

MEMORANDUM FOR THE RECORD

Event: Interview with Susan Mills, Managing Director and Head of Mortgage Finance at Citigroup Global Markets Inc.

Type of Event: Group interview

Date of Event: February 3, 2010 at 4:30 p.m.

Team Leader: Brad Bondi

Location: 1285 Avenue of the Americas, New York, NY; Paul Weiss conference room

Participants - Non-Commission:

- Susan Mills, Citigroup
- Mary “Mimi” Reisert, Citigroup counsel
- Susanna Buergel, Paul Weiss
- Joyce Huang, Paul Weiss
- Philip Kopczynski, Paul Weiss

Participants - Commission:

- Brad Bondi
- Tom Krebs
- Dixie Noonan
- Karen Dubas

Summary of the Interview or Submission:

This MFR is a paraphrasing of the dialogue and should not be quoted as a transcript.

Biography from Paul Weiss

Ms. Mills is a managing director and the head of Mortgage Finance at Citigroup Global Markets Inc. She reports to Jeffrey Perlowitz, co-head of Global Securitized Markets. Ms. Mills oversees the Mortgage Finance business, including residential mortgage securitizations, warehouse lending, and business development. Ms. Mills joined Salomon Brothers in 1987 and has worked in all aspects of residential mortgage finance.

Krebs: Explains FCIC’s mission and timeline and the details of 18 U.S.C. 1001.

What position do you hold?

Mills: I'm a managing director and I run the Mortgage Finance department. I've been a Managing Director since December 2003, and I've run the department since 1999. We manage all of the finance work related to covering clients and buying & securitizing loans. I have a team of people that work for me to make sure that we buy loans with documents that cover the firm.

Krebs: Tell me about residential mortgage-backed securities (RMBS). How do they start?

Mills: I'll speak about a transaction where we are the principal—where we're buying the loan and turning it into bonds (alternatively, we could just be an underwriter). We buy whole loans.

A seller of loans, who is typically also the originator, will conduct a competitive bid for a pool of loans. They'll send out a data file to market, they'll set a bid date, and we'll bid a dollar price and set trade stipulations. Trade stipulations create certain carve-outs in the pool of loans and might be geographic limits, certain loan-to-value (LTV) ratios, maximum number of stated income loans, etc. The seller evaluates the bids and decides who wins.

If we're the winner, we can conduct due diligence on loans. Once we own the pool of individual loans, we'll send the money to the seller, they'll send us a receipt that says, I'm holding these loans subject to your due diligence. We always reserve the right to do due diligence. The percentage of loans that we subject to due diligence depends on the seller and the types of loans.

Krebs: Did you notice that a certain counterparty's loans deteriorated in quality from 1999 to today?

Mills: I realize it now, that underwriting got looser and originators' guidelines became more lenient—they allowed higher LTV ratios and less strict income, asset, or employment verification.

The underwriting guidelines that we used are those of the loan originator. We did not have our own guidelines. Other firms would publish their own guidelines and essentially publish a request for loans, but we would buy from well-capitalized institutions that we were familiar with. We didn't have the team nor the infrastructure to manage underwriting individual loans.

Krebs: As a part of the bid, were you required to submit the percentage of the loans that you would subject to due diligence?

Mills: No. It varied by seller and by the collateral of loans. Prime loans would get less due diligence than subprime. For a counterparty that we were unfamiliar with, we would do 100% due diligence. If we got comfortable with the counterparty and their process and how they did their business, they would be subjected to less due diligence.

Krebs: For those counterparties with whom you became comfortable—did you see deterioration with respect to the quality of the underwritings?

Mills: Well, very few companies are in business any longer, so in hindsight, yes, we became too comfortable.

Krebs: What was in the data files that you received?

Mills: It was essentially an Excel spreadsheet with a large number of data attributes about each loan.

Krebs: Would you get the material aspects of the loan, or all of the aspects?

Mills: There were hundreds of data fields for each loan. The quantity of data was sufficient for us to do an analysis of the loan.

Krebs: What did due diligence involve?

Mills: It was a data integrity check. In the context of subprime, it was sometimes more subjective. We'd hire third party vendors (Matt Bollo was responsible for this), and he would supervise the people that they used to review the loan files. We'd accept or reject loans accordingly depending on the due diligence. We made all of the decisions about what was in and out.

