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**FCIC memo of staff interview with Elise Bean and Chris Barkley,
Senate Permanent Subcommittee on Investigations (PSI)**

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See next page for additional authors

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MEMORANDUM FOR THE RECORD

Event: Interview with **Elise Bean, Chris Barkley**, staff of Senate Permanent Subcommittee on Investigations

Type of Event: Group meeting

Date of Event: Wednesday, May 5, 2010; 10:00 a.m.

Team Leader: Brad Bondi, Chris Seefer

Location: Russell Senate Office Building, Room 199, Washington, DC

Participants - Non-Commission:

- Elise Bean, staff director, PSI
- Chris Barkley, minority staff director, PSI
- Dan
- Ross Kirchner
- Allison Murphy
- Laura
- Zach
- David
- Bob

Participants - Commission:

- Brad Bondi
- Chris Seefer
- Tom Greene
- Bruce McWilliams
- Carl McCarden
- Shaista Ahmed
- Karen Dubas

MFR Prepared by: Karen Dubas

Date of MFR: May 11, 2010

MFR Reviewed by: Alexis Simendinger on November 30, 2010.

Summary of the Interview or Submission:

FCIC staff met with the staff of the Permanent Subcommittee on Investigations (PSI) to learn about the investigations that PSI has conducted in connection with their recent hearings on Wall

Street and the Financial Crisis: “The Role of High Risk Home Loans” (April 13, 2010), “The Role of Bank Regulators” (April 16, 2010), “The Role of Credit Rating Agencies” (April 23, 2010), and “The Role of Investment Banks” (April 27, 2010). FCIC staff expressed particular interest in the investigations related to the credit rating agencies (Moody’s, Standard and Poor’s, and Fitch) and the investment banks (Goldman Sachs and AIG).

If the FCIC is interested in the documents that PSI obtained during their investigations, the FCIC needs to submit a written request for “access to review and copy documents regarding the credit rating agencies and the investment banks,” and the Senate will have to pass a resolution allowing the FCIC to see the documents. Elise Bean, the PSI staff director, suggested that this would only take a few days. She cautioned that PSI will only release documents for investigations that it has closed. The FCIC will be able to obtain documents for the rating agencies, WaMu, and the banking regulators, but PSI will not provide documents related to the investment banks because they are part of an ongoing investigation. All of the documents are in Concordance format. PSI will not share their interview notes for any of the investigations per committee policy, but they may informally give FCIC a general sense of what they learned from their interviews.

PSI will eventually be issuing one massive report on all of its hearings. They weren’t sure of the timing of the report, but said that it would definitely be issued before the end of 2010.

Credit Rating Agencies

PSI primarily focused their investigation on S&P because they were more forthcoming and had better documentation than Moody’s. PSI shared their views on a number of different investigation lines that the FCIC is considering:

Is MBIA AAA? PSI thought that this would be an interesting issue and angle to investigate; they were unable to investigate the monolines due to time constraints. The staff noted that the rating agencies didn’t conduct surveillance on bonds with monoline insurance because of the protection.

Rating memoranda. PSI thought that it might be difficult to track a story through the rating memoranda because the rating agencies, especially Moody’s, kept such bad records. They called Moody’s decision-making records a “black box.”

Forensics on formulas and methodologies. To the extent that PSI investigated formulas and methodologies, they focused on S&P. PSI didn’t have the quantitative depth on its staff to investigate the assumptions and underlying equations in detail, but they encouraged the FCIC to pursue it. They were especially interested in what the FCIC might find related to correlation assumptions.

PSI did look at major model changes (related to credit enhancement) that were made in 2006, but the committee focused on why the rating agencies did not go back and re-rate securities that were issued in the previous six months under the old ratings model.

Decision-making process for mass downgrades. PSI encouraged the FCIC to try to find the people who made the decisions for the mass downgrades in July 2007 and October 2007—when PSI tried to investigate this issue, they discovered that “the memories of employees seemed to fade.” They also said that the investment banks may have been getting news about potential downgrades that other firms weren’t privy to, and they suggested that the FCIC might want to look into this issue further. PSI had heard that UBS was talking to Moody’s about the downgrades, and they suggested looking for emails between UBS and Moody’s from July 1-30, 2007.

Brian Clarkson. PSI didn’t interview Clarkson, nor did they invite him as a hearing witness. They agreed that he is an important part of the story and would be a good witness for the FCIC’s hearing.

Whistleblowers. PSI said that there were other whistleblowers beyond Kolchinsky and Michalek, but that the FCIC will need to get the Senate approval for its request for access before PSI can provide that information.

“Victims Panel.” PSI didn’t have time to look for investors or municipalities who relied heavily on ratings to make their investment decisions. They suggested that the FCIC might want to find out which senior employee from TIAA-CREF made the statement that “if it’s AAA, it’s good enough for me.” PSI also agreed that IKB and ACA would not make very sympathetic victims.

Governance and the Board. PSI didn’t look at this issue, and they acknowledged that no one has held any board members responsible yet.

Collusion between rating agencies. PSI staff were emphatic that there would not have been any collusion between the rating agencies because they strongly disliked each other. They described the identical timing of the mass downgrades as a “prisoner’s game” between the rating agencies.

Even though the agencies had completely different rating models, both of the agencies knew that the ratings wouldn’t hold. They also knew that once the securities were downgraded, their business would slow down, so they waited for the other agency to act. The day before the mass downgrades in July, the rating agencies put out a huge amount of deals—the third highest volume in the past six months. PSI interpreted that action as the rating agencies wanting to get as much revenue as possible before the downgrades.

Miscellaneous issues to consider. Does an AAA rating have a different meaning for traditional bonds versus structured finance? How long is a rating good for (*e.g.* does AAA last for the life of a security)?

Investment Banks

PSI’s investigations of Goldman Sachs and AIG are still ongoing, so they cannot provide investment bank documents to the FCIC. At the discretion of the Chairman and the Ranking

Member, PSI staff may be able to elaborate on materials that have already been released to the public. If the FCIC wants to obtain copies of the subpoenas that PSI has served to the investment banks, it will be more expeditious to get these letters directly from the entity to whom they were served.

Regulators

PSI only investigated the regulators of Washington Mutual.

Other FCIC Lines of Investigation

Compensation. PSI thought that a hearing that focused exclusively on compensation would be interesting, and they said that PSI has looked at this issue extensively over the past two decades. They suggested that the best resources would be the Corporate Library and a group of compensation experts at Harvard (lead by Bebchuk).

Government Housing Policy. PSI said that WaMu used the affordable housing policy as an excuse to give out bad loans, but that it wasn't the driver of such behavior. PSI said that document review suggested that the driver of the bad loans was profits and revenue. PSI also noted that across the different subprime lenders, there was a commoditization of conforming loans, which drove yields down and forced lenders to either sell more conforming loans to account for the smaller margin or to go into riskier loans, like interest-only.

Fannie Mae and Freddie Mac. PSI has an open investigation into the GSEs and cannot provide the FCIC with documents.