

CIO TASK FORCE UPDATE

July 13, 2012

Task force scope

- **Management review and assessment of circumstances surrounding CIO losses**
 - Assisted by outside counsel

- **Comprehensive fact-gathering effort**
 - Conducted numerous interviews with JPMC personnel, including Firm Management, CIO Management, other CIO personnel, Risk and other corporate functions
 - Reviewed emails and other documentary materials
 - Analyzed trade history, valuation of portfolio positions and risk measures (e.g., VaR, stress)

- **Regular progress reviews with Board Review Committee and its advisors in conjunction with their and our ongoing work**

Summary observations

- 1 CIO judgment, execution and escalation in 1Q12 were poor**
- 2 Level of scrutiny did not evolve commensurate with increasing complexity of CIO activities**
- 3 CIO Risk Management was ineffective in dealing with Synthetic Credit Portfolio**
- 4 Risk limits for CIO were not sufficiently granular**
- 5 Approval and implementation of CIO Synthetic Credit VaR model were inadequate**

Historical context

Facts

- **Principal objective of Synthetic Credit Portfolio was to provide benefit in a stressed credit environment**
 - Intended to provide a partial hedge to credit exposures
 - Included long positions to reduce costs of credit protection
 - Adjusted over time to reflect changes in macro views

- **Synthetic Credit Portfolio performed as expected between 2007-2011**
 - Portfolio generated approximately \$2B in P&L during 2007-2011
 - P&L was positive in each year

Transformation of the portfolio

Facts

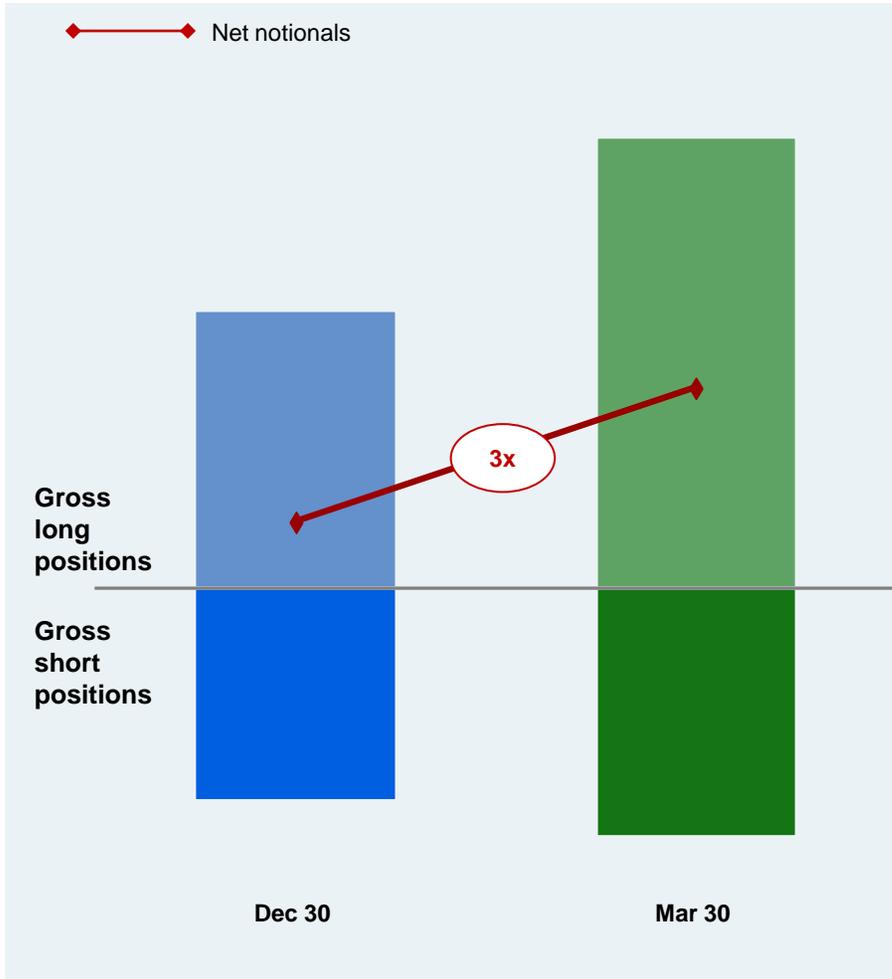
- **In late 2011, Firm Management instructed CIO to reduce Risk Weighted Assets (RWA) as part of annual budgeting process**
- **1Q12: CIO intended to reduce short credit position and lower RWA, while maintaining benefit from individual corporate defaults and optimizing P&L**
 - Increased net long position on Investment Grade (IG) indices
 - Increased short positions in some junior tranches for further default protection
 - Continued to increase size in attempt to balance portfolio and deal with market and P&L pressures, including perceived vulnerability to other market participants
- **By end of March, result was dramatically increased size, complexity and exposure to various risks, including:**
 - Exposure to relationship of Investment Grade to High Yield indices
 - Default correlation across capital structure (e.g., Super Senior vs. Mezzanine)
 - Basis between off-the-run indices and on-the-run indices
- **Despite change in size, complexity and risk, insufficient escalation to Firm Management**

