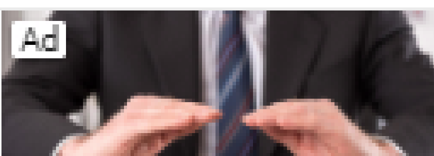

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BUSINESS NEWS MAY 15, 2012 / 6:37 PM / 6 YEARS AGO

Analysis: JPMorgan repeats basic mistakes managing traders

Rachel Wolcott 7 MIN READ

(Repeats to add ANALYSIS to headline)

By Rachel Wolcott

LONDON, May 15 (Thomson Reuters Accelus) - JPMorgan Chase & Co's Chief Investment Office (CIO), which was responsible for at least $2 billion in mark-to-market losses, appears to have made some classic mistakes in managing trading desk risk and monitoring traders.

Although the CIO losses have not been blamed on a rogue trader, they do have much in common with the incidents at UBS and Société Générale (SG), where single traders lost billions seemingly overnight.

At the time the losses were announced last week, Jamie Dimon, JPMorgan chief executive, said the strategy that was responsible for the losses was "flawed, complex, poorly reviewed, poorly executed and poorly monitored."

Dimon's candor says plenty about the state of trading desk risk management at JP Morgan and other Wall Street firms. In the cases of MF Global, UBS and SG, sloppiness and incompetence in the institutions' risk management of trading operations were cited as important contributing factors.

But there were other factors. Complex positions such as the ones presumed to have been taken by the CIO are notoriously difficult to manage for risk due to a lack of data and because they do not fit neatly into firms' risk management software and systems.

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Usually, such positions are monitored on spreadsheets or somehow shoehorned into a system. An ad hoc approach makes it tough for risk managers to get a genuine picture of what is going on.

"JPMorgan's problem, like many large firms, is that they couldn't detect and mitigate the risk in their aggregated view of the portfolios. Part of the reason that's a problem is the multiple, disconnected trading and risk management silos that are managed by (off-the-shelf, inappropriately tailored reporting systems)," said PJ Di Giammarino, chief executive of JWG, a regulatory think tank.

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A "use-case" process outlines who and what steps are necessary to achieve an objective.

Losses often occur around a single trader or a small team who have done well for the firm in the past. In the JPMorgan case, that trader is Bruno Iskil, a London City veteran.

That points to what experts say is usually the main reason trading desks are so lightly managed for risk: If a trader is doing well, the tendency is for their managers to let them get on with making money, not to call time because they've breached their position limits.

"Was risk management checking the trades? I believe they did, but assessing the risk of some complex transactions is not easy. Probably these trades were approved at the top level, but because it has become more difficult to make money prop trading, some people are taking big risks to collect pennies in front of a steamroller," said Giorgio

Questa, a former senior banker and now a professor in the faculty of finance at Cass Business School in London.

CLOUT FACTOR

CEO Dimon has made other telling comments about the losses that convey in stark terms his attitude to risk management. He admitted the firm reacted badly to warning flags last month that it had large trading losses in complex financial derivatives.

When risk management professionals talk about a firm's risk culture and risk managers' ability to have an impact on how the firm is run, they often talk about the clout factor.

If a chief risk officer and team members have insufficient influence to stand up to senior management and the board of directors, their warnings and recommendations can go unheeded.

Or senior management might brush off concerns, calling them a "storm in a tea cup", like Dimon did, instead of following through and taking remedial action.

JPMorgan is not considered to be the only firm that fails to heed its risk managers. Even in the aftermath of the financial crisis, risk managers do not enjoy as much influence as they should.

Risk management teams have come a long way, bolstered by regulators desire to see firms take the risk management discipline more seriously. But they still lack clout.

Marco Delzio, chief executive of Martingale Risk in Rome, said: "There are new units in banks made up of quants that do theoretical research and risk measurements. They have no power. They don't talk directly to senior management. It's my impression that banks have these units so they can tell the authorities they are doing something about risk, but they have no real impact on management decisions."

SETTING TONE FROM THE TOP

Since the financial crisis started, regulators have emphasized the need for senior management at financial services firms to set the tone when it comes to risk management, regulatory compliance and corporate governance.

In 1989 JPMorgan's former chairman, Dennis Weatherstone, set the tone by asking for daily risk reporting. The daily reports soon grew into a corporate risk management group and then the RiskMetrics Group, which ultimately went public as a standalone firm and was bought by MSCI in 2010.

In the 1990s, however, it was the RiskMetrics Group that made JPMorgan one of the first banks to develop and sell risk management products.

The tone set by Weatherstone has changed somewhat over the years. JPMorgan held onto its reputation for canny risk management through the financial crisis.

Since then, however, Dimon as CEO has chosen to battle publicly with regulators seeking to implement reforms of excessive risk taking.

For the time being, the CIO's loss of at least $2 billion seems to have dented the reputations of Dimon and his firm more than JPMorgan's balance sheet.

What is not clear is whether this setback is going to change the tone at the top when it comes to taking risk and managing it.

(This article was produced by the Compliance Complete service of Thomson Reuters Accelus. Compliance Complete (here) provides a single source for regulatory news, analysis, rules and developments, with global coverage of more than 230 regulators and exchanges.)

Editing by Randall Mikkelsen and Jeffrey Benkoe

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