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D R A F T
M E M O R A N D U M

TO: File
DATE: February 2, 2010; ?? – 3:25pm
RE: Memo re Interview with Joe Forlenza and Kevin Murray
This is not a transcript of the proceeding and should not be quoted as such.

Biographies from Paul Weiss
Mr. Forlenza is a managing director in Audit and Risk Review in the Institutional Clients Group. Since 2003, he has been responsible for the capital markets global liaison function, which provides product expertise to the worldwide audit coverage of capital markets. In addition, since 2004, he has overseen a program that provides risk-based coverage for all institutional equities, fixed income trading and sales, and investment banking businesses in North America. Prior to joining Citigroup in 1994, Mr. Forlenza was a senior audit manager at Coopers and Lybrand specializing in financial services.

Mr. Murray is a managing director in Audit and Risk Review. He is the chief auditor for the Institutional Clients Group. Mr. Murray joined Citigroup in March 1985 and worked in a variety of investment banking and treasury roles before assuming his current role in Audit and Risk Review in September 2004.

Paul Weiss
Susanna Buergel, Phil _____

Citigroup
Mimi _____, Kevin Murray, Joe Forlenza

FCIC
Brad Bondi, Tom Krebs, Dixie Noonan, Karen Dubas

BONDI: [Explains FCIC's mission and goals & that they must be truthful]

We're looking at the origination, securitization, and CDO businesses of Citigroup and Citi entities. We're trying to understand risk & risk management practices. What was your experience from 2000 to the present?

MURRAY: I head up the audit team for the Institutional Clients Group (ICG; investment bank) that does CDOs and securitization. I took over responsibility in September 2004 and cover ICG globally. Joe is in the Capital Markets North America team.

From an audit perspective, we take a risk-based approach. We create a risk assessment profile for the business. That generates for us a number of risk families that we use as context for evaluating the business. It includes strategy, compliance, staffing, market, etc.

In those areas we look at inherent risks, controls, and residual risk. Based on the residual risk, we classify it as high, medium-high, medium-low, or low. High risk results in annual examinations and follow-up, low risk entities are examined every 48 months, and the other categories fall somewhere in-between. We update the risk assessment profile for each entity and develop coverage based on each risk level. In the context of setting up the cycle approach and taking a look at the businesses, I have the responsibility for looking at the audit portfolio overall.

Joe and the members of his team would have the expertise to go look at these businesses and be responsible for the execution, production, follow-up, and other details.

BONDI: Let’s focus on your group, Kevin. How many people are in that group and how has it changed since 2000?

MURRAY: There are seven hundred people in the audit and risk function globally. About two hundred and forty report to my group.

Over the ten years, we started out at 700 people around 2004. We ramped up the organization in 2005 and 2006 after there were increased regulatory responsibilities, and that continued somewhat to 2007. The organization has pulled back from 2008 to the present 2010. The ICG group has remained fairly constant—it started at 240 in 2004, increased to about 280 in 2005 and 2006, and is now down to about 250 people.

The other Audit & Risk teams are:

- <u>Consumer</u>: retail products, business, banking, credit cards, etc. (both North America and international)
- <u>Private Bank</u>
- <u>Operations</u>: infrastructure
- <u>Technology</u>: data centers and technological infrastructure

BONDI: What interaction has the ICG group had with the Consumer group in respect to mortgages?

FORLENZA: There was an integration of Citi Residential Lending when we took on

Ameriquest. We had coordinated some coverage with the Consumer group. To the extent that we have real estate in the context of capital markets (securitization), we would supplement their team.

BONDI: Was there any feedback from the Consumer group to the ICG group about the mortgage market? What communication would go from the Consumer group to the ICG group?

MURRAY: There isn't a lot of interaction between our businesses. We're looking at the activities of the ICG markets securitizations team in the context of CDOs and securitizations. In terms of origination, we wouldn't talk about that other than in general terms.

I report to Bonnie Howard, who is the chief auditor for Citigroup (since spring 2004). She reports to the chairman of Audit Committee, Gene McQuade, who is the CEO for Citibank N.A.

BONDI: Did you report to the Chief Risk Officer?

MURRAY: There was no reporting relationship to the CRO.

BONDI: Do any reports go to the Chief Risk Officer?

MURRAY: The Chief Risk Officer and the ICG Chief Risk Officer would be cc-ed on our reports, unless we were auditing the CROs.

