UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549-4561

DIVISION OF
CORPORATION FINANCE

March 13, 2012

Paul M. Neuhauser
pmneuhauser@aol.com

Re: JPMorgan Chase & Co.
Incoming letter dated February 3, 2012

Dear Mr. Neuhauser:

This is in response to your letters dated February 3, 2012 and February 17, 2012 concerning the shareholder proposal submitted to JPMorgan by the Sisters of Charity of Saint Elizabeth, Missionary Oblates of Mary Immaculate, Maryknoll Sisters of St. Dominic, Inc., Maryknoll Fathers and Brothers, and Community of the Sisters of St. Dominic of Caldwell, NJ. We also have received a letter on behalf of JPMorgan dated February 23, 2012. On January 27, 2012, we issued our response expressing our informal view that JPMorgan could exclude the proposal from its proxy materials for its upcoming annual meeting. You have asked us to reconsider our position. After reviewing the information contained in your letters, we find no basis to reconsider our position.

Copies of all of the correspondence on which this response is based will be made available on our website at http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8.shtml. For your reference, a brief discussion of the Division's informal procedures regarding shareholder proposals is also available at the same website address.

Sincerely,

Thomas J. Kim
Chief Counsel &
Associate Director

cc: Martin P. Dunn
O'Melveny & Meyers LLP
mdunn@omm.com

O

O'MELVENY & MYERS LLP

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1934 Act/Rule 14a-8

February 23, 2012

VIA ELECTRONIC MAIL (shareholderproposals@sec.gov)

Office of Chief Counsel
Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: JPMorgan Chase & Co.
Shareholder Proposal of Sisters of Charity of Saint Elizabeth, *et. al.*
Entitled "Transparency in Repurchase Markets"
Securities Exchange Act of 1934 Rule 14a-8

Dear Ladies and Gentlemen:

This letter concerns the request dated January 10, 2012 (the ***"No-Action Request"***) that we submitted on behalf of JPMorgan Chase & Co., a Delaware corporation (the ***"Company"***), seeking confirmation that the staff (the ***"Staff"***) of the Division of Corporation Finance of the U.S. Securities and Exchange Commission (the ***"Commission"***) would not recommend enforcement action to the Commission if, in reliance on Rule 14a-8 under the Securities Exchange Act of 1934 (the ***"Exchange Act"***), the Company omitted the shareholder proposal (the ***"Proposal"***) submitted by the Sisters of Charity of Saint Elizabeth, Missionary Oblates of Mary Immaculate, Maryknoll Sisters of St. Dominic, Inc., Maryknoll Fathers and Brothers, and Community of the Sisters of St. Dominic of Caldwell, NJ (collectively, the ***"Proponent"***) from the Company's proxy materials for its 2012 Annual Meeting of Shareholders (the ***"2012 Proxy Materials"***). On January 27, 2012, the Staff expressed its informal view that the Proposal could be omitted from the Company's 2012 Proxy Materials pursuant to Rule 14a-8(i)(7), as the Proposal "relates to the repurchase agreement program maintained by JPMorgan Chase as part of the financial services offered by the company" and proposals concerning "the sale of particular services are generally excludable under [R]ule 14a-8(i)(7)" (the ***"No-Action Letter"***). This letter is not attached hereto, but is availably publicly (along with a copy of the No-Action Request) at http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/sistersofcharity012712-14a8.pdf.

We submit this letter on behalf of the Company to rebut and respond to some of the claims made in two letters submitted on behalf of the Proponent on February 5 and February 17, 2012, by Paul Neuhauser, as representative of the Proponent, to the Staff (individually, each a ***"Proponent Letter"*** and, together, the ***"Proponent Letters"***), in the event that the Staff views the Proponent Letters as requests for reconsideration of the view expressed in the No-Action Letter. The Company believes that the Proponent Letters do not set forth sufficient facts to support a request for reconsideration and that the informal view expressed in the No-Action Letter (*i.e.*, that the Staff will not recommend enforcement action to the Commission if the Company omits the Proposal from its 2012 Proxy Materials in reliance on Rule 14a-8) should be allowed to stand.

I. BACKGROUND

On December 5, 2011, the Company received the Proposal, which requested three distinct actions: (i) disclosure of the Company's use of repurchase agreement (***"repo"***) transactions and securities lending transactions, (ii) disclosure of the Company's position on efforts by regulatory or supervisory authorities to collect and report information about repo markets, and (iii) the adoption of the use of transparent, multilateral trading facilities for repo transactions. In the No-Action Request, the Company requested that the Staff concur in its view that the Company may exclude the Proposal from its 2012 Proxy Materials in reliance on Rules 14a-8(c) and (f), as the as the Proposal contained three distinct and unrelated proposals, Rule 14a-8(i)(7), as the Proposal related to ordinary business matters regarding concerning the sale of particular products and services, and in reliance on Rule 14a-8(i)(3), as the Proposal was materially false and misleading.

On January 27, 2012, the Staff expressed its informal view that it concurred with the Company's view that the Proposal and Supporting Statement could be omitted from the 2012 Proxy Materials in reliance on Rule 14a-8(i)(7), as the Proposal relates to the repurchase agreement program maintained by the Company as part of the financial services it offers and that proposals concerning the sale of particular services are generally excludable under Rule 14a-8(i)(7).

On February 5 and February 17, 2012, Paul Neuhauser, as representative of the Proponent, submitted the Proponent Letters to the Staff, asserting his view that the Proposal is required to be included in the 2012 Proxy Materials. The Proponent Letters are attached hereto as Exhibit A.

II. EXCLUSION OF THE PROPOSAL

A. Any Request For Reconsideration of the Views Expressed in the No-Action Letter Should Be Denied, as the Proponent Letters Do Not Set Forth Sufficient Facts To Support Reconsideration

The Staff's No-Action Letter concurring in the exclusion of the Proposal pursuant to Rule 14a-8(i)(7) was granted prior to its receipt of the Proponent Letters. As a matter of practice, the

Staff generally will assess whether such a later-received letter provides a basis for reconsideration of its no-action response. Should the Staff undertake such an assessment with regard to the Proponent Letters, the Company is of the view that the Proponent Letters do not provide sufficient facts to support reconsideration of the views set forth in the No-Action Letter. First, the Proponent Letters, although submitted significantly after the No-Action Letter was sent to the Company and the Proponent, do not address the views expressed in that letter. The Proponent Letters do not address the ordinary business aspects of the repurchase agreement program maintained by the Company or the fact that proposals that relate to the sale of particular services are generally excludable under Rule 14a-8(i)(7). The Proponent Letters do not address with any level of specificity why disclosure of the details of each repurchase agreement transaction and securities lending transaction (including the information set forth in the first bullet of the Proposal) does not relate (individually or in the aggregate) to ordinary business matters regarding sale of a particular product. The Proponent Letters also provide no explanation of how the Company's "position on efforts by regulatory or supervisory authorities to collect and report information about repo markets" does not relate to ordinary business matters regarding lobbying. Further, the Proponent Letters provide no analysis as to why a proposal attempting to dictate the platform used by a financial institution to clear trades is not an ordinary business matter relating to the manner in which services are provided.

As with its consideration of any Rule 14a-8(i)(7) no-action request, the Staff necessarily considered whether the Proposal related to any significant policy issue prior to issuing the No-Action Letter. Nothing in the Proponent Letters support reconsideration of the views expressed in that letter regarding the application of Rule 14a-8(i)(7) to the Proposal. The first Proponent Letter begins by stating that the Company is "one of two Tri-Party Clearing Banks" and asserts the view that this "portion of the repo market...is especially implicated in systemic risk to the financial system." Although NOT the subject matter of the Proposal, 16 pages of the first Proponent Letter consist of reproductions of several articles, speeches and quotations from activist websites (some of which are more than two years old) that refer only to the Company in its capacity as a "tri-party clearing bank." None of the articles or quotes cited provide direct, clear support for the view that this Proposal relates (a) to some unidentified significant policy issue regarding all or certain aspects of repo transactions, or (b) any empirical data that such issue "implicates an important policy issue for Chase." The second Proponent Letter similarly focuses almost entirely on the Company's capacity as a "tri-party clearing bank."

B. The Proposal May Be Excluded in Reliance on Rules 14a-8(c) and (f) because it Violates the "One-Proposal" Limitation

As the No-Action Letter granted the Company's request pursuant to Rule 14a-8(i)(7), it did not address the Company's view that it may properly exclude the Proposal in reliance on Rules 14a-8(c) and (f). The Company continues to believe it may properly exclude the Proposal because it requests that the Company undertake at least three distinct actions relating to three distinct subject matters, and, as such, the three different proposals contained in the Proposal lack a single well-defined unifying concept.

While the Proposal contained no such discussion or distinction, the first Proponent Letter contends that each of the three proposals relates to a "single concept," namely "how the Company is responding to the systemic risks to the financial system created by a non-transparent repo-market." However, the first Proponent Letter then identifies directly the three distinct subject matters that are contained in the Proposal:

- transaction disclosure processes and decisions (***"Proposal One"***);
- lobbying processes and decisions (***"Proposal Two"***); and
- transaction execution processes and decisions (***"Proposal Three"***).

While the Commission has stated that a single proposal made up of several components does not constitute more than one proposal if the components "are closely related and essential to a single well-defined unifying concept," *Exchange Act Release* No. 12999 (November 22, 1976), subsequent no-action letter precedent has shown that there are limits on what constitutes a "single well-defined unifying concept." *See Parker-Hannifin Corporation* (September 4, 2009) (concurring in the exclusion of two distinct shareholder proposals that broadly related to executive compensation), *General Motors Corporation* (April 9, 2007) (concurring that a proposal seeking shareholder approval for numerous transactions to restructure the company could be omitted in reliance on Rule 14a-8(c)), *and Pfizer Inc.* (February 19, 2007) (concurring that a proposal with multiple elements relating to the election to the board of directors could be omitted in reliance on Rule 14a-8(c)). Simply stating that the Proposal generally relates to "how the Company is responding to the systemic risks to the financial system created by a non-transparent repo market" is not enough to establish that the three separate proposals contained therein are "closely related and essential to a single well-defined unifying concept," and the first Proponent Letter fails to provide any further explanation.

Despite the first Proponent Letter's contention otherwise, the Proposal is directly analogous to *Exxon Mobil Corporation* (March 19, 2002) (***"Exxon"***), and it is immaterial whether the elements of the proposals in *Exxon* had been separately submitted to the company in the past. In *Exxon*, the Staff concurred with the view that a proposal seeking (i) the inclusion of a slate of nominees larger than the available board seats by a reasonable number and (ii) requesting that these additional nominees come from a variety of different background could be omitted in reliance on Rule 14a-8(c), as relating to the submission of more than one proposal as it contained two distinct concepts -- (a) the number of board nominees and (b) director qualifications. The Staff concurred in this view despite the proponent's contention that each of the proposals related to the diversification of the board of directors.

Similarly, the Proposal requests that the Company (i) provide specific disclosure concerning its trading activities (Proposal One), (ii) provide specific disclosure concerning its lobbying activities (Proposal Two), and (iii) "adopt the use of" certain trading facilities for future transactions (Proposal Three). Each of these proposals relate to a distinct concept -- (a) the manner in which the Company provides specific products and services to its customers, (b) the

Company's specific lobbying activities that are related to the Company's ordinary business operations, and (c) the manner in which the Company sells and markets its products.

Based on the foregoing and the reasons discussed in the No-Action Request, the Company continues to believe that the Proposal contains three distinct proposals that are not so closely related as to comprise a single well-defined unifying concept, and that, as a result, the Proposal may be properly excluded from the Company's 2012 Proxy Materials in reliance on paragraphs (c) and (f) of Rule 14a-8.

C. The Proposal May Be Excluded in Reliance on Rule 14a 8(i)(3), as it is Materially False and Misleading

As the No-Action Letter granted the Company's request pursuant to Rule 14a-8(i)(7), it did not address the Company's view that it may properly exclude the Proposal in reliance on Rules 14a-8(i)(3). The Company continues to believe that it may properly exclude the Proposal because it impermissibly suggests that the Company would be able to implement the third part of the Proposal -- i.e., "adopt the use of transparent, multilateral trading facilities" when "acting as a repo dealer." As described in the No-Action Request, there are currently only a small number of multilateral trading facilities that may be used to clear and settle repurchase agreement transactions, all of which only allow for repurchase agreement transactions among eligible members regarding either U.S. Treasury Bonds or other highly liquid government or agency securities. In other words, the "transparent, multilateral trading facilities" the Proposal asks the Company to use do not, in fact, exist for all but a limited number of repo transactions. Further, the assumption that the Company could simply "create" such facilities if currently unavailable ignores the realities of how "multilateral" trading facilities are established.

The first Proponent Letter expresses the view that the Company failed to carry its burden of establishing that the phrase "transparent, multilateral trading facility" is impermissibly vague or indefinite. Specifically, the Proponent asserts that the "the phrase would convey an identical meaning to all who encounter it." However, the Company has not and does not argue that the phrase "transparent, multilateral trading facilities" is impermissibly vague or indefinite. Rather, the Company contends that this part of the Proposal is impermissibly vague and indefinite because it requests that the Company "adopt the use of transparent, multilateral trading facilities" where no such trading facilities exists.

This third part of the Proposal is directly analogous to *Wendy's International, Inc.* (February 24, 2006) (***"Wendy's"***). As noted by the first Proponent Letter, despite the fact that the company in *Wendy's* purchased and sold large amounts of poultry, the company successfully argued that it was "not in the business of slaughtering and processing poultry," and therefore was not "not in a position to directly 'accelerate development of CAS [CAK] either in terms of actually utilizing CAS [CAK] or conducting research on CAS [CAK] methods in the course of slaughtering chickens," and that therefore, a proposal requesting the company "accelerate development" of "CAS [CAK]" was misleading and excludable pursuant to Rule 14a-8(i)(3). Similarly, the Company, despite participating in and executing repurchase agreement transactions, is not in the business of "assisting in developing" or "modifying" "transparent,

multilateral trading facilities," and a Proposal requesting that the Company "adopt the use of transparent, multilateral trading facilities" where none exist is similarly misleading and excludable under Rule 14a-8(i)(3).

Based on the plain language of the Proposal, the fact that the Company is not in the business of creating or assisting in developing multilateral trading facilities, and the discussion above and in the No-Action Request, the Company continues to believe that it may properly exclude the Proposal from its 2012 Proxy Materials in reliance on Rule 14a-8(i)(3).

III. CONCLUSION

For the reasons set forth above and in the No-Action Request, the Company previously maintained and continues to believe that the Proposal may be omitted in reliance on Rule 14a-8. The Company therefore requests that the Staff not reconsider its informal view set forth in the No-Action Letter stating that the Proposal may be omitted from the 2012 Proxy Materials in reliance on Rule 14a-8(i)(7). To the extent that the Staff does reconsider its view as to the application of Rule 14a-8(i)(7) to the Proposal, the Company renews its request that the Staff concur with the Company's view that the Proposal may be omitted from the 2012 Proxy Materials in reliance on Rules 14a-8(c) and (f), Rule 14a-8(i)(7), and Rule 14a-8(i)(3). If we can be of further assistance in this matter, please do not hesitate to contact me at (202) 383-5418.

Sincerely,

Martin P. Dunn
of O'Melveny & Myers LLP

Attachments

cc: Sister Barbara Aires, SC
Sisters of Charity of Saint Elizabeth

Paul Neuhauser

Anthony Horan, Esq.
Corporate Secretary
JPMorgan Chase & Co.

EXHIBIT A

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February 3, 2012

Securities & Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Att: Ted Yu, Esq.
Special Counsel
Division of Corporation Finance

Via email to shareholderproposals@sec.gov

Re: Shareholder Proposal submitted to JP Morgan Chase & Co.

Dear Sir/Madam:

I have been asked by The Sisters of Charity of St. Elizabeth, the Missionary Oblates of Mary Immaculate, the Maryknoll Sisters of St. Dominic, Inc., the Maryknoll Fathers and Brothers and the Sisters of St. Dominic of Caldwell, N.J. (hereinafter referred to jointly as the "Proponents"), each of which is the beneficial owner of shares of common stock of JP Morgan Chase & Co. (hereinafter referred to either as "Chase" or the "Company"), and who have jointly submitted a shareholder proposal to Chase, to respond to the letter dated January 10, 2010, sent to the Securities & Exchange Commission by O'Melveny & Myers LLP on behalf of the Company, in which Chase contends that the Proponents' shareholder proposal may be excluded from the Company's year 2012 proxy statement by virtue of Rules 14a-8(i)(7), 14a-8(i)(3) and 14a-8(c).

I have reviewed the Proponents' shareholder proposal, as well as the aforesaid letter sent by the Company, and based upon the foregoing, as well as upon a review of Rule 14a-8, it is my opinion that the Proponents' shareholder proposal must be included in Chase's year 2012 proxy statement and that it is not excludable by virtue of any of the cited rules.

The Proponents' shareholder proposal requests the Company to disclose additional information about its participation in the "repo" (repurchase agreements) market and to adopt greater transparency with respect to its activities in that market.

RULE 14a-8(i)(7)

GENERAL BACKGROUND

The Company is one of the two Tri-Party Clearing Banks. This portion of the repo market, as delineated below, most notably in the comments quoted from Chairman Bernanke, is especially implicated in systemic risk to the financial system. Daily transactions in the overall repo market total about $6.5 trillion, of which about 25% are in the Tri-Party repo market. It is estimated that the tri-party market was much larger prior to the financial crash, with about $2.8 trillion in daily transactions.

The following description of the repo market is taken from a paper entitled "Systemic Risk and the Tri-Party Repo Clearing Banks" by Bruce Tuckman and appears at www.centerforfinncialstability.org (pages 2-3, footnotes omitted):

1. A Brief Introduction to U.S. Repo Markets

A repurchase agreement, or repo, is essentially a secured loan. One party borrows cash from another and posts securities as collateral. When the agreement expires, the borrower pays back the loan principal with interest and the lender returns the collateral. Agreements are typically "overnight, "expiring after a day, but "term" agreements are struck for several months or longer. Collateral is typically U.S. Treasuries, Agencies, and agency MBS, but corporate bonds, municipal bonds, other assetbacked securities, and equities are posted as well.

The repo market plays several important roles in financial markets:

*While broker-dealers want to hold securities, both to facilitate their market-making activities and as investments, they do not want to commit scarce capital by purchasing these securities outright. The repo market allows them to use borrowed money to pay for the purchases by posting the securities they buy as collateral. (When the repo expires, the borrower of cash must either sell the security to pay back the loan or, quite commonly, "roll" or renew the repo for another day or term.) Repo trades for this purpose are also called "funding trades."

*Leveraged investors, like many hedge funds, buy securities and finance the purchases through the repo market as well.

*Non-leveraged investors, including state and local governments, money market funds, other mutual funds, and foreign sovereign entities, prefer the relative safety of lending money on a secured basis to bearing the direct credit risk inherent in other money market investments.

*The repo market provides the mechanism by which securities are borrowed so that they may be sold short: the short-seller lends money in the repo market, takes the security he wishes to short as collateral, and then sells the security. (When the repo expires the short-seller must either buy the security in the market to return the repo collateral or roll the repo.) By facilitating short sales the repo market not only promotes price efficiency but provides opportunities for holders of securities, e.g., insurance companies and pension funds, to earn incremental returns by lending out their securities as repo collateral.

*The Federal Reserve uses repo to add or remove liquidity from the financial system, particularly when such actions are expected to be unwound in relatively short order.

