ORDERLY LIQUIDATION OF A FAILED SIFI

March 2012

JPMorgan Chase & Co.

Agenda

Overview of contingency plans for recovery and resolution

Recovery & Resolution Plans

Regulations, including those issued under the Dodd-Frank Act, mandate that large and systemically important financial institutions (SIFIs) maintain detailed and robust recovery and resolution plans:

- **Recovery plans** detail the actions a firm would take to ***avoid failure*** by staying well-capitalized and well-funded in the case of an adverse event
  - *JPMC has a comprehensive recovery plan*
- **Resolution plans** detail strategies for rapid, orderly and least-cost resolution under ordinary insolvency law ***in the event of failure*** (without the use of taxpayer money)
  - *JPMC will submit a resolution plan on 7/1/2012, an executive summary of which will be available for public review*

JPMC's Fortress Balance Sheet

- JPMC's fortress balance sheet, significant earnings power and strong risk management will allow it to endure severe stress events and absorb substantial losses without failing
  - Significant excess capital
    - Basel I Tier 1 Common of $123B, ratio of 10.0%[1]
    - Estimated Basel III Tier 1 Common ratio of 7.9%[1]
  - Firm-wide total credit reserves of $28B, loan loss coverage ratio of 3.35%[1]
  - Global liquidity reserves of $379B[1]
  - Benefits from diversification – funding, capital, lower volatility

[1] As of 4Q11

Beyond SIFI's contingency plans: the Orderly Liquidation Authority (OLA)

What is the Orderly Liquidation Authority

- Orderly Liquidation Authority (OLA) was created by the Dodd-Frank Act to **establish a new system, if needed, for the resolution of failed financial institutions** (limited to potentially systemically important financial companies)
  - Bankruptcy is still the primary resolution process, OLA is only a fall-back option to mitigate systemic consequences
- FDIC is granted authority to close, liquidate and resolve a failing SIFI so that:
  - **Shareholders and creditors bear all losses**, with no exposure for taxpayers
  - **Management** responsible for the failure is **replaced**
- Therefore, **orderly liquidation is comparable to a bankruptcy… it is <u>not</u> a "bail out"**

When is the Orderly Liquidation Authority invoked

Treasury Secretary, in consultation with the President, after recommendation by Board of Governors and Designated Regulator (principally FDIC or SEC), can invoke OLA to resolve a SIFI when, among other things:

- The SIFI is in default or in danger of default
- No viable private sector alternative is available to prevent the default
- The SIFI's failure and its resolution (through traditional bankruptcy) would have serious adverse effects on the financial stability of the United States

Goals of the Orderly Liquidation Authority (OLA)

What are the goals of an orderly resolution

- Ensure that **shareholders and creditors**, rather than taxpayers, **bear all losses and costs**
- Ensure that **management** responsible for the failure is **replaced**
  - **Clawback features exist** to recover compensation from directors and senior executive officers responsible for the failure
- Ensure that resolution occurs **without** a **lengthy** period of **government control** and in an orderly fashion
- **Minimize** the **value-destruction and wide-spread contagion effects** inherent in fire sales or disorderly liquidation

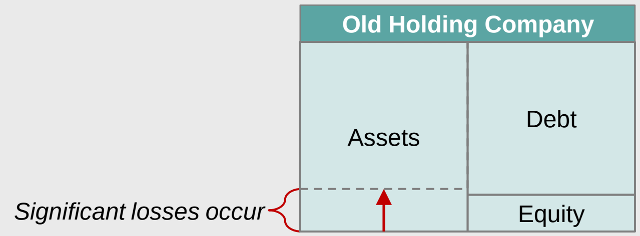
As a result:

- Critical operations of **systemically important activities continue uninterrupted**, such as:
  - Consumer activities: credit card processing; ATM withdrawals; checking/debit cards
  - Wholesale activities: custody services of client assets; payments processing; asset management; securities and derivatives market making
- OLA preserves the **going concern value** of the restructured firm for the benefit of the most senior creditors, **protection of taxpayers** and the financial system overall

Illustration of the how a SIFI could be recapitalized under orderly liquidation

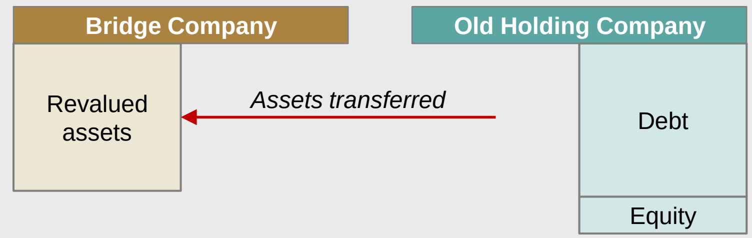
Step 1 OLA receivership initiated

- After receiving necessary regulatory approvals, the SIFI is placed into FDIC receivership under the Orderly Liquidation Authority