Krebs: Did you make decisions about individual loans?

Mills: I probably did at some point, but Matt [Bollo] did the majority of that.

Krebs: What about subjective decisions of loans? Did you have to be on site for that?

Mills: We didn't have to be on site. Eventually, originators could image files and there was no need to go on site

Krebs: Was there a mix in the source of the loans within the pool?

Mills: Sometimes, yes.

Krebs: Would there be Citi-affiliated mortgages in the pool?

Mills: I don't believe so. Most of Citi's origination business was held on portfolio. They did maybe six deals in 2002 and 2003 with subprime loans.

Krebs: You did the RMBS—you had nothing to do with CDOs or SIVs?

Mills: No.

Once you finished your due diligence, you finalize your pool of loans and you submit the loans to the rating agencies. They need to be rated by at least two of the rating agencies (usually S&P, Moody's, or Fitch; DBRS is a smaller firm that was sometimes used). The rating agencies would tell us what bond sizes we could create from the pool of loans—the percent of bonds that could be issued in each of the rating categories (Bbb, A, Aa, and Aaa). These bonds would be what we would sell in the market.

Krebs: Was the function of the rating agencies to assist you in the structuring of the RMBS?

Mills: They helped us to assess how many bonds could be in each rating category.

We would send each rating agency a data file. Each agency had their own preferred layout—the Mortgage Analytics department would map the data from the tape on to the correct mortgage data file (typically an Excel file). This allowed rating agencies to load it into their model.

[What Mills calls “data file” is alternately referred to as “tape.”]

Krebs: How did the data that you sent to the rating agencies differ, if at all, from what you sent to the due diligence firms?

Mills: Due diligence compared the data in tapes to data in the actual physical loan file. The rating agencies did not do double due diligence. They would work with the data in the file. It wasn't their business practice to review the data again.

Krebs: How you can take a pool of subprime loans and turn that loan into Aaa paper? How much over-collateralization was required in subprime deals?

Mills: It varied—it correlated to the specifics underlying the pool of loans. Overcollateralization is only for subprime—it would be divided into Senior, Mezzanine, and Overcollateralization tranches. Prime follows the six-pack structure: Aaa, Aa, A, Bbb, Bb, and B.

The Aaa tranche is not a discrete group of loans—it dictates how the cash gets allocated. When payments are made on bonds, the payments go to the trustee, and the trustee pays down tranches from top to bottom. He sends out a “Remittance Report” describing the payments. At the bottom of the waterfall is the overcollateralization.

The original prospectus would be off of the SBMSI shelf (now known as CMLTI—rebranding probably occurred in April 2004).

There was a subsequent securitization that would be a private placement offering. You would take the overcollateralization bond, deposit it into a new trust, and create two new bonds (one was debt and one was equity). It was a very short weighted average life bond. The cash that went

to the overcollateralization bond wasn't needed to maintain credit support or to pay the coupon on the Senior or Mezz tranches. The overcollateralization bond would also get any cash from prepayment penalties. It became a NIM – Net Interest Margin.

You submit these cash flows to rating agencies and they turn them into a rated security. It could be rated because it had such a short life, and it was rated based on the underlying collateral of the loans. We were able to sell this rated NIM—it was another way to sell bonds and get paid back for our initial cost.

REMICs—Real Estate Mortgage Investment Conduits—are the initial securitization. The next securitization can't be a REMIC, so it is the NIM. You sell the NIM and retain the equity.

Krebs: How different were the ratings of the rating agencies?

Mills: When we got back the levels from the rating agencies, they had differing assumptions of how the loans would perform. The agency that told us that we could issue the most Aaa's gave us the strongest rating.

Krebs: Who did you sell the NIMs to?

Mills: I'm not the best person to answer. I recall that some hedge funds bought them.

Krebs: Did the NIMs and the lower-rated tranches have higher yields?

Mills: Yes.

Krebs: When, if ever, did the super-senior tranche come into play?

Mills: Super-senior is a CDO concept.

Krebs: When the NIMs were sold in private placement, were they done as 506 Reg D's or 144As?

Mills: I don't know.

Krebs: Was there a secondary market for NIMs?

Mills: I'm not sure, but I believe so. Phil [Seares] would know.

