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JPMorgan Trading Loss Takes Toll on Dimon, Industry

By Rob Blackwell
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WASHINGTON — There's a seminal moment in the 1987 movie "Predator" when Arnold Schwarzenegger's character, facing a seemingly indestructible alien, finds its blood on a leaf and declares, "If it bleeds, we can kill it."

For Jamie Dimon, JPMorgan Chase & Co.'s announcement that it was taking a $2 billion loss on its trading activities was the blood-on-a-leaf moment for his multitude of regulatory and political opponents.

The loss didn't just deal a crippling blow to the bank's arguments to dial back the Volcker Rule, which is intended to stop similar kinds of trading activity, and add ammunitions to those, like the Federal Deposit Insurance Corp.'s Tom Hoenig, that want risky activities separated from commercial banks.

It also undercut the myth of Dimon himself, a man who has appeared largely invulnerable because he helped lead his bank through the financial crisis mostly unscathed.

"Of all the banks this could have happened to, this is the one that probably hurts us the most," said one industry representative who — like many in the banking sector on Friday — declined to speak on the record. "They are the gold standard."

Banking lobbyists saw the situation much the same way.

"We had one spokesman within our industry that had the credibility to push back on some of the worst or most excessive parts of Dodd-Frank regulatory actions," a lobbyist said. "And his standing — while I don't think it's ruined — it's obviously damaged."

One critic went even further, suggesting Dimon should be removed.

"In any other industry, when faced with large losses incurred in such a haphazard way and under his direct personal supervision, the CEO would resign," wrote Simon Johnson, a professor at the MIT Sloan School of Management, on his blog baselinescenario. "No doubt Jamie Dimon will remain in place."

Lawmakers wasted no time in pouncing.

"Jamie Dimon doesn't want derivatives regulated," said Sen. Carl Levin, the chairman of the Senate Permanent Subcommittee on Investigations, in a conference call with reporters, adding that Dimon also wants Dodd-Frank to be rolled back and to allow non-U.S. parts of U.S. banks to fall outside U.S. jurisdiction. "And all three of those positions of his have been proven to be wrong."

Senate Banking Committee Chairman Tim Johnson agreed.

"The fact that this can happen at a bank with a solid reputation like J.P. Morgan is evidence that our banking regulators must remain vigilant, and why opponents of Wall Street reform must not be allowed to gut important protections for the financial system and taxpayers," he said in a statement.

In a conference call on Thursday evening, Dimon acknowledged the bank had made an "egregious mistake," and predicted — rightly — that it would be fodder for his opponents.

"It is very unfortunate that it plays right into the hands of a bunch of pundits out there, but that's life," he said.

But by using the word "pundits," Dimon appeared to be vastly underestimating the threat.

Regulators immediately mobilized against the bank, with both the Securities and Exchange Commission and U.K. regulators probing the trades, according to media reports.

Fitch Ratings, meanwhile, downgraded the bank by one notch to A-plus from double-A-minus citing a "lack of liquidity" and questions about the bank's management, according to Dow Jones Newswires.

The $2 billion loss was also sure to have a significant impact on other policy areas, most notably the Volcker Rule and a proposal from Hoenig to eliminate highly risky activities from the banking system.

Large banks have been attempting to dial back the Volcker Rule, which was included in the Dodd-Frank Act and bans proprietary trading, arguing that regulators' first proposal to implement it was unworkable.

Indeed, the plan, named after former Federal Reserve Board chairman Paul Volcker, has become a top symbol for banks representing Dodd-Frank's alleged excesses.

Although JPMorgan insisted its trades in London were legitimate hedging activities — which would be allowed under the Volcker Rule once it goes into effect in two years — that argument may only hurt the industry's position. If policymakers believe the trades would not have been prevented, they are likely to push for steps to toughen the ban, not weaken it.

Levin and Sen. Jeff Merkley made just such an argument on Friday, citing the trades as why the regulators should beef up the proposal to ensure they are captured under the prop trading ban.

"JP Morgan claimed they were hedging, but the reality is very different," Merkley said on the conference call. "The draft rules are way too lax."

Until Friday, many in the industry had thought they were making headway against the proposal, which even supporters agreed was overly complex. But in the wake of the losses, it seems more likely that the plan will be dialed up, not down.