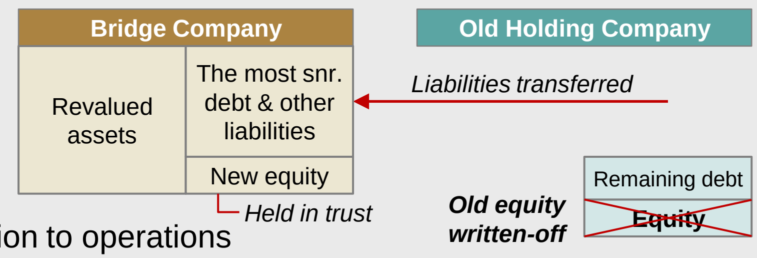
Step 2 Temporary ("bridge") company created

- FDIC establishes bridge company
- FDIC revalues the SIFI's assets
- FDIC transfers the assets to the bridge



Step 3 Old equity written off; some debt transferred

- FDIC writes off original equity
- FDIC transfers liabilities by seniority – until the bridge is capitalized at 10% Tier 1 common equity (equity held in trust)
- **Impact**: Bridge company opens with clean B/S and without interruption to operations

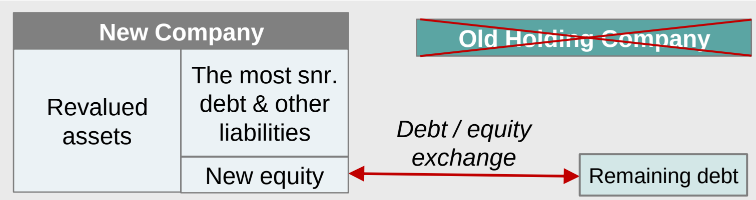


Step 4 Temporary, industry-backed funding provided

- Liquidity, which is industry-backed, is provided to support the bridge company

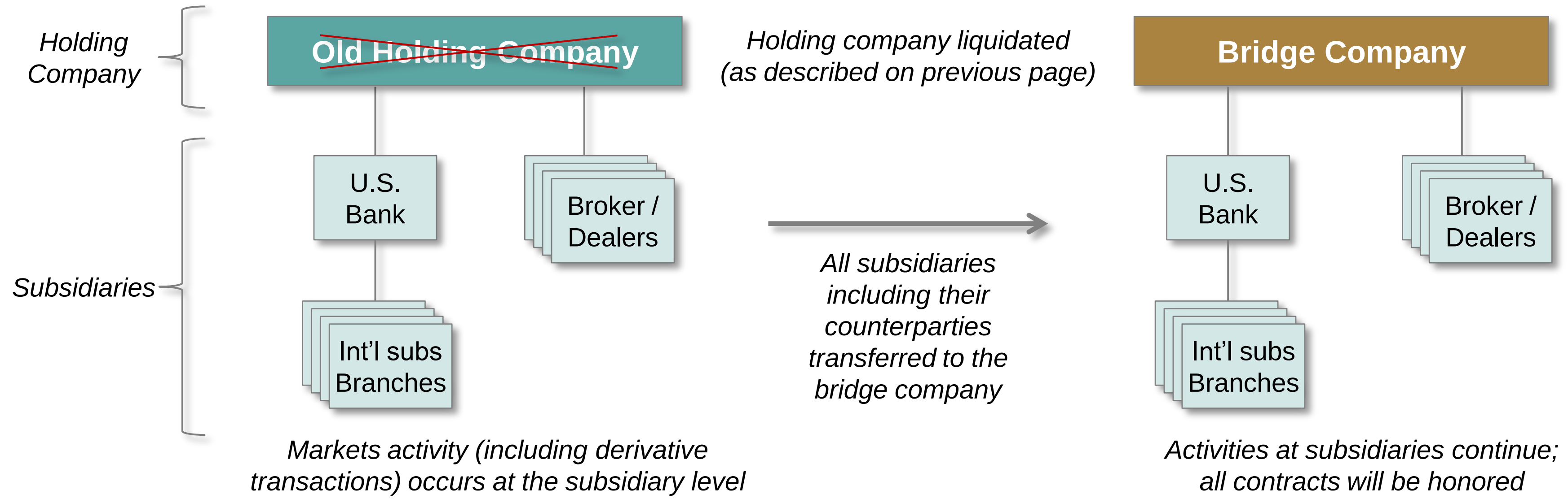
Step 5 Remaining debt exchanged for equity in new company

