Testimony of Jamie Dimon
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Chairman Angelides, Vice-Chairman Thomas, and Members of the Commission, my name is Jamie Dimon, and I am Chairman and Chief Executive Officer of JPMorgan Chase & Co. I appreciate the invitation to appear before you today. The charge of this Commission, to examine the causes of the financial crisis and the collapse of major financial institutions, is of paramount importance, and it will not be easy. The causes of the crisis and its implications are numerous and complex. If we are to learn from this crisis moving forward, we must be brutally honest about the causes and develop an understanding of them that is realistic, and is not – as we are too often tempted – overly simplistic. The FCIC's contribution to this debate is critical as policymakers seek to modernize our financial regulatory structure, and I hope my participation will further the Commission's mission.

The Commission has asked me to address a number of topics related to how our business performed during the crisis, as well as changes implemented as a result of the crisis. Some of these matters are addressed at greater length in our last two annual reports, which I am attaching to this testimony.

While the last year and a half was one of the most challenging periods in our company's history, it was also one of our most remarkable. Throughout the financial crisis, JPMorgan Chase never posted a quarterly loss, served as a safe haven for depositors, worked closely with the federal government, and remained an active lender to consumers, small and large businesses, government entities and not-for-profit organizations. As a result of our steadfast focus on risk management and prudent lending, and our disciplined approach to capital and liquidity management, we were able to avoid the worst outcomes experienced by others in the industry.

Throughout the crisis, we maintained capital ratios far in excess of "well capitalized standards." We began 2008 with a Tier 1 capital ratio of 8.4% and ended it at 8.9% (10.9% including Troubled Asset Relief Program (TARP) funds). At the end of the third quarter of 2009, following our repayment of TARP, our Tier 1 capital ratio stood at 10.2%. Our Tier 1 common ratio at the beginning of 2008 was 7.0% and stood at 8.2% at the end of the third quarter of 2009. In addition to our strong capital ratios, we maintained a high level of liquidity to prepare for unexpected draws and increased our loan loss reserves to account conservatively for anticipated losses.

To be sure, there are a number of things we could have done better: the underwriting standards in our mortgage business, for example, should have been higher, and we wish we had done an even better job in managing our leveraged lending and mortgage-backed securities exposures, all of which I discuss later in my testimony. But our entire team – including the firm's credit officers, risk officers, and legal, finance, audit and compliance teams – worked diligently to address these issues and minimize the cost to our company and our customers. I would like to outline a few of the actions we took leading up to and during the financial crisis.

- The mortgage market meltdown occurred for a number of reasons, but new and poorly underwritten mortgage products were a significant contributor that proved costly for consumers, the entire financial system and our economy. Even before I became CEO in 2005, JPMorgan Chase was intently focused on managing cyclical risks. We recognized that credit losses, both consumer and wholesale, were extremely low, and we decided not to offer higher-risk, less-tested loan products. In particular, we did not write payment option ARMs (adjustable rate mortgages that often led to higher principal balances and decreased home equity for borrowers) because we did not think they were appropriate products for consumers. Although we made mistakes in the mortgage business, this was not one of them.

- We did not build up our structured finance business. While we are a large participant in the asset-backed securities market, we deliberately avoided large, risky positions on structured collateralized debt obligations (CDOs).

- JPMorgan Chase did not unduly leverage our capital, nor did we rely on low-quality forms of capital. We have always used conservative accounting, built up appropriately strong loan loss reserves (which now exceed $30 billion), and have been acutely focused on maintaining a fortress balance sheet. In addition, we have always maintained a high level of liquidity and have been prepared for unexpected draws on liquidity. We continually stress test our capital and liquidity to ensure that we can withstand a wide range of highly unlikely, but still possible, negative scenarios. High-quality capital, strong loan loss reserves, and strong liquidity helped us to weather the storm and continue to serve our clients by making loans throughout the period.

- We avoided short-term funding of illiquid assets and did not rely heavily on wholesale funding. In addition, we essentially stayed away from sponsoring structured investment vehicles (SIVs) and minimized our financing of SIVs for the same reasons. We viewed SIVs as arbitrage vehicles with plenty of risk but little business purpose. In 2005, we divested the only small SIV we had sponsored.

Bear Stearns and Washington Mutual

Because of our strong foundation, JPMorgan Chase was called on during the crisis to take actions to help stabilize the financial system: the acquisition of Bear Stearns in March of 2008 and the purchase of Washington Mutual assets in September 2008. While we believed these transactions would produce long-term benefits for our company, each carried – and still carries – substantial risk. We were willing and able to take on these risks as a result of our strong balance sheet and capital base.