BONDI: Has the Chief Risk Officer ever had any role in directing your audits?

MURRAY: No, we are entirely independent.

BONDI: Joe, who is in your group and how do you operate?

FORLENZA: We've been relatively stable in terms of team size. It fluctuates between twenty-nine to the low thirties in size as we've made some adjustments in skill sets. We've added a Program Director who runs field operations and additional market risk skills and credit market skills. It's a mix of professionals with audit experience as well as those with less audit experience but significant market experience.

Our global liaisons bring risk and control expertise to the group.

BONDI: Do you report to Kevin?

FORLENZA: Yes I do. Just to him.

BONDI: What is a risk assessment profile?

FORLENZA: It's a formal document that cuts across ten risk families. We start out inherently and identify risks in each risk family, then we identify controls that can mitigate those risks.

Inherent risk – control = residual risk

We document that, write a report, and devise a judgmental risk rating. We will discuss it with the business to get a view of how they see risk. It's our document though, and it's completely independent. The ultimate residual risk level will drive the audit frequency (minimum is once per year).

BONDI: Who has the ultimate sign-off on an assessment?

FORLENZA: The official approval is at the program-officer level. I may sign it too, but Kevin would not need to approve it.

BONDI: Would it be shared with the Audit Committee or the Board?

MURRAY: The audit will go through our Audit Committee, but I've never been involved in a conversation about how we are auditing a particular segment.

In our audit reports, we give a risk assessment of the business. When we have a "needs improvement" review, we would give those to the audit committee, but they would never see the risk profile itself. They would understand it from discussions with the Corporate Audit and Risk Management committee—they'll get the summary and the residual risk level. The ultimate score will only go up to the Audit Committee if it's less than satisfactory ("needs improvement" or "unsatisfactory").

BONDI: Was there communication with members of the Board about the contents of your risk review?

MURRAY & FORLENZA: No, never.

BONDI: Let's take the CDO business at Citi. Can you tell me what sort of audits you've done from 2004 to the present?

FORLENZA: Are you interested in the scope or frequency or both?

BONDI: What sort of audits have you performed since 2004?

FORLENZA: The frequency in the United States would have been: 2004, 2005, 2006, 2007, 2008, 2009. The published reports in North America were in 2005, 2007, 2008, and

2009. The 2006 report was published in early 2007.

BONDI: What are the names of those reports?

FORLENZA: In 2004 they were the "North America Credit Derivatives and Emerging Market Credit Derivatives." In 2005 and 2006 they were the "Structured Credit Products North America," and in 2007 they were the "Exotic Products North America."

BONDI: Why was there a change in name?

FORLENZA: We wanted to bring more organizational focus to the purpose.

MURRAY: We redefine our audit entity structure constantly. It's internally organizational, not mandated by a regulator.

BONDI: We'd like that piece of paper, and a copy of those reports.

BUERGEL: We got them at the beginning of this week and should have them to you soon.

MURRAY: There is a structured credit products business in Europe as well.

BONDI: Who heads up the audit function in Europe?

MURRAY: Fatoullah Charalambos (sp?) heads up the European team.

BONDI: Does he have responsibility for the SIVs?

MURRAY: Yes, that's the European team.

BONDI: Has the risk assessment from 2004 forward been high?

MURRAY: Yes.

BONDI: Of the entities that are ranked high, how does CDO business rank against them?

FORLENZA: It ranks equally. High is high. It's not apples to apples to compare one business to another.

BONDI: From 2004 going forward, what business unit under your watch gave you the most concern? Was it the CDO business?

MURRAY: From the perspective of how we risk rate businesses, this was certainly one that we were worried about. There were some operational entities that were also a point of concern during that time. That is reflected in the consistency of our risk rating. This was a focus point for us.

BONDI: Would Mr. Bushnell be copied on the reports that you referred to earlier?

MURRAY: In his role as Chief Risk Officer, he would have been on the cc list. Tom Maheras would have also been on the list.

BONDI: Would Janice Warne have been cc-ed?

FORLENZA: I don't recall. I'd have to look at the list.

BONDI: Take me through 2004 to 2008. What did you do through the course of your audit of the CDO business? What did you do, and what was the scope?

FORLENZA: The scope of the report will be reported in a bullet point summary at the end of the report.

It starts with a risk assessment. Each year you could have a variety of risk factors: how the desk is supervised, middle office support, trade processing, remediation of issues, market risk management, etc.

