

# [J.p. morgan chase and co project failure](https://assignbuster.com/jp-morgan-chase-co-project-failure/)

J. P. Morgan Chase & Co

On September 2011, the above named company; a banking and financial firm initiated a project for financial analysis under the nameNewSynthetic Credit VaR (Value at Risk) Model at an estimated cost of approximately $6B. The main aim of this project was to create a system that is responsible for managing the bank’s financial risk by use of complex financial hedging strategies in the derivatives markets (Robert, 2013).

According to JPMorgan (2013), the Synthetic Credit Portfolio introduced by the company and managed by CIO was to work towards offsetting the credit risk that JPMorgan faced, including in its CIO investment portfolio and in its capacity financial institution that carried out lending activities. This Synthetic Credit Portfolio comprised of both long positions and short positions in credit default swap indices and related instruments.

In order to make its operations efficient, the company developed a “ Synthetic Credit Value at Risk (VaR)Model” with the intention of helping them understand the level of risk that thy they were exposed to thereby making decisions about what trades they be engaging in and when.

This tool was developed by use of sing a series of Excel spreadsheets that were built within the country in the year 2011. However, the system failed and the entries had to be completed manually, by copying and pasting data from one spreadsheet to another and picking what appears to be an appropriate word. In J. P’S case, the appropriate word was YIKES! It is however important to note that copying and pasting is so risky to businesses since One minor slip and the data that one has may not be what one expected to have. For instance one can accidentally move and wipe out the embedded formulas unknowingly. Relying on copy and pasting in a tool that supports billion dollar transactions is very risky. The project was therefore a total failure and lead to loss of billions of shilling.

Reasons for the perceived failures

After the failure of the project, J. P. Morgan initiated investigation to find out why the project failed. The internal report into the incident indicated how various failures that were experienced while developing the tool were the driving forces that lead to the final debacle. The report indicates that despite the financial risks that were involved, the company gave a cavalier approach to develop the tool. According to the internal audit report six issues were the main contributing factors that left the London Whale with a tool that never helped (Robert, 2013). Among the reasons for the perceived failure according to the report include;

Firstly, the company allocated inadequate resources to the development of the model. The individual who was contracted by the company to develop the model had not previously developed or implemented a similar VaR model. Ina addition to that, the individual was not provided with sufficient financial support which they had developed. This led to the development of a substantial model.

On the model review policy and process that was provided for reviewing the new VaR model inappropriately presumed the existence of a robust operational and risk infrastructure that faced the model. The model policy reviews thus did not involve the Model Review Group or any other reputable Firm unit to test and monitor the performance and the efficiency of the model. On the contrary, the Back-testing was left to the discretion of the Model Review Group before it was approved by the Firm policy as required. The Model Review Group therefore only relied on limited back-testing of the new model therefore insufficiently analyzing the results that were submitted (Robert, 2013).

In addition to that, The Model Review Group’s review of the newly designed model was not rigorously as it should have been done. The review therefore focused basically on methodology and CIO-submitted test results. In addition to that, The Model Review Group did not compare the results based on the existing Basel I model in relation to the results that were being generated under the new model. According to JPMorgan (2013), It is factual that any comparison of the numbers being produced under the two available models was unnecessary because the new model was more complicated and sophisticated and therefore was expected to produce a more accurate and reliable VaR

It is also important to note that the model was approved despite the fact that operational problems had been observed. The Model Review Group on their report noted that the VaR computation was being done manually on the spreadsheets and was therefore prone to various errors and irreconcilable mistakes. The assumption of this nature had impact on the performance of the model.

Despite the fact that the Model Review Group included an action plan that required CIO to do various upgrade on its infrastructure so as to enable the VaR calculation to be automated ones the model was to approved, it had no basis for making conclusion that the expected automation would be possible on the specified time. On the other hand, both the Model Review Group and CIO did not follow up to found out if the automation had actually taken place (Robert, 2013).

It is also important to note that the CIO Risk Management played little role in the development of the model, its approval, implementation and the monitoring process. In addition, the CIO Risk Management personnel viewed themselves more as consumers of the model than important stakeholders that were responsible in both the development and operation of the model.

According to JPMorgan (2013), another reason for failure was that The CIO’s implementation of the model was flawed. This is because; the CIO relied heavily on the model creator to operate the model. Data were therefore uploaded manually without putting into consideration sufficient quality control. Spreadsheet-based calculations were also conducted with insufficient controls and various frequent formula and code changes were made to the system by the operator.

In addition, the Firm’s Chief Investment Officer, Ina Drew in his official capacity failed heavily in three critical areas with respect to the Synthetic Credit Portfolio. These areas included; firstly, he failed to ensure that CIO management body properly understood and vetted the flawed trading strategy and appropriately monitored the execution of the whole project.

Secondly, he failed to ensure that the CIO control functions including that of the CIO Risk and Finance organizations performed efficiently and properly and were provided with effective

Performing well and were providing effective oversight of CIO’s trading goals and strategy towards accomplishing the goals.

Finally, the Firm’s Chief Investment Officer failed to appreciate the magnitude, relevance and the significance of the changes that were made in the Synthetic Credit Portfolio during the first quarter of its inception in 2012. This therefore had impact by increasing the size, complexity and riskiness of the project portfolio of the RWA.

Another reason for failure is that The CIO Risk organization was not adequately equipped to properly manage the risks that were associated to the portfolio during the first quarter of

2012. It therefore performed ineffectively as the portfolio grew in size, complexity and developed a number of technicalities during that period that it experienced the failure.

