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Blythe Masters, JPMorgan's Credit Derivatives Guru, Is Not Sorry

By Paul M. Barrett September 12, 2013

(Corrects name of her husband's employer in the 15th paragraph.)

Oct. 27, 2009: *CNBC calls Masters "the woman behind financial weapons of mass destruction"*

Photograph by Cart'1/Abode of ChaosGraffiti artist Cart'1 painted Masters's portrait at the Demeure du Chaos museum in France

Blythe Masters is the most recognizable woman on Wall Street—and arguably its most resilient. At 44, she heads the largest commodities trading operation at the largest bank in the U.S., JPMorgan Chase (JPM). In the mid-1990s she developed and marketed credit derivatives, which rapidly became a new wonder of high finance. These contracts—in which sellers agree to compensate buyers if specified loans go into default—were supposed to disperse risk and spur additional lending. They did that, but in the hands of reckless buyers they also blew huge holes in balance sheets. In a September 2009 list of "100 to Blame" for the global economic mess, *Vanity Fair* ranked Masters No. 65, just behind convicted Ponzi mastermind Bernard Madoff.

Undeterred by her initial infamy, Masters hit another rough patch in 2010, when she led a team that suffered a huge loss in a coal trade. Again, she toughed it out, bucking up subordinates as ballsy and taunting rivals as running scared. (Masters's excellent trash talk has all the more zip delivered in her crisp BBC accent.) Having bounced back from the coal debacle, she found herself targeted by bloggers who flamed her as a “wicked witch” and a “money-grubbing b---- on wheels” who supposedly manipulated precious-metals prices—an unproven accusation she flatly denies.

“One of the destroyers of the world”

It’s turning out that 2013 is Masters’s rockiest year yet. In the spring the *New York Times* reported on a confidential memorandum in which investigators for the Federal Energy Regulatory Commission alleged that she made “false and misleading statements” under oath about electricity-trading improprieties. The FERC memo described “manipulative schemes” devised by Masters’s underlings that purportedly transferred $83 million from California and Michigan ratepayers to JPMorgan’s coffers. Masters pushed back hard, insisting within the bank and in discussions with FERC that she and her people had done nothing wrong, according to a person involved in internal bank communication. Chief Executive Officer Jamie Dimon stood behind her, and on July 30, JPMorgan settled the FERC case by agreeing to pay $410 million, without admitting or denying wrongdoing. Four days earlier, amid heightening federal scrutiny of Wall Street’s acquisition of power plants, metals warehouses, and other physical commodity operations, JPMorgan announced it would sell much of the business that Masters oversees. Masters declined to comment for this article. Through a spokeswoman, Dimon says, “Blythe is an outstanding individual and has done an impressive job at our firm over many years.”

Masters has plenty of admirers who say she’s been unfairly singled out for criticism. “The only reason [the FERC probe] got front-page treatment was that Blythe Masters’s name was attached to it,” says Richard Farley, a partner with the law firm Paul Hastings, who has done bond work for JPMorgan. That’s not exactly right. The energy trading investigation received widespread attention because it’s one of several pending federal investigations that raise the specter of misconduct by JPMorgan. Farley is on firmer ground, though, when he argues that “some people like to demonize” Masters because she’s an attractive woman in a man’s world—and because of her catalytic role in the 2008 banking crisis.

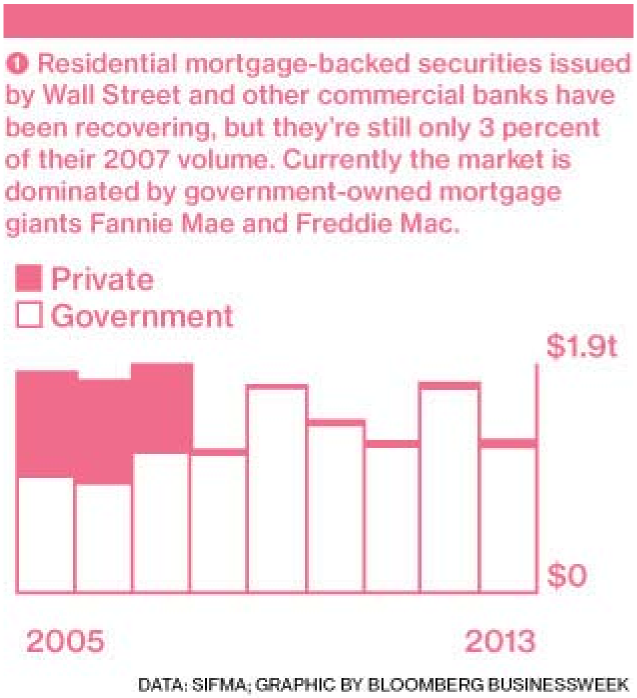
Masters grew up in bucolic Kent, in southeast England. She excelled at mathematics at an elite school, rode horses, and displayed a precocious professional drive. In 1987, while fellow graduates backpacked in the Alps, she spent a gap year working at JPMorgan in London. She returned during breaks from Cambridge University and joined the bank full time in 1991, after earning a degree in economics. She wasn’t just industrious, *Financial Times* columnist Gillian Tett wrote in *Fool’s Gold,* a 2009 book about JPMorgan: “She was a pretty blonde with a slim frame and porcelain face.” She turned heads. Some colleagues expected Masters to leave the bank, Tett recounted, when she married a fellow young banker and became pregnant at 23. Masters defied expectations, although she told friends that motherhood turned out to be “more demanding than anyone could be prepared for.”

