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THE FINANCIAL CRISIS INQUIRY COMMISSION

Official Transcript

Commission Hearing

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COMMISSIONERS

PHIL ANGELIDES, CHAIRMAN

BILL THOMAS, VICE CHAIRMAN

BROOKSLEY BORN

BYRON GEORGIU

KEITH HENNESSEY

HEATHER MURREN

JOHN W. THOMPSON

PETER WALLISON

Reported by: Cassandra E. Ellis, RPR

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P R O C E E D I N G S

1
2 CHAIRMAN ANGELIDES: Good morning. The
3 meeting of the Financial Crisis Inquiry Commission
4 will come to order.

5 I want to welcome everyone on behalf of
6 Vice Chairman Thomas and the rest of the
7 Commissioners. We're honored to welcome you as we
8 begin three days of public hearings focused on the
9 role of subprime lending and securitization in the
10 financial and economic crisis that has gripped our
11 nation.

12 I want to thank Vice Chairman Thomas and
13 all my fellow Commissioners for all their hard work
14 and dedication as we strive to fulfill our mission on
15 behalf of the American people. And I particularly
16 want to thank Commissioners Murren, Georgiou, and
17 Wallison, who are the lead Commissioners in
18 preparation for this hearing and for our investigation
19 into subprime lending practices.

20 This hearing is one of a series that will
21 focus on key topics which this consider -- Commission
22 must consider as we examine the causes of the
23 financial crisis.

24 Over the next several months, we will look
25 at the role that, among other things derivatives,

1 credit ratings agencies, the shadow banking system,
2 too-big-to-fail institutions, regulatory failure, and
3 speculation played in bringing our financial system to
4 its knees. These hearings are just part of a research
5 and investigation effort we are undertaking to
6 under -- to conduct a full and fair inquiry that this
7 nation deserves.

8 In each of these hearings, we will examine
9 the larger forces, policies and events that may have
10 shaped the crisis. And we will also undertake a
11 series of case studies of companies and government
12 agencies so we can see what happened on Wall Street
13 and in Washington as the seeds of this crisis were
14 sown and as it developed and spread across the nation
15 and the globe.

16 As we meet today, the mortgage and housing
17 crisis is still very much with us over two million
18 American families have lost their homes to
19 foreclosure. Another two million homes are in the
20 foreclosure process; and an additional 2.5 million
21 households are more than 90 days behind on their home
22 loans.

23 One in four homeowners owe more on their
24 mortgages than the value of their homes. And American
25 households have lost almost 7 trillion dollars in

1 residential home value.

2 Over the next three days we will look at
3 how we got to where we are today. We'll examine the
4 role of the Federal Reserve in the mortgage crisis and
5 in subprime lending. We'll explore Citigroup's
6 activities and losses related to subprime loans and
7 mortgage-related securities. We will probe the
8 actions of the Office of the Comptroller of the
9 Currency as it oversaw Citigroup and other financial
10 institutions engaged in the subprime market. And we
11 will look at what happened at Fannie Mae and its
12 regulator as the crisis unfolded.

13 As we have noted before, this Commission is
14 a proxy for the American people, perhaps the only
15 opportunity to have their questions asked and
16 answered. On their behalf, we hope to take stock of
17 what happened so we can learn from it and restore
18 faith in our economic system.

19 As always, we welcome your thoughts and
20 input. In that regard, we have posted, on our web
21 site, draft preliminary staff reports for review and
22 comment. Those can be found at FCIC.GOV. These
23 reports have not been adopted by the Commission and we
24 invite you to submit your comments by May 15th.

25 Today's hearing is another step along the

1 road in our inquiry. We hope it will further our and
2 the public's understanding of what has happened. We
3 need candor about the past so we can face the future.

4 I'd now like to ask Vice Chairman Thomas to
5 make some opening remarks, along with me, this
6 morning. Thank you.

7 VICE CHAIRMAN THOMAS: Thank you,
8 Mr. Chairman. I, too, want to thank all of the
9 participants in the hearing. I want to underscore the
10 fact that everyone we have worked with have been
11 extremely cooperative and, therefore, none of the
12 statutory tools that we have available, which will
13 allow us even with uncooperative folks to get the
14 story, have been necessary.

15 The people who are here before us today
16 have a story to tell, it isn't necessarily the
17 exclusive story of those who are telling it,
18 especially when we look at a corporation like
19 Citicorp.

20 We're not singling out anyone, but as we
21 examine the fundamental, systemic crisis, we thought
22 it was useful and valuable, frankly, to have examples
23 so that we could, with the public, in these public
24 hearings, examine, in some depth, the questions that
25 we will be asking others: Other corporations, other

1 government agencies, other important players, a little
2 bit like just showing the tip of the iceberg with
3 seven-eighths behind the scenes in terms of what we're
4 doing.

5 As we did in the first hearing I'm going to
6 ask each witness if they would voluntarily allow us to
7 continue our communication with them, in writing,
8 since this is the journey of education for us as well
9 as the American people.

10 And at any one time the questions we may
11 think relevant, of the various witnesses, may very
12 well be, but not the kind of follow-up questions that
13 we would very much enjoy continuing to get answers to,
14 which are impossible only in the setting of a hearing.

15 So, Mr. Chairman, it's a pleasure to be
16 here. I thank the Chairman for kicking this off for
17 us, with the full understanding that we're ju- -- just
18 dealing with one-eighth of what it is that we're going
19 to be looking at, and seven-eighths will go on behind
20 the scenes, as it has for several months.

21 Thank you, Mr. Chairman.

22 CHAIRMAN ANGELIDES: Thank you, Mr. Vice
23 Chairman.

24 Now, Chairman Greenspan, as we have done
25 with all witnesses, and we will do with all witnesses

1 through the course of our hearings, I'm going to ask
2 you to stand so I can administer the oath to you.

3 Do you solemnly swear or affirm, under
4 penalty of perjury, that the testimony you are about
5 to provide the Commission will be the truth, the whole
6 truth and nothing but the truth, to the best of your
7 knowledge?

8 MR. GREENSPAN: I do.

9 CHAIRMAN ANGELIDES: Thank you very much.

10 So, Mr. Chairman, first of all, let me
11 start by saying thank for being here; thank you for
12 your extraordinary years of public service.

13 And, with that, I would -- I know you've
14 submitted written testimony to us, and I would ask if
15 you would like to make opening remarks of no greater
16 than ten minutes in terms of oral testimony to us, if
17 you would like to commence now.

18 MR. GREENSPAN: Thank you very much. Thank
19 you very much.

20 CHAIRMAN ANGELIDES: Can you pull the
21 microphone toward you?

22 VICE CHAIRMAN THOMAS: Is there an on/off
23 button, there?

24 MR. GREENSPAN: I thought I had it, I
25 missed it. Chairman Angelides?

1 the Ways and Means Committee had the microphones
2 working. So I'm going to read the contract you have
3 with the Chairman in terms of what it is that we get
4 when we get the room.

5 CHAIRMAN ANGELIDES: Here we go. No?

6 VICE CHAIRMAN THOMAS: We're on -- we're on
7 the track. I'm going to blame it on them scrambling
8 over there, the reporters.

9 CHAIRMAN ANGELIDES: Live television. All
10 right.

11 Good morning, this is -- welcome to the
12 meeting of the Financial Crisis Inquiry Commission.
13 All right, thank you very much.

14 And with that, Chairman Greenspan, of no
15 more than ten minutes, an opening statement.

16 MR. GREENSPAN: Thank you very much,
17 Mr. Chairman. Good morning to you, Vice Chairman
18 Thomas and members of the Commission.

19 I want to thank you for the opportunity to
20 share my views on important issues raised in the
21 Commission's invitation to appear today.

22 As I noted in my prepared remarks, while
23 the roots of the crisis were global it was securitized
24 U.S. subprime mortgages that served as the crises'
25 immediate trigger.

1 The rate of global housing appreciation was
2 particularly accelerated beginning in late 2003 by the
3 heavy securitization of American subprime and Alt-A
4 mortgages, bonds that found willing buyers at home and
5 abroad, many encouraged by grossly inflated credit
6 ratings.

7 The search and demand for mortgage-backed
8 securities was heavily driven by Fannie Mae and
9 Freddie Mac, which were pressed by the Department of
10 Housing and Urban Development and the Congress to
11 expand affordable housing commitments.

12 During 2003 and 2004 the firms purchased an
13 estimated 40 percent of all private label subprime
14 mortgage securities newly purchased and retained on
15 investors' balance sheets.

16 The enormity of these purchases was not
17 revealed until Fannie Mae in September 2009
18 reclassified a large part of its prime mortgages
19 securities portfolio as subprime.

20 And yet the effect of these GSE purchases
21 was to preempt 40 percent of the market up front,
22 leaving the remaining 60 percent to fill other
23 domestic and foreign investor demand.

24 As a consequence, mortgage yields fell
25 relative to ten-year treasury notes, exacerbating the

1 house price rise, which in those years was driven by
2 interest rates on long-term mortgages.

3 I warned of the consequences of this
4 situation -- to testimony -- in testimony before the
5 Senate Banking Committee in 2004, and specifically
6 recommended that the GSEs need to limited in the
7 issuance of GSE debt and in the purchase of assets,
8 both mortgages and non-mortgages, that they hold. I
9 still hold that view.

10 The U.S. subprime market -- subprime market
11 grew rapidly in response to this demand, from global
12 investors, GSEs, and others. For years subprime
13 mortgages in the United States had been a small but
14 successful appendage to the broader U.S. home mortgage
15 market, comprising less than 2 and a half percent of
16 total home mortgages serviced in the year 2000.

17 At that time almost 70 percent of subprime
18 loans were fixed rate mortgages. Fewer than half had
19 been securitized, and few, if any, were held in
20 portfolios outside the United States.

21 By early 2007 virtually all subprime
22 originations were being securitized and subprime
23 mortgage securities, outstanding, totaled more than
24 900 billion dollars, a more than six fold rise since
25 the end of 2001.

1 The large imbalances of demand led mortgage
2 originations to reach deeper into the limited
3 potential subprime homeowner population by offering a
4 wide variety of exotic products, products that lowered
5 immediate monthly servicing requirements, thereby
6 enabling previously untapped, high-risk, marginal
7 borrow- -- borrowers to purchase a home.

8 Consequently, subprime loan underwriting
9 standards rapidly deteriorated, and subprime mortgage
10 originations swelled in 2005 and 2006 to a bubbly
11 20 percent of all U.S. home mortgage originations,
12 almost triple their share in 2002.

13 The house price bubble was engendered by
14 lower interest rates but not the overnight rates of
15 central banks. It was long-term mortgage rates that
16 galvanized prices.

17 And by 2002 and 2003 it had become apparent
18 that individual country long-term rates were, in
19 effect, de-linked from the historical tie to central
20 bank overnight rates.

21 In 2002 I expressed concern to the Federal
22 Open Market Committee noting that our extraordinary
23 housing boom financed by very large increases in
24 mortgage debt cannot continue indefinitely.

25 Yet it did continue, despite the extensive

1 two-year-long tightening of monetary policy that began
2 in mid-2004.

3 In addition to tightening monetary policy
4 and warning of GSE risks, the Federal Reserve
5 exercised oversight of consumer protection risks under
6 the Home Ownership Equity Protection Act and its
7 general supervisory authority.

8 In 2000 the Board held hearings around the
9 country on implementing its HOEPA authority, focusing
10 on expanding the scope of mortgage loans covered by
11 HOEPA, on prohibiting specific practices, on improving
12 consumer disclosures, and of educating consumers.

13 Thereafter, we adopted rules that lowered
14 the trigger for HOEPA coverage and increased consumer
15 protections, including limitations on flipping, the
16 use of balloon payments, and the sale of
17 single-premium credit insurance.

18 More broadly, the Federal Reserve carefully
19 monitored, in the subprime market, and adjusted
20 supervisory policy to meet evolving marketplace
21 challenges. In March 1999 the Federal Reserve issued
22 its first inter-agency guidance on subprime lend- --
23 lending, which addressed a variety of subprime
24 mortgage risks, including the importance of reliable
25 appraisals and the need for income and other

1 documents, documentation.

2 In October 1999, in 2001, and in 2004, the
3 Federal Reserve issued detailed guidance addressing
4 many of the loan features that have received recent
5 attention, including prepayment penalties, low
6 introductory rates and low down payment loans, among
7 others. A summary of these initiatives is included
8 with my written testimony.

9 The supervision of the federal banking
10 agencies, including the Federal Reserve, is an
11 important reason why banks and bank holding company
12 affiliates were not as significant originators of the
13 most controversial loan products as non- -- as
14 non-bank affiliated companies that operated outside
15 the jurisdiction of federal bank regulators.

16 The recent crisis reinforces some important
17 messages about what supervision and examination can
18 and cannot do. The forecasts of regulators have had a
19 woeful record of chronic failure. History tells us
20 regulators cannot identify the timing of a crisis or
21 anticipate exactly where it will be located or how
22 large the losses and spillovers will be. Regulators
23 cannot successfully use the bully pulpit to manage
24 asset prices, and they cannot calibrate regulation and
25 supervision in response to movements in asset prices.

1 Nor can regulators fully eliminate the possibility of
2 future crises.

3 What supervision and examination can do is
4 promulgate rules that are preventative and rules that
5 are preventative and that make the financial system
6 more resilient in the face of inherently unforeseeable
7 jobs. Such rules would protect automatically without
8 relying on a fallible human regulator to predict the
9 coming crisis.

10 Concretely, I argue that the primary
11 imperatives, going forward, have to be, one, increased
12 risk-based capital and liquidity requirements on banks
13 and, two, significant increases in collateral
14 requirements for globally traded financial products
15 irrespective of the financial institutions making the
16 trades. We will also need far greater enforcement
17 of -- of misrepresentation and fraud than has been the
18 case for decades.

19 If capital and collateral are adequate and
20 enforcement against misrepresentation and fraud is
21 enhanced, losses will be restricted to equity
22 shareholders who seek abnormal returns but in the
23 process expose themselves to abnormal losses.