Over the weekend of March 15, 2008, the federal government asked us to assist in preventing Bear Stearns from going bankrupt before the opening of the Asian markets on Monday morning. To a person, our Board of Directors felt JPMorgan Chase had a special obligation to do all we could to help, especially knowing that we were among the few companies in a position to do so. However, this deal also had to make sense for our shareholders. We ultimately believed it did. Our first post-acquisition priority was to reduce our risk by consolidating Bear Stearns' approximately $400 billion in assets into our financial and risk systems and quickly reduce them to approximately $200 billion of assets. We asked the government to finance and assume the risk (beyond the first $1 billion of possible losses) on approximately $30 billion of the less risky mortgage assets, as we believed it would have been irresponsible for us to take on the full risk of all of those assets at that time. We knew that most of the common equity we were buying would be used for close-down costs, litigation expenses, severance costs and quickly eliminating the risk on the balance sheet. As it turned out, all of the equity was used up in this process and several billion dollars in losses ran through our income statement in the second half of 2008.

On September 25, 2008, the Federal Deposit Insurance Corporation (FDIC) seized the banking assets of Washington Mutual in the largest bank failure in U.S. history. We acquired the deposits, assets and certain liabilities of Washington Mutual, and later learned we were the only bank that had been prepared to act immediately in response to the FDIC's efforts to find an acquirer. Absent this acquisition, Washington Mutual's failure could well have imposed enormous costs on the FDIC's deposit insurance fund as well as uninsured depositors. With the acquisition, we purchased approximately $240 billion of mortgage and mortgage related assets, with $160 billion in deposits and $38 billion in equity. We immediately wrote down most of the bad or impaired assets (approximately $31 billion) and established proper reserves for the remaining assets, as well as for severance and close-down costs. We also sold $11.5 billion in common stock the morning after the deal announcement to maintain our strong capital base.

TARP Funds

On October 13, 2008, I went to Washington, DC with eight other chief executives of other financial firms. We were asked by the Secretary of the Treasury, the Chairman of the Federal Reserve, the Office of the Comptroller of the Currency, the FDIC and the New York Federal Reserve Bank to agree to accept a package of capital from the government to help fix the collapse in the credit and lending markets.

JPMorgan Chase did not ask for, nor did we need, a capital infusion from the federal government. As I noted earlier, our capital ratios remained well in excess of recommended regulatory levels throughout the crisis, even excluding federal assistance. We continued to lend to customers, invest in the business, hire new employees, and attract substantial deposit flows. However, federal officials asked us to set an example for others by accepting the TARP funds as a sign of support for the government's actions to strengthen the economy. We viewed our participation as the right thing to do for the economy and the financial system. We think the government acted boldly in a very tough situation, and the outcome possibly could have been far worse had it, and other governments around the world, not taken such steps. Some individual financial institutions were certainly rescued through these actions, but the entire economy benefited from the restoration of stability to the financial system.

After acceptance of the government's $25 billion preferred stock investment, we continued our lending activities to consumers, businesses and governments. In the fourth quarter of 2008 alone, we extended over $150 billion in new credit to consumers, businesses, municipalities and non-profit organizations. That figure includes over $50 billion in new consumer originations (mortgages, home equity loans, credit cards, student loans, auto loans, etc.); over $20 billion in new credit extended to 8,000 small and mid-sized businesses; and $90 billion in new and renewed commitments to our corporate and other clients. We also dramatically increased our presence in the interbank market, lending an average of $50 billion a day to other banks. We did so while maintaining prudent risk management and underwriting standards, mindful of market and credit risks.

In early May 2009, we successfully completed an extensive stress testing program for major banking institutions that determined there would be no need for us to raise additional capital even under the most adverse scenario envisioned by regulators. After consultation with our regulators and the Treasury Department, we received approval to pay back TARP funds in June 2009. Along with the $25 billion that we repaid, we paid $806 million in dividends on the preferred stock. In December 2009, the United States Treasury sold for $936 million the JPMorgan Chase warrants it received in connection with its TARP investment. Thus, all told, taxpayers received more than $1.7 billion, or an 11% annualized return on their investment.

Lines of Business

You have requested that we detail our business models and our major sources of income. We have six lines of business: our Investment Bank, Retail Financial Services, Card Services, Commercial Banking, Treasury and Securities Services and Asset Management.

Investment Bank.