BONDI: What about independent market risk management?

FORLENZA: You look at how it monitored its trading book and how it interacts with market risk. The Independent Risk structure is a different silo that reports directly to Dave Bushnell.

We also looked at Product Control, which reports to a separate entity, and we would bring all of this into the risk reporting for the CDOs. We would look at the types of limits that have been established, the effectiveness of stress testing, and how limited excesses are approved and documented. If a business is going to exceed a limit—in the CDO desk, for example, there might be a limit by product type—that needs to be looked at by market risk management.

Generally, we would cover all of this pretty consistently. On the product control side, we would make sure that pricing is independent, etc. It's a quite extensive examination. We'd look at supervisory responsibilities, how the middle office enters and recognizes trades, etc. We'd look at the technology risk family.

A lot of this comes down to risk appraisal and areas that need to be focused on.

BONDI: Do you look at reputational risk? Do you have a definition of that?

FORLENZA: Yes. I'd define that as anything that is thought to be critical in terms of potential negative ramifications on the franchise. It's something that could have a significant impact on organization. It's very difficult to assess. A lot of high risk businesses do high profile things. It requires a fair degree of judgment.

BONDI: Did you look at reputational risk in your audits of the CDO business from 2004 to the present?

FORLENZA: I can't recall without the Risk Appraisals in front of me. We looked at market risk and pricing.

BONDI: I understand that Citi held certain tranches of CDOs that it issued. Did you evaluate the risk of these?

FORLENZA: One of the things that we want to understand are the products and the exposures that these products generate. A product like a CDO tends to be credit intensive. Our basic mission is to make sure that the types of limits on products are appropriate for that kind of organization.

MURRAY: The risk management organization identifies those limits. We just make sure that they stay within the limit. That's the auditor function.

BONDI: From 2000 through 2009, were they meeting those credit limits?

FORLENZA: In 2007, there were some situations where we would have exceeded a limit. In our coverage, people generally followed policy and protocol if they exceeded a limit. For instance, there may be a limit on a product that you can own in a particular credit classification. The limits are set annually (at a minimum) by the Chief Risk Officer and the risk management team. If the business ends up holding more than the approved threshold, there are policies for giving up those assets.

BONDI: It's hard not to have an opinion on the limits that were set by other people. Were there any points in time that you saw limits set by the Chief Risk Officer and his group and thought that they were too high or too low?

FORLENZA: Do you mean appropriate in terms of their level?

BONDI: Yes. Did you feel like it was too much risk for this organization to be taking on?

FORLENZA: Up until about 2007 Q3, I would say no. When you looked at the exposures versus the limits—this is before the market crashed—there was a consistent thread.

MURRAY: I would agree with that. Knowing the risk framework that had been established, I wouldn't say that I had any concerns.

BONDI: The market froze leading up to asset-backed securities market freeze in 2007. Did you have any concerns before that happened?

FORLENZA: In late 2007 Q2, we were talking to management about market volatility. People were paying attention, but it wasn't until the wheels came off into 2007 Q3 that people thought that we needed to cut limits or significantly reduce risk.

MURRAY: People were looking at the data, but if they see lots of AAA securities, there's no reason to challenge the limits that had been set.

BONDI: When you had the discussions with management in the second quarter of 2007 about concerns, who did you talk to?"

FORLENZA: We generally have a quarterly meeting with the fixed income people, typically to get a perspective on the market. That was pretty much the interaction. For us it's trying to figure out the next control process or concern.

MURRAY: From a risk perspective, we're not going there to talk to them about trading, risk-based prices, etc.

BONDI: Who are you referring to with "we discussed"?

FORLENZA: The liaison who covers the Global Fixed Income group, Robbie Kamar (sp?). On the business side, we tend to have one of three people talk to us: Randy Barker, Paco Yberra, and Geoff Coley.

The Business Risk Control and Compliance (BRCC) meeting was held quarterly and included business heads and representatives from risk management. At this point in time, subprime and pricing (inventory) were important topics.

BONDI: Were there notes or minutes from these meetings?

MURRAY: A deck was prepared for the meeting. Minutes may have been prepared

BONDI: Can we get a copy of the deck and minutes?

What do you remember from 2007Q2?