Krebs: Did you have much interaction with any of the investors in these transactions?

Mills: Not me personally, but my department would have interacted with investors in the process of marketing the deal. Prior to pricing the deal, they would solicit interest to determine who would like to buy it. Prior to the Prospectus, we would issue a Term Sheet. If we had twenty-five

firms that might want to buy bonds off of our subprime deals, some of the investors might ask you to slice or dice it into customized cash flows.

People in my group might speak to an investor if we had questions about stress runs.

Noonan: Did the bonds have fixed coupons?

Mills: They varied. Most of the loans were adjustable rate; in subprime they were LIBOR rate floaters, and they typically traded at par. Depending on how much interest there was, they'd tighten the spread on the bonds. The lowest was LIBOR + 6. If there was less interest, the spread would widen.

Noonan: From the perspective of the investor in the REMIC or RMBS...?

Mills: Stress runs were more focused on how the collateral would perform. Aaa's should perform; Bbb's might not perform completely. Different investors might want the bonds stressed more severely to know what returns they were likely to receive.

Krebs: What interaction did you have with any of the other securitization or structuring groups here?

Mills: I was friendly with Janice Warne on a personal basis, but not a professional basis.

Krebs: Did there come a point in time when you became worried about the subprime market?

Mills: It's hard to say in hindsight. It was probably mid-2006. It was related to the quality of the underlying loans—the LTVs were going up and the documents were going down. When we bought whole loans, we required that the originator represent to us that a borrower would make its first payment, or we had the right to put the loan back.

We saw the EPDs—early payment defaults—rise. It was a default on the first month of payment—the first payment due by the borrower. The first payment was usually due two months into owning the home; if you close on a home in February, your first payment is not due until April.

Krebs: What did you do?

Mills: We had developed a Surveillance Unit in late 2005 or early 2006. Because we were becoming a larger issuer of securities, we wanted to be aware of how our deals were performing. The Surveillance Team received loan-level information on how prior deals were performing.

We started to pay more attention to EPDs. My recollection is that at first, with EPDs, the seller would just buy the loan back. As EPDs increased, it would take a lot longer for them to respond to you and for them to pay you back.

There are 30 to 40 representations that originator makes to you about the loan: that it's the first lien, owner occupied, etc. If we find out that there is a false representation, we can put the loan back to them.

All of this information is in the mortgage loan schedule. The details vary from trade to trade.

Krebs: can we just get a sample of one?

Mills: We put Credit Review Managers on all transactions for subprime deals. PentAlpha and Clayton Holdings were the third party managers. They would get monthly data on the loans, check the remittance reports, and note how many loans were in each category of 30 days delinquent, 60 days delinquent, 90 days delinquent, and in foreclosure. They would make sure that the report was right and look at the loans where the servicer was not putting the loan through foreclosure in accordance with that state's regulations. Credit review managers can contact their contact at the servicer to find out why things are not being done correctly. The Credit Review Manager would give a monthly report, and the Surveillance Team would review the report each month and dialogue with CRM.

Krebs: You created the Surveillance Unit in late 2005 to early 2006. What did that tell you in 2006?

Mills: We started to see that loans were performing worse than expected. Delinquency and losses were higher than expected.

We slowed down our purchase of loans, and we weren't buying as many pools; we built more stipulations into our bids; we increased our diligence; we were stricter with due diligence. We tried to improve the credit quality of the pools that we bought. If we didn't like Interest Only, we'd say that we'll only accept 5% Interest Only in this pool.

The rating agencies were also tightening their criteria.

Krebs: Were more recourse loans going back to originators?

Mills: Yes. That in turn stresses the originators, and they were going into bankruptcy.

In early 2007, we were also lending money to the institutions that we were borrowing from. As the underlying quality got worst and rating agencies tightened their standards (so we could issue less AAAs), whole loan prices dropped, so we would mark the warehouse line, and we would make a margin call and call for cash.

Krebs: You talked about warehouse agreements. Are you financing the originator's acquisition of the loan that he's giving to you?

Mills: The warehouse lines were secured lines of credit that are backed by pooled loans. The originator needs cash to close with the borrower. New Century might build up a large pool of loans on our warehouse line, and then they would identify the pool that they wanted to put out for the bid. When the pool was sold and the money was sent to New Century, we wouldn't let go of our bid until we were paid.