24 CHAIRMAN ANGELIDES: Mr. Chairman, could
25 you also -- could you try to wrap up, at least in

1 terms of --

2 MR. GREENSPAN: I will in just a moment,
3 one sentence.

4 Taxpayers will not be at risk, and
5 financial institutions will no longer be capable of
6 privatizing profit and socializing losses.

7 I thank the Commission for the opportunity
8 to submit these thoughts and look forward to answering
9 your questions.

10 CHAIRMAN ANGELIDES: Good. Thank you very
11 much.

12 EXAMINATION BY CHAIRMAN ANGELIDES

13 CHAIRMAN ANGELIDES: So, Mr. Chairman, I
14 will start with a few questions and then the Vice
15 Chair and then we're going to go to the members, the
16 lead members, on this hearing.

17 So, let me pick up on some of your
18 testimony, both your written testimony as well as what
19 you have talked about today. And I specifically want
20 to focus on the area of subprime lending, which as you
21 know and you've indicated, that exploded across this
22 country from 2000 on, particularly in the later years.

23 And in your testimony, you pointed to the
24 fact that the securitization of toxic, subprime
25 mortgages was a key driver of the crisis. And, of

1 course, that securitization could not have occurred
2 without the origination of those products.

3 I want to focus very specifically on the
4 actions that the Federal Reserve could have taken, did
5 or did not take, with respect to reg- -- regulating
6 subprime mortgage products across this country.

7 And, specifically, I want to touch on
8 something you mentioned, the Home Ownership and Equity
9 Protection Act, and I have other questions about other
10 areas in which you could have acted.

11 So let me lay this out for you. I mean,
12 first of all, there was a whole set of a pieces of
13 public action urging the Federal Reserve to act, as
14 well as public information, which would have urged you
15 to do the same.

16 And starting about 1999, a set of community
17 groups began to visit with the Federal Reserve,
18 warning about predatory lending practices. In January
19 of 2000, both HUD and Treasury urged the Federal
20 Reserve to use its authority, under HOEPA to curb
21 abusive lending. In 2002, Sheila Bair, then Assistant
22 Secretary of the Treasury, worked hard to try to put
23 in place best practices for mortgage -- subprime
24 mortgage lending. In 2004, the FBI warned that there
25 was an epidemic of mortgage fraud that if unchecked,

1 could lead to losses greater than the S&L crisis. In
2 2005, the mortgage insurers wrote a letter to the
3 Federal Reserve as well as other federal agencies,
4 warning that it is, quote, deeply concerned about
5 increased mortgage market fragility, which combined
6 with growing bank portfolios and high-risk products
7 poses serious potential problems that occur without --
8 with dramatic suddenness.

9 In addition to that there were a number of
10 internal actions, some of which you referred to: A
11 staff memo in 1998 to the Community and Consumer
12 Affairs Committee, urging action in this area; a
13 report by the staff called The Problem of Predatory
14 Lending, in November 2000 in which the staff proposal
15 urged that loans be banned to people who did not have
16 the ability to pay and that there be broad
17 prohibitions on deceptive lending; Governor Gramlich,
18 of course, urged the promulgation of regulations.

19 You did note that you issued guidance, not
20 regulation, which showed an awareness of the subprime
21 problem.

22 And in our interview by our staff of you,
23 you noted yourself that "I sat through innumerable
24 meetings on HOEPA, the issues came up quite often", and
25 you noted also, at another point recently that we at

1 the Federal Reserve were aware as early of 2000 of
2 incidence of some highly irregular, subprime mortgage
3 underwriting practices.

4 I mean very simply, Mr. Chairman, why, in
5 the face of all that, did you not act to contain
6 abusive, deceptive subprime lending? Why did you
7 allow it to become such an infection in the
8 marketplace?

9 MR. GREENSPAN: First of all, Mr. Chairman,
10 we did. There is a whole series of actions that we
11 take, which I've outlined in the appendix, which you
12 have and which I repeated summarily in my testimony.

13 But, you know, let's remember that in a
14 document that you sent to us, which is a Federal
15 Reserve document, it says, in July 1998, the Federal
16 Reserve board and HUD submitted a report to Congress
17 on mor- -- mortgage reform. That report concluded
18 that improved disclosures alone were unlikely to
19 protect vulnerable consumers from unscrupulous
20 creditors.

21 The report recommended that Congress
22 consider the need for additional legislation. And the
23 report made several recommendations to possible
24 amendments to HOEPA, such as further restricting
25 balloon notes, regulating the sale of single-premium

1 credit insurance, and minimum standards for
2 foreclosure.

3 Now, I sat through innumerable meetings on
4 the issue of HOEPA. And we had, for example, detailed
5 requests coming from a large group of representatives
6 in 2000, and I think it was seven senators, about a
7 month or so later, requesting that we do a series of
8 things, I mean, including taking the HOEPA trig- --
9 trigger down from 10 percent to 8 percent, and a whole
10 list of things, which I won't outline here, but they
11 are in the appendix.

12 We did do almost all of the things that you
13 are raising. And the consequence of that is that I
14 think things were better than they would have been.
15 Were they enough to stop the surge in subprime
16 lending? They were not. And the reason for that is
17 the extraordinary changes that were going in the
18 marketplace and, indeed, the actions of Fannie and
19 Freddie, which we didn't know about until September
20 2009, which altered the structure of that market from
21 what was in, say, prior to 2002, a small,
22 well-functioning group -- institution.

23 CHAIRMAN ANGELIDES: But I want to -- I
24 want to press on this, because you didn't have the
25 ability to regulate Fannie and Freddie. And, by the

1 way, I've seen your numbers, and we're going to have a
2 whole day on them, and clearly things did not go well
3 at those institutions, given where they stand today
4 and over a hundred billion dollars of taxpayer
5 assistance to them.

6 But I just do want to note that you cited
7 the numbers from `03 and `04. They were 13 percent of
8 the private label security market in `05, and they
9 were negligible in `06.

10 But what I really want to say is you -- you
11 did have the ability to regulate the products
12 currently in the marketplace. And so, you know, I do
13 want to make sure we're not rewriting or forgetting
14 history here.

15 And so I want to focus on what the result
16 was of what the Federal Reserve did. You mention the
17 guidance and, in fact, I know you issued guidance in
18 1999, 2001, 2004, 2006, 2007, of course that was
19 guidance to examiners, not binding, and most
20 importantly couldn't apply to the whole marketplace
21 like HOEPA could. It could only apply to those
22 institutions you regulated, not all the independent
23 mortgage lenders across the country.

24 So it's good that you issued guidance, but
25 I think that's more evidence that there isn't an

1 awareness of the problem and a failure to act.

2 But I want to specifically focus on the
3 2001 regulations which you cited. And, in fact, I
4 think you said in your interview to our staff that,
5 quote, we developed a set of rulings that have held up
6 to this day.

7 But here are the facts: The facts are you
8 adopted those rules in 2001. And at the time that
9 they were adopted, they were projected to cover
10 38 percent of the subprime lending activity in the
11 country.

12 When it was all said and done and an
13 evaluation was done of those rules in 2006, not 2009,
14 2010, what in fact had happened is the rules you
15 adopted covered just 1 percent of the market.

16 And so I return to you, again, was there
17 just a reluctance to regulate? Was there just a
18 belief that regulation was not the right tool to kind
19 of constrain this level of abusive lending that ended
20 up leading to the origination of product and then the
21 mass securitizations you talked about?

22 Because frankly, without the origination,
23 you couldn't have the securitization. But comment
24 specifically on that 1 percent. Are you aware that
25 that finding was that the rules only covered

1 1 percent?

2 MR. GREENSPAN: Well, look, Mr. Chairman,
3 I'll just go back to what I said in my opening
4 remarks.

5 We at the board in 1998 were obviously
6 aware of the nature of the problems. Remember that
7 the Federal Reserve board is a rule-making; it is not
8 an enforcement agency. We did not have the capacity
9 to implement to the types of enforcement that the FTC
10 has, HUD has, the Department of Justice, and
11 consequently that -- we were -- we were extending what
12 the rules should be and, indeed, we covered as much as
13 one -- anyone could conceive of.

14 CHAIRMAN ANGELIDES: But if you had adopted
15 those broader rules the FTC could have enforced
16 them --

17 MR. GREENSPAN: No, but we did adopt --

18 CHAIRMAN ANGELIDES: -- and others could
19 have enforced them.

20 MR. GREENSPAN: No, we did adopt a whole
21 series of rules.

22 CHAIRMAN ANGELIDES: But as I said, they
23 only covered 1 percent of the activity. I mean, you
24 know, my view is, and I want to move on to another
25 issue, is you could have, you should have, and you

1 didn't. And I do think this is one area we have to
2 explore, how this contagion could have been
3 constrained.

4 Let me move on to a related issue, and it
5 does; it's the same issue but it's a different take.

6 There was the issue of examination of
7 non-bank subsidiaries. In January 1998, you
8 formalized a policy not to conduct routine consumer
9 compliance exams of the non-bank subsidiaries under
10 your purview. The GAO criticized that policy in
11 November 1999. Governor Gramlich proposed that there
12 should be examinations of consumer finance lenders,
13 which would have covered, depending on the
14 calculation, anywhere between another 12 to 18 percent
15 of the subprime originations. It wouldn't have
16 covered everyone by any extent.

17 There was an August 2000 memo from Delores
18 Smith and Glen Loney, I think, of your staff, called
19 compliance inspections of non-bank subsidiaries of
20 bank holding companies suggesting a pilot program. In
21 2004 the GAO weighed in again, urging action given,
22 quote, the significant amount of subprime lending
23 among holding company subsidiaries. But, again, no
24 action, no willingness to go in and examine a non-bank
25 subsidiaries.

1 Even though after your tenure, finally in
2 2007, the Federal Reserve with the FTC and the OTS and
3 state regulators did launch a pilot and then, in 2009,
4 began those examinations. Why weren't you willing to
5 go in and at least examine these institutions?

6 MR. GREENSPAN. Well, first of all, let me
7 just say, with respect to 2009, supervision and
8 regulation evolves over the years. And I thought what
9 the actions the Fed took, in recent years, well after
10 I left, were appropriate given the changing
11 conditions.

12 But let's -- let me take a second to give
13 you a sense in how the decision making operations at
14 the Fed took place.

15 We have, of course, this hundred large,
16 very sophisticated, professional group in the division
17 of consumer and community affairs, we have an outside
18 consumer advisory group, we had 12 community groups
19 within each of the Federal Reserve banks, and we
20 finally had the subcommittee of the board, which is a
21 committee on consumer and community affairs, which
22 essentially oversaw a whole operation. That
23 operation, as it worked its way through, would come to
24 the board of governors with recommendations.

25 Now, all I'm saying to you is that with

1 respect to a number of the issues that, for example,
2 Governor Gramlich, who is, frankly, one of the best
3 governors I think the board has ever had and a very
4 close friend of mine, he was the chair of that
5 committee and, indeed, we always looked to him to
6 decide which we should be doing and which we shouldn't
7 be doing because he had the most knowledge.

8 He chose not to bring those issues to the
9 board. So I can't say, particularly, why, in
10 individual cases, but frankly I always thought his
11 grasp of the situation was as good as anybody I had
12 ever run into in the issue of consumer an affairs.

13 CHAIRMAN ANGELIDES: Well, he was one of --
14 he was one person, but there were also others and
15 there were staff reports, I mean, would you -- let me
16 just ask you -- would you put this under the category
17 of, "Oops," should have done it?

18 MR. GREENSPAN: I'm sorry, of what?

19 CHAIRMAN ANGELIDES: Would you have put
20 this all under the category of, "Oops," we should have
21 done it?

22 MR. GREENSPAN: You know, I -- when you've
23 been in government for 21 years, as I have been, the
24 issue of retrospective and figuring out what you
25 should have done differently is a really futile

1 activity because you can't, in fact, in the real
2 world, do it.

3 I mean, I think, I mean, my experience has
4 been in the business I was in, I was right 70 percent
5 of the time, but I was wrong 30 percent of the time.
6 And there are an awful lot of mistakes in 21 years.

7 So I --

8 CHAIRMAN ANGELIDES: Would this be one of
9 them?

10 MR. GREENSPAN: I'm not sure -- I'm not
11 sure what good it does --

12 CHAIRMAN ANGELIDES: Would you put this in
13 the 30 percent category?

14 MR. GREENSPAN: I'm sorry?

15 CHAIRMAN ANGELIDES: Would you put this in
16 the 30?

17 MR. GREENSPAN: I don't know.

18 CHAIRMAN ANGELIDES: All right, let's do
19 this, then.

20 MR. GREENSPAN: Certainly part of it I
21 would.

22 CHAIRMAN ANGELIDES: Let's do this, then,
23 I'm going to stop at this moment. I'll have
24 additional questions, but what I would like to do is
25 now move to Commissioner Murren -- oh, I -- to my dear

1 friend, Bill Thomas. Bill Thomas?

2 VICE CHAIRMAN THOMAS: Thanks, to my dear
3 friend the Chairman.

4 EXAMINATION BY VICE CHAIRMAN THOMAS

5 VICE CHAIRMAN THOMAS: You are in 21, '87
6 to '06, I was in 28, from '78 to January of '07. I
7 used to think timing was really important. Now I
8 think timing's everything.

9 And so, from your perspective and my
10 perspective, looking back at it, and in this
11 particular instance, probably more so than anyone I
12 can think of, there are enormous number of would have,
13 could have, should have from an enormous number of
14 institutions in government and in the private sector.

15 One of the things -- and you've written a
16 book, the recent paper in front of Brookings, the
17 crisis and your analysis here does a pretty good job
18 of pointing out problems in a number -- and you
19 focused, to a certain extent, on government and not --
20 and not the private sector, but it's easy to do in
21 terms of risk management decisions that were made.

22 I want to try to focus in a slightly
23 different way on your role as the chairman of the
24 Federal Reserve. During a period that you and I
25 shared in terms of an economy that in your attempts to

1 stimulate you were beginning to run out of basis
2 points in the cupboard, and we were real close to
3 jawboning because that was all we were going to have
4 left, and always when you approach a crisis you
5 approach it from today looking at tomorrow.

