, JPMorgan was planning to file with the Commission its report for the first quarter of 2012 in early May 2012. In part due to the questions being raised about the valuation of the SCP, JPMorgan Senior Management, with approval of the Audit Committee, decided to postpone the filing to May 10. JPMorgan Senior Management delayed the filing so that it had additional time to assess whether CIO's first quarter results, which had been publicly released on April 13, were in fact compliant with GAAP and should be disclosed again in the quarterly report.

### *The Investment Bank's Review*

31. On April 25, 2012, a member of JPMorgan Senior Management asked the Valuation Control Group in the firm's IB ("IB-VCG") to price-test the SCP traders' marks for March 30, 2012 as if the positions had been held by the IB. IB-VCG also reviewed the price-testing work that had been done by CIO-VCG at the end of March 2012. The IB-VCG review was conducted under the supervision of the IB's Chief Financial Officer.

#### *IB-VCG Valuation "In Line with the Counterparties"*

32. The next day, IB-VCG performed a preliminary analysis of the SCP traders' marks. On a conference call that day, IB-VCG staff informed CIO management and CIO-VCG that "[t]he rough initial result [of its analysis] . . . seems to, to be in line with the mark-to-market differences you see on the collateral calls. . . . In terms of dollar value, the number seems pretty much in line . . . with the counterparties." In other words, IB-VCG's preliminary valuation of the SCP positions was in line with those of CIO's trading counterparties, who had valued the SCP at several hundreds of millions of dollars less than the SCP traders did.

33. During the conference call, CIO-VCG explained to IB-VCG staff that in setting thresholds around independent prices during its month-end price-testing process, it often consulted with the SCP traders—whose valuations it was supposed to validate—"to see if they have any market input to decide whether, you know, if it's, that's wrong, that's correct, et cetera." CIO-VCG also informed IB-VCG that, when completing its price-testing process, it

used dealer quotes selected by SCP traders. IB-VCG staff believed that this process of consulting the traders had the potential to significantly impair the independence and effectiveness of the CIO-VCG process.

34. On Saturday, April 28, 2012, at a meeting with members of JPMorgan Senior Management and CIO management, the IB's CFO presented IB-VCG's analysis of the SCP traders' marks. He reviewed with the attendees a spreadsheet that detailed IB-VCG's work to date ("IB-VCG Spreadsheet"). At that meeting, at least one of the positions in the IB-VCG Spreadsheet was reviewed on a column-by-column basis in order to describe the data included in each individual column.

35. As of this time, JPMorgan Senior Management and CIO management knew that the SCP traders' marks were \$275 million greater than independent mid-market prices computed by CIO-VCG based on a combination of broker quotes and data from consensus pricing services. IB-VCG relied exclusively upon consensus pricing services, and the IB-VCG Spreadsheet calculated that the SCP traders' marks were approximately \$767 million greater than the values placed on the SCP positions by consensus mid-market prices published by Markit and Totem.

36. As part of its analysis, IB-VCG staff calculated an approximate bid-offer spread, based on market information from March 30, 2012, for six SCP positions, including several of the largest positions and some with the greatest total dollar value differences between trader marks and IB-VCG's consensus pricing. The IB-VCG Spreadsheet contained data regarding 133 positions and reflected, among other things, that for the six positions for which it calculated an approximate bid-offer spread, the traders' quarter-end marks were outside the bid-offer spreads that IB-VCG had approximated.

37. After presenting IB-VCG's analysis, the IB's CFO began to calculate the profit-and-loss impact if CIO marked the SCP to the conservative end of the bid-offer spread, rather than to mid-market prices, as a price-taker would have done (since price-takers often buy and sell at prices that are inferior to the consensus, mid-market Markit or Totem prices). This analysis showed that adjusting marks to the conservative end of the bid-offer spread would have further reduced the value of the SCP by approximately \$250 million, resulting in an over \$1 billion difference between the traders' marks and a price-taker's marks at the conservative end of the bid-offer spread. JPMorgan Senior Management elected not to pursue this marking methodology with respect to the March 2012 quarter-end marks because, among other reasons, it understood that using mid-market prices was acceptable under GAAP.

