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### Draft Agenda for Business Meeting of the FCIC on 9-14-2010

Gretchen Kinney Newsom

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**Agenda for Financial Crisis Inquiry Commission Telephonic Business Meeting of  
Tuesday September 14, 2010**

**12:00-1:30pm EST**

**Conference Dial-In Number: 866-692-3582**

**Participant Access Code: 3387529**

Leader: 4459479

**START RECORDING**

<u>Agenda Item</u>	<u>Presentation</u>
1) Call to Order	Chairman Angelides
2) Roll Call	Chairman Angelides
oPhil Angelides oBill Thomas oBrooksley Born oByron Georgiou X Bob Graham - Keith Hennessey ( <i>joined midway through Agenda Item 10</i> ) X Doug Holtz-Eakin oHeather Murren oJohn W. Thompson oPeter Wallison	
Wendy, Gary, Scott, Gretchen, Shaista; Mina Simhai joined the meeting during Agenda Item 10 (referral to Justice)	
3) Approval of Minutes of Telephonic Business Meeting of August 17, 2010 (Attached)	Chairman Angelides
Questions/Comments – Born/Wallison 7-0 Passed	
4) Chairman’s and Vice Chairman’s Report	Chairman Angelides and Vice-Chairman Thomas

**Phil: Initial drafts of reports forthcoming. Field hearings. Wrap up on investigations and research.**

**Bill: focus on tasks at hand – prioritize.  
(re-listen to this section)**

**5) Executive Director’s Report Wendy Edelberg, Executive Director**

**Combine 5&6. Website designer engaged and moving forward. Getting organized in terms of archiving. Report – we have hired a senior editor – highly recommended by agents and publisher – Mike Bryan – involved in more than 25 books (co-authored, ghost written, comes in at the end). Moving to DC in a couple of days. How we are organizing task – writers devoted to each section. Section A – about how the crisis has affected human beings (Kirsten Downey); section 1 – prelude to the crisis – Steven Mintz – will be delivered to the Commission by this Friday; Section 2 being worked on – at least 10-14 days away – but making progress – Housing Bubble/Crisis; Section 3 – two subsection; how bubble burst) 1) up to collapse of Bear and 2) what happens after Bear collapses – will get first half to Commission by early next week. Part 4 – Alexis Simendinger – forthcoming. PA – Wendy to issue estimated schedule of production/review to Commission today, including Section A. (Section A after the field hearings have concluded).**

**6) Update on the Report Wendy Edelberg, Executive Director**

**7) Upcoming September 28-29 Meeting Chairman Angelides and Vice-Chairman Thomas**

**PA/BT will talk re: this meeting soon. Nothing specific. Thoughts on most productive way to approach it. BT: made some progress at last face to face meeting. Will have some substance that they can examine – must be more substantive. We still have a rosy attitude – silence is not agreement – needs to be realistic on if we can move this together. Third party comments? Not an academic/economic document, but a political document. WE: get input on seminal events. JWT with Bill – doesn’t understand how it would change overall tone of what we do. Time better spent dialoguing amongst ourselves. PA – not consume our time – staff ought to have ability to do some fact checking for our report – not making any whoppers/mistakes/glaring omission. PA – Wendy needs to limit this – check facts, not gather opinions. BT: doesn’t care – shouldn’t hold itself to middle of the road economists – difficult to understand value of their input (*threatened consensus*)**

**8) Field Hearings – Overview of Bakersfield and Las Vegas; and upcoming hearings in Miami and Sacramento Chairman Angelides, Vice Chairman Thomas, Commissioners Murren, Georgiou, and Graham**

**BT: Interesting. Reinforced with Las Vegas hearing – outrageous behavior and attitude on part of lenders. Repeated story of homeowners trying to circumvent the system and lots of confusion. Didn’t make economic sense.**

**HM: echo BT – if there is a way we could bring out/illuminate the issue many people are having – which is prolonging the crisis – mortgage modification and resolution – worth for Commission to take action. PA – Wendy – this issue should be dealt with in Chapter 4 – ability to modify. Also, in Section 2 – the inability early on to modify mortgages that might have pushed more toward foreclosure.**

**BG: most striking testimony – last panel – (*his panel*) – impact on local government and services.**

**HM: ask for action on mortgage modification process**

**PA: book will be best venue to take actions/recommendation**

**PA: TY to BT/HM/BG re: work on hearings.**

- 9) Approval of Extension to Execute Agreements and Contracts on behalf of the Financial Crisis Inquiry Commission**  
*(Attached)* **Gary Cohen, General Counsel**

**Motion: Murren; 2<sup>nd</sup> by Born. Passes. 7-0**

- 10) Referral to Justice Memo**  
*(Attached)* **Gary Cohen, General Counsel**

**Gary Cohen – as stated in the memo. Refer criminal activity to Attorney General. 7 items laid out in this memo, many of which are subject to investigations by SEC, etc. If commission asks us to move forward – staff to compile evidence (documents, transcripts, etc) and send over to DOJ with cover letter – not excruciating detail – not making case for prosecution – if discover new facts/docs – here you are – provided to DOJ and let them make decision on what to do with it. PA: referral only, not a recommendation.**

**PA: this memo should be sufficient and accompanied by list of documents.**

**PW: will our referral be confidential? We will not announce that we referred anything? Not authorized to state that we referred matters to the justice department.**

**PA: yes – confidential.**

**BT: what were dates on each item?**

**GC: earliest was Citi. Latest is Clayont due diligence.**

**BT: why haven't we transmitted this earlier? Why now? Just doesn't understand the timing. Lots of concerns re: timing and leaks. Not the right timing.**

**PA: doesn't see this as political.**

**BB: preferred immediate action as data come in but happy to go forward now. Doesn't see political implications of this matter. But keep this confidential.**

**BT: didn't intend to place a political pitch on this ; is this perishable product?**

**\*\*\*Keith Hennessey joins the call\*\*\***

**GC:** would require a week of staff time. Chris now freed up to devote some time to this. Tom Greene. Doesn't require that much time – and need to do this while there is still FCIC staff.

**JWT:** moved by notion that is consistent with statute – move ahead. Facts are facts.

**HM:** How useful do you think this will be to other agencies working on these investigations?

**GC:** can't address that – no idea what stage their investigations are up to.

**HM:** if there is a possibility of it being helpful – we should do what we can to be helpful and provide what they may not already have.

