Dimon Gives Regulators New Ammunition For Tougher Volcker Rule

By Steven Sloan and Silla Brush - Jun 13, 2012 6:47 PM ET

JPMorgan Chase & Co. (JPM) Chief Executive Officer Jamie Dimon conceded a key point when pressed by lawmakers about a proposed ban on proprietary trading at banks: Had the rule been in place, it may have prevented the firm's recent $2 billion loss.

The ban "may very well have stopped parts of what this portfolio morphed into," Dimon said yesterday in testimony to the Senate Banking Committee.

Dimon's comments provided new ammunition to lawmakers and regulators emboldened by JPMorgan's mistakes who argue that a stricter ban on banks using their own money to make trades is needed to prevent a repeat of the 2008 financial crisis. The ban, part of the 2010 Dodd-Frank Act, was named for Paul Volcker, the former Fed chairman who championed the measure.

"The Volcker rule is the law," Bart Chilton, a Democratic member of the Commodity Futures Trading Commission, one of five federal regulators working on the details, said in an e-mail. "JPMorgan's recent circumstances certainly should light a fire under regulators to get on with it ASAP."

For the past year, in part because of public tiffs between Dimon and regulators including Federal Reserve Chairman Ben S. Bernanke, JPMorgan has become the public face of Wall Street's opposition to the Volcker rule.

While Dimon acknowledged the Volcker rule might have prevented the trades in question, he stopped short of endorsing the measure. Later in the hearing, he said the rule was "unnecessary" because of other changes to the banking system, such as higher capital levels, and warned that a tough ban on proprietary trading could restrict access to credit.

'Traffic Laws'

"Think of it as traffic laws," Dimon said. "Some cars should go 65. Some shouldn't. Some streets should be different. Some lights should be bright. Things should be done right. We have the widest, deepest, and best capital markets in the world. It would be a shame to shed that out of anger."

The Dodd-Frank Act requires regulators to make rules that prevent proprietary trading at federally insured financial institutions. Volcker and other proponents argued that banks whose deposits are insured by taxpayers should not be allowed to engage in trading that threatens the stability of the bank and risks a government bailout.

The Fed, along with the CFTC, the Federal Deposit Insurance Corp., Office of the Comptroller of the Currency and the Securities and Exchange Commission, have issued proposed versions of the Volcker rule. They haven't yet completed the rule, which is set to take effect July 21.

Hedging Exemption

Dimon highlighted one of the central challenges facing regulators: how to ban proprietary trading without banning hedges. The Dodd-Frank law specifically allows banks to conduct hedging activities.

"It's going to be very hard to make a bright-line distinction between proprietary trading and hedging because you could look at almost anything we do and call it one or the other," Dimon said. "Every loan we make is proprietary. If we lose money, the firm loses money. If we buy Treasury bonds and they lose money, we lose money."

Under questioning from Senator Richard Shelby of Alabama, the top Republican on the committee, Dimon said that hedges aren't just tools to minimize losses. He said they're also designed to make money for the bank.

"Yes, it's supposed to earn revenue," Dimon said, referring to hedging inside JPMorgan's chief investment office unit, where the $2 billion loss originated. "This particular synthetic credit portfolio was intended to earn a lot of revenue if there was a crisis. I consider that a hedge."

Hedging 'Boring'

Such a strategy can easily backfire on a bank, said Karen Shaw Petrou, a managing partner at Federal Financial Analytics, a Washington research firm.

"Hedging should be boring," she said. "If they make a lot of money, they could also lose a lot of money and they're not hedges. More importantly, if people engaged in the transaction are rewarded for those profits and revenues, then they're not being paid to hedge and by definition anything they do is not hedging."

Dimon said he didn't believe JPMorgan's pay policies "made this problem worse" because "none of these folks were paid on a formula."

Debate Evolves

The hearing illustrated how the Volcker debate has evolved in Washington. Earlier this year, lawmakers and regulators were focused on provisions ensuring that banks can still conduct market-making activities. Since JPMorgan's loss, focus has shifted to the hedging exemption, said Mark Calabria, an economist and the director of financial studies at the Cato Institute in Washington.

"The hedging part is going to get more attention in Volcker because it's the more substantive part," said Calabria, who is also a former aide to Republicans on the Senate Banking Committee. "We basically know what a market maker is. There's so much more subjectivity about hedging."

Dimon said he was glad to continue the discussion over the Volcker rule as well as other Dodd-Frank regulations with lawmakers from both parties -- and would even make arrangements to do it more often in person in Washington.

"We'll even get apartments down here," Dimon said. The Dodd-Frank law "would have been better had there been more collaboration."

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