#### *Spreadsheet Errors*

38. IB-VCG also reviewed the process that CIO-VCG had applied to the traders' quarter-end marks. During this review, IB-VCG learned that in March 2012 CIO-VCG used a spreadsheet in its price-testing process into which data had been manually entered, and that this spreadsheet contained certain errors and reflected differences from the IB-VCG methodology that may have had the effect of understating the difference between the traders' marks and the independent mid-market prices derived by CIO-VCG. On May 8, 2012, IB-VCG forwarded an email to one member of JPMorgan Senior Management explaining these issues. IB-VCG and CIO-VCG were instructed to work together to address the errors and other issues.

39. The next day, IB-VCG corrected one such error, which involved the calculation of the difference between the value of the SCP based on the traders' marks and CIO-VCG's independent prices. Before the correction, the difference was believed to be approximately \$275 million. After the correction, the difference increased to \$512 million. IB-VCG informed JPMorgan Senior Management of the correction and the quantitative impact it had.

40. Based on the price-testing work of IB-VCG and other information, the management of the IB expressed concerns to JPMorgan Senior Management about the potential for mismarking of the SCP and whether CIO VCG was an effective control over the SCP. On May 6, 2012, for example, a senior IB executive explained to a member of JPMorgan Senior Management that the securities in the SCP had "very good price discovery mechanisms" (*i.e.*, could effectively be priced in the marketplace) and that he could not recall a variance between trader marks and independent prices in the IB "greater than \$50mm that remained at any month end across the ENTIRE IB's positions."

41. In light of their concerns relating to CIO, two senior IB executives initially expressed some reservations regarding the scope of their sub-certifications that JPMorgan required officers in the various business lines to provide in connection with its quarterly and annual filings. One of the executives apprised JPMorgan Senior Management that in light of the CIO related information to which he was privy, he had a conversation with an outside lawyer concerning the scope of his certification obligations. After relaying that conversation to the other Investment Bank executive with certification obligations, both executives signed their sub-certifications.

### ***The Internal Audit Review***

42. In addition to the IB-VCG review, on or around May 2, 2012, JPMorgan Senior Management instructed Internal Audit to review the CIO-VCG process, including whether it had been applied consistently over past quarters. Also on May 2, at the end of a meeting of the Audit Committee of JPMorgan's Board of Directors, the Audit Committee, having just been informed of the losses recently suffered, separately requested that Internal Audit review CIO.

43. The Internal Audit team discovered deficiencies with the thresholds CIO-VCG had applied at March 30. As noted above, JPMorgan policy required that CIO-VCG set a threshold around its independent price for each SCP position that was representative of the average spread between the bids and the offers received from dealers for the position. Because the threshold was applied on each side of the independent price, in order to reflect the bid-offer spread the threshold on each side would be one-half of the entire spread.

44. By May 9, 2012, the Internal Audit team learned that in validating the SCP traders' quarter-end marks in March 2012, CIO-VCG had in some cases applied the entire bid-offer spread (rather than one half of the spread) on each side of its independent prices. The result was a threshold that was twice the size of the bid-offer spread and beyond the range of reasonable fair value estimates. The Internal Audit team calculated that, had CIO-VCG applied the thresholds appropriately, it would have adjusted the traders' quarter-end marks downward by \$307 million—\$290 million more than the \$17 million adjustment CIO-VCG had actually made at month end.

45. On May 10, the Internal Audit team collected its work in a draft memo (“Internal Audit Draft Memo”), which stated, among other things, that CIO-VCG was “inconsistent in the application of [its] own thresholds.”

46. Although Internal Audit completed this work in the days prior to May 10, it did not fully share this information with JPMorgan Senior Management and did not circulate the Internal Audit Draft Memo to JPMorgan Senior Management or the Audit Committee.

### *The Controller’s Review*

47. On April 28, 2012, JPMorgan Senior Management asked the Controller’s staff to assess whether the traders’ quarter-end marks complied with GAAP and to review the effectiveness of CIO-VCG’s quarter-end internal control process.

48. The Controller’s staff made several significant observations. One was that, as losses in the SCP increased in March 2012, the traders departed from their historical practice of marking the positions close to the mid-point between the bids and offers received from dealers. Instead, they marked many positions at the aggressive end of the bid-offer spreads, *i.e.*, they marked the positions in a manner that resulted in smaller mark-to-market losses. JPMorgan Senior Management was informed of this fact in late April 2012. The traders justified their marks to the Controller’s staff by explaining that the market had become volatile and dislocated. This volatility, the SCP traders claimed, caused significant intraday price movements that may help explain the difference between the SCP traders’ marks and consensus pricing services. To test the volatility explanation, the Controller’s staff analyzed intraday pricing information, and determined that the difference between the SCP traders’ marks and the mid-market prices was less than the average daily price movement. While accepting the SCP traders’ justification, however, the Controller’s staff failed to adequately assess whether CIO could transact at the price where the SCP was marked.

