

Financial Crisis Inquiry Commission
Agenda Item 8 for Closed Session Meeting of October 20, 2009

**Preliminary Draft Work Plan for
the Report of the Financial Crisis Inquiry Commission**

I. Principles

The following are the principles that should guide the work of the commission as it undertakes its inquiry.

- The commission should provide the public, policy makers, regulators, and market participants with a better understanding of the causes of the financial crisis.
- The work of the commission should be based on facts, not opinion, with a rigorous process to ensure the validity and accuracy of facts and evidence.
- The report of the commission should be an unbiased historical accounting of the policies, events, and practices that contributed to the financial crisis. It will be based on a thorough review and analysis of all known, credible sources and work already done coupled with an aggressive investigation which uncovers new, critical facts and evidence.
- The commission will pursue facts and evidence as needed to conduct a full and thorough inquiry through strategic investigative techniques, including if necessary, the use of compulsory process.
- The commission will present its work in a clear, understandable, and compelling manner. That work will include a treatment of the larger forces that drove the crisis as well as real and tangible examples of the practices that existed in the marketplace that also helped bring about the crisis.
- The products of the inquiry will include the final report, interim reports, public hearings, and video materials. The commission will use traditional media, new media, and the web to maximize the accessibility to its work.

II. Outline of the Commission's Report

What follows is a working outline of the Commission's report. This outline is designed to provide a logical sequence of chapters and to logically categorize the specific areas of examination called out in the statute. Specific examples of the practices and actions taken by institutions and individuals at all levels of the marketplace will be woven throughout the narrative.

It should be noted that while each specific statutory study area is listed once, a number of areas of examination will in all probability be covered in more than one section, given the interconnected nature of the issues to be examined. In

addition, this outline is not meant to draw conclusions but rather attempts to create an initial structure for the ultimate framework of the report. Further, as indicated in Section III, while this outline suggests an initial conceptual approach to the report, staff will move forward on the various “chapters” of this report concurrently given the timeframe for completion of the Commission’s work. Indeed, the commission’s hearings and interim reports may not proceed in the same sequence as the outline. Finally, it is recognized that this work plan will evolve as the inquiry proceeds and as investigative results warrant.

- **The Crisis.** This section will describe the nature of the financial and economic crisis - from the cataclysmic events of 2007 and 2008 to the downward spiral in the financial sector to the economic and social consequences of the crisis, in relation to both its impact on the macroeconomy and on individual households. This includes widespread housing defaults and foreclosures; failure and near failure of financial institutions; impairment of credit markets; loss of asset values; and dramatic increases in unemployment.

After describing the crisis, the report would go back to “trace the fuses that set off the explosion.”

- **The Backdrop.** This section would examine the underlying macroeconomic, policy, and regulatory framework as it existed and evolved over the past three decades, with a particular focus on the period of _____ to _____. It would examine, among other things, the changing contour of the U.S. and global economies, monetary policy, the changing shape of the financial system, changes in financial market and business practices and associated changes in financial incentives, and changes in law and regulation affecting the financial sector. The statutory provisions examined in this section would include:
 - i. “The global imbalance of savings, international capital flows, and fiscal imbalances of various governments” (Public Law 111-21, § 5(c)(1)(c));
 - ii. “Monetary policy and the availability and terms of credit” (Public Law 111-21, § 5(c)(1)(d));
 - iii. “Affiliations between insured depository institutions and securities, insurance, and other types of nonbanking companies” (Public Law 111-21, § 5(c)(1)(j));
 - iv. “Tax treatment of financial products and investments” (Public Law 111-21, § 5(c)(1)(f)); and
 - v. “The concept that certain institutions are ‘too-big-to-fail’ and its impact on market expectations” (Public Law 111-21, § 5(c)(1)(k)).
- **Home Mortgages/Real Estate Lending.** This section would examine the development and evolution of the single family housing/mortgage market, including but not limited to the dramatic explosion of subprime lending;

the role of Fannie Mae, Freddie Mac, investment banks, and other home mortgage lending entities; practices ranging from origination through securitization; and fraud in this sector. For the purposes of this initial outline, this section would also examine the commercial real estate sector, although this subject would probably be treated separately in the final report. This section would cover the following statutory sections:

- i. “Fraud and abuse in the financial sector, including fraud and abuse towards consumers in the mortgage sector” (Public Law 111-21, § 5(c)(1)(a));
- ii. “Lending practices and securitization, including the originate-to-distribute model for extending credit and transferring risk” (Public Law 111-21, § 5(c)(1)(i));
- iii. “The legal and regulatory structure of the United States housing market” (Public Law 111-21, § 5(c)(1)(o)); and
- iv. “Financial institutions and government-sponsored enterprises” (Public Law 111-21, § 5(c)(1)(u)).