6 It's unfair, as you said, but I would like
7 you, for just a little bit, to turn around, because
8 you've categorized concerns in the credit rating
9 structure, risk management structure, obviously the
10 GSEs, and I'm not going to ask you to assign a
11 weighting, but I do want to ask you, since we're not
12 going to be able to accomplish everything that we want
13 to accomplish in the timeframe, as I said in my
14 opening statements, would you be willing to respond to
15 written questions, in part based upon this hearing,
16 but in the other information that we might need,
17 moving forward, understanding consideration of time,
18 place, and manner.

19 MR. GREENSPAN: Most certainly, I would be
20 delighted to do so.

21 VICE CHAIRMAN THOMAS: Thank you very much.

22 In your testimony you point to a lot of the
23 causes, none of them, not the subprime mortgage
24 origination, nor the housing bubble, nor the prudent
25 regulation of large entities, like Citi, that we'll

1 hear from, are really the narrow focus and even to a
2 certain extent the broader focus of the Fed.

3 So, in your words, what, exactly, is the
4 role and, therefore, the degree of fault that should
5 fall on the Federal Reserve --

6 MR. GREENSPAN: Well --

7 VICE CHAIRMAN THOMAS: -- during that
8 period?

9 MR. GREENSPAN: Yeah, statutorily we have a
10 number of -- we had a number, and still do, have a
11 number of different authorities. Fundamentally, it's
12 monetary policy, and that's what a central bank does.
13 We had supervision and regulation as secondary but
14 major issue. And we even, as we specify in the --
15 some of our written documents, the third one was
16 systemic risk.

17 So there's a very broad mandate that the
18 Federal Reserve has, and it's structured according to
19 meet those particular mandates.

20 We have an organization that is the best in
21 the business, as I'm concerned, in the issue of
22 monetary policy. I know of no better supervision and
23 regulatory operation than exists within the total
24 Federal Reserve system. And we are dealing basically
25 with problems by its very nature which are insoluble that

1 require us to make judgments about what the future is
2 going to hold.

3 And as I mentioned before, if we get it
4 right 70 percent of the time, that is exceptionally
5 good. And I think that we -- what we tried to do is
6 the best we could with the data that we had, and all I
7 can say is did we make mistakes? Of course we made
8 mistakes. I don't know of -- I know of no way that
9 that can be altered under the existing structure.

10 And I make a special point, as you know, of
11 trying to emphasize that the only type of regulation
12 that works and, in fact, works sufficiently and
13 adequately are those that do not require forecasts.

14 VICE CHAIRMAN THOMAS: Is it fair for me to
15 indicate that the thrust of your testimony was that
16 the crisis to a very great extent was caused by the
17 demand for subprime securities; is that a fair --

18 MR. GREENSPAN: Well, the fundamental cause
19 of the crisis goes back to the end of the Cold War,
20 which is pretty obscure, but it's a global crisis.

21 You cannot think of the United States
22 crisis in any form without looking at the global
23 context.

24 VICE CHAIRMAN THOMAS: I'm going -- I'm
25 going to get into that as we go forward, but the

1 narrow focus -- and I do want to thank you for citing
2 a book which I think is especially useful, Reinhart
3 and Rogoff, in getting the context and taking us down
4 memory lane on the history of bubbles.

5 But if you were focusing on subprime
6 securities, weren't they certainly predicated, to a
7 degree, on rising housing prices?

8 MR. GREENSPAN: First of all, let's
9 remember that the subprime mortgage market was
10 actually a very effective market in its early years.
11 It served a limited population, homeowner, potential
12 homeowner population, which couldn't afford the
13 20 percent down payment that prime mortgages required.

14 VICE CHAIRMAN THOMAS: I agree with you in
15 the early history. I've looked at statements from
16 1999. As they were moving into this area, a number of
17 people wanted it, isn't that the story of all bubbles,
18 regardless of what it is, whether they all start out
19 with good intentions and somehow they go awry?

20 MR. GREENSPAN: Well, I'm just trying to --

21 VICE CHAIRMAN THOMAS: And what we're
22 trying to focus on is, in this particular bubble, what
23 is it that went awry?

24 Would you feel comfortable saying that at
25 least some of the concern with the housing bubble was

1 the FED's monetary policy or not at all?

2 MR. GREENSPAN: I'll try to explain, in
3 some detail. In the Brookings paper I go through a
4 lot of econometrics and the like, that certain
5 fundamental things changed in the world economy, which
6 made monetary policy, essentially, ineffective in
7 dealing with long-term asset prices.

8 So are you asking --

9 VICE CHAIRMAN THOMAS: I agree with you. I
10 understand the argument. I'm just trying to move down
11 a line.

12 MR. GREENSPAN: I would say --

13 VICE CHAIRMAN THOMAS: And clearly capital,
14 the savings rate, the change in the movement of money,
15 and that had you -- it wasn't monetary policy in terms
16 of your argument because, frankly, longer-term yields
17 would have been kept down by the inflow of capital and
18 long-term rates were kept below -- low by
19 international capital flows.

20 But isn't it a minimally fair statement to
21 at least say that if you had raised rates, wouldn't
22 longer rates, albeit suppressed somewhat, still would
23 have risen and slowed the growth of the housing
24 bubble?

25 MR. GREENSPAN: I'm afraid that's precisely

1 what we found didn't happen. We --

2 VICE CHAIRMAN THOMAS: And so even more
3 capital would be flowing in, and it would have left
4 basically long-term rates unchanged?

5 MR. GREENSPAN: Well, you cannot explain --

6 VICE CHAIRMAN THOMAS: And that's your
7 argument, isn't it?

8 MR. GREENSPAN: What I'm saying is,
9 basically, you cannot explain long-term rates in the
10 United States, other than what is being arbitrated in
11 the rest of the world, is the data I produced in the
12 Brookings paper demonstrates that between the years
13 2002 and 2005, the period when the bubble was
14 emerging, that short-term rates, that is, the federal
15 funds rate, over which we had full control, did not
16 affect long-term rates.

17 And that, as a consequence of that, even
18 though we tightened monetary policies, starting in
19 mid-2004, for a considerable period of time, we had
20 very little to negligible effect on inflations in the
21 home markets which, of course, is what the bubble is.

22 So the simple answer to your question is --

23 VICE CHAIRMAN THOMAS: Give myself an
24 additional five minutes, Mr. Chairman.

25 MR. GREENSPAN: Simple answer to your

1 question is that the evidence stipulates that we --
2 our endeavor to tighten monetary policy did not affect
3 long-term rates as it always had at the beginning of
4 tightening cycle or earlier.

5 VICE CHAIRMAN THOMAS: Okay. If the
6 ten-year treasuries on which mortgages are based don't
7 react to short-term rates, what was the argument for
8 keeping the Fund's rate low?

9 MR. GREENSPAN: The Fund's rate --

10 VICE CHAIRMAN THOMAS: Wouldn't make any
11 difference?

12 MR. GREENSPAN: Yeah, well --

13 VICE CHAIRMAN THOMAS: It was for another
14 reason?

15 MR. GREENSPAN: Yes. The Fund's rate was
16 kept low because even though monitoring policy
17 de-linked from long-term interest rates in that
18 period, it still had a significant impact on
19 short-term rates. And short-term rates do have an
20 impact on the economy.

21 The reason we pushed rates down was in 2003
22 there was a very considerable concern that the type of
23 deflationary processes which were underway looked very
24 much like those that were occurring in Japan and,
25 indeed, similar -- similar to what is going on today,

1 and we decided that we needed insurance against that,
2 in the short end of the market. That was the reason
3 we kept rates down until mid-2004, that is.

4 VICE CHAIRMAN THOMAS: As we're looking at
5 attempts, I mean, obviously we're dealing with a
6 situation in which a number of institutions failed,
7 both in and out of government, and we're asking
8 ourselves questions: Does it make sense to
9 consolidate supervision to try to make sure that the
10 left hand knows what the right hand is doing; is it
11 better to decentralize it; what about transparency,
12 the whole question of the rating structure,
13 third-party analysis.

14 In terms of looking at where people in
15 office and in positions of responsibility are going
16 now, monetary policy, bubbles, making sure that
17 certain things don't occur again, including, I think,
18 the Fed, in terms of recent statements that are made,
19 if they're moving toward regulatory instruments to
20 target the bubble and interest rates to target
21 economic activity, isn't that, to a degree, a -- maybe
22 repudiation is too strong a term -- but isn't that
23 different than the policy that you thought was
24 appropriate, or is it that they're looking at that
25 period of history that they went through and are

1 talking about where they need to go, and what's your
2 assessment of that?

3 MR. GREENSPAN: I think it's mainly the
4 latter. It's difficult for me to know precisely what
5 was going on in meetings which I was not at, but the
6 markets are changing all the time.

7 And it is critically important for the
8 Federal Reserve to keep up with those changes, and in
9 many instances, they change in directions and require
10 actions which previously would have been
11 inappropriate.

12 VICE CHAIRMAN THOMAS: And then, just let
13 me say, that in the last large paragraph of your
14 testimony, are you really that -- in my opinion, that
15 pessimistic about our ability to deal with the
16 conditions we find ourselves in. Because inevitably
17 it will always be something else, but to a certain
18 extent, I mean, when you've got a river that overflows
19 its banks, whether it's the Nile or the Kern River,
20 building a dam seems to help in terms of allowing a
21 more regulated release. I got out of that last
22 paragraph, the only possible solution is capital and
23 collateral at an adequate rate. And I take a look at
24 Citibank, and we'll be hearing from them recently, and
25 that every turn, they were, quote, unquote, adequately

1 capitalized in all the categories.

2 So it's easy to say that, but what does
3 adequately capitalized mean? And, yes, we're in the
4 human condition and, yes, I cited a book which kind of
5 puts us in a historical perspective of, this time it's
6 different but it isn't, but I cannot believe that we
7 can't get an understanding of how we can mitigate and,
8 to me, it's always transparency; it's always someone
9 who's disinterested slowing down the process and
10 examining it, to a certain extent.

11 MR. GREENSPAN: Well, Mr. Thomas, you're
12 raising exactly what the appropriate issue that should
13 confront regulators is, what is adequate capital.

14 And the reason I say that is, leaving aside
15 what that number is, and I might -- let me just say
16 parenthetically, that you're quite right; Citi and
17 everyone else was considered adequately capitalized.
18 The major mistake in the system, that adequate
19 capitalization issue is a function of what your risk
20 management system is, and as I mention in both the
21 Brookings paper and in the testimony, the written
22 testimony, what we discovered is that there was a
23 fatal flaw in that system. We did not recognize it
24 until we saw the outcome of what happened to the
25 markets after Lehman, the Lehman bankruptcy.

1 But the issue of adequate capital is
2 important because, just think for the minute, if we
3 knew what the actual number should be, and I have
4 views as to what that number ought to be, it's
5 higher --

6 VICE CHAIRMAN THOMAS: There will be a
7 follow-up question, in writing.

8 MR. GREENSPAN: If we had adequate capital
9 and liquidity, whatever else we do would be helpful
10 but not critical. If we have everything else, but not
11 adequate capital and liquidity, the system will fail
12 to function.

13 In short, I'm saying we can solve this
14 problem on the capital liquidity and collateral side
15 as well as doing it in other areas. Like I said, fraud
16 and misrepresentation, in my judgment, over the last
17 decades, has been inadequately enforced. And that is
18 a critical question.

19 But how you structure regulation is
20 interesting, important, but not critical to resolving
21 this crisis and preventing the next one.

22 VICE CHAIRMAN THOMAS: And I think we'll
23 hear from a number of folks offering testimony that
24 fraud or behavior should have consequences. And if
25 it's illegal or criminal, something should result from

1 it. And it has been, in my opinion, a failure from
2 Main Street to Wall Street and here in the nation's
3 capital. Thank you very much.

4 CHAIRMAN ANGELIDES: All right. Thank you,
5 Mr. Vice Chairman. Now, we are going to go to
6 Ms. Murren.

7 COMMISSIONER MURREN: Thank you,
8 Mr. Chairman. And thank you, Chairman Greenspan, for
9 your testimony. I enjoyed reading it.

10 EXAMINATION BY COMMISSIONER MURREN

11 COMMISSIONER MURREN: I'd like to focus
12 specifically my line of questioning on the
13 responsibilities of the Federal Reserve as it relates
14 to insuring the safety and soundness of the financial
15 holding companies and the bank holding companies and
16 their supervisory role.

17 And, in particular, go back to a time
18 period that you mentioned, 2005, which was the --
19 arguably, the peak of the housing bubble, and talk a
20 little bit about the supervisory structure and
21 examination staff of the Federal Reserve system.

22 It's my understanding that there were
23 approximately 2600 people throughout the -- throughout
24 the Federal Reserve system engaged in supervision and
25 examination. And during that time, approximately 12

1 of those people were allocated to examining Citibank
2 specifically, and a similar number were allocated to
3 examining the other major banks, which, of course,
4 represent the major concentration of assets within the
5 banking system.

6 And I'm curious, in retrospect, as to
7 whether you would say that perhaps there could have
8 been better resource allocation within that framework
9 towards those larger banks, particularly in light of
10 the fact that the Federal Reserve is not constrained
11 by the appropriations process, as are some of the
12 other agencies.

13 MR. GREENSPAN: Let me go back to your
14 original remarks. You were asking about the
15 compensation issues that were involved recently and in
16 history.

17 I think it's important to --

18 COMMISSIONER MURREN: Mr. Chairman, I'm
19 sorry, I actually didn't mean compensation, but just
20 the number of individuals that were assigned to each
21 enterprise.

22 MR. GREENSPAN: Yes, and I thought you
23 were.

24 COMMISSIONER MURREN: Okay.

25 MR. GREENSPAN: And I'll go to that.

1 COMMISSIONER MURREN: Got it.

2 MR. GREENSPAN: The Federal Reserve and all
3 of the banking regulators have a fairly large cadre of
4 permanent on-site examiners in all of the big
5 institutions. And there is a very large contingent,
6 not only, obviously, from the Office of the
7 Comptroller of the Currency, which of course regulates
8 Citibank, which is by far the largest institution in
9 the Citi holding company system. But we had -- the
10 Federal Reserve had a number of people involved.