49. For two quarter end marks assigned by the SCP traders, the Controller’s staff also detected significant differences from mid-market consensus pricing that were not supported by pricing data received by the SCP traders on the date that the mark was assigned. When the Controller’s staff questioned these marks, one of the SCP traders agreed that they were too wide as compared to the mid-market price. This fact had not been adequately considered by CIO-VCG during its actual price testing process in connection with the first quarter of 2012, nor was this fact given appropriate scrutiny by the Controller’s staff. Consequently, the Controller’s staff did not escalate this information to JPMorgan Senior Management.

### *The Special Review by Outside Counsel*

50. In addition to the foregoing reviews, on or around May 1, 2012, JPMorgan retained an outside law firm to provide advice regarding disclosure and to review, among other things, whether the independence of the CIO-VCG process had been improperly compromised by the involvement of the SCP traders. By May 10, 2012, when JPMorgan filed its first quarter report, the law firm had interviewed the employee of CIO-VCG who had price-tested the SCP marks, the executive to whom he reported, and other members of CIO management. The law

firm also had collected and reviewed a limited number of the relevant emails and Bloomberg chats from the first quarter of 2012.

### **The Process for Synthesizing and Escalating Information from the Various Reviews**

51. JPMorgan Senior Management led a process that involved daily—sometimes twice daily—meetings and calls in which participants involved in the different reviews discussed what they and their teams were doing and learning. Despite that process, a number of significant facts learned in the course of the various reviews were not shared in these group meetings and calls and were not otherwise escalated to JPMorgan Senior Management. This in turn led to JPMorgan’s incomplete understanding of deficiencies relating to the CIO-VCG process in March 2012.

52. JPMorgan Senior Management’s emphasis on confidentiality and sharing information on a need-to-know basis contributed to this incomplete understanding. JPMorgan Senior Management was concerned about sensitive information relating to CIO’s positions being widely distributed and imposed restrictions on the creation and sharing of work product relating to those positions. These instructions affected the ability of those conducting the reviews to share, learn from, and build upon each other’s work.

53. On April 29, 2012, the Controller’s staff was instructed not to “discuss [its work] with people outside the immediate group” and to exercise caution in committing its findings to writing.

54. A member of JPMorgan Senior Management also instructed IB-VCG to “keep [its] analysis in a relatively tight group.” On April 29, 2012, an IB executive confirmed to the member of JPMorgan Senior Management that IB-VCG “speaks to no one,” including the Controller’s staff, “without getting my express approval first.”

55. Finally, the Internal Audit team was instructed to maintain strict confidentiality in connection with its review.

56. JPMorgan Senior Management did not receive all relevant information for another reason: some employees conducting the reviews failed to appreciate the significance of certain of the facts they had learned and their relevance to the quarterly report that was about to be filed. For example, in looking back on his work after learning in late June that the integrity of the traders’ marks was in question, a London-based employee primarily responsible for the Controller’s review conducted an after-the-fact assessment, noting that he “[s]hould have better understood the \$767 [million] diff.,” *i.e.*, IB-VCG’s calculation of the disparity between the SCP traders’ quarter-end marks and Markit and Totem consensus, mid-market prices. The employee further noted that he “[s]hould have pressed [CIO-VCG] more on how the tolerances (thresholds) were determined” and “should have picked up that the tolerances determined by adding whole bid-offer,” a fact already known to members of the Internal Audit team prior to May 10, 2012. Although executives were in contact with those responsible for the various reviews, some of those employees failed to timely analyze and escalate to JPMorgan Senior Management important facts that they had discovered.

**JPMorgan Senior Management's  
Response to the Information It Received**

57. Despite the inadequate information sharing and escalation described above, significant information learned in the management-commissioned reviews was escalated to JPMorgan Senior Management. This information, which related to the adequacy of the CIO-VCG process that produced the \$17 million fair value adjustment to the traders' quarter-end marks, included the following:

- a. As losses began to mount, SCP traders began consistently marking at or near the very edge of the advantageous side of the bid-offer spread.
- b. There was a collateral dispute of over \$500 million.
- c. Independent analysis by IB-VCG of the SCP traders' quarter-end marks was "in line with . . . the counterparties." Specifically, the value of the SCP based on trader marks was approximately \$767 million more than the value based on mid-point consensus pricing.

