



**Agenda for Financial Crisis Inquiry Commission Meeting on
Wednesday June 28th and Thursday, June 29, 2010
9:00am-5:30pm ET 9:00am-3:15pm ET
Woodrow Wilson Center, 4th Floor Conference Room
One Woodrow Wilson Plaza
1300 Pennsylvania Ave. NW, Washington, D.C. 20004**

Day 1: Wednesday, June 28th

1. **Overview of Meeting**
(9:00-9:15am)
2. **Session One: Presentation by the Shadow Banking Working Group/ Discussion of Takeaways**
(9:15-10:30am)
Attached Background materials: Shadow Banking Working Group Takeaways
3. **Break**
*Beverages served at the conference room
(10:30-10:45am)
4. **Session Two: Presentation by the Housing Working Group/ Discussion of Takeaways**
(10:45-12:00pm)
Attached Background materials: Housing Working Group Takeaways
5. **Break for Lunch**
*Served at the conference room
(12:00-12:45pm)
6. **Session Three: Presentation by the Credit Rating Agencies Working Group/ Discussion of Takeaways**
(12:45-2:00)
ATTACHED Background materials: Credit Rating Agencies Working Group Takeaways
7. **Session Four: Presentation by the Derivatives Working Group/ Discussion of Takeaways**
(2:00-3:15)
FORTHCOMING Background materials: Derivatives Working Group Takeaways
(The Derivatives Working Group will meet immediately after retreat sessions conclude today, from 3:45-6:00pm)
8. **Break**
*Beverages served at the conference room
(2:00-2:15)

9. **Session Five: Discussion of List of Priority Institutions**
(2:15-3:15pm)
Attached Background materials: Draft List of Priority Institutions
10. **Session Six: Other Items of Business**
(3:15-3:45pm)

Day 2: June 29th

1. **Session One: Draft Section 4 of the Report**
(9:00-10:30am)
FORTHCOMING Background materials: Draft Section 4 with Commissioners' comments compiled
2. **Break**
****Beverages served at the conference room***
(10:30-10:45am)
3. **Session One Continued: Draft Section 4 of the Report**
(10:45-12:15pm)
4. **Break for Lunch**
****Served at the conference room***
(12:15-1:00pm)
5. **Session One Continued: Draft Section 4 of the Report**
(1:00-2:00)
6. **Session Two: Discussions of forthcoming sections of the report**
(2:00-3:00)
7. **Wrap Up and Adjournment**
(3:00-3:15pm)

A. Specific Takeaways with which the whole Working Group agreed

- The definition of shadow banking should focus on activities and institutions. There is significant overlap between the traditional and shadow banking sectors.
- Shadow banking markets were very fragile due to the combination of high leverage, short-term funding, risky assets, a lack of a formal backstop via deposit insurance or the Discount Window, and light and ineffective regulation. Liquidity problems first appeared in the shadow banking system. Funds borrowed short-term were essentially unstable. Many lenders focused on counterparty risk rather than the quality of collateral. When signs of credit trouble emerged, lenders such as mutual funds and hedge funds as well as money lent in the interbank lending markets quickly withdrew, causing liquidity pressures, asset sales, and diminished capital.
- The mortgage market was a trigger that set off the crisis. The unexpected fall in housing prices created losses for levered households and for levered investors who had bought mortgage-backed instruments. However, there were asset bubbles and/or deterioration in underwriting standards in other markets. For example, bubbles occurred and underwriting standards declined in the commercial real estate sector. It is feasible that a crisis in a different sector could have had similar repercussions due to the fragility of the financial system.
- Certain products were particularly important in spreading and in some cases increasing risk. These include, among others, subprime CDOs, CDO-squareds, synthetic CDOs, and asset-backed commercial paper programs that invested in MBS and CDOs.
- Risk management failures were a cause of the crisis. Corporate leadership and risk management failed on a grand scale at many institutions, such as Fannie Mae and Freddie Mac among the GSEs, Bear, Lehman, and Merrill Lynch among investment banks and Citigroup and Wachovia among commercial banks.
- Lack of transparency made the crisis worse. There are several components of this argument, including, but not limited to: (1) it was difficult for investors to understand their exposures to subprime mortgages embedded in shadow banking instruments such as CDOs and ABCP; (2) it was difficult to measure counterparty risk because counterparties' relative exposures were unknown; (3) mark-to-market was difficult when trading dried up.
- The shadow banking system grew to great scale without proper evaluation of risks and regulation: by the time of the crisis, the shadow banking system rivaled the traditional banking system in scale and impact. It grew partly in response to evolving market conditions and partly as a matter of regulatory arbitrage. Policy makers consciously did not reign in the growth of the shadow banking system,
- Many warning signs were ignored both in the public and private sector: there were many warnings signs that were ignored (e.g. as evidenced in monthly SEC reports, internal concerns at Bear re their mortgage book and ability to weather a storm), but also significant knowledge re the risks of the shadow banking system (e.g. as evidenced by speeches given by Geithner re shadow banking risks, etc; known levels of leverage, illiquidity, and short term borrowing) that similarly were not acted upon. These warning signs, combined with all of the red and yellow lights re the housing bubble and potential bust, should have signaled a system at risk of unraveling.

