COUNTY OF LOS ANGELES
TREASURER AND TAX COLLECTOR

JOSEPH KELLY
TREASURER AND TAX COLLECTOR

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 437
LOS ANGELES, CALIFORNIA 90012
TELEPHONE: (213) 974-2101 FAX: (213) 626-1812

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October 22, 2015

TO: Mayor Michael D. Antonovich
Supervisor Hilda L. Solis
Supervisor Mark Ridley-Thomas
Supervisor Sheila Kuehl
Supervisor Don Knabe

FROM: Joseph Kelly
Treasurer and Tax Collector

SUBJECT: **BANK FOREIGN EXCHANGE SETTLEMENT (BOARD AGENDA ITEM #14 OF SEPTEMBER 15, 2015)**

On September 15, 2015, your Board directed the Treasurer and Tax Collector (TTC) to report back on certain details of a multi-billion dollar settlement between the United States Department of Justice and five global banks that plead guilty to criminal charges related to the manipulation of foreign exchange prices. Specifically, your Board requested information regarding 1) the identification of the banks involved, 2) the County's exposure, if any, 3) the ethical standards and business protocols bank employees violated and the mechanisms through which the banks are attempting to prevent a re-occurrence and 4) the mechanisms the TTC has in place to monitor the activities of our financial partners and hold them accountable to certain business standards. This memorandum constitutes the requested report.

Background

In May 2015, the United States Department of Justice announced that five major banks – Citicorp, JPMorgan Chase, Barclays PLC, The Royal Bank of Scotland plc, and UBS AG – agreed to plead guilty to a one-count felony charge of conspiring to manipulate the price of U.S. dollars and euros exchanged in the foreign exchange (FX) spot market, spanning various periods from 2007 through 2013, and that the banks agreed to pay criminal fines and penalties totaling more than $5 billion. In essence, the Justice Department maintained that this group of banks constituted a cartel, some staff of which used an exclusive electronic chat room and coded language to manipulate benchmark exchange rates to the financial benefit of their respective employers. This announcement received a fair amount of coverage in the press at the time, primarily due to the fact that each bank had agreed to plead guilty to the one-count felony charge and that many of the banks subsequently announced that they had terminated the employment of the involved staff. In announcing the guilty pleas, Attorney General Loretta E. Lynch stated the actions "serve as a stark reminder that this Department of Justice intends to vigorously prosecute all those who tilt the economic system in their favor."

Identification of the banks in the settlement that do business with the County

The TTC manages one of the largest municipal Treasury pools in the nation. Under State law, I am the Treasurer not only for the County, but also for the school and community college districts in the County. Valued at approximately $25 billion, the pool's size averages $5 billion more than the combined value of the next four largest County Treasury pools in the State of California. Approximately 51% of this balance is attributed to the school and community college districts.

Accordingly, to manage risk and to ensure competitive pricing mechanisms are in play among our financial partners, we have established a number of contractual relationships for depository services, and in some instances disbursement and lockbox services, with Bank of America, Bank of the West, California Bank and Trust, Citicorp, JPMorgan Chase, MUFG Union, U.S. Bank and Wells Fargo. Of this population, Citicorp and JPMorgan Chase were named in the settlement. Additionally, in order to invest the excess funds in the Treasury, we also have agreements in place with a number of broker-dealers and banks from whom we purchase securities, and of this population, Barclays PLC, the Royal Bank of Scotland plc and UBS AG were named in the settlement. The Treasury also custodies all the assets of the Treasury Pool – the underlying securities – with an independent custodian, and that custodian is currently Citibank, a Citicorp affiliate.

County Exposure

The County Treasury did not have any exposure to this matter because all of our investments, commercial paper issuances, and debt financings are US Dollar based. We do not have exposure to any foreign exchange market, let alone the euro market.