Rapid growth in portfolio size and complexity increased risk

Facts

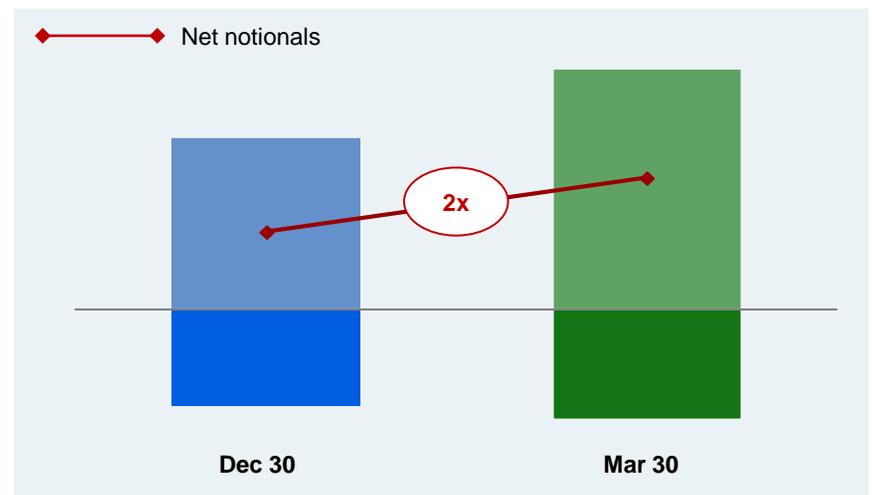
Size:

Increase in portfolio size (notional)

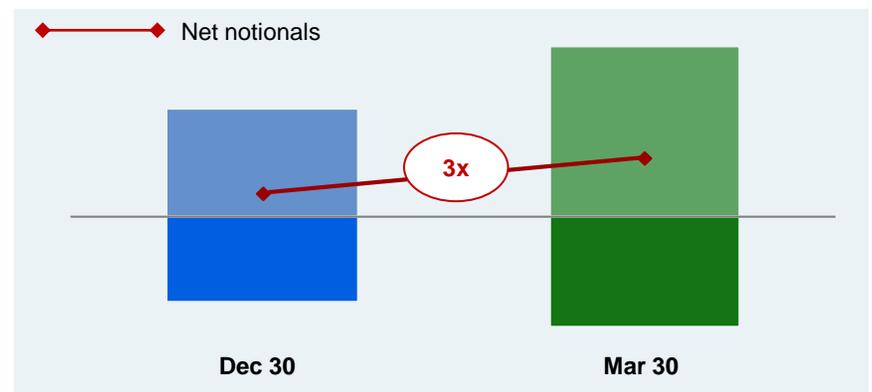


Complexity:

Increase in tranche positions (notional)



Increase in off-the-run indices (notional)



Key events through the build-up of positions

Facts

- **Certain CIO-level risk limits exceeded during 1Q12**
 - Related to credit spread widening
 - Addressed within CIO
- **New Synthetic Credit VaR model approved by independent Model Review Group in late January**
 - In response to VaR limit excessions, Firm Management approved temporary increase of firmwide VaR limit in anticipation of lower VaR from new CIO Synthetic Credit model
- **February CIO Business Review with Firm Management**
 - Limited discussion of Synthetic Credit Portfolio
 - CIO indicated that portfolio was well-positioned and RWA reduction was on track

Vast majority of positions accumulated by March 23

CIO Management directed curtailment of trading on March 23

Key events between position build-up and 1Q12 earnings release

Facts

- **Losses increased in late March**
- **Heightened external market visibility of CIO positions including news reports in early April**
- **Firm Management requested review of Synthetic Credit Portfolio**
 - Head of CIO conducted review with regular updates to CFO and CRO
 - CIO estimated 2Q12 probable P&L range of -\$250mm to +\$350mm (with bias to the positive end) and potential for greater gains or losses in extreme scenarios
 - CIO Management expressed firm belief that market visibility had significantly affected pricing and that P&L would revert
 - CEO and CFO given multiple assurances that position was manageable
- **April 13: Earnings release and Synthetic Credit Portfolio related commentary**

Key events leading up to new CIO leadership and Management Review

Facts

- **Late April: Increase in losses prompts detailed review by Corporate Risk Management**
 - Senior Corporate Risk Management team began on site, bottom-up engagement on April 27 and provides daily updates to Firm Management
 - Corporate Risk Management assumes control of Synthetic Credit Portfolio on April 30