Our Investment Bank advises corporations, governments and investors and raises capital for these clients. We also execute trades, provide research, make markets and give our clients the ideas and financing they need to grow their businesses and execute their investment plans. Throughout the financial crisis, we continued to support our clients' financing and liquidity needs. For example, we helped provide state and local governments financing to cover cash flow shortfalls (we were the only institution that agreed to lend California $1.5 billion to help stabilize its cash flow). The tough economic environment led to write downs in leveraged lending and mortgage-related assets, some of which were associated with the acquisition of Bear Stearns, and from 2008 through the third quarter of 2009, our Investment Bank increased reserves by nearly $3.4 billion.

Retail Financial Services.

Our Retail Financial Services business serves consumers and businesses through personal service at bank branches and through ATMs, online banking and telephone banking, as well as through loan offices, auto dealerships and school financial aid offices. During the financial crisis, deposit flows to our Retail Banking business increased substantially, even before taking account of deposits related to our acquisition of Washington Mutual. Primarily due to weak economic conditions and housing price declines, we increased provisions for credit losses in our Consumer Lending business. From 2008 through the third quarter of 2009, we increased our reserves by more than $10 billion. In the third quarter of 2009, small business loan applications were down 37% over the previous year, yet we have maintained our lending to small businesses at nearly the same levels despite this drop in demand. In November 2009, we also announced plans to increase lending to small businesses by up to $4 billion in 2010, boosting total expected new lending to about $10 billion this year.

Card Services.

Our Card Services business offers a wide variety of general purpose cards to meet the needs of individual consumers, small businesses and partner organizations. We also issue several private-label cards and cards for small business owners. At a time of deteriorating credit conditions, we were able to keep credit open and available to both businesses and individual customers in a safe and sound manner. The net charge off rate for 2008 was 5% of loans, up 48% over 2007. Early in the crisis, we made considerable risk management improvements that helped to minimize losses. As with small business lending, credit card demand has decreased, with consumer card spending down 7% through the third quarter of 2009, and the net charge off rate rising to 10.3% in the third quarter of 2009. From 2008 through the third quarter of 2009, our Card Services business increased reserves by almost $6 billion.

Commercial Banking.

Our Commercial Banking business works with our other lines of business to provide lending, treasury services, investment banking and asset management for thousands of corporations, municipalities, financial institutions, not-for-profit organizations, and real estate investors and owners. While there have been losses in certain sectors, including real estate and commercial construction, our business and reserves remained strong throughout the crisis, which we attribute to strong credit quality, risk management, client service, operational efficiency, expense control and effective pricing. We added $1.4 billion to our reserves between the beginning of 2008 and third quarter of 2009.

Treasury and Securities Services.

Our Treasury and Securities Services (TSS) provides cash management, trade, wholesale card and liquidity products and services; holds, values, clears and services securities, cash and alternative investments; and manages depository receipt programs. These services are provided to small- and mid-sized companies, multinational corporations, financial institutions, government entities, investors and broker-dealers throughout the world. During the financial crisis, we helped our clients to optimize their working capital, manage their collateral and help mitigate their risk.

Asset Management.

Our Asset Management business provides investment and wealth management services to institutions, retail investors and high-net-worth individuals throughout the world. These services include global investment management in equities, fixed income, real estate, hedge funds, private equity and liquidity; trust and estate, banking and brokerage services to high-net worth clients; and retirement services for corporations and individuals. During the crisis, we experienced a significant inflow of new clients and there was a large change in the mix of assets under management. Cash we manage for clients increased dramatically, with liquidity balances growing substantially as clients moved from riskier investments. The considerable strain on short-term debt markets during the crisis also threatened the viability of money market funds, and we worked closely with industry groups and regulators to protect these funds and stabilize the industry.

While some of our businesses have faced substantial headwinds over the course of the financial crisis, others have performed remarkably well. Our size and our diversity of businesses have helped us. Size matters in businesses where economies of scale can be critical to success, particularly in areas such as systems, operations, innovation and especially risk diversification. I believe our performance and the events of the last 18 months validate this.

Some have suggested that size alone, or the combination of investment banking and commercial banking, contributed to the crisis. We disagree. If you consider the institutions that have failed during the crisis, many have been small; some of the largest and most consequential failures were firms that were principally engaged in one business. JPMorgan Chase has grown in a manner that strengthened each of our businesses, and without the diversification and synergies permitted by our business model, it is far from certain that we could have acquired Bear Stearns or Washington Mutual.

Our economy needs financial institutions of all sizes, business models and areas of expertise to promote economic stability, job creation and consumer service. America's largest companies operate around the world and employ millions of people. These firms need banking partners that operate globally, offer a full range of products and services, and provide financing in the billions of dollars.

