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Senate JPMorgan Probe Said to Seek Tougher Volcker Rule

By Cheyenne Hopkins - Sep 21, 2012 12:01 AM ET

A U.S. Senate panel probing the multibillion-dollar trading loss by JPMorgan Chase & Co. (JPM) plans to unveil its findings at a hearing this year to press regulators to tighten the Volcker rule, according to three people briefed on the matter.

Staff members of the Permanent Subcommittee on Investigations, headed by Senator Carl Levin, have interviewed JPMorgan officials as well as examiners and supervisors at the institution's regulator, the Office of the Comptroller of the Currency, said the people, who spoke on condition of anonymity because the inquiry isn't public.

One focus of the queries is whether JPMorgan's wrong-way bets on derivatives would have been permitted under regulators' initial draft of the Volcker ban on proprietary trading, the people said. The lender lost $5.8 billion on the trades in the first six months of the year.

Levin of Michigan and Senator Jeff Merkley of Oregon, both Democrats, inserted the trading ban into the 2010 Dodd-Frank Act, leaving the details largely up to regulators. The senators have said that the JPMorgan loss highlights a loophole in the regulators' draft that would allow banks to continue hedging their portfolio risks, and they said it should be closed.

Levin "has pride of authorship in the Volcker rule and wants to make sure it's implemented correctly," said Joseph Engelhard, senior vice president of Washington-based investment advisory firm Capital Alpha Partners LLC.

OCC Interviews

The panel's investigators have interviewed OCC officials including Scott Waterhouse, the examiner-in-charge for JPMorgan, and Julie Williams, the agency's chief counsel, and plan to meet with Comptroller Thomas J. Curry, according to two of the people. Bloomberg News reported Sept. 7 that the committee also has sought testimony from those who worked in or helped lead JPMorgan's chief investment office.

No hearing date has been set and the committee hasn't settled on who will be summoned from the regulatory agency or the bank, the people said.

Tara Andringa, a spokeswoman for Levin, and Joe Evangelisti, a spokesman for JPMorgan, declined to comment.

The rule, named for its original proponent, former Federal Reserve Chairman Paul Volcker, is intended to prevent banks that have federally insured deposits from trading for their own account. Regulators have struggled to draw a line between proprietary trades and trades intended to hedge a bank's risk -- an activity permitted by Dodd-Frank.

After the bank disclosed its losses May 10, Levin and Merkley sent a letter to five federal regulators urging them to remove "ill-advised loopholes" from the Volcker draft issued in October 2011.

'London Whale'

"Last fall's proposed rule ignored the clear legislative language and clear statement of congressional intent and allowed for so-called 'portfolio hedging,'" the lawmakers wrote on May 17. "Now, in recent days, we've seen exactly what 'portfolio hedging' might mean. This 'JPMorgan Loophole' is big enough to drive a 'London Whale' through."

The letter referred to Bruno Iksil, the French-born trader in London who ran JPMorgan's credit-derivatives book and came to be known as the London Whale because of the size of his bets.

In June, the Senate Banking and House Financial Services committees held hearings on the trading loss that touched on the effect of the Volcker rule. JPMorgan Chief Executive Officer Jamie Dimon, who testified before both panels, said the rule might have prevented the trades. He also said the Volcker rule was unnecessary because other changes, including requiring higher capital levels, would reduce risk in the banking system.

SEC Probe

Besides the Levin panel, the Securities and Exchange Commission, the Commodity Futures Trading Commission and at least nine other state, federal and international enforcement bodies have been investigating the circumstances of the trades. An internal bank review found that U.K. traders may have tried to hide the size of their losses from the bank's leadership.

JPMorgan shares plunged as much as 24 percent in the month after the loss was disclosed. They have since erased that decline, closing at $41.25 in New York yesterday.

Mary Miller, Treasury's undersecretary for domestic finance, and Martin Gruenberg, acting chairman of the Federal Deposit Insurance Corp., have said regulators aim to complete the Volcker rule by the end of the year.

Levin and Merkley are hoping that JPMorgan's troubles will persuade the regulators to restrict hedging in the final language, said Mark Calabria, director of financial regulations studies at the Washington-based Cato Institute and a former top Republican aide on the Senate Banking Committee.

"The Volcker process has been slower than they hoped and it's not as strong as they hoped," Calabria said.

Goldman Report

Levin's investigations panel is known for the depth of its research and its bipartisan efforts. The subcommittee probed Wall Street for two years following the 2008 credit crisis, issuing a 640-page report that focused on Goldman Sachs Group Inc. (GS) and pinned much of the blame on the largest banks for the near-collapse of the financial system.

Still, said Engelhard of Capital Alpha Partners, the panel's hearing on the JPMorgan trades would come months after lawmakers and regulators began considering the role of the Volcker rule.

"I'm not sure what impact a hearing will have given how the regulators have already reacted," Engelhard said.

To contact the reporters on this story: Cheyenne Hopkins at Chopkins19@bloomberg.net; To contact the editor responsible for this story: Christopher Wellisz at cwellisz@bloomberg.net