

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 8906 / March 27, 2008**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13000**

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<b>In the Matter of</b>	:	<b>ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER</b>
<b>JPMORGAN CHASE &amp; CO.,</b>	:	
<b>Respondent.</b>	:	

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**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), against JPMorgan Chase & Co. (“Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

**III.**

On the basis of this Order and Respondent’s Offer, the Commission finds<sup>1</sup> that:

**Respondent**

1. JPMorgan Chase & Co., a Delaware corporation headquartered in New York, is a financial holding company created by the December 2000 merger of JP Morgan & Co. with The Chase Manhattan Corporation, and the July 2004 merger of JPMorgan Chase & Co. with Bank

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<sup>1</sup> The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

One Corporation. JPMorgan Chase & Co.'s securities are registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and are listed for trading on the New York Stock Exchange (symbol: "JPM").

### **Related Parties**

#### **Bank One Corp.**

2. Bank One Corporation, formerly a Delaware corporation headquartered in Chicago, was at all times relevant a financial holding company. During the relevant period, Bank One Corporation's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and listed for trading on the New York Stock Exchange (symbol: "ONE"). Bank One Corporation merged with JPMorgan Chase & Co. in July 2004. As a result of the merger, Bank One Corporation no longer exists. JPMorgan Chase & Co. is the successor in interest to Bank One Corporation for purposes of this action.

#### **National Century Financial Enterprises**

3. National Century Financial Enterprises, Inc. ("NCFE") was incorporated in Ohio in December 1990. During the relevant period, NCFE was a privately held Ohio corporation headquartered in Dublin, Ohio. NCFE is now defunct.

4. During the relevant period, NCFE organized and owned several special-purpose subsidiary programs, including NPF VI and NPF XII, both of which were Ohio corporations.

### **Overview**

5. This case concerns negligent conduct by Bank One, N.A. ("Bank One") and JPMorgan Chase Bank, N.A. ("JPMorgan Chase") as asset-backed indenture trustees (the "indenture trustees" or "asset-backed indenture trustees") for certain special-purpose subsidiaries ("program" or "programs") of National Century Financial Enterprises, Inc. ("NCFE"), formerly a Dublin, Ohio healthcare financing company, during the approximate period 1999-2002 (the "relevant period").

6. During the relevant period, the NCFE programs offered and sold nearly \$3.5 billion in asset-backed notes to qualified institutional buyers. NCFE and the programs collapsed in November 2002 when investors and others discovered that NCFE had made large improper transfers among program accounts and caused collateral shortfalls. The collapse caused investor losses of approximately \$2.6 billion.

7. The NCFE programs purchased medical account receivables from health-care providers and issued asset-backed notes that securitized those receivables. In private placement memoranda ("PPMs") through which the NCFE programs offered the notes, NCFE represented to investors that NCFE would use the proceeds from the note offerings primarily for the purchase of healthcare account receivables and that the programs would maintain specified balances ("Specified Balances") for two separate reserve accounts and an Equity Account ("Reserve Accounts") that would be held by the indenture trustees. While NCFE used some investor funds to purchase healthcare account receivables, NCFE used a substantial portion of the private

placement proceeds and Reserve Account funds to make either unsecured loans or loans secured by collateral other than healthcare account receivables, contrary to NCFE's representations to investors and contrary to the requirements of the master trust indentures ("indentures") that governed NCFE's note offerings.

8. A principal feature of the scheme that allowed NCFE to hide investor losses was the transfer of huge amounts of Reserve Account funds on or around the first and last business day of every month ("Month-End Transfers"). The indentures required that the programs maintain Specified Balances in the Reserve Accounts totaling approximately 17% of the value of the outstanding notes issued by the program. However, even though the indenture trustees for the NCFE programs had the ability to look at the balances in the Reserve Accounts at any time, the indentures only required the programs to report on the balances in Reserve Accounts as of one day of the month, called the "Monthly Payment Date." The largest program for which JPMorgan Chase served as asset-backed indenture trustee was reported on by NCFE and tested by JPMorgan Chase as of the last business day of the month. The largest program for which Bank One served as asset-backed indenture trustee was reported on by NCFE and tested by Bank One as of the first business day of the month. As a result of this structure, NCFE was able to kite large amounts of funds back and forth between the programs to make it appear that the programs were maintaining the Specified Balances. In fact, NCFE was consistently and severely depleting the balances in these Reserve Accounts without telling investors.