- FDIC transfers equity in bridge to bank creditors which remain in OLA receivership
- **Impact**: New company returns to the private sector



Step 2
additional detail

Market activity at the subsidiary level will continue under orderly liquidation



Customer facing activities continue

- Activities at the subsidiary level (where market / derivative transactions occur) continue; all required payments, reflecting market value / contract terms, will be made
  - Payments cannot be clawed back in the future
- Temporary liquidity support from the FDIC may be given to the Bridge Company and can then be provided to subsidiaries to meet cash flows of counterparty contracts
- FDIC has authority to prevent close-outs at the subsidiary level in the select cases that the counterparty contract has a clause regarding the financial health of the Holding Company
  - In such cases, the clause would be nullified upon transfer to the Bridge Company
  - Traditional bankruptcy code does not as easily allow for such transfers, OLA does

Operations of systemically important activities continue

Temporary funding available to provide liquidity, if needed, to meet counterparty demands

Temporary, industry-backed funding overview

- **FDIC** to **provide liquidity**, if needed, **to fund systemically important operations, avoid fire sales and prevent widespread market contagion**
  - FDIC has used similar authority for the resolution of insured regional banks / thrifts for decades
- FDIC may borrow funds from Treasury to make loans to, guarantee or provide direct assurances regarding the obligations of, the SIFI:
  - Up to 10% of assets (last reported book value) until FDIC determines fair value of assets (max 30 days)
  - Up to 90% of the fair value of assets available for repayment thereafter
  - Regulators' capacity to issue guarantees and direct assurances is based upon FDIC/Treasury expected loss
- Funds provided are on a super-senior basis (at a penalty rate of interest), and only until private financing can be found (similar to a DIP facility)
- In the event of losses, ***taxpayers will have no exposure****;* FDIC/Treasury will be repaid from:
  1) Asset liquidation from the failed SIFI
  2) Creditors of the Holding Company who, through the use of OLA, receive more value than they would have received in a liquidation
     – For example, if a creditor receives 90% in OLA vs. 75% in liquidation, it could be requested to pay back the difference to the FDIC
  3) Fees imposed on SIFIs and other financial companies with total assets of $50 billion or more

Agenda

Hypothetical, illustrative example of the orderly liquidation of JPMorgan Chase

For illustrative purposes, we describe the impact of a catastrophic, idiosyncratic event causing a <u>$200B loss</u> and <u>$550B of liquidity outflows</u> – leading to Orderly Liquidation Authority being invoked to resolve JPMC

Scale of the $200B loss

- **> 4x** **the largest <u>one-quarter</u> write-down** of any firm during the crisis ($50B, Wachovia 4Q`08)
- **> 2x** **the largest <u>one-year</u> loss** of any firm during the crisis ($99B, AIG 2008 post-tax net income) – also the largest one-year corporate loss of all time in nominal terms
- **> 1.4x** **the largest <u>cumulative</u> write-downs** of any firm during the crisis ($143B, Citigroup 3Q`07–2Q`08) – including 9 consecutive quarters of write downs above $10B
- **> 2x** **JPMC CCAR Stress Scenario losses** 2012 CCAR results – $33B trading, securities and other losses and an additional $56B of credit losses over 9 quarters

Orderly steps towards resolution

Step 1 OLA receivership is initiated following a **$50B loss**, which results in a run on the bank where **$375B of funding** (deposits and other liabilities) leave JPMC

Step 2 Temporary bridge company created, which assumes all assets and some liabilities of JPMC. As part of this process, the FDIC marks the Firm's assets down leading to an **additional $150B loss**

Step 3 JPMC equity is written off; the most senior debt and liabilities transferred to the bridge company with new equity (held in trust). ***Bridge bank opens as critical activities continue to operate smoothly***

Step 4 Temporary, industry-backed funding is provided to cover day-to-day operations ($25B) and $**175B of additional funding outflows**

Step 5 Bridge company returned to private sector as a new bank with a clean balance sheet (equity in trust is transferred to creditors)