The pool of loans that was the security for the warehouse line were loans that had been originated but not sold. It was an aggregation period. When they would put a pool out for bid, it wouldn't be every pool on my line. It would be picked and chosen from different warehouse lines.

Since we were also a lender, we were able to see what was happening with the collateral. We were in the top ten of active market lenders. If financial covenants were breached, we could take their collateral. If there was a breach, the credit department might get involved.

Krebs: You were concerned in late 2005, through 2006, and now we're in early 2007. Where is risk management at this time?

Mills: The trading desk has positions and can buy a certain number of mortgage loans, and they have to be within their risk limits. I wasn't involved with that.

Krebs: Did you ever tell audit or risk management about what you were seeing?

Mills: We told Credit if there was a breach of covenants. There was one company that we noticed was not making money and had breached several profitability covenants. We knew them from a previous entity, which is why we gave them a warehouse line, but they stopped making money. Their front end was not connected to their back end, and it was bringing in low quality loans that their back end couldn't sell. The line was up for renewal, and I called them to let them know that we wouldn't renew the line.

We had a window into the market, and that was part of the reason why we slowed down in 2006. In 2007 we did one large trade with Argent/Ameriquist. We saw what was happening, and we backed up a little. There was still demand for these investments, but you couldn't make the math work—even with so much credit enhancement, you couldn't make Aaa's. Other Wall Street firms were still engaging in it, but we were slowing down.

Krebs: Other departments at Citi were still doing it.

Mills: CitiMortgage was buying loans from brokers or correspondents, but they would portfolio them and keep them. We tried to work with them at one point, but it wasn't a material amount of loans.

Krebs: You never spoke to the CDO guys and ask if they were seeing what you were seeing?

Mills: No.

Bondi: Did you report up the chain in your group about what you were seeing with EPDs?

Mills: We were careful, because the trading desk can only trade on public information. Jim De Mare did not trade the market on a daily basis, so we told him what we were doing. Jim knew what the early payment default was, but I don't know what he might have told to someone else.

Bondi: Did you send the report to someone above Jim?

Mills: I did not—I wouldn't have gone over his head.

Bondi: Did you ever attend a meeting with Bushnell or Maheras or anyone in their offices?

Mills: No.

Bondi: These surveillance units, who headed them?

Mills: James Xanthos joined Citi from Credit Suisse and he had a credit background. He was going to leave the firm and he was talented, and I asked him to set this up for me.

Bondi: How often would he generate reports?

Mills: Frequently. Probably once a month

Bondi: Who would have received those reports? Who was on the distribution list?

Mills: Besides myself, I'm not sure.

Bondi: Did you give the report to anyone?

Mills: No.

Bondi: Who were the ten that had the warehouse lines?

Mills: New Century, Ameriquest (may have included Argent), Option 1, Resmae (old Long Beach—they were the line that we did not renew), Centex (now NationStar), and Ames are the ones that I remember.

Bondi: Which was first to close?

Mills: I think it was in October 2006 when we did not renew Resmae.

The next line was New Century. That line we were paid in full for. New Century was a publicly

traded originator and historically had very low EPDs. Because they were public, they had to report this. We assumed that they were finding a way to pick better loans because their EPD didn't go up. We had a large position and a lot of exposure to them.

They came to us in early 2007 and had these new securities that were residuals of REIT securitizations. They wanted us to finance them, so we ran the numbers. If we thought they were worth \$100, we offered to lend them \$25. They also had the warehouse line that had (\$80? \$800?) million.

The company came in and met with us and assured us that EPDs were fine. Then they had public announcement that their EPDs needed to be marked to par. They did something with a hedge fund—Greenlight hedge fund with David Einhorn. We were on a conference call with all of the lenders, and _____ announces that Citi has a lot of extra collateral.

New Century's other big lender was Morgan Stanley, and Morgan Stanley had a big EPD claim back to New Century. So Morgan Stanley heard that we had this extra collateral and paid off all of our loans.

I can't remember what the next line was to close.

Bondi: Who made the decisions to close warehouse lines?

Mills: Martin Lifshutz and Jim De Mare both helped to make decision to close lines.

Bondi: What's your view of Argent?

