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Fed Seeking More Information on JPMorgan’s $2 bln Trading Loss

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Federal Reserve officials are gathering more information about the trading position that led to a $2 billion loss at JPMorgan Chase & Co. (JPM), which they have known about for several weeks, according to a person familiar with the matter.

Fed officials don’t view it as their role to approve or reject individual trades at banks, the person said. Rather, their job is to ensure the firms have sufficient capital to withstand losses, said the person, who wasn’t authorized to discuss the matter and asked not to be identified.

JPMorgan Chief Executive Officer Jamie Dimon announced the “egregious” trading loss yesterday, two months after the biggest U.S. bank by assets passed a Fed stress test that put its loans and securities through a scenario of deep recession and a simulated global financial market shock.

“This is the way the system should work,” said Mark Calabria, a former Senate Banking Committee staff member and now director of financial regulation studies at the Cato Institute in Washington. “The capital should be there to actually absorb losses.”

The U.S. Securities and Exchange Commission opened a preliminary investigation into JPMorgan’s disclosures related to the trades, according to a person briefed on the probe who spoke on condition of anonymity because the matter isn’t public.

JPMorgan’s announcement points to gaps in the Fed’s enforcement of governance and risk management, said Robert Eisenbeis, a former research director at the Atlanta Fed.

‘Watching the Store’

“The fact that Jamie Dimon could come out and make some of those statements” raises “lots of questions about who was watching the store,” said Eisenbeis, who is now chief monetary economist at Sarasota, Florida-based Cumberland Advisors. The Fed “ought to be going in and looking at the internal controls and monitoring procedures that the institution is taking, and stress those.”

Krishna Guha, a spokesman for Federal Reserve Bank of New York, JPMorgan's regulator, declined to comment. JPMorgan spokesman Joseph Evangelisti also declined to comment.

The Financial Stability Oversight Council, a group of regulators charged with preventing a financial crisis, wasn't convened to discuss the JPMorgan loss and had no plans to meet, said a Treasury Department official who declined to be identified. The council is chaired by Treasury Secretary Timothy F. Geithner and includes Fed Chairman Ben S. Bernanke.

Capital Ratio

JPMorgan's tier 1 common capital ratio, a measure of capital strength tracked by the Fed, never dipped below 5 percent in the 2012 stress scenario despite a hypothetical $28 billion in trading and counterparty losses and $56 billion in loan losses, according to results of the stress tests released on March 13.

"I don't think this particular number is big enough to get in the way of the capital buffers that JPMorgan has," Robert Engle, winner of the Nobel Prize in economics, said of the $2 billion loss.

"We think of JPMorgan as being one of the more systemic institutions because it is so big," said Engle, a professor at New York University's Stern School of Business, who helped develop a model of systemic risk at the school's Volatility Lab. "But because it is big, a loss like this is not going to bring it to its knees."

JPMorgan shares fell 9.3 percent to $36.96 at the close of trading today in New York. The KBW Bank Index of 24 financial stocks was down 1.2 percent to 46.40.

Separately, the Commodity Futures Trading Commission, the main U.S. derivatives regulator, has been reviewing JPMorgan's derivatives trading activities since last month, according to another person who was briefed on the matter.

The CFTC hasn't opened an enforcement action against the bank, according to the person, who spoke on condition of anonymity because the review is private.

By Craig Torres and Caroline Salas Gage

Courtesy of Bloomberg News