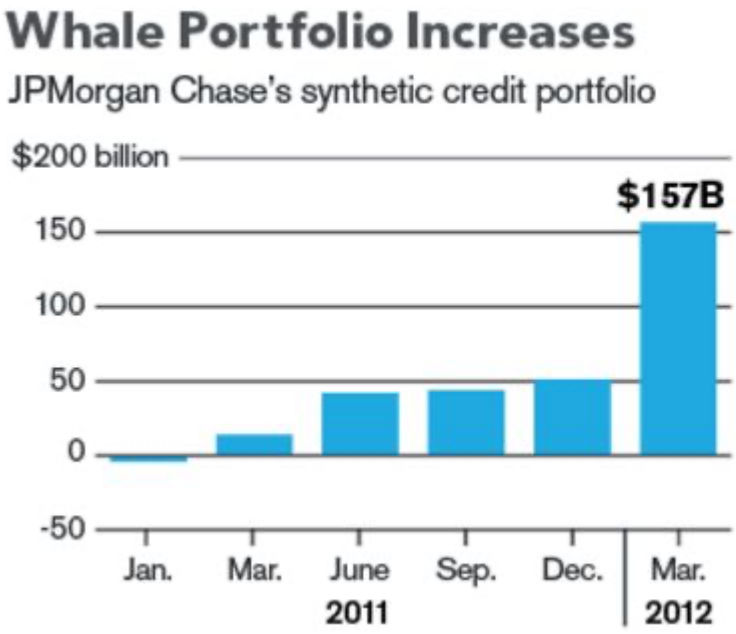
The London Whale

The trader known as the London Whale lost at least $6.2 billion for JPMorgan Chase & Co. in 2012. That's a lot of money until you remember that it didn't stop the bank from earning a record profit of $21.3 billion the same year. The pain came elsewhere: Two former traders face criminal charges, the bank admitted violating securities laws and agreed to pay fines of more than $1 billion, a U.S. Senate subcommittee wrote a scathing report and the bank's chief executive, Jamie Dimon, took a pay cut. The London Whale case drew a bigger reaction than other missteps by banks since the 2008 financial crisis, partly because of Dimon's previous rock-star status. More importantly, it raised two worrisome questions: What if the banks are still addicted to risk? And what if regulators haven't gotten better at spotting that?

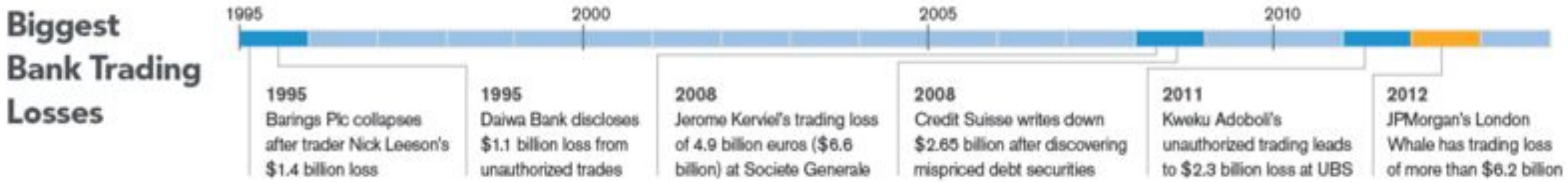
The Situation

Neither the Whale himself, Bruno Iksil, nor any senior managers faced criminal charges. (Iksil, who says the losses weren't his fault, is cooperating with prosecutors.) Iksil's former boss and a junior trader were indicted in 2013, but the charges weren't about the trades themselves — U.S. prosecutors say the pair committed securities fraud by hiding the true extent of losses from bank management. Lawyers for both men, who remain in Europe, say they're innocent. In April 2015, a Spanish court rejected the U.S. extradition request in the case of Iksil's supervisor, Javier Martin-Artajo. The former head of Iksil's division was fined $1.1 million for failing to be forthcoming with British regulators. At home, Dimon faced criticism in the Senate's report, which said the bank misled investors and dodged regulators as losses mounted. In 2013, the bank reported the first quarterly loss of his tenure, with results weighed down by $7.2 billion in legal costs, including a $100 million settlement with the Commodity Futures Trading Commission, which found that it had deployed a reckless trading strategy. In early 2016, the bank reached a tentative $150 million settlement of lawsuits filed by investors. Regulators faced criticism, too; the U.S. Federal Reserve's Inspector General issued a report saying they had botched oversight of the JPMorgan unit where the losses took place.