While extremely safe relative to other financial transactions, borrowing and investing cash in the repo market is not risk free. Should the borrower of cash default on a loan, the lender of cash can sell the collateral and use the proceeds to cover the loan. The risk of a repo to the lender of money, therefore, is that the counterparty defaults on the loan at the same time that the value of the collateral has fallen. Conversely, should the lender of cash default by not returning collateral, the borrower of cash need not repay the debt. Hence the risk of a repo to the borrower of money is that the counterparty defaults at the same time that the value of the collateral has risen. To mitigate these risks, the weaker of the two counterparties typically posts margin. For example, the borrower of cash might post $100mm of collateral to borrow $80mm of cash or the lender of cash might lend $110mm of cash to take $100mm of collateral.

The repo market is a significant source of funding for security brokers and dealers and, as a result, has been at the center of recent market convulsions. From 2003 to 2007 net repo borrowings by broker-dealers increased from $490.4 billion to $1.1 trillion, accounting for between 30% and 40% of their total liabilities over that time period and for 37.9% at the end of 2007. Subsequently, as a result of deleveraging in 2008-2009, net repo borrowings fell to $480.0 billion by the end of the second quarter of 2009, accounting for only 25% of total liabilities.

A RECENT ILLUSTRATION OF THE PROBLEM

The following article from Reuters (Westlaw) illustrates one aspect of the repo problem, as it relates to the bankruptcy of ML Global (the eighth largest bankruptcy in US history), namely the off-balance sheet treatment of repos-to-maturity:

Off balance sheet repo risks come back to bite

NEW YORK, Nov.16 [2011](Business Law Currents) - Off balance sheet items and undisclosed liabilities are coming back to bite companies, as repo-to-maturity disclosures prove to be a jarring reminder of pre-crisis risk proclivity.

Symptomatic of a wider problem gripping U.S. banks, MF Global's bankruptcy has drawn attention to the danger of financial services firms hiding their true liabilities, no matter how safe they think they are.

The revelation that MF Global's off balance sheet leveraged repo-to-maturity play was stuffed full of toxic Eurozone debt proved to be its downfall. The prospect of a Eurozone default spooked markets and MF Global's liquidity drained away. A review of U.S. banks' SEC disclosures reveals, however, some troubling implications of the gaps in U.S. GAAP filings as the true nature of hidden debt exposure becomes apparent.

SEC filings from Nomura, Santander and Merrill Lynch have all acknowledged the heavy use of off-balance sheet repo-to-maturity transactions, and some even admitted to including Eurozone debt within these structures.

REPOS

By way of background, repos are used by many banks as a way to increase liquidity and involve the sale of a security (e.g. bonds) together with an agreement for the seller (the bank) to repurchase the securities at a later date. In return for "selling" the securities, the seller receives a purchase price with an agreement to repurchase the securities at a later date and probably for a greater price – effectively representing the "interest" (known as the "repo rate"). A repo is the economic equivalent of a secured loan with the buyer receiving securities as collateral and the seller receiving the purchase price as the loan principle, although as seen in Lehman Brothers' collapse, this can be abused for accountancy purposes.

When a repo is set to mature at the same time as its underlying security (a "repo-to-maturity"), a company can treat these repos as sales and remove both assets and liabilities from its balance sheet. The problem is that banks remain exposed to the risks of repo assets defaulting or decreasing in value. A reduction in value can result in margin calls (a call for additional security) or can leave a repo seller exposed to off balance sheet defaults.

NOMURA

Most transparent over its exposure to off balance sheet transactions is Nomura who acknowledged in recent filings that as of 31 March 2011, it had derecognized Yen 160.9 billion into repo-to-maturity transactions, a figure that had increased to Yen 169.7 billion by the end of 30 June 2011. In other words, Nomura has derecognized (removed) Yen 169.7 of assets and liabilities from its balance sheet, despite the fact it remained economically exposed to those assets.

Summed up in this concise note to its balance sheet, Nomura acknowledged that its filed balance sheet does not include the full extent of its liabilities:

> Reconciles to the total assets amount disclosed on the face of Nomura's consolidated balance sheets and therefore excludes the fair value of securities transferred to counterparties under repo-to-maturity and certain Japanese securities lending transactions which are accounted for as sales rather than collateralized financing arrangements.

To make matters worse, Nomura disclosed in a recent 8K that it has a credit risk concentration that includes significant amounts of EU debt. Nomura disclosed that:

> Nomura has credit risk concentrations on bonds issued by the Japanese Government, U.S. Government, Governments within the European Union ("EU"), their states and municipalities, and their

agencies. These concentrations generally arise from taking trading securities positions and are reported within Trading assets in the consolidated balance sheets.

According to the same filing Nomura's total exposure to the EU was Yen 2.6 billion, but allowing for the additional Yen 169.7 billion in repo-to-maturity transactions not included in this figure, the true exposure is likely much higher.

MERRILL LYNCH

Also disclosing significant use of repo-to-maturity transactions was Merrill Lynch although whether these include Eurozone debts is much harder to determine.

Merrill Lynch stated that:

> Merrill Lynch enters into repo-to-maturity sales only for high quality, very liquid securities such as U.S. Treasury securities or securities issued by the government-sponsored enterprises ("GSEs"). Merrill Lynch accounts for repo-to-maturity transactions as sales and purchases in accordance with applicable accounting guidance, and accordingly, removes or recognizes the securities from the Condensed Consolidated Balance Sheet and recognizes a gain or loss, as appropriate, in the Condensed Consolidated Statement of Earnings.

While one might be mistaken for thinking that Merrill Lynch only invests in U.S. government debt from this disclosure, the wording is perhaps tellingly vaguer than many of its competitors.

According its filing, Merrill Lynch only undertakes repo-to-maturity transactions for "high quality, very liquid securities such as U.S. Treasury Securities" but it does not, unlike many other banks, discount the possibility that these transactions include Eurozone debt.

Although Merrill Lynch disclosed that the use of repo-to-maturity transactions were not "material" for the period it does recognize the potential impact that these and other OTC contracts could have on it business if confidence was to be lost in its ability to pay its creditors. Merrill Lynch stated:

> In addition, under the terms of certain OTC derivative contracts and other trading agreements, the counterparties to those agreements may require us to provide additional collateral or to terminate these contracts or agreements which could cause us to sustain losses and/or adversely impact our liquidity. If Bank of America's or ML & Co's short–term credit ratings, or those of our bank or broker–dealer subsidiaries, were downgraded by one or more levels, the potential loss of access to short–term funding sources such as repo financing, and the effect on our incremental cost of funds could be material.

OPPENHEIMER HOLDINGS

Contrast Merrill Lynch's disclosures with those of Oppenheimer Holdings, a U.S. investment bank that has a notional exposure to $1.75 billion in repo-to-maturity transactions out of total repurchase agreements (including short term repos) of $7.2 billion.

Oppenheimer goes to great lengths to clarify what its repo-to-maturity debts include. It stated that:

> Recent events have caused increased review and scrutiny on the methods utilized by financial service companies to finance their short term requirements for liquidity. The Company utilizes commercial bank loans, securities lending, and repurchase agreements (through overnight, term, and repo–to–maturity transactions) to finance its short term liquidity needs (See "Liquidity"). All repurchase agreements and reverse repurchase agreements are collateralized by short term U.S. Government obligations and U.S. Government Agency obligations.

BANK OF AMERICA

As well as going into great detail to spell out what assets might be behind off balance sheet transactions, some banks, such as Bank of America, make a point of advertising that they no longer engage in this kind of behaviour. According to Bank of America's most recent annual report, it no longer engages in repo-to-maturity transactions despite having an exposure of $6.5 billion at the end of 2009.

Bank of America stated:

> In repurchase transactions, typically, the termination date for a repurchase agreement is before the maturity date of the underlying security. However, in certain situations, the Corporation may enter into repurchase agreements where the termination date of the repurchase transaction is the same as the maturity date of the underlying security and these transactions are referred to as "repo–to–maturity" (RTM) transactions. The Corporation enters into RTM transactions only for high quality, very liquid securities such as U.S. Department of the Treasury (U.S. Treasury) securities or securities issued by government–sponsored enterprises (GSE). The Corporation accounts for RTM transactions as sales in accordance with applicable accounting guidance, and accordingly, removes the securities from the Consolidated Balance Sheet and recognizes a gain or loss in the Consolidated Statement of Income. At December 31, 2010, the Corporation had no outstanding RTM transactions compared to $6.5 billion at December 31, 2009, that had been accounted for as sales.

EUROPEAN DISCLOSURES

Perhaps surprisingly, and not without some irony, disclosures from Europe reveal a slightly healthier picture. Despite the crisis raging across the continent, European banks generally file under IFRS rather than U.S. GAAP. The different accounting principles mean that repo-to-maturity transactions are much less likely to be treated as sales and more as financing. This means that although European banks (e.g. Dexia) carry substantial PIIGS exposure, this exposure is less likely to be in the form of off balance sheet transactions and more likely to be accounted for.

Unable to treat its repos as sales under IFRS, Santander's SEC disclosure noted significant exposure to Eurozone debt as at 30 June 2011, although these are in the form of "financing" rather than repo sales of sovereign debt. According to Santander it has £1.5 billion in reverse repos which were collateralised by OECD Government (but not Spanish) securities.

Similarly, Royal Bank of Scotland (RBS) discloses significant on sheet exposure to Eurozone debt in the form of assets and derivatives. In its recent annual report, RBS stated that its net exposure to Portugal and Greece (combined) was around £3 billion. HSBC also disclosed that it had a combined exposure to Greece and Portugal debt of around £1.6 billion and both companies booked impairment charges as a result of the ongoing instability in the region.

Ironically, while IFRS filing banks acknowledge and disclose Eurozone debts, the full extent of U.S. banks' debt exposure may never be fully known. While these debts may not, in some instances, include Eurozone debt, they are not risk free and their off balance sheet characterization makes them difficult to assess and perhaps even harder to prepare for.

The downgrading of U.S. treasury debt only highlighted the fall from grace of sovereign debt as the safest form of assets. With U.S. debt no longer seemingly risk free, few people would argue that the off sheet treatment of treasury bonds was appropriate. Should U.S. treasury debt suffer further problems, then U.S. banks use of off balance sheet repo transactions could come back to haunt them.

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In addition to the repos to maturity debacle, repos may have been responsible for the missing $1.2 billion in customer's funds at ML Global. According to a first page Wall Street Journal article on January 30, 2012, the "evaporation" of its customer's funds may have been caused by the broker having invested those funds (for the broker's profit, as permitted) in repos which then became unprofitable trades. (See last paragraph of the article.)

THE FINANCIAL CRISIS

At the core of the financial crisis was the combination of overleverage and "borrowing short and lending long". The key ingredient in that combination was the use of repurchase agreements, which provided the "borrowing short" portion of the equation, and when in 2008 the "repo" market virtually "froze", the financial system virtually collapsed and many non-financial companies with legitimate short term credit needs were frozen out of the credit market and unable to borrow for their current needs. This financial panic was then followed, as usual, by a deep recession.

Following is a summary (with interspersed comments) of testimony given on November 17, 2009, by Federal Reserve Chairman Ben Bernanke before the Financial Crisis Inquiry Commission (Chairman Bernanke's testimony is in italics and the summary can be found at www.repowatch.org. under the title "Bernanke emphasizes run on repo and too big to fail"):

> The biggest threat to the financial system during the crisis was the run on the repurchase market, especially the tri-party operation, Federal Reserve Chairman Ben Bernanke told the Financial Crisis Inquiry Commission in Nov. 17, 2009, testimony just released by the commission. The most critical repair needed to prevent another financial crisis is to make sure no institution is too big to fail, he said.
>
> In his testimony, Bernanke repeatedly returned to the repo theme, urging the commissioners to include the run on the repurchase market in their research into the causes of the crisis. Credit default swaps were a threat, but they were not a cause of the crisis, he said.
>
> Here are some comments from his testimony:
>
> Banks that are too big to fail are "a very, very serious problem, and one that was much bigger than was expected. And I think it's absolutely critical that if we do only one thing in financial reform, it is to get rid of that problem," he said.
>
> He urged commissioners to review Yale professor Gary Gorton's studies on the run on repo.
>
> *I think one of the things that struck me the most about this, though, was liquidity which, again, we saw in the crisis in September and October. We saw what are, again, old-fashioned bank runs, except they were much more sophisticated. For example, runs in the tri-party repo market. where what we used to think was very stable funding, which is funding through repurchase agreements where the investment banks*

would put out assets overnight and use that as collateral, they thought that was a pretty much foolproof form of short-term funding. But in a crisis where people began to doubt the liquidity or the value of those assets, the haircuts went up and you got into a vicious cycle which led to the Bear Stearns collapse and was important in the Lehman collapse as well.

The tri-party repurchase market was in danger, he said.

So let me first say that the toughest choice we made was the Bear Stearns action. It was the first one. And it came in the middle of a very sharply intensifying financing crisis in March of 2008. What we were seeing at that time was exactly this cycle of worsening haircuts, that is, where the financing — so that Bear Stearns was the weakest of the six or five investment banks. The investment banks relied on this repurchase agreement, overnight tri-party repo financing model. And this is when that model was really beginning to break down. And as the fear increased, the lenders, via the tri-party repo market and other short-term lending markets, again, began to demand larger and larger haircuts, premiums, which was making it more and more difficult for the financial firms to finance themselves and creating more and more liquidity pressure on them. And it was heading sort of to a black hole. Considered at the time of Bear Stearns – and I think we'll want to give you a much fuller answer at some point — was that the collapse of Bear Sterns might bring down the entire repo market, the entire tri-party repo market, which is a two-and-a-half trillion-dollar market, which was the source of financing for all the investment banks and many other institutions as well. Because if it collapsed, what would happen would be that the short-term overnight lenders would find themselves in possession of the collateral, which they would then try to dump on the market. You would have a big crunch in asset prices. And probably what would have happened would — our fear, at least — was that the tri-party repo market would have frozen up. That would have led to huge financing problems for other investment banks and other firms; and we might have had a broader financial crisis.

Later he returned to the repo theme.

And again, to answer your question most directly, I think we were primarily focused on the potential collapse of the short-term funding markets, particularly the overnight repo markets and tri-party repo markets, which would have created a contagion to many other firms.

J.P. Morgan's role in the tri-party repo market was critical, Bernanke said.

Fortunately. J.P. Morgan was pretty stable. But J.P. Morgan actually is the bank that runs — one of the two banks — that runs the tri-party repo market. J.P. Morgan's failure would have been a huge problem because that market would have essentially been inoperative because there are only two banks that run in that market, and they don't have compatible computer systems.

Also available on the www.RepoWatch.org website is an article posted January 12, 2012 entitled "Matt King had it right in 2008, joins Gordon, Mills" which discusses the fact that an analyst at Citigroup was among those who warned *before* the financial crisis that over-dependence on the repo market was causing systemic risk to the financial system. The article is quoted below:

The Financial crisis of 2008 was not caused by financial institutions having to write down the value of subprime loans, collateralized debt obligations of asset-backed securities, asset-backed commercial paper, auction rate securities, and just plain old home loans.

Instead, it was caused by financial institutions borrowing too much on the repurchase and securities lending* markets, according to a research report by Citigroup analyst Matt King in London.

"Ho-hum," RepoWatch readers must be saying about now. "This is very old news to us."

But check out the date of the report: September 5, 2008, two days before the start of one of the most amazing two weeks in Wall Street history:

-Sept. 7: The Treasury Department seized mortgage giants Freddie Mac and Fannie Mae
-Sept. 15: Lehman Brothers declared bankruptcy
-Sept. 15: Bank of America took over Merrill Lynch at the urging of regulators
-Sept. 16: The Federal Reserve took control of American International Group
-Sept. 16: The Reserve Primary Money Fund broke the buck
-Sept. 21: Goldman Sachs and Morgan Stanley became commercial banks in a flight to safety, ending the storied era of powerful Wall Street investment banks

King wrote his report after watching mortgage troubles mount since June 2006, repo slowly freeze since June 2007, sales of asset-backed commercial paper dry up since July 2007, Northern Rock fail in February 2008 and Bear Stearns collapse in March 2008.

Much of the focus on finance als during the credit crunch has been upon writedowns. First on subprime and CDOs of ABS, then on ABCP, ARS and a string of other products, and now on more normal loan portfolios. Investors have been almost obsessive about finding the next 'shoe to drop'.

Yet from a credit perspective, the major question facing all financials going forward is not one of writedowns but one of funding and leverage. After all, it was the catastrophic loss of funding caused by a sudden evaporation of confidence which led to the demise of both Bear Stearns and Northern Rock, not anything to do with writedowns.

The common strand linking those two institutions was their dependence on wholesale markets for funding. And yet their models were not so different from those of many other financial institutions today. The other US broker-dealers, in particular, are funded heavily through short-term repo and secured lending markets, and do not have the diversification implied by a large deposit base. Does this mean that they too are similarly vulnerable?

Yes, it did.

Read King's whole 21-page report, "Are The Brokers Broken?" It's the most concise yet thorough explanation RepoWatch has found of the panic that hit the financial markets in 2007-2008.

The paper puts King in a rare category of people who really did understand what was happening to the credit markets, as it was happening, and tried to tell others.

Also in that category are Yale professor Gary Gorton, who warned the world's top economists in August 2008, and Loughborough University professor Alistair Milne, who spent July 2008 to March 2009 writing a book that would explain the panic to the average reader.

Other early warners, although without any of the critical context, were then-president of the Federal Reserve Bank of New York Timothy Geithner and Federal Reserve Chairman Ben Bernanke – informed by their vantage points as regulators, especially of tri-party repo - who used speeches in June and August 2008 to put the blame solidly on the repurchase market.

King's report is notable not only for its date but also for its detail and for how his analysis has stood up over time.

In his report, King explained a repo feature that was little understood at the time: The very elements that made repo safe for lenders – short terms and collateral – made it dangerous for borrowers and the financial markets.

As we have argued elsewhere, and as is demonstrated by the failure of so many hedge funds, the very same features which are designed to make repo safe for cash lenders do tend to create risks for those who depend on it for their borrowing.

Moreover, and despite increasing scrutiny from regulators, we get the impression that repo remains extremely poorly understood by most investors, in part because accounting is confusing. In particular, we argue that brokers' and banks' gross usage of repo, revealed in footnotes of 10-Qs, far exceeds that which shows up on balance sheet.

King showed his readers in detail how to find the hidden repo in the financial statements of the major broker-dealers, and he estimated they were funding half their assets with repos.

They were.

That was risky, King explained.

These numbers imply a gross dependence on repo financing far larger than the on balance sheet numbers suggest. Suppose, for example, that counterparties were to become concerned about the stability of a broker, and became reluctant to execute trades with and place collateral with them. The broker would, of course, immediately pass on this difficulty in their refusal to provide financing to their clients. But that in turn might spark other changes in the clients' behaviour, such as an abrupt decision to withdraw their unencumbered cash balances and place them elsewhere, and/or to move their broader business to another counterparty. The broker would probably find their ability to conduct day-to-day business providing liquidity in markets somewhat hampered, and in extremis might even start to find themselves running short of cash. If this sounds extreme, it is worth remembering that it was just such a run on cash – as a result of hedge funds moving their money elsewhere – which is thought to have precipitated the problems at Bear Stearns.

To summarize: If repo lenders or securities lenders stopped doing business with a broker, the broker's hedge fund clients might also take back their money, and the broker could find itself short of cash.

Precisely.

King "followed the money," as reporters are supposed to do but did not, and asked himself who were the repo lenders. He discovered they were giant securities lenders who then repoed out the cash they got from the securities borrowers, creating the rehypothecated daisy chains that are such a hot topic today.

Until now, we have not really considered the question who is providing all this financing, is prepared to lend such enormous volumes of collateral and indeed who would have them on hand to lend in the first place. It turns out that the vast majority comes from just a handful of counterparties, whose obscurity is matched only by their absolutely colossal size. To understand some of the shifts going on at present, we need to digress slightly to consider their role.