But let me be clear: No institution, including our own, should be "too big to fail." The solution is not to cap the size of financial firms. We need a regulatory system that provides for even the biggest bank to be allowed to fail, but in a way that does not put taxpayers or the broader economy at risk. Creating the necessary structures to allow for the orderly failure of a large financial institution starts with giving regulators the authority to facilitate and manage failures when they occur. Under such a system, a failed bank's shareholders should lose their value; unsecured creditors should be at risk and if necessary, wiped out. A regulator should be able to terminate management and boards and liquidate assets. Those who benefited from mismanaging risks or taking on inappropriate risk should feel the pain. I think there is much that can be learned from the process by which the FDIC closes banks today.

Changes in Business Operations

While we were able to withstand the crisis and I believe emerge as a stronger institution, we, like many others, made mistakes. As always, we try to learn from them.

In our Investment Bank, we should have been more diligent when negotiating and structuring commitment letters to fund future transactions in our leveraged lending business. We allowed the lending terms to create too much leverage and assumed too stable a market appetite for these types of loans. In response, we have returned to more traditional lending standards and have tightened the level of loan commitments we will make prior to syndication.

As the overall amount of counterparty risk grew in the derivatives market, so did our concern about increased exposure. To address this issue, we supported the development of clearinghouses to reduce counterparty risk and increase transparency for standardized contracts.

In 2009, we worked with the Federal Reserve and other major swaps dealers to launch a clearinghouse for credit default swaps.

We also misjudged the impact of more aggressive underwriting standards and should have acted sooner and more substantially to reduce the loan-to-value ratios. We have substantially enhanced our mortgage underwriting standards, returning to traditional 80% loan-to-value ratios and requiring borrowers to document their income. We also closed down all business originated by mortgage brokers. Our worst mistake over the past several years was not doing this sooner. In general, credit losses in the broker-originated business are two to three times worse than that of the business we originated ourselves.

JPMorgan Chase is also at the forefront in doing everything we can to help families meet their mortgage obligations. Even before this current crisis, we undertook comprehensive efforts to help families avoid foreclosure. Our foreclosure prevention efforts include both the loans that we own and those that we service. We believe that it is in the best interests of both the home owner and the mortgage holder to take corrective actions as early as possible. Since 2007, we have helped prevent over 885,000 foreclosures through our own program, as well as through participation in government programs like the U.S. Making Home Affordable initiative. Through November 30, 2009, we have offered almost 570,000 new trial loan modifications to struggling homeowners. Of these, over 112,000 loans have been approved for permanent modification.

We are also conducting extensive outreach to borrowers. By March 31, 2010, Chase will have opened 51 mortgage assistance centers across the country where our customers receive direct and personal assistance in reviewing their mortgage loans and documents, and gain a better understanding of their options. We also launched a coordinated program to call a customer 36 times, reach out by mail 15 times and make at least two home visits, if necessary, to obtain the appropriate documents. We attempt to explore every avenue for borrowers in helping them keep their homes.

As I noted earlier, we have also made changes to our credit card business, including raising the credit score threshold for direct mail marketing; increasing the number of applications subject to a more thorough review process; lowering credit lines for the riskiest borrowers while offering extensions to the most creditworthy borrowers; and closing accounts that are inactive, which in our experience, are at increased risk. We are offering payment plans for our borrowers where necessary. In 2008, we enrolled 600,000 borrowers in payment plans - flexible plans that help borrowers who are experiencing economic challenges.

In September 2009, our Retail Financial Services business announced changes to our debit card overdraft protection policies to make them clearer and simpler, and to give customers more control over their debit cards and the fees they pay.

In Commercial Banking, we have re-focused resources to our workout units, where clients at risk can receive assistance from expert senior management. To meet the needs of our clients in these difficult economic times, we are also working across the board to upgrade our infrastructure – systems, data centers, products and services.

Executive Compensation

Many have questioned the extent to which compensation practices at financial institutions incentivized excessive risk taking. I think some of those concerns are quite legitimate.

At JPMorgan Chase, we have long-adhered to compensation practices that are designed to reward long-term performance, not just revenues, and we have aimed to align employee and shareholder interests. We believe our practices have been in keeping with prudent risk management standards. Before the financial crisis and since, we have used a disciplined and rigorous approach to compensation:

- We have always paid our employees based on risk-adjusted, multi-year performance that considers whether they have helped to build a company with long-term, sustainable performance.
- We have had in place a bonus recoupment policy beyond that required by Sarbanes-Oxley.
- We don’t have change-of-control agreements, special executive retirement plans, golden parachutes, special severance packages for senior executives, merger bonuses, and eliminated just about every other perquisite.
- We have always paid a significant percentage of our incentive compensation in stock that vests over multiple years, and require our most senior executives to hold approximately 75% of all stock they have ever received from the company until retirement.