**PW:** have heard that SEC is doing an investigation of Fannie/Freddie for not reporting quality of mortgages. Why isn't that in this memo? What have we found in this matter. We do mention in this memo that SEC is looking at Fannie inflating assets. **PA: staff should look into this matter and report back on it.**

**BB:** but that doesn't detract from the memo at hand.

**PW:** cover memo should NOT specify that we believe a violation of law occurred. Not recommend any type of legal action.

**BT:** why not wait to see if staff have additions to this re: PW's item – wait a week.

**BB:** my comments had nothing to do with when staff dispatched docs to DOJ – Commission doesn't need to wait.

**BT:** based on Brooksley's comments – approve 7 items before us – include amendment if necessary re: PW's item – PA: if 8<sup>th</sup> item – come back to us.

**Motion to approve 7 items and look at 8<sup>th</sup> item (or more), return to Commission on 8<sup>th</sup> item at which point it can move forward as a 7 item + package.**

**Keith:** if we approve this motion and at some point we forward to Justice, Commission members are going to need to explain what they voted for and why – respond to questions and responses from various accused parties...PA: strong belief of Commissioners – this is all confidential – before and after the report.

**BB:** we have gotten info on all these things previously (except Clayton holdings)

**Keith:** civil and penal statutes – still uncomfortable making this decision without being able to ask staff questions. Bill's point good one – despite efforts to have this remain confidential – it will become public – and will color how work will be perceived.

**PA:** entertain motion to move forward as discussed. OR if discomfort is temporal – we could take this up from resolution at 9/28 meeting OR utter discomfort moving forward.

**Bill:** if we waited since April – take week or so to see if there is an addition to the package. Keith – that would allow me enough time to question staff – also review one by one. HM/BB/JWT: week extension fine. BG motion to continue matter on 28<sup>th</sup> or 29<sup>th</sup>. All in favor. 8-0. **Agenda for meeting on the 28<sup>th</sup> and 29<sup>th</sup>**

**WE: set up meeting with various staffer – but send us your questions via email in advance to Gary (referral in subject line). Will examine Peter's question.**

**from Commissioners**

**None.**

**12) Other Items of Business**

**All Commissioners**

**None.**

**13) Adjournment**

**Chairman Angelides**

Motion to adjourn by Byron; second by murren. 1:30pm 8-0.



**Financial Crisis Inquiry Commission**  
**Agenda Item 3 for Telephonic Business Meeting of September 14, 2010**  
**Minutes of Telephonic Business Meeting of**  
**August 17, 2010**

**Agenda Item 1: Call to Order**

Chairman Angelides called the telephonic business meeting to order at 12:05pm EST.

**Agenda Item 2: Roll Call**

Chairman Angelides asked Gretchen Newsom to call the roll of the Commissioners. Present were Phil Angelides, Bill Thomas, Brooksley Born, Byron Georgiou, Bob Graham, Keith Hennessey, Doug Holtz-Eakin, and John W. Thompson. Commissioner Wallison joined the call midway into Agenda Item 4 and Commissioner Murren joined midway through Agenda Item 7.

Also participating in the meeting were: Wendy Edelberg, Executive Director; Gary Cohen, General Counsel; Gretchen Newsom, assistant to Chairman Angelides; and Scott Ganz, assistant to Vice Chairman Thomas.

**Agenda Item 3: Approval of Minutes of Meeting, July 13, 2010**

Chairman Angelides introduced the minutes from the FCIC meeting of July 13, 2010. Commissioner Hennessey asked for a revision to the minutes: at the end of the section for Agenda Item 6, insert before the last sentence: "Commissioner Hennessey described a possible alternate structure for the report."

MOTION: Holtz-Eakin moved and Thompson seconded a motion to adopt the meeting minutes (attached) and the insertion requested by Commissioner Hennessey subject to verification by staff.

APPROVED: 8-0 (Commissioners Wallison and Murren absent; Commissioner Georgiou abstained as he was not present at the July 13<sup>th</sup> meeting.

**Agenda Item 4: Chairman's and Vice Chairman's Report**

Chairman Angelides and Vice Chairman Thomas briefed the Commissioners on the selection of Little Brown as publisher of the official report of the Commission. The Commission was informed during the last retreat (July 28<sup>th</sup> and 29<sup>th</sup>) of the process for selecting a publisher and

the use of literary agents. The literary agents proposed two finalist candidates for publisher and the Chairman and Vice Chairman mutually agreed upon Little Brown. This publisher particularly excelled in the field of e-books. Chairman Angelides noted that the financial terms of the agreement have not yet been made public and a formal contract has not been executed.

Chairman Angelides and Vice Chairman Thomas then spoke broadly about the different facets of the report: a physical book/report; an e-book with hyperlinks to expanded material and sources; and a virtual library of documents, interviews, video clips, etc. for review by scholars, reporters, and other interested parties. Discussion ensued on how to construct a user friendly electronic library.

Chairman Angelides advised the Commissioners that the forthcoming hearing on “Too Big to Fail” (September 1<sup>st</sup>) might be split into two days but would maintain the same amount of time for Commissioner deliberations during the upcoming retreat (September 2<sup>nd</sup> and 3<sup>rd</sup>). The Commissioners will focus on areas of agreement and disagreement with the aim to help guide on the writing of the report.

#### **Agenda Item 5: Executive Director’s Report**

Executive Director Wendy Edelberg informed the Commissioners that Congress has approved an additional appropriation to the Commission in the amount of \$1.8 billion. This appropriation will be used to hire additional staff, conduct additional document review, and provide additional resources to the staff. Edelberg also updated the Commission on the hiring of additional writers and reporters.

#### **Agenda Item 6: Update on the Report**

Executive Director Wendy Edelberg briefed the Commission on the progress being made on the report and noted that internal deadlines are in place to ensure the Commissioners receive a high quality product for their review in September.

#### **Agenda Item 7: Upcoming September 2-3 Meeting**

Chairman Angelides and Vice Chairman Thomas led a broad discussion on what outcomes the Commissioners wish to see from the September 2<sup>nd</sup> and 3<sup>rd</sup> retreat meetings. There was general agreement that the Commissioners would focus on major issues that need agreement wherein disagreement might lie and that the Commissioners would prioritize these issues by importance to the final product.

#### **Agenda Item 8: Approval of Continuation of Designation Of Commissioners as Special Government Employees**

General Counsel Gary Cohen introduced the resolution to continue the designation of Commissioners as Special Government Employees. He noted that some Commissioners may have exceeded the maximum number of days worked as special government employees, but this does not disqualify Commissioners from continuing as special government employees as our Commission terminates in February and Commissioners are highly unlikely to exceed the 130 day maximum.