58. Management also learned of the following facts that directly related to CIO-VCG and the processes it was using in March 2012:

- a. The CIO-VCG process relied on manual spreadsheets that contained errors, one of which caused CIO-VCG to understate the disparity between its independent prices and the traders' marks by \$237 million.
- b. The SCP traders provided some of the quotes that were used in CIO-VCG's price-testing process and this process "need[ed] to be enhanced to ensure independence."

59. In response to what it was learning prior to May 10, JPMorgan Senior Management decided to enhance CIO-VCG's valuation policies. To assist with this task, the persons conducting the reviews recommended certain changes, and a member of JPMorgan Senior Management drafted revisions to CIO-VCG procedures, which were shared with JPMorgan Senior Management and CIO management on May 5, 2012. On May 7, 2012, a senior CIO executive circulated a "proposed operational approach to VCG price testing" that contained additional policy revisions. Both sets of changes were implemented before May 10, 2012.

60. Collectively, the new policies were intended to remediate several of the issues discovered by the management-commissioned reviews of CIO-VCG and the traders' marks:

- a. Disparity between CIO-VCG independent prices and traders' marks. The revised policies significantly curtailed the size of thresholds that CIO-VCG could apply, directing that the difference between a trader's mark and CIO-VCG's independent price could not exceed \$500,000 for an index position and \$2,000,000 for a tranche position.



- b. Trader involvement in the VCG process. The revised policies required CIO-VCG to “source broker quotes independently from the market,” rather than through the traders, thereby “eliminating any reliance on [the traders] for sourcing of market data.”
- c. Variance between Markit and CIO-VCG’s independent prices. The revised policies stated that, for positions where CIO-VCG could rely on dealer quotes in calculating independent prices, CIO-VCG must obtain at least two quotes and, if two are not available, it must use Markit or Totem as an input. The revised policies also provided that, even when dealer quotes are obtained, “mid prices derived from selected dealer quotes should be compared . . . to Markit/Totem sourced data and any material differences . . . must be reported to the CFO of CIO and must be reconciled.”
- d. Inadequate oversight over sole CIO-VCG price-tester. The revised policies introduced a new protocol for escalating to management valuation disputes between CIO-VCG and the traders, requiring the involvement of JPMorgan risk personnel and the Chief Financial Officer of CIO.

61. In addition to these policy changes, in early May the staff of IB-VCG prepared a remedial plan to address the spreadsheet errors it had identified in CIO-VCG’s price-testing process, and to ensure proper review of the spreadsheets. On May 8, 2012, after CIO finance management and CIO-VCG concurred in the remedial plan, IB-VCG described it to JPMorgan Senior Management.

### **The Reviews of CIO-VCG Are Not Addressed with the Audit Committee**

62. The responsibility for overseeing JPMorgan’s management on behalf of the firm’s stockholders—including oversight of management’s responsibilities for internal controls—ultimately rests with JPMorgan’s Board of Directors. The Board, in turn, discharges its oversight function through several Board committees. One of the principal committees is the Audit Committee, which is charged with overseeing JPMorgan’s efforts to assure that it has effective internal controls, which are critical to the integrity of the firm’s financial reports and compliance with applicable policies and laws.

63. To assist the Audit Committee in carrying out its responsibility, the Audit Committee’s Charter requires JPMorgan management to provide updates to the Committee on all “significant operating and control issues in internal audit reports,” the “initiation and status of significant special investigations,” the “identification and resolution status of material weaknesses” in controls, and any “reportable conditions in the internal control environment, including any significant deficiencies.” These updates serve an important internal control function, allowing the Audit Committee to fulfill its oversight role by, among other things, keeping the Board up-to-date on significant matters, assessing whether to approve the filing of quarterly and annual reports, and evaluating whether the Committee should conduct its own independent investigation of any issues raised with it.

64. In late April and early May 2012, while JPMorgan's Senior Management was devoting daily attention to CIO-VCG and the SCP traders' quarter-end marks—in large measure to ensure that CIO results reported in its upcoming quarterly report would be accurate—it also was in contact with members of the Audit Committee.

