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Six Lessons from JPMorgan's Terrible Thursday

by Rob Blackwell
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WASHINGTON — To put it in the simplistic terms of a classic children's story, JPMorgan Chase (JPM) had a "terrible, horrible, no good, very bad day" on Thursday, agreeing to pay more than $1 billion in regulatory fines and at least $300 million in restitution to customers.

It was slapped with multiple cease and desist orders covering everything from its derivatives trading to debt collection practices to the sale of add-on products for credit cards. In statements, the bank apologized multiple times for the various errors and, in the words of one executive, promised to "get it right" going forward.

While some bankers may be gloating over JPMorgan Chase's pain, considering what critics see as the formerly smug attitude exhibited by its chief executive, the various orders, fines and acknowledgements of guilt have enormous implications for the rest of the industry.

It is a "sea change in enforcement actions by regulators," said Karen Shaw Petrou, the managing partner of Federal Financial Analytics.

Following are the key lessons that other institutions should learn from this debacle:

1. Banks Shouldn't Embarrass Their Regulators

One of JPMorgan Chase's chief errors during the London Whale episode was its failure to communicate with regulators. Both the Federal Reserve Board and Office of the Comptroller of the Currency were forced to admit that they learned about the massive bets the bank was making overseas through media reports.

Perhaps even worse, the bank also allegedly misled its supervisors, telling them that it was reducing its exposure when the opposite was true. The result was a huge embarrassment for the Fed and OCC, which were grilled on Capitol Hill about why they didn't know more.

It is no surprise, then, that the regulators came down hard on the bank, forcing it to pay $920 million

in fines related to the Whale episode in addition to the $6 billion it took in losses.

"One of the messages here is: don't embarrass the regulators and don't hide things from the regulators," said Edward Mills, a policy analyst at FBR Capital Markets.

2. Banks Must Now Acknowledge Guilt

The days of banks agreeing to a large fine while neither "admitting nor denying" the allegations appear to be in the past. In its agreement with the Securities and Exchange Commission, JPMorgan Chase admitted the underlying facts of the case and agreed it had violated several securities laws. That is likely to be a precedent for other enforcement actions going forward.

"Fines can be viewed sometimes as the cost of doing business for some institutions," Mills said. "The admission of guilt is something that is new. This new tack in D.C. makes people sit up — they're less concerned about paying a fine, much more concerned about admitting guilt"

Yet the admission of guilt also appears to be in the bank's own interests.

"Politically, that's huge," said Jaret Seiberg, a policy analyst at Guggenheim Securities. " As a society, we like it a lot better when somebody admits they did something wrong and tells us what they're going to do in the future. ... It can only help, because it makes it look like they're really coming clean and not trying to hide behind legalese."

3. Banks Must Simplify Operations

The fines came shortly after Jamie Dimon, the bank's chairman and CEO, sent an e-mail to employees promising to simplify the firm's various businesses.

"We have been asking our senior people to eliminate products and services that are not essential to serving our customers and are not core to our business," Dimon wrote.

For example, the bank said Thursday it had already stopped offering a credit card add-on product that was the focus of a separate regulatory agreement under which it must now pay $309 million in restitution and face an additional $80 million in civil money penalties.

More recently, the bank dropped its student loan and physical commodities businesses.

The lesson here is simple: Engaging in a slew of additional businesses, such as add-on products where JPMorgan Chase was not effectively overseeing its third-party vendors selling them, is an invitation to disaster.

"They're trying to demonstrate that a megabank can be managed -- that the arguments that, at a certain point, these entities become 'too big to manage' don't hold water," said Seiberg. "So you argue that you're simplifying operations, hiring more people to oversee what's going on and you improve relations with your regulator. All of this is taking a path forward that I think the bank has reason to believe will less contentious."

4. Timing Is Everything

One of the more interesting what-if scenarios is to posit what would have occurred if the London Whale trades had occurred in 2009, during the height of the financial crisis, rather than 2012.

Several other large banks faced problems during the crisis related to internal controls and risk management, yet none paid the same price in terms of attention or fines that JPMorgan Chase just did. The reason is simple: the government then was more worried about harming the system and did not want to potentially upset markets by assessing large fines. With such worries behind it, the

government is likely to be more aggressive with banks in the future.

"If this had happened in 2010... the supervisory response would have been very different," Petrou said.

5. Dimon Is Not Invulnerable

Before and during the financial crisis, Dimon was one of the industry's last remaining stars, someone who could credibly say he didn't need the government's help to weather the storm. In the wake of the London Whale incident, his reputation and credibility have been tarnished.

JPMorgan "came out of the financial crisis perceived... as one of the cleaner mega banks," said Marcus Stanley, policy director for the Americans for Financial Reform. "I think that perception has changed for a long time to come. They have serious internal problems to fix."

Dimon's troubles have also affected the perception of other big banks, which many now see as "too big to manage."

"JPMorgan has long been thought, correctly, I think, to be America's best-managed big bank," said Mark J. Roe, a professor at Harvard Law School. "This just adds some fuel to the notion that something has happened where it just very hard for have even first-rate managers like Jamie Dimon and crew to manage organizations that have become as complex as JPMorgan."

Still, there are signs that Dimon is aiming for a comeback. He's been more outspoken since a failed vote this summer to strip him of his chairman title and appears anxious to put the Whale incident behind him. After his public apologies for the bank's problems — and his pledge to fix them — many believe Dimon will not be in the doghouse for much longer.

"Given that he seems to show remorse and is aiming to correct the course, to me that's probably enough to buttress his position at the bank — most people still respect him," said Jason Ware, an analyst at Albion Financial Group.

6. The Whale May Be Back

One of the bigger questions after Thursday is whether the Whale scandal is truly behind Dimon and his bank. The settlements take care of the Fed, OCC, SEC and others, but there is still the issue of possible criminal wrongdoing. Prosecutors have already charged two traders involved in the case, and Sen. Carl Levin, D-Mich., clearly believes more should follow.

"The whole issue of misinforming investors and the public is conspicuously absent from the SEC findings and settlement," said Levin, the chairman of the Senate Permanent Subcommittee on Investigations, who probed the Whale losses earlier this year. "Our PSI investigation showed that senior bank executives made a series of inaccurate statements that misinformed investors and the public as the London Whale disaster unfolded. Other civil and criminal proceedings apart from this settlement are continuing, so there is still time to determine any accountability on that matter."

Joe Adler, Donna Borak, Victoria Finkle and Rachel Witkowski contributed to this article.

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