Many of our employees took significant cuts in compensation in 2008, and the more senior executives took the larger percentage cuts. For our most senior management group, incentive compensation declined more than 60%. I did not receive any bonus in 2008. For the firm as a whole, average incentive compensation per employee was down 38%. This is true even though, during one of the most tumultuous periods our economy has ever experienced, we earned a profit in every quarter and executed the Bear Stearns and Washington Mutual transactions. Our employees worked harder than ever and performed admirably for the company and for clients under enormously challenging conditions in 2008. I believe our compensation policies have been and remain appropriate. While we haven’t finalized our compensation arrangements for 2009, we will continue to pay our employees in a responsible and disciplined manner that allows us to attract and retain the best talent and reward their long-term, risk-adjusted performance over a broad spectrum of criteria.

Causes of the Financial Crisis

I would be remiss if I did not touch briefly on some of the factors I believe led to our current economic situation. This is necessarily a truncated recitation, as economists, historians and policymakers will no doubt debate the causes – and fill books with their views on them – for years to come. I believe the key underlying causes of the crisis include: the creation and ultimately the bursting of the housing bubble; excessive leverage that pervaded the system; the dramatic growth of structural risks and the unanticipated damage they could cause; regulatory lapses and mistakes; the pro-cyclical nature of policies, actions and events; and the impact of huge trade and financing imbalances on interest rates, consumption and speculation. Each of these causes had multiple contributing factors, many of which were known and discussed before the crisis.

As the housing bubble grew, new and poorly underwritten mortgage products helped fuel asset appreciation, excessive speculation and far higher credit losses. Mortgage securitization had two major flaws that added risk: nobody along the chain had ultimate responsibility for the results of the underwriting for many securitizations, and the poorly constructed tranches converted a large portion of poorly underwritten loans into Triple A-rated securities. In hindsight, it's apparent that excess speculation and dishonesty on the part of both brokers and consumers further contributed to the problem.

Excessive leverage by consumers, some commercial banks, most U.S. investment banks and many foreign banks, pervaded the system. This included hedge funds, private equity firms, banks using off-balance sheet arbitrage vehicles, nonbank entities, and even pension plans and universities.

Several structural risks or imbalances grew in the lead-up to the crisis. Many structures increasingly relied on short-term financing to support illiquid, long-term assets. A small structural risk in money market funds that allowed investment in up to 180-day commercial paper or longer term asset-backed securities became a critical point of failure when losses on such securities encouraged investors to withdraw their funds and liquidity was not available to meet redemptions. Over time, repo financing terms became too loose, with some highly leveraged financial institutions rolling over this arrangement every night. Financial institutions were forced to liquidate securities at distressed prices to repay short-term borrowing. Investors caused enormous flows out of the banking and credit system as they collectively acted in their own self-interest.

In many instances, stronger regulation may have been able to prevent some of the problems. I want to be clear that I do not blame the regulators. The responsibility for a company's actions rests with the company's management. However, it is important to examine how the system could have functioned better. The current regulatory system is poorly organized with overlapping responsibilities, and many regulators did not have the statutory resolution authority needed to address the failure of large, global financial companies.

While banks in the mortgage business were regulated, most of the mortgage industry was not or lacked uniform treatment – mortgage brokers were not regulated and insurance regulators were essentially unaware of large and growing one-sided credit insurance and credit derivative bets by some companies. Basel II capital standards, which were adopted by global banks and U.S. investment banks, allowed too much leverage. Extraordinary growth and high leverage of Fannie Mae and Freddie Mac were allowed where the fundamental premise of their credit was implicit support by the U.S. government.

The abundance of pro-cyclical policies has proven harmful in times of economic distress. Loan loss reserving causes reserves to be at their lowest levels at times when high provisioning is needed the most. Although we are a proponent of fair value accounting in trading books, we also recognize that market levels resulting from large levels of forced liquidations may not reflect underlying values. Continuous credit downgrades by credit agencies in the midst of a crisis also required many financial institutions to raise more capital.

Many macroeconomic factors also contributed to the crisis, including the impact of huge trade and financing imbalances on interest rates, consumption and speculation. The U.S. trade deficit likely kept U.S. interest rates low, and excess demand kept risk premiums depressed for an extended period of time.

Conclusion

The great strength of any organization – and indeed our country – lies in our ability to face problems, to learn from our experiences and to make necessary changes. I would like to thank the Commission for their contribution to this process and commitment to identifying the causes of the crisis. JPMorgan Chase stands ready to assist the Commission in any way we can. Thank you for the opportunity to testify before you today.