

UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION

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In the Matter of: : **CFTC Docket No. 12-17**
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JPMORGAN CHASE BANK, N.A., : **ORDER INSTITUTING**
: **PROCEEDINGS PURSUANT TO**
: **SECTIONS 6(c) AND 6(d) OF THE**
Respondent. : **COMMODITY EXCHANGE ACT AND**
: **MAKING FINDINGS AND**
: **IMPOSING REMEDIAL SANCTIONS**
: :

I.

The Commodity Futures Trading Commission (the “Commission”) has reason to believe that JPMorgan Chase Bank, N.A. (“JPM” or the “Respondent”), has violated Section 4d(b) of the Commodity Exchange Act (the “CEA” or “Act”), 7 U.S.C. § 6d(b); as amended by the Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-246, Title XIII (the CFTC Reauthorization Act of 2008 (“CRA”)), § 13101-13204, 122 Stat. 1651 (enacted June 18, 2008), to be codified at 7 U.S.C. § 6d(b), and Commission Regulations 1.20(a) & (c), 17 C.F.R. §§1.20(a) & (c) (2008). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted to determine whether the Respondent engaged in the violations set forth herein, and to determine whether an order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, the Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings and conclusions herein, the Respondent acknowledges service of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act and Making Findings and Imposing Remedial Sanctions (“Order”).¹

¹ The Respondent consents to the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that the Respondent does not consent to the use of this Order or the Offer, or the findings and conclusions in this Order consented to in the Offer, as the sole basis for any other proceeding brought by the Commission, other than in a proceeding in bankruptcy or to enforce the terms of this Order. Nor does the Respondent consent to the use of the Offer or this Order, or the findings and conclusions in this Order consented to in the Offer, by any other party in any other proceeding.

III.

The Commission finds the following:

A. Summary

From at least in or about November 2006 through in or about September 2008, JPM was a depository institution serving Lehman Brothers, Inc. ("LBI"), which was a futures commission merchant ("FCM"), registered as such with the Commission. LBI deposited with JPM funds belonging to LBI's customers ranging in aggregate amounts from approximately \$250,000,000 to over \$1,000,000,000. Pursuant to the Commodity Exchange Act ("CEA"), neither JPM nor LBI was permitted to use or hold these customer funds as though they belonged to anyone other than LBI's customers, and the funds were not permitted to be used to extend credit to LBI.

During this period, JPM violated Section 4d(b) of the CEA and Commission Regulations 1.20(a) and (c), by extending credit to LBI based on LBI's customers' segregated funds, and then by declining to release the funds for a period of approximately 14 days after September 17, 2008, which was two days after LBI's holding company, Lehman Brothers Holdings, Inc. ("LBHI") filed for bankruptcy. Ultimately, on September 30, 2008, after receiving instructions from the LBI Trustee and Commission officials, JPM released LBI's customers' segregated funds.

B. Respondent

JPMorgan Chase Bank, N.A. is a national banking association chartered under the laws of the United States, with its principal business at 111 Polaris Parkway, Columbus, Ohio 43240. JPM is a subsidiary of JPMorgan Chase & Co. ("JPMC") and a successor by merger to the Chase Manhattan Bank ("Chase"). During the relevant period, JPM was a depository for LBI.

C. The Facts

1. **CEA and Commission Regulations Concerning FCMs and Depositories**

FCMs receive money, securities and other property ("funds") from their customers to margin, guarantee, or secure the customers' futures and options trades. Such customer funds are required to be separately accounted for and are prohibited from being commingled with the funds of the FCM, or to be used to margin or guarantee the trades of someone other than the customer for whom they are held. *See* 7 U.S.C. § 6d(a)(2). The accounts in which such customer funds are held are commonly referred to as "customer segregation accounts."

Customer segregation accounts are a critical customer protection feature of the United States commodity laws. These accounts are designed to ensure that customer funds are protected and available for immediate withdrawal or transfer, even if an FCM experiences financial distress or enters into bankruptcy.

FCMs are authorized by the CEA and Commission Regulations to place their customer segregated funds with a depository bank. *See* 7 U.S.C. § 6d(b) and 17 C.F.R. § 1.20(a) (2008). Such depository banks also are subject to certain CEA and Commission Regulations imposing restrictions on the handling and use of customer segregated funds. As relevant here, the CEA makes it unlawful

for a depository to hold, dispose of, or use any such funds as belonging to the depositing FCM or any person other than customers of such FCM. 7 U.S.C. § 6d(b) (2006). *See also* CFTC Regulation 1.20(a), 17 C.F.R. 1.20(a) (2008) (containing same prohibition). Such customer segregated funds also may not be used to “extend the credit of any other person other than the one for whom the same are held.” *See* CFTC Regulation 1.20(c), 17 C.F.R. § 1.20(c) (2008).