The Background

In a sense, what Iksil and his colleagues did was the same old story — doubling down after a loss with bigger and bigger bets. But plenty more was wrong. They worked in a part of the bank, the Chief Investment Office, whose job was to hold down the bank's risk level. Instead, the CIO used the $350 billion it had to invest (much of it from federally insured deposits) to become a money-maker, with its London office focused on complex derivative trades that had less and less to do with hedging. In 2011, for example, one trade by Iskil brought in $400 million. The trouble came in early 2012, when the bank decided to reduce the risk in the London swaps portfolio by making more offsetting bets. As the strategy unravelled, Iksil's positions grew so big that they disrupted the thinly traded markets he worked in — earning him nicknames of Whale and Voldemort, and making his group's hard-to-unwind trades a target for hedge funds. After the trades collapsed, regulators found that Iksil's colleagues had been keeping two sets of books to minimize the projected size of the losses — a discovery that triggered investigations in the U.S. and U.K.



The Argument

When the Whale's trading first came to light, Dimon dismissed it as "a tempest in a teapot." Later he was more contrite, calling the trades "flawed, complex, poorly reviewed, poorly executed and poorly monitored." The Senate report, however, depicted not the work of a rogue trader but a broader systemic failure: Risk limits, for instance, were breached more than 300 times before the bank switched to a more lenient risk-evaluation formula — one that underestimated risk by half because of a spreadsheet error. The report by the Fed's inspector general also supported the view that deeper issues were involved here, as it showed failures in prioritization, loss of institutional knowledge through turnover and poor coordination among agencies. To critics of Wall Street, the real lesson of the London Whale is that megabanks such as JPMorgan are not only too big to fail — they may also be too big to manage and too big to regulate.

The Reference Shelf

- The March 2013 Senate report.
- JPMorgan’s internal report on the CIO losses.
- Bloomberg news timeline of biggest trading losses.
- The New Yorker asks, “Would Better Regulation Have Prevented the London Whale Trades?“

https://www.bloomberg.com/quicktake/the-london-whale

Case -1
Wachovia to settles drug-money laundering case

Banking giant Wachovia Corp. paid $160 million to settle a federal investigation into laundering of illegal drug profits through Mexican exchange houses in the largest case of its kind ever brought against a U.S. bank..

"This is historic," acting U.S. Attorney Jeffrey Sloman said. "There is no other case like this one anywhere."

The probe, began when a Drug Enforcement Administration narcotics dog in Florida detected cocaine traces in an airplane, ultimately uncovered at least $110 million in drug profits laundered from Mexico through Wachovia. The total settlement included forfeiture in that amount plus a $50 million fine.

The agreement ensured Wachovia and its executives escaped criminal prosecution in return for the $160 million payment and significant improvements in its anti-money laundering program.

Wachovia, now a unit of San Francisco-based Wells Fargo & Co., said in a statement that Wells Fargo had already set aside money to pay the settlement.

The $160 million fine and forfeiture represents the biggest penalty ever imposed under the Bank Secrecy Act, which requires financial institutions to keep close tabs on suspicious transactions that could indicate money is being laundered from criminal enterprises. According to prosecutors, Wachovia's program was woefully inadequate and bank executives knew it, meaning that numerous red flags were missed over a three-year period.

In fact, Wachovia had no way of checking some $420 billion in transactions from Mexican exchange houses for possible money-laundering activity. That means investigators didn't get potentially key information on drug cartels, terrorist financing networks and other organized crime enterprises.

Beginning with that DEA drug-sniffing dog, investigators began tracing the source of money for airplanes being used to ferry cocaine in Colombia and Mexico that was ultimately destined for the U.S. Those initial money transfers were overseen by a Wachovia office in Miami.

Ultimately at least $13 million from the Mexican exchanges went through Wachovia for the purchase of aircraft, according to court documents. Four of them were seized by investigators, along with more than 22 tons of cocaine.From there, investigators from the DEA, Internal Revenue Service and other agencies tracked billions of dollars in wire transfers, bulk cash shipments and other transactions from the Mexican exchanges through Wachovia. Many were considered suspicious, including such tactics as multiple round-number wire transfers on the same day for a single account; deposits of traveler's checks with sequential numbers that contain unusual markings; and bulk cash transfers up to 50 percent larger than a customer had led Wachovia to expect.