65. However, while JPMorgan Senior Management was informed of, and was addressing, various issues with internal controls at CIO-VCG, JPMorgan Senior Management did not engage in a considered assessment, before the firm filed its first quarter report on May 10, 2012, to determine if these matters constituted a significant deficiency or material weakness in the firm's internal control over financial reporting and therefore had to be disclosed to the firm's Audit Committee. Nor, more broadly, did JPMorgan Senior Management disclose to the Audit Committee its concerns regarding the operation of CIO-VCG.

66. On May 2, 2012, the Audit Committee met with some members of JPMorgan Senior Management. The focus of the meeting was on the mounting losses in the SCP portfolio. Despite the requirement to keep the Audit Committee apprised of the significant control issues that were under review, there was no discussion of the IB-VCG or Controller reviews related to CIO-VCG and the traders' marks, although that work was underway. There was also no discussion of the fact that an outside law firm had been retained to advise on disclosures to be made in the first quarter Form 10-Q that related to CIO and to assess certain aspects of the CIO-VCG process, including whether the SCP traders exercised undue influence on the process.

67. During a full meeting of the Board of Directors hours before the filing of JPMorgan's first quarter report on May 10, 2012, JPMorgan Senior Management mentioned that reviews of what occurred in CIO were underway, including by Internal Audit, legal, the Controller's staff, and risk management. But, JPMorgan Senior Management did not discuss the details of or facts learned in the IB-VCG, Controller, or Internal Audit reviews.

68. Because the Audit Committee was not apprised of the initiation of the reviews or facts learned as a result of those reviews, it was unable to provide input on the issues before the filing of JPMorgan's first quarter report, and was unable to engage with those doing the work to ensure that it was sufficient from the perspective of the Audit Committee.

69. As noted above, the Audit Committee was not made aware before JPMorgan filed its first quarter report of the facts learned by various members of the review teams, including that CIO-VCG's March 2012 price-testing process was compromised by spreadsheet errors, that SCP traders may have exerted influence over that process, or that CIO-VCG applied valuation thresholds that were in some instances twice the applicable spread.

70. Other information learned by various members of the review teams that further called into question CIO-VCG's March 2012 quarter-end valuation process was not shared with the Audit Committee. At the end of the first quarter, CIO-VCG made a fair value adjustment of \$17 million to the traders' marks. However, certain facts raised issues as to the adequacy of this adjustment and the process through which it was made, including the \$520 million in collateral disputes over SCP positions, the \$767 million disparity between the SCP traders' marks and consensus, mid-market prices, the fact that the traders marked some of the largest notional SCP

positions outside the bid-offer spread approximated by IB-VCG, and the fact that the traders began to mark the SCP at the aggressive end of the bid-offer spread when losses began to mount.

71. Finally, the Audit Committee was not apprised of, or included in, JPMorgan Senior Management's efforts to remedy the control issues at CIO-VCG by revising valuation policies to ensure proper oversight by CIO management. As a result, the Audit Committee did not have any input into the proposed changes or an understanding of the reasons that motivated them.

### **Subsequent Disclosures by JPMorgan**

72. Based on the information available to it, the Audit Committee approved of the content of JPMorgan's quarterly report on Form 10-Q that was filed on May 10, 2012. On July 13, 2012, JPMorgan disclosed that a material weakness existed in its internal control over financial reporting stemming from the "effectiveness of CIO's internal controls over valuation of the synthetic credit portfolio." In its amended Form 10-Q for the first quarter of 2012 filed on August 9, 2012, JPMorgan disclosed that this material weakness finding "was the result of issues in certain interrelated and interdependent control elements comprising that process, including insufficient engagement of CIO senior finance management in the valuation control process in light of the increased size and heightened risk profile of the synthetic credit portfolio during the first quarter of 2012, and in the effectiveness of certain procedures employed during the first quarter of 2012 by the CIO Valuation Control Group in performing the price verifications."

73. JPMorgan also corrected prior statements concerning its disclosure controls and procedures. In its May 10 Form 10-Q, JPMorgan stated, "As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Firm's management, including its Chairman and Chief Executive Officer and its Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the Chairman and Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective." On August 9, 2012, when JPMorgan disclosed that it had determined that a material weakness existed at CIO as of March 31, 2012, it also disclosed that, "[a]s a result of that determination, the Firm's Chairman and Chief Executive Officer and Chief Financial Officer also concluded that the Firm's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) were not effective at March 31, 2012."