By the mid-1990s she’d transferred to New York and joined a squad of hotshots in their twenties and thirties who pushed the boundaries of credit derivatives. Masters and her collaborators combined derivatives using a process called securitization. Traditionally, securitization entailed lenders selling loans to an investment bank, which bundled the loans and sold slices to investors. As they evolved, securitized credit derivatives accrued an almost magical aura. “Five years hence, commentators will look back to the birth of the credit derivatives market as a watershed development,” Masters declared in 1997 in *Derivatives Strategy* magazine.

Credit derivatives became potentially lethal once JPMorgan and others mingled them with subprime mortgages. After residential real estate cratered in 2006 and 2007, derivatives tied to soured home loans collapsed in value. What had seemed like a salutary diffusion of risk transmogrified into a contagion infecting financial institutions around the world.

While it peddled subprime-derivative cocktails, JPMorgan kept few on its own books. That helps explain why the bank survived (as part of JPMorgan Chase), while Bear Stearns, Lehman Brothers, and Merrill Lynch did not. Some acute observers, though, connected the dots back to JPMorgan as the bartender that helped get Wall Street drunk on derivatives. Masters, in particular, came to represent an institution that set the table for disaster. In September 2008, the *Guardian* opined, "If Warren Buffett is to be believed in his verdict that derivatives are 'financial weapons of mass destruction,' then Blythe Masters is one of the destroyers of the world."

Janet Tavakoli offers a more nuanced critique. She met Masters in the mid-1990s, when Tavakoli worked on derivatives for Bank of America (BAC). "Blythe is a smart woman, and she had to know that financial products she developed could be abused," says Tavakoli, who now heads Tavakoli Structured Finance, a consulting firm in Chicago. "In the wrong hands, [they] almost certainly would become perverted."



Without admitting culpability, Masters has acknowledged the potential danger of her creations. "It is important to distinguish between tools and their users," she said in a speech in October 2008, when she served as chairwoman of the Securities Industry and Financial Markets Association, Wall Street's main lobbying group in Washington. "Tools that transfer risk," she added, "can also increase systemic risk if major counterparties fail to manage their own risk exposures properly." On CNBC, she identified one offending counterparty: "The likes of AIG emerged, became major players, but were largely unregulated, if not completely unregulated, and therein [was] the problem," she said. A London subsidiary of American International Group (AIG) recklessly sold billions of dollars of doomed credit-default swaps—essentially a wrong-way bet that mortgage-backed securities would maintain their value.[1] When the securities went bad, the insurance giant's losses pushed it to the edge of collapse. That panicked investors and required a massive U.S. taxpayer bailout. The rogue AIG unit did indeed slip through the regulatory net.

Masters, however, left out a critical piece of the story: She was the one who, back in 1999, sold the head of an AIG unit in London, Joseph Cassano, on credit derivatives. "Masters pitched Cassano that AIG take over JPMorgan's super-senior risk, either in the form of a purchase of securities or by simply signing credit derivatives contracts that would insure Morgan against any loss," Tett recounted in *Fool's Gold*. "Only many years later did it become clear that Cassano's trade set AIG on the path to near ruin." Masters's spokeswoman, Jennifer Zuccarelli, wrote via e-mail, "AIG approached us as a professional counterparty in 1998, requesting high-grade corporate credit-default swaps. Considering Blythe has never sold or created a mortgage-backed security, nor a derivative linked to one, it's a gross exaggeration of the facts to connect her to AIG's subprime mortgage-backed securities investment decisions that caused its collapse a decade later."

That disavowal doesn't satisfy the skeptics. "After the crash, Masters and many others on Wall Street tried to walk away from what they'd helped cause," says Jeff Connaughton, a former Democratic political aide, lobbyist, and author of the 2012 book *The Payoff: Why Wall Street Always Wins.* "You can't market incredibly risky securities and then pretend you're shocked when things get out of control, especially when you and your bank have made huge profits along the way."

Within JPMorgan, Masters's personal stock still had upside. Dimon, who became CEO in 2005, had promoted her in 2006 to oversee commodities trading globally. He admired her quantitative sophistication and ability to represent the bank externally, says Heidi Miller, the former head of JPMorgan's international business. Unlike a lot of other male executives on Wall Street, Miller says, "Jamie doesn't have problems with strong women." Still, Dimon's attitude hasn't erased sexism at the 260,000-employee bank. "It takes a lot of skill to get where [Masters] is as a woman," Miller adds. "There are large swaths [of JPMorgan] without many women in senior positions."