Mills: We acquired their company and their servicing, and in the end it wasn't such a good idea. At that time in the market, Wall Street was buying originators so they could create MBS to sell to investors. Argent was from Long Beach, and we'd known them for a long time.

We would buy their platform and servicing book, and it would keep us in the business of securitizing mortgage. We signed a letter of intent in February 2007, but it took until August 2007 to close the deal. In those months, there was a tectonic shift in subprime. But we still believed in origination, and we thought we could turn Argent into a Fannie and Freddie originator.

We didn't ever originate a lot of loans with them—it was less than 100 loans. It never got off the ground. In hindsight you wish it had never happened. No one thought that this was as bad as it was. We thought it was just New Century, not a lot of firms. The business model just didn't work, and they all ran out of money.

Bondi: Were you involved in the decision to acquire Argent?

Mills: I wasn't involved in the decision, but I was involved in doing the diligence on the

platform. M&A Strategy is a group of Citi investment bankers that looks for platforms for Citi to acquire. I helped prepare some of the slides about the merits of acquiring the platform.

Bondi: Did you support the decision to acquire the platform?

Mills: From a competitive perspective, I thought we needed to acquire loans to be in the business. I thought that it would also allow us to originate better loans.

Bondi: Was Citi acquiring loans from Argent up until their acquisition?

Mills: We bought large pool of loans in early 2007 that was probably their last production. It was between March and May 2007. Because the subprime market had deteriorated so much, they had essentially stopped originating loans.

Bondi: Did your group ever hire anyone from the rating agencies?

Mills: We did over time. One was Venkat Veerubhotla. Taruna Reddy went from Moody's to Merrill Lynch to Citi. A lot of people have come through the group since 1999.

Bondi: Was Venkat rating deals for Citi at the time that he came into Citi?

Mills: I don't know for sure, but people in our group knew him. He wasn't only rating our deals, but he must have worked with us.

Bondi: How good were you at predicting what rating a rating agency would give you?

Mills: Personally, I was not involved in that at all. S&P Levels was an S&P modeling system that you could buy that would give you a rough estimation of what the credit enhancement might be.

Bondi: Did you ever sell RMBS to Fannie, Freddie, or Ginnie?

Mills: We sold Aaa's to Fannie. I don't remember about Freddie, and I don't think we sold to Ginnie.

Bondi: Would this have been a prearranged structure?

Mills: In order for Fannie to buy securities for their portfolio, they had to fit certain requirements. We divided the collateral into two groups. In these scenarios, when we sold Aaa's to Fannie, we would have two pools of loans. In some of these instances where we sold to Fannie, we would have a Fannie and a non-Fannie pool of loans. They could only receive credit enhancement from their own loans.

Bondi: Do you know the amount of RMBS sold to Fannie over the years?

Mills: The firm has that. That would be in the sales department.

Bondi: Were securities sold to Fannie to meet CRA requirements?

Mills: I don't know. It's not something that was a driver or something that would be focused on. I seem to remember CRA inquiries relative to whole loans. We didn't keep loans on portfolio like other Wall Street firms

Bondi: Did any of the RMBS that you sold go into CDOs created by Citi?

Mills: A lot of loans did go to the Citi CDO desk, but that would be something to ask the trading desk.

Bondi: Could we find out how many RMBS that were securitized by Citi were sold to Citi? I'm interested in sales of RMBS to any Citi entities.

Mills: I don't know.

Bondi: Who were the Credit Review Managers?

Mills: Clayton did the majority of transactions and we also worked with PentAlpha. Clayton was the same firm that we used for due diligence, but we worked with a different department.

Bondi: What other counsel have you worked with?

Mills: Our counsel that represented the shelf was Thacher Proffitt & Wood, which was recently absorbed into Sonnenschein, Nath & Rosenthal. We've also worked with McKee Nelson.

Bondi: Have you ever given a deposition before?

Mills: Yes. In the mid-90s, we did business with an REIT named Wilshire. There was a lawsuit brought against a Smith Barney office because it had sold some Wilshire unsecured debt to a pension fund. The deposition was related to the business we transacted with Wilshire and whether we shared information with Smith Barney.

I also met with FINRA to discuss a lawsuit.

Bondi: Looking back, did you make any mistakes in the securitization business?