9. At the instruction of NCFE, Bank One and JPMorgan Chase made Reserve Account transfers that contradicted NCFE's representations to investors about how the Reserve Accounts would be used and contravened the requirements of the indentures regarding the Reserve Accounts. Among other things, pursuant to NCFE's instructions, Bank One and JPMorgan Chase made the Month-End Transfers that helped NCFE mask substantial and growing Reserve Account shortfalls.

10. The Month-End Transfers were large, recurring, and contrary to the requirements of the indentures. In participating in the Month-End Transfers that were contrary to the requirements of the indentures, Bank One and JPMorgan Chase were negligent and should have known that NCFE was misusing the Month-End Transfers.

### **NCFE's Basic Business**

11. NCFE's programs were set out in a series of agreements (the "program agreements") between the programs, healthcare providers, and investors, including, among other things, the indentures. NCFE included the indentures as part of offering materials to prospective investors in the asset-backed notes issued by the programs.

12. The indentures allowed the programs to engage only in one type of business activity: the purchase of "eligible" medical account receivables of a hospital, physicians' group, or other healthcare provider on a weekly basis. The programs purchased the receivables at a price equal to 97% of the receivables' estimated collectible value. In most instances, the value of an "eligible receivable" was limited to the insured portion of a receivable for which medical services had already been rendered. Before purchasing a receivable, the programs required detailed billing information from the healthcare provider, including the insurance or government

payor, diagnosis code, billing date, patient account number, and patient discharge date. The program agreements required NCFE to review that information once each week and purchase only those receivables that were deemed eligible.

13. With limited exceptions, the indentures prohibited the programs from engaging in transactions with NCFE or any NCFE subsidiary, including any other program.

14. Under the indentures, the programs contractually engaged another NCFE subsidiary, National Premier Financial Services, to act as the servicer (“Servicer”) for the programs.

15. From 1991 through 2002, the NCFE programs issued over \$17 billion in asset-backed bonds or notes through private placements. When the company collapsed in November 2002, NCFE had over \$3 billion in notes outstanding.

16. While NCFE conducted numerous programs during its existence, the largest programs by far during the relevant period were the programs NPF VI and NPF XII. During 1999-2002, NPF VI and NPF XII collectively engaged in 15 separate note issuances worth nearly \$3.5 billion.

### **Reserve Accounts**

17. The program agreements contained safeguards to protect investors from loss. One of the significant safeguards for investors was the requirement in the indentures that the programs maintain three specific Reserve Accounts with the asset-backed indenture trustees. Various provisions of the indentures collectively required that the Reserve Accounts hold, in aggregate, approximately 17% of the value of the outstanding notes issued by the program at all times. The three Reserve Accounts were called the “Equity Account,”<sup>2</sup> “Seller Credit Reserve Account,”<sup>3</sup> and “Offset Reserve Account.”<sup>4</sup>

### **Investor Reports**

18. The asset-backed indenture trustees received monthly investor reports from the Servicer, a wholly owned subsidiary of NCFE. The monthly investor reports presented a regular “snapshot” of each program’s financial performance. The investor reports included, among other things, information on the amounts in the Reserve Accounts as of a certain day of the month, referred to in the reports as the “Determination Date.” For the NPF VI program, the

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<sup>2</sup> The Equity Account served as the account through which the program paid principal and interest to investors and paid indenture trustee fees.

<sup>3</sup> The Seller Credit Reserve Account served as a reserve account in the event that an eligible receivable purchased by the program became a defaulted receivable. A defaulted receivable included any receivable for which more than 180 days had passed since the date the receivable was billed.