MOTION: Born moved and Holtz-Eakin seconded a motion to adopt the delegation of continuation of Commissioners as Special Government Employees.

APPROVED: 10-0

### **Agenda Item 9: Revised Future Meeting Schedule**

Chairman Angelides and Vice Chairman Thomas introduced the revised meeting schedule. Commissioners did not raise questions or objections.

### **Agenda Item 10: Comments and Questions from Commissioners**

Commissioner Thompson raised concerns in regard to the recent electronic communications among Gary Cohen, Chairman Angelides and Commissioner Wallison concerning Mr. Cohen's opinion that Commissioner Wallison had violated the Ethics Guidelines for Commissioners by providing an internal staff memo to Mr. Edward Pinto. Commissioners Georgiou, Born, and Murren also expressed concerns regarding the actions taken by Commissioner Wallison. Chairman Angelides reaffirmed that Commissioners must operate by the Commission's adopted procedures for release of information and/or documents to the public. Cohen pointed out that the Ethics Guidelines for Commissioners require that the Chair or the full Commission agree to the release of confidential information, and various Confidentiality Agreements to which the Commission is a party require that either the Chair and the Vice Chair, or the full Commission, agree to the release of such information. No staff products or other confidential information are to be released without compliance with these procedures. Cohen also informed that Commissioners that he has reached out to Mr. Pinto who has agreed not to share this document with anyone, and that he has provided a Confidentiality Agreement to Mr. Pinto. Commissioner Wallison announced he understood the Commission's policies and will comply in the future.

### **Agenda Item 11: Other Items of Business**

No other items of business were brought up by the Commissioners.

### **Agenda Item 12: Adjournment**

Chairman Angelides requested a motion to adjourn the meeting.

MOTION: Thompson moved and Georgiou seconded a motion to adjourn the meeting.

APPROVED: 10-0



**Financial Crisis Inquiry Commission**  
**Agenda Item 3 for Telephonic Business Meeting of September 14, 2010**  
**Minutes of Telephonic Business Meeting of**  
**August 17, 2010**

**ATTACHMENT**  
**Approved Minutes of Telephonic Business Meeting of**  
**July 13, 2010**

**Agenda Item 1: Call to Order**

Chairman Angelides called the telephonic business meeting to order at 12:04pm EST.

**Agenda Item 2: Roll Call**

Chairman Angelides asked Gretchen Newsom to call the roll of the Commissioners. Present were Phil Angelides, Bill Thomas, Brooksley Born, Byron Georgiou, Keith Hennessey, Heather Murren, and Peter Wallison. Commissioner John W. Thompson joined the call midway into Agenda Item 4. Commissioners Bob Graham and Douglas Holtz-Eakin were absent.

Also participating in the meeting were: Wendy Edelberg, Executive Director; Gary Cohen, General Counsel; Gretchen Newsom, assistant to Chairman Angelides; Scott Ganz, assistant to Vice Chairman Thomas; and Shaista Ahmed, assistant to Wendy Edelberg.

**Agenda Item 3: Approval of Minutes of Meeting, June 15, 2010**

Chairman Angelides introduced the minutes from the FCIC meeting of June 15, 2010.

**MOTION:** Born moved and Murren seconded a motion to adopt the meeting minutes (attached) and addenda (attached – see PDF file) with the correction of a typo.

**APPROVED:** 6-0 (Commissioners Thompson, Graham and Holtz-Eakin absent; Commissioner Georgiou abstained as he was not present at the June 15<sup>th</sup> meeting).

**Agenda Item 4: Chairman's and Vice Chairman's Report**

Chairman Angelides and Vice Chairman Thomas briefed the Commissioners on the upcoming field hearings in Bakersfield, Las Vegas, Miami, and Sacramento. Staff will provide

Commissioners dates and locations for these hearings. The subject matter of these hearings will be customized to each region and determined by the host Commissioner(s).

#### **Agenda Item 5: Executive Director's Report**

Executive Director Wendy Edelberg spoke briefly in regard to the upcoming Commissioner retreat in July. In addition to discussing a draft section of the report at the retreat, Edelberg will review with the Commission the takeaways from each working group and a list of institutions to be investigated by FCIC staff.

#### **Agenda Item 6: Update on the Report**

Wendy Edelberg informed the Commission that the writing of the draft report is behind schedule, but staff is making great progress. Section IV of the report will be sent forth shortly for review by the Commission and for discussion at the retreat. It was acknowledged that the Chairman and Vice Chairman would have more time to review and have greater input on subsequent draft sections of the report. Edelberg informed the Commission that she is looking to strengthen the team of writers to supplement current skill sets on staff.

Commissioner Hennessey inquired about a reconciliation process for approval of language that does not meet unanimous concurrence for incorporation into the report. Chairman Angelides noted that based on the Commission's discussion in June, the Commission would proceed to work hard to resolve differences short of casting votes, and if and when a dispute mechanism was needed, we could put this into place during our September Commission meetings. A variety of dispute mechanisms were discussed, as well as Section IX-C of the Commission's Rules of Procedure. The Chairman will conference with the Vice Chairman on this matter and will return to the Commission.

Discussion ensued on the general structure and outline of the report. "Commissioner Hennessey described a possible alternate structure for the report."

#### **Agenda Item 7: Comments and Questions**

Commissioner Georgiou inquired about the status of the Commission being granted a supplement to our original funding amount. Chairman Angelides informed the Commission that there appears to be progress as \$1.8 million has been incorporated for the FCIC in the Senate version of the war supplemental bill.

Commissioner Georgiou inquired about the status of the multi-media production of the report. Chairman Angelides informed the Commission that a literary agent has been retained and will set up meetings with potential publishers, and electronic media/e-book capabilities will be discussed with publishers.

#### **Agenda Item 8: Report to Commission re: Legislative and Regulatory Update**

Mr. Ganz presented the Commission with an update on legislative and regulatory matters.

**Agenda Item 9: Other Items of Business**

No other items of business were brought up by the Commissioners.

**Agenda Item 10: Adjournment**

Chairman Angelides requested a motion to adjourn the meeting.

MOTION: Georgiou moved and Born seconded a motion to adjourn the meeting.