Securities lenders, to give them their full (and rather apt) title, are massive participants in both repo and reverse repo, and their role is crucial to understanding not only broker-dealers' current difficulties, but also much of the liquidity of markets in general. These are generally institutions like Bank of New York Mellon, or State Street, or JP Morgan, with custodial responsibility for the assets in end-investors' portfolios. Although they do not own the assets themselves (indeed, they are held off balance sheet), they are given the authority by the end-investors (pension funds, central banks, and so on) to repo out their assets (which are mostly government bonds and agencies) in return for cash. They can then reinvest that cash so as to provide some extra return for the end-investors' portfolios.*

The reinvestments have an emphasis on security. Much consists of commercial paper (CP), or is deposited with externally managed money market funds. The bulk, though, consists of reverse repos, in which less liquid securities (such as corporate bonds, ABS, or equities) are accepted as collateral and the cash lent out in return for interest. Because these assets are generally of lower credit quality (and certainly

lower liquidity) than are the original, mostly government or agency, assets, the interest rate received on this reverse repo is significantly higher than the rate paid on the original outbound repo.

King showed how profitable this all was, and he put numbers to it.

He showed that the danger lay in the collateral, in the margin calls.

He predicted that regulators were seriously worried.

At this point, it should be apparent that there are numerous reasons why the regulators are worried. The scale of the flows, their concentration, the size of the shifts, the sheer extent to which most people are unfamiliar with all this – all these argue for increased unease in a post-Bear Stearns world.

And finally, here's his prescient conclusion, written in September 2008. It sounds a lot like our world today, doesn't it?

At this point, it is hard to see exactly how all this plays out. Even if the transition is achieved smoothly, markets in future seem likely to be significantly less liquid than they were until recently, with both hedge funds and brokers unable to play the same role in a world of reduced leverage. Returns on equity will almost inevitably be lower, though higher bid-offer and greater power in asset pricing may help compensate somewhat. In general, it feels like the world of tomorrow will look more like the world of yesteryear – before leverage and liquidity embarked on their dizzy climb in the late 1990s. The brokers may not be broken, but in future we expect the financial system in general – and the brokers in particular – to become shadows of their recent selves.

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*Securities lending, a smaller cousin to the repo market, is where asset managers lend securities, including stocks, in return for cash or other securities. Companies borrow securities mainly for short selling, to use as collateral for loans, and for hedging derivatives.

*Reverse repos are repos viewed from the side of the lender. In a reverse repo, the party lends cash and takes collateral in return.

The website www.RepoWatch.org also has a series of quotes down the left-hand side of its home page entitled "Quotes in the News". These excerpts illustrate the fact that the repo system is widely seen as an unaddressed generator of systemic risk in the financial system. We include below a selection of these short quotes from people such as Federal Reserve officials, market analysts, economists and even Charlie Munger (#2 at Berkshire Hathaway):

Repurchase agreements (repo) are the largest part of the 'shadow' banking system: a network of demand deposits that, despite its size, maturity, and general stability, remains vulnerable to investor panic." --Jeff Penney, senior advisor, McKinsey & Company, June 2011.
*****

"What happened in September 2008 was a kind of bank run. Creditors lost confidence in the ability of investment banks to redeem short-term loans, leading to a precipitous decline in lending in the repurchase agreements (repo) market." --Robert E. Lucas, Jr., Nancy L. Stokey, visiting scholars, Federal Reserve Bank of Minneapolis, May 2011.
*****

"Runs involving repos are, as far as I can tell, still about as possible (and problematic) as before, yet it's hardly on anyone's radar." –Mark Thoma, Professor of Economics, University of Oregon, April 29, 2011.
*****

"The really interesting thing that happened in September 2008 was the worldwide panic in the banking system – financial institutions running on each other behind the scenes." —David Warsh, economic journalist, Feb. 6, 2011.
*****

"Since repo financing was the basis of most of the leveraged positions of the shadow banks, a large part of the run occurred in the repo market." --Viral V. Acharya and T. Sabri Öncü, professors, Stern School of Business, New York University, 2011.
*****
"Housing policies alone, however, would not have led to the near insolvency of many banks and to the credit-market freeze. The key to these effects was the excessive leverage that pervaded, and continues to pervade, the financial industry." --Anat R. Admati, Professor of Finance and Economics, Graduate School of Business, Stanford University. January 30, 2011.
*****
"Without some repo reform, we are at risk for another panic." --Gary B. Gorton, Professor of Management and Finance, Yale School of Management, November 16, 2010.
*****
"Repo has a flaw: It is vulnerable to panic, that is, 'depositors' may 'withdraw' their money at any time, forcing the system into massive deleveraging. We saw this over and over again with demand deposits in all of U.S. history prior to deposit insurance. This problem has not been addressed by the Dodd-Frank legislation. So, it could happen again. The next shock could be a sovereign default, a crash of some important market -- who knows what it might be?" -- Gary B. Gorton, Professor of Management and Finance, Yale School of Management, August 14, 2010.
*****
"Leaving the repo market as it currently functions is not an alternative; if this market is not reformed and their participants not made to internatlize the liquidity risk, runs on the repo will occur in the future, potentially leading to systemic crises." --T. Sabri Öncü and Viral V. Acharya, professors, Stern School of Business, New York University, July 16, 2010.
*****
"It is disconcerting that that the Act is completely silent about how to reform one of the systemically most important corners of Wall Street: the repo market, whose size based on daily amount outstanding now surpasses the total GDP of China and Germany combined." --Viral V. Acharya and T. Sabri Öncü, professors, Stern School of Business, New York University, July 16, 2010.
*****
"The potential for the tri-party repo market to cease functioning, with impacts to securities firms, money market mutual funds, major banks involved in payment and settlements globally, and even to the liquidity of the U.S. Treasury and Agency securities, has been cited by policy makers as a key concern behind aggressive interventions to contain the financial crisis." --Task Force on Tri-Party Repo Infrastructure, May 17, 2010.
*****
"Banks should have learned by now it's dangerous to rely on overnight lending." --Allan Meltzer, Professor of Political Economy, Carnegie Mellon University, March 28, 2010.
*****
"This banking system -- repo based on securitization -- is a genuine banking system, as large as the traditional, regulated banking system. It is of critical importance to the economy." --Gary B. Gorton, Professor of Management and Finance, Yale School of Management, February 20, 2010.
*****
"I think we were primarily focused on the potential collapse of the short-term funding markets, particularly the overnight repo markets and tri-party repo markets, which would have created a contagion to many other firms."-- Federal Reserve Chairman Ben Bernanke. November 17, 2009.
*****
"Given its size and importance, it is surprising that repo has such a low profile; for example, there is little discussion of it in the financial press." -- Moorad Choudhry, Head of Treasury, Europe Arab Bank plc, London, "The REPO Handbook," September 2009.
*****
"Our regulators allowed the proprietary trading departments at investment banks to become hedge funds in disguise, using the 'repo' system - one of the most extreme credit-granting systems ever devised. The amount of leverage was utterly awesome." --Charles T. Munger, chairman Berkshire Hathaway Inc., Spring 2009.
*****
"Repo borrowing is now by far and away the most important form of short-term finance in modern financial markets.." -- Alistair Milne, Reader in Banking and Finance, City University, London, "The Fall of the House of Credit," March 2009.
*****

"This helps explain how a relatively small quantity of risky assets was able to undermine the confidence of investors and other market participants across a much broader range of assets and markets." --Timothy Geithner, president, Federal Reserve Bank of New York, June 9, 2008.
*****
"Until recently, short-term repos had always been regarded as virtually risk-free instruments." Federal Reserve Board Chairman Ben Bernanke, May 13, 2008.
*****

In summary, the "shadow banking system" relied on repos for financing and, just as would have happened with actual banks prior to FDIC insurance, when troubles appeared in the sub-prime mortgage market, there was a run on the non-banks with the resulting financial panic. However, there has been no attempt at addressing the repo problem since that time, whether by Dodd-Frank or otherwise.

Although the Proponents believe, based on credible, convincing evidence, that the unregulated repo market was one of the principle arsonists that ignited the recent financial firestorm, even if repos were not, as suggested by the commentators quoted above, the principle arsonist, surely, at the least, they were the powerful accelerant which created the giant conflagration.

THE DANGER IS RETURNING

A front page article in today's (February 3) Financial Times suggests that rather than being a matter for historians, that systemic risk arising from repos is gain threatening the world economy. Excerpts from that article follow:

Risky debt use on repo market hits 2008 levels

By Tracy Alloway in New York
Financial Times, February 3, 2012 4:28 am

The use of lower-rated debt in a key US funding market has returned to pre-crisis levels, fuelling fears that the so-called shadow banking system is becoming riskier.

The repo market is an important part of the shadow banking sector, which consists of unregulated financial institutions and activities.

In the repo market, banks pledge their securities as collateral for short-term loans from money managers and other investors.

The market played a key role in the build-up to the 2008 financial crisis. Banks used toxic assets, such as repackaged subprime loans, to secure trillions of dollars worth of cheap funding.

When the US housing bubble burst, the banks' trading partners refused to accept such securities as collateral and the repo market rapidly contracted.

However, a study by Fitch Ratings says the proportion of bundled debt being used as security in repo transactions has returned to pre-crisis levels.

Using the repackaged loans can increase risk in the repo market, the rating agency says. This is because the securities may be prone to sudden pullbacks such as the one experienced in 2008.

"These are less liquid, longer-tenor assets that are funded short-term by highly risk-averse lenders," said Robert Grossman, head of macro credit research at Fitch. "In a period of market turbulence, all of the parties to a repo would be affected," he added, meaning that both banks and funds could be hit.

About 20 per cent of the collateral used to secure the transactions now comes from "structured finance", or repackaged loans, Fitch said in the report.

Almost half of the bundled debt is made up of riskier residential mortgages, including subprime.
The reason behind the resurgence is difficult to pinpoint, Fitch said. It may reflect a shortage of safer securities or the need to secure funding for an inventory of assets. "It could reflect a thawing of structured finance," said Mr Grossman. "But it could also be a strategy to increase yield, or a combination of things."

Money market funds, where business models are under pressure from extremely low interest rates, might accept riskier debt as security for their short-term loans because doing so can generate a higher return. According to Fitch, repos backed by structured debt typically yield more than 50 basis points. Those backed by US Treasuries and agency debt might be deemed safer but they yield just 5 bps and 15 bps, respectively.

The Fitch study is based on repo data sourced from the 10 biggest money market funds in the US, encompassing about $90bn worth of repo transactions.

The actual US repo market is worth $1.6tn, and many of the smaller funds only accept government-guaranteed securities, such as Treasuries, in exchange for their loans.

The Federal Reserve has set up a special task force to work on a plan to scale back systemic risk in the repo market and reduce its dependence on JPMorgan Chase and Bank of New York Mellon, the biggest clearing banks in the US triparty repo system. . . .

THE SHAREHOLDER PROPOSAL ADDRESSES THE PROBLEM

As noted above, there has been as yet no real attempt to address the repo problem. Nevertheless the Federal Reserve has initiated examination of one aspect of the problem. Although a final report has not been issued, the Fed released a "white paper" on "Tri-Party Repurchase Agreements (Repo) Reform" on May 17, 2010. However, reform of the Tri-Party repo market has been left in the hands of the market participants (the "Tri-Party Repo Infrastructure Reform Task-Force") and, thus far, little has happened. The current state of affairs is again summed up at www.RepoWatch.org ("Regulators talk tough about tri-party reform", posted Sept. 30, 2011):

> If the industry task force working to make the tri-party repurchase market more stable in a crisis won't do the job, regulators may have to do it for them.

That tough warning comes from William Dudley, president of the Federal Reserve Bank of New York, in a September 23 speech before the 2011 Bretton Woods Committee International Council meeting in Washington, D.C.

In a surprising show of force, Dudley seemed to be throwing down the gauntlet, telling the world's most powerful bankers and brokers – including tri-party giant JP Morgan Chase - that if they can't get their act together on tri-party reform, regulators can impose solutions.

From Dudley's speech:

I have my doubts whether the next set of industry recommendations to reduce risk in the triparty repo market will be sufficient to eliminate all the major potential sources of instability—including inadequate risk management practices and lack of resiliency to a dealer default.

Experience suggests that it is not easy for market participants to agree on measures that enhance financial stability when this goal conflicts with the commercial and business interests.

If the private sector falls short in this instance, public authorities may need to intervene and impose more forceful regulatory solutions. . . .

Dudley's speech repeats a warning issued by the Financial Stability Oversight Council in its 2011 annual report to Congress released July 26, but Dudley has a bigger hammer because the New York Fed works intimately with the tri-party market 24/7.

In a ground-breaking story September 26 – ground-breaking because the U.S. press so rarely writes about repos - Wall Street Journal reporter Min Zeng said:

Three years after the collapse of Lehman Brothers triggered a panicked credit crunch, changes aimed at bolstering safeguards in a key segment of the short-term lending market have fallen behind schedule, leaving the sector vulnerable to systemic risks at a sensitive time in world markets.

Now, the slow progress in a private-sector-led effort to strengthen the settlement structure for tri-party securities repurchases, or repos, has prompted a senior Federal Reserve official to signal that financial regulators may need to step in and push the overhauls forward.

Even better, Zeng provided this context:

The tri-party repo market has shrunk from a peak of around $2.8 trillion in 2008 following the financial crisis. The size of that market, and the systemic risks that went along with it, were a key motivation for the Fed's moves to pump liquidity into the banking system.

And get this. Here's the headline:

Tri-Party Repos Remain Vulnerable to Systemic Shocks

Imagine. The r-word (repo) is even in the headline.

In RepoWatch's view, this is one of the most important stories about the crisis clean-up that the U.S. press has written, because it tells how little has changed in the pivotal tri-party repurchase market, and why.

Tri-party repo is a corner of the usually-bilateral repurchase market, where JP Morgan Chase and Bank of New York Mellon act as middlemen, performing such services as settling transactions and valuing and managing collateral. RepoWatch estimates tri-party represents about one-fourth of U.S. repo transactions, including all of those conducted by the Federal Reserve to implement monetary policy and

many conducted by money market funds. Daily transactions are now at about $1.6 trillion, according to the Federal Reserve.

In 2008 JP Morgan withheld tri-party financing from Bear Stearns and Lehman Brothers, triggering their collapse - which then caused the Reserve Primary money market fund to break the buck - and intensifying fears that Goldman Sachs, Merrill Lynch, Morgan Stanley and maybe even JP Morgan itself would be next. This was the seminal systemic risk most responsible for the Federal Reserve's dramatic intervention in the financial markets in 2008, according to Federal Reserve Chairman Ben Bernanke.

In 2009, the New York Fed formed a task force* of the large bank companies, mortgage giant Fannie Mae and the New York Fed to study ways to reduce the potential for systemic risk in tri-party repo, but the task force has been unable to settle on reforms.

In Dudley's speech, he described the conditions in the tri-party repo market that led up to the crisis:

Poor infrastructure design can serve to mask and obscure participants' understanding of the credit and liquidity risks that they are exposed to. A good example of this is the triparty repo market, which plays a central role in providing funding on a collateralized basis.

This market for short-term credit evolved in the United States in a manner in which transactions between lenders and borrowers covered only part of each day—from late afternoon to early morning. During the middle of the day, the two large clearing banks supplied huge amounts of intraday credit to the major securities dealers.

Borrowers' assumed this credit would always be available to them, and did not appreciate the rollover risk to which they could be exposed if a clearing bank decided not to lend to them during the day. Similarly, triparty lenders underestimated their exposure to borrowers, believing that the clearing banks would always return their funds each morning.

When triparty borrowers encountered funding pressures, these assumptions were starkly called into question.

The private sector Triparty Repo Infrastructure Task Force, created in 2009, has made progress toward the objective of creating a more stable triparty market, but deeper change is needed to achieve real systemic risk reduction in this market. . . .

In addition, the industry is reengineering how the triparty repo system operates in order to significantly reduce the large intraday exposures of the two clearing banks in the system. This is important because, as we saw during the financial crisis, very large intraday exposures can prove destabilizing.

However, I would argue that progress on the liquidity front has not progressed as far as desired.

First, many banks remain dependent on short-term funding to finance longer-term assets from counterparties that tend to flee at the first signs of distress. In particular, money market mutual funds remain vulnerable to runs. Such runs can occur even when the underlying risks remain negligible, making money market mutual funds a source of instability. Just a question from an investor about the fund manager's exposures can cause the fund manager to withdraw funding from a counterparty. This may be market discipline, but it does not operate in a way that makes the financial system more stable. The SEC is leading an effort to reform the money market mutual fund industry. . . .

Further, markets and regulators still don't have enough information about financial institutions, Dudley said:

Similarly, information about counterparty exposures is not broadly available. Occasionally, information is revealed following specific stress tests, but disclosure is very incomplete and irregular. . . .

The Proponents' shareholder proposal is an attempt to get the private sector to disclose some of the data that the markets need to know in order to avoid sudden and unanticipatable shocks. As noted in Section 9 ("Assessment") of the "White Paper" on Tri-party repos, "the recent credit crisis highlighted material weaknesses in the U.S. tri-party repo market that exposed the global financial markets to systemic risk" and noted that one of these weaknesses was "**Transparency**: The market generally lacked transparency in terms of market depth and risk." (At p.30.)

The need for disclosure of data was highlighted earlier this month in a paper by four economists at the Federal Reserve Bank of New York. Their findings are summarized at www.RepoWatch.org. in a January 24 article entitled "Here's the data regulators need to collect on repo":

To spot the build-up of systemic risk in the financial markets, regulators need to collect six bits of information about every repo and securities lending transaction, according to a report from four economists at the Federal Reserve Bank of New York.

From the four economists:

Better data is particularly important for understanding repo and securities lending markets and monitoring developments that may be indicative of stress. Such early warning signals can be the basis for policy decisions that aim at stabilizing the financial system.

These are the money markets at the heart of the market based financial system.

These four economists should talk to the Office of Financial Research, which has no plans to collect any of this information, even though Congress created the Office specifically to collect the data that regulators need in order to be able to spot systemic risk.

The six bits of information are:

1.The principal amount of the repo or securities loan
2. The interest rate
3. The type of collateral
4. The haircut (the amount that the market value of the collateral exceeds the loan)
5. The term
6. The parties

In addition, the economists recommended a further step. When securities lenders get cash as collateral, they usually reinvest it, often using it to make a repo loan. The economists recommended tracking the reinvestment of this cash, noting the type of instrument, its credit rating and its term.

From Fed economists Tobias Adrian, Brian Begalle, Adam Copeland, and Antoine Martin in their January 2012 paper "Repo and Securities Lending":

These data would create a complete picture of the repo and sec lending trades in the market, and so allow for a deeper understanding of the institutional arrangements in these markets, and for accurate measurement of firm-level risk.

Further, these data would allow for measures of the interconnectedness of the repo and sec lending markets, which allow for better gauges of the systemic risk in these markets. . . .

That these recommendations are being made now, more than three years after the financial crisis of 2007-2008, is a measure of how little has changed since then. Meanwhile, the dangers caused by this information gap are growing, as collateralized lending becomes increasingly important in today's uncertain financial markets. . . .

Both repo and securities lending experienced runs during the financial crisis, Adrian and his co-authors show. It's important that we acquire a deeper understanding of these markets, they argue.

Given the essential role of these markets to the functioning and efficiency of the financial system, it is important to better understand and monitor repo and sec lending.

An accompanying article on www.RepoWatch.org entitled "Still no data – What's taking so long" (also dated January 24, 2012) had the following comments:

It's three years after the financial crisis, and we still don't have the most basic data that we need in order to be able to spot a gathering storm in the financial markets.

Especially needed is more information about shadow banking transactions, particularly repurchase agreements, securities lending, derivatives and securitization. These were the interconnected markets that seized in 2008.

At that time, neither bankers nor regulators could tell what was happening or how to respond. There was little data and even less analysis.

