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Two Cheers for JP Morgan's "Clawbacks"

By: Ben W. Heineman, Jr.

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JP Morgan Chase has used its internal compensation recovery policies to "clawback" two years of "total annual compensation" for London traders involved in what is now a $5.8 billion derivatives loss: Bruno Iksil (the "London Whale"); another trader, Javier Martin-Artajo; and their boss, Achilles Macris. All three have also left the firm with no severance pay.

So says Michael Cavanagh — who has been cleaning up the trading mess for JPM CEO Jamie Dimon — on the company's quarterly earnings call. On the same call, Dimon himself announced that the global supervisor of the London office and head of the firm's retired Chief Investment Office (CIO), Ina Drew, would voluntarily give up the "equivalent to the maximum clawback amount." Ms. Drew earned $15.5 million in 2011, including $7.5 million in stock awards, and also was due as much as $14.5 in severance according to this year's Proxy Statement.

As to all other employees, including Dimon, Cavanaugh said that "2012 performance year compensation and clawbacks, if appropriate, will be determined in the ordinary course." Dimon himself, who oversaw the CIO, could well have his 2012 compensation cut as a result of the trading problems.

These announcements are important developments in showing how financial service firms (as well as other companies) can use voluntary adopted compensation recovery policies to discourage bad behavior and excessive risk-taking. Six weeks ago, I argued that JP Morgan could win back some of the reputation lost from the large trading losses and poor risk management by transparently holding those responsible to financial account under its own policies, which are much broader than the mandatory clawbacks contained in Dodd-Frank.

But, three critical elements of full transparency are missing from today's JPM announcement.

First, how much money will the affected individuals in fact lose — and what are the specific elements (salary, bonus, equity) which constitute the maximum clawback amount (or the two years of total compensation)?

Second, which of the numerous compensation recovery policies were used to pull back the 2010 and 2011 remuneration? As noted in my prior piece, JPM has a range of tools — from being terminated for cause, to causing material financial or reputational harm to the firm, to material misrepresentations, to gross negligence in identifying and raising risks.

Third, who made the decisions (senior management, the board) based on what fact-finding and what kind of deliberative process?

The answers to these questions are critical if this remarkable incident is going to be a powerful teaching moment for other businesses.

We know what business mistakes were made in a general sense. Michael Cavanaugh reiterated them today: poor judgment; not enough scrutiny given the level of risk; ineffective risk management in the Chief Investment Office; insufficiently detailed risk limits; use of the wrong risk models for the type of investment. But it is vitally important to know with some specificity who was responsible for those business mistakes, and how those personal failures tied back to JPM compensation recovery policies.

It may be that in the days and weeks ahead there will be more disclosure on these salient but unaddressed issues.

For now, two cheers for JPM on compensation recovery. It sends a strong message. But the firm only gets three cheers when we know not just the result (serious financial penalties for those responsible), but the details and reasoning within the JPM voluntarily adopted framework which supported that result.

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