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A 'Marshall Plan for America': Takeaways from Jamie Dimon's shareholder letter

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In the 54-page missive, the CEO of the nation's largest bank urged policymakers to ease capital rules for large banks and tackle inefficiencies in the housing markets, while offering bold ideas of his own for improving education and fixing the bloated U.S. health care system.

He also offered an endorsement of Europe's new data privacy rules, called on fellow CEOs to take positions on public policy issues — even controversial ones — and explained why JPMorgan Chase is (finally) all in on the cloud. Here are the highlights.

'Tying up capital in perpetuity' will not foster growth

Dimon’s letter to shareholders emphasized the need for additional regulatory relief for banks, including globally systemically important banks.

“We also need to get the recalibration of other regulatory requirements right, particularly around operational risk capital, the Fed’s Comprehensive Capital Analysis and Review (CCAR) stress test and the additional allocation of capital to global systemically important banks (GSIB),” Dimon’s letter said. “If we don’t do so, certain products and services will continue to be pushed outside the banking system (where they are, fundamentally, not regulated), distorting markets and raising the cost of credit for clients."

Dimon said that JPMorgan currently holds $400 billion of operational risk-weighted assets, which means it now holds more than $40 billion of equity for assets that don't exist.

"Tying up capital in perpetuity — looking for shadows on the wall — is probably not the best idea for fostering growth in America," Dimon said.

Dimon also said there is "arbitrariness" to the CCAR stress testing regime, saying that the single test and the results show that most banks at the worst part of the stress cycle can barely cover their required capital, which he said is "fundamentally inaccurate."

Dimon criticized G-SIB capital requirements, saying that most of the factors used in the requirements are not risk-adjusted.

"Their methodology irrationally multiplies certain factors over and over, and many of the facts are simply unjustified on any basis," he said.

Under the current system, he said, banks will actually be in worse position to pull the country out of a recession than they were a decade ago.

"New regulations mean that banks will have to maintain more liquidity going into a downturn, be prepared for the impacts of even tougher stress tests and hold more capital because capital requirements are even more procyclical than in the past," he wrote.

"Effectively, some new rules will force capital to the sidelines just when it might be needed most by clients and the markets."

'Onerous' mortgage rules are exacerbating affordable housing crisis

A surplus of unnecessary regulations and mortgage rules left over from the financial crisis are hampering the healthy growth of the U.S. economy, and have caused JPMorgan Chase to re-evaluate its role in originating, servicing and holding mortgages, Dimon said.

"The odds are increasing that we will need to materially change our mortgage strategy going forward," he said.

Extensive mortgage reform hasn't been achieved yet because of the high concentration of regulators involved in crafting new rules — along with repeated political intervention — which is why banks have been gradually moving away from the mortgage business as it becomes more unprofitable, according to Dimon.

Dimon's comments echo those of other housing executives and some congressional Republicans, who have argued that regulatory burdens have strained the supply of housing and driven up costs, exacerbating what many consider to be an affordable housing crisis.

With more than 3,000 federal and state origination and servicing requirements, obtaining a mortgage has become more difficult, especially for borrowers who are younger, self-employed or who have had prior defaults on loans, Dimon claimed.

"Reducing onerous and unnecessary origination and servicing requirements … and opening up the securitization markets for safe loans would dramatically improve the cost and availability of mortgages to consumers," he said.

This could lead up to a 0.2% increase in homeownership and economic growth per year, according to JPMorgan Chase economists.

A 'Marshall Plan' for America

Dimon's letter includes a roundup of broader economic problems facing the country — along with some potential solutions.

"Our shortcomings in these areas clearly have impeded the prosperity of the U.S. economy and have failed many of our fellow citizens over the past two decades or so," he writes.

The problems he highlights are expansive, including an "ineffective and out-of-touch" educational system, "soaring" costs for health care and crumbling infrastructure. He also cites "irrational" student lending and debt, "frustrating" immigration policies, declining labor force participation, "excessive" regulation and poor government budgeting and planning, among other challenges for the country.

"If I were king for a day, I would always have a competitive business tax system and invest in infrastructure and education as a sine qua non to maximize the long-term health and growth of our economy and our citizens," Dimon writes. "I would not trade these issues off — I would figure out a way to properly pay for them."

Broadly, he calls for fundamental reforms to the political system, asking Republicans and Democrats alike to consider the other's perspective and agree on a set of effective, common-sense solutions to shoring uo the safety net for the elderly, sick and poor, improving education and repairing infrastructure.

He called it a "Marshall Plan for America," and to pay for it all, Dimon suggested raising taxes on wealthy individuals — so long as the money pays for programs that work.

"If we can demonstrate we are spending money wisely, we should spend more," he wrote.