11 It's not an issue of resources. It's not
12 an issue of people. It's an issue that's an
13 inherently rather difficult job. And you're not going
14 to get it done materially better by just reshuffling
15 the chairs. I think it requires a better
16 understanding of the type of problems which arise and
17 most specifically, in my view, the necessity of -- the
18 reason I raise the capital so often is that, in a
19 sense, it solves every problem.

20 Now, banks don't like the issue of having
21 to put up more capital, but if they didn't and,
22 indeed, this last crisis exhibits this, they are
23 getting a subsidy unpaid for by the federal government
24 which has to bail out the banks at the tail end of a
25 crisis.

1 And I think what the point, the critical
2 question here is to focus on something we can do
3 something about, control, and generally have far
4 greater effect than any changes we could make in
5 supervision and regulation.

6 COMMISSIONER MURREN: Well, to the extent
7 that allocations of capital are similar in certain
8 respects to the management of an agency or a business
9 in terms of allocating resources that may be precious,
10 personnel, time, energy, intellect, when you think
11 about that, as an individual who's charged with
12 insuring safety and soundness for bank holding
13 companies, in this case, Citigroup, in concert with
14 other agencies, even when you -- if you look back at
15 some of the commentary from within the Federal Reserve
16 system, there is a review of the operations of the
17 Federal Reserve Bank of New York, as it relates to
18 their supervision of Citibank, which suggests that, it
19 was done in 2005, and I quote, that it had
20 insufficient resources to conduct supervisory
21 activities in a consistent manner.

22 And I understand this may not have been
23 brought to your attention in 2005, but that it is
24 ongoing and has not been remedied as of the tail-end
25 of 2009.

1 And I'm curious as to whether you think
2 part of the accountabilities of the Federal Reserve is
3 to insure that these resources are allocated in a
4 manner that would be consistent with insuring safety
5 and soundness?

6 MR. GREENSPAN: Well, I've heard those
7 statements. And I must say I do not recall a single
8 instance in which requests for funding for supervision
9 and regulation was turned down by the board.

10 More specifically, I cannot imagine that if
11 the Federal Reserve Bank of New York perceived that it
12 had inadequate resources to do the jobs that it's
13 required to do, that the president of the Federal
14 Reserve Bank would have been on the phone with me,
15 very quickly, and complained. No such telephone call
16 or any other communication ever existed.

17 So I find this notion of inadequacy not
18 verifiable. I do think there are always problems of
19 turnover, and I think the New York Bank had a
20 significant amount of turnover, which does create
21 managerial problems. It's not a resource problem. In
22 other words, it's not a lack of funds, as you
23 correctly point out, importantly, the Federal Reserve
24 is not subject to -- I should say -- the Federal
25 Reserve uses its own funds, and it does not require

1 funds appropriated by the Congress.

2 So we're not limited, ourselves, even
3 though we try to restrict what we spend on, because we
4 don't have appropriated funds.

5 COMMISSIONER MURREN: May I continue on
6 this discussion of the supervisory responsibilities?
7 And perhaps in this instance, working with other
8 agencies, some of the -- some of the safety and
9 soundness determinations for the holding companies
10 were the results of a dependence on the -- the
11 conclusions of other agencies; for example, the
12 securities dealers, the broker dealers for some of
13 these major institutions would be governed by the SEC.

14 And, if I'm not mistaken, in the
15 legislative language, it suggests that you -- the
16 Federal Reserve, should result -- rely on the results
17 of their supervisions, their examinations.

18 And I wonder, in some respects, if this
19 doesn't in some ways mirror a dependence, say, on a
20 rating agency? I mean, essentially you're depending
21 on the work of others to determine the safety,
22 soundness, and security of an underlying asset?

23 MR. GREENSPAN: Yeah, that -- that's a very
24 tough question to answer. And the reason, basically,
25 is that this gets to the issue of centralization and

1 the extent to which the pros and cons of having, for
2 example, as we do now, a number of different
3 regulatory operations within banking.

4 Since I came to the Federal Reserve, there
5 has been all sorts of discussions about should we have
6 a single consolidated regulator, including the SEC the
7 Fed, the OCC, et cetera.

8 And there are arguments, and I think
9 effective arguments, on both sides of the argument. I
10 think the current system has worked as well as it can.
11 I'm not sure that centralization, per se, moving the
12 chairs around, will alter its effectiveness.

13 COMMISSIONER MURREN: Could you comment
14 briefly on the composition of the board of the New
15 York Federal Reserve Bank and your feeling about the
16 constitution. If you have six of nine members who are
17 themselves subject to the supervision of the entity,
18 itself, do you think that that influences in any way
19 the outcomes of their decision making?

20 And I would note that Lehman Brothers --
21 Dick Fuld was one of the members of the board. Do you
22 think it makes them too close to the companies that
23 they regulate?

24 MR. GREENSPAN: Theoretically, I think
25 that's an issue that has to be thought through. I

1 personally have seen no evidence that the members of
2 the board at the New York Bank had any influence on
3 policy, other than giving us advice.

4 They were an extraordinary valuable source
5 of information because of their scope. But the notion
6 that we in any way favored any of them or basically
7 were influenced with respect to policy by what they
8 said, other than facts they gave us, which we always
9 evaluated, I saw no evidence of that in my tenure.

10 COMMISSIONER MURREN: And just a final
11 question, on -- back to subprime origination that
12 occurred outside of entities that were supervised by
13 the Federal Reserve, is it your opinion that those
14 entities should be supervised by the Federal Reserve
15 now?

16 MR. GREENSPAN: Well, first of all,
17 remember, you have to distinguish between supervision
18 and enforcement.

19 A lot of the problems which we had in the
20 independent issuers of subprime and other such
21 mortgages, the -- the basic problem there is that if
22 you don't have enforcement, and a lot of that stuff
23 was just plain fraud, you're not coming to grips with
24 the issue.

25 The Federal Reserve, remember, is not an

1 enforcement agency. We don't have or didn't have the
2 types of personnel, which that the SEC, the Department
3 of Justice and HUD has, to do that, so I can't answer
4 that question, fully, because I can't say as fully
5 cognizant of all the possibilities I'd like to have.

6 COMMISSIONER MURREN: Do you think that,
7 then, you should have those types of enforcement
8 authorities?

9 MR. GREENSPAN: It would require a very
10 significant set of revisions with respect to how our
11 supervision and examination force would -- would be,
12 because remember that what the Federal Reserve
13 examiners are, are largely experts in examining
14 concentration of assets, the bookkeeping, a whole set
15 of issues which relate to how banks work and how banks
16 work in an effective manner.

17 It's not a group who can ferret out
18 embezzlement, fraud, misrepresentation. And, indeed,
19 when we get such examples, what we tend to do is to
20 recognize that we don't have the facilities, and we
21 refer it to the Department of Justice, which we did on
22 innumerable occasions on a lot of issues; in other
23 words, we were requesting other enforcement agencies
24 to rectify the problems that we, in our examinations,
25 were able to unearth.

1 COMMISSIONER MURREN: Do I have one more?

2 Thank you.

3 When you look forward, one of the comments
4 that you'd made in the past is that future supervision
5 will, of necessity, have to rely far more on a banks'
6 risk management information systems to protect against
7 loss and then, further, technology and innovation, the
8 development of sophisticated market structures and
9 responses.

10 Do you still feel that that is the
11 direction that supervision and regulation should go,
12 or do you think that there should be some balance
13 between that and what would perhaps be viewed as more
14 old-fashioned auditing of the various assets that lie
15 within an organization?

16 MR. GREENSPAN: Well, we are still working
17 with the supervision structure and philosophy that
18 existed a hundred years ago; that is, back, in say the
19 year 1900, the examiners for the Comptroller of the
20 Currency would go into a bank and be able to actually
21 see the individual loan documents and review them in
22 the usual manner.

23 The system has become so complex that
24 there's no longer the capacity, except in very small
25 community banks to still do it that way, which,

1 incidentally, is the ideal way to actually do
2 supervision and regulation.

3 So we are confronted with a problem that in
4 order to vet the individual counter-parties of various
5 banks which we supervise and oversee, we are reaching
6 far beyond our capacities so that you have to rely,
7 because there's no other real alternative to a sound
8 risk management system on the part of individual
9 institutions who, in my experience, know far more
10 about the people to whom they lend than we at the
11 Federal Reserve would know, so that they're -- they
12 have to be the first line of defense. If they fail,
13 and they did in this instance, it's not a simple issue
14 of saying, Well, let's regulate better.

15 The old-fashioned regulation to which you
16 refer was the best. It has been -- it has been
17 largely a victim of the degree of complexity that a
18 current complex division of labor society requires and
19 the financial institutions that are required to
20 support it.

21 So that you can't turn the clock back --
22 this is all interrelated and we have -- it's a
23 different world. The standards of living are much
24 higher, the complexity is awesome, and I wish I knew a
25 simple answer to this problem.

1 But I do know that if you cannot depend on
2 the counterparty surveillance of the individual banks,
3 which we regulate, our ability as regulators
4 would be far less effective, to the extent that it is.

5 COMMISSIONER MURREN: Thank you.

6 CHAIRMAN ANGELIDES: Thank you, Ms. Murren.
7 Let's now go to Mr. Wallison. And you have 15
8 minutes, Mr. Wallison.

9 COMMISSIONER WALLISON: Thank you,
10 Mr. Chairman.

11 EXAMINATION BY COMMISSIONER WALLISON

12 COMMISSIONER WALLISON: Mr. Chairman, it's
13 good to have you here. And I look forward to the
14 opportunity to talk with you today.

15 As you know, we are in the business of
16 trying to find out what actually caused the financial
17 crisis. And you mentioned in your opening statement
18 and in your written statement, subprime and Alt-A
19 mortgages, and I wanted to follow up a little bit on
20 that.

21 It's not in the material that the
22 Commission has put out, but it appears that there were
23 as many as 27 million subprime and Alt-A, in other
24 words, weak loans, in the us financial system, of
25 which 12 million, according to the information that

1 Fannie itself put out, as you mentioned, in 2009, 12
2 million were held and guaranteed by Fannie Mae and
3 Freddie Mac, and about 5 million guaranteed by FHA, so
4 that would be maybe 17 million out of the total 27
5 million that were on the books of government agencies.

6 Now, what we've forgotten a little bit in
7 this is that we were very happy, during the late '90s
8 and the early 2000s, with the fact that these
9 mortgages were increasing home ownership in the United
10 States, something that is very important.

11 And we understood that these mortgages were
12 subprime and otherwise weak. But the whole objective
13 was to increase ownership among groups that had
14 previously been underserved. And in fact the home
15 ownership in the United States increased from about
16 64 percent in 1992, '93, to about 69 percent by the
17 2003, 2004. And this was -- this was a very
18 significant thing in the minds of most people.

19 Now these mortgages, however, as you
20 pointed out, drove a bubble, a very significant
21 bubble, and when that bubble deflated, they began to
22 deflate themselves, to default themselves, in
23 unprecedented numbers.

24 And in 19 -- in 2007, as you're aware, the
25 entire asset-backed market for mortgage-backed

1 securities simply disappeared.

2 As far as I know, this is an unprecedented
3 event in financial history where a market simply
4 disappears. And as a result of that, a large number
5 of financial institutions were simply unable to market
6 or even value the assets they were holding.

7 Now, I would like to -- I would like to
8 give you a chance to expand on what might have -- on
9 what this whole series of events might have meant as a
10 cause for the financial crisis and particularly what
11 was the fatal flaw you spoke about after Lehman
12 Brothers failed.

13 And I would like you also to focus in your
14 remarks, perhaps, on the role of government policy in
15 creating or at least demanding the creation of all of
16 these weak and high-risk mortgages.

17 You've got a very broad experience in
18 markets, worldwide markets, exactly the kind of
19 problem that we've been looking at, the collapse of
20 the worldwide market and, in fact, a worldwide
21 financial crisis and, to me, your experience there
22 would be invaluable to us in understanding the
23 connections between government policy, on home
24 ownership, and that crisis.

25 MR. GREENSPAN: Well, Mr. Wallison, as I

1 mentioned in my prepared remarks, government policy,
2 as such, was very strongly related to the issue of
3 enhancing home ownership for lower and middle income
4 groups.

5 The way I put it, when Honda was a major
6 issue, early on, to the Federal Reserve, and we were
7 beginning to observe the extent of discrimination
8 that was involved in a lot of mortgage-making, the
9 thrust of policies were all acutely aware was very
10 strongly to move towards increasing home ownership, a
11 policy which I supported, because I think in a
12 market-oriented capitalist economy, the greater the
13 degree of ownership of property, the greater the
14 participation of all people in that -- that type of
15 economy.

16 The trouble, unfortunately, is that if you
17 now go back and track policy, we started off from a
18 point -- from the point where redlining was the real
19 concern. And, indeed, what that implied was that
20 there were a lot of banks which were leaving
21 potentially profitable loans on the table, so to
22 speak. And so we at the Fed were pushing for them to
23 evaluate these loans in a more objective way and they
24 were doing that.

25 The evolution of the subprime market goes

1 over the years and then begins to accelerate, because
2 it was the broad thrust of this government to expand
3 home ownership, especially amongst lower and middle
4 income groups. It was the policy officially of HUD
5 which gave standards to Fannie and Freddie to
6 significantly increase their participation in those
7 types of loans.

8 And we look back now at the numbers, as you
9 will -- as you point out correctly, that is, as often
10 the case, we go from one extreme to the other. And if
11 you take the extent of Fannie and Freddie
12 participation in endeavoring to meet the HUD goals,
13 the numbers are extraordinarily large and very -- so
14 large, in fact, that they are preempting a major part
15 of the market, and that which we learned only in
16 retrospect, starting in September 2009, was a major
17 factor in producing the bubble.