- **Early May:**
 - VaR model analyzed and implementation errors detected; previous model reinstated
 - 10Q filed on May 10 with disclosure pertaining to CIO trading losses; Synthetic Credit Portfolio update provided on May 10 conference call
 - New CIO leadership appointed and Management Review of CIO launched

Facts leading to observations

Facts

- CIO intended to reduce short credit position and RWA in 1Q12
- Executed strategy resulted in increased position size, complexity and risk
- CIO-level risk limits exceeded in 1Q12 and trading curtailed in late March
- CIO review in early April resulted in multiple assurances to Firm Management that position was manageable
- As losses increased in late April, Corporate Risk Management assumed control
- New CIO leadership appointed and Management Review launched in mid-May

Observations

- 1 CIO judgment, execution and escalation in 1Q12 were poor
- 2 Level of scrutiny did not evolve commensurate with increasing complexity of CIO activities
- 3 CIO Risk Management was ineffective in dealing with Synthetic Credit Portfolio
- 4 Risk limits for CIO were not sufficiently granular
- 5 Approval and implementation of Synthetic Credit VaR model were inadequate

1 CIO judgment, execution and escalation in 1Q12 were poor

Observations

- **Trading approach was poorly designed, vetted and executed**
 - Poor trading judgment in 1Q12
 - CIO Management did not set clear objectives, properly vet the trading strategy or sufficiently examine underlying positions and correlations

- **Traders and managers of Synthetic Credit Portfolio did not adequately highlight issues or seek support from broader CIO or Firm Management**

- **CIO-led review and analysis of Synthetic Credit Portfolio in advance of earnings release was too optimistic in hindsight**
 - Gave assurances that magnitude of potential losses was manageable; and that the portfolio was balanced and would recover

2 Level of scrutiny did not evolve commensurate with increasing complexity of CIO activities

Observations

- **CIO's mandate and historical performance may have contributed to less rigorous scrutiny of CIO**
 - Perception that CIO risks were primarily related to managing Firm's investment portfolio
 - Track record of CIO unit
 - Synthetic Credit Portfolio produced positive results from 2007 to 2011

- **This resulted in a level of scrutiny inconsistent with that for client-facing businesses**

3 CIO Risk Management was ineffective in dealing with Synthetic Credit Portfolio

Observations

- **CIO Risk Management group faced challenges**
 - Transitions in key roles and lack of adequate resources
 - Lack of robust Risk Committee structure

- **Nonetheless, CIO Risk Management failed to meet expectations**
 - Inadequacy of risk limits should have been addressed in a timely manner
 - Insufficient engagement in VaR model implementation
 - Not forceful in challenging front office
 - Insufficient escalation to Firm Management

4 Risk limits in CIO were not sufficiently granular

Observations

- **No specific risk limits for Synthetic Credit Portfolio**
 - Portfolio was subsumed within more aggregated CIO limits

- **No limits by size, asset type or risk factor for Synthetic Credit Portfolio**

- **Credit derivatives desk in IB operated under more granular risk limits**

5 Approval and implementation of Synthetic Credit VaR model were inadequate

Facts and observations

- **Between August and November 2011, CIO developed a new Synthetic Credit VaR model to prepare for implementation of Basel 2.5**
- **Independent Model Review Group (MRG) review between November 2011 and January 2012 focused primarily on methodology and CIO-submitted test results**
 - Model review policy and process presumed robust operational and risk infrastructure that exists in client-facing businesses
 - Relied on CIO to conduct parallel testing and ensure operational stability
- **CIO Risk Management played passive role in model development, approval, implementation and monitoring**
 - Relied on testing by front office prior to implementation
 - Insufficient challenge of VaR results generated by the front office prior to approval
 - Insufficient ownership, oversight, and post-implementation monitoring of VaR operational environment
- **Implementation of model by CIO front office suffered from operational challenges**
- **Although a correctly implemented model was expected to result in lower VaR, errors in model implementation contributed to a further lowering of VaR**

Observations leading to remedial actions

Observations

- 1 CIO judgment, execution, and escalation in 1Q12 were poor
- 2 Level of scrutiny did not evolve commensurate with increasing complexity of CIO activities
- 3 CIO Risk Management was ineffective in dealing with Synthetic Credit Portfolio
- 4 Risk limits for CIO were not sufficiently granular
- 5 Approval and implementation of Synthetic Credit VaR model were inadequate

Remedial Actions

- CIO leadership, governance, mandate and processes revamped
- Corporate oversight of CIO enhanced to firmwide levels of oversight
- Risk Management findings addressed
 - CIO Risk Management strengthened
 - Risk committees enhanced
 - Ensured granular market risk limits firmwide
 - Model development and governance strengthened