Under the Marshall Plan, known formally as the European Recovery Program and spearheaded by Secretary of State George C. Marshall, the United States spent about $13 billion to help Western European nations recover from the devastation of World War II.

Dimon also encourages various groups, including government agencies and corporations, to "set aside narrow self-interest" when backing legislative and regulatory proposals.

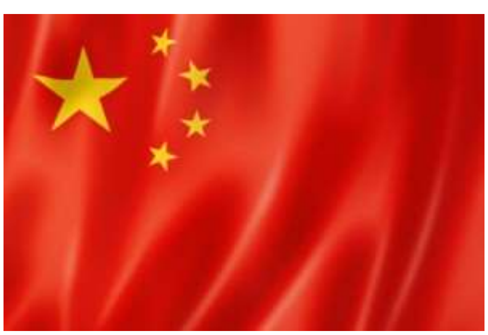
"While leaders obviously fight for their institutions, we all need to be able to advocate for policies that are good for our organizations without being bad for our country," he notes.

But he offers specifics as well. On education, Dimon lends support for mandatory preschool and further calls for high schools and community colleges to "work with local businesses to create specific skills training programs, internships and apprenticeships that prepare graduating students to be job-ready — whether they go on to earn a credential, to work or to attend college."

He lists a series of potential fixes for the bloated health care system, such as more transparent plan pricing, affordable end-of-life care and improved corporate wellness programs, with a focus on obesity and smoking. He suggests that small-business licensing should be simplified and urges governments at all levels to conduct transparent, multiyear budgeting and planning exercises.

"When the government says it is going to spend money, it should tell the American people what the expected outcome is and report on it," Dimon says. "It should account for loans the same way the private sector does, and it should be required to do cost-benefit analysis."

Concerns about China are legitimate, but manageable



Dimon also took the opportunity to address a host of concerns about rising superpower China.

China has undergone rapid economic development over the past 40 years, but its population still faces serious issues, like inadequate food, water and energy, as well as state corruption. The country is seeing corporate and government debt levels rise, and participation in its political system is lacking.

The United States' trade issues with China are also "substantial and real," he said. Besides tariffs and unfair subsidies for state-owned enterprises, the U.S. must also contend with issues like intellectual property theft and non-tariff barriers to trade.

President Trump was set to meet with Chinese Vice Premier Liu He at the White House on Thursday to continue negotiations over a trade deal between the world's two largest economies. The ongoing trade dispute has hit U.S. farmers particularly hard, and that has implications for the banks that lend to them, too.

Dimon tempered his message about China with doses of both reality and optimism.

He said he expects the U.S. and China to eventually hammer out a fair trade deal, while also cautioning that China is merely acting in its own best interests.

"We believe that [China] should and will agree to some of the United States' trade demands because, ultimately, the changes will create a stronger Chinese economy," he said.

Additionally, he noted that the Chinese people have been consistently pushing for greater transparency and economic reform for the past 30 years.

Though China "does not have a straight road to becoming the dominant economic power," Dimon stressed the importance of developing a mutually beneficial relationship between the two countries.

He wrote, "If China and the United States can maintain a healthy strategic and economic relationship (and that should be our goal), it could greatly benefit both countries — as well as the rest of the world."

National debt is 'not at danger level'

Dimon was more sanguine this year than he has been in the past about the rising national debt.

"America's debt level is rapidly increasing but is not at the danger level," he wrote.

He noted that U.S. companies and investors hold more than $25 trillion in claims on foreigners, compared with $6 trillion that the U.S. government owes to foreign creditors.

"So we earn more on foreign assets than we pay to foreign creditors. This is not a major issue," Dimon wrote.

Dimon added that at a certain point the increasing national debt could cause concern in global capital markets. But his warning was more muted than it was in the wake of Congress' failure to enact debt-reduction recommendations from a commission chaired by Alan Simpson and Erskine Bowles.

"The inability to face our fiscal reality is a concern," Dimon wrote in 2013. "I believe that if we had adopted some form of the Simpson-Bowles plan to fix the debt, it would have been extremely beneficial to the economy."

National debt rose from $16.7 trillion in the first quarter of 2013 to $21.5 trillion in the third quarter of 2018. The federal budget deficit is projected at around $900 billion in fiscal year 2019, a level not seen in seven years.

In his letter to shareholders, Dimon did not mention the impact that tax cuts passed in 2017, which he supported, are having on the nation's fiscal outlook. The Congressional Budget Office has projected that the tax law will increase the projected deficit over the 2018-2028 period by about $1.9 trillion.

"The new tax code establishes a business tax rate that will make the United States competitive around the world and frees U.S. companies to bring back profits earned overseas," Dimon wrote.