B. Specific Takeaways on which Commissioner Born and Commissioner Holtz-Eakin have not reached consensus

- The Working Group discussed two ideas of a “common shock”: a liquidity shock (hoarding by liquidity providers, redemption requests, etc.) and a mortgage shock (exposure to mortgages was the common thread for institutions that suffered runs or actual losses). The group agreed to explore these themes and that more research was needed to weight them properly.
- Was poor supervision, deregulation, and/or inattention to the shadow banking sector a cause of the crisis? The hearing focused on the failures of the SEC’s investment bank supervision program, both in its capital framework and in the way that it was implemented. Commercial bank supervisors also did not fully understand the exposures some banks and their affiliates had to the shadow banking sector. Some key parts of the shadow banking system were largely unregulated, such as the commercial paper market and the repo market or poorly supervised. Some regulation, notably the SEC’s CSE program failed. The Working Group agreed with these observations but did not reach consensus that poor supervision or a deregulatory trend were causal. In addition, the Working Group did not agree that a lack of regulations was a cause of the crisis.
- The role of the relationship between the shadow banking system and the traditional banking system still needs to be addressed. The Working Group did not come to agreement on how the interplay may have played a role in the causes of the crisis.
- Interconnectedness vs. common shock. A common theme is that interconnectedness among large financial firms created systemic risk. We do not have a consensus as to what we mean by interconnectedness.
- Role of compensation. The Working Group agreed that risk management failures generally were a cause of the crisis. However, the group did not agree whether compensation amounts and asymmetric compensation incentives should be considered an important aspect of risk management failures or a significant contributor to the crisis.

Takeaways from R and I plan/hearing on Supprime Lending, Securitization, and the GSEs

As of 7/22/2010

Materials for Session 2 of July 28th FCIC Meeting

A. Specific Takeaways with which the whole Working Group agreed

- **Subprime lending and securitization led to significant losses at case study institutions:** Both Fannie Mae and Citi experienced significant losses/write-downs due to subprime lending related activities, requiring substantial taxpayer assistance.
- **There was untrammelled growth in subprime/alt A/risky mortgages:** unsustainable, toxic loans polluted the financial system and fueled the housing bubble and bust; there was an explosion of mortgage debt (mortgage debt in country double from 2000-2006)
- **Lending standards collapsed:** there was a dramatic deterioration of lending standards. creation and marketing of new mortgage products destined to fail – dependent on ever rising prices, unrelated to ability to pay, etc (delinquencies on subprime ARM that reach 40% plus!). An open factual item: how much of the market was fraudulent or a result of predatory lending (see section below re more information needed).
- **There was a complete failure of accountability and responsibility throughout the lending system:** a failure at all levels – from loan brokers to originators to securitizers to corporate board rooms – to do due diligence, to detect deficiencies and fraud, to act responsibly, to heed warning signs, to perform reasonable stress tests, to use basic guideposts such as ability to pay, etc.
- **Regulators, principally the Fed, failed to rein in risky home lending:** the Fed could have, but didn't constrain dangerous subprime lending, despite warnings, evidence of the housing bubble, information regarding unfair and deceptive lending, and warnings re fraud. No effective regulations, no enforcement re: unfair and deceptive lending, no oversight of non-bank subsidiaries. Deregulatory ideology was crippling. Pre – GLB roll backs to Glass Steagall facilitated the securitization market by regulated institutions. OCC's preemption efforts curtailed state efforts to curtail unfair and deceptive lending.
- **There were significant regulatory gaps and failures in financial institution oversight:** beyond the failure to rein in subprime lending, the regulators of Citi and Fannie failed to stop practices that led to enormous losses. Despite spotting some of the problems (e.g. Fed halt on Citi acquisitions, OCC concerns in 2005, OFHEO concerns), there were significant regulatory weaknesses and gaps. In the case of OFHEO, regulators were further hamstrung by lack of clout and authority.
- **Corporate leadership/ risk management failed on a grand scale:** both at Fannie and at Citi, there was a dramatic failure of risk management and corporate management. At Citi, there was a striking lack of knowledge by corporate heads re exposure and risks (e.g. \$13 billion exposure that becomes \$55 billion, liquidity puts, RMBS unit slowing up/ CDO unit accelerating, Bowen warnings re quality of mortgages). At Fannie, extraordinary risk with high leverage, acceleration of purchase/guaranteeing of high risk loans. No real internal restraints at either organization.
- **Excessive leverage put institutions, and ultimately the taxpayers, at risk:** leverage was outsized at both Citi and Fannie. Even more so with off-balance sheet at Citi and portfolio/guarantee book at Fannie. So little capital, so much risk.