Source: Bloomberg

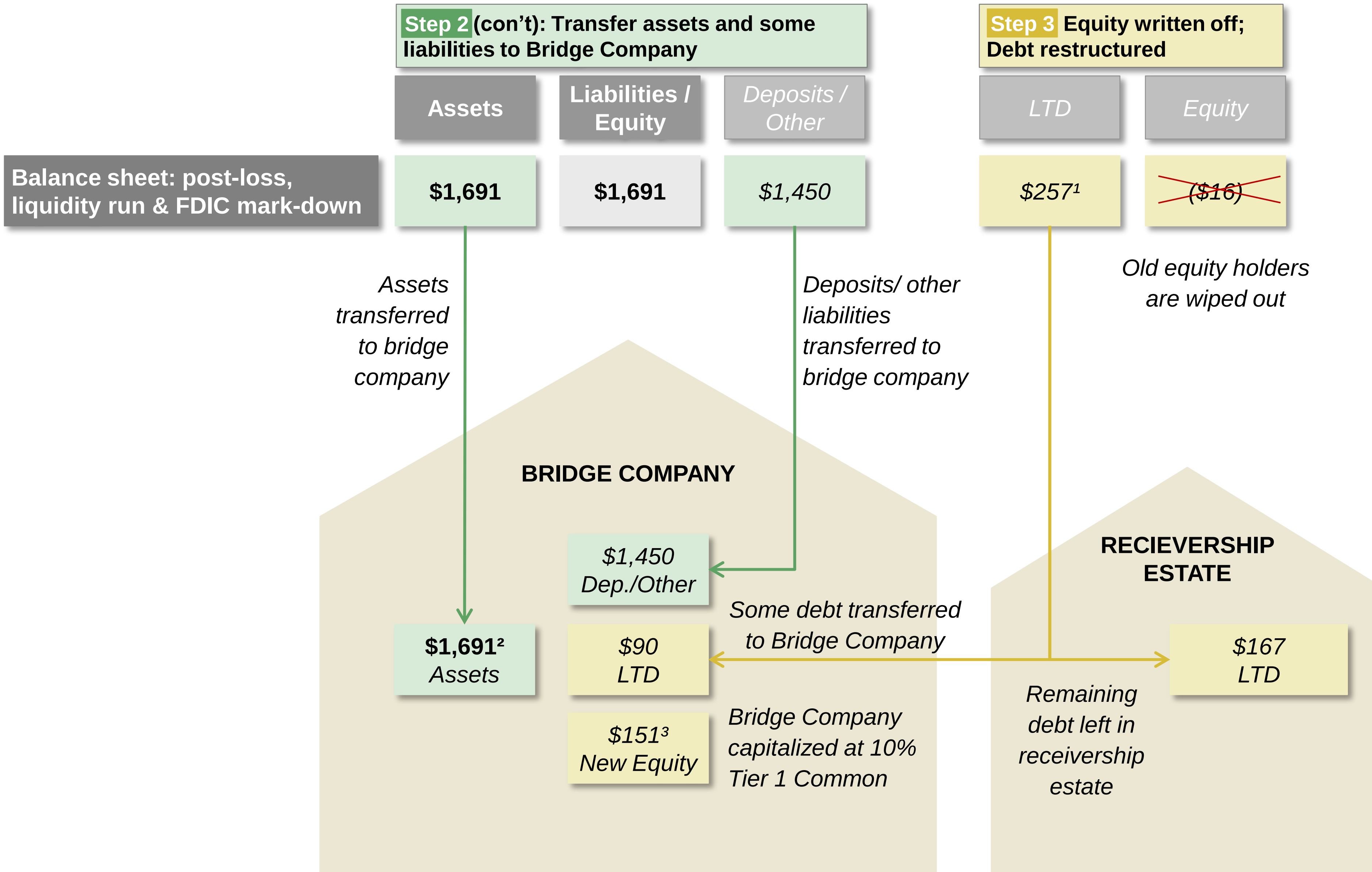
Impact of the hypothetical loss on JPMC's balance sheet (illustrative)

Represents action driving changes (red box)

		Assets	Liabilities / Equity	*Deposits / Other*	*LTD*	*Equity*
JPM Balance Sheet: 12/31/11		**$2,266**	**$2,266**	*$1,825*	*$257*	*$184*
Step 1: Initiate OLA Receivership	$50B after-tax loss reduces asset value and common equity	↓ **$50** (red box)	↓ **$50**	-	-	↓ *$50*
	$375B of deposits and other funding leave[1], which depletes the Firm's global liquidity reserves	↓ **$375**	↓ **$375**	↓ *$375* (red box)	-	-
Step 2: Bridge company created	Assets are marked-down $150B by the FDIC, which also results in an equity reduction	↓ **$150** (red box)	↓ **$150**	-	-	↓ *$150*
Balance sheet: post-loss, liquidity run & FDIC mark-down		**$1,691**	**$1,691**	*$1,450*	*$257*	*($16)*