MURRAY: I attended those meetings, not Joe. We talked about unverified inventory levels. It wasn't any surprise that it was getting more difficult to price the inventory. As we were watching it, it was likely that we could get more of a handle on it. That was the perspective that I had coming to it.

BONDI: Was Bonnie Howard there?

MURRAY: I'm not sure. She would have been invited. The Control and Compliance Group now runs the BRCC meetings, but it used to be in a transitional phase. I believe that Andrew Crean (sp?) might have presided over it.

BONDI: Did David Bushnell attend?

MURRAY: I'm not sure. He usually didn't come.

BONDI: Did you assess the risks associated with an investor purchasing a CDO?

BUERGEL: You were auditing the trading desk and the syndicate function of that desk.

FORLENZA: For these audits, I would say no.

BONDI: Are there any other audits that would have looked at this?

FORLENZA: I don't think there was anything dedicated specifically to having the client risk in mind in the context of these audits. I can go back and check.

BONDI: What about investor suitability?

FORLENZA: There's a suitability concern. In our sample testing, it may or may not have covered CDOs. I don't remember anything specific to CDOs—CDOs would have been contemplated by the larger suitability policy.

BONDI: What was your role with respect to the suitability policy?

FORLENZA: It generally classifies derivative products by complexity and requires formal classification by product types. A more sophisticated investor would be considered less risky.

We would go back and make sure that we're following the right evaluation process and that we're providing to the investor exactly what was required.

BONDI: Did you review the suitability policy with respect to CDO business?

FORLENZA: No, I did not.

BONDI: I'd like to see the suitability policy for 2004 through 2009 for Fixed Income and ICG.

Do you know what a liquidity put is?

MURRAY & FORLENZA: Yes.

BONDI: In 2004, were you aware whether Citi had a liquidity put on any of its cash CDOs?

FORLENZA: I was not.

BONDI: At what point in time, if at all, did you become aware about liquidity puts?

FORLENZA: At the tail end of 2006.

MURRAY: There were definitely some on the books in 2005.

BUERGEL: Janice can give you more information.

BONDI: Did you evaluate the risk to Citigroup relative to those liquidity puts?

MURRAY: Our process would not be to evaluate the risk of liquidity puts, but to understand the risks related to them. We would want an awareness of the market risk or pricing risk around it. We wouldn't evaluate the risk to the company of these being outstanding. We looked at it related to the risks associated with the business.

BONDI: Did Bushnell know about the liquidity puts?

FORLENZA: I don't know.

MURRAY: I don't know.

FORLENZA: Murray Barnes (the independent risk manager with responsibility for CDO area) would have known about it.

BONDI: What about Maheras?

FORLENZA & MURRAY: I don't know.

BONDI: He would have been aware at least by the 4th quarter of 2006?

FORLENZA: Yes, but I don't know if he would have known earlier.

BONDI: What were the primary risks with respect to the CDOs in 2005, in terms of the severity of risk? What about 2006, 2007, etc?

FORLENZA: We're always concerned with pricing—whether the CDOs are priced correctly—and market risk and exposure. Until we got into 2007, we knew it was a complex product and that it had to be reported and priced correctly, but until then we felt that we would be somewhat insulated from the shocks of the market. We didn't feel overly concerned about it.

BONDI: These reports that you described, are there recommendations included in the reports?

FORLENZA: Yes.

BONDI: Were the recommendations implemented to your satisfaction? And if not, which ones were not?

FORLENZA: We didn't have any recurring issues that carried over from year to year. They were implemented to our satisfaction in North America. In Europe, we had made some comments to the business—they might still have been working on following up from previous report because it ended up requiring more technology and buildup.

In 2007 and 2008, they were still working on one of the issues that we had identified. This is at the time that we were getting out of the business. But we felt like they were following up with it.

BONDI: Joe, how reliant was your group on credit rating agencies?

FORLENZA: To the extent that it was an important part of a control process, we would accept the rating agencies as being reputable.

BONDI: You wouldn't check to independently confirm that it was an appropriate rating?

FORLENZA: That's correct.

BONDI: And ratings were an important part in evaluating the risk?

FORLENZA: They were an important part of the controls that we used to mitigate those risks.

BONDI: The SIVs were brought onto balance sheet. Were you a part of the decision to bring SIVs on balance sheet? Were you consulted/?

MURRAY: No. Most of the work revolved around pricing type work. In 2007 and 2008, as a lot of the assets became illiquid, we looked at the pricing of the assets in those vehicles.