B. Specific Takeaways with which Commissioner Wallison does not concur

- **There is no evidence, at least to date, that would suggest that the CRA was a driver of subprime lending and securitization:** among other things, there does not appear to be a correlation between the level of subprime activities/losses between institutions subject to the CRA and those not subject to it. Studies presented to the commission do not support the view that the CRA was a factor.
- **The single most important cause of the financial crisis is abdication of personal responsibility, abandonment of a sense of basic fair play and the glorification of self-interest** that has poisoned our culture from the individual to corporations and regulators. Very few people seem to be willing to sacrifice money or time to ensure the health of their customers, fellow citizens or the legacy that they leave personally and professionally.
- **Outsized compensation and tilted incentives shaped decisions:** at both Fannie and Citi, outsized compensation and asymmetric compensation incentives encouraged big bets. Enormous upside for short term performance, no real economic downside equivalent to that in real economy. No clawbacks. Compensation system for all along the way – from brokers to originators to securitizers to corporate management – was tilted towards origination and securitization of risky mortgage loans. Comp clearly did not reflect real results/value creation at Citi/Fannie.
- **Subprime lending was supported in significant ways by major financial institutions and financial markets:** while a significant amount of subprime lending was done by mortgage lending companies, they could not have done so without the support of warehouse lines provided by institutions like Citi, securitization markets, creation of exotic products such as mezzanine CDOs, CDO2, and CDS and purchase/guarantees by the GSEs.
- **Fannie Mae's flawed business model and risky practices led to its fall:** Fannie Mae's flawed business model – a private corporation with shareholder/profit/compensation incentives coupled with an implicit/explicit government guarantee - ultimately proved fatal. Faced with loss of market share to the Wall Street/PLS (GSE origination share dropped by 57% on 2003 to 37% in 2005), Fannie increased its risky loan activities to regain market share and to drive future earnings, while secondarily meeting affordable housing goals. Based on the data reviewed to date, it appears that Fannie followed Wall Street/PLS – rather than led – in driving the subprime lending market. Additionally, it appears that default rates for GSE loans have been lower than Wall Street/PLS mortgages with similar risk characteristics. Nonetheless, Fannie (and Freddie) was a disaster.

C. Big Thoughts/Reactions to Testimony with which Commissioner Wallison does not concur

- **Human actions vs. the perfect storm:** there seems to be little recognition by the financial sector of the link between the activities/practices in which they engaged and the crisis which those activities/practices precipitated. It is striking the extent to which all fingers point away.
- **The absence of any real consequences:** the lack of repercussions for both public and financial leaders contributed to a lack of self examination and critical analysis –they very qualities required to constrain risk in the bubble and needed to change behavior and avoid future risks and disaster.
- **No recognition of collective responsibility:** there is/was very little recognition of collective responsibility or the need to balance private actions with the sustainability of the overall system.

- **“No one saw it coming”:** the financial sector and responsible public officials ignored many warning signs in data and at the ground level. This was in no small part due to the separation of the financial sector and regulators from the real economy and communities across the nation.
- **Casino:** struck by the extent to which financial sector became a casino with enormous capital/resources/talent were devoted to financial engineering/betting of no real value to the real economy or the mortgage markets –e.g. CDOs/CDO2/synthetic CDOs, etc.
- **Cause and effect:** the effect of the crisis was to leave the financial system and its participants protected and supported while tens of millions of Americans lost their jobs, their homes, and their life savings.