Europe's privacy rules: Right principles, but complex to execute

Dimon's letter includes an endorsement of European-style consumer privacy rules, or at least the spirit behind them.

"New laws in Europe stipulate that consumers should be able to see what data companies have on file about them and to correct or delete this information if they choose," Dimon wrote. "These are the right principles, but they are very complex to execute."

Dimon called for the creation of uniform federal rules, rather than a patchwork of state regimes. Last year, California passed a groundbreaking law that gives consumers various rights with respect to the collection of their personal information.

"Different state laws around privacy rules would create a virtually impossible legal, compliance and regulatory-monitoring situation," Dimon wrote.

He also stated that JPMorgan Chase is inventing new products to make it easier for its customers to understand where the company sends their data, as well as how to place restrictions on the use of their personal information.

'Full speed ahead' on the cloud

Dimon took partial responsibility for the bank's slow adoption of cloud computing.

As with bitcoin, which Dimon once called a "fraud," Dimon didn't initially see much use for the cloud, viewing it as "just another term for outsourcing."

But over time, he realized that the cloud is broad reaching in its capabilities, secure enough for a bank and easy enough to access and audit for a bank. "[W]e are now full speed ahead," he said.

The cloud's computing power can scale faster and is more elastic and holds more data ets, analytics and machine learning than the bank's own data centers. Software developers experience less friction and engineers can prototype quickly. Adding a database or a machine learning algorithm to an application can be done instantaneously.

"It increases developers' effectiveness by multiples — you can almost 'click and drop' new elements into existing programs as opposed to writing extensive new code," Dimon said.

With that ease, the bank can have smaller developer teams of five to 20 people, and the bank will be 'refactoring' applications so they can be deployed in the cloud. Then, employees will decide whether those applications will be deployed in the bank's internal cloud or external cloud.

Dimon has been bullish on the "real" power of artificial intelligence and machine learning which is already helping the bank fight fraud, enhance customer service and marketing, and improve underwriting. "[T]hese tools are rapidly being deployed across virtually everything we do," Dimon said.

While in the past algorithms have overcharged minority people for mortgages like humans have, Dimon said that the bank plans to make mortgages even more available to minority groups with AI.

JPMorgan Chase recently sent a senior leadership team to China to see how firms there are using AI and fintech and Dimon said his letter that "it's hard not to be both impressed and a little worried about the progress China has made. It made our management team even more motivated to move quickly."

Since the opportunities for using AI are only beginning, the bank is looking at ways for the company to prepare to relocate employees who are displaced by the technology inside or outside of the firm.

"The combined power of virtually unlimited computing strength, AI applied to almost anything and the ability to use vast sets of data and rapidly change applications is extraordinary," he said.

Bad things happen when companies try to 'make' their numbers

Dimon has long believed that companies should not provide earnings guidance because it can lead to bad decision-making, and he doubled down on that message in this year's letter.

"The real damage to an organization comes from the cumulative corrosiveness of trying to 'make' its numbers," he wrote.

Dimon told shareholders that he doesn't worry about quarterly earnings because the results themselves are "a function of decisions made over many, many years" and that any one quarter's results can be upended by everything from the cost of goods to extreme weather.

Providing guidance, he wrote, can lead to companies "doing stupid things in the short term that help earnings but are bad in the long term."

Some examples: Asking customers to buy products they don't want or need, curtailing marketing or holding back on investments — in a new branch or technology, for example — that may not pay off for a year or two.

Dimon also said that he never worries about loan growth or about charge-offs rising during an economic downturn.

"We fully expect it, and we manage our business knowing there will be good times and bad," he said.

Message to CEOs: 'Your country needs you'

In his annual letter to CEOs in January, BlackRock Chairman and CEO Larry Fink (pictured) called on his peers and banking and other industries to use their influence to help solve some of these pressing social and economic problems, and Dimon echoed those sentiments in his letter.

"CEOs: Your country needs you!" Dimon wrote. "It's not enough for the companies to meet the letter and the spirit of the law. They can also aggressively work to improve society [and] take positions on public policy that they think are good for the country."

Like Fink, Dimon expressed frustration with the federal government's inaction on important public policy issues and said that CEOs now have a responsibility to take stands on issues they have historically avoided. Dimon, for example, was a was among the most prominent business leaders to criticize President Trump for pulling the United States out of the Paris Agreement on climate change in June 2017. He also condemned the president for failing to call out racist groups for inciting violence at a rally in Charlottesville, Va., two months later.

"In the past, boards and advisors to boards have advised company CEOs to keep their head down and stay out of the line of fire," he wrote. "Now the opposite may be true. If companies and CEOs do not get involved in public policy issues, making progress on all these problems may be more difficult."

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