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Jamie Dimon may have to call an audible

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During the third-quarter conference call, JPMorgan Chase & Co. CEO Jamie Dimon remarked that it was a board decision regarding a proposed settlement with the U.S. government for alleged mortgage misdeeds that were primarily inherited through acquisitions. Apparently the board had enough. This weekend it was reported that JPMorgan will settle all civil issues, though the company will be obligated to assist the government in its investigation of individuals who may have committed criminal acts. The government's hand was strengthened once California threatened to bring a criminal indictment in September. Firms usually do not survive such a mark. Arthur Anderson folded when a criminal indictment was brought in the wake of the Enron accounting scandal.

Attorney General Holder knew he had a strong hand, demanding an additional $2 billion and thereby pushing the settlement to $13 billion. As noted in a recent musing, the charge is a little less than two quarters' worth of pretax earnings when earnings are not burdened with large charges. But it comes out of shareholders' pockets. Regardless of what has been reserved, the money represents capital that could have been retained and levered or distributed — subject to the Federal Reserve not objecting.

My prediction is that the next major outcome of the settlement will be the resignation of Jamie Dimon as CEO and chairman — though not right away. The fine is too big, and the company looks like it needs a fresh start with Washington and the media, though management retains considerable support among investors. Besides, Jamie Dimon seems like the type of guy who would do the honorable thing once the dust settles, even if he is not directly culpable beyond underestimating contingent liabilities that would flow from the acquisitions of Washington Mutual and Bear Stearns. Bad calculus with mentor Sandy Weill and his daughter led to an exile to Chicago and Bank One Corp. from Citigroup Inc. in 2000 that lasted four years. This is much worse than offending the chairman.

As CEO of Bank One, Dimon engineered the JPMorgan/Bank One deal, returned to New York and would eventually become CEO and chairman ahead of schedule. Whether JPMorgan avoided much of the mortgage excesses that occurred during 2004-2006 because the company was preoccupied with the integration or because management knew better is unknown. In early 2006 a portfolio manager who had dined with Dimon the night before told me that he thought leverage in the shadow banking system and elsewhere in the financial markets was out of hand. Regardless, what is known is that JPMorgan avoided life threatening issues in 2008 that led to massive and permanent share dilution that afflicted some competitors while others failed.

As of Oct. 19, JPMorgan's shares produced a total return of 81% from July 1, 2004 when Bank One's merger with JPMorgan was consummated. The return is comparable to Goldman Sachs Group Inc. (87%), U.S. Bancorp (83%) and Wells Fargo & Co. (95%), while Morgan Stanley's return is negative (-20%) thanks to prior CEO John Mack's pivot from Phil Purcell's more prudent views. Citigroup (-86%) and Bank of America Corp. (-55%) returns are disasters, but not as bad as Lehman's and Bear Stearns' returns. Had the "Whale" incident not occurred, I suspect JPMorgan's shares would be comfortably above $60 per share, rather than $54.30 per share as of Oct. 19, with the government pressing for a lesser amount than $13 billion.

Headline and fine risks for JPMorgan still look gamey to me, though its position with corporate clients probably has never been better. Execution matters. The unfolding currency trading scandal — if it is a scandal — has risk given the size of the market with $5 trillion of daily trading, though Citigroup is the 800-pound gorilla among U.S. banks in currency trading. Also, the unfolding LIBOR rate-rigging scandal is another risk. Only central banks are allowed to rig rates. In the current environment, it is hard to imagine these issues will be settled quietly for a modest amount. The risk is that they morph into another multiyear headline-producing event that results in another massive fine.

There is plenty of precedent for a CEO change. General Motors' CEO Rick Wagoner was not able to call an audible. He resigned in March 2009 at the request of the White House. More recently, Bob Diamond resigned as CEO and chairman of Barclays Plc in July 2012. Diamond had been the able CEO of Barclays Capital Inc., or Barcap as it is known on the Street, when he was tapped to head the company in January 2011 after overseeing the acquisition of the assets of Lehman Brothers' broker-dealer following the bankruptcy filing of the parent company. Diamond was not rigging rates in 2008 when the Bank of England and other central banks probably wanted their banks to sit on LIBOR rates lest further increases create more panic; however, Diamond's scalp was a small price for the Barclays board to offer when the worst kept secret about LIBOR rates became widely reported in the media. Diamond had to go; Dimon may be getting close to that point.

Dimon's potential audible aside, we cannot put the 2008-2009 financial panic behind us. JPMorgan struggles with what were thought to be bargain purchases over five years ago. SunTrust Banks Inc. management touched upon the lingering issues, too, when discussing third quarter earnings on Oct. 18. CEO Bill Rogers stunned analysts on the call by noting that the company's NIM will decline further in 2014 because higher-yielding assets and receive fixed swaps that were acquired when rates were higher will mature in a very low rate environment; however, he noted that the bank will be more asset-sensitive in mid-to-late 2014 "as short-term rates ought to start to go up." An hour later, First Horizon National Corp. CEO Bryan Jordan noted the same predisposition of his company to rising rates. He then added that management was rethinking whether more fixed rate lending might be appropriate to build customer relationships. We are in the seventh year since the crisis began to unfold in mid-2007. Its impact is still being felt much longer than many would have guessed.

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