<sup>4</sup> The Offset Reserve Account served as a reserve account in the event that an eligible receivable purchased by the program became a rejected receivable. A rejected receivable included any receivable as to which the seller had breached a representation about the receivable.

Determination Date was the last business day of every month, meaning that the investor reports for the NPF VI program reported the amounts in the NPF VI Reserve Accounts as of the last business day of every month. For the NPF XII program, meanwhile, the Determination Date was the first business day of every month, meaning that the investor reports for the NPF XII program reported the amounts in the NPF XII Reserve Accounts as of the first business day of every month. The investor reports did not report on the amounts in the Reserve Accounts as of any other days of the month other than the Determination Date.

19. Although the indentures only required that the Servicer distribute the investor report to the indenture trustees and to the ratings agencies that rated the program notes, NCFE routinely distributed the investor reports to existing and prospective investors.

### **The Asset-Backed Indenture Trustees' Role**

20. During the relevant period (1999-2002), either Bank One or JPMorgan Chase served as asset-backed indenture trustees for all of the NCFE programs. During the relevant period, Bank One served as indenture trustee for the NPF XII program (as well as for two much smaller programs, NPF WL and NPF LP), and JPMorgan Chase served as indenture trustee for the NPF VI program (as well as for a much smaller program, NPF XI). Bank One and JPMorgan Chase received revenues from the NCFE programs by collecting several different types of fees from the programs.

21. Under the indentures, deposits into and disbursements out of the trust accounts generally were required to be made by written instruction to the indenture trustee to make the deposit or disbursement. With respect to the Equity Account, the indentures required that the indenture trustee adhere to the indentures' restrictions on disbursements from the Equity Account, which included a restriction on disbursements from the Equity Account on any day of the month other than on the Monthly Payment Date of any funds held in the Equity Account as of the last Monthly Payment Date. The Monthly Payment Date was the first business day of every month.

22. Additionally, the indentures required the asset-backed indenture trustees to review the investor reports issued by the programs, and, based on the investor reports, determine whether the program held the Specified Balance for the Equity Account ("Equity Account Specified Balance") as of the Monthly Payment Date. An event of default occurred if a program did not hold the Equity Account Specified Balance as of the Monthly Payment Date or within a cure period of seven days after the Monthly Payment Date. If an event of default was "continuing," then the indentures required that the indenture trustee serve notice on the Servicer of an event of default by the program. If the Servicer failed to demonstrate within one business day that no such event of default had occurred, then the indentures required that the asset-backed indenture trustee also declare a principal amortization event, which resulted in an immediate wind-down of the program.

23. With respect to the Seller Credit Reserve Account and Offset Reserve Account, the indentures required the indenture trustee to follow the instructions of the Servicer in regard to deposits into and disbursements out of those accounts. However, in the indentures, the programs represented and warranted that they would maintain the Seller Credit Reserve Account Specified

Balance and Offset Reserve Account Specified Balance. If the programs materially breached this representation and warranty, then the indentures gave the indenture trustees the right, but not the duty, to declare an event of default based on any such breach of which they were aware.

### **NCFE's Improper Depletion and Manipulation of the Reserve Accounts**

24. From at least February 1999 to October 2002, NCFE engaged in a pattern of depleting the Reserve Accounts to make unsecured loans or loans secured by ineligible collateral, then manipulating the Reserve Accounts on or around the Determination Dates to make it appear that the programs were maintaining the Specified Balances in the Reserve Accounts. NCFE's manipulation of the Reserve Accounts included not only improperly transferring funds between Reserve Accounts within a program, but also transferring funds back and forth between programs, in violation of the indentures.

25. During the relevant period, NCFE routinely depleted the Reserve Accounts to far below the Specified Balances for those accounts, contrary to NCFE's representations to prospective investors in the PPMs, and contrary to the requirements of the indentures. As an example, in March 2000, the NPF VI Equity Account Specified Balance was \$68.7 million. Yet the average daily balance in the NPF VI Equity Account during March 2000 was only \$36 million, with the balance dropping as low as \$20.3 million. Similarly, in December 2000, the Specified Balance in the NPF VI Seller Credit Reserve Account was over \$50 million, yet the average daily balance in the account in this month was only \$9.2 million. At one point in this month, the balance in the NPF VI Seller Credit Reserve Account dropped to a mere \$49,067.