According to Robert (2013), the risk limits that were applicable to CIO were not sufficiently granular in nature. This is because, there were no limits by size, asset type or risk factor that were applicable to the specific Synthetic Credit Portfolio. Limits in CIO were however applied only to CIO as a whole. The absence of this granular limit played a major role in allowing the flawed trading strategies to proceed in the first quarter of the inception with little attempt to counter, especially as the positions grew

It is also worth noting that inadequate information technology resources were also devoted to the development and implantation process of the model. This was against the action plan that was contained in the model approval thus making the automation of the model a daunting task.

According to JPMorgan taskforce report (2013), the entire project was very complex, poorly reviewed by the CIO and not only poorly executed, but was also poorly monitored. According to the internal audit report conducted by the firm, Synthetic Credit Portfolio incurred slightly more than $2 billion in its mark-to-market losses in the first quarter up to that point in the second quarter, with the obvious possibility of additional future losses and volatility. It was therefore a total failure and the company had to examine the reasons for the failure and stop using it.

Recommendations for how effective project management could have helped to avoid the problems above

The failure of the project was because of a number of management lapses that could have however been avoided or corrected at the initial stages to ensure that the project was successful. Among the recommendations that were provided by the internal audit body included the following;

To begin with, it was necessary that the Firm appointed a new, experienced CIO leadership team to spearhead the inception of the project. This would ensure that the team works to initiate a project that professional knowledge about instead of incorporating a body that was blank about the whole project (Robert, 2013)

It was also important that the Firm has adopts a variety of relevant governance measures to improve its oversight of CIO, and ensure that the CIO was better integrated into the rest of the Firm’s department. For instance, the Firm was to institute a team of new and robust committee structures within CIO that would take effective steps to enhance the Firm’s internal audit coverage of the CIO activities and ensure that tight linkages existed among CIO, Corporate Treasury and other operations within the Firm’s corporate sector. This linkage would have enhanced solution solving and better understanding of the whole project.

According to Robert (2013), it was also important that The Firm’s management integrates the existing CIO Valuation Control Group staff into the Investment Bank’s Valuation Control Group. This would not only enhance the operations of the team but would also make them to have a better understanding of the model thus making it easier for them to detect the various failures.

In addition to that, the Firm out to have established a CIO Valuation Governance Forum as part of a Firm’s-wide initiative to strengthen the governance of the model’s valuation activities. Moreover, the Firm was to give the CIO Corporate Business Review mandate to be conducted with increasing frequency, and with the same enthusiasms that is similar to the reviews for the Firm’s client-facing lines of business

It was also necessary that the firm enhance the independence of the CIO Risk function by making it an independent body that was answerable to none. For example, it was necessary that the CIO Chief Risk Officer’s functional reporting practices conform to his official reporting line. This would to accuracy and lack of confusion due to conflicting interests.

The CIO’s Risk Committee mandate was also to be made broader to cover has been renamed Treasury and Corporate functions as well as its official CIO function and was to have significant representation beyond CIO. It was also necessary that they meet regularly to evaluate the performance of the model and to give appropriate recommendations before the risks reached critical level (JPMorgan, 2013)

According to Robert (2013), it was also important that the CIO implements several restructured risk limits that covers a broad set of risk parameters, including both geographic and concentration risks With respect to the Synthetic Credit Portfolio project in particular this would measure geographic exposure, credit-type exposure, single-index positions and curve shifts and compression. It was also necessary that the firm conducts a comprehensive self-assessment of its entire risk organization in order to evaluate the possibility of project failure.

It is also recommended that the project managers on a continuous revisit the project progress. This will make it easy to reevaluate its progress thereby taking necessary measures to address the challenges if any (Cornelius, 2013). Regular assessment of the project also makes it possible to do necessary adjustments in order to make the implementation process not only successful but also easy.

It is also necessary to Plan the designation of the work by utilizing a well defined project definition document that sets out the criteria for the setting of the project, goals and objectives of the project, implementation and criteria for assessment and evaluation of the project. This will ensure that everything is done within the stipulated time and any inadequacy is addressed at the appropriate.

According to Tom (2009), project definition plan should include factors such the overview of the project, the objectives of the project scopes and the assumption. It should also contain the approach to both implementation and designation, the initial effort required for implementation alongside the costs and the duration estimates. The document should therefore be comprehensive enough to cover the whole concept of the project.

In addition, it is necessary to create a project plan for the organization. The work plan should provide step-by-step procedure and instructions for constructing the project deliverables and management of the entire project. The development of the work plan should rely on prior successful work plan from a similar successful project that acts as a model. However, if no model project exists, it is necessary to utilize the old-fashioned design that involves utilizing a work-breakdown structure and network diagram (Tom, 2009).

It is necessary according to Tom (2009) to create a detailed work plan that includes assigning both human and financial resources and estimating the work as far out as out as it is felt it can meet the expectation of the designers, developers and the implementers. This is also referred to as the planning horizon. Beyond the planning horizon, it is important to lay out the project at a higher level, reflecting the increased level of uncertainty. The planning horizon will always move forward as the project progresses with time. High-level activities that the project seeks to address and were thought to be vague need to be defined in more detail as the project moves to more advanced level.

Finally, it is always important to allocate enough funds towards the construction and the implementation of the projects. The personnel that are involved in the construction and implementation of the project should be well paid to ensure that they are well motivated so as to make an effective project.

In conclusion, the process of developing and implementing a project is usually a difficult task. This is because it may involve a lot of risks that are accompanied by financial implications. It is always important that project developers managers and developers appreciates the existence of such risks and works towards ensuring that they do not lead to failure of the project.

In addition, it is always necessary that the management forms an evaluation and risks assessment team to carry out regular assessment of the project. This team should comprise of professional with better understanding of the project and should be in a position to provide immediate and instant solutions to the problem or the potential threat.

## References

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