Since then, not much has changed.

"It was the collapse in funding markets which made the crisis global, and yet we cannot really see funding patterns in the available data," said Hervé Hannoun, Deputy General Manager of the Bank for International Settlements, as he called for better data collection back in April 2010

From a Bank for International Settlements conference about information gaps August 25-26, 2011

[This quotation is from a paper presented at the first Session of the Conference that was based on work of the International Monetary Fund staff and the quotation may be found on page 17 of the Basel Proceedings.]:

A key feature of the crisis was the high dependence on short-term finance to purchase long-term assets, leading to a mismatch between the maturity structure of the corporations' assets and liabilities. Such maturity transformation exposes financial institutions and entire markets to vulnerabilities of market runs. However, owing to a lack of data, regulators, supervisors and market participants could not fully measure the degree of maturity transformation or the extent to which financial institutions and markets were interconnected.

In the absence of government action to make the repo market more transparent, the Proponents have suggested in their shareholder proposal that the Company disclose certain data relating to that market, including the equivalent of

three of the six bits of information called for by the four economists at the Federal Reserve Bank of New York, namely, item 3 (Proponents' (i) in the first paragraph of the Resolve Clause), item 4 (Proponents' ii) and item 5 (Proponents' iii), as well as adopting transparent, multilateral trading facilities whenever possible.

Consequently, the Proponents believe that their shareholder proposal is wholly consistent with the widespread call to forestall systemic risk by enhancing disclosure of repo transactions, not only to regulators, but also to the markets.

ARGUMENT

The proposal raises a significant policy issue that precludes its exclusion on ordinary business grounds.

The Company's clear and well written argument (not surprising in light of its authorship) covers 9 single spaced pages (pp. 7-16) and contends that the Proponents' shareholder proposal deals with the Company's ordinary business activities (e.g. "the manner in which the Company provides specific products and services to its customers"; "the sale of particular products and services"; "the manner in which the company sells and markets its products"). Even if we were to concede that that is so, it would not answer the question of whether the Proponents' shareholder proposal can be excluded from Chase's proxy statement by virtue of Rule 14a-8(i)(7). That is true because a proposal that deals with the ordinary business operations of a registrant nevertheless cannot be excluded if it raises a significant policy issue for that registrant. This exception to the ordinary business exclusion applies not only to significant social policy issues raised by shareholder proposals, but to significant financial policy issues as well, as is apparent from a review of the history of Rule 14a-8(i)(7).

In 1976 the Commission in Release 12999 (November 22, 1976) reviewed and reversed certain prior Staff determinations which had excluded shareholder proposals on ordinary business grounds and concluded that:

> The Commission is of the view that the provision adopted today can be effective in the future if it is interpreted somewhat more flexibly than in the past. Specifically, the term "ordinary business operations" has been deemed on occasion to include certain matters which have significant policy, economic or other implications inherent in them. For instance, a proposal that a utility company not construct a proposed nuclear power plant has in the past been considered excludable under former subparagraph (c)(5) [now (i)(7)]. In retrospect, however, it seems apparent that the ***economic*** and safety considerations

> attendant to nuclear power plants are of such magnitude that a determination whether to construct one is not an "ordinary" business matter. Accordingly, proposals of that nature, as well as others that have major implications, will in the future be considered beyond the realm of an issuer's ordinary business operations, and future interpretative letters of the Commission's staff will reflect that view. [Emphasis supplied.]

The context was that the Staff had excluded shareholder proposals concerning the generation of power via nuclear reactors and had concluded (e.g. in *Carolina Power & Light Co.* (April 5, 1976)) that a shareholder proposal that the registrant cease planning for additional nuclear power plants was excludable:

> this Division believes there is some basis for your opinion that the subject proposal may be excluded from the company's proxy material under Rule 14a-8(c) (5) [now 14a-8(i)(7)]. In arriving at this position, we have noted that there is a direct relation between the proposal and the conduct of the company's ordinary business operations. That is, the proposal deals with the construction of nuclear power plants, and you have indicated that the management of the company, as an ordinary business matter, determines the fuel mix and the types of electrical generating methods that will be utilized to furnish electricity to the company's customers.

Meanwhile, many electric utilities were facing very severe financial crises because of the enormous cost overruns which were almost uniformly being incurred in building nuclear power plants and which had, in some instances, led either to virtual insolvency or to abandoning the construction of the plant. In that context, the Commission, in its revision of the Rule, noted that the policy exception to the ordinary business rule applied not only to social policy issues (like safety), but also to *economic* issues.

We believe that this truth was recently reinforced in Staff Legal Bulletin 14E (October 27, 2009) (the "Staff Legal Bulletin") where, in Section B., the Staff considered when resolutions should be excluded because they involved an analysis of risk. Since policies relating to risk normally affect the financial condition of the registrant rather than, as in the case with social issues, considering the harm that the registrant is inflicting on third parties, it is clear that the Staff has reaffirmed the mandate of the 1976 Release that shareholder proposals which raise economic issues of sufficient magnitude cannot be excluded by Rule 14a-8(i)(7). Thus, the Staff Legal Bulletin stated:

> Based on our experience in reviewing these requests, we are concerned that our application of the analytical framework discussed in SLB No. 14C may have resulted in the unwarranted exclusion of proposals that relate to the evaluation of risk but that focus on significant policy issues. . . . In addition, we have become increasingly cognizant that

the adequacy of risk management and oversight can have major consequences for a company and its shareholders.

> .... In those cases in which a proposal's underlying subject matter transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote, the proposal generally will not be excludable under Rule 14a-8(i)(7) ....

We believe that the materials supplied earlier in this letter conclusively establish that the Proponents' shareholder proposal implicates an important policy issue for Chase. As noted above, Chairman Bernanke's November 17, 2009, testimony was summarized by RepoWatch as follows: "the biggest threat to the financial system during the crisis was the run on the repurchase market, especially the tri-party operation, Federal Reserve Chairman Ben Bernanke told the Financial Crisis Inquiry Commission in Nov, 17, 2009, testimony". Bernanke testified, *inter alia*, that "we were primarily focused on the potential collapse of the short-term funding markets, particularly the overnight repo markets and the tri-party markets" and that it was the operation of the repo market that was the precipitating cause of the collapse of both Bear Stearns and Lehman Brothers. These views are reinforced by the two quotations, more immediately above, from officials of the Bank for International Settlements, including that of its Deputy Director who said that "it was the collapse of the funding markets which made the crisis global" but that publicly available data remains insufficient to permit timely action by regulators or markets.

Furthermore, according to the *Financial Times* article quoted above, the failure to address the problems in the repo markets may be leading to a return performance of the financial panic scenario.

"Those who ignore history are doomed to repeat it."

We therefore believe that the policy issue raised by the Proponents' shareholder proposal is similar to that raised by shareholder proposals concerning collateral in over the counter derivatives trades, proposals pertaining to which have been deemed by the Staff to raise significant policy issues for banks engaged in their trade. Thus, the Staff has opined that the relationship between "collateralization of derivatives transactions and systemic risk" raises a significant policy issue which precludes the application of Rule 14a-8(i)(7). *JP Morgan Chase & Co.* (March 19, 2010); *Citigroup Inc.* (February 23, 2010) (identical language); *Bank of America Corporation* (February 24, 2010) (identical language).

The relationship between Chase's engagement in the repo market and systemic risk equally raises a significant policy issue for the Company, with the consequence that the Proponents' shareholder proposal is not merely one pertaining to the sale of particular services. This is made even more abundantly clear from the fact that Chase is one of the only two clearing banks for tri-party repo trades.

For the forgoing reasons, the Proponents' shareholder proposal raises an important policy issue for the Company and therefore the Company has failed to carry its burden of establishing that the Proponents' shareholder proposal is excludable pursuant to Rule 14a-8(i)(7).

RULE 14a-8(c)

There is but one, single shareholder proposal

The Proponents' shareholder proposal pertains to but a single concept: namely, how the Company is responding to the systemic risks to the financial system created by a non-transparent repo market. It therefore requests Chase (i) to disclose information about its repo transactions, (ii) asks that repo transactions be done on transparent trading facilities and (iii) asks the Company to reveal its views on government collection of data about those markets. We think that it is indisputable that the proposal therefore meets the legal standard as set forth in the Company's letter (page 5, first paragraph) that "a single proposal made up of several components does not constitute more than one proposal if the components are closely related and essential to a single well-defined unifying concept".

Within the past year, the Staff rejected a similar argument that attempted to claim that a proposal on human rights in China submitted to Yahoo was actually two separate proposals because it contained not only a request for the registrant to adopt principles that would restrict transfer of technology or assistance to the Chinese government and other repressive regimes but also a request that it review all of the registrant's actions that might affect human rights, including specifically the alleged abuse of the Yahoo Human Rights Fund. *Yahoo! Inc.* (April 5, 2011). Similarly, the Staff rejected last year another attempt to claim that there was more than one proposal because a proposal focused primarily on executive compensation (whether it is excessive and whether it benefits from layoffs and the level of pay to

the lowest paid employees) also contained a request to analyze "the way in which fluctuations in revenues" affect not only executive compensation, but also "the Company's shareholders". *The Goldman Sachs Group, Inc.* (March 2, 2011). See also *JP Morgan Chase & Co.* (March 18, 2009) (proposal on numerous aspects of executive compensation is only one proposal); *Regions Financial Corporation* (February 5, 2009) (Same); *AT&T Wireless Services, Inc.* (February 11, 2004) (Same); *Washington Mutual, Inc.* (February 20, 2007) (setting financial requirements for qualification as directors and prohibiting employees from becoming directors is one proposal); *United Parcel Service, Inc.* (February 20, 2004) (Same).

In *Safeway, Inc.* (March 17, 2010) the Staff rejected a claim by a registrant that a proposal concerning global warming was more than a single proposal because it contained "at least six different demands", each of which would require "separate and distinct actions by the Board, ranging from engaging in lobbying efforts to creating a market to reduce carbon emissions". Thus a proposal that combined requests to establish a market and to lobby did not contain two separate proposals. There is no reason why the Proponents' shareholder proposal that contains virtually those same two elements should be treated any differently by the Staff, even by virtue of the current proposal having added a request to disclose the Company's own activities in the subject market.

In contrast to the squarely on point *Safeway* letter, the no-action letters cited by Chase bear no resemblance to the instant case. For example, in *Torotel, Inc* (November 1, 2006) the proposal encompassed, according to the Staff summary of the proposal, such diverse matters as amending the articles to reduce the number of directors, amending the articles to end classification of directors, amending the articles to provide that only shareholders can amend the by-laws, amending the by-laws to permit shareholders owning 15% of the shares to call a special meeting of shareholders, altering the by-law specifying the presiding officer at shareholder meetings, removing advance notice provisions in the by-laws, amending the by-laws to prevent directors from filling board vacancies and amending the by-laws to delete provisions permitting an executive committee of the board. Is it any wonder that the Staff opined that there was more than one proposal? Similarly, in *Pacific Enterprises* (February 19, 1998) the proponent requested that shareholders be allowed to vote on six distinct types of transactions, including issuing certain debt, the sale certain assets, golden parachutes, certain types of acquisitions and abridging certain specified shareholder rights. Clearly, both the *Torotel* and the *Pacfic Enterprises* proposals were aimed at a comprehensive corporate governance over-hall, and addressed numerous and diverse topics.

Although the remaining letters cited by the Company are not quite so wide of the mark, they nevertheless are clearly inapplicable in the instant situation. In *Exxon Mobil Corporation* (March 22, 2002) the registrant had received the prior year, and placed in its proxy statement, two different shareholder proposals, one requesting competitive director elections (that the board nominate two persons for each board vacancy) and a second proposal requesting more diversity on the board. The shareholder proposal at issue in the no-action letter request combined both of these concepts into a single proposal and, not surprisingly, the Staff opined that they remained two distinct proposals and combining them resulted in a violation of the one proposal rule. The result in *Parker-Hannifin Corporation* (September 9, 2009) is equally inapplicable to the instant case. The proposal that was the subject of that letter, in the words of the Staff summary, concerned "shareholder votes on executive compensation at every third shareholder meeting" and also "a discussion forum on executive compensation policies and practices". Although both aspects of the proposal pertain to the general question of executive compensation, clearly shareholder voting and discussion fora are separate and distinct solutions to that problem. Similarly, *in Fotoball USA, Inc.* (May 6, 1997), although the proposal concerned the company's directors, it had a scatter-shot approach, including establishing as a new qualification for election that directors own 10,000 shares of stock, setting permissible compensation for directors, and prohibiting compensation from the registrant other than for board services. The Staff's view was that each of these matters addressed a different problem, such as aligning the director's interests with those of the shareholders, establishing director compensation and preventing conflicts of interest.

We submit that, in contrast to the letters cited by the Company but consonant with the *Safeway* letter, as well as the *Yahoo!, Goldman Sachs* and other letters cited above, the Proponents' shareholder proposal consists of a single proposal made up of several components that are closely related and essential to a single well-defined unifying concept.

For the forgoing reasons, the Proponents' shareholder proposal constitutes but a single, unified proposal and therefore the Company has failed to carry its burden of establishing that the Proponents' shareholder proposal is excludable for failure to comply with Rule 14a-8(c).

RULE 14a-8(i)(3)

The proposal is neither vague nor indefinite

In a desperate attempt to find a phrase that is even vaguely ambiguous, the Company has, in vain, latched onto the phrase "transparent, multilateral trading facilities". The Company fails to say why anyone would find the phrase ambiguous. That is because that phrase would convey an identical meaning to all who encounter it. Indeed, a search of the Lexis database for SEC Releases reveals that the term "multilateral trading facility" has shown up in Releases seven times since the financial crisis and the addition of the word "transparent" hardly makes the phase less transparent. Thus, unable to argue that the phrase itself if vague or ambiguous, Chase resorts to arguing that it simply hasn't yet been done. Not even that it cannot be done. Merely that it hasn't been done.

Thus, the Company states (page 17, third paragraph) that "no such multilateral trading facilities exist for certain securities" and that "as discussed in more detail above, if the Company were to implement Proposal Three, it would be *required* to forgo transacting in any repurchase agreements where the underlying securities are not either U.S. Treasury Bonds" etc. (Emphasis supplied.) We find no such discussion (in more detail or otherwise) above. Instead, what we find, and what is apparently referred to, is the discussion of "Proposal Three" in connection with its (i)(7) argument. (Pages 12-15.) Apparently the specific reference is to be found beginning with the second sentence of the first full paragraph on page 13 and continuing on through the opening of the following paragraph. These sentences read as follows:

> ***Currently***, there are only a small number of multilateral trading facilities that may be used to clear and settle repurchase agreement transactions, all of which limit the participants that can execute transactions on their platforms to members that meet certain eligibility requirements (generally the larger financial institutions) and, therefore, cannot accommodate all transactions. In addition, ***these*** multilateral trading facilities are only available for clearing and settling repurchase agreements in U.S. Treasury Bonds and other highly liquid government or agency securities. None are ***available*** to be utilized for the multitude of other types of securities underlying repurchase agreement transactions . . . As such, transactions in these other types of securities may ***currently*** be conducted only on a bilateral basis or not done through a

clearing house at all. For example, a significant part of the "repo" market involves tri-party repurchase agreements . . . which are executed on a bilateral basis and cleared and settled at a clearing bank. As ***existing*** multilateral repo facilities may not consider many of such counterparties or instruments as eligible, much of this tri-party market is not conducted on multilateral facilities. . . .

Proposal Three is seeking a singular approach to a wide range of transactions and counterparties; however, ***existing*** multilateral trading facilities do not ***currently*** provide for such widespread usage. If the Company were to implement Proposal Three, it would be required to discontinue the provision of numerous products that may not ***currently*** be cleared and settled on one of the few multilateral trading facilities ***available***. (Emphasis supplied.)

However, the Company's argument that the Proponents' shareholder proposal would require it to "forgo" doing a large category of repo transactions is incorrect. If it could not do such transactions on existing trading facilities, that would not prevent it from assisting in developing new trading facilities where such transactions could take place, or taking steps to effectuate the modification of the rules of existing facilities or modifying existing systems of creating such repo transactions (e.g. by requiring guarantees by eligible institutions).

Indeed, even if Chase had to forgo such transactions, that would only mean that it would be excluded from a portion of the repo market. Such an eventuality might conceivably be an argument that the Company might use in its Statement in Opposition to the Proponents' shareholder proposal, but it would never render that proposal either inherently vague or indefinite, as required by the Rule.

Finally, the four no-action letters cited by the Company in support of its position are clearly inapposite. The Company's own parenthetical summary of the *Exxon*, *Peoples Energy* and *NSTAR* letters shows that the proposals there at issue were either inherently vague, using undefined terms with no commonly known definition (e.g. "record keeping of financial records" or "reckless neglect") or that were remarkably ambiguous (e.g. being uncertain whether the term "the company" referred to the registrant or to other companies on whose board the director sat). No such infirmity infects the Proponents' shareholder proposal. Thus, Chase relies principally on *Wendy's International, Inc.* (February 24, 2006). That reliance is misplaced. In *Wendy's*, the proposal requested the registrant's board to issue reports that "detail the progress made toward accelerating development of CAK". CAK is a method (allegedly more humane) of slaughtering chickens. Wendy's, in

its no-action letter request, quite tellingly argued that the proposal was misleading because not only did Wendy's not engage in CAK research, but that "is not in the business of slaughtering and processing poultry" and that since "[t]he company does not raise, transport, or slaughter animals" it "is not in a position to directly 'accelerate development of CAS [CAK] either in terms of actually utilizing CAS [CAK] or conducting research on CAS [CAK] methods in the course of slaughtering chickens". In stark contrast, Chase is, in fact, in the business of trading in the repo markets. Therefore, the *Wendy's* letter lends no support whatsoever to the Company's contention that the Proponents' shareholder proposal is inherently vague or misleading.

For the forgoing reasons, the Proponents' shareholder proposal is not vague or indefinite and consequently not misleading. Therefore the Company has failed to carry its burden of establishing that the Proponents' shareholder proposal is excludable for failure to comply with Rule 14a-8(i)(3).

In conclusion, we request the Staff to inform the Company that the SEC proxy rules require denial of the Company's no action request. We would appreciate your telephoning the undersigned at 941-349-6164 with respect to any questions in connection with this matter or if the staff wishes any further information. Faxes can be received at the same number. Please also note that the undersigned may be reached by mail or express delivery at the letterhead address (or via the email address).

Very truly yours,

Paul M. Neuhauser
Attorney at Law

cc: Martin Dunn, Esq.
Sr. Barbara Aires
Fr. Seamus Finn
Cathy Rowan
Laura Berry

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February 17, 2012

Securities & Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Att: Ted Yu, Esq.
Special Counsel
Division of Corporation Finance

Via email to shareholderproposals@sec.gov

Re: Shareholder Proposal submitted to JP Morgan Chase & Co.

Dear Sir/Madam:

On February 3, 2012, I submitted a letter on behalf of The Sisters of Charity of St. Elizabeth, the Missionary Oblates of Mary Immaculate, the Maryknoll Sisters of St. Dominic, Inc., the Maryknoll Fathers and Brothers and the Sisters of St. Dominic of Caldwell, N.J. (hereinafter referred to jointly as the "Proponents"), each of which is the beneficial owner of shares of common stock of JP Morgan Chase & Co. (hereinafter referred to either as "Chase" or the "Company"), and who have jointly submitted a shareholder proposal to Chase, in response to the letter dated January 10, 2010, sent to the Securities & Exchange Commission by O'Melveny & Myers LLP on behalf of the Company, in which Chase contended that the Proponents' shareholder proposal may be excluded from the Company's year 2012 proxy statement by virtue of Rules 14a-8(i)(7), 14a-8(i)(3) and 14a-8(c).