APPROVED: 8-0 (Commissioners Graham and Holtz-Eakin absent)

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**Financial Crisis Inquiry Commission  
Agenda Item 3 for Telephonic Business Meeting of September 14, 2010  
Minutes of Telephonic Business Meeting of  
August 17, 2010**

**ATTACHMENT  
Approved Continuation of Designation Of Commissioners as  
Special Government Employees**

FROM: Gary Cohen  
TO: All Commissioners  
DATE: August 9, 2010  
RE: Memo re Special Government Employees

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It is time to renew the Commission's determination that the Commissioners are special Government employees.

On August 19, 2009, the Commission resolved by a vote of 10 to 0 as follows (Graham moved and Holtz-Eakin seconded) as follows:

Whereas, the Commission estimates that no appointed Commissioners of this Commission are expected to perform temporary duties for more than 130 days during the next 365 calendar days; and

Whereas, the Commission expects to hire additional employees to serve as fulltime staff handling the daily operations of the Commission;

I move that all appointed Commissioners of this Commission are hereby designated "special government employees" under 18 U.S.C. § 202(a) for the period of August 19, 2009 to August 18, 2010, and to authorize the Chair and Vice-Chair to notify the Committee on Standards of Official Conduct of such designation in writing.

I recommend that the Commission adopt a new Resolution to the same effect for the period commencing at the end of the prior special Government employee resolution in the form attached. I believe that status as a special Government employee for the period August 19, 2010 to August 18, 2011 is available to the Commissioners despite the fact that some may have exceeded 130 days of service to the Commission for the period August 19, 2009 to August 18, 2010.

By way of background, 18 U.S.C. § 202(a) provides:

For the purpose of sections 203, 205, 207, 208, and 209 of this title the term "special Government employee" shall mean an officer or employee of the executive or legislative branch of the United States Government, of any independent agency of the United States or of the District of Columbia, who is retained, designated, appointed, or employed to perform, with or without compensation, for not to exceed one hundred and thirty days during any period of three hundred and sixty-five consecutive days, temporary duties either on a full-time or intermittent basis...

The special Government employee category was created by Congress as a way to apply an important, but limited set of conflict of interest requirements to a group of individuals who provide important, but limited, services to the Government.

The Office of Government Ethics (OGE) has issued a report, Conflict Of Interest And The Special Government Employee, A Summary Of Ethical Requirements Applicable To SGEs, which notes:

The determination of SGE status must be made prospectively, at the time the individual is appointed or retained. Employees should be designated as SGEs only where the agency makes an advance estimate of the number of days the employee is expected to serve during the ensuing 365-day period. This is done so that employees are on notice with respect to the rules that will apply to them. As the Office of Legal Counsel has stated, "as a general matter, employees are presumed to be regular government employees unless their appointing Department is comfortable with making an estimate that the employee will be needed to serve 130 days or less." 7 Op. O.L.C. 123, 126 (1983)(emphasis added). If an agency designates an employee as an SGE, based on a good faith estimate, but the employee unexpectedly serves more than 130 days during the ensuing 365-day period, the individual still will be deemed an SGE for the remainder of that period. However, upon the commencement of the next 365-day period, the agency should reevaluate whether the employee is correctly designated as an SGE, i.e., expected to serve no more than 130 days. Indeed, any time an SGE serves beyond one year, the agency should perform a new estimate of the expected number of days of service for the next 365-day period; this is true whether the employee is actually reappointed for a new one-year term, which is the ordinary procedure, or is merely completing an indefinite or multiyear term. See, e.g., OGE Informal Advisory Letter 81 x 24.

Thus, as long as the resolution by which the Commissioners were designated "special Government employees" under 18 U.S.C. § 202(a) for the prior year, and for the upcoming year, was, and is, adopted based on a good faith estimate of the time expected to be involved by the Commissioners, it is my view that status as a special Governmental Employee for the upcoming

365 day period will be available to the Commissioners regardless of how much time Commissioners worked in the prior 365 day period. (Blake Chisam, Staff Director and Chief Counsel of the House Committee on Standards of Official Conduct, joins me in this view). Since the Commission's report is due on December 15, 2010 (four months away), the determination for the Commissioners' continued status as a special Government employee for the upcoming 365 day period should be straightforward.

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### **Proposed Resolution for Continued Status as Special Government Employees**

WHEREAS, the Commission estimates that no appointed Commissioners of this Commission are expected to perform temporary duties for more than 130 days during the next 365 calendar days; and

WHEREAS, the Commission expects to hire additional employees to serve as fulltime staff handling the daily operations of the Commission;

NOW THEREFORE, BE IT RESOLVED THAT: all appointed Commissioners of this Commission are hereby designated "special government employees" under 18 U.S.C. § 202(a) for the period of August 19, 2010 to August 18, 2011,

AND BE IT RESOLVED THAT, that the Chair and Vice-Chair shall notify the Committee on Standards of Official Conduct of such designation in writing.



**Financial Crisis Inquiry Commission**  
**Agenda Item 9 for Telephonic Business Meeting of September 14, 2010**

**Delegation to execute agreements and contracts  
on behalf of the Financial Crisis Inquiry Commission**

Pursuant to the authority set forth in Public Law 110-21(d)(3) that allows the Financial Crisis Inquiry Commission to enter into contracts to enable the Commission to conduct its business; and,

Now, pursuant to the unanimous written consent provisions of the Commission's [adopted](#) procedures, it is:

Hereby delegated to the Chairman of the Commission the authority to enter into agreements on behalf of the Financial Crisis Inquiry Commission in order to facilitate the work of the Commission. This delegation is effective until termination of the Commission, unless revoked earlier.

The Chairman may delegate this authority to the Vice-Chairman in order to expedite the business of the Commission. If the Chairman does delegate to the Vice-Chairman, the delegation shall remain in effect until termination of the Commission, unless revoked earlier.

In addition, any actions taken by the Chairman and the Vice-Chairman in order to establish the Commission, and agreements signed by the Chairman or the Vice-Chairman, are hereby ratified by the Commission.





**Financial Crisis Inquiry Commission**  
**Agenda Item 10 for Telephonic Business Meeting of September 14, 2010**  
**Confidential Referral Memorandum**

FROM: Financial Crisis Inquiry Commission Legal Staff

TO: Commissioners of the Financial Crisis Inquiry Commission

Cc: Wendy Edelberg

DATE: September 12, 2010

RE: Confidential Referral Memorandum

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Pursuant to section 5(c) (4) of the Fraud Enforcement and Recovery Act of 2009, one function of the Financial Crisis Inquiry Commission is to:

refer to the Attorney General of the United States and any State attorney general any person that the Commission finds may have violated the laws of the United States in relation to such crisis.