Takeaways from Research and Investigation Plan on Credit Rating Agencies

As of 7/26/2010

Materials for Session 3 of July 28th FCIC Meeting

Takeaways with which the whole Working Group agreed

1. The ratings agencies (RAs) were major enablers of the issuance and purchase of toxic mortgage related securities, the failure of which contributed significantly to the financial crisis. Their ratings helped fuel the proliferation of mortgage related securities and their massive downgrades helped accelerate the downward spiral of those securities. They bear major responsibility for the crisis.
2. Ratings were vital and central to the operation of the mortgage related securities business – e.g. they were needed by issuers; they were utilized and, in some cases needed, by investors; they were used in determining regulatory capital, etc. The RAs failed in their responsibility to deliver credible ratings to the marketplace. There was a huge gap between the reliance on and competence of the ratings.
3. The status of the RAs as NRSROs, and the limitations and beneficial treatment in regulations, federal, and state laws surrounding NRSRO highly-rated securities and NRSRO rated securities more broadly, may have created moral hazard because financial institutions and other investors took the SEC designation as NRSRO as a government certification of agencies' legitimacy and the ratings' accuracy. In fact, the SEC did not do follow up examinations of the NRSROs to ensure that ratings were being accurately or appropriately assessed.

Takeaways with which Commissioner Wallison did not concur with all or some portions of the following:

1. The RAs relied on flawed models to issue deeply flawed ratings on mortgage related securities, failing to undertake any real due diligence on the assets underlying the securities and continuing to rely on those models even after it became obvious that the models were wrong. The models failed, among other things, to take into account reasonable stress scenarios as evidenced by the fact that significant downgrades begin in 3Q 2007 when national housing prices had dropped only about 4% from the peak.
2. The RAs failed to heed many red and yellow flashing lights indicating significant problems in the housing/mortgage sector. As an example, Moody's failed to heed the October 2006 analysis by Mark Zandi predicting a "crash" in the housing market in 20 major metropolitan areas. Indeed, the evidence indicates that, upon the receipt of warnings and negative information, Moody's continued accelerating its issuance of ratings on mortgage-related securities, rather than make necessary adjustments.
3. The RAs abysmally failed in their central mission – to provide quality ratings on securities for the benefit of investors. As an example, Moody's failed to provide the resources necessary to issue

quality ratings, despite record earnings and profits. It pushed ratings out the door – issuing more than 30 AAA ratings each and every working day in 2007- without adequate review and analysis. The rating agencies were not an independent party in the process.

4. The RAs placed business/profit considerations above the quality and integrity of their ratings. For example, Moody's did not provide adequate personnel or resources to do the job right, despite record profits and revenues and dramatic growth in the structured products business. They failed to say "no" to rating securities of dubious quality. They based compensation on five factors – three of which were related to market share, revenues, and marketing and admitted that the factor relating to ratings quality was not immediately measurable in a compensation system geared to annual performance. Management made it abundantly clear, in many respects, that market share was a driving goal.
5. The RAs business model was fundamentally flawed in many respects:
 - 1) an effective duopoly that assured a flow of business notwithstanding quality, pricing, etc;
 - 2) an issuer pays model that allowed issuers to place pressure on the RAs under the threat of removing business which would, in turn, marginally reduce revenues and market share;
 - 3) an inherent conflict between profit goals and the role of a gatekeeper. Ratings ended up being "AAA" to satisfy the issuer/customer.
 - 4) a set of legal protections which shielded the RAs from the consequences of their mistakes and
 - 5) the outsourcing of critical gatekeeper(and sometimes statutory) duties to a for profit entity.
 - 6) the credit rating agencies got paid when the issuance was sold, not when the issuance was rated, creating an incentive to make sure the issuance was saleable.
6. The structure of the business, largely a duopoly, created a bad environment for encouraging incisive, critical analysis. Instead, as economic theory suggests, this duopoly competed for market share by bending to the needs of issuers, not on price or the quality of the rating.
7. There was a clear failure of corporate governance and management at Moody's. The shareholders, the board, and the management failed to take the steps necessary to ensure the quality of ratings on tens of thousands of mortgage related securities – a key service/product of the company – and failed to take the management actions needed to ensure the sustainability of the company and its value. The damage to the company and its shareholders was enormous (Moody's did not protect its brand) as was the damage to the overall financial system and economy.
8. The structured finance rating committees lacked specific expertise in the housing business, the area in which they were required to be experts. There were no "boots on the ground" in housing markets. The ratings committees use theoretical analysis that did not have any connection to the market. There was not an effective iterative process whereby new information was used to enhance the models and ratings.
9. There were no clawbacks of salaries, bonuses, or fees if the ratings were wrong, which led to insufficient accountability.
10. The issuers themselves bear responsibility for the faulty ratings, given their intimate involvement in manipulating the models and intimidating the rating agencies.