The Proponents' shareholder proposal requests the Company to disclose additional information about its participation in the "repo" (repurchase agreements) market and to adopt greater transparency with respect to its activities in that market.

The Company is one of the two Tri-Party Clearing Banks.

In light of the position taken by the Federal Reserve Bank of New York earlier this week, I am hereby submitting this supplemental letter. The complete text of the New York Fed's press release of February 15 is attached as Exhibit A.

RULE 14a-8(i)(7)

As delineated in my letter of February 3, 2012, the proposal raises a significant policy issue because of the relationship between the repo market in which the Company is an important player and systemic risk in the financial markets. The policy issue raised by the Proponents is therefore all but identical to the policy issue raised by the relationship between "collateralization of derivatives transactions and systemic risk", which the Staff has opined precludes the application of Rule 14a-8(i)(7). *JP Morgan Chase & Co.* (March 19, 2010); *Bank of America Corporation* (February 24, 2010); *Citigroup Inc.* (February 23, 2010).

This conclusion has been strengthened by the statements made by the Federal Reserve Bank of New York upon its receipt of the industry's report submitted by the Tri-Party Repo Infrastructure Reform Task Force. As characterized by *The Wall Street Journal* (February 16, Section C.), "the New York Fed expressed its disappointment with the pace of reform promoted by the group" and the "industry group failed to move quickly enough to overhaul the sector" after having been "commissioned" by the Fed "to reduce systemic risks". Similarly, *The Financial Times* reported that "[f]ailure to overhaul the so-called tri-party market could set big Wall Street groups on a collision course with financial authorities". The Proponents' shareholder proposal is a request that the Company engage in private ordering to reform its own practices, rather than await stringent governmental action.

We believe that it is especially relevant to the 14a-8(i)(7) issue that the New York Fed stated:

> However, as observed during the recent financial crisis, the tri-party repo market's infrastructure exhibits significant structural weaknesses that undermine market stability in a stressed environment. The Federal Reserve was forced to take extraordinary policy actions beginning in 2008 to counteract the effect of these flaws and avert a collapse of confidence in this critical financing market. These structural weaknesses are unacceptable and must be eliminated.

The New York Fed also noted that the work thus far accomplished by the Task Force "may not substantially strengthen market participant's credit and liquidity risk management practices and mitigate the risk of fire sales of assets in the event of a large dealer's default".

In light of the foregoing, and especially because of the company's almost unique role in the Tri-Party repo market, we reiterate our conviction that the Proponents' shareholder proposal raises an important policy issue for the Company and therefore the Company has failed to carry its burden of establishing that the Proponents' shareholder proposal is excludable pursuant to Rule 14a-8(i)(7).

Very truly yours,

Paul M. Neuhauser
Attorney at Law

cc: Martin Dunn, Esq.
Sr. Barbara Aires
Fr. Seamus Finn
Cathy Rowan
Laura Berry

EXHIBIT A

Statement on the Release of the Tri-party Repo Infrastructure Reform Task Force's Final Report

February 15, 2012

Earlier today, the Tri-Party Repo Infrastructure Reform Task Force issued a report describing the status of industry efforts to reform the tri-party repo market. While the Federal Reserve commends the Task Force for its efforts to achieve systemic risk reduction in this market, much work remains to be done.

The tri-party repo market is an important part of the U.S. financial system. However, as observed during the recent financial crisis, the tri-party repo market's infrastructure exhibits significant structural weaknesses that undermine market stability in a stressed environment. The Federal Reserve was forced to take extraordinary policy actions beginning in 2008 to counteract the effect of these flaws and avert a collapse of confidence in this critical financing market. These structural weaknesses are unacceptable and must be eliminated.

The Task Force was formed to develop options to address three fundamental areas of concern identified by policymakers at the Federal Reserve: (1) market participants' overreliance on intraday credit from tri-party

clearing banks, (2) risk management practices that are vulnerable to procyclical pressures, and (3) the absence of an effective and transparent process for the orderly liquidation of a defaulted broker-dealer's collateral. The Task Force released a set of recommendations in May 2010 to modify industry operations and practices to sharply reduce the market's dependency on intraday credit provided by clearing banks. At that time, the Task Force indicated that the industry would complete the recommended operational changes in 2011. This goal was not achieved.

Based on the recommendations of the Task Force, market participants have made a number of important changes to the tri-party repo settlement process in the past year, all of which are prerequisites for reducing market participants' reliance on intraday credit provided by the two tri-party repo clearing banks. Among these improvements are the establishment of automated collateral substitution functionality for most trades in the market and the implementation of a 3-way trade confirmation process for all tri-party repo transactions. The Task Force also improved transparency in the tri-party repo market by publishing a monthly report on market size, collateral composition and margining

practices on its website. These accomplishments could not have been realized without the concerted effort and dedication of the clearing banks and the Fixed Income Clearing Corporation (FICC), as well as the borrowers and lenders that actively participated in the Task Force.

Despite these accomplishments, the amount of intraday credit provided by clearing banks has not yet been meaningfully reduced, and therefore, the systemic risk associated with this market remains unchanged.

When significant obstacles arose in the industry's work last year, senior executives from firms on the Task Force met to enumerate a shared vision of the processes and practices needed to achieve the goal. Their vision, outlined in the Task Force's report, reflects lessons from the 2010-2011 implementation effort and input from the New York Fed regarding the characteristics that a future settlement infrastructure for tri-party repo must satisfy.

The clearing banks and FICC have submitted new plans and timelines for the work needed to achieve this vision, and the New York Fed has instructed them to begin work on refining and implementing the plans immediately. As the Task Force's report indicates, some systemic risk reduction is likely to be achieved later this year with the

elimination of non-maturing trades from the daily unwind process by at least one clearing bank. However, a multi-year effort will be required to achieve all of the changes needed to realize the Task Force's vision for the entire tri-party repo market. The clearing banks and FICC are expected to provide clear communication to the public on the timing of deliverables in order to help ensure that all market participants have adequate time to prepare for and adjust to the changes.

Given the expanded timeline for the industry's work to reduce reliance on intraday credit, and the fact that this work may not substantially strengthen market participants' credit and liquidity risk management practices and mitigate the risk of fire sales of assets in the event of a large dealer's default, the Federal Reserve is making two changes in its approach to tri-party repo reform going forward.

First, the New York Fed will intensify its direct oversight of the infrastructure changes that the clearing banks and FICC are undertaking in order to reduce market reliance on intraday credit. While the Task Force has been an essential forum for generating and developing ideas, it has not proved to be an effective mechanism for

managing individual firms' implementation of process changes.

Second, the Federal Reserve is escalating its efforts to explore additional policy options to address the remaining sources of instability identified in the New York Fed's May 2010 White Paper. The Federal Reserve will pursue this work in parallel with the industry efforts to reduce reliance on intraday credit and will consult with other regulators and tri-party repo market participants as ideas are further developed. Ideas that have surfaced and could be considered include restrictions on the types of collateral that can be financed in tri-party repo and the development of an industry-financed facility to foster the orderly liquidation of collateral in the event of a dealer's default.

Ending tri-party repo market participants' reliance on intraday credit from the tri-party clearing banks remains a critical financial stability policy goal. While the bulk of the work on operational changes will fall to the clearing banks and FICC, borrowers and investors in the tri-party repo market will also need to modify their credit and liquidity risk management practices to realize the promise of these operational changes. As highlighted in the Task

Force's May 2010 recommendations, dealers should be taking steps to reduce their reliance on short-term financing and investors should be taking actions to ensure their credit risk management policies and practices are robust to stress events. Such actions can help to ensure that market participants better internalize and price the costs associated with the credit and liquidity risks they bear in tri-party repo transactions. The Federal Reserve and other regulators will be monitoring the actions of market participants to ensure that timely action is being taken to reduce sources of instability in this market.

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February 17, 2012

Securities & Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Att: Ted Yu, Esq.
Special Counsel
Division of Corporation Finance

Via email to shareholderproposals@sec.gov

Re: Shareholder Proposal submitted to JP Morgan Chase & Co.

Dear Sir/Madam:

On February 3, 2012, I submitted a letter on behalf of The Sisters of Charity of St. Elizabeth, the Missionary Oblates of Mary Immaculate, the Maryknoll Sisters of St. Dominic, Inc., the Maryknoll Fathers and Brothers and the Sisters of St. Dominic of Caldwell, N.J. (hereinafter referred to jointly as the "Proponents"), each of which is the beneficial owner of shares of common stock of JP Morgan Chase & Co. (hereinafter referred to either as "Chase" or the "Company"), and who have jointly submitted a shareholder proposal to Chase, in response to the letter dated January 10, 2010, sent to the Securities & Exchange Commission by O'Melveny & Myers LLP on behalf of the Company, in which Chase contended that the Proponents' shareholder proposal may be excluded from the Company's year 2012 proxy statement by virtue of Rules 14a-8(i)(7), 14a-8(i)(3) and 14a-8(c).

The Proponents' shareholder proposal requests the Company to disclose additional information about its participation in the "repo" (repurchase agreements) market and to adopt greater transparency with respect to its activities in that market.

The Company is one of the two Tri-Party Clearing Banks.

In light of the position taken by the Federal Reserve Bank of New York earlier this week, I am hereby submitting this supplemental letter. The complete text of the New York Fed's press release of February 15 is attached as Exhibit A.

RULE 14a-8(i)(7)

As delineated in my letter of February 3, 2012, the proposal raises a significant policy issue because of the relationship between the repo market in which the Company is an important player and systemic risk in the financial markets. The policy issue raised by the Proponents is therefore all but identical to the policy issue raised by the relationship between "collateralization of derivatives transactions and systemic risk", which the Staff has opined precludes the application of Rule 14a-8(i)(7). *JP Morgan Chase & Co.* (March 19, 2010); *Bank of America Corporation* (February 24, 2010); *Citigroup Inc.* (February 23, 2010).

This conclusion has been strengthened by the statements made by the Federal Reserve Bank of New York upon its receipt of the industry's report submitted by the Tri-Party Repo Infrastructure Reform Task Force. As characterized by *The Wall Street Journal* (February 16, Section C.), "the New York Fed expressed its disappointment with the pace of reform promoted by the group" and the "industry group failed to move quickly enough to overhaul the sector" after having been "commissioned" by the Fed "to reduce systemic risks". Similarly, *The Financial Times* reported that "[f]ailure to overhaul the so-called tri-party market could set big Wall Street groups on a collision course with financial authorities". The Proponents' shareholder proposal is a request that the Company engage in private ordering to reform its own practices, rather than await stringent governmental action.

We believe that it is especially relevant to the 14a-8(i)(7) issue that the New York Fed stated:

> However, as observed during the recent financial crisis, the tri-party repo market's infrastructure exhibits significant structural weaknesses that undermine market stability in a stressed environment. The Federal Reserve was forced to take extraordinary policy actions beginning in 2008 to counteract the effect of these flaws and avert a collapse of confidence in this critical financing market. These structural weaknesses are unacceptable and must be eliminated.

The New York Fed also noted that the work thus far accomplished by the Task Force "may not substantially strengthen market participant's credit and liquidity risk management practices and mitigate the risk of fire sales of assets in the event of a large dealer's default".

In light of the foregoing, and especially because of the company's almost unique role in the Tri-Party repo market, we reiterate our conviction that the Proponents' shareholder proposal raises an important policy issue for the Company and therefore the Company has failed to carry its burden of establishing that the Proponents' shareholder proposal is excludable pursuant to Rule 14a-8(i)(7).

Very truly yours,

Paul M. Neuhauser
Attorney at Law

cc: Martin Dunn, Esq.
Sr. Barbara Aires
Fr. Seamus Finn
Cathy Rowan
Laura Berry

EXHIBIT A

Statement on the Release of the Tri-party Repo Infrastructure Reform Task Force's Final Report

February 15, 2012

Earlier today, the Tri-Party Repo Infrastructure Reform Task Force issued a report describing the status of industry efforts to reform the tri-party repo market. While the Federal Reserve commends the Task Force for its efforts to achieve systemic risk reduction in this market, much work remains to be done.

The tri-party repo market is an important part of the U.S. financial system. However, as observed during the recent financial crisis, the tri-party repo market's infrastructure exhibits significant structural weaknesses that undermine market stability in a stressed environment. The Federal Reserve was forced to take extraordinary policy actions beginning in 2008 to counteract the effect of these flaws and avert a collapse of confidence in this critical financing market. These structural weaknesses are unacceptable and must be eliminated.

The Task Force was formed to develop options to address three fundamental areas of concern identified by policymakers at the Federal Reserve: (1) market participants' overreliance on intraday credit from tri-party

clearing banks, (2) risk management practices that are vulnerable to procyclical pressures, and (3) the absence of an effective and transparent process for the orderly liquidation of a defaulted broker-dealer's collateral. The Task Force released a set of recommendations in May 2010 to modify industry operations and practices to sharply reduce the market's dependency on intraday credit provided by clearing banks. At that time, the Task Force indicated that the industry would complete the recommended operational changes in 2011. This goal was not achieved.

Based on the recommendations of the Task Force, market participants have made a number of important changes to the tri-party repo settlement process in the past year, all of which are prerequisites for reducing market participants' reliance on intraday credit provided by the two tri-party repo clearing banks. Among these improvements are the establishment of automated collateral substitution functionality for most trades in the market and the implementation of a 3-way trade confirmation process for all tri-party repo transactions. The Task Force also improved transparency in the tri-party repo market by publishing a monthly report on market size, collateral composition and margining

practices on its website. These accomplishments could not have been realized without the concerted effort and dedication of the clearing banks and the Fixed Income Clearing Corporation (FICC), as well as the borrowers and lenders that actively participated in the Task Force.

Despite these accomplishments, the amount of intraday credit provided by clearing banks has not yet been meaningfully reduced, and therefore, the systemic risk associated with this market remains unchanged.

When significant obstacles arose in the industry's work last year, senior executives from firms on the Task Force met to enumerate a shared vision of the processes and practices needed to achieve the goal. Their vision, outlined in the Task Force's report, reflects lessons from the 2010-2011 implementation effort and input from the New York Fed regarding the characteristics that a future settlement infrastructure for tri-party repo must satisfy.

The clearing banks and FICC have submitted new plans and timelines for the work needed to achieve this vision, and the New York Fed has instructed them to begin work on refining and implementing the plans immediately. As the Task Force's report indicates, some systemic risk reduction is likely to be achieved later this year with the

elimination of non-maturing trades from the daily unwind process by at least one clearing bank. However, a multi-year effort will be required to achieve all of the changes needed to realize the Task Force's vision for the entire tri-party repo market. The clearing banks and FICC are expected to provide clear communication to the public on the timing of deliverables in order to help ensure that all market participants have adequate time to prepare for and adjust to the changes.

Given the expanded timeline for the industry's work to reduce reliance on intraday credit, and the fact that this work may not substantially strengthen market participants' credit and liquidity risk management practices and mitigate the risk of fire sales of assets in the event of a large dealer's default, the Federal Reserve is making two changes in its approach to tri-party repo reform going forward.

First, the New York Fed will intensify its direct oversight of the infrastructure changes that the clearing banks and FICC are undertaking in order to reduce market reliance on intraday credit. While the Task Force has been an essential forum for generating and developing ideas, it has not proved to be an effective mechanism for

managing individual firms' implementation of process changes.

Second, the Federal Reserve is escalating its efforts to explore additional policy options to address the remaining sources of instability identified in the New York Fed's May 2010 White Paper. The Federal Reserve will pursue this work in parallel with the industry efforts to reduce reliance on intraday credit and will consult with other regulators and tri-party repo market participants as ideas are further developed. Ideas that have surfaced and could be considered include restrictions on the types of collateral that can be financed in tri-party repo and the development of an industry-financed facility to foster the orderly liquidation of collateral in the event of a dealer's default.

Ending tri-party repo market participants' reliance on intraday credit from the tri-party clearing banks remains a critical financial stability policy goal. While the bulk of the work on operational changes will fall to the clearing banks and FICC, borrowers and investors in the tri-party repo market will also need to modify their credit and liquidity risk management practices to realize the promise of these operational changes. As highlighted in the Task

Force's May 2010 recommendations, dealers should be taking steps to reduce their reliance on short-term financing and investors should be taking actions to ensure their credit risk management policies and practices are robust to stress events. Such actions can help to ensure that market participants better internalize and price the costs associated with the credit and liquidity risks they bear in tri-party repo transactions. The Federal Reserve and other regulators will be monitoring the actions of market participants to ensure that timely action is being taken to reduce sources of instability in this market.

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February 3, 2012

Securities & Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Att: Ted Yu, Esq.
Special Counsel
Division of Corporation Finance

Via email to shareholderproposals@sec.gov

Re: Shareholder Proposal submitted to JP Morgan Chase & Co.

Dear Sir/Madam:

I have been asked by The Sisters of Charity of St. Elizabeth, the Missionary Oblates of Mary Immaculate, the Maryknoll Sisters of St. Dominic, Inc., the Maryknoll Fathers and Brothers and the Sisters of St. Dominic of Caldwell, N.J. (hereinafter referred to jointly as the "Proponents"), each of which is the beneficial owner of shares of common stock of JP Morgan Chase & Co. (hereinafter referred to either as "Chase" or the "Company"), and who have jointly submitted a shareholder proposal to Chase, to respond to the letter dated January 10, 2010, sent to the Securities & Exchange Commission by O'Melveny & Myers LLP on behalf of the Company, in which Chase contends that the Proponents' shareholder proposal may be excluded from the Company's year 2012 proxy statement by virtue of Rules 14a-8(i)(7), 14a-8(i)(3) and 14a-8(c).

I have reviewed the Proponents' shareholder proposal, as well as the aforesaid letter sent by the Company, and based upon the foregoing, as well as upon a review of Rule 14a-8, it is my opinion that the Proponents' shareholder proposal must be included in Chase's year 2012 proxy statement and that it is not excludable by virtue of any of the cited rules.

The Proponents' shareholder proposal requests the Company to disclose additional information about its participation in the "repo" (repurchase agreements) market and to adopt greater transparency with respect to its activities in that market.

RULE 14a-8(i)(7)

GENERAL BACKGROUND

The Company is one of the two Tri-Party Clearing Banks. This portion of the repo market, as delineated below, most notably in the comments quoted from Chairman Bernanke, is especially implicated in systemic risk to the financial system. Daily transactions in the overall repo market total about $6.5 trillion, of which about 25% are in the Tri-Party repo market. It is estimated that the tri-party market was much larger prior to the financial crash, with about $2.8 trillion in daily transactions.

The following description of the repo market is taken from a paper entitled "Systemic Risk and the Tri-Party Repo Clearing Banks" by Bruce Tuckman and appears at www.centerforfinncialstability.org (pages 2-3, footnotes omitted):

1. A Brief Introduction to U.S. Repo Markets

A repurchase agreement, or repo, is essentially a secured loan. One party borrows cash from another and posts securities as collateral. When the agreement expires, the borrower pays back the loan principal with interest and the lender returns the collateral. Agreements are typically "overnight, "expiring after a day, but "term" agreements are struck for several months or longer. Collateral is typically U.S. Treasuries, Agencies, and agency MBS, but corporate bonds, municipal bonds, other assetbacked securities, and equities are posted as well.

The repo market plays several important roles in financial markets:

*While broker-dealers want to hold securities, both to facilitate their market-making activities and as investments, they do not want to commit scarce capital by purchasing these securities outright. The repo market allows them to use borrowed money to pay for the purchases by posting the securities they buy as collateral. (When the repo expires, the borrower of cash must either sell the security to pay back the loan or, quite commonly, "roll" or renew the repo for another day or term.) Repo trades for this purpose are also called "funding trades."

*Leveraged investors, like many hedge funds, buy securities and finance the purchases through the repo market as well.