- **Financial Products and Practices** This section will look at the financial market practices and financial products, beyond those covered in the section above, which may have driven, contributed to, or amplified the financial crisis. This section will examine, among other things, derivatives including credit default swaps, compensation practices, leverage, creation of off-balance sheet entities, short selling, and fraud. This section will also examine the breakdown of corporate risk management mechanisms and practices and how they might have exacerbated the crisis. This section will be closely related to the above section on housing and commercial real estate given the interconnection between the subject matters. Statutory provisions covered would include:

- i. “Derivatives and unregulated financial products and practices, including credit default swaps” (Public Law 111-21, § 5(c)(1)(p));
- ii. “Financial institution reliance on numerical models, including risk models and credit ratings” (Public Law 111-21, § 5(c)(1)(r));
- iii. “Short-selling” (Public Law 111-21, § 5(c)(1)(q));
- iv. “Compensation structures” (Public Law 111-21, § 5(c)(1)(m));
- v. “Changes in compensation for employees of financial companies, as compared to compensation for others with similar skill sets in the labor market” (Public Law 111-21, § 5(c)(1)(n));
- vi. “Corporate governance, including the impact of company conversions from partnerships to corporations” (Public Law 111-21, § 5(c)(1)(l)); and
- vii. “The quality of due diligence undertaken by financial institutions” (Public Law 111-21, § 5(c)(1)(v)).

- **The Backstops.** This section will examine the role of regulators as the crisis developed and gained steam. It will investigate the actions or inactions of key public entities charged with regulating the marketplace

including, but not limited to, the Federal Reserve, the SEC, the various bank and thrift regulators, OFHEO/FHFA, and the CFTC – looking at how such regulatory bodies may have failed or been derelict in their duties, been constrained from fulfilling their responsibilities, or acted in a manner that may have contributed to the crisis. It will analyze a range of matters including the legal authority of such entities, the effectiveness and independence of enforcement, the adequacy of resources, the structural deficiencies in the regulatory regime, and the knowledge and actions of the regulators as the crisis unfolded. Statutory areas of study would include:

- i. “Federal and State financial regulators, including the extent to which they enforced, or failed to enforce statutory, regulatory, or supervisory requirements” (Public Law 111-21, § 5(c)(1)(b));
- ii. “Capital requirements and regulations on leverage and liquidity, including the capital structures of regulated and non-regulated financial entities” (Public Law 111-21, § 5(c)(1)(g));
- iii. “The legal and regulatory structure governing financial institutions, including the extent to which the structure creates the opportunity for financial institutions to engage in regulatory arbitrage” (Public Law 111-21, § 5(c)(1)(s)); and
- iv. “The legal and regulatory structure governing investor and mortgagor protection” (Public Law 111-21, § 5(c)(1)(t)).

In addition to the examination of regulatory bodies, this section will probe the role of third party entities such as credit rating agencies, accounting firms, and law firms with key marketplace responsibilities. This would encompass the following statutory provisions:

- i. “Credit rating agencies in the financial system, including reliance on credit ratings by financial institutions and Federal financial regulators, the use of credit ratings in financial regulation, and the use of credit ratings in the securitization markets” (Public Law 111-21, § 5(c)(1)(h)); and
- ii. “Accounting practices, including, mark-to-market and fair value rules, and treatment of off-balance sheet vehicles” (Public Law 111-21, § 5(c)(1)(e)).

- **The Fate of Major Financial Institutions** After tracing the course of the financial crisis, the report will catalogue the fate of major financial institutions in the context of the crisis. This examination is consistent with the statutory mandate “to examine the causes of the collapse of each major financial institution that failed (including institutions that were acquired to prevent their failure) or was likely to have failed if not for the receipt of exceptional Government assistance from the Secretary of the Treasury during the period beginning in August 2007 through April 2009.”