11. Moody's acted to increase short-term profits by gaining market share to the detriment of its long-term viability; the marketplace eventually lost faith in their ratings.
12. Because there was more money to be made in banking, employees repeatedly left rating agencies to join investment banks. This one-way street led employees at rating agencies to be uncritical of deals issued by potential future employers.

Material for Session 5 of July 28th FCIC Meeting –

Discussion of List of Priority Institutions

M E M O R A N D U M
Financial Crisis Inquiry Commission

To: Commissioners

From: Wendy Edelberg and Ron Borzekowski

Date: July 22, 2010

Re: Institutions for Investigation by virtue of Meeting Guidelines in FCIC Statute

According to the FCIC statute, we are “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 following chart contains our recommended list of institutions to be studied pursuant to this part of the statute. This list does not predetermine whether institutions would have failed if not for the receipt of exceptional assistance per the above. The following page includes additional firms that could be considered to qualify under these criteria. Shaded firms have been studied or are in the process of being studied through case study investigations.

Summary Indicators of Selected Financial Institutions

	Assets (\$ Bil) ¹	Rank ¹	Status	Treasury Support ² (\$ Bil)
Commercial Banks				
Citigroup	1,884	1		45
Bank of America	1,464	2		45
JP Morgan Chase	1,351	3		25
Wachovia	707	4	Acquired	-
Wells Fargo	482	5		25
Investment Banks				
Morgan Stanley	1,121	1	Converted to BHC	10
Merrill Lynch	841	2	Acquired	-
Goldman Sachs	838	3	Converted to BHC	10
Lehman Brothers	503	4	Bankruptcy	-
Bear Stearns	350	5	Acquired	-
Thriffs				
Washington Mutual	345	1	Failed/Acquired	-

GSEs

Fannie Mae	844	1	Conservatorship	83.6
Freddie Mac	813	2	Conservatorship	61.3

Insurers

AIG	979	-		69.8
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1 Date of assets is as of 12/31/2006. Assets shown are for holding company. Rank is based upon the size of the firm within its industry sector. 2. Treasury support includes funds provided by TARP under the Capital Purchase Program, Automotive Industry Financing Program, Targeted Investment Program, and the AIG Investment Program or for the GSEs, using Senior Preferred Stock Purchase Agreements. Note that there were significant government assistance programs from entities other than the Treasury (for example FDIC's TLGP and various Federal Reserve programs).

Other institutions that failed or received assistance from the Treasury

The following institutions may meet the criteria in the statute either by virtue of their size, role in the financial system or their receipt of government assistance.

Commercial Banks / Thrifts

State Street

- No retail banking, but critical player in institutional markets
- \$96 billion in assets¹ ; 13th largest domestic bank holding company²
- One of two tri-party repo banks; major securities custodian; large fund operation
- Received \$2 billion in TARP funds

Bank of New York

- No retail banking, but critical player in institutional markets
- \$88 billion in assets; 14th largest domestic bank holding company
- Major securities custodian; large fund operation; large trustee operations
- Received \$3 billion in TARP funds
- Acquired Mellon Bank (\$43 b), 7/1/2007; currently over \$220 billion in assets

PNC Bank / National City Corp

- \$102 billion in assets; 15th largest domestic bank holding company
- Received \$7.6 billion from TARP; money used in acquisition of National City
- Acquired National City Corp (\$140 b), 12/31/2008;

U.S. Bancorp

- \$219 billion in assets; 6th largest domestic bank holding company
- Received \$6.6 billion from TARP

Countrywide

- Approximately \$95 billion in total thrift assets as of 3/31/2007 (after institution converted to thrift charter);
- Holding company assets of roughly \$200 billion; 2nd largest thrift after Washington Mutual
- Largest mortgage originator in the US in 2007
- Acquired by Bank of America

Indy Mac

- Government assistance: placed into conservatorship
- \$30 billion in assets; 8th ranked thrift
- Failed, July 2008

¹ Date of assets is as of 12/31/2006.

² Does not include US holding companies owned by foreign banks.

- Largest FDIC resolution as of that date.

Finance Companies / Credit Card Banks

GMAC

- Very large source of funding for auto purchases; mortgages as well
- Assets of \$287 billion as of 12/31/2006
- Received \$16.3 billion in TARP funds

CIT Group

- Specialize in financing to small, mid size and large companies including 80% of fortune 500
- Assets of \$77.5 billion at 12/31/2006
- Requested conversion to bank holding company on grounds of systemic importance
- Received \$2.3b in TARP funds
- Declared bankruptcy; first major loss of TARP funds.