18 COMMISSIONER WALLISON: Let me -- let me
19 follow up a little on that, and I'm delighted to have
20 the time to do that, because I've wondered for a
21 while. I wanted to get a little bit more of the
22 flavor of what it was like to have sat in your seat
23 for many years during this period. In 2003, 2004,
24 maybe even 2005, if the Federal Reserve had tried to
25 clamp down on subprime lending when home ownership was

1 increasing in the United States, what would you
2 imagine would have happened?

3 MR. GREENSPAN: Well, observe that at that
4 time foreclosures were low, home ownership was
5 expanding; the delinquencies in subprime markets were
6 remarkably small. If the Fed, as a regulator, tried
7 to thwart what everyone perceived in, I would say, a
8 fairly broad consensus, that the trend was in the
9 right direction, home ownership was rising, that was
10 an unmitigated good, the Congress would have clamped
11 down on us.

12 There's a presumption there that the
13 Federal Reserve is an independent agency, and it is up
14 to a point, but we are a creature of the Congress.
15 And if in that midst of period of expanding home
16 ownership no problems perceived in the subprime
17 markets had we said we were running into a bubble and
18 we would have to start to retrench, the Congress would
19 say we haven't a clue what you are talking about.

20 And I can virtually guarantee, indeed, if
21 you want to go back and look at what various members
22 of the House and the Senate said during these periods,
23 on the subject, I would suggest the staff do a little
24 run and you will be fascinated by how different it
25 sounded back then than the way the retrospective view

1 of history has evolved.

2 I mean, I sat through meeting after meeting
3 in which the pressures on the Federal Reserve and on,
4 I might add, all the other regulatory agencies to
5 enhance lending were remarkable -- the less -- right
6 now we have, as you point out, a nonexistent subprime
7 market. There's also a nonexistent Alt-A market, as
8 well. And we have a lot of regulations for subprime,
9 especially HOEPA, which are non-operative, at this
10 stage. There is no market.

11 I certainly trust it comes back, but the
12 private subprime market shows no signs of moving, and
13 it's not self-evident to me that it's coming back, so
14 we could argue what the rules should be. The rules
15 over what? There's nothing left.

16 And I -- I am merely saying that having
17 gone 18 and a half years before the Congress, there's
18 a lot of amnesia that is emerging currently.

19 COMMISSIONER WALLISON: Let me follow up a
20 little bit more, too, on one other part of this whole
21 process.

22 When the market collapsed, it was
23 impossible, as I said, for financial institutions that
24 were holding these instruments to value them or to
25 sell them; in other words, this had a major effect on

1 their liquidity but also on their financial
2 statements.

3 And I would like your views on the
4 significance of the elimination, the end of this
5 asset-backed market for mortgage-backed securities on
6 the accounting that financial institutions were
7 required to pursue, the rules of mark-to-market or
8 fair value accounting, and what effect those might
9 have had on the financial crisis.

10 MR. GREENSPAN: Yeah, this is a major
11 dispute within the accounting profession and in,
12 obviously, the banking industry, as well.

13 I've always held the view that on
14 fundamental straight loans, commercial loans or
15 personal loans, which you do not expect to sell prior
16 to maturity, that book valuation with amortization, as
17 is usually done, is the probably sensible thing to do.

18 But there are an awful lot of assets out
19 there which fluctuate in the value and you do sell.
20 And the accounting profession says that those,
21 definitely, have to be mark-to-market.

22 Now, this is a dispute which we could take
23 two hours on, and I don't want to get involved in it,
24 specifically, but there is no simple solution for --
25 if you don't have a market value, as poor as it may

1 be, how else do you value these things? So you really
2 have fundamentally either book or market. There's
3 nothing, really, in between.

4 COMMISSIONER WALLISON: What about cash
5 flow valuation? Many -- many institutions attempted
6 to use discounted cash flow because these -- many of
7 these assets, as I understand it, and we'll talk about
8 this later, when we get to Citi, were continuing to
9 flow cash. Is that not a valid way to do it?

10 MR. GREENSPAN: Well, as I said, there are
11 pros and cons to all of this, and there is no general
12 agreement within the accounting professions or the
13 banking professions.

14 And I think it's a very important and
15 useful discussion because it points out the fact that
16 our books of account are not necessarily sacrosanct
17 merely because they're printed and published.

18 We do not know exactly what the
19 consequences of mark-to-market was, although, as you
20 remember, I guess, following the Lehman default, there
21 were very major arguments that the accounting process
22 of acquiring mark-to-market was a factor in
23 exacerbating the price declines.

24 That's a hard argument to make. It sounds
25 plausible but the question is always, relative to

1 what? And so I'm not -- I -- I have not taken a
2 position that I feel fully comfortable with on this
3 issue. I'm still learning.

4 COMMISSIONER WALLISON: I have one more
5 question, my final question, and that is, the National
6 Community Reinvestment Coalition reported in its
7 annual report, in 2007, that banks had made over 2 --
8 4 and a half trillion dollars in CRA loan commitments
9 in connection with obtaining approvals for mergers,
10 principally by the Federal Reserve, and that is
11 because the banks had to meet certain standards in
12 their CRA Community Reinvestment Act lending.

13 Do you recall these commitments, in
14 connection with approvals of mergers by the Fed, and
15 would you refer to that and describe that to us if you
16 do?

17 VICE CHAIRMAN THOMAS: Mr. Chairman, I
18 yield Commissioner Wallison three minutes.

19 CHAIRMAN ANGELIDES: So done.

20 COMMISSIONER WALLISON: I've got three more
21 minutes so you have three more minutes.

22 MR. GREENSPAN: All mergers and
23 acquisitions that are under the auspices of the
24 Federal -- that is, the Holding Company Act, require
25 us to evaluate CRA in conjunction with coming to a

1 decision. It can only be made by the full board, in
2 other words, it cannot be made -- it cannot be done in
3 any other place in the Fed.

4 So every merger that we authorized was
5 always accompanied with an evaluation of CRA and the
6 degree of meeting CRA requirements.

7 The law is pretty specific on that, and I
8 think that there were innumerable cases which we
9 turned down mergers and acquisitions that are far
10 greater, in which the staff initially said the board
11 would not, under its existing various procedures, is
12 not likely to agree with this merger unless you
13 altered your CRA commitments.

14 And so most of the mergers that occurred I
15 say probably had some CRA adjustment either directly,
16 in threatening to say no to the merger, or indirectly,
17 by anticipating that we would say no and therefore
18 change.

19 So in that regard, I think it was a fairly
20 heavy CRA commitment in the banking industry, and it
21 is working because you don't hear about it.

22 COMMISSIONER WALLISON: Thank you.

23 CHAIRMAN ANGELIDES: Thank you,
24 Mr. Wallison. Now we will go to Mr. Georgiou.
25 Fifteen minutes.

1 COMMISSIONER GEORGIU: Thank you.

2 EXAMINATION BY COMMISSIONER GEORGIU

3 COMMISSIONER GEORGIU: Dr. Greenspan, let
4 me just follow up on one thing Commissioner Wallison
5 began on. At page 12 of your prepared testimony, you
6 state that, in my judgment the origination of subprime
7 mortgages, as opposed to the rise in global demand for
8 securitized -- securitized subprime mortgage interest,
9 was not a significant cause of the financial crisis.

10 Could you elaborate on that, briefly,
11 please?

12 MR. GREENSPAN: I'm sorry, would you repeat
13 that, again?

14 COMMISSIONER GEORGIU: It says, you say,
15 let me respectfully reiterate that, in my judgment,
16 the origination of subprime mortgages was not a
17 significant cause of the financial crisis, as opposed
18 to the rise in global demand for securitized subprime
19 mortgage interest, the bottom of page 12?

20 MR. GREENSPAN: Yeah. The actual
21 originations of subprime mortgages, when the subprime
22 mortgages were evolving from the early 1990s through,
23 say, the year 2002, was a contained market, largely
24 fixed rate, and that mortgage -- that market worked
25 well.

1 It, in and of itself, was not the problem
2 and would not have been the problem, because it's only
3 when we went to adjustable rate subprime dipping deep
4 into the potential of home ownership that the problems
5 began to emerge because the defaults of foreclosures
6 were not a major problem early on.

7 So it's the securitization, which, in turn,
8 is a consequence of the demand coming largely from
9 Europe. I mean, there was a remarkably large demand
10 in collateralized debt obligations in Europe which
11 were funded by subprime mortgages.

12 And the reason the demand was so large is
13 the prices, I mean, the yields were high and the
14 credit rating agencies were giving the tranches of
15 these various CDOs Triple-A.

16 COMMISSIONER GEORGIU: Well, you just
17 turned me directly to where I wanted to move to.

18 You know, one of the things that you said
19 at the end of your testimony, your prepared testimony,
20 again, is that you have a number of suggestions to
21 ensure that financial institutions will no longer be
22 capable of privatizing profit and socializing losses.

23 And those suggestions are largely in the
24 area of increased capital requirements and liquidity
25 requirements, which you suggest might have avoided

1 some of the most significant problems that we've had.
2 You know, you served the better part of two decades as
3 the most important banker in the world, which was
4 20 percent of the time the Federal Reserve has been in
5 existence, and ultimately the Federal Reserve is the
6 ultimate prudential regulator responsible for the
7 safety and soundness of all of our financial
8 institutions, all the principal bank holding companies
9 and financial holding companies in the United States,
10 which are some of the most important financial
11 institutions in the world.

12 I would ask you if your suggestions that
13 more capital and more -- more focus on liquidity could
14 have been implemented during your tenure in a way that
15 could have avoided the financial crisis?

16 MR. GREENSPAN: Not by the Federal Reserve,
17 by itself, because, remember, that where most of the
18 problems existed is in the so-called shadow banking
19 area, that is, investment banks and others not
20 directly supervised and regulated by the Federal
21 Reserve.

22 COMMISSIONER GEORGIU: Well, except that
23 the capital requirements, frequently, were established
24 by the Federal Reserve.

25 MR. GREENSPAN: That's only --

1 COMMISSIONER GEORGIU: Let me just --

2 MR. GREENSPAN: That's only for bank

3 holding companies and banks. We had -- we did not
4 have capital requirements which we could enforce on
5 the investment banks. That's not -- it's an SEC --

6 COMMISSIONER GEORGIU: Well, understood,
7 but the -- of course, in many instances, the banks
8 that you supervised were facilitating the creation of
9 securitized assets by the investments banks that were
10 within their -- their groups.

11 For example, let me just give you an
12 example here. The -- the securitization rule in 2001,
13 which addressed early forms of capital arbitrage
14 through securitization, established risk weightings,
15 as you may recall, based on the credit ratings of each
16 tranche of a securitization.

17 And, soon after, regulators allowed
18 liquidity puts on asset-backed commercial paper
19 tranches to get 10 percent risk weighting resulting in
20 a capital charge of only eight-tenths of 1 percent in
21 liquidity puts.

22 And one of the Citi executives has told our
23 staff that Citi made a decision to support their
24 growing CDO business with its own capital because the
25 regulatory capital associated with holding the super

1 senior Triple-A tranches was close to zero.

2 How -- who how did your supervisors, if at
3 all, go about identifying and addressing the prob- --
4 problems of capital arbitrage in the -- in the
5 marketplace?

6 MR. GREENSPAN: Remember that the so-called
7 basal accord, which was the consolidated international
8 system of determining, for example, what risk weights
9 to put on various assets and the various other issues
10 which determine risk-adjusted capital.

11 I -- it's not clear to me what that has got
12 to do with, for example, any of the large investment
13 banks, whether it be Bear Stearns, Lehman, others.
14 It's not clear to me how we could have regulated
15 specifically their capital.

16 Remember, their tangible capital got to
17 levels well below that requires -- as is required by
18 banks. We had no capability --

19 COMMISSIONER GEORGIOU: But some of the
20 activities of the -- of the -- the investment bankers
21 ho- -- affiliates, that were within the financial
22 holding companies and within the bank holding
23 companies have -- were impacted. The bank itself was
24 significantly impacted by the commitments that they
25 made.

1 Let me just give you an example, here,
2 again. We found from our investigation of Citi that
3 these credit default -- credit collateralized debt
4 obligations, where ultimately Citi, the bank itself
5 had to come up with 25 billion dollars on liquidity
6 puts that they had committed to bring these assets
7 back onto their balance sheet when the crisis hit and
8 they were basically illiquid and unable to deal with
9 them.

10 Now that had a significant impact; that was
11 roughly 30 percent or more of the capital that was
12 being held at that time by Citi and certainly that
13 eventuality is something that as a prudent safety and
14 soundness regulator at the Federal Reserve, somebody
15 ought to have known about and had some impact on.

16 MR. GREENSPAN: Well, I think you're
17 raising a legitimate question in the sense that, while
18 we didn't have any control over the capital of
19 investment banks, hedge funds, insurance companies, to
20 the extent that banks lend to those entities,
21 obviously that is an issue which does impact on the
22 overall financial markets.

23 But that is a question of supervision and
24 regulation on -- it's even, I would say, the
25 old-fashioned regulation.

1 Is -- are the loans that you're making
2 sound and do they have the capacity of being repaid.

3 COMMISSIONER GEORGIU: Well, but, again,
4 here, what we had is the bank, the ultimate bank
5 holding company backstopping and taking --
6 undertaking, effectively, the risk of the
7 securitized -- the securitized, in this case,
8 collateralized debt obligations of the investment
9 bank.

10 Because the -- you know, and this is -- it
11 strikes me, frankly, as I study these things, you
12 know, I consider myself a reasonably intelligent
13 person. It takes considerable study, I'm not a
14 trained economist, to understand these extraordinary
15 exotic financial structures.

16 And you've pointed out in your testimony
17 that we run real risks in that frequently they're
18 misunderstood and exceedingly difficult to value.

19 And just to take this one example. It
20 seems to me that they were essentially engaged in
21 something akin to the medieval or the mythical
22 medieval alchemy in that they were able -- they were
23 claiming the ability to turn Triple-B mortgage-backed
24 securities into, effectively, Triple-A-plus senior
25 prime securities through the collateralized debt

1 obligations.