2. LBI’s Customers’ Segregation Accounts at JPM

During the relevant period, LBI was registered with the CFTC as an FCM and established customer segregation accounts, as mandated by the CEA.

On or about January 3, 2001, LBI established a set of two customer segregation accounts with JPM’s predecessor by merger, Chase, which acted as depository. The set was labeled in Chase’s records: “Lehman Brothers Inc. Customer Segregated Commodity Funds Account” (Domestic Customers’ Segregation Account). After the merger, JPM’s records reflected the account using the name “LB Inc. Customer Seg.” One of the two accounts, titled the “LWZ Account”, held Federal Book Entry (“FBE”) wireable securities. The other account held cash. On or about March 19, 2007, LBI established a third Domestic Customers’ Segregation Account at JPM to hold physical securities.

As required by Commission Regulation 1.20(a), Chase and LBI executed a written agreement, dated January 3, 2001, confirming that LBI’s customers’ segregated funds would be held in accordance with the CEA and Commission Regulations. Such a written acknowledgement is generally known as a “No-lien” letter.

Thereafter, LBI deposited customers’ funds in the segregation accounts at Chase (and at JPM post-merger).

3. JPM Extended Credit to LBI Based on LBI’s Customers’ Segregated Funds

From at least January 2006 through September 2008, JPM also was LBI’s principal clearing bank, and extended intraday credit on a daily basis to its client, LBI, to assist in the clearance and settlement of a variety of transactions. Each day, JPM calculated the amount of intraday credit it would extend to LBI based principally on the value of the securities and other assets held in groups of LBI accounts, known as “dealer groups.” The amount of credit remaining available to LBI at any point in time during the trading day was referred to as “net free equity” (“NFE”). NFE is a risk metric employed by clearing banks, such as JPM, to determine how much credit remains unutilized by the clearing bank’s client. A client’s NFE is a measure of the securities and cash the client owns and holds on deposit with the clearing bank relative to the client’s liabilities to the clearing bank. NFE does not include assets that do not belong to, and are not available for pledge by, the client.

When the client’s NFE is positive—*i.e.*, when the value of the assets securing the FCM’s obligation to the clearing bank sufficiently exceeds the obligation itself—the clearing bank may, in its discretion, extend further intra-day credit to the client; when the NFE is zero or negative, the clearing bank may not, in its discretion, extend further intra-day credit. The extension of credit

based upon a positive NFE, as with all clearing advances, allows a clearing bank to cover the intraday mismatch between its client's incoming and outgoing funds. Such mismatches arise when the client participates in tri-party repurchase agreements, known as "repos", on a daily basis, as LBI did.

In or about September 2006, LBI added the LWZ Account to the group of accounts whose assets were used to calculate the amount of intraday credit JPM would make available to LBI. LBI added the LWZ Account to a particular dealer group – Dealer Group 92, even though the funds in that account belonged to LBI's customers and LBI neither owned them nor was authorized to pledge them, so that it could borrow more money from JPM than it otherwise could borrow from JPM without such use of the LWZ Account.

Beginning on or about November 17, 2006, JPM acceded to LBI's inclusion of the LWZ Account in the group of accounts intended to secure JPM's extensions of intraday credit to LBI, and thereby used LBI's customers' segregated funds to secure extensions of credit to LBI. JPM did so each business day for approximately 22 months, from November 2006 to September 2008. By September 2008, the LWZ Account held more than \$330 million in LBI's customers' funds, none of which belonged to LBI nor was it authorized to pledge. During this 22 month period, the LWZ Account unlawfully increased the NFE based upon Dealer Group 92, depending on the amount of credit utilized by LBI at any particular point in time, by 5% or less and the assets in Dealer Group 92 by less than 1%.

4. After LBHI Declared Bankruptcy, JPM Declined Repeated Requests to Return LBI's Customers' Segregated Funds

During the early morning hours of September 15, 2008, LBHI (the holding company for LBI) filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code, in the midst of an ongoing financial crisis in the United States and elsewhere. The crisis, with added fuel from LBHI's bankruptcy, imposed enormous challenges on banks and other financial institutions in part because many investors including futures and options customers were negatively affected and were in urgent need of liquidity.

It was against this backdrop that, on September 17, 2008, LBI requested in writing that JPM transfer the customer segregated funds in the LWZ Account back to LBI. JPM refused LBI's transfer request because the LWZ Account was included in the group of accounts whose assets were used to calculate LBI's NFE, which was negative at the time.

On September 19, 2008, as part of the LBHI bankruptcy, the Securities Investor Protection Corporation ("SIPC") an organization, the primary role of which is to return funds and securities to investors if the broker-dealer holding these assets becomes insolvent, instituted a liquidation proceeding against LBI pursuant to the Securities Investor Protection Act, 15 U.S.C. §§78aaa, *et seq.* (2006). That same day, the bankruptcy court appointed a Trustee who "stood in the shoes" of LBI and empowered him to "take action as necessary and appropriate for the orderly transfer of customers' accounts and related property."