BONDI: A portion of those SIVs were RMBS. How much?

MURRAY: I would say in a range it was 10-25% of the vehicle, depending on which of the seven SIVs you're talking about.

BONDI: Was there a percentage of RMBS that was subprime in nature?

MURRAY: Less than 1%. A very, very small percent would be subprime.

BONDI: Do you have an understanding of what prompted Citi to bring the SIVs onto its balance sheet?

MURRAY: No.

BONDI: What kind of interaction did you have with Tom Maheras?

MURRAY: We met periodically, usually in the context of BRCC meetings.

BONDI: Did you meet at same rate, or did the frequency change?

MURRAY: Usually at same rate. We'd try to get together on a quarterly basis, but that didn't always happen. BRCC was the main forum for the meetings.

BONDI: Do you think Maheras appreciated the risks that the CDO business posed to Citigroup?

MURRAY: I did not have any direct conversations with Tom about the risks that the CDOs had to the organization. In my interactions with this team, I got the impression that they clearly understood the risks to the organization.

BONDI: Same question to Joe.

FORLENZA: I didn't interact with Maheras. My conversations were with Randy, Geoff, and Paco [mentioned above].

BONDI: In hindsight, could you have done a better job in the course of your review of the CDO business at Citi?

MURRAY: I think that the mistake that was made from our perspective was that when you look at the structure of the CDOs and look at it from a credit rating perspective, it was ultimately the underlying structure of these products that was the problem. Looking at the buildup of subprime exposures collectively, the framework of the business needed to be driven much more by the structure of the CDO from a risk perspective. When you look back and saw what caused the implosion and caused the issues that we faced and the deterioration of the market, it was really the understanding of the components of that structure.

I don't think w e would have changed our audit process, but the overall mistake was related to the risk framework at the end of the day.

BONDI: By risk framework, are you talking about that which was overseen by Bushnell?

MURRAY: In hindsight, I'm referring to the risk framework not just for Citi, but for the whole industry. The comfort of sitting at the top of the chain with a CDO on a pile of assets wasn't necessarily the best way to structure.

BONDI: How often did you see Bushnell? What grade would you give him?

MURRAY: I saw him at quarterly meetings. It's difficult to assign a grade. If you knew then what you know today, you'd have to grade it very harshly that those things were missed.

BONDI: Looking back with what you know now, what grade would you give him?

MURRAY: I'd have to say a D.

BONDI: Back then and looking forward, what grade would you have given him at the time?

MURRAY: I thought the focus was to have us positioned in the most secure part of those structures. I'd put him in the C to B range.

BONDI: The same question to Joe. How often did you interact with him?

FORLENZA: I had minimal contact with him. If you look back and look at the financial impact and the ramifications that it's had, it's hard to make a case for the—it's in the D range. Looking at what was going on at the time in the industry, and there was a lot of interaction with regulators, none of those entities had the answer to this, at least from this perspective. I would give him a C or C+ at the time.

KREBS: Did you ever have occasion to look at one division who had a very critical view of a market, while at the same time another division going directly against by committing significant assets to the market. What would you do in this situation, with two disparate positions held in the organization?

MURRAY: You will have differing views within the organization, and that's how risk comes into play. One area might short the market and one area might be long, and that's how Citi is structured.

BONDI: In 2006, who within Citigroup was the most critical of David Bushnell?

MURRAY: I never heard anyone openly criticize him

BONDI: Did that change in 2007?

MURRAY: As events were unfolding in the early quarters of 2007, there was some challenging of the way that we had been doing things. To attribute it to any one individual would be very difficult. N o, I can't remember anyone openly criticizing him. I would participate in the Corporate Audit and Risk Management subcommittees, and there were challenges going on, but I can't remember one in particular.

BUERGEL: That's a tough question.

MURRAY: As risk management was being restructured, there was a transition period.

BONDI: Have there been occasions and reports, documents, evaluations, memos, etc. in which Citi did a post mortem on risk management, the audit function, etc.?

MURRAY: From a risk management perspective, you should look at the changes that Brian Leach made going forward to create a new risk management structure.

BUERGEL: That should be in the board minutes.

BONDI: Can you flag those within the board material?

BUERGEL: Yes

FORLENZA: No, I didn't hear any criticism with Bushnell.

BONDI: [Explains need for confidentiality.]

[END AT 3:25PM]

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