- **The Aftermath.** This section will provide an update, as of the final writing of the report, on the status of the practices and policies identified in the report as key contributors to the financial and economic crisis. For example, this section would identify the change or lack of change in areas such as regulations, compensation practices, risk management practices, and financial products to the extent those items were identified as factors in the crisis.
- **Conclusions and Recommendations.** The commission is not required to make recommendations. However, to the extent that the Commission chooses to do so, we can conclude our report with a set of recommendations.

III. Preliminary Work Plan

Below is a preliminary overview of the Commission’s work plan.

- **Strategy.** The commission is charged with the obligation to review and report on twenty-two specific issues that may have helped trigger or accelerate the financial crisis. The commission is also obligated to examine the “causes of the collapse of each major financial institution that failed (including institutions that were acquired to prevent failure) or was likely to have failed if not for the receipt of exceptional Government assistance” (Public Law 111-21, § 5(c)(2)). This suggests that the commission should pursue a parallel, two-track approach to its work. Track one would focus on the larger trends and developments that drove the crisis. Track two would focus on specific institutions that contributed to the crisis.

Squaring these two approaches is possible by examining specific institutions and their actions, while putting those actions in the broader context of the factors that appear to have triggered and accelerated the crisis. Although not without challenges, an institution-centric track has at least four major advantages: (1) major questions about the causes of the crisis will be examined in the real world of real companies, allowing the commission to test common assumptions about the crisis; (2) the issues will be dramatically illuminated by the actions and testimony of real actors in the marketplace; (3) a series of case studies of specific institutions, private and public, will allow the commission to uncover common threads of causation; and (4) such an approach will illustrate how firms operated in their regulatory environment.

- **Investigative Steps.** Practically, the commission does not have enough time to do full-blown examinations of a large number of entities that may be within its purview so it should begin by profiling the most important entities for examination. This should start with a searching profile of what

is publicly known about each firm. As patterns emerge by firm or regulatory entity, e.g., the effect of compensation practices on risk-taking in the case of firms or potentially inadequate disclosures of risk in the case of a regulator, further investigative steps can be implemented. These steps may include, among other things, targeted document retention letters; interviews of risk officers; interviews of current and former high-level officials or executives; letter requests for documents and e-mails followed, if necessary by subpoenas for these materials and testimony.

Against these profiles, we will want to lay information on what the respective boards of selected companies were doing; what the accountants were saying and doing; what the company was disclosing; and what regulators were doing or not doing. Throughout this process, we will take advantage of work that has already been done by, among others, congressional committees, GAO, financial regulators, scholars and the press.

- **Hearings.** Based on the examinations above, the commission should select firms and regulatory (or quasi-regulatory) entities for case studies in public hearings. Once a specific firm or combination of firms has been selected to illustrate activities in a particular part or multiple parts of the market, we will want to put this firm in the context of its business and regulatory environment.

This examination should include testimony on the nature of the business, including suppliers and customers; rating agencies; accountants and regulators. Although it is too early to forecast the contours of specific hearings, possible examples include:

- i. A mortgage originator/bundler and a securitizer;
- ii. A national bank or banks;
- iii. An investment bank or banks;
- iv. One or both major government-sponsored home lending institutions ; and
- v. A risk insurer.

In addition to examinations of firms at different levels of the financial system, we also need to more deeply examine the “backstops” that had independent obligations to protect the financial system. This suggests additional hearings on:

- i. Rating agencies;
- ii. Accountants/Auditors; and
- iii. Regulators.

This means that the commission will be conducting as many as eight major hearings within approximately nine months. At the same time, our writing staff, including our researchers, will be generating first drafts of chapters for the report and supplying information to the public in the form of interim reports and a robust Web presence.

This is ambitious but it does square the circle of our need to answer specific questions and our need to examine specific firms. More generally, our goal is to look at the broad drivers of the crisis but also conduct a “deep dive” into specific institutions to determine the ground truths of the crisis.

- **Schedule.** This plan means that we will be conducting hearings every 4-6 weeks starting in December 2009. Our investigative teams and our writers/editors will be concurrently preparing rough chapters. Hearings would conclude by mid-August 2010.

The commission will conduct its inquiries, hearings and reports mindful of the schedule of the Congress in addressing legislation related to the financial crisis, subject to the commission’s own independent mandate and a commitment to highest quality products.

A draft report would be presented to the commission by mid-September 2010. It is assumed that the Government Printing Office will need the final version for printing by November 1, 2010 to make our statutory deadline for presentation of our report.

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