26. Since the Determination Date for the NPF VI program fell on the last business day of the month, and the Determination Date for the NPF XII program fell on the first business day of the month, NCFE concocted a scheme to kite funds back and forth between the two programs through the Month-End Transfers to try to satisfy the Reserve Account Specified Balances on the Determination Dates for the two programs. Internal NCFE memoranda documented the scheme's mechanics.

27. For example, in an October 26, 1999 internal memo, NCFE discussed several options for satisfying the Reserve Account Specified Balances for the October 1999 Determination Dates, including:

On Thursday, October 28, 1999, NCFE will meet the minimum compliance requirements in NPF VI and NPF XI, for which the Trustee is Chase Manhattan, by wiring approximately \$36,000,000 from NPF XII to NPF VI and NPF XI. . . .

On Friday, October 29, 1999, NCFE will wire the \$36,000,000 from NPF VI and NPF XI back to NPF XII.

28. Similarly, in a January 2000 internal memo, NCFE discussed several options for satisfying the Reserve Account Specified Balances for the end of January 2000/beginning of February 2000 Determination Dates, including:

Assuming there will be no anomalous cash receipts before the end of January and the Programs are funding \$10 million in excess of cash collections each week, the books will be short by about \$50 million on January 31, 2000. The last business day of January 2000 will be Monday, January 31, 2000. Currently, the only way to force all of the programs into compliance will be to hold month end open until February 1, 2000, for some of the trust accounts. On January 31, 2000, the Chase Manhattan Bank trust accounts (NPF VI and XI) will be tested per normal procedures. Then, on February 1, 2000, sufficient funds will be wired from the Chase accounts to the Bank One trust accounts (NPF WL, XII, and LP) in order to pass the month end requirements.

29. To mask the purpose of the Month-End Transfers, NCFE attached fictitious accounts receivable information to the transfer instructions to the asset-backed indenture trustees to give the appearance that the programs were purchasing receivables from each other, although no actual transfers of receivables between the programs occurred.

#### **The Asset-Backed Indenture Trustees' Negligence Regarding NCFE's Depletion and Manipulation of the Reserve Accounts**

30. On occasion, certain of Bank One's and JPMorgan Chase's asset-backed indenture trustee employees raised questions internally about NCFE's conduct to more senior-level indenture trustee employees. The failure of those more senior-level indenture trustee employees to adequately respond to those questions was negligent.

31. For example, in February 1999, despite its manipulation of the Reserve Accounts, NCFE did not have sufficient funds to satisfy the Specified Balances in the Reserve Accounts for the NPF VI program. Instead of issuing an investor report that identified the deficiencies, NCFE delayed issuing an investor report until late March 1999, after the program had raised \$180 million in funds from a new securitization. NCFE deposited the new funds in the NPF VI Reserve Accounts and then issued an investor report falsely reporting that NCFE had satisfied the Specified Balances in the Reserve Accounts as of the last business day of February 1999.

32. The JPMorgan Chase administrator assigned to the account became aware of the false figures in the February 1999 investor report and alerted NCFE, the ratings agency, and her supervisors. JPMorgan Chase then contacted NCFE, which gave JPMorgan Chase and the ratings agency the explanation that the Reserve Account balances had been deficient in February 1999 and that as a result the February 1999 investor report had been inaccurate due to a "timing error" by NCFE personnel in failing to direct JPMorgan Chase to allocate certain funds to the Reserve Accounts.

33. In fact, as the account balances equally available to JPMorgan Chase and NCFE showed, the Reserve Accounts were woefully deficient because NCFE had depleted the accounts to below the Specified Balances, and NCFE did not have the funds to replenish them until NCFE raised new funds from a new securitization in late March 1999. JPMorgan Chase knew or should have known that the investor report did not comply with the terms of the indenture and that it had a duty to give notice of an event of default based on the program's failure to meet the

Equity Account Specified Balance as of the last business day of February 1999 and failure to cure the deficiency within the cure period, as required by the indenture.

