

- I would first like to thank His Highness Shaikh Salman bin Hamad Al-Khalifa, Crown Prince and Chairman of the Economic Development Board for hosting this event. Thank you also to His Excellency, Rasheed bin Mohammed Al-Maraj, Governor of the Central Bank of Bahrain, Mr. Mayank Malik, Chairman of the Bahraini Association of Banks and Mr. Robert Ainey, its CEO, for inviting me to be here with you this evening.
- I would also like to welcome all of our distinguished guests, including [names TBD]
- It is an honor to be here tonight.
- Over the past eighteen months, we have experienced the most profound global economic shock of our lifetimes. One year ago, we were in the midst of a crisis of immeasurable proportions, with markets, prices and demand in free fall and liquidity all but non-existent.
- Today, following aggressive actions by the U.S. Federal Reserve, and the U.S. Treasury with other authorities worldwide, principal equity exchanges are up, spreads and volatility have declined, and credit is flowing again.
- If indeed, we are a quarter or two away from an economic recovery, it is right to now focus on lessons learned and what we should do differently next time.
- In this context, I would like to share with you some of my thoughts on topics that are central to how we need to approach the enormous challenges that lie ahead.
- These issues are Systemic Risk, Regulation, and Reward.
- Most of the world's citizens have learned of "Systemic Risk" the hard way. They have experienced first hand the real consequences of personal financial loss that can happen quickly when confidence in the world financial markets falters.
- The near failure of Fannie Mae and Freddie Mac, followed by the bankruptcy of Lehman Brothers and the intervention in AIG, obliged most governments around the world to support bank deposits and money funds. Markets reacted with a devastating contraction in credit and a dramatic reduction in the appetite for risk.
- We were on the verge of a systemic breakdown. And just being close to the possibility of the financial markets failing resulted in the worse recession in our lifetimes, and for some, we came all too close to a 1930's depression.
- The economic impact of a possible systemic failure has been profound. So much so, that many politicians, regulators, and pundits have concluded that "Systemic Risk" needs to be eliminated altogether. While this is an admirable goal, it is both impractical and illusory. In my view, you cannot eliminate systemic risk.

- Systemic risk is an unavoidable consequence of a financial system that provides our economy with the capital and liquidity necessary for its development. A healthy financial market supports decisions on credit and duration risk that generate broad economic growth. These risks can only be taken safely if all of us have confidence. If confidence leaves us, then exposure to credit and funding risks, even if prudently managed, will inevitably lead to a systemic failure.
- The truth is, the only way to avoid a systemic failure is to have a public institution that can step in when a failure is coming, and provide a stabilizing amount of liquidity. As a historical point, the United States had chronic systemic failures until it created the Federal Reserve and FDIC in the 1930's, and we were late to the game. The UK figured this out in 1694, the French in 1800 and Japan in 1822. So while we all hope to avoid systemic failure, we should recognize that financial failures happen, and we need the financial support of central banks to provide the ultimate back stop.
- Another scary reality is that in all likelihood, the nature of systemic risk is going to get more complicated, not less. In my career, I have been through three periods when the solvency of the U.S. banking system was in question: The Latin American debt crises of 1982, the U.S. commercial real estate crises of 1990 and last year's events. What was unique about -2008 was not that it happened, but its complexity and globality.
- It's abundantly clear that future crises are likely to require more elaborate and robust treatment as the world financial markets continue the trend towards near instantaneous connection of companies, citizens and nations with diverse economic regimes.
- The global marketplace needs global banks that operate in extraordinary markets 24 hours a day. We need to address regulatory reform prospectively and not by attempting to conform our industry and its institutions to outdated regulations. New regulations must conform to global finance as practiced in the 21st century.
- Evolution in complexity and connectivity is a reality of our global economy akin to the trends towards ever advancing speeds in computer processing.
- The answer is not to suppress what banks can do. For if we do, all that will happen is that new financial vehicles will develop to support the evolving needs of financial markets.
- The investment banks of 20 years ago did not seem to pose systemic risk. But then the world embraced global capital markets and Fed regulated banks became handicapped in this new environment. In short order, investment banks, exploiting the capital markets and loosely regulated, themselves became players with systemic risk. Limiting the creativity of regulated banks will not change the reality of evolving global markets.
- The answer to avoiding a systemic failure is perhaps found in the extraordinary measures taken by the U.S. Treasury and Federal Reserve last year.