*Non-leveraged investors, including state and local governments, money market funds, other mutual funds, and foreign sovereign entities, prefer the relative safety of lending money on a secured basis to bearing the direct credit risk inherent in other money market investments.

*The repo market provides the mechanism by which securities are borrowed so that they may be sold short: the short-seller lends money in the repo market, takes the security he wishes to short as collateral, and then sells the security. (When the repo expires the short-seller must either buy the security in the market to return the repo collateral or roll the repo.) By facilitating short sales the repo market not only promotes price efficiency but provides opportunities for holders of securities, e.g., insurance companies and pension funds, to earn incremental returns by lending out their securities as repo collateral.

*The Federal Reserve uses repo to add or remove liquidity from the financial system, particularly when such actions are expected to be unwound in relatively short order.

While extremely safe relative to other financial transactions, borrowing and investing cash in the repo market is not risk free. Should the borrower of cash default on a loan, the lender of cash can sell the collateral and use the proceeds to cover the loan. The risk of a repo to the lender of money, therefore, is that the counterparty defaults on the loan at the same time that the value of the collateral has fallen. Conversely, should the lender of cash default by not returning collateral, the borrower of cash need not repay the debt. Hence the risk of a repo to the borrower of money is that the counterparty defaults at the same time that the value of the collateral has risen. To mitigate these risks, the weaker of the two counterparties typically posts margin. For example, the borrower of cash might post $100mm of collateral to borrow $80mm of cash or the lender of cash might lend $110mm of cash to take $100mm of collateral.

The repo market is a significant source of funding for security brokers and dealers and, as a result, has been at the center of recent market convulsions. From 2003 to 2007 net repo borrowings by broker-dealers increased from $490.4 billion to $1.1 trillion, accounting for between 30% and 40% of their total liabilities over that time period and for 37.9% at the end of 2007. Subsequently, as a result of deleveraging in 2008-2009, net repo borrowings fell to $480.0 billion by the end of the second quarter of 2009, accounting for only 25% of total liabilities.

A RECENT ILLUSTRATION OF THE PROBLEM

The following article from Reuters (Westlaw) illustrates one aspect of the repo problem, as it relates to the bankruptcy of ML Global (the eighth largest bankruptcy in US history), namely the off-balance sheet treatment of repos-to-maturity:

Off balance sheet repo risks come back to bite

NEW YORK, Nov.16 [2011](Business Law Currents) - Off balance sheet items and undisclosed liabilities are coming back to bite companies, as repo-to-maturity disclosures prove to be a jarring reminder of pre-crisis risk proclivity.

Symptomatic of a wider problem gripping U.S. banks, MF Global's bankruptcy has drawn attention to the danger of financial services firms hiding their true liabilities, no matter how safe they think they are.

The revelation that MF Global's off balance sheet leveraged repo-to-maturity play was stuffed full of toxic Eurozone debt proved to be its downfall. The prospect of a Eurozone default spooked markets and MF Global's liquidity drained away. A review of U.S. banks' SEC disclosures reveals, however, some troubling implications of the gaps in U.S. GAAP filings as the true nature of hidden debt exposure becomes apparent.

SEC filings from Nomura, Santander and Merrill Lynch have all acknowledged the heavy use of off-balance sheet repo-to-maturity transactions, and some even admitted to including Eurozone debt within these structures.

REPOS

By way of background, repos are used by many banks as a way to increase liquidity and involve the sale of a security (e.g. bonds) together with an agreement for the seller (the bank) to repurchase the securities at a later date. In return for "selling" the securities, the seller receives a purchase price with an agreement to repurchase the securities at a later date and probably for a greater price – effectively representing the "interest" (known as the "repo rate"). A repo is the economic equivalent of a secured loan with the buyer receiving securities as collateral and the seller receiving the purchase price as the loan principle, although as seen in Lehman Brothers' collapse, this can be abused for accountancy purposes.

When a repo is set to mature at the same time as its underlying security (a "repo-to-maturity"), a company can treat these repos as sales and remove both assets and liabilities from its balance sheet. The problem is that banks remain exposed to the risks of repo assets defaulting or decreasing in value. A reduction in value can result in margin calls (a call for additional security) or can leave a repo seller exposed to off balance sheet defaults.

NOMURA

Most transparent over its exposure to off balance sheet transactions is Nomura who acknowledged in recent filings that as of 31 March 2011, it had derecognized Yen 160.9 billion into repo-to-maturity transactions, a figure that had increased to Yen 169.7 billion by the end of 30 June 2011. In other words, Nomura has derecognized (removed) Yen 169.7 of assets and liabilities from its balance sheet, despite the fact it remained economically exposed to those assets.

Summed up in this concise note to its balance sheet, Nomura acknowledged that its filed balance sheet does not include the full extent of its liabilities:

> Reconciles to the total assets amount disclosed on the face of Nomura's consolidated balance sheets and therefore excludes the fair value of securities transferred to counterparties under repo-to-maturity and certain Japanese securities lending transactions which are accounted for as sales rather than collateralized financing arrangements.

To make matters worse, Nomura disclosed in a recent 8K that it has a credit risk concentration that includes significant amounts of EU debt. Nomura disclosed that:

> Nomura has credit risk concentrations on bonds issued by the Japanese Government, U.S. Government, Governments within the European Union ("EU"), their states and municipalities, and their

agencies. These concentrations generally arise from taking trading securities positions and are reported within Trading assets in the consolidated balance sheets.

According to the same filing Nomura's total exposure to the EU was Yen 2.6 billion, but allowing for the additional Yen 169.7 billion in repo-to-maturity transactions not included in this figure, the true exposure is likely much higher.

MERRILL LYNCH

Also disclosing significant use of repo-to-maturity transactions was Merrill Lynch although whether these include Eurozone debts is much harder to determine.

Merrill Lynch stated that:

> Merrill Lynch enters into repo-to-maturity sales only for high quality, very liquid securities such as U.S. Treasury securities or securities issued by the government-sponsored enterprises ("GSEs"). Merrill Lynch accounts for repo-to-maturity transactions as sales and purchases in accordance with applicable accounting guidance, and accordingly, removes or recognizes the securities from the Condensed Consolidated Balance Sheet and recognizes a gain or loss, as appropriate, in the Condensed Consolidated Statement of Earnings.

While one might be mistaken for thinking that Merrill Lynch only invests in U.S. government debt from this disclosure, the wording is perhaps tellingly vaguer than many of its competitors.

According its filing, Merrill Lynch only undertakes repo-to-maturity transactions for "high quality, very liquid securities such as U.S. Treasury Securities" but it does not, unlike many other banks, discount the possibility that these transactions include Eurozone debt.

Although Merrill Lynch disclosed that the use of repo-to-maturity transactions were not "material" for the period it does recognize the potential impact that these and other OTC contracts could have on it business if confidence was to be lost in its ability to pay its creditors. Merrill Lynch stated:

> In addition, under the terms of certain OTC derivative contracts and other trading agreements, the counterparties to those agreements may require us to provide additional collateral or to terminate these contracts or agreements which could cause us to sustain losses and/or adversely impact our liquidity. If Bank of America's or ML & Co's short–term credit ratings, or those of our bank or broker–dealer subsidiaries, were downgraded by one or more levels, the potential loss of access to short–term funding sources such as repo financing, and the effect on our incremental cost of funds could be material.

OPPENHEIMER HOLDINGS

Contrast Merrill Lynch's disclosures with those of Oppenheimer Holdings, a U.S. investment bank that has a notional exposure to $1.75 billion in repo-to-maturity transactions out of total repurchase agreements (including short term repos) of $7.2 billion.

Oppenheimer goes to great lengths to clarify what its repo-to-maturity debts include. It stated that:

> Recent events have caused increased review and scrutiny on the methods utilized by financial service companies to finance their short term requirements for liquidity. The Company utilizes commercial bank loans, securities lending, and repurchase agreements (through overnight, term, and repo–to–maturity transactions) to finance its short term liquidity needs (See "Liquidity"). All repurchase agreements and reverse repurchase agreements are collateralized by short term U.S. Government obligations and U.S. Government Agency obligations.

BANK OF AMERICA

As well as going into great detail to spell out what assets might be behind off balance sheet transactions, some banks, such as Bank of America, make a point of advertising that they no longer engage in this kind of behaviour. According to Bank of America's most recent annual report, it no longer engages in repo-to-maturity transactions despite having an exposure of $6.5 billion at the end of 2009.

Bank of America stated:

> In repurchase transactions, typically, the termination date for a repurchase agreement is before the maturity date of the underlying security. However, in certain situations, the Corporation may enter into repurchase agreements where the termination date of the repurchase transaction is the same as the maturity date of the underlying security and these transactions are referred to as "repo–to–maturity" (RTM) transactions. The Corporation enters into RTM transactions only for high quality, very liquid securities such as U.S. Department of the Treasury (U.S. Treasury) securities or securities issued by government–sponsored enterprises (GSE). The Corporation accounts for RTM transactions as sales in accordance with applicable accounting guidance, and accordingly, removes the securities from the Consolidated Balance Sheet and recognizes a gain or loss in the Consolidated Statement of Income. At December 31, 2010, the Corporation had no outstanding RTM transactions compared to $6.5 billion at December 31, 2009, that had been accounted for as sales.

EUROPEAN DISCLOSURES

Perhaps surprisingly, and not without some irony, disclosures from Europe reveal a slightly healthier picture. Despite the crisis raging across the continent, European banks generally file under IFRS rather than U.S. GAAP. The different accounting principles mean that repo-to-maturity transactions are much less likely to be treated as sales and more as financing. This means that although European banks (e.g. Dexia) carry substantial PIIGS exposure, this exposure is less likely to be in the form of off balance sheet transactions and more likely to be accounted for.

Unable to treat its repos as sales under IFRS, Santander's SEC disclosure noted significant exposure to Eurozone debt as at 30 June 2011, although these are in the form of "financing" rather than repo sales of sovereign debt. According to Santander it has £1.5 billion in reverse repos which were collateralised by OECD Government (but not Spanish) securities.

Similarly, Royal Bank of Scotland (RBS) discloses significant on sheet exposure to Eurozone debt in the form of assets and derivatives. In its recent annual report, RBS stated that its net exposure to Portugal and Greece (combined) was around £3 billion. HSBC also disclosed that it had a combined exposure to Greece and Portugal debt of around £1.6 billion and both companies booked impairment charges as a result of the ongoing instability in the region.

Ironically, while IFRS filing banks acknowledge and disclose Eurozone debts, the full extent of U.S. banks' debt exposure may never be fully known. While these debts may not, in some instances, include Eurozone debt, they are not risk free and their off balance sheet characterization makes them difficult to assess and perhaps even harder to prepare for.

The downgrading of U.S. treasury debt only highlighted the fall from grace of sovereign debt as the safest form of assets. With U.S. debt no longer seemingly risk free, few people would argue that the off sheet treatment of treasury bonds was appropriate. Should U.S. treasury debt suffer further problems, then U.S. banks use of off balance sheet repo transactions could come back to haunt them.

[This article was first published by Thomson Reuters' Business Law Currents, a leading provider of legal analysis and news on governance, transactions and legal risk. Visit Business Law Currents online at http://currents.westlawbusiness.com.]

In addition to the repos to maturity debacle, repos may have been responsible for the missing $1.2 billion in customer's funds at ML Global. According to a first page Wall Street Journal article on January 30, 2012, the "evaporation" of its customer's funds may have been caused by the broker having invested those funds (for the broker's profit, as permitted) in repos which then became unprofitable trades. (See last paragraph of the article.)

THE FINANCIAL CRISIS

At the core of the financial crisis was the combination of overleverage and "borrowing short and lending long". The key ingredient in that combination was the use of repurchase agreements, which provided the "borrowing short" portion of the equation, and when in 2008 the "repo" market virtually "froze", the financial system virtually collapsed and many non-financial companies with legitimate short term credit needs were frozen out of the credit market and unable to borrow for their current needs. This financial panic was then followed, as usual, by a deep recession.

Following is a summary (with interspersed comments) of testimony given on November 17, 2009, by Federal Reserve Chairman Ben Bernanke before the Financial Crisis Inquiry Commission (Chairman Bernanke's testimony is in italics and the summary can be found at www.repowatch.org. under the title "Bernanke emphasizes run on repo and too big to fail"):

> The biggest threat to the financial system during the crisis was the run on the repurchase market, especially the tri-party operation, Federal Reserve Chairman Ben Bernanke told the Financial Crisis Inquiry Commission in Nov. 17, 2009, testimony just released by the commission. The most critical repair needed to prevent another financial crisis is to make sure no institution is too big to fail, he said.
>
> In his testimony, Bernanke repeatedly returned to the repo theme, urging the commissioners to include the run on the repurchase market in their research into the causes of the crisis. Credit default swaps were a threat, but they were not a cause of the crisis, he said.
>
> Here are some comments from his testimony:
>
> Banks that are too big to fail are "a very, very serious problem, and one that was much bigger than was expected. And I think it's absolutely critical that if we do only one thing in financial reform, it is to get rid of that problem," he said.
>
> He urged commissioners to review Yale professor Gary Gorton's studies on the run on repo.
>
> *I think one of the things that struck me the most about this, though, was liquidity which, again, we saw in the crisis in September and October. We saw what are, again, old-fashioned bank runs, except they were much more sophisticated. For example, runs in the tri-party repo market, where what we used to think was very stable funding, which is funding through repurchase agreements where the investment banks*

would put out assets overnight and use that as collateral, they thought that was a pretty much foolproof form of short-term funding. But in a crisis where people began to doubt the liquidity or the value of those assets, the haircuts went up and you got into a vicious cycle which led to the Bear Stearns collapse and was important in the Lehman collapse as well.

The tri-party repurchase market was in danger, he said.

So let me first say that the toughest choice we made was the Bear Stearns action. It was the first one. And it came in the middle of a very sharply intensifying financing crisis in March of 2008. What we were seeing at that time was exactly this cycle of worsening haircuts, that is, where the financing — so that Bear Stearns was the weakest of the six or five investment banks. The investment banks relied on this repurchase agreement, overnight tri-party repo financing model. And this is when that model was really beginning to break down. And as the fear increased, the lenders, via the tri-party repo market and other short-term lending markets, again, began to demand larger and larger haircuts, premiums, which was making it more and more difficult for the financial firms to finance themselves and creating more and more liquidity pressure on them. And it was heading sort of to a black hole. Considered at the time of Bear Stearns – and I think we'll want to give you a much fuller answer at some point — was that the collapse of Bear Sterns might bring down the entire repo market, the entire tri-party repo market, which is a two-and-a-half trillion-dollar market, which was the source of financing for all the investment banks and many other institutions as well. Because if it collapsed, what would happen would be that the short-term overnight lenders would find themselves in possession of the collateral, which they would then try to dump on the market. You would have a big crunch in asset prices. And probably what would have happened would — our fear, at least — was that the tri-party repo market would have frozen up. That would have led to huge financing problems for other investment banks and other firms; and we might have had a broader financial crisis.

Later he returned to the repo theme.

And again, to answer your question most directly, I think we were primarily focused on the potential collapse of the short-term funding markets, particularly the overnight repo markets and tri-party repo markets, which would have created a contagion to many other firms.

J.P. Morgan's role in the tri-party repo market was critical, Bernanke said.

Fortunately, J.P. Morgan was pretty stable. But J.P. Morgan actually is the bank that runs — one of the two banks — that runs the tri-party repo market. J.P. Morgan's failure would have been a huge problem because that market would have essentially been inoperative because there are only two banks that run in that market, and they don't have compatible computer systems.

Also available on the www.RepoWatch.org website is an article posted January 12, 2012 entitled "Matt King had it right in 2008, joins Gordon, Mills" which discusses the fact that an analyst at Citigroup was among those who warned *before* the financial crisis that over-dependence on the repo market was causing systemic risk to the financial system. The article is quoted below:

The Financial crisis of 2008 was not caused by financial institutions having to write down the value of subprime loans, collateralized debt obligations of asset-backed securities, asset-backed commercial paper, auction rate securities, and just plain old home loans.

Instead, it was caused by financial institutions borrowing too much on the repurchase and securities lending* markets, according to a research report by Citigroup analyst Matt King in London.

"Ho-hum," RepoWatch readers must be saying about now. "This is very old news to us."

But check out the date of the report: September 5, 2008, two days before the start of one of the most amazing two weeks in Wall Street history:

-Sept. 7: The Treasury Department seized mortgage giants Freddie Mac and Fannie Mae
-Sept. 15: Lehman Brothers declared bankruptcy
-Sept. 15: Bank of America took over Merrill Lynch at the urging of regulators
-Sept. 16: The Federal Reserve took control of American International Group
-Sept. 16: The Reserve Primary Money Fund broke the buck
-Sept. 21: Goldman Sachs and Morgan Stanley became commercial banks in a flight to safety, ending the storied era of powerful Wall Street investment banks

King wrote his report after watching mortgage troubles mount since June 2006, repo slowly freeze since June 2007, sales of asset-backed commercial paper dry up since July 2007, Northern Rock fail in February 2008 and Bear Stearns collapse in March 2008.

Much of the focus on finance als during the credit crunch has been upon writedowns. First on subprime and CDOs of ABS, then on ABCP, ARS and a string of other products, and now on more normal loan portfolios. Investors have been almost obsessive about finding the next 'shoe to drop'.

Yet from a credit perspective, the major question facing all financials going forward is not one of writedowns but one of funding and leverage. After all, it was the catastrophic loss of funding caused by a sudden evaporation of confidence which led to the demise of both Bear Stearns and Northern Rock, not anything to do with writedowns.

The common strand linking those two institutions was their dependence on wholesale markets for funding. And yet their models were not so different from those of many other financial institutions today. The other US broker-dealers, in particular, are funded heavily through short-term repo and secured lending markets, and do not have the diversification implied by a large deposit base. Does this mean that they too are similarly vulnerable?

Yes, it did.

Read King's whole 21-page report, "Are The Brokers Broken?" It's the most concise yet thorough explanation RepoWatch has found of the panic that hit the financial markets in 2007-2008.

The paper puts King in a rare category of people who really did understand what was happening to the credit markets, as it was happening, and tried to tell others.

Also in that category are Yale professor Gary Gorton, who warned the world's top economists in August 2008, and Loughborough University professor Alistair Milne, who spent July 2008 to March 2009 writing a book that would explain the panic to the average reader.

Other early warners, although without any of the critical context, were then-president of the Federal Reserve Bank of New York Timothy Geithner and Federal Reserve Chairman Ben Bernanke – informed by their vantage points as regulators, especially of tri-party repo - who used speeches in June and August 2008 to put the blame solidly on the repurchase market.

King's report is notable not only for its date but also for its detail and for how his analysis has stood up over time.

In his report, King explained a repo feature that was little understood at the time: The very elements that made repo safe for lenders – short terms and collateral – made it dangerous for borrowers and the financial markets.

As we have argued elsewhere, and as is demonstrated by the failure of so many hedge funds, the very same features which are designed to make repo safe for cash lenders do tend to create risks for those who depend on it for their borrowing.

Moreover, and despite increasing scrutiny from regulators, we get the impression that repo remains extremely poorly understood by most investors, in part because accounting is confusing. In particular, we argue that brokers' and banks' gross usage of repo, revealed in footnotes of 10-Qs, far exceeds that which shows up on balance sheet.

King showed his readers in detail how to find the hidden repo in the financial statements of the major broker-dealers, and he estimated they were funding half their assets with repos.

They were.

That was risky, King explained.