34. Similarly, on September 1, 2000, a Bank One administrator assigned to the NCFE account sent a memo to the account executive responsible for the NCFE account regarding NCFE's August 31, 2000 funding requests. The administrator told the account executive that these funding requests resulted in "large dollar amounts taken from the deals, in which the compliance standards are not up to par." The administrator provided the account executive with evidence of NCFE's August 31, 2000 large transfers from the NPF XII and NPF WL programs, for which Bank One was indenture trustee, to the NPF VI and NPF XI programs at JPMorgan Chase, as well as the large transfers back from the programs at JPMorgan Chase to the programs at Bank One on September 1, 2000. Despite being notified of evidence of the large August 31, 2000 and September 1, 2000 Month-End Transfers involving the Reserve Accounts, the Bank One account executive took no action.

35. Bank One and JPMorgan Chase followed NCFE's instructions to make the large, recurring Month-End Transfers. As noted above, these transfers were contrary to the terms of the indentures, which required NCFE to maintain the Specified Balances in the Reserve Accounts.

### **Legal Analysis**

36. Section 17(a)(3) of the Securities Act makes it unlawful for any person in the offer or sale of securities to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

37. NCFE violated Section 17(a)(3) of the Securities Act by engaging in a fraudulent scheme to deplete and manipulate the Reserve Accounts, including making the Month-End Transfers.

38. Section 8A of the Securities Act provides that the Commission may issue a cease-and-desist order against a person who is "a cause of [another person's] violation, due to an act or omission the person knew or should have known would contribute to such violation . . . ."<sup>5</sup> Based on the conduct described above, Respondent was a cause of NCFE's violations of Section 17(a)(3) of the Securities Act.

## **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent JPMorgan Chase & Co.'s Offer.

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<sup>5</sup> A finding of negligent conduct is sufficient to establish liability for violating Section 17(a)(3) of the Securities Act. *See Aaron v. SEC*, 446 U.S. 680, 696 n.13 (1980). Where the primary violation underlying a finding that a person is "a cause of" violations does not itself require a finding of scienter, as here, the standard of liability for being a cause of such violations is negligence. *Cf. KPMG LLP v. SEC*, 289 F.3d 109, 112, 114 (D.C. Cir. 2002) (holding that the Commission, in an administrative proceeding under Section 21C, could use a negligence standard in determining whether a violation of Section 13(a) of the Exchange Act had occurred.)



Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, Respondent JPMorgan Chase & Co. cease and desist from committing or causing any violations and any future violations of Section 17(a)(3) of the Securities Act.

B. IT IS FURTHER ORDERED THAT Respondent shall, within 10 days of the entry of this Order, pay disgorgement of \$1,286,808.82 and prejudgment interest of \$711,335.76. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to U.S. Bank, as paying agent for the trustee of the post-confirmation trusts ("bankruptcy trustee") created in *In re National Century Financial Enterprises, Inc.*, Case No. 02-65235 (Bankr. S.D. Ohio), for distribution on a pro rata basis solely to the injured investors in asset-backed notes issued by NPF VI and NPF XII; and (C) submitted under cover letter that identifies JPMorgan Chase & Co. as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Jane E. Jarcho, Chicago Regional Office, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604. Respondent shall bear the costs of distribution of the disgorgement and prejudgment interest amounts.

C. IT IS FURTHER ORDERED THAT Respondent shall make reasonable efforts to obtain and provide to the Commission written confirmation from the bankruptcy trustee or U.S. Bank that U.S. Bank received the disgorgement and prejudgment interest amounts ordered in paragraph IV.B. above and that U.S. Bank distributed those amounts on a pro rata basis solely to the injured investors in asset-backed notes issued by NPF VI and NPF XII. This written confirmation shall be provided to Jane E. Jarcho, Chicago Regional Office, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604.

By the Commission.

Nancy M. Morris  
Secretary