Violations of Ethical and Business Standards and Enhanced Monitoring of Transactions

Subsequent to the announcement of the settlement, my Chief Deputy and I met with representatives from Citicorp and JPMorgan Chase to discuss this matter. The purpose of the meetings was twofold. First, I wanted to reiterate that we have a number of core values in this department, chief among which relate to our responsibility to safeguard the financial assets of the County and other entities entrusted to us. Second, I wanted to determine if the settlements were covered by reserves and discuss their impact to each firm's ability to meet regulatory capital requirements.

In the initial conversations in May, and in subsequent written material provided to us, the banks stated the actions that were the subject of the settlement were attributable to a small group of industry traders, spanning a handful of financial institutions. The traders violated each firm's commitment to a business practice of putting its customer first and other sections of each firm's Code of Conduct. In the processes the group established to tilt the profit scales toward their employers, they also violated antitrust laws. Each firm terminated the employees found to have been responsible for the activities that resulted in the charges.

Each bank stated the settlements were covered by legal reserves and did not compromise in any way their abilities to meet regulatory capital requirements.

Citibank and JPMorgan Chase each stated it has made improvements in the control mechanisms, protocols, and oversight bodies to ensure this business and others are operating at the standards company management and regulators demand. These mechanisms include, but are not limited to:

- Restricted the use of electronic chat rooms and instant messaging groups, and now executes certain FX transactions via an automated algorithm.
- Improved the reporting of key control metrics to enhance supervisory and management oversight over trading staff.
- Enhanced compliance testing and expanded internal audit plans.

Monitoring Mechanisms

The Treasury's business relationships with our banking partners are deep and broad.

For example:

- We deposit and collect on checks written to any County department, and process direct deposit payroll and disbursement files initiated by the Auditor-Controller.
- We purchase investment securities for the Treasury Pool through affiliated broker-dealers.
- We custody assets of the Treasury Pool.
- We issue commercial paper notes, backed by bank letters of credit, to fund the initial stages of a capital project.
- We access the capital markets, by issuing short and long term debt through bond underwriters.

For each of these services, the bank's obligations and responsibilities are codified, typically in a contract or agreement, and we monitor the provision of services accordingly.

We also communicate with our banks on a regular basis on various issues, and I have made it a point since my appointment earlier this year to meet the most senior managers in each of our banks. I also instituted an annual relationship review through which all related Treasury staff and bank staff meet and discuss the successes and challenges of the previous year, and plans for the upcoming year. For both the Treasury and bank staff, this has been very well received.

The responsibility for ensuring that the bank as an organization is conducting itself, at an enterprise-wide level, to an established business standard is the responsibility of each bank's management committee and Board of Directors. In the event it does not, regulators can develop new or revised rules and regulations to limit certain conduct; criminal justice agencies can investigate activity that rises to a criminal level; and shareholders can call for replacement of management.

Conclusion

In summary, five major banks agreed to plead guilty to a one-count felony charge of conspiring to manipulate the price of U.S. dollars and euros exchanged in the foreign exchange (FX) spot market and pay criminal fines and penalties. The County Treasury did not have any exposure to this matter because all of our investments, commercial paper issuances, and debt financings are US Dollar based. By the nature of the size of our Treasury Pool and other financial responsibilities, the Treasury has a business relationship with all the banks named in the settlement, but none of those relationships are foreign exchange related. Citibank and JPMorgan Chase stated the actions were attributable to a small group of industry traders, and each terminated the employment of staff involved in this matter as each deemed appropriate. Each bank stated it has made improvements in the control mechanisms, protocols, and oversight bodies to ensure this business and others are operating at the standards regulators and company management demand. The Treasury's relationships with its banking partners are broad and deep, and these relationships are governed by contract or agreement the terms of which are monitored. Each bank's management committee and Board of Directors are responsible for ensuring the bank – through its employees – conducts itself to an established business standard. In the event it does not, regulators, criminal justice agencies, and shareholders play their respective roles.

Should you have any questions, please contact me directly or your staff may contact Keith Knox, Chief Deputy Treasurer and Tax Collector at (213) 974-0703 or kknox@ttc.lacounty.gov.

JK:KK:st

c: Chief Executive Officer
Auditor-Controller
Acting Executive Officer