CIO leadership, governance, mandate and processes revamped

Remediation

Team	<ul style="list-style-type: none">■ New CIO management team appointed on May 14, 2012■ Established stronger linkages across regional CIOs■ Enhancing talent and resourcing of key support functions
Governance	<ul style="list-style-type: none">■ Instituted robust committees to improve governance and controls (weekly Investment Committee, monthly Business Control Committee, monthly CIO Valuation Governance Forum)■ Restructured governance to ensure tight linkages between CIO, Corporate Treasury, and other activities in Corporate■ Corporate Business Reviews to be conducted with same structure and frequency as for client-facing businesses
Mandate	<ul style="list-style-type: none">■ Focus on core mandate of managing the Firm's investment portfolio■ Support other firmwide needs such as hedging currency and capital exposures
Reporting and controls	<ul style="list-style-type: none">■ Enhanced key business processes and reporting (e.g., CIO Executive Management Report, Daily Risk Report)■ Improved controls around valuation and independent price testing

Risk Management observations addressed

Remediation

CIO Risk Management

- New Chief Risk Officer for CIO and Corporate Sector
- Added resources and talent in CIO Risk
- Modified market risk reporting to best practice levels

Risk governance

- Launched Joint Treasury-CIO-Corporate Risk Committee
 - Detailed portfolio reviews conducted for sub-portfolios in CIO
- Enhanced firmwide oversight

Risk limits

- Introduced granular limits across CIO
- Reaffirmed market risk limits and thresholds across Firm
- Strengthened firmwide limit excession policy for more rapid escalations and more thorough periodic reviews

Enhancements to model approval and monitoring

Remediation

Clarified roles of Model Review Group (MRG), LOB Risk Management and front office in model development, approval, implementation and monitoring

Model Review Group

- MRG to approve models based on an evaluation of:
 - The integrity of the analytical framework
 - Independent analysis of results
 - Soundness of operational environment
- Enhanced MRG oversight of implemented models
 - Formed new team to review model usage and environment
 - MRG to sign-off on LOB actions and monitoring post-implementation

Line of Business

- LOB responsibilities to include:
 - Conducting independent tests of models
 - Ensuring robust operational environment
 - Regular post-implementation monitoring
 - Remediation of action plans proposed by MRG
- Risk-based model approval hierarchy including escalation to LOB Risk Committees

We believe the losses in CIO are an isolated failure

Circumstances in CIO were unique

- CIO's mandate is to offset firmwide balance sheet risk
- Preponderance of activity was managing the Firm's investment portfolio

We have done a thorough review

- CIO activities inspected
 - Mandates reconfirmed
 - Appropriate risk parameters in place
- Affirmed appropriateness of risk limits in all trading areas
- Conducted risk assessment across all LOBs

Management focus on risks taken in client-facing business has been, and continues to be, rigorous

Q & A

- CIO valuation matters
- Compensation

CIO valuation matters

Q1 2012 Earnings restatement¹

- **CIO valuation processes related to quarter-end**
 - CIO traders marked their positions at end of Q1
 - CIO's Valuation Control Group (VCG), which is part of Finance, verified that trader marks were within pre-established thresholds that considered market bid/offer spreads; marks outside those thresholds were adjusted
- **Management review has recently identified concerns around the integrity of traders' marks**
 - Emails, voice tapes and other documents, supplemented by interviews, suggestive of trader intent not to mark positions where they believed they could execute
 - Traders may have been seeking to avoid showing full amount of losses
 - As a result, the Firm decided to utilize external mid-market benchmarks, adjusted for liquidity considerations

Q1 2012 Material weakness¹

- Management has concluded that a material weakness in the CIO valuation controls over the Synthetic Credit Portfolio existed in Q1 2012
- We believe the material weakness has been substantially remediated in Q2 2012 and does not exist elsewhere in the Firm

¹ For further detail, please refer to the Form 8-K

Employment-related actions for responsible CIO managers

- **To date, all CIO managers based in London with responsibility for Synthetic Credit Portfolio have been separated from the Firm**
 - No severance
 - No 2012 incentive compensation
- **Decision to claw back compensation from each individual**
- **Maximum permitted clawbacks invoked**
 - Represents approximately 2 years of total annual compensation for each individual
 - Includes restricted stock clawbacks and cancelled stock option grant values
- **Broad set of factors considered in clawback decisions**
 - Balance of factors different in each case
- **The Board has reviewed these decisions**

Board statement on other compensation determinations

- **For all other individuals, 2012 performance-year compensation and clawbacks, if appropriate, will be determined in the ordinary course considering, among other things, the following factors:**
 - Company, unit and individual performance both on absolute and relative basis
 - Achievement of non-financial objectives
 - Involvement in and responsibility for CIO matter
 - Made public as required