1. Includes all funding outflows, e.g., deposit withdrawals, asset drawdowns, and the unwind of derivative funding transactions (e.g., repos and reverse repos)

Bridge company created and JPMC's debt and equity restructured (illustrative)



1. $257B of GAAP LTD reflects $194B of HoldCo debt and $63B of debt at subsidiaries
2. $1,691B of notional assets includes $1,024B of RWA and $48B of goodwill
3. New Equity held in Trust; Equity reflects 10% of Basel I RWA plus goodwill and intangibles

Temporary funding provided and new bank returned to private ownership (illustrative)

		Assets	Liabilities / Equity	*Deposits / Other*	*LTD*	*New Equity*	*Temporary Funding*
Bridge Balance Sheet: Post Restructuring and Recapitalization		**$1,691**	**$1,691**	*$1,450*	*$90*	*$151 held in trust*	-
Step 4: Temporary funding provided	$200B of temporary funding provided $25B for day-to-day business $175B to cover add'l outflows[1]	↑ **$25** *Liquidity to support day-to-day operations*	↑ **$25**	↓ *$175 Additional outflows*	-	-	↑ *$200 Temporary funding is provided*
Balance Sheet after temporary funding is provided by the FDIC		**$1,716**	**$1,716**	*$1,275*	*$90*	*$151 held in trust*	*$200*
Step 5: Firm is returned to private sector ownership *(see next page for alternate scenarios)*	Funding is repaid by private financing Creditors receive ownership of new equity in exchange for debt in the receivership estate	**-**	**-**	↑ *$200 Raise private funding*	-	*Ownership transferred to debt holders in exchange for claims in receivership estate*	↓ *$200 Repay temporary funding*
New Bank Balance Sheet		**$1,716**	**$1,716**	*$1,475*	*$90*	*$151 creditors own*	-

- Private funding is raised to repay temporary funding (industry ultimately responsible for repaying, if other options fail)
- Creditors receive $151B in new equity in exchange for the $167B of debt in the receivership estate (results in $17B loss[2])

1. Includes all funding outflows, e.g., deposit withdrawals, asset drawdowns, and the unwind of derivative funding transactions (e.g., repos and reverse repos)
2. Size of loss will vary based on changes in the value of equity

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Alternate scenarios for repaying $200B of FDIC temporary funding

Scenario 1: OLA process is *successful*, able to raise funding from markets / customers

(assumed in example)

- Market confidence in the New Bank's asset valuation (post mark-downs) and capitalization (10% Tier 1 Common) – further bolstered by the FDIC's support – allows it to:
  - Access funding through the markets (e.g., Repo)
  - Attract deposits
  - Raise debt or preferred equity

Scenario 2: Limited market support, need to sell or pledge select assets

- Limited ability to raise funding from markets or customers requires the Bank to sell or pledge additional assets[1] (beyond the $375B of collateral used to meet initial outflows):
  - Pledge / sell available unencumbered securities
  - Sell remaining loans, which cannot be pledged, but are available for sale
    - Limited ability to securitize based on assumed environment

Scenario 3: Liquidity outflows continue, requiring liquidation of some or all LOBs

- OLA process does not reassure the markets and counterparties continue to withdraw their funds resulting in the need to begin liquidation
- Bank is required to sell some or all of its businesses in order to repay the FDIC
  - $1,716B of assets (post write-downs) less $1,275B of unsecured liabilities to counterparties
  - ~$440B of potential value available to repay $200B of FDIC funding (assuming no premium)
  - Timing of sales will depend on regulatory approval (traditionally 90 days)

If the FDIC is not repaid it will assess the industry to cover any losses

1. Subject to timing and capacity constraints

Orderly Liquidation of a Failed SIFI

- Systemically important activities have continued to operate
- Going concern value of restructured firm preserved for benefit of its creditors
- Restructured firm with clean balance sheet has returned to private sector promptly, in an orderly fashion and without a lengthy period of government control
- Widespread contagion effects of failure have been mitigated
- Taxpayers have faced no risk of loss from $200B draw on the industry-backed Orderly Liquidation Fund to provide temporary liquidity to fund recapitalization