At the same time, JPM “froze” all of LBI’s accounts at JPM, including the LWZ Account, and initially denied all access, including by LBI and the Trustee, to JPM’s Broker Dealer Automated System (BDAS), in order to prevent the unilateral transfer of assets out of accounts that LBI had maintained at JPM. This action had the effect of precluding LBI and the Trustee from reconciling trades and accessing bank accounts relating to the LBI Domestic Customers’ Segregation Account including the LWZ Account.

On or about September 20, 2008, the Bankruptcy Court approved the sale of LBI’s commodity and futures businesses to Barclays Capital Inc. (“Barclays”).

From September 23 through September 30, 2008, the Trustee made additional requests of JPM for the return of the LBI customers’ segregated funds held in the LWZ Account. JPM declined these requests for various reasons, including its inability to verify that the funds were in fact LBI’s customers’ segregated funds.

On the morning of September 30, 2008, in light of JPM’s continued refusals to transfer the funds in the LWZ Account, Commission staff instructed JPM to transfer to Barclays the customer segregated funds in the LWZ Account, namely securities valued at more than \$333 million. JPM acceded to the Trustee’s and the CFTC’s request, and transferred the funds to Barclays.

D. Legal Discussion

JPM unlawfully (i) extended credit to LBI based on LBI’s customers’ segregated funds in violation of Section 4d(b) of the CEA, and Commission Regulations 1.20(a) and (c); and (ii) declined to transfer the customer funds in the LWZ Account notwithstanding LBI’s and then the Trustee’s requests in violation of Section 4d(b) of the CEA, and Commission Regulation 1.20(a).

1. Applicability of Section 4d(b) to Depositories

Recognizing that it is essential to a system for segregation of customer funds that such funds be available to the customer and to an FCM immediately upon demand, Congress enacted Section 4d(b) and made it unlawful for a depository to use or hold an FCM’s customer segregated funds as belonging to any person other than the customers to whom they belong. Without immediate access to customer funds, the FCM is hindered in its ability to satisfy margin requirements. In times where there is a market disruption, any impediment or restriction upon the ability to immediately withdraw funds “could magnify the impact of any market disruption and cause additional repercussions.” *See Financial and Segregation Interpretation No. 10* (“Interpretation No. 10”), 70 Fed. Reg. 24768 (May 11, 2005) (“[a]lthough it is permissible under Section 4d(2) of the Act to deposit customer funds in a bank, it has always been the Division’s position that customer funds deposited in a bank cannot be restricted in any way, that such funds must be held for the benefit of customers and must be available to the customer and the FCM immediately upon demand.”). *See also Financial and Segregation Interpretation No. 9 – Money Market and Now Accounts*, 1 Comm. Fut. L. Rep. (CCH) 7119 (Nov. 23, 1983) (customers are required to have immediate access to their funds held in customer segregation accounts).

2. JPM's Unlawful Treatment of Customers' Segregated Funds

From November 2006 through September 2008, JPM violated Section 4d(b) of the CEA and Commission Regulation 1.20(a) by holding or using LBI's customers' segregated funds as belonging to LBI for the purpose of determining the amount of credit it would extend to LBI. JPM also violated Commission Regulation 1.20(c) by allowing LBI's customers' segregated funds to be used in the extension of credit for LBI.²

In addition, from September 17 through September 30, 2008, JPM violated Section 4d(b) of the CEA and Commission Regulation 1.20(a) by keeping, retaining, maintaining possession of, or authority over, LBI's customers' segregated funds after repeated requests for their immediate transfer first by LBI and then by the Trustee.

JPM's inclusion of the LWZ Account in LBI's NFE calculation was the reason why JPM denied LBI's September 17, 2008 transfer request of the LWZ Account. JPM acted as if these funds were LBI's funds, not customer segregated funds. Thus, it denied LBI's lawful transfer request and prevented customers from having immediate access to their funds in a time of enormous economic turmoil.

IV.

FINDINGS OF VIOLATIONS

Based on the foregoing, the Commission finds that JPM violated Section 4d(b) of the Act, 7 U.S.C. § 6d(b), and Commission Regulations 1.20(a) & (c), 17 C.F.R. §§ 1.20 (a) & (c) (2008).

V.

OFFER OF SETTLEMENT

The Respondent has submitted an Offer in which it acknowledges service of this Order, admits the jurisdiction of the Commission with respect to the matters set forth in this Order and waives: (1) the service and filing of a complaint and notice of hearing; (2) a hearing and all post-hearing procedures; (3) judicial review by any court; (4) any claim of double jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief; and (5) any and all objections to the participation by any member of the Commission's staff in consideration of the Offer;

² The prohibition in Commission Regulation 1.20(c) against using customer segregated funds "to secure or guarantee the trades, contracts or commodity options, or to secure or extend the credit of any other person," applies to all persons, subject to the provisos in that subsection.