Although FCIC staff has been primarily focused on our overall mission of examining and reporting to Congress, the President and the American people on the causes of the financial crisis, our inquiry has nonetheless generated information that the Commission should consider referring to the Department of Justice. Because FCIC staff has focused on understanding the causes of the financial crisis, rather than developing cases for prosecution, all of the referral matters will require further investigation by the Department of Justice. Nonetheless, the matters presented below constitute serious indications of violation of a number of laws.

At a meeting of the Commissioners held on May 18, 2010, a process for referrals was presented to the Commissioners for consideration and review. Further to that process, this memorandum describes certain items FCIC staff believes meet the standards of our enabling statute and therefore should be considered by the Commission for potential referral. This is not a full elaboration of the matters, but rather highlights possible items, and is based on conversations with senior Commission investigators. We also note that our statute does not limit our referrals to only criminal matters, thus we have broadly interpreted the statutory provision.

It is the staff's recommendation that these items be delegated to Commission investigators for preparation of a referral memorandum on each subject (which memorandum will be based on investigations already completed by the Commission staff) for presentation to the Attorney General.

Our plan, should the Commission determine to proceed, would be to send a letter to Attorney General Holder which will include detailed summaries for each of the matters with appropriate attachments such as e-mails, other documents and interview transcripts.

Although there is no established template for referrals, we have typically seen packages from investigative agencies seeking criminal prosecutions or civil enforcement filings that consist of: (1) a referral memo containing an overview of the investigation (why started, what investigative steps, comments about motivations and credibility of witnesses) and an analysis of the facts and law that indicate that there may be a violation; (2) reports of investigative interviews prepared by investigators (similar to our MFRs) and (3) any reports, documents or other evidence that might support the proposed referral. As to (2), in the event that we have recordings or transcripts, it would be appropriate to include these in the referral package.

We well understand that some of these matters are under investigation by federal agencies and departments; may have been the subject of investigations, or may have been resolved in whole or in part, e.g., the SEC's recent settlement with Citigroup and Goldman Sachs. However, since the Commission is not privy to the full record of these investigations( for example, the FCIC has not been given access to information about on-going criminal investigations), and our statute does not provide a carve-out for matters that may be under investigation by others, we nonetheless recommend consideration of referrals based on our inquiry as follows:

**1. Potential Fraud: False and Misleading Representations about Loan Underwriting Standards by UBS and Other Issuers**

UBS, like a number of other financial institutions, used Clayton Holdings to assess the quality of the mortgages it was purchasing for resale in the form of Residential Mortgage-Backed Securities (RMBS). Typically UBS, or the other financial institutions, bid on packages consisting of a thousand or more mortgages from originators like Countrywide or Fremont.

From these large pools of mortgages, UBS would require Clayton Holdings to examine 5% to 10% of the mortgage pool to ascertain whether the mortgages met underwriting guidelines. In its RMBS offering documents, UBS disclosed its loan underwriting standards used in making the loans. These disclosures were designed to assure the prospective investor that the mortgages were of high quality and reasonably secure. However, after five or more pages explaining these criteria, UBS would state—typically in a single sentence--that *some number* of the mortgages constituting the pool for its RMBS did not meet these criteria.

UBS did not disclose that the number of loans sampled by Clayton that did not meet UBS's underwriting standards was substantial. For example, in 1Q07, 62% of the loans sampled by Clayton did not meet UBS's underwriting standards, an unusually high failure rate. But UBS waived enough of these failures to result in a failure rate of a little more than 10%. To protect itself from possible liability, Clayton kept records of the re-marked mortgages, noting them as 2-

W's, that is, mortgages that were upgraded from failing to meet underwriting standards to meeting these standards based on a waiver of the underwriting criteria by UBS.

While our investigative record is not as complete for other companies, we have received documents from Clayton that disclose loans to be acquired by the following companies had substantial failure rates—that is rates at which samples of loans did not meet established underwriting criteria-- in the full year of 2006 and the first half of 2007. However, in order to get to even these numbers, companies waived their established underwriting criteria:

<b><u>Company</u></b>	<b><u>Total Loans Sampled</u></b>	<b><u>Waiver Rate<sup>1</sup></u></b>	<b><u>Final Failure Rate<sup>2</sup></u></b>
Credit Suisse	56,306	33%	21%
Citigroup	6,205	31%	29%
Freddie Mac	2,985	60%	14%
Goldman	111,999	29%	16%
JPMorgan	23,668	51%	13%
Lehman	70,137	37%	16%
Merrill	55,529	32%	16%
Societe Generale	4,781	33%	31%
UBS	27,618	33%	13%
WaMu	35,008	29%	19% <sup>3</sup>

The large percentage of mortgages in significant samples that did not meet initial underwriting standards appears to be material because there is “a substantial likelihood that the disclosure [of this information] would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”<sup>4</sup> Specifically, one would assume that the fact that a significant percentage of mortgages in a sample of a population of mortgages being packaged into an RMBS failed to meet underwriting criteria would be useful in predicting the performance of the RMBS. The failure to disclose this information potentially violates both the 1933 and 1934 Securities Acts. In addition, depending on the means of communications employed, material omissions may also constitute mail fraud or wire fraud.

## **2. Potential Accounting Fraud and False Certifications: Fannie Mae**

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<sup>1</sup> To achieve the final failure rate.

<sup>2</sup> After waivers.

<sup>3</sup> All Clayton Trending Reports, 1<sup>st</sup> Quarter 2006 – 2<sup>nd</sup> Quarter 2007

<sup>4</sup> *Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988).

A March 8, 2008 e-mail from a White House economic analyst Jason Thomas to Undersecretary of the Treasury for Domestic Finance Robert Steel attached a report that stated:

Any realistic assessment of Fannie Mae's capital position would show the company is currently insolvent. Accounting fraud has resulted in several asset categories (non-agency securities, deferred tax assets, low income partnership investment) being overstated, while the guarantee liability is understated. These accounting shenanigans add up to billions of exaggerated net worth.