These numbers imply a gross dependence on repo financing far larger than the on balance sheet numbers suggest. Suppose, for example, that counterparties were to become concerned about the stability of a broker, and became reluctant to execute trades with and place collateral with them. The broker would, of course, immediately pass on this difficulty in their refusal to provide financing to their clients. But that in turn might spark other changes in the clients' behaviour, such as an abrupt decision to withdraw their unencumbered cash balances and place them elsewhere, and/or to move their broader business to another counterparty. The broker would probably find their ability to conduct day-to-day business providing liquidity in markets somewhat hampered, and in extremis might even start to find themselves running short of cash. If this sounds extreme, it is worth remembering that it was just such a run on cash – as a result of hedge funds moving their money elsewhere – which is thought to have precipitated the problems at Bear Stearns.

To summarize: If repo lenders or securities lenders stopped doing business with a broker, the broker's hedge fund clients might also take back their money, and the broker could find itself short of cash.

Precisely.

King "followed the money," as reporters are supposed to do but did not, and asked himself who were the repo lenders. He discovered they were giant securities lenders who then repoed out the cash they got from the securities borrowers, creating the rehypothecated daisy chains that are such a hot topic today.

Until now, we have not really considered the question who is providing all this financing, is prepared to lend such enormous volumes of collateral and indeed who would have them on hand to lend in the first place. It turns out that the vast majority comes from just a handful of counterparties, whose obscurity is matched only by their absolutely colossal size. To understand some of the shifts going on at present, we need to digress slightly to consider their role.

Securities lenders, to give them their full (and rather apt) title, are massive participants in both repo and reverse repo, and their role is crucial to understanding not only broker-dealers' current difficulties, but also much of the liquidity of markets in general. These are generally institutions like Bank of New York Mellon, or State Street, or JP Morgan, with custodial responsibility for the assets in end-investors' portfolios. Although they do not own the assets themselves (indeed, they are held off balance sheet), they are given the authority by the end-investors (pension funds, central banks, and so on) to repo out their assets (which are mostly government bonds and agencies) in return for cash. They can then reinvest that cash so as to provide some extra return for the end-investors' portfolios.*

The reinvestments have an emphasis on security. Much consists of commercial paper (CP), or is deposited with externally managed money market funds. The bulk, though, consists of reverse repos, in which less liquid securities (such as corporate bonds, ABS, or equities) are accepted as collateral and the cash lent out in return for interest. Because these assets are generally of lower credit quality (and certainly

lower liquidity) than are the original, mostly government or agency, assets, the interest rate received on this reverse repo is significantly higher than the rate paid on the original outbound repo.

King showed how profitable this all was, and he put numbers to it.

He showed that the danger lay in the collateral, in the margin calls.

He predicted that regulators were seriously worried.

At this point, it should be apparent that there are numerous reasons why the regulators are worried. The scale of the flows, their concentration, the size of the shifts, the sheer extent to which most people are unfamiliar with all this – all these argue for increased unease in a post-Bear Stearns world.

And finally, here's his prescient conclusion, written in September 2008. It sounds a lot like our world today, doesn't it?

At this point, it is hard to see exactly how all this plays out. Even if the transition is achieved smoothly, markets in future seem likely to be significantly less liquid than they were until recently, with both hedge funds and brokers unable to play the same role in a world of reduced leverage. Returns on equity will almost inevitably be lower, though higher bid-offer and greater power in asset pricing may help compensate somewhat. In general, it feels like the world of tomorrow will look more like the world of yesteryear – before leverage and liquidity embarked on their dizzy climb in the late 1990s. The brokers may not be broken, but in future we expect the financial system in general – and the brokers in particular – to become shadows of their recent selves.

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*Securities lending, a smaller cousin to the repo market, is where asset managers lend securities, including stocks, in return for cash or other securities. Companies borrow securities mainly for short selling, to use as collateral for loans, and for hedging derivatives.

*Reverse repos are repos viewed from the side of the lender. In a reverse repo, the party lends cash and takes collateral in return.

The website www.RepoWatch.org also has a series of quotes down the left-hand side of its home page entitled "Quotes in the News". These excerpts illustrate the fact that the repo system is widely seen as an unaddressed generator of systemic risk in the financial system. We include below a selection of these short quotes from people such as Federal Reserve officials, market analysts, economists and even Charlie Munger (#2 at Berkshire Hathaway):

Repurchase agreements (repo) are the largest part of the 'shadow' banking system: a network of demand deposits that, despite its size, maturity, and general stability, remains vulnerable to investor panic." --Jeff Penney, senior advisor, McKinsey & Company, June 2011.
*****

"What happened in September 2008 was a kind of bank run. Creditors lost confidence in the ability of investment banks to redeem short-term loans, leading to a precipitous decline in lending in the repurchase agreements (repo) market." --Robert E. Lucas, Jr., Nancy L. Stokey, visiting scholars, Federal Reserve Bank of Minneapolis, May 2011.
*****

"Runs involving repos are, as far as I can tell, still about as possible (and problematic) as before, yet it's hardly on anyone's radar." --Mark Thoma, Professor of Economics, University of Oregon, April 29, 2011.
*****

"The really interesting thing that happened in September 2008 was the worldwide panic in the banking system – financial institutions running on each other behind the scenes." —David Warsh, economic journalist, Feb. 6, 2011.
*****

"Since repo financing was the basis of most of the leveraged positions of the shadow banks, a large part of the run occurred in the repo market." --Viral V. Acharya and T. Sabri Öncü, professors, Stern School of Business, New York University, 2011.
*****
"Housing policies alone, however, would not have led to the near insolvency of many banks and to the credit-market freeze. The key to these effects was the excessive leverage that pervaded, and continues to pervade, the financial industry." --Anat R. Admati, Professor of Finance and Economics, Graduate School of Business, Stanford University. January 30, 2011.
*****
"Without some repo reform, we are at risk for another panic." --Gary B. Gorton, Professor of Management and Finance, Yale School of Management, November 16, 2010.
*****
"Repo has a flaw: It is vulnerable to panic, that is, 'depositors' may 'withdraw' their money at any time, forcing the system into massive deleveraging. We saw this over and over again with demand deposits in all of U.S. history prior to deposit insurance. This problem has not been addressed by the Dodd-Frank legislation. So, it could happen again. The next shock could be a sovereign default, a crash of some important market -- who knows what it might be?" -- Gary B. Gorton, Professor of Management and Finance, Yale School of Management, August 14, 2010.
*****
"Leaving the repo market as it currently functions is not an alternative; if this market is not reformed and their participants not made to internatlize the liquidity risk, runs on the repo will occur in the future, potentially leading to systemic crises." --T. Sabri Öncü and Viral V. Acharya, professors, Stern School of Business, New York University, July 16, 2010.
*****
"It is disconcerting that that the Act is completely silent about how to reform one of the systemically most important corners of Wall Street: the repo market, whose size based on daily amount outstanding now surpasses the total GDP of China and Germany combined." --Viral V. Acharya and T. Sabri Öncü, professors, Stern School of Business, New York University, July 16, 2010.
*****
"The potential for the tri-party repo market to cease functioning, with impacts to securities firms, money market mutual funds, major banks involved in payment and settlements globally, and even to the liquidity of the U.S. Treasury and Agency securities, has been cited by policy makers as a key concern behind aggressive interventions to contain the financial crisis." --Task Force on Tri-Party Repo Infrastructure, May 17, 2010.
*****
"Banks should have learned by now it's dangerous to rely on overnight lending." --Allan Meltzer, Professor of Political Economy, Carnegie Mellon University, March 28, 2010.
*****
"This banking system -- repo based on securitization -- is a genuine banking system, as large as the traditional, regulated banking system. It is of critical importance to the economy." --Gary B. Gorton, Professor of Management and Finance, Yale School of Management, February 20, 2010.
*****
"I think we were primarily focused on the potential collapse of the short-term funding markets, particularly the overnight repo markets and tri-party repo markets, which would have created a contagion to many other firms."-- Federal Reserve Chairman Ben Bernanke, November 17, 2009.
*****
"Given its size and importance, it is surprising that repo has such a low profile; for example, there is little discussion of it in the financial press." -- Moorad Choudhry, Head of Treasury, Europe Arab Bank plc, London, "The REPO Handbook," September 2009.
*****
"Our regulators allowed the proprietary trading departments at investment banks to become hedge funds in disguise, using the 'repo' system - one of the most extreme credit-granting systems ever devised. The amount of leverage was utterly awesome." --Charles T. Munger, chairman Berkshire Hathaway Inc., Spring 2009.
*****
"Repo borrowing is now by far and away the most important form of short-term finance in modern financial markets.." -- Alistair Milne, Reader in Banking and Finance, City University, London, "The Fall of the House of Credit," March 2009.
*****

"This helps explain how a relatively small quantity of risky assets was able to undermine the confidence of investors and other market participants across a much broader range of assets and markets." --Timothy Geithner, president, Federal Reserve Bank of New York, June 9, 2008.
*****
"Until recently, short-term repos had always been regarded as virtually risk-free instruments." Federal Reserve Board Chairman Ben Bernanke, May 13, 2008.
*****

In summary, the "shadow banking system" relied on repos for financing and, just as would have happened with actual banks prior to FDIC insurance, when troubles appeared in the sub-prime mortgage market, there was a run on the non-banks with the resulting financial panic. However, there has been no attempt at addressing the repo problem since that time, whether by Dodd-Frank or otherwise.

Although the Proponents believe, based on credible, convincing evidence, that the unregulated repo market was one of the principle arsonists that ignited the recent financial firestorm, even if repos were not, as suggested by the commentators quoted above, the principle arsonist, surely, at the least, they were the powerful accelerant which created the giant conflagration.

THE DANGER IS RETURNING

A front page article in today's (February 3) Financial Times suggests that rather than being a matter for historians, that systemic risk arising from repos is gain threatening the world economy. Excerpts from that article follow:

Risky debt use on repo market hits 2008 levels

By Tracy Alloway in New York
Financial Times, February 3, 2012 4:28 am

The use of lower-rated debt in a key US funding market has returned to pre-crisis levels, fuelling fears that the so-called shadow banking system is becoming riskier.

The repo market is an important part of the shadow banking sector, which consists of unregulated financial institutions and activities.

In the repo market, banks pledge their securities as collateral for short-term loans from money managers and other investors.

The market played a key role in the build-up to the 2008 financial crisis. Banks used toxic assets, such as repackaged subprime loans, to secure trillions of dollars worth of cheap funding.

When the US housing bubble burst, the banks' trading partners refused to accept such securities as collateral and the repo market rapidly contracted.

However, a study by Fitch Ratings says the proportion of bundled debt being used as security in repo transactions has returned to pre-crisis levels.

Using the repackaged loans can increase risk in the repo market, the rating agency says. This is because the securities may be prone to sudden pullbacks such as the one experienced in 2008.

"These are less liquid, longer-tenor assets that are funded short-term by highly risk-averse lenders," said Robert Grossman, head of macro credit research at Fitch. "In a period of market turbulence, all of the parties to a repo would be affected," he added, meaning that both banks and funds could be hit.

About 20 per cent of the collateral used to secure the transactions now comes from "structured finance", or repackaged loans, Fitch said in the report.

Almost half of the bundled debt is made up of riskier residential mortgages, including subprime.
The reason behind the resurgence is difficult to pinpoint, Fitch said. It may reflect a shortage of safer securities or the need to secure funding for an inventory of assets. "It could reflect a thawing of structured finance," said Mr Grossman. "But it could also be a strategy to increase yield, or a combination of things."

Money market funds, where business models are under pressure from extremely low interest rates, might accept riskier debt as security for their short-term loans because doing so can generate a higher return. According to Fitch, repos backed by structured debt typically yield more than 50 basis points. Those backed by US Treasuries and agency debt might be deemed safer but they yield just 5 bps and 15 bps, respectively.

The Fitch study is based on repo data sourced from the 10 biggest money market funds in the US, encompassing about $90bn worth of repo transactions.

The actual US repo market is worth $1.6tn, and many of the smaller funds only accept government-guaranteed securities, such as Treasuries, in exchange for their loans.

The Federal Reserve has set up a special task force to work on a plan to scale back systemic risk in the repo market and reduce its dependence on JPMorgan Chase and Bank of New York Mellon, the biggest clearing banks in the US triparty repo system. . . .

THE SHAREHOLDER PROPOSAL ADDRESSES THE PROBLEM

As noted above, there has been as yet no real attempt to address the repo problem. Nevertheless the Federal Reserve has initiated examination of one aspect of the problem. Although a final report has not been issued, the Fed released a "white paper" on "Tri-Party Repurchase Agreements (Repo) Reform" on May 17, 2010. However, reform of the Tri-Party repo market has been left in the hands of the market participants (the "Tri-Party Repo Infrastructure Reform Task-Force") and, thus far, little has happened. The current state of affairs is again summed up at www.RepoWatch.org ("Regulators talk tough about tri-party reform", posted Sept. 30, 2011):

> If the industry task force working to make the tri-party repurchase market more stable in a crisis won't do the job, regulators may have to do it for them.

That tough warning comes from William Dudley, president of the Federal Reserve Bank of New York, in a September 23 speech before the 2011 Bretton Woods Committee International Council meeting in Washington, D.C.

In a surprising show of force, Dudley seemed to be throwing down the gauntlet, telling the world's most powerful bankers and brokers – including tri-party giant JP Morgan Chase - that if they can't get their act together on tri-party reform, regulators can impose solutions.

From Dudley's speech:

I have my doubts whether the next set of industry recommendations to reduce risk in the triparty repo market will be sufficient to eliminate all the major potential sources of instability—including inadequate risk management practices and lack of resiliency to a dealer default.

Experience suggests that it is not easy for market participants to agree on measures that enhance financial stability when this goal conflicts with the commercial and business interests.

If the private sector falls short in this instance, public authorities may need to intervene and impose more forceful regulatory solutions. . . .

Dudley's speech repeats a warning issued by the Financial Stability Oversight Council in its 2011 annual report to Congress released July 26, but Dudley has a bigger hammer because the New York Fed works intimately with the tri-party market 24/7.

In a ground-breaking story September 26 – ground-breaking because the U.S. press so rarely writes about repos - Wall Street Journal reporter Min Zeng said:

Three years after the collapse of Lehman Brothers triggered a panicked credit crunch, changes aimed at bolstering safeguards in a key segment of the short-term lending market have fallen behind schedule, leaving the sector vulnerable to systemic risks at a sensitive time in world markets.

Now, the slow progress in a private-sector-led effort to strengthen the settlement structure for tri-party securities repurchases, or repos, has prompted a senior Federal Reserve official to signal that financial regulators may need to step in and push the overhauls forward.

Even better, Zeng provided this context:

The tri-party repo market has shrunk from a peak of around $2.8 trillion in 2008 following the financial crisis. The size of that market, and the systemic risks that went along with it, were a key motivation for the Fed's moves to pump liquidity into the banking system.

And get this. Here's the headline:

Tri-Party Repos Remain Vulnerable to Systemic Shocks

Imagine. The r-word (repo) is even in the headline.

In RepoWatch's view, this is one of the most important stories about the crisis clean-up that the U.S. press has written, because it tells how little has changed in the pivotal tri-party repurchase market, and why.

Tri-party repo is a corner of the usually-bilateral repurchase market, where JP Morgan Chase and Bank of New York Mellon act as middlemen, performing such services as settling transactions and valuing and managing collateral. RepoWatch estimates tri-party represents about one-fourth of U.S. repo transactions, including all of those conducted by the Federal Reserve to implement monetary policy and

many conducted by money market funds. Daily transactions are now at about $1.6 trillion, according to the Federal Reserve.

In 2008 JP Morgan withheld tri-party financing from Bear Stearns and Lehman Brothers, triggering their collapse - which then caused the Reserve Primary money market fund to break the buck - and intensifying fears that Goldman Sachs, Merrill Lynch, Morgan Stanley and maybe even JP Morgan itself would be next. This was the seminal systemic risk most responsible for the Federal Reserve's dramatic intervention in the financial markets in 2008, according to Federal Reserve Chairman Ben Bernanke.

In 2009, the New York Fed formed a task force* of the large bank companies, mortgage giant Fannie Mae and the New York Fed to study ways to reduce the potential for systemic risk in tri-party repo, but the task force has been unable to settle on reforms.

In Dudley's speech, he described the conditions in the tri-party repo market that led up to the crisis:

Poor infrastructure design can serve to mask and obscure participants' understanding of the credit and liquidity risks that they are exposed to. A good example of this is the triparty repo market, which plays a central role in providing funding on a collateralized basis.

This market for short-term credit evolved in the United States in a manner in which transactions between lenders and borrowers covered only part of each day—from late afternoon to early morning. During the middle of the day, the two large clearing banks supplied huge amounts of intraday credit to the major securities dealers.

Borrowers' assumed this credit would always be available to them, and did not appreciate the rollover risk to which they could be exposed if a clearing bank decided not to lend to them during the day. Similarly, triparty lenders underestimated their exposure to borrowers, believing that the clearing banks would always return their funds each morning.

When triparty borrowers encountered funding pressures, these assumptions were starkly called into question.

The private sector Triparty Repo Infrastructure Task Force, created in 2009, has made progress toward the objective of creating a more stable triparty market, but deeper change is needed to achieve real systemic risk reduction in this market. . . .

In addition, the industry is reengineering how the triparty repo system operates in order to significantly reduce the large intraday exposures of the two clearing banks in the system. This is important because, as we saw during the financial crisis, very large intraday exposures can prove destabilizing.

However, I would argue that progress on the liquidity front has not progressed as far as desired.

First, many banks remain dependent on short-term funding to finance longer-term assets from counterparties that tend to flee at the first signs of distress. In particular, money market mutual funds remain vulnerable to runs. Such runs can occur even when the underlying risks remain negligible, making money market mutual funds a source of instability. Just a question from an investor about the fund manager's exposures can cause the fund manager to withdraw funding from a counterparty. This may be market discipline, but it does not operate in a way that makes the financial system more stable. The SEC is leading an effort to reform the money market mutual fund industry. . . .

Further, markets and regulators still don't have enough information about financial institutions, Dudley said:

Similarly, information about counterparty exposures is not broadly available. Occasionally, information is revealed following specific stress tests, but disclosure is very incomplete and irregular. . . .

The Proponents' shareholder proposal is an attempt to get the private sector to disclose some of the data that the markets need to know in order to avoid sudden and unanticipatable shocks. As noted in Section 9 ("Assessment") of the "White Paper" on Tri-party repos, "the recent credit crisis highlighted material weaknesses in the U.S. tri-party repo market that exposed the global financial markets to systemic risk" and noted that one of these weaknesses was "**Transparency**: The market generally lacked transparency in terms of market depth and risk." (At p.30.)

The need for disclosure of data was highlighted earlier this month in a paper by four economists at the Federal Reserve Bank of New York. Their findings are summarized at www.RepoWatch.org. in a January 24 article entitled "Here's the data regulators need to collect on repo":

To spot the build-up of systemic risk in the financial markets, regulators need to collect six bits of information about every repo and securities lending transaction, according to a report from four economists at the Federal Reserve Bank of New York.

From the four economists:

Better data is particularly important for understanding repo and securities lending markets and monitoring developments that may be indicative of stress. Such early warning signals can be the basis for policy decisions that aim at stabilizing the financial system.

These are the money markets at the heart of the market based financial system.

These four economists should talk to the Office of Financial Research, which has no plans to collect any of this information, even though Congress created the Office specifically to collect the data that regulators need in order to be able to spot systemic risk.

The six bits of information are:

1.The principal amount of the repo or securities loan
2. The interest rate
3. The type of collateral
4. The haircut (the amount that the market value of the collateral exceeds the loan)
5. The term
6. The parties

In addition, the economists recommended a further step. When securities lenders get cash as collateral, they usually reinvest it, often using it to make a repo loan. The economists recommended tracking the reinvestment of this cash, noting the type of instrument, its credit rating and its term.

From Fed economists Tobias Adrian, Brian Begalle, Adam Copeland, and Antoine Martin in their January 2012 paper "Repo and Securities Lending":

These data would create a complete picture of the repo and sec lending trades in the market, and so allow for a deeper understanding of the institutional arrangements in these markets, and for accurate measurement of firm-level risk.