In commodities, Masters has faced jarring ups and downs. Her response to adversity was on display in July 2010, when, after a disappointing first two quarters that year, including the coal-trade loss, reportedly valued at as much as $250 million, she delivered a salty pep talk to her troops. According to someone who has heard it, but who declined to speak on the record, Masters called JPMorgan one of the boldest and gutsiest businesses where she'd ever had the privilege to work. It is also the only employer she's ever worked for.

Masters and her second husband, Gareth Evans, a self-employed investor who operates through an entity called Hermitage Capital LLC, live in a six-bedroom, 6,800-square-foot townhouse in Manhattan's Tribeca. She owns and rides show horses in Florida; in 2009 she fell from the saddle and broke a leg, but she went back to competing as soon she'd healed. She melds socializing with good works, raising hundreds of thousands of dollars a year for the treatment of breast cancer, a disease her mother suffered from.

Idara Otu, a 26-year-old JPMorgan natural gas trader, has seen another facet of Masters's generosity. After hearing Masters speak two years ago, Otu sought her out as a mentor. When Hurricane Sandy ravaged New York last October, Masters learned that Otu's mother was driven from her house in the Canarsie section of Brooklyn. "Tell your mom to come stay with me," the executive instructed. The elder Otu moved into Masters's townhouse and stayed for six months.

It's not easy to square the hurricane hostess and philanthropist with the caricatures of Masters widely available online. The buzz about alleged manipulation of silver prices got so loud last year that Masters addressed it during an April 2012 interview on CNBC. She said JPMorgan trades exclusively for clients. "We have no stake in whether prices rise or decline," she said, denying misconduct of any kind. "That's not part of our business model," she said. "It would be wrong, and we don't do it."

❷ According to FERC, JPMorgan gamed the regulations. The firm's traders offered to provide electricity at relatively low rates in "forward markets," then agreed to sell it at inflated prices in real-time markets. This approach resulted in power-grid operators not choosing JPMorgan to provide certain services, even as the bank sought and received payments to recover startup costs for making the power-plant units theoretically available.

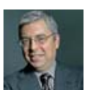
The recent FERC investigation of JPMorgan posed a more severe threat to Masters. The probe came to light in 2012, after the agency went to court seeking internal e-mails from the bank. A 70-page confidential notice FERC sent JPMorgan in March 2013 said the agency staff intended to recommend enforcement actions concerning a Houston-based power-trading unit the bank acquired when it picked up the pieces of Bear Stearns in 2008, the *New York Times* reported. The notice threatened to hold Masters and traders she supervised “individually liable” for eight “schemes” executed from September 2010 to June 2011. Allegedly, the JPMorgan traders misquoted energy prices, prompting state authorities in California and Michigan to make $83 million in excessive payments to the bank.[2] “The accusations are reminiscent of the wrongdoing by Enron in 2000 and 2001,” says Wallace Turbeville, a former banker at Goldman Sachs (GS) who serves as a senior fellow at the research group Demos. Masters’s potential liability is related to “a systematic coverup,” the FERC investigators alleged. In response to the investigation, Masters “falsely” denied under oath any awareness of the problems, the FERC staff said.

The July 30 settlement reflected the energy commission’s decision not to pursue the allegations. JPMorgan agreed to pay a civil penalty of $285 million and return $125 million in ill-gotten gains. “We’re pleased to have this matter behind us,” Brian Marchiony, a bank spokesman, said in a prepared statement. The truce with FERC came in the context of JPMorgan’s broader attempt to untangle a thicket of regulatory problems, including some dating to the excesses of the housing bubble as well as investigations by the Department of Justice and the Securities and Exchange Commission of the $6.2 billion London Whale derivatives loss in 2012 (an episode that didn’t implicate Masters but did ensnare Ina Drew, another high-ranking woman at JPMorgan).

Another element of Dimon’s initiative to reassure regulators was the July 26 announcement that JPMorgan would sell the physical commodities business Masters has built up, including the troubled energy trading unit. Word of the sale came three days after a congressional hearing that examined whether large banks are using ownership of raw materials to manipulate markets. JPMorgan emphasized that it planned to retain the financial derivatives portion of its commodities operation, which assists corporate clients seeking to hedge against shifts in currencies and changes in the prices of such things as fuel and foodstuffs. More than 80 percent of the bank’s 2,200 commodities clients purchase these financial services, says Masters’s spokeswoman, Zuccarelli.

In the wake of the settlement, the bank has sent signals supporting Masters. “She has carried herself really well under the pressure,” says Michael Cavanagh, co-CEO of JPMorgan’s corporate and investment bank. Still, it would not be shocking if, after a decent interval—six months or a year—Masters were eased out as one more symbol of contrition and fresh starts.

Paul Fribourg, the chairman and CEO of Continental Grain, a JPMorgan client, says Masters still has his trust. “We deal every day with people who operate on the borderline and even over the edge,” he says. “She’s the opposite of that.” He’d hire Masters in a second. “Tell her if she’s looking for a job, she’d be first on our list.”



Barrett is an assistant managing editor and senior writer at *Bloomberg Businessweek*. His new book, *Law of the Jungle*, which tells the story of the Chevron oil pollution case in Ecuador, will be published by Crown in September 2014. His most recent book is *GLOCK: The Rise of America's Gun*.

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