Subsequent findings by the Federal Housing Finance Agency ("FHFA"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Reserve all indicate, (during 2007 and 2008), that Fannie Mae may have overstated assets, earnings and capital through various accounting improprieties. FHFA detailed the overuse of historic losses against potential gains as part of the firm's capital.<sup>5</sup> It also found that liabilities had increased dramatically, to the point that the firm was found to be "in an unsafe or unsound condition to transact business."<sup>6</sup>

The OCC found that Fannie was not fully recognizing losses associated with its HomeSaver program.<sup>7</sup> It also criticized Fannie for using 2003 loss data to estimate then-current market values of its portfolio of subprime securities. We understand that allegations of inflating assets and understating liabilities are currently under investigation by the Securities and Exchange Commission and the U.S. Department of Justice.

Failure to accurately report financial results could violate a number of securities laws, including sections 11 and 12 of the 1933 Act and section 10b-5 of the 1934 Act. During 2008, Fannie raised new capital. As a consequence, it may have also violated section 11 of the 1933 Act. However, it should be noted that the company's auditors, Deloitte and Touche LLP, signed off on its 2007 financial statements, and that Fannie has still not restated its financial statements for that year. The possibility of accounting improprieties was cited in the FCIC's draft preliminary Fannie Mae investigative report as a matter warranting further investigation.<sup>8</sup>

FHFA's memorandum supporting conservatorship also provides details about long-time failures of risk management at Fannie Mae. The memorandum notes that prior government assessments, not provided to the markets, repeatedly warned of significant, systemic risk management problems going back at least to 2005.<sup>9</sup>

This suggests two potential legal violations. The first is a failure to disclose accurate information about the state of risk management at Fannie Mae. Assuming this information is material, this is a violation of 10b-5 of the 1934 Act.

Second, as with any other publicly traded company, the CEO and CFO of Fannie Mae certified the firm's annual and quarterly financial statements as disclosing all material information under

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<sup>5</sup> Memorandum from Christopher Dickerson, Acting Deputy Director, Division of Enterprise Regulation to James B. Lockhart, Director, Federal Home Finance Agency, September 6, 2008, re: Proposed Appointment of the Federal Housing Finance Agency as Conservator for the Federal National Mortgage Association at 19. (hereinafter "Conservator Memo").

<sup>6</sup> Conservator Memo at 21.

<sup>7</sup> OCC5-00076169, Office of the Comptroller of the Currency, Observations-Allowance Process and Methodology at 2.

<sup>8</sup> FCIC, Preliminary Draft Investigative Findings on Fannie Mae, March 31, 2010, at 57.

<sup>9</sup> Conservator's Memo at 6 (2005 condition), 8 (2006 condition), 11 (2007 condition) and 13-15 (2008 condition).

section 302 of the Sarbanes-Oxley Act. These certifications presume that the CEO and CFO have reviewed and put in place adequate risk management systems.

**3. Moody's Appears to Have Made Selective Disclosures of Imminent Ratings Downgrades; UBS and Possibly Other Recipients of this Information Fail to Disclose Upcoming Downgrades to Purchasers of Their Securities**

Downgrades of ratings on mortgage-based securities led to drops in their market value. Internal e-mails between UBS Investment Bank executives indicate that UBS—and possibly other investment banks--received advance notice of potential downgrades by Moody's. In a July 5, 2007 e-mail from David Goldstein to Dayna Corlito, the MBS/ABS Manager of UBS, captioned "ABS Subprime & Moody's downgrades," Goldstein writes (emphasis added):

I just got off the phone with David Oman...Apparently they're meeting w/Moody's to discuss impacts of ABS subprime downgrades, etc. Has he been in touch with the Desk?

It sounds like Moody's is trying to figure out when to start downgrading, and how much damage they're going to cause—**they're meeting with various investment banks**

David<sup>10</sup>

Five days later on July 10, 2007, Moody's downgraded 299 CDOs; the market value of these securities immediately dropped.

UBS is alleged to have sold three of its soon to be de-rated CDOs to Pursuit Partners, a hedge fund. In a Connecticut state court action, Pursuit has claimed that UBS violated *state* law by continuing to sell these CDOs knowing they were about to be de-rated, which it knew would drastically reduce their value. In a 2009 trial court decision, UBS was ordered to set aside \$35 million because the judge found probable cause that the plaintiff would prevail at trial.<sup>11</sup>

These facts potentially implicate three provisions of federal securities law. First, as to UBS and any other firms that were informed of the potential downgrades and failed to disclose the imminent downgrade of their CDOs, SEC Rule 10b-5 prohibits "any person... [t]o make any untrue statement or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading...in connection with the purchase or sale of any security."

Second, as to these same firms, any person who had access to this information and sold stock or other securities may have traded on confidential insider information in violation section 10 of the 1934 Act. Determining whether such trades took place will require further investigation by the agency to which the matter is referred.

Finally, as to Moody's, SEC Rule FD, issued under the 1934 Act, prohibits selective disclosure of material nonpublic information. Either as a direct violation of the terms of this regulation or the more general standards of the 1934 Act, Moody's may be subject to an enforcement action.

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<sup>10</sup> UBS-CT 021485 (PSI Exh. 94o).

<sup>11</sup> Memorandum of Decision on Plaintiffs' Application for Prejudgment Remedy, *Pursuit Partners, LLC v. UBS AG*, Stamford Superior Court No. XO5CV084013452S (Complex Litigation Docket).

#### **4. Potential Fraud and False Certifications: Citigroup**

The Securities and Exchange Commission recently concluded a \$75 million civil settlement with Citigroup, its former chief financial officer and the head of investor relations arising from affirmative statements to the markets in 2007 that the company had only \$13 billion in subprime exposure when, in fact, the company ultimately disclosed \$55 billion in subprime exposure.

The SEC's complaint, filed in conjunction with the settlement, does not name the CEO, the chair of the Executive Committee of the Board of Directors, other members of the Board who were briefed on these exposures or the president of the firm's Citi Markets and Banking unit, Citigroup's investment bank, even though they all were aware of this information well before it was disclosed to the public

Based on FCIC interviews and documents obtained during our investigation, it is clear that CEO Chuck Prince and Robert Rubin, chair of the executive committee of the Board of Directors knew this information. They learned of the existence of the super senior tranches of subprime securities and the liquidity puts no later than September 9, 2007.

On October 15, 2007, the same day markets were told that Citi's subprime exposure amounted to \$13 billion, members of the Corporate Audit and Risk Management Committee of the Board were advised that: "The total sub-prime exposure in Markets and Banking was \$13bn with an additional \$16bn in Direct Super Seniors and \$27bn in Liquidity and Par Puts."<sup>12</sup> This information was shared with other members of the Board of Directors.