- Although many have questioned the appropriateness of actions taken by the Fed, the FDIC and other agencies, their activities greatly reduced the ultimate economic pain of this crisis. And what the Fed and other central banks did was to extend their reach beyond commercial banks.
- The next time ~~that~~ a potential systemic breach of the global financial system appears, it is more likely that the appropriate countermeasures will need policy backing and the collective balance sheets of the world's leading economies in order to respond with a force commensurate to the magnitude of Systemic Risk in this new century.
- While the world showed an admirable level of cooperation in facing this recent crisis, the next time will require an even more efficient collective global response. JPMorgan supports the G20's efforts to reform financial regulation so that governments have broader and more coordinated authority.
- We have suggested that regulation be by product (derivatives, for example) and not necessarily by legal entity. We support the increased use of clearing houses and the proposals regarding lending disclosures. Hedge funds, private equity firms, and off balance sheet vehicles should be within the reach of regulators, without eliminating their freedoms and positive attributes.
- Systemic regulators should have the freedom to seek out risk everywhere and be able to do something about it. In addition, procedures need to be put into place to deal with problems in the large global institutions that are considered by some to be in the large "Too Big to Fail" institutions. Failure is fine so long as it's orderly, controlled, and leads to resolution. What we need is a resolution process that allows failure without causing damage to the whole system.
- Leading up to last years' events, some markets, like parts of the mortgage business, were unregulated; others were over-regulated or improperly regulated. Reinsurance companies like AIG, AMBAC and MBIA guaranteed trillions in bonds and securitized loans with less than 15% of the capital ratios that applied to the regulated banking sector. Broker-dealers like Lehman were freed from the capital and regulatory framework applied to commercial banks. Leverage ratios were in general too lax and virtually all policies were pro-cyclical.
- Many adopted a view that AAA securities were virtually riskless and immediately liquid. This terrible mistake was made by the best and the brightest in both government cabinets and financial board rooms. This notion that AAA securities was equal to cash led to assumptions in models. These assumptions became the market's reality, and the rest is history.
- Regulation and policy can have profound unintended consequences. It's no surprise that two of the most highly regulated US agencies, Fannie Mae and Freddie Mac, were at the epicenter of our most recent crisis. In order to satisfy political agendas, these entities were exempt from existing bank accounting disclosure, and were encouraged to make high Loan-to-Value loans to scores of non-qualified buyers.

- The message is that better and broader regulation is needed. But we need to do this with great caution. Because poor regulation may very well plant the seed of a distortion in the financial markets that will grow into our next crisis.
- This brings me to the sensitive topic of compensation--that is, how to measure, motivate and deliver rewards prudently in the financial sector. In my experience – particularly over the last year – this topic has become increasingly more critical, complex and fraught with misunderstanding.
- Mismanaging compensation can destroy a company. Improperly regulating compensation can destroy an industry. We strive to hire, train and retain the best talent-smart, ethical, hardworking entrepreneurial individuals--and getting compensation right is critical.
- Why? We cannot ask our people to earn significantly less than what their talents can generate in a free market. We need to ensure that we pay people in accordance with the growing complexities of the global market and in alignment with the growing parameters of systemic risk.
- Simply put, we need talent to manage risk. If not, we will be forced to rely on less talented people to operate a far more complex environment than we had in the past...just as the Navy places nuclear engineers in our nuclear submarines...we need the best and most qualified employees in our most complex businesses.
- At JPMorgan, our Asset Management division made some \$2 billion for the firm at a time that we were in the midst of the financial crises. We provided a counter balance to some of our businesses in Morgan tied to credit. This was a good thing.
- But we compete with many diverse players in the financial world, from mutual fund companies like Fidelity, to private equity firms like KKR. So when we think about compensation we have to think about fairness for our people in the context of the market place. We need to pay portfolio managers competitively—or we will not be able to retain the necessary talent. Moreover, to think that a trader managing the complex balance sheet of a global bank requires anything less than the financial skill, market insight, and understanding of risks that the best hedge fund manager needs, is nothing short of dangerous.
- Wall Street and similar markets are their best and most productive when allowed to function as meritocracies. We operate in a harsh and difficult industry and true success should be rewarded.
- That said, let me tell you a little about some prudent and important compensation practices we adopted early on at JPMorgan. Here's an overview:
 - 1) First, we pay our people based on an assessment of their multiyear performance and how they have helped to build long-term sustainable results. Because of this approach, our compensation was not excessively exuberant in the best of times, during which the rising tide frequently lifted all boats.

2) Also I want to make the point that performance for us is not a simple financial measure. It includes a review of broader factors and contributions a person brings to the company, other factors such as integrity, a strong work ethic, and compliance to policies and practices, the commitment to recruiting, training, and develop a diversity team, as well as the ability to show creativity and innovation. ~~awareness, innovation and creativity.~~

- 3) We have a bonus recoupment policy beyond that's required by Sarbanes-Oxley.
 - 4) We do not provide executives with change-of-control agreements, golden parachutes, special retirement plans, severance packages or merger bonuses.
 - 5) For quite some time, we have paid a significant portion of incentive compensation in stock that vests over multiple years; roughly 50% for our senior management compensation is paid in stock.
 - 6) Lastly, the most senior managers must retain 75% of all stock that they have received from the Company.
- In our Asset Management division we have a policy that specifically prohibits the granting of compensation guarantees. In my view, guaranteeing a bonus violates the principle of pay for performance and puts one employee on a different risk return scale than another employee. But compensation needs to be fair.
 - Let me close by saying that we have a lot to reflect on here. And, as business and government leaders start to draw conclusions from events that unfolded during the past year, it is my hope that they can respond constructively to put in place appropriate safeguards and regulations for our increasingly complex financial market.
 - For me, the silver lining in last year's crises was how much the world has learned about its interconnectedness. The impact of our actions is not isolated. We are in this together, and we will need to face the next financial challenge as one market. To do so, we must understand the ever more nuanced operating environment in which markets function.
 - My colleagues and I at JPMorgan would like to encourage all who are present today to participate actively in the dialogue with governments, agencies, and businesses about the realities of Systemic Risk, the need for a more global policy framework to respond to future crises, and the importance of fair and just rewards for performance in our industry.
 - But let's have that dialogue with a clear understanding that we can't go back to the steam engine after learning how to harness nuclear power. As the world financial system grows and evolves in complexity, let's ensure that we keep pace—both technologically and philosophically—to ensure that we can continue to meet the challenges presented by the changing spectrum of systemic risk and regulation.

Thank you.