Mills: With the benefit of hindsight, maybe we could have stepped away from business sooner, maybe we could have put stricter limits on trade pools.

With respect to a market that blew up, what happened was unprecedented, and I think we were

careful with whom we did business with. I'm glad that we didn't run a whole loan conduit, and that we dealt with sound counterparties. With respect to counterparties, we lost less than most. Other firms had much greater losses with respect to the same business that I'm in.

Bondi: Have you done any post mortems, lessons learned, etc. about the crisis?

Mills: Not in the RMBS group. It wasn't a scenario that you could have planned for or hedged. I don't know of any other post mortems done within Citi.

Bondi: Looking back, with respect to your business, could you have managed risk better?

Mills: Honestly, we did the best job that we could at the time. Now that we're among the wreckage, there isn't a business that we can step into and apply any lessons learned.

The business is now clean vanilla. The market has snapped back to the mid-80s, and is securitizing for Fannie, Freddie, and FHA. There's been virtually no new-issue, non-agency business.

Noonan: Regarding the Bbb investors in an RMBS. If the underlying loans did not perform well enough to pay them, what happened?

Mills: If enough loans default, borrowers aren't making their coupon. Bonds always typically get coupon, but if they start to lose principal, the amount of the coupon would diminish. If the principal value gets eroded, it would be reflected in the coupon.

Noonan: Did you see deals where principal got eroded into the higher levels?

Mills: I know that has happened.

Noonan: Did you know that underwriting standards were eroding based on originators' disclosure to you?

Mills: Yes, they were widening their guidelines in LTV ratios and were not verifying that borrowers had income (stated income loans).

We as a firm didn't really deal with option ARMs. We didn't like them.

Noonan: Who at Citi had authority to say that these underwriting standards are okay, even though they are loosening?

Mills: Our business model was to securitize the loans that we were given. We were transparent with rating agencies. We put pages of disclosure into the prospectus explaining all of the possible risk factors, and we explained all of the underwriting guidelines. The risk factors section might have said: there are stated income loans in this deal.

My policy was to tell everyone everything about the deal and let them decide. I did not hesitate to put risk factors into the prospectus.

As the quality of loans got worse, there were less Aaa's, and eventually the economics didn't work.

Noonan: Can you talk about the economics of the securitization?

Mills: Phil Seares would be a better resource.

Noonan: Did Citi get stuck with loans that it couldn't sell?

Mills: Yes. I'm not sure what the magnitude was. We had a separate business that bought whole loans at distressed levels. It was a separate team, and I wasn't involved in the strategy, but they tried to get the loan and get the borrower to pay, or they put loan into foreclosure.

The loans that we got stuck with were EPDs or defaulting loans. I think that we did a deal in mid-2007, and we would have done it even if we had lost money just to get that pool off of our portfolio.

Noonan: Would you mix pools of adjustable-rate and fixed-rate loans?

Mills: The majority of subprime loans were adjustable rate. If there was a large enough pool of fixed rate, you would put those in a separate bucket.

Noonan: You mentioned that the market blew up spectacularly. Do you have any opinion as to why that happened?

Mills: There were a couple of reasons from my securitization perspective. Loans were originated on the front end that shouldn't have been, and that had been happening for a few years. This drove up value of homes because people were buying what they couldn't afford. That caught up to people, and they foreclosed, and originators went out of business. Foreclosures rolled across the country, and that drove home prices down.

We knew that a pool of 100% stated income or 100% high LTV loans would perform horribly. But the problem was that other pools that we thought were safer didn't perform well either.

I don't have a view on the CDO connection to the problem.

Noonan: It wasn't Citi's issue that loans were originated that shouldn't have been?

Mills: For what our job was—to make a market in fixed income securities—at the time we thought that we were appropriately disclosing what the investors should know about the loans.

It's always easy to say what you should have done differently. At the time, we thought that we were doing what we needed to do to give them the information to make informed decisions. We weren't making them buy those loans.

Bondi: On the chart you gave us yesterday, how was the subprime category defined?

Mills: Loans were categorized based on how the originator classified them. If Argent said it was subprime, we put it in the subprime book. Same for Alt-A.

Bondi: [Asks Susan to keep conversation confidential beyond consulting with counsel].

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