

Developing Forensic Investigative Capabilities in OFR Recommendation

Recommendation: The Office of Financial Research (OFR) should prepare to be able to lead a forensic investigation of the next major event that threatens financial stability. This is likely to involve bringing in outside experts to assist in a rapid investigation soon after an event. As a first step, the OFR can identify the different types of expertise that are needed for such an investigation and then identify candidates within each area of expertise who are willing to be "on call" in case they are needed. Another aspect of preparation is opening a dialogue with organizations that have demonstrated competence and expertise in conducting such forensic investigations to get their advice about how to structure such processes (including governance rules, organizational hierarchies, legal issues with respect to admissibility of evidence, etc.). The preparation could be concluded with a report looking at past investigations to determine best practices.

Background:

There have been situations in the past when the nation has benefited from a rapid objective analysis of large financial disruption. The President's Working Group on Financial Markets (PWGFM) was formed in the wake of the 1987 stock market crash as a response to that event. But during the most recent financial crisis the PWGFM, the U.S. Senate, and a specially-convened Financial Crisis Inquiry Commission all produced reports, but with differing lags and coverage.

The OFR is well-positioned to be a first responder in evaluating threats to financial stability. It has four potential advantages over other parts of the government that could take on this role:

1. First, it already has an ongoing mandate to monitor threats to financial stability. Hence it should be familiar with the issues involved in an event immediately and ready to lead an investigation.
2. Second, it should have relationships with a broad set of external experts that could assist in an investigation. Other agencies with narrower mandates would not have as wide a set of contacts.
3. Third, it has procedures in place for collecting and handling confidential data.
4. Finally, by virtue of not having any regulatory responsibility, it does not have any baggage regarding turf considerations that might complicate an investigation.

Financial Research Advisory Committee
Research Subcommittee

The OFR can use the time now to prepare for this kind of assignment. One aspect of preparations is to identify a set of experts that it would approach for different topics. The OFR Annual Report already lists the leading risks to financial stability, so it would be natural to begin by finding experts that it could enlist if any of the obvious risks already identified materializes. Ideally, it would have already been in touch with these people as part of its preparations for the report.

A second part of preparation would be to assess lessons from past efforts of this sort. Opening a dialogue with other groups that have experience in conducting these kinds of investigations would be prudent. The National Transportation Safety Board would be an example of an organization that could be consulted.

A third aspect of preparing would be to look at which past reports have been influential and which have not. There are likely to be best and worst practices that can be identified from previous efforts. We are unaware of any analysis of this sort. But planning for this eventuality and determining which reports have succeeded and failed could be a very valuable exercise.

Proceeding down this path will raise a number of practical issues. One that we foresee includes establishing a policy and protocol for how confidential information relating to an investigation would be shared with members of the forensic team. Others will relate to how the decision to initiate a report would be determined and who makes the decision. For instance, it is possible that the Financial Stability Oversight Council (FSOC), or FSOC member, might request the OFR to launch an investigation. But, it is important that the OFR has the unilateral option of deciding to begin an investigation on its own. Given the importance of maintaining trust in the functioning of financial markets, we believe it is clearly within the mandate and authority of the OFR to have this option.

There are no doubt many other implementation issues that will arise. This is another reason why preparing to be able to undertake such investigations now, before one is needed, is prudent.