2 And, in fact, as it turns out, they weren't
3 able to sell these to anybody. They held them on
4 their trading books. And part of the reason we're
5 told by people within the Fed and within the Citigroup
6 are that they held them on the trading book because on
7 the trading book, the capital requirements -- that the
8 leverage was essentially 700 or 800 to one because
9 there was, essentially, no capital requirement while
10 they were held on the trading book.

11 And the liquidity puts themselves were only
12 rated at 10 percent. So -- so -- so what -- what
13 effectively is going on, it seems to me, is a capital
14 arbitrage which puts the safety and soundness of the
15 ultimate bank in jeopardy in order to support -- in
16 order to support exotic financial instruments, which
17 we now know didn't deserve the ratings that they
18 ultimately received, and ought not to have been
19 regarded as so risk-free and should have been very
20 significantly greater capitalized.

21 And I guess I'm just pointing out to you,
22 really, one of the consequences of your own testimony,
23 which is that I think that isn't it -- isn't it true
24 that the Fed could have and should have understood
25 these linkages better and required greater capital on

1 the part of all the bank and financial holding
2 companies in order to avoid the crisis that we -- we
3 face.

4 MR. GREENSPAN: Well, ultimately, I can't
5 speak in specific detail, but I do know what the
6 problem is. The problem is that the bank supervisors
7 and examiners would be looking at the Triple-A ratings
8 that they see in a lot of these securities.

9 And we have a fundamental problem that the
10 credit rating agencies gave Triple-A valuations to
11 certain tranches of collateralized debt obligations,
12 which in retrospect were nonsense, as you point out.
13 They couldn't sell them.

14 And my impression is, but I don't know
15 because I wasn't there, and I don't know what was
16 going on, specifically, in certain areas, that a bank
17 examiner would be looking at whether a loan was being
18 made which was backed up in some form or another by an
19 inappropriate credit rating agency, because when
20 you're dealing with the size and complexity of the
21 types of things that people have to evaluate, there is
22 a tendency, especially of an average pension fund
23 manager, to seek the --

24 COMMISSIONER GEORGIU: The safety.

25 MR. GREENSPAN: -- the safety --

1 COMMISSIONER GEORGIU: The safety of a
2 credit rating agency, understood. And we have a whole
3 `nother hearing that we'll be doing in the future with
4 regard to credit rating agencies, but the OCC
5 examiners that we talked to suggested to us that they
6 regarded these liquidity puts as essentially outside
7 of their purview because they were only supposed to be
8 looking at the -- you know, this was a principal
9 business that was existing within the investment bank,
10 and they regarded that as something that wasn't --
11 wasn't their responsibility, essentially, to -- to --
12 or not only wasn't their responsibility, they were
13 affectively precluded from examining it. So I think
14 some of these linkages, as you look at the
15 fragmentation of the -- of the regulation, these
16 linkages between various units within the holding
17 companies put the banks' safety and soundness at
18 significant risk.

19 And that, seems to me, to be an area where
20 the Federal Reserve could do a much better job in its
21 role as the ultimate prudential regulator and the
22 systemic risk regulator.

23 MR. GREENSPAN: Well, let me just say this.
24 Not knowing the details of the particular transactions
25 that you're working on, I mean, I certainly agree with

1 you, in principal, that there have been failures,
2 because you can't account for what happened without
3 supervision failure occurring as part of the problem.
4 But not knowing --

5 COMMISSIONER GEORGIU: Well, the specific
6 detail basically in Citi's case is that they had to
7 come up with 25 billion dollars, they came up with 25
8 billion dollars for the liquidity puts, to bring
9 back -- to buy back, essentially, these -- these
10 assets that were -- were -- were standing behind the
11 commercial paper.

12 Rather than having issued a strict bank
13 guarantee, which would be customary in a commercial
14 paper asset-backed transaction, which you would have
15 to --

16 MR. GREENSPAN: Absolutely.

17 COMMISSIONER GEORGIU: -- you would have
18 to provide capital to, in this instance they --
19 they -- they honored these liquidity puts to the tune
20 of 25 billion dollars, and that was roughly 30 percent
21 of their capital at the time, the bank did.

22 MR. GREENSPAN: Actually, what year -- what
23 year -- what year is this?

24 COMMISSIONER GEORGIU: 2007.

25 MR. GREENSPAN: See, I -- I --

1 COMMISSIONER GEORGIU: I mean, it was
2 after you were gone, but it's just emblematic. I'm
3 not trying to focus exclusively on Citi. I'm just
4 trying to say this is an emblematic structure of the
5 collateralized debt obligations which were these
6 exotic instruments that really didn't justify the
7 ratings that they had and -- and -- and caused
8 additional risk to the system which might have been
9 avoided by the capital.

10 CHAIRMAN ANGELIDES: I'll yield another
11 additional three minutes.

12 COMMISSIONER GEORGIU: Thank you. So I
13 guess my point really -- and, you know, I'm sorry that
14 I've run close to out of time.

15 CHAIRMAN ANGELIDES: No.

16 COMMISSIONER GEORGIU: But my point is to
17 focus, again, on your fundamental obligation to
18 enforce an adequate safety and soundness of the
19 institutions.

20 And at the end of the day, really, I
21 understand your suggestion, and I think your
22 suggestion is a sound one that at this point we need
23 to have additional capital and liquidity requirements
24 on all of these financial intermediaries in order to
25 avoid a crisis in the future, because none of us can

1 predict precisely what exotic financial instrument
2 that's next devised will fail and not perform as
3 represented by the originators.

4 I note one thing, you testified in front of
5 the Waxman committee, back in October of `08, and one
6 thing I noticed that you said was that, as much as I
7 would prefer it otherwise, in this financial
8 environment I see no choice but to require that all
9 securitizers retain a meaningful part of the
10 securities they issue. This will offset, in part,
11 market deficiencies stemming from the failures of
12 counterparty surveillance.

13 I take it by that, you mean that that would
14 be a -- that would provide confidence to the market if
15 they were to retain a portion of those securities,
16 that those securities -- that they believed those
17 securities actually to be sound and worthy of
18 investment, is that -- was that your point?

19 MR. GREENSPAN: That's correct.

20 COMMISSIONER GEORGIU: Right. And isn't
21 that the case, really, with regard to part of our
22 focus here is on securitization, and isn't it the case
23 that we -- we've created a situation in which a number
24 of the parties involved in the origination of these
25 securities are all paid in cash as the securities are

1 issued and retained no ultimate interest in the
2 ultimate -- in the ultimate success or failure of the
3 security, ranging all the way, if you count, you know,
4 the originators of the mortgages, the mortgage
5 brokers, the investment bankers, the lawyers who write
6 the prospectuses, the auditors who audit the books,
7 the credit rating agencies that rate the agents --
8 that rate the securities, and at the end of the day,
9 they've left -- they've left all their -- they have no
10 skin in the game, they have no obligation to have a
11 financial consequence to their -- their creation.

12 And isn't that a problem that needs to be
13 addressed?

14 MR. GREENSPAN: Well, yeah, and I agree
15 with you in that the regard. The -- the major source
16 of that problem was that because of the complexity of
17 the types of products that were being issued, that
18 otherwise sensible people, in despair, relied on the
19 credit rating agencies issued by the -- issued.

20 And if they were otherwise, in other words,
21 of, instead of giving Triple-A designations to a lot
22 of these things, they gave them B or Triple-B, which
23 many of them were, people wouldn't have bought them.
24 The problem further is that you are raising wouldn't
25 have happened.

1 COMMISSIONER GEORGIU: Well, of course,
2 and they wouldn't have bought them because many of
3 them were prohibited by either the statute or their
4 own requirements --

5 MR. GREENSPAN: Precisely.

6 COMMISSIONER GEORGIU: -- for not buying
7 them. And of course the problem, further, is that the
8 credit rating agencies frequently are only paid if
9 they -- if the securities were sold. They were paid
10 as a portion of the issue.

11 So they obviously had an incentive to
12 create a Triple-A rating which might not otherwise
13 have been justified. Thank you.

14 CHAIRMAN ANGELIDES: Thank you very much.
15 Let's do this -- we're going to take a --

16 VICE CHAIRMAN THOMAS: Mr. Chairman, just
17 please let me, for the record, Mr. Chairman, I noticed
18 that you were nodding your head at the final statement
19 that the gentleman made.

20 Were you in agreement with his assessment
21 in terms of the behavior of the credit rating
22 agencies, to a certain degree?

23 MR. GREENSPAN: The credit rating agencies,
24 as such? All I will say is what I can say for myself
25 is that the rating -- the ratings that were developed

1 by the credit rating agencies were a major factor in
2 the cause of the problem.

3 VICE CHAIRMAN THOMAS: Thank you.

4 CHAIRMAN ANGELIDES: Thank you. We'll take
5 a five-minute break -- ten -- let's be back here in
6 five. Thank you.

7 (Recess.)

8 CHAIRMAN ANGELIDES: Reporters, please
9 depart the well, please, but do not disconnect the
10 mics this time.

11 All right, let's start again, we are
12 starting with Mr. Hennessey. Your turn,
13 Mr. Hennessey.

14 COMMISSIONER HENNESSEY: Great. Thank you,
15 Mr. Chairman.

16 EXAMINATION BY COMMISSIONER HENNESSEY

17 COMMISSIONER HENNESSEY: Chairman
18 Greenspan, I want to focus on Fannie Mae and Freddie
19 Mac's role in creating or exacerbating the explosion
20 of bad subprime mortgages and specifically on their
21 portfolios.

22 Now, it's possible that not everyone
23 watching has read your written testimony, so I want
24 to, if I can, try to summarize how I understand that
25 part of your testimony, and then I want to ask about

1 specific House action, from 2007, which I think
2 contributes to this.

3 As I understand it, Fannie Mae and Freddie
4 Mac held huge portfolios of securities that they
5 issued, on the order of about 6- or 700 billion
6 dollars each. These portfolios were undercapitalized
7 and they ultimately led to Fannie and Freddie's
8 collapse.

9 In October of 2000 the Department of
10 Housing and Urban Development significantly raised the
11 affordable housing goals they set for Fannie and
12 Freddie.

13 Fannie and Freddie chose to meet those new
14 goals by dramatically increasing their purchase and
15 holding of securities backed by subprime, adjustable
16 rate mortgages.

17 Your testimony says that in 2003 and 2004
18 they bought about 40 percent of this market, five
19 times more than they did in 2002, and at the time
20 Fannie classified these mortgages as prime, in
21 September of `09 they reclassified much of that
22 portfolio to be subprime.

23 Now, as I understand it, this huge increase
24 in demand from Fannie and Freddie in 2003 and 2004
25 contributed to a decline in long-term mortgage rates

1 relative to treasuries. That decline in long-term
2 mortgage rates helped fuel the rise in housing prices.
3 And then when that housing price bubble burst, it hurt
4 not just people who owned adjustable rate mortgages,
5 but also fixed rate mortgages, as well.

6 Now, in February of 2004, and what we're
7 talking about here is we're both talking about the
8 GSEs' holding huge portfolios, this in effect
9 multi-hundred-billion-dollar hedge funds on top of
10 their guarantee and securitization business combined
11 with new affordable housing goals set in the fall of
12 2000.

13 Now, in February of 2004 you testified
14 that, quote, GSEs need to be limited in the issuance
15 of GSE debt and the purchase of assets, both mortgages
16 and non-mortgages that they hold. That was in 2004. In
17 2007, the Congress considered the Housing Finance
18 Reform Act. And the bill that came out of Chairman
19 Frank's committee gave the new housing finance
20 regulator certain authorities.

21 And because it's important I want to read
22 the language. What that language said is that the
23 director shall consider any potential risks posed by
24 the nature of the portfolio holdings. That's it.
25 Okay. So the new regulator should consider the risk

1 of these multi-hundred-billion-dollar portfolios when
2 he or she is evaluating Fannie Mae and Freddie Mac.

3 Now, there was an amendment; it was House
4 Amendment 207; it passed the House on May 22nd, 2007,
5 on a 383 to 36 vote. That is an overwhelming
6 bipartisan vote.

7 And what that amendment did is it limited
8 the new housing regulator's authorities. It said that
9 the new housing regulator can only consider the risk
10 that these portfolios place to the safety and
11 soundness of Fannie Mae and Freddie Mac, not to the
12 financial system as a whole.

13 What I want to do is I want to read to you
14 language from the sponsor of the amendment,
15 Mr. Neugebauer, he said, this legislation clarifies
16 that when a regulator looks at regulating this entity
17 that he looks at the safety and soundness of that
18 entity and not external factors.

19 He later says, we shouldn't put things out
20 there that the regulator is not able to quite honestly
21 articulate, because what is a systemic risk? That
22 becomes a point of order that sometimes the regulator
23 cannot explain exactly the systemic risk is they
24 believe it is. It is a way to limit their portfolios.

25 So, in effect, 221 House Democrats and 162

1 House Republicans voted to preclude the regulator from
2 being able to consider systemic risk with the GSE
3 portfolios, this is directly contradicting your
4 recommendation of February 2004.

5 Suppose it had gone the other way. Suppose
6 that Housing regulator had had the authority to limit
7 the GSE portfolios in 2007 and had exercised that
8 authority. What effect do you think that might have
9 had on the crisis?

10 MR. GREENSPAN: Well, let's -- let's go
11 back a number of years, because the original mandate
12 of Fannie and Freddie was read as securitization
13 solely and that the cumulation of portfolios of assets
14 was not in their business plan with the onset of, I
15 guess, a cynical view of the market that the
16 presumption that Fannie and Freddie were not backed by
17 the full faith and credit of the United States
18 government, and that cynicism basically led to a 20 to
19 40 basis points subsidy in their divestitures in
20 short-term debt, which, for a financial institution,
21 is huge.

22 And so the -- the procedures that were
23 involved with Fannie and Freddie were largely to build
24 up the asset side of the portfolios. It didn't al- --
25 it almost didn't matter what they held just so long as

1 they harvested the subsidy. That created huge
2 profits, huge rates of return on equity, and set into
3 place a very large component of potentially toxic
4 assets.