The Respondent stipulates that the record on which this Order is entered consists solely of the findings contained in this Order to which the Respondent has consented without admitting or denying such findings. The Respondent consents to the Commission's issuance of this Order, which makes findings as set forth herein that the Respondent does not admit or deny, and orders that the Respondent: (1) cease and desist from violating Section 4d(b) of the CEA, 7 U.S.C. § 6d(b), and Commission Regulations 1.20(a) & (c), 17 C.F.R. §§1.20 (a) & (c) (2011); (2) pay a civil monetary penalty in the amount of \$20,000,000; and (3) comply with the undertakings set forth herein.

Upon consideration, the Commission has determined to accept the Respondent's Offer.

VI.

ORDER

Accordingly, **IT IS HEREBY ORDERED THAT:**

- A. The Respondent shall cease and desist from violating Section 4d(b) of the Act, 7 U.S.C. § 6d(b), and Commission Regulations 1.20(a) & (c), 17 C.F.R. §§1.20 (a) & (c) (2011).
- B. The Respondent shall pay a civil monetary penalty in the amount of \$20,000,000 within ten (10) business days of the date of entry of this Order. The Respondent shall pay the civil monetary penalty by making electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made by other than electronic funds transfer, the payment shall be made payable to the Commodity Futures Trading Commission and sent to the address below:

Commodity Futures Trading Commission
Division of Enforcement
ATTN: Marie Bateman – AMZ-300
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone 405-954-6569

If payment by electronic transfer is chosen, the Respondent shall contact Marie Bateman or her successor at the telephone number above to receive payment instructions and shall fully comply with those instructions. The Respondent shall accompany payment of the penalty with a cover letter that identifies the Respondent and the name and docket number of this proceeding. The Respondent shall simultaneously transmit copies of the cover letter and the form of payment to: (1) the Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581; and (2) the Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission at the same address. In accordance with Section 6(e)(2) of the Act, 7 U.S.C. § 9a(2) (2006), if this amount is not paid in full within fifteen (15) days of the due date, the Respondent shall be prohibited automatically from the privileges of all registered entities, and, if registered with the Commission, such registration shall be suspended automatically.

until it has shown to the satisfaction of the Commission that payment of the full amount of the penalty with interest thereon to the date of the payment has been made.

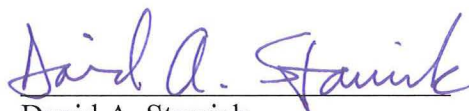
C. The Respondent shall comply with the following conditions and undertaking as consented to in the Offer:

1. JPM agrees that neither it nor any of its agents or employees under its authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order, or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect JPM's (i) testimonial obligations or (ii) right to take legal positions in other proceedings to which the Commission is not a party. JPM shall undertake all steps necessary to ensure that all of its agents and/or employees under its authority or control understand and comply with this agreement.
2. JPM agrees that it and its agents or employees under its authority or control shall transfer any and all customer segregated funds held pursuant to Section 4d(b) of the CEA in accordance with the requirements set forth in the amendments to Rule 1.20(a) proposed by the CFTC on August 9, 2010, or as finally amended, subject to the requirements of U.S. or non-U.S. law as applicable, upon proper notice and instruction by the Commission or the Commission's delegee, the relevant FCM, or a court appointed official;
3. JPM agrees that neither it nor any of its agents or employees under its authority or control shall deprive an FCM client of JPM, which FCM maintains customer segregation accounts at JPM, or such FCM's successors, including bankruptcy trustees, of visual access to the BDAS system (or any system that serves in a similar manner as BDAS) after the FCM client or such FCM client's parent files for bankruptcy; *provided* JPM had provided the FCM client with at least visual access to the BDAS system prior to the FCM having filed for bankruptcy;
4. JPM agrees that it shall implement and maintain comprehensive procedures for the proper maintenance and transfer of customer segregated funds it holds pursuant to Section 4d(b) of the Act; that such procedures shall be made known to all JPM offices, divisions or departments that conduct business with FCMs; and that it shall provide the Commission with a copy of such procedures and evidence of the implementation of such procedures within thirty (30) days from the date of this Order; *provided*, all such procedures shall be subject to all relevant laws, Commission Regulations, including Commission Regulations 1.20 and 30.7, and court orders; and
5. JPM agrees that it shall maintain the written acknowledgements required by Commission Regulation 1.20(a) in electronic format, in a widely accessible centralized location, as well as an electronic log of all such written acknowledgements executed by JPM officials.

The provisions of this Order shall be effective on this date.

By the Commission:

Dated: April 4, 2012



David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission