

May 7, 2009

House passes the Fraud Enforcement and Recovery Act of 2009; Would Establish a Financial Crisis Inquiry Commission for 18-Month Investigation of the U.S. Financial Crisis

Yesterday, the House of Representatives passed the Fraud Enforcement and Recovery Act of 2009 ("FERA") (S.326), which, among other things, establishes a Financial Crisis Inquiry Commission ("Commission") with broad powers to investigate the domestic and global causes of the current financial and economic crisis in the United States. As the House legislation makes only modest revisions to the similar Senate bill passed last month, and the Obama Administration has already expressed its strong support of the Senate version of FERA, the Act is expected soon to become law.

House Speaker Nancy Pelosi likened the Commission to the Pecora Commission, which was "established to investigate the 1929 stock market crash [and] uncovered the fraudulent and unscrupulous practices on Wall Street that led to the Great Depression and laid the groundwork for regulatory reforms." Press Release, Nancy Pelosi, *Pelosi Statement on House Passage of Anti-Fraud Legislation and Bipartisan Financial Markets Commission* (May 6, 2009). Under both the House and Senate versions of the bill, the Commission will have broad investigative authority, including the power to hold hearings, take testimony, and issue subpoenas for testimony and documents. The Commission is also authorized to refer to the U.S. Attorney General and any appropriate state authority any individual who may have violated laws in connection with the current financial crisis. Both bills also require that the Commission issue a report of its findings to the President and Congress on December 15, 2010.

Membership

The Commission will be comprised of ten members who must be private citizens with significant experience in fields such as banking, market regulation, taxation, finance, economics, consumer protection and housing. (§ 5(b)(1), (2)(A-B).) Under the House bill, six Commission members will be appointed by Democrats (three appointed by each the Senate Majority Leader and the Speaker of the House of Representatives), and four Commission members will be appointed by Republicans (two appointed by each the minority leader of the Senate and the

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minority leader of the House). (§ 5(b)(1)(A-D).)¹ The Chairperson of the Commission is expected to be a Democrat, selected jointly by the Senate Majority Leader and the Speaker of the House; and the Vice Chairperson is expected to be a Republican, selected jointly by the Senate Minority Leader and the House Minority Leader. (§ 5(b)(3).)

Functions

The Commission has two main functions. The first is to examine the causes of the financial crisis, which FERA defines broadly to encompass more than 20 areas, including, among others: the role of fraud and abuse in the financial sector; tax treatment of financial products and investments; capital requirements and regulations on leverage and liquidity; reliance on credit ratings by financial institutions; lending practices and securitization; corporate governance; compensation structures; derivatives and unregulated financial products; short-selling; financial institutions' reliance on numerical models; and the quality of due diligence undertaken by financial institutions. (§ 5(c)(1)(A-V).) The second is to examine the causes of collapse of each major financial institution that failed, including institutions acquired to prevent failure, and institutions that would have failed if not for extraordinary government assistance from the Secretary of the Treasury between August 2007 and April 2009. (§ 5(c)(2).)

Powers

As stated above, the Commission will have to the power to hold hearings and compel production of testimony and documents through subpoena. (§ 5(d)(1)(A-B).) Under the House version, a subpoena may only be issued by agreement of the chairperson and vice chairperson or by affirmative majority vote of the Commission. (§ 5(d)(2)(B)(iii)(I-II).) Due to the expected composition of the Commission, this procedure places power over subpoenas squarely in the hands of the Democratic members of the Commission. The Senate version of the bill does not specify by what process the Commission may issue a subpoena. (§ 5(d)(1-2).)

FERA specifies that the Commission may obtain information directly from other federal agencies and that any confidential information obtained therefrom should be maintained "in a secure manner." (§ 5(d)(4)(A).) The Act also anticipates that the Commission will obtain information from other organizations and private parties, but does not address the confidentiality of such information. (§ 5(d)(4)(B).)

Report

After approximately 18 months of investigation, the Commission will issue its report to the President and Congress on December 15, 2010. (§ 5(h)(1).) At the discretion of the Chairperson, the report may include specific findings on any institution identified in subsection (c)(2), meaning any financial institution that failed or would have failed if not for extraordinary government assistance between August 2007 and April 2009. (§ 5(h)(2).)

Other Provisions of the Act

We believe that establishment of the Commission is the most notable provision of FERA. However, we also want to call attention to the fact that other sections of the bill update a variety

¹ The Senate version of the Act does not substantially differ, except in the manner of selecting members of the Commission (e.g., the chairmen and ranking members of the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services each select a member) (§ 5(b)(G-H)). Both bills set total Commission membership at ten people and the partisan ratio at six Democrats and four Republicans.

of federal criminal laws regarding financial activity (e.g., amending the definition of “financial institution” to include mortgage lending businesses (§ 2(a-b)) and modifying the definition of “securities fraud” to include fraud related to commodities (§ 2(e)(1))), and authorize additional funding to various federal agencies to combat mortgage and financial fraud, particularly with regard to the use of economic recovery funds (§ 3).

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. If you have any questions, or would like to discuss any of the foregoing in further detail, please feel free to call any of the following Paul, Weiss lawyers:

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