5 And the failure of Fannie and Freddie was a
6 major factor in the crisis, remembering it occurs
7 prior to the Lehman default. And the result of that
8 is that a combination of the system breaking down had
9 extraordinarily large effects, which are difficult to
10 judge, because you only have a single incident. You
11 can't say, well, what could have happened "if," but
12 there is no doubt in my mind that if Fannie and
13 Freddie had held only those mortgages in its portfolio
14 which were required to make securitization feasible --
15 they have to hold a certain amount of inventory, which
16 is a very small fraction of what they actually held.
17 If that didn't happen, they would not have failed.

18 And the lack -- that particular event,
19 which is a very important event in the evolution of
20 the crisis, may have headed it off. I don't frankly
21 know. I don't know how one would know. But that
22 would have been far better off, in my judgment, is
23 unquestionable.

24 COMMISSIONER HENNESSEY: Thank you. And a
25 secondary point, as I understand your testimony, part

1 of what you're suggesting is that to meet the higher
2 affordable housing goals set in October of 2000,
3 Fannie and Freddie increased their purchase of
4 specifically subprime ARMs. They classified them at
5 the time as ARM as weak -- sorry -- as prime. They
6 reclassified them later.

7 We have the former head of Fannie Mae
8 coming in, and we have the former regulators coming
9 in. What would you recommend we ask them about the
10 interactions of these housing goals and the actions
11 that they took in 2003 and 2004?

12 MR. GREENSPAN: Well, I would ask them,
13 other than making profit for the corporation what was
14 the purpose of accumulating the assets in their
15 portfolio?

16 The reason I raise the issue is I never got
17 a straight answer in the early years that I was
18 involved with them. And I think this is an
19 unfortunate event, which as far as I'm concerned, had
20 it not occurred, namely the huge accumulation of
21 assets, for a lot of different reasons, including
22 potential distortions in the marketplace, we would
23 have not have had, incidentally, the big affordable
24 housing purchases by Fannie and Freddie because it's
25 based on volumes. And the amount of Fannie and

1 Freddie, as it turned out, ARMs that they bought would
2 have been very much less, and that would removed a
3 very substantial amount of weight on the -- on the
4 subprime market, because remember, that mandated
5 demand. It's mandated, remember that mandated demand
6 took out, effectively as the first tranche, 40 percent
7 of the market. And when you do that to any market, it
8 has extraordinary major impacts.

9 And I can't help but believe that even with
10 the affordable housing goals with a far smaller Fannie
11 and Freddie portfolio that we would have run into the
12 extent of the types of problems we were to run into in
13 2008, for example.

14 COMMISSIONER HENNESSEY: Thank you.

15 CHAIRMAN ANGELIDES: Thank you very much.

16 Ms. Born?

17 COMMISSIONER BORN: Thank you.

18 EXAMINATION BY COMMISSIONER BORN

19 COMMISSIONER BORN: Mr. Chairman, you long
20 championed the growth of the over-the-counter
21 derivatives market --

22 MR. GREENSPAN: Excuse me, can you put your
23 microphone closer?

24 CHAIRMAN ANGELIDES: Is your mic on,

25 Ms. Born?

1 COMMISSIONER BORN: It is on, yes.

2 CHAIRMAN ANGELIDES: Now we hear you.

3 COMMISSIONER BORN: You've longed
4 championed the growth of the over-the-counter
5 derivative market because of the risk-shifting
6 opportunities that it provides. You've also taken the
7 position that the over-the-counter derivatives market
8 should not be regulated.

9 As chair of the Federal Reserve board, you
10 endorsed a President's Working Group report in
11 November 1999 calling on Congress to eliminate
12 regulation of the OTC derivatives market.

13 You then welcomed the adoption of the
14 Commodity Futures Modernization Act of 2000, which
15 eliminated virtually all federal government regulation
16 of the OTC derivatives market and also preempted
17 certain state laws relating to it. So as a result OTC
18 derivatives have been trading with virtually no
19 regulation for a decade. And the market grew to
20 exceed 800 -- 680 trillion dollars in notional amount
21 by the summer of 2008.

22 In your view, did credit default swaps,
23 which are a type of over-the-counter derivatives
24 contract, play any role in causing or exacerbating the
25 financial crisis?

1 MR. GREENSPAN: Well, first, let's remember
2 that in the early years, credit default swaps were an
3 extremely small part of the total notional value.
4 And, indeed, the arbiter or the collector of
5 international data, the bank for international
6 settlements, didn't find credit default swaps in
7 sufficient volume to show them as a separate category
8 until the end of 2004.

9 And if you separate credit default swaps
10 from the rest of the market and look at the rest of
11 the market essentially as interest rate derivatives
12 and foreign exchange derivatives, which it still is,
13 you have the remarkable phenomenon of these
14 unregulated derivatives having the most extraordinary
15 stress test in 2008, 2009 with no evidence of which I
16 am aware that they didn't work exactly as they were
17 going to. It is certainly the case that credit
18 default swaps did create problems, and indeed, the
19 Federal Reserve Bank of New York was probably the very
20 first group to really come to grips with the problems
21 in 2005.

22 So as you go back to the earlier periods,
23 credit default swaps were never discussed in
24 president's working group, to my knowledge. When we
25 talked about derivatives, we were talking about,

1 essentially, interest rate derivatives and foreign
2 exchange derivatives.

3 And they had been unregulated, to be sure,
4 and no problems have emerged as a consequence of that.
5 Credit default swaps are a more complex issue, but
6 they were not on the agenda in the early years when we
7 had these discussions at the president's working
8 group.

9 COMMISSIONER BORN: Well, they certainly
10 existed as of that time. I think there is an August
11 12, 1996, supervisory guidance for credit derivatives
12 that were issued, was issued, by the Federal Reserve
13 Board on the bank -- to the banking committee, the
14 community, about the use of credit default swaps and
15 other credit derivatives.

16 And certainly, if you've read Gillian
17 Tett's book called Fools' Gold, it talks about the
18 extensive activity in credit derivatives, including
19 some very creative things that J.P. Morgan did in
20 1997.

21 Are you aware that the collapse of AIG was
22 caused by its commitments under credit default swaps
23 that it had issued? The taxpayers had to bail out AIG
24 because of its exposure on credit default swaps to the
25 tune of more than 180 billion dollars.

1 MR. GREENSPAN: Well, first, let me respond
2 to your 1997 reference.

3 I can't give you an exact number, but my
4 recollection was that there was credit default swaps
5 were something like 1 percent of the total notional
6 value of all derivatives. And that the mere fact that
7 it was being discussed is something which is to be
8 expected.

9 But if you're evaluating their impact on
10 the economy and on the financial system, a 1 percent
11 or less in notional value is not a big factor in
12 anything.

13 With respect to AIG, it is correct that
14 their offering and selling vast amounts of credit
15 default swaps was the proximate cause of their
16 problem.

17 But they were selling insurance. They
18 could just have easily have sold and gotten into the
19 same trouble by issuing insurance instruments rather
20 than credit default swaps.

21 My understanding is that it had -- the
22 reason that they did that was it was a capital --
23 differential capital requirements. But that was not
24 an issue of the credit default swaps, per se.

25 The issue was the extraordinary behavior of

1 investment officers at AIG who took unbelievable risks
2 with essentially very little capital.

3 There is a difference between credit
4 default swaps and, for example, interest rate
5 derivatives in the sense that credit default swaps
6 insure the principal as well as the interest.
7 Interest rate derivatives, for example, only deal with
8 interest and are, therefore, far less subject to the
9 problems that exist when you're insuring the level of
10 principal as well as interest.

11 COMMISSIONER BORN: Mr. Chairman, the
12 market for credit default swaps had risen to 60
13 trillion dollars in notional amount equal to the gross
14 national -- the gross domestic product of all the
15 countries in the world by 2008.

16 Also, let me point out, that had these been
17 being sold as insurance products, they would have been
18 regulated by insurance regulators and supervisors.
19 There would have been a requirement of capital
20 reserves. There would have been a requirement that
21 these contracts could only have been sold to entities
22 that had an insurable interest, that is, held the
23 bonds or securities that were being insured against.

24 There was no such regulation in the OTC
25 derivatives market thanks to the action of the

1 president's working group and Congress in 2000.

2 Let me go onto another subject. In your
3 recent book, you described yourself as an outlier in
4 your libertarian opposition to most regulation. Your
5 ideology has essentially been that financial markets,
6 like the OTC derivatives market, are self-regulatory
7 and the government -- and the government regulation is
8 either unnecessary or harmful.

9 You've also stated that as a result of the
10 financial crisis, you have now found a flaw in that
11 ideology.

12 You served as chairman of the Federal
13 Reserve Board for more than 18 years, retiring in
14 2000, and became, during that period, the most
15 respected sage on the financial markets in the world.

16 I wonder if your belief in deregulation had
17 any impact on the level of regulation over the
18 financial markets in the United States and in the
19 world.

20 You said that the mandates of the Federal
21 Reserve were monetary policy, supervision and
22 regulation of banks and bank holding companies, and
23 systemic risk.

24 You appropriately argue that the role of
25 regulation is preventative but the Fed utterly failed

1 to prevent the financial crisis.

2 The Fed and the banking regulators failed
3 to prevent the housing bubble; they failed to prevent
4 the predatory lending scandal; they failed to prevent
5 our biggest banks and bank holding companies from
6 engaging in activities that would bring them to the
7 verge of collapse without massive taxpayer bailouts;
8 they failed to recognize the systemic risk posed by an
9 unregulated over-the-counter derivatives market; and
10 they permitted the financial system and the economy to
11 reach the brink of disaster.

12 You also failed to prevent many of our
13 banks from consolidating and growing into gigantic
14 institutions that are now too big and/or too
15 interconnected to fail.

16 Didn't the Federal Reserve system fail to
17 meet its responsibilities, fail to carry its mandates?

18 CHAIRMAN ANGELIDES: And by the way, on
19 this, I'm going to yield two minutes for the response.
20 We're over time.

21 MR. GREENSPAN: First of all, the flaw in
22 system that I acknowledged was an inability to fully
23 understand the state and extent of potential risks
24 that were as yet untested. We didn't see what those
25 risks were until they unwound at the end of the Lehman

1 Brothers' bankruptcy.

2 And I had always presumed, as did virtually
3 everyone in academia, regulatory areas, banks,
4 presumed that risk potential was, having failed there,
5 means that we were undercapitalizing the banking
6 system probably for 40 or 50 years. And that has to
7 be adjusted.

8 But the notion that somehow my views on
9 regulation were predominant and effective as
10 influencing the Congress is something you may have
11 perceived. It didn't look that way from my point of
12 view.

13 First of all, I took an oath of office to
14 support the laws of the land. I don't have the
15 discretion to use my own etiology to effect my
16 judgments as to what Congress is requiring the Federal
17 Reserve and others to do.

18 As far as I'm concerned, if somebody asked
19 me my view on a particular subject, I would give it to
20 them, and I express them in the book you're referring
21 to, but that is not the way I ran my office.

22 I ran my office as required by law. And
23 there's an awful lot of laws that I would not have
24 constructed in the way that they were constructed.
25 But I enforced them, nevertheless, because that was my

1 job: That was built into my oath of office when I
2 took over the FED's chairmanship in 1987.

3 CHAIRMAN ANGELIDES: Thank you.

4 MR. GREENSPAN: So, I know my time has run
5 out, but I really fundamentally disagree with your
6 point of view.

7 CHAIRMAN ANGELIDES: Thank you.

8 Mr. Thompson?

9 COMMISSIONER THOMPSON: Thank you,
10 Mr. Chairman.

11 CHAIRMAN ANGELIDES: Microphone,
12 Mr. Thompson?

13 COMMISSIONER THOMPSON: Thank you,
14 Mr. Chairman.

15 EXAMINATION BY COMMISSIONER THOMPSON

16 COMMISSIONER THOMPSON: Dr. Greenspan, I
17 would like to go back to the line of questioning that
18 Mr. Georgiou raised regarding regulatory arbitrage, if
19 I might.

20 You said in the Brookings paper that
21 regulators can, and I quote, prohibit a complex
22 affiliate and subsidiary structure whose sole purpose
23 is tax avoidance and regulatory arbitrage.

24 It's clear from our view of Citi that that
25 was, in fact, part of what drove some of their

1 decisions as they looked at opportunities.

2 So how should supervisors have prevented
3 this regulatory arbitrage from occurring prior to the
4 financial crisis?

5 MR. GREENSPAN: Well, it's -- to a large
6 extent, it's caused by the legal structure of these
7 organizations. You know, one of the problems that
8 exists is that people are concerned about
9 off-balance-sheet accounting, that's not what bothers
10 me.

11 What bothers me is if you take something
12 off your balance sheet you should be prohibited from
13 bringing it back.

14 And I cannot believe that people
15 secondarily thought that reputation risk all of the
16 sudden emerged, that they didn't know about it, so I
17 think there's a bit of dubious bookkeeping going on at
18 that particular point.

19 But if you -- if the regulators can
20 determine what type of subsidiary structures you can
21 have in a large organization, you can eliminate a
22 fairly significant amount of the regulatory arbitrage.

23 And it's not an economic issue, it's
24 basically a means by looking at what the capital
25 requirements or other requirements are and figure out

1 how you would structure the various subsidiaries of
2 your organization to avoid that. That is in nobody's
3 interest.

4 COMMISSIONER THOMPSON: So financial
5 innovation has been an important component of what's
6 driven the contribution to GDP growth from the
7 financial services sector over the last 20 years or
8 so. If you were to think about other industries that
9 have significant societal impact, pharmaceuticals,
10 transportation, a range of others, they are required
11 to test their products and have those products
12 certified before they release them into the
13 marketplace.

14 So if we were to now think about the
15 societal impact of financial services and your views
16 around collateral and capital, should there be a
17 different scheme for new product introduction in this
18 industry that would mitigate, perhaps, the societal
19 impact that some of the risks that we are taking
20 really represent today?

21 MR. GREENSPAN: Well, that's a good
22 question. I think you first you have to start with
23 the question of what's the function of our financial
24 system. And basically it's to supply financial
25 services to the non-financial sector, Main Street, so

1 to speak, which facilitates the production and
2 standards of living that emerge as a consequence of
3 that.