"Clearly it will raise support for it," said Bob DeYoung, a professor at The University of Kansas School of Business. "This is the reality of politics. It'll strengthen support for moving the rule forward and getting it done, because it's just been harder to write this rule than anyone thought. It's less likely to be written in a watered down fashion."

George Kaufman, finance professor at Loyola University in Chicago, agreed.

"It strengthens the argument, particularly for the Volcker Rule… People say, 'Yes, we've got to do it.' But it doesn't make the job of writing down the rules any easier."

Rep. Barney Frank, D-Mass. said in an interview that it was clear that opposition to Volcker is wrong.

"It means… that the Volcker Rule should be gone ahead with," he said.

Sen. Bob Corker, R-Tenn., a member of the Banking Committee, sent a letter to Johnson asking for a full hearing on the issue, and raising several questions about the transactions.

"Were these bona fide hedging transactions or were these poorly managed proprietary trades?" wrote Corker. "And what, precisely, is the distinction?"

But the impact is unlikely to stop at Volcker.

A growing chorus of current and former regulators, as well as other policy heavyweights, have been arguing for stricter limitations on the biggest banks.

One of the principal proponents is Hoenig, the former head of the Federal Reserve Bank of Kansas City who testified Wednesday that banks should be forced to spin-off riskier activities, such as derivatives and broker-dealer units.

In an interview Friday, Hoenig — who emphasized he was not talking about the JPMorgan trades and was speaking about a proposal he made before he became an FDIC board member last month — said the banking system must be walled off from the riskiest transactions.

"Those activities can be easily gamed by these institutions, and the incentives, being within the safety net, encourage them to game those," he said. "By moving them out, you actually separate out away from the safety net the incentives around the high-risk activities of the broker-dealer. You put those back into the marketplace, you will in my personal opinion reinvigorate the competitive environment around those activities outside, and you will bring them to greater market discipline."

Some analysts saw Hoenig's idea — dubbed the "Hoenig Rule" by Corker — gaining traction.

"We believe the Hoenig plan is getting considerable attention on Capitol Hill and it could form the backbone for an eventual legislative response to J.P. Morgan's losses," said Jaret Seiberg, senior policy analyst for Guggenheim Securities' Washington Research Group.

Sen. Sherrod Brown, D-Ohio, has already introduced legislation to place stricter limits on a bank's allowable share of the nation's deposits and liabilities — effectively forcing the big banks to break up.

While the legislation is highly unlikely to pass anytime soon, the momentum for this kind of idea is clearly gaining steam. Although Hoenig's proposal would take legislation, bank regulators have considerable leeway to take other kinds of actions that could effectively accomplish something similar.

"It's a real threat," the lobbyist said. "It's not like you need to do one thing that limits the size of banks. It's just you do so much stuff — like higher capital requirements, tougher single-party counterparty exposure, tougher interchange rules — it's the weight of all those things. At some point, what is the proverbial straw that breaks the camel's back?"

Other analysts said too much was being made out of JPMorgan's trades. Mark Calabria, a former top aide to Sen. Richard Shelby and now at the Cato Institute, said the losses had not endangered the bank or the system.

"Where are the systemic affects from this $2 billion loss?" he asked. "Did our credit markets freeze up? It's hard to see any systemic effect from any of this… There's this sort of ridiculous reaction that any time a bank takes a loss that's the argument for why we need some random rule. Banks are businesses. Banks that don't take losses are banks that aren't lending."

Eugene Ludwig, the former comptroller of the currency, said it is unrealistic to expect JPMorgan never to make a significant mistake, but noted it had no systemic impact.

"This is a fine institution with a fine management team and it would be shocking if it, like any other private sector institution, went forever without any hiccups," said Ludwig , the CEO of Promontory Financial Group. "The system is markedly safer and dramatically better capitalized than it was prior to the crisis."

Rep. Brad Miller, D-N.C. who has introduced a companion bill to Brown's in the House, said the long-term policy impact of JPMorgan's news depends mostly on what happens next.

"If there aren't other incidents like this, this might not end up having such a big impact," Miller acknowledged.

Still, he said, for now the fallout is clear.

"It certainly strengthens the hand of reformers, " he said. "It weakens the position of opponents of reform like Jamie Dimon."

Joe Adler, Kate Davidson and Kevin Wack contributed to this article in Washington. Donna Borak and Barbara A. Rehm contributed from Chicago.