Two weeks later, on November 4, 2007, after a steep decline in subprime valuations, Citigroup announced that it had subprime exposures amounting to \$55 billion; the value of these assets had declined by \$8 to \$11 billion and CEO Chuck Prince had resigned.

Based on the foregoing, the representations made in the October 15, 2007 analysts call appear to have violated SEC Rule 10b-5, which makes it unlawful for "any person, directly or indirectly" using any means of interstate commerce to "omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading" in connection with "the purchase or sale of any security."

The SEC's civil settlement ignores the executives running the company and Board members responsible for overseeing it. Indeed, by naming only the CFO and the head of investor relations, the SEC appears to pin blame on those who speak a company's line, rather than those responsible for writing it.

The former CEO, Mr. Prince, the former chairman of the Board, Mr. Rubin, and members of the Board may have been "directly or indirectly" culpable in failing to disclose material information to the markets in violation of section 10b-5 of the 1934 Act.

In addition, section 302 of the Sarbanes-Oxley Act requires the CEO and the CFO to certify that annual and quarterly reports do "not contain any untrue statement...or omit to state a material fact. In carrying out this certification obligation, the "signing officers" are responsible for

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<sup>12</sup> CITI-FCIC 00002793, "Risk Management Review: An Update to the Corporate Audit and Risk Management Committee," October 15, 2007.

establishing “internal controls” that “ensure that material information...is made known” to the officers during the time they are preparing the report.<sup>13</sup>

Although financial statements were routinely signed by the CEO and the CFO during the lead up to Citigroup’s ultimate disclosure of \$55 billion in subprime exposure, internal controls were facially inadequate. As noted in a Federal Reserve Board report,

...there was little communications on the extensive level of subprime exposure posed by Super Senior CDSs, nor on the sizable and growing inventory of non-bridge leveraged loans, nor the potential reputational risk emanating from SIVs which the firm either sponsored or supported. Senior management, as well as the independent Risk Management function charged with monitoring responsibilities, did not properly identify and analyze these risks in a timely fashion.”<sup>14</sup>

Since the CEO and CFO are responsible under the Act for accurate quarterly and annual reports, as well as the adequacy of the risk management systems needed to make those reports accurate, referrals for violations of section 302 of the Sarbanes-Oxley Act appear warranted.

## **5. Potential Fraud by Goldman Sachs in Connection with Collateral Calls on AIG**

By the end of 2006, Goldman Sachs decided to reduce its exposure to subprime real estate and throughout 2007, it maintained a “net short” or close to “net short” position on real estate-related assets. Therefore, it was in Goldman’s interest for “marks” on CDOs to be as low as possible because gains on its “short” positions would exceed losses on “long” positions. In addition, lower marks would require AIG to post larger amounts of collateral under its CDS contracts with Goldman.

The CDOs on which Goldman purchased CDS protection from AIG were illiquid instruments that could not be valued by obtaining prices from trades. Instead, they were primarily valued by looking at trades of other securities, indices like the ABX, and the use of models. Marks for CDOs were often referred to as marks-to-model, and frequently required extrapolation of very limited data to estimate a market price.

Goldman was consistently the most aggressive firm on Wall Street in setting low marks. In fact, in May 2007, Goldman’s CRO Craig Broderick wrote in an email to Dan Sparks that the firm was “in the process of considering making significant downward adjustments to the marks [on CDOs]” and that “this will potentially have a big P&L impact on us., but also to our clients due to the marks and associated margin calls on...derivatives.”<sup>15</sup> Other evidence indicates Goldman may have known its marks were too low. For example:

- Marks sent to Bear Stearns in June 2007 value securities in the BSAM funds at 50-60 cents on the dollar compared to higher marks provided by other dealers.<sup>16</sup> These marks

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<sup>13</sup> 15 U.S.C. § 7241.

<sup>14</sup> FCIC-Citi-000198, letter from the Federal Reserve Board of New York to Vickram Pandit and the Board of Directors of Citigroup, April 15, 2008, at 8.

<sup>15</sup> GS MBS-E009978118, e-mail from Craig Broderick to Dan Sparks, May 11, 2007.

<sup>16</sup> Complaint, *SEC v. Ralph R. Cioffi and Matthew M. Tannin*, Civ. No. 08-2457, June 19, 2008.

caused BSAM's NAV to decline from approximately a discount of 6.75% to a discount of 19%.

- Goldman lowered its initial \$1.8 billion collateral demand to AIG to \$1.2 billion after AIG pointed out that the demand was based on “bid” prices rather than “mid” prices.<sup>17</sup> Goldman Co-CEO Michael Sherwood recounted that Goldman “didn’t cover ourselves in glory” in this incident.<sup>18</sup>
- AIG countered Goldman’s marks with marks from another investment bank, noting that the other institution was marking the specific CDOs at 80-95% while Goldman was marking at 55-60%.<sup>19</sup>
- Societe Generale withdrew a collateral call on AIG based on Goldman’s marks when told AIG would dispute the marks.<sup>20</sup>
- Goldman’s Sherwood reportedly told Cassano that “the market’s starting to come our way,” apparently recognizing that prior marks were too low.<sup>21</sup>

These facts raise potential legal issues that merit further exploration. First, with respect to the May 2007 e-mail previewing the fact that Goldman was about to significantly reduce its marks, this would be material information to anyone purchasing securities from Goldman. If Goldman knew it was about to lower the values of the securities it was selling, pursuant to an offering circular, or if Goldman had a fiduciary relationship with any of the buyers, this could represent a violation of the 1934 Act or other laws arising from the failure to disclose this information to potential buyers. Second, this could also be a 1933 Act violation if this information was omitted from an offering document concerning the securities being sold.

## **6. Potential Fraud in AIG Investor Calls**

On a December 5, 2007, investor call, CEO Sullivan and Financial Services unit president Cassano assured participants with respect to its super senior portfolios that they “were highly confident that we will have no realized losses on these portfolios during the life of these portfolios.” AIG executives reported that there was an estimated \$1.5 billion unrealized valuation loss on the super senior credit default swap portfolio. However, it was not revealed that AIG’s calculations included (1) a \$3.6 billion “negative basis” adjustment which reflected the difference between the value of the “synthetic” super senior credit default swap portfolio and the underlying “cash” bond that was being valued and (2) a \$732 million “structured mitigant” adjustment.