Further, these data would allow for measures of the interconnectedness of the repo and sec lending markets, which allow for better gauges of the systemic risk in these markets. . . .

That these recommendations are being made now, more than three years after the financial crisis of 2007-2008, is a measure of how little has changed since then. Meanwhile, the dangers caused by this information gap are growing, as collateralized lending becomes increasingly important in today's uncertain financial markets. . . .

Both repo and securities lending experienced runs during the financial crisis, Adrian and his co-authors show. It's important that we acquire a deeper understanding of these markets, they argue.

Given the essential role of these markets to the functioning and efficiency of the financial system, it is important to better understand and monitor repo and sec lending.

An accompanying article on www.RepoWatch.org entitled "Still no data – What's taking so long" (also dated January 24, 2012) had the following comments:

It's three years after the financial crisis, and we still don't have the most basic data that we need in order to be able to spot a gathering storm in the financial markets.

Especially needed is more information about shadow banking transactions, particularly repurchase agreements, securities lending, derivatives and securitization. These were the interconnected markets that seized in 2008.

At that time, neither bankers nor regulators could tell what was happening or how to respond. There was little data and even less analysis.

Since then, not much has changed.

"It was the collapse in funding markets which made the crisis global, and yet we cannot really see funding patterns in the available data," said Hervé Hannoun, Deputy General Manager of the Bank for International Settlements, as he called for better data collection back in April 2010

From a Bank for International Settlements conference about information gaps August 25-26, 2011

[This quotation is from a paper presented at the first Session of the Conference that was based on work of the International Monetary Fund staff and the quotation may be found on page 17 of the Basel Proceedings.]:

A key feature of the crisis was the high dependence on short-term finance to purchase long-term assets, leading to a mismatch between the maturity structure of the corporations' assets and liabilities. Such maturity transformation exposes financial institutions and entire markets to vulnerabilities of market runs. However, owing to a lack of data, regulators, supervisors and market participants could not fully measure the degree of maturity transformation or the extent to which financial institutions and markets were interconnected.

In the absence of government action to make the repo market more transparent, the Proponents have suggested in their shareholder proposal that the Company disclose certain data relating to that market, including the equivalent of

three of the six bits of information called for by the four economists at the Federal Reserve Bank of New York, namely, item 3 (Proponents' (i) in the first paragraph of the Resolve Clause), item 4 (Proponents' ii) and item 5 (Proponents' iii), as well as adopting transparent, multilateral trading facilities whenever possible.

Consequently, the Proponents believe that their shareholder proposal is wholly consistent with the widespread call to forestall systemic risk by enhancing disclosure of repo transactions, not only to regulators, but also to the markets.

ARGUMENT

The proposal raises a significant policy issue that precludes its exclusion on ordinary business grounds.

The Company's clear and well written argument (not surprising in light of its authorship) covers 9 single spaced pages (pp. 7-16) and contends that the Proponents' shareholder proposal deals with the Company's ordinary business activities (e.g. "the manner in which the Company provides specific products and services to its customers"; "the sale of particular products and services"; "the manner in which the company sells and markets its products"). Even if we were to concede that that is so, it would not answer the question of whether the Proponents' shareholder proposal can be excluded from Chase's proxy statement by virtue of Rule 14a-8(i)(7). That is true because a proposal that deals with the ordinary business operations of a registrant nevertheless cannot be excluded if it raises a significant policy issue for that registrant. This exception to the ordinary business exclusion applies not only to significant social policy issues raised by shareholder proposals, but to significant financial policy issues as well, as is apparent from a review of the history of Rule 14a-8(i)(7).

In 1976 the Commission in Release 12999 (November 22, 1976) reviewed and reversed certain prior Staff determinations which had excluded shareholder proposals on ordinary business grounds and concluded that:

> The Commission is of the view that the provision adopted today can be effective in the future if it is interpreted somewhat more flexibly than in the past. Specifically, the term "ordinary business operations" has been deemed on occasion to include certain matters which have significant policy, economic or other implications inherent in them. For instance, a proposal that a utility company not construct a proposed nuclear power plant has in the past been considered excludable under former subparagraph (c)(5) [now (i)(7)]. In retrospect, however, it seems apparent that the ***economic*** and safety considerations

> attendant to nuclear power plants are of such magnitude that a determination whether to construct one is not an "ordinary" business matter. Accordingly, proposals of that nature, as well as others that have major implications, will in the future be considered beyond the realm of an issuer's ordinary business operations, and future interpretative letters of the Commission's staff will reflect that view. [Emphasis supplied.]

The context was that the Staff had excluded shareholder proposals concerning the generation of power via nuclear reactors and had concluded (e.g. in *Carolina Power & Light Co.* (April 5, 1976)) that a shareholder proposal that the registrant cease planning for additional nuclear power plants was excludable:

> this Division believes there is some basis for your opinion that the subject proposal may be excluded from the company's proxy material under Rule 14a-8(c) (5) [now 14a-8(i)(7)]. In arriving at this position, we have noted that there is a direct relation between the proposal and the conduct of the company's ordinary business operations. That is, the proposal deals with the construction of nuclear power plants, and you have indicated that the management of the company, as an ordinary business matter, determines the fuel mix and the types of electrical generating methods that will be utilized to furnish electricity to the company's customers.

Meanwhile, many electric utilities were facing very severe financial crises because of the enormous cost overruns which were almost uniformly being incurred in building nuclear power plants and which had, in some instances, led either to virtual insolvency or to abandoning the construction of the plant. In that context, the Commission, in its revision of the Rule, noted that the policy exception to the ordinary business rule applied not only to social policy issues (like safety), but also to *economic* issues.

We believe that this truth was recently reinforced in Staff Legal Bulletin 14E (October 27, 2009) (the "Staff Legal Bulletin") where, in Section B., the Staff considered when resolutions should be excluded because they involved an analysis of risk. Since policies relating to risk normally affect the financial condition of the registrant rather than, as in the case with social issues, considering the harm that the registrant is inflicting on third parties, it is clear that the Staff has reaffirmed the mandate of the 1976 Release that shareholder proposals which raise economic issues of sufficient magnitude cannot be excluded by Rule 14a-8(i)(7). Thus, the Staff Legal Bulletin stated:

> Based on our experience in reviewing these requests, we are concerned that our application of the analytical framework discussed in SLB No. 14C may have resulted in the unwarranted exclusion of proposals that relate to the evaluation of risk but that focus on significant policy issues. . . . In addition, we have become increasingly cognizant that

the adequacy of risk management and oversight can have major consequences for a company and its shareholders.

. . . . In those cases in which a proposal's underlying subject matter transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote, the proposal generally will not be excludable under Rule 14a-8(i)(7) . . . .

We believe that the materials supplied earlier in this letter conclusively establish that the Proponents' shareholder proposal implicates an important policy issue for Chase. As noted above, Chairman Bernanke's November 17, 2009, testimony was summarized by RepoWatch as follows: "the biggest threat to the financial system during the crisis was the run on the repurchase market, especially the tri-party operation, Federal Reserve Chairman Ben Bernanke told the Financial Crisis Inquiry Commission in Nov, 17, 2009, testimony". Bernanke testified, *inter alia*, that "we were primarily focused on the potential collapse of the short-term funding markets, particularly the overnight repo markets and the tri-party markets" and that it was the operation of the repo market that was the precipitating cause of the collapse of both Bear Stearns and Lehman Brothers. These views are reinforced by the two quotations, more immediately above, from officials of the Bank for International Settlements, including that of its Deputy Director who said that "it was the collapse of the funding markets which made the crisis global" but that publicly available data remains insufficient to permit timely action by regulators or markets.

Furthermore, according to the *Financial Times* article quoted above, the failure to address the problems in the repo markets may be leading to a return performance of the financial panic scenario.

"Those who ignore history are doomed to repeat it."

We therefore believe that the policy issue raised by the Proponents' shareholder proposal is similar to that raised by shareholder proposals concerning collateral in over the counter derivatives trades, proposals pertaining to which have been deemed by the Staff to raise significant policy issues for banks engaged in their trade. Thus, the Staff has opined that the relationship between "collateralization of derivatives transactions and systemic risk" raises a significant policy issue which precludes the application of Rule 14a-8(i)(7). *JP Morgan Chase & Co.* (March 19, 2010); *Citigroup Inc.* (February 23, 2010) (identical language); *Bank of America Corporation* (February 24, 2010) (identical language).

The relationship between Chase's engagement in the repo market and systemic risk equally raises a significant policy issue for the Company, with the consequence that the Proponents' shareholder proposal is not merely one pertaining to the sale of particular services. This is made even more abundantly clear from the fact that Chase is one of the only two clearing banks for tri-party repo trades.

For the forgoing reasons, the Proponents' shareholder proposal raises an important policy issue for the Company and therefore the Company has failed to carry its burden of establishing that the Proponents' shareholder proposal is excludable pursuant to Rule 14a-8(i)(7).

RULE 14a-8(c)

There is but one, single shareholder proposal

The Proponents' shareholder proposal pertains to but a single concept: namely, how the Company is responding to the systemic risks to the financial system created by a non-transparent repo market. It therefore requests Chase (i) to disclose information about its repo transactions, (ii) asks that repo transactions be done on transparent trading facilities and (iii) asks the Company to reveal its views on government collection of data about those markets. We think that it is indisputable that the proposal therefore meets the legal standard as set forth in the Company's letter (page 5, first paragraph) that "a single proposal made up of several components does not constitute more than one proposal if the components are closely related and essential to a single well-defined unifying concept".

Within the past year, the Staff rejected a similar argument that attempted to claim that a proposal on human rights in China submitted to Yahoo was actually two separate proposals because it contained not only a request for the registrant to adopt principles that would restrict transfer of technology or assistance to the Chinese government and other repressive regimes but also a request that it review all of the registrant's actions that might affect human rights, including specifically the alleged abuse of the Yahoo Human Rights Fund. *Yahoo! Inc.* (April 5, 2011). Similarly, the Staff rejected last year another attempt to claim that there was more than one proposal because a proposal focused primarily on executive compensation (whether it is excessive and whether it benefits from layoffs and the level of pay to

the lowest paid employees) also contained a request to analyze "the way in which fluctuations in revenues" affect not only executive compensation, but also "the Company's shareholders". *The Goldman Sachs Group, Inc.* (March 2, 2011). See also *JP Morgan Chase & Co.* (March 18, 2009) (proposal on numerous aspects of executive compensation is only one proposal); *Regions Financial Corporation* (February 5, 2009) (Same); *AT&T Wireless Services, Inc.* (February 11, 2004) (Same); *Washington Mutual, Inc.* (February 20, 2007) (setting financial requirements for qualification as directors and prohibiting employees from becoming directors is one proposal); *United Parcel Service, Inc.* (February 20, 2004) (Same).

In *Safeway, Inc.* (March 17, 2010) the Staff rejected a claim by a registrant that a proposal concerning global warming was more than a single proposal because it contained "at least six different demands", each of which would require "separate and distinct actions by the Board, ranging from engaging in lobbying efforts to creating a market to reduce carbon emissions". Thus a proposal that combined requests to establish a market and to lobby did not contain two separate proposals. There is no reason why the Proponents' shareholder proposal that contains virtually those same two elements should be treated any differently by the Staff, even by virtue of the current proposal having added a request to disclose the Company's own activities in the subject market.

In contrast to the squarely on point *Safeway* letter, the no-action letters cited by Chase bear no resemblance to the instant case. For example, in *Torotel, Inc* (November 1, 2006) the proposal encompassed, according to the Staff summary of the proposal, such diverse matters as amending the articles to reduce the number of directors, amending the articles to end classification of directors, amending the articles to provide that only shareholders can amend the by-laws, amending the by-laws to permit shareholders owning 15% of the shares to call a special meeting of shareholders, altering the by-law specifying the presiding officer at shareholder meetings, removing advance notice provisions in the by-laws, amending the by-laws to prevent directors from filling board vacancies and amending the by-laws to delete provisions permitting an executive committee of the board. Is it any wonder that the Staff opined that there was more than one proposal? Similarly, in *Pacific Enterprises* (February 19, 1998) the proponent requested that shareholders be allowed to vote on six distinct types of transactions, including issuing certain debt, the sale certain assets, golden parachutes, certain types of acquisitions and abridging certain specified shareholder rights. Clearly, both the *Torotel* and the *Pacfic Enterprises* proposals were aimed at a comprehensive corporate governance over-hall, and addressed numerous and diverse topics.

Although the remaining letters cited by the Company are not quite so wide of the mark, they nevertheless are clearly inapplicable in the instant situation. In *Exxon Mobil Corporation* (March 22, 2002) the registrant had received the prior year, and placed in its proxy statement, two different shareholder proposals, one requesting competitive director elections (that the board nominate two persons for each board vacancy) and a second proposal requesting more diversity on the board. The shareholder proposal at issue in the no-action letter request combined both of these concepts into a single proposal and, not surprisingly, the Staff opined that they remained two distinct proposals and combining them resulted in a violation of the one proposal rule. The result in *Parker-Hannifin Corporation* (September 9, 2009) is equally inapplicable to the instant case. The proposal that was the subject of that letter, in the words of the Staff summary, concerned "shareholder votes on executive compensation at every third shareholder meeting" and also "a discussion forum on executive compensation policies and practices". Although both aspects of the proposal pertain to the general question of executive compensation, clearly shareholder voting and discussion fora are separate and distinct solutions to that problem. Similarly, *in Fotoball USA, Inc.* (May 6, 1997), although the proposal concerned the company's directors, it had a scatter-shot approach, including establishing as a new qualification for election that directors own 10,000 shares of stock, setting permissible compensation for directors, and prohibiting compensation from the registrant other than for board services. The Staff's view was that each of these matters addressed a different problem, such as aligning the director's interests with those of the shareholders, establishing director compensation and preventing conflicts of interest.

We submit that, in contrast to the letters cited by the Company but consonant with the *Safeway* letter, as well as the *Yahoo!, Goldman Sachs* and other letters cited above, the Proponents' shareholder proposal consists of a single proposal made up of several components that are closely related and essential to a single well-defined unifying concept.

For the forgoing reasons, the Proponents' shareholder proposal constitutes but a single, unified proposal and therefore the Company has failed to carry its burden of establishing that the Proponents' shareholder proposal is excludable for failure to comply with Rule 14a-8(c).

RULE 14a-8(i)(3)

The proposal is neither vague nor indefinite

In a desperate attempt to find a phrase that is even vaguely ambiguous, the Company has, in vain, latched onto the phrase "transparent, multilateral trading facilities". The Company fails to say why anyone would find the phrase ambiguous. That is because that phrase would convey an identical meaning to all who encounter it. Indeed, a search of the Lexis database for SEC Releases reveals that the term "multilateral trading facility" has shown up in Releases seven times since the financial crisis and the addition of the word "transparent" hardly makes the phase less transparent. Thus, unable to argue that the phrase itself if vague or ambiguous, Chase resorts to arguing that it simply hasn't yet been done. Not even that it cannot be done. Merely that it hasn't been done.

Thus, the Company states (page 17, third paragraph) that "no such multilateral trading facilities exist for certain securities" and that "as discussed in more detail above, if the Company were to implement Proposal Three, it would be *required* to forgo transacting in any repurchase agreements where the underlying securities are not either U.S. Treasury Bonds" etc. (Emphasis supplied.) We find no such discussion (in more detail or otherwise) above. Instead, what we find, and what is apparently referred to, is the discussion of "Proposal Three" in connection with its (i)(7) argument. (Pages 12-15.) Apparently the specific reference is to be found beginning with the second sentence of the first full paragraph on page 13 and continuing on through the opening of the following paragraph. These sentences read as follows:

> ***Currently***, there are only a small number of multilateral trading facilities that may be used to clear and settle repurchase agreement transactions, all of which limit the participants that can execute transactions on their platforms to members that meet certain eligibility requirements (generally the larger financial institutions) and, therefore, cannot accommodate all transactions. In addition, ***these*** multilateral trading facilities are only available for clearing and settling repurchase agreements in U.S. Treasury Bonds and other highly liquid government or agency securities. None are ***available*** to be utilized for the multitude of other types of securities underlying repurchase agreement transactions . . . As such, transactions in these other types of securities may ***currently*** be conducted only on a bilateral basis or not done through a

> clearing house at all. For example, a significant part of the "repo" market involves tri-party repurchase agreements . . . which are executed on a bilateral basis and cleared and settled at a clearing bank. As ***existing*** multilateral repo facilities may not consider many of such counterparties or instruments as eligible, much of this tri-party market is not conducted on multilateral facilities. . . .
>
> Proposal Three is seeking a singular approach to a wide range of transactions and counterparties; however, ***existing*** multilateral trading facilities do not ***currently*** provide for such widespread usage. If the Company were to implement Proposal Three, it would be required to discontinue the provision of numerous products that may not ***currently*** be cleared and settled on one of the few multilateral trading facilities ***available***. (Emphasis supplied.)

However, the Company's argument that the Proponents' shareholder proposal would require it to "forgo" doing a large category of repo transactions is incorrect. If it could not do such transactions on existing trading facilities, that would not prevent it from assisting in developing new trading facilities where such transactions could take place, or taking steps to effectuate the modification of the rules of existing facilities or modifying existing systems of creating such repo transactions (e.g. by requiring guarantees by eligible institutions).

Indeed, even if Chase had to forgo such transactions, that would only mean that it would be excluded from a portion of the repo market. Such an eventuality might conceivably be an argument that the Company might use in its Statement in Opposition to the Proponents' shareholder proposal, but it would never render that proposal either inherently vague or indefinite, as required by the Rule.

Finally, the four no-action letters cited by the Company in support of its position are clearly inapposite. The Company's own parenthetical summary of the *Exxon*, *Peoples Energy* and *NSTAR* letters shows that the proposals there at issue were either inherently vague, using undefined terms with no commonly known definition (e.g. "record keeping of financial records" or "reckless neglect") or that were remarkably ambiguous (e.g. being uncertain whether the term "the company" referred to the registrant or to other companies on whose board the director sat). No such infirmity infects the Proponents' shareholder proposal. Thus, Chase relies principally on *Wendy's International, Inc.* (February 24, 2006). That reliance is misplaced. In *Wendy's*, the proposal requested the registrant's board to issue reports that "detail the progress made toward accelerating development of CAK". CAK is a method (allegedly more humane) of slaughtering chickens. Wendy's, in

its no-action letter request, quite tellingly argued that the proposal was misleading because not only did Wendy's not engage in CAK research, but that "is not in the business of slaughtering and processing poultry" and that since "[t]he company does not raise, transport, or slaughter animals" it "is not in a position to directly 'accelerate development of CAS [CAK] either in terms of actually utilizing CAS [CAK] or conducting research on CAS [CAK] methods in the course of slaughtering chickens". In stark contrast, Chase is, in fact, in the business of trading in the repo markets. Therefore, the *Wendy's* letter lends no support whatsoever to the Company's contention that the Proponents' shareholder proposal is inherently vague or misleading.

For the forgoing reasons, the Proponents' shareholder proposal is not vague or indefinite and consequently not misleading. Therefore the Company has failed to carry its burden of establishing that the Proponents' shareholder proposal is excludable for failure to comply with Rule 14a-8(i)(3).

In conclusion, we request the Staff to inform the Company that the SEC proxy rules require denial of the Company's no action request. We would appreciate your telephoning the undersigned at 941-349-6164 with respect to any questions in connection with this matter or if the staff wishes any further information. Faxes can be received at the same number. Please also note that the undersigned may be reached by mail or express delivery at the letterhead address (or via the email address).

Very truly yours,

Paul M. Neuhauser
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cc: Martin Dunn, Esq.
Sr. Barbara Aires
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