Without the undisclosed adjustments, the unrealized valuation loss on the super senior credit default swap portfolio would have been \$5.9 billion. On February 11, 2008, AIG disclosed the \$3.6 billion negative basis adjustment, the \$732 million “structured mitigant” adjustment, and material weakness in the company’s risk management system. The result was the largest full-day decline in AIG’s share price since the general stock market crash of 1987.

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<sup>17</sup> AIII SEC 2035262, e-mail from Andrew Forster to Joseph Cassano, August 2, 2007.

<sup>18</sup> MFR of Joseph Cassano (June 25, 2010) at 3.

<sup>19</sup> AIG SEC2152433, e-mail from Andrew Forster to Joseph Cassano (with attached spreadsheet), November 9, 2007.

<sup>20</sup> AIG FCIC00382794, e-mail from Tom Athan to Joseph Cassano, January 1, 2008.

<sup>21</sup> MFR of Joseph Cassano (June 25, 2010) at 4.



The failure to disclose this information on the December 5, 2007, investor call presents, at a minimum, a potential violation of section 10b-5 of the 1934 Act. A potentially more interesting question is who might be penalized for this violation.

One reason Mr. Cassano testified at our hearing was that the Department of Justice and the Securities and Exchange Commission decided not to prosecute him because he had disclosed the negative basis adjustment to Mr. Sullivan, the CEO, Mr. Bensinger, the CFO, and the firm's auditors, PriceWaterhouseCoopers ("PWC") before the December 5 call. Evidence of these disclosures include notes of a meeting prepared by PWC attended by Sullivan, Bensinger and the auditors on November 19, 2007,<sup>22</sup> and a December 1, 2007 e-mail from Cassano describing the derivation of the negative adjustment.<sup>23</sup>

Mr. Sullivan and Mr. Bensinger may be an appropriate focus of an enforcement action because they (1) knew about the problems with the \$1.5 billion figure (although Mr. Sullivan testified before us that he does not recall this part of the November meeting); (2) they had the power to direct an adequate disclosure, but didn't use that power; and (3) personally participated in the December call.

PWC may also be exposed on these facts. PWC was not present at the 12/5/07 investor call and therefore did not make any representations. But the auditors may be liable as aiders and abettors of the false representations. Although private plaintiffs cannot invoke aider and abettor liability, the SEC retains this authority.<sup>24</sup>

Mr. Sullivan and Mr. Bensinger may also be liable under section 302 of the Sarbanes-Oxley Act. As discussed in the sections on Citigroup and Fannie Mae, this section requires both the certification of accuracy and the certification of an appropriate risk management section.

## **7. Potential Fraud by Goldman Sachs in Connection with Abacus 2007-18 CDO**

Abacus 2007-18 was one of a series of synthetic CDOs developed by Goldman Sachs. Goldman took the short side and sold the long side. It then sold a portion of its short position to FrontPoint LLC and others. Steve Eisman, the principal deal maker at FrontPoint, reported that a few months after the transaction was concluded, Goldman's Jonathan Egol and David Lehman met with him, at his request, to further explain the deal and Goldman's role in it. According to Eisman, the explanation was "half English and half jargon," so he asked them to tell him "if I'm right. Eisman then said:

so you put this stuff together and you went to the agencies to get a rating and the biggest issue with the rating is the correlation of loss, and you presented a correlation analysis that was lower than you actually thought it was but the rating agencies were stupid, so they'd buy it anyway. So assuming your correlation analysis was correct, you took the short side, sold it to the client and then [did the deal with me to get a mark].<sup>25</sup>

Eisman stated that Egol responded, "well, I wouldn't put it in those terms exactly."

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<sup>22</sup> AIG-SEC5981397-99

<sup>23</sup> PWC-FCIC 000381-383 at 381.

<sup>24</sup> *Stoneridge Investment Partners, LLC v. Scientific Atlanta, Inc.*, 552 U.S. \_\_\_, 128 S.Ct. 761 (2008), citing *Alexander v. Sandoval*, 532 U.S. 275, 290 (2001).

<sup>25</sup> MFR of Steve Eisman (April 22, 2010, April 28, 2010) at 11.

Egol's reported response indicates that he was not disputing Eisman's characterization. This is a species of adoptive admission, the scope of which turns on the degree to which "exactly" is interpreted as acceptance of Eisman's statement.

Assuming that Egol did agree with Eisman, this could raise legal issues for Goldman. First, if Goldman did deliberately mislead the rating agencies through the use of an inaccurate correlation, more of the security may have been rated AAA than should have been. In this event, this could be a material omission for purposes of the 1934 Act. It could also implicate the 1933 Act if the offering documents on Abacus 2007-18 did not include material information that disclosed how much of the security should have been AAA.

Eisman went on to say that he believed that Goldman, "wanted another party in the transaction so if we have to mark the thing down, we're not just marking it to our book." He commented further that, "Goldman was short, and we [FrontPoint] were short. So when they go to a client and say we're marking it down, they can say well it wasn't just our mark."

This suggests that Goldman was expecting to lower the value of the security when it was created by Goldman. This would require the long investor to make payments to the short investors. Having other short investors would allow Goldman to show the long investors that Goldman was not the only beneficiary of the marks, which would make the marks appear to be more genuine than if Goldman were the sole short investor. If this was done deliberately by Goldman, it raises a potential 10b-5 violation of the 1934 Act.

### **Note Concerning the Failure Objectively to Assess Internal Controls and Procedures**

The Commission's ultimate report is likely to include discussions of failures of internal controls and risk management systems which should have revealed problems to senior management, investors and regulators. These problems are similar to those that brought down Enron and Worldcom, which the Sarbanes-Oxley Act ("SOX") was designed to address. Section 404 of SOX requires senior management to (1) accept responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting, (2) assess the effectiveness of these systems and (3) provide that the firm's auditor also attest to management's assessment of these systems. Furthermore, Section 302 of SOX (and the rules promulgated by the SEC there under), require issuers to maintain disclosure controls and procedures designed to ensure that information required to be disclosed in the issuer's reports filed with the SEC under the Exchange Act (e.g. Forms 10-Q and Form 10-K) is accumulated and communicated to the issuer's management (including its CEO and CFO), in order to allow timely decisions regarding required disclosure. Section 302 further requires CEOs and CFOs to make a number of certifications in their quarterly and annual reports.

Given the failure of financial reporting and risk management systems at some of the firms mentioned above (Fannie Mae, Citigroup and AIG), after further review by the staff of potential violations of section 404, in addition to the violations of section 302 already discussed, section 404 violations may be included in the referral letter to the Attorney General as well.