4 When you -- for example, we have an
5 extraordinary rise in the share of national income
6 going to finance starting in 1947, year after year
7 after year, and so what we're dealing with is a major
8 problem in how to make judgments of what is innovation
9 that works and what is it that doesn't work but that
10 you need innovation to essentially keep up with the
11 complexity of the non-financial economy, it goes
12 without saying, all innovation, by its nature, is
13 unforecastable with respect to how it will come out.

14 So I think what we find in finance, as well
15 as in the non-financial area, is that a large number
16 of innovations fail, but fortunately what causes
17 progress and productivity is that more innovations are
18 positive than otherwise. You cannot tell, in advance,
19 which is which, so my judgment is the only way to
20 solve that problem is to have enough capital that will
21 absorb X percent of innovations failing.

22 We will never see SIVs or synthetic CDOs as
23 far in the future as I can imagine. They're gone.
24 The critical issue here is in investors who determine
25 what products fail and what succeeded, it's not the

1 banking system. The banking system can offer them,
2 but if they don't buy them, there's no use.

3 So the non-financial part of our economy is
4 the arbiter of what products fail and not fail.

5 COMMISSIONER THOMPSON: So would you,
6 therefore, be an advocate of some form of incremental
7 capital being put in place ahead of the release of
8 these critical new innovations?

9 MR. GREENSPAN: As a general rule I'm not
10 comfortable with variable capital changes, you know,
11 whether it's for -- I mean, the main argument is
12 usually that there's cyclically adjusted capital
13 requirements. That would be fine if we could forecast
14 where in the business cycle we were in real time.

15 We're always very thoughtful on the issue
16 of where we were in the business cycle but it's
17 another -- it's a wholly different issue when you're
18 in real time and saying, are we in the beginning of
19 the cycle or are we closer to the end. And I think
20 to --

21 COMMISSIONER THOMPSON: Well, for new
22 products we would clearly be at the beginning of the
23 cycle.

24 MR. GREENSPAN: I'm sorry?

25 COMMISSIONER THOMPSON: For a new product

1 innovation --

2 MR. GREENSPAN: Yes.

3 COMMISSIONER THOMPSON: -- we would clearly
4 be at the beginning of the cycle.

5 MR. GREENSPAN: No, no, I'm referring to
6 the business cycle, generally.

7 COMMISSIONER THOMPSON: Oh, okay.

8 MR. GREENSPAN: But I agree with you. In
9 other words, that every new -- every innovation always
10 starts at the beginning, and you don't really know
11 where it's going to come out, and the non-financial
12 system will tell you whether it's valuable to them.
13 And I would just as soon not try incremental. I have
14 nothing in principal against it; it's just that I feel
15 it's not easy to implement.

16 COMMISSIONER THOMPSON: Well you commented
17 this morning that the issue of consolidated regulatory
18 scheme had been discussed for years within the Fed
19 and, I guess, amongst the peer agencies.

20 And it's your opinion that the change
21 that -- there's no evidence that would suggest the
22 change to consolidating the regulatory scheme would,
23 in fact, help.

24 So, therefore, should I conclude from that
25 comment that you, as someone who sat over and was the

1 standard bearer, if you will, for our financial system
2 for almost 20 years, believes that no meaningful
3 change is necessary now.

4 MR. GREENSPAN: I don't know the answer to
5 that question because we've got so many overlapping
6 jurisdictions and the like that are frankly kept that
7 way for political, not economic or financial reasons.
8 And I have no doubt --

9 COMMISSIONER THOMPSON: But politics aside.

10 MR. GREENSPAN: I have no -- I'm sorry?

11 COMMISSIONER THOMPSON: Politics aside.

12 MR. GREENSPAN: Politics aside, yeah, I
13 have always thought that there are differing things that
14 could be done.

15 But I wanted to emphasize that it's not the
16 particular agency which does these things, but more
17 importantly what is done than who does it.

18 COMMISSIONER THOMPSON: So you strongly
19 believe that incremental capital and incremental
20 collateral would help? I interpret that from your
21 comments.

22 MR. GREENSPAN: I would say I'd be more
23 inclined to just set absolute levels. There is a
24 problem with it changing capital requirements largely
25 because it creates an element of uncertainty in the

1 marketplace, which, probably, I have no idea how big
2 it would be, but it's certainly negative.

3 I think that you're far better off just
4 fixing capital requirements at levels and just holding
5 them there as permanent requirements. I think that
6 would address, in my judgment, most of the problems I
7 see that are out there.

8 COMMISSIONER THOMPSON: While I would tend
9 to agree with that, it would also seem to me that
10 combining the notion of supervisory as well as
11 enforcement would also help, because you indicated
12 that in many instances, while the Federal Reserve had
13 supervisory responsibility, you really did not have
14 enforcement.

15 So I'm not sure how the system works and
16 improves without us making some changes not just in
17 capital and collateral, but in how we execute on the
18 rules and laws that we have in place.

19 MR. GREENSPAN: Well, I think in order to
20 do that, if the Federal Reserve were required to
21 enforce the rules and regulations that it promulgates,
22 I think the staff would have to be vastly larger.

23 COMMISSIONER THOMPSON: But some other part
24 of government would also have to shrink?

25 MR. GREENSPAN: Well, there's a -- right

1 now there's a great deal of discussion that's going on
2 with respect to who should be supervising what, and
3 the problems that -- I'm not sure that we solve any of
4 the problems that have been properly identified in
5 this crisis by moving the chairs around.

6 I do not deny that, and if you ask me,
7 starting from scratch, would I have a different type
8 of regulatory system focused on the areas where I
9 think they can be most effective, the answer is I --
10 I -- I suggested that in the Brookings panel piece,
11 where I went through the reasons why, what regulations
12 can do and what they can't do. And if we emphasize
13 what we can do, which can be very effective and, in my
14 judgment, determinative, what you tend to do is to
15 cause the losses to be concentrated in the common
16 shareholders of institutions.

17 And if capital is large enough, all of the
18 losses accrue to them and not to the debt holders and
19 therefore they do not default. And therefore you
20 don't have serial contagion which is caused by the
21 faults of senior debt mainly, but debt in general.

22 CHAIRMAN ANGELIDES: Thank you very much.

23 COMMISSIONER THOMPSON: Unfortunately, we
24 don't have the luxury of being able to start over from
25 scratch. And so I think we're going to have to

1 implement incremental changes.

2 And your knowledge of the system and what
3 changes would be beneficial to the American public
4 would be very helpful.

5 CHAIRMAN ANGELIDES: Thank you. All right.
6 Now, Mr. Thomas, you and I have some remaining time.
7 Do you want to -- should I go ahead and take my just
8 cleanup items and then turn to you?

9 VICE CHAIRMAN THOMAS: I would advise you
10 that setting politics aside, as chairman you should
11 let me go first.

12 CHAIRMAN ANGELIDES: You go ahead, Mr. Vice
13 Chairman.

14 VICE CHAIRMAN THOMAS: And then you get to
15 close. Although I'm very tempted by that invitation.

16 CHAIRMAN ANGELIDES: Go ahead, Mr. Thomas.

17 VICE CHAIRMAN THOMAS: Thank you. I would
18 just tell my -- my friend that setting politics aside
19 is a sheer invitation for politicians to show you that
20 you can't.

21 COMMISSIONER THOMPSON: And it's hard to
22 do.

23 VICE CHAIRMAN THOMAS: And we have seen
24 that over and over again, just the way the system
25 works.

1 And if you're going to start with a clean
2 sheet of paper, it means you have it turned over. You
3 really need to turn it over because there is no such
4 thing as a clean sheet of paper.

5 EXAMINATION BY VICE CHAIRMAN THOMAS

6 VICE CHAIRMAN THOMAS: Mr. Chairman, this
7 is a question that I will ask you that I don't need
8 you to answer now. You might want to do it on paper
9 to me. If you don't and you can offer a reasonably
10 short version, that's perfectly acceptable.

11 And the reason I put it in that context is
12 that your mention of the book Reinhart and Rogoff, I
13 serve at AEI with a colleague, who was the husband of
14 Professor Reinhart, Vince Reinhart. And in
15 discussions that we've had, he's indicated in his
16 position -- I should give a bit of background -- he's
17 the head of monetary affairs at the Fed from '01 to
18 '09, and he's talked about the fact that he thinks,
19 based on his knowledge and experience, that the Fed
20 made a mistake signaling to the market that it was
21 going to slowly raise short-term rates.

22 And the argument goes that this created a
23 steep yield curve, because the market, as we saw over
24 and over again, quickly adjusted to where they knew
25 the rates would eventually go.

1 And the steep yield curve led to novel ways
2 for firms to take advantage of borrowing very
3 short-term and lending long-term.

4 Do you agree with that analysis? In
5 retrospect, was the Fed's strategy the right one to
6 take, or is it the usual argument at the time given
7 the information we had and under the circumstances?

8 MR. GREENSPAN: Well, Vincent Reinhart is a
9 first-rate economist and whose judgment I, for many
10 years, relied on.

11 Let me answer that question in writing
12 after I go over the particular details of the position
13 I know he's taking.

14 VICE CHAIRMAN THOMAS: And I wanted to
15 offer that to you because I am interested in -- in a
16 more fundamental answer, because it will lead to other
17 questions as we go forward, so thank you. And we'll
18 submit it to you in writing.

19 CHAIRMAN ANGELIDES: Additional questions,
20 Mr. Thomas?

21 VICE CHAIRMAN THOMAS: Not at this time,
22 Mr. Chair.

23 CHAIRMAN ANGELIDES: All right. All right,
24 couple of items just -- first of all, a couple of
25 clarifications, because I just want to make sure we

1 have the facts for the record.

2 Even by your own submission, and by the
3 way, let me stipulate that Fannie Mae and Freddie Mac
4 were disasters, but I just do want to point out,
5 because you keep referring to 40 percent of the
6 market, that if you'll look at that 2002 to 2005
7 period, the private market, Wall Street was anywhere
8 from 59 to 92 percent of that private label security
9 market. That's just a fact.

10 Secondly, I did want to just follow up on
11 Ms. Murren's question of earlier.

12 I just wanted to point out, because when
13 she referred to the review of the Federal Reserve
14 Bank, and I don't think there's any expectation you
15 would have seen this review from 2005, but this was
16 not some third-party wild-eyed critic. This 2005
17 review, which Ms. Murren referenced, was a peer review
18 by other Federal Reserve banks.

19 And I might say there was a second review
20 in December 2009 where again the peer, other Federal
21 Reserves, commented on the supervision of Citibank by
22 the Federal Reserve Bank in New York, and they said,
23 quote, the supervision program for Citigroup has been
24 less than effective although the dedicated supervisory
25 team is well qualified and generally has sound

1 knowledge organization, there have been significant
2 weaknesses in the execution of the supervisory
3 program. So I just want to point out that these were
4 internal reviews as to the inadequacy of supervision.

5 But I do want to return to just one line of
6 questioning that I asked you that I want to follow up
7 on, because you indicated that in many respects what
8 was important was to go after fraud, embezzlement,
9 illegal activities. And you've been very clear on
10 that. So very quickly, there was the FBI warning in
11 2004; there was a sevenfold increase in the number of
12 suspicious activity reports related to mortgage fraud
13 by banks from 2003 to 2006; your own Federal Reserve
14 in 2005 put out a white paper on the detection,
15 investigation, deterrents of mortgage loan fraud.

16 Just very quickly, what was the most
17 important thing you did to combat fraud, the single
18 most important thing that the Fed did in light of the
19 evidence that it was growing in mortgage.

20 MR. GREENSPAN: Well, first of all, the
21 enforcement against fraud and misrepresentation is one
22 of the key elements in any market society. You cannot
23 have an effective market society if counterparties
24 cannot trust individuals with whom they're dealing
25 with wholly independently of what that contractual

1 relationships and enforcement is.

2 The FBI, I believe they had 22,000 cases in
3 2005. That's important and critical. One issue of
4 fraud is enough. But 22,000, when you have 55 million
5 total mortgages outstanding, residential only, home
6 mortgages as well as a lot of commercial mortgages,
7 it's not a systemic problem.

8 CHAIRMAN ANGELIDES: But what -- but did
9 you then make any actions? I mean, I could only count
10 two referrals under fair lending laws from 2000 to
11 2006 by the Fed to Justice, just two: One for First
12 American Bank in Carpentersville, Illinois, and one
13 for Dessert Community Bank in Victorville. It seems
14 pretty slim.

15 MR. GREENSPAN: Well, the issue was that
16 this staff, in evaluating what was going on, which --
17 see, remember, a goodly part of supervision and
18 regulation is to get things solved so that if somebody
19 is in violation of something and you can get them to
20 adjust so that the regulators are satisfied, it never
21 gets to the point where it's a referral for
22 enforcement in some form or another.

23 I agree with you in the sense that the
24 number of actual referrals that were made to the
25 Department of Justice were small and I believe a good

1 reason for that is we were able to get compliance
2 without doing that.

3 CHAIRMAN ANGELIDES: All right. Well, I
4 want to -- here's my final observation. It really
5 follows up on Mr. Georgiou's questions and Ms. Born's.
6 And I'm going to ask you that in the remaining time
7 just to, I think, deal with something that's very
8 significant around which I think a lot of Americans
9 have questions.

10 Their -- (Power outage.) all right. That's what -- that's
11 what God thinks about the questions.

12 CHAIRMAN ANGELIDES: Stay. Stay. Hang on
13 one second so we can get this back up. All right,
14 let's do this, let's do this. Let's just finish up
15 and see if there's any -- speak up a little and see if
16 there's any other questions.

17 So here is my final question, which is, it
18 does seem that there's a big issue here about this,
19 and there's something, as I read all these documents
20 which are coming through, something called the
21 Greenspan Doctrine. I knew what the Truman Doctrine
22 was. We see the threat of communism. The Bush
23 Doctrine, but there seemed to me with the Greenspan
24 Doctrine that even if you saw evident threats to the

1 financial system, you took no regulatory action.

2 I think the one thing I want to ask,
3 following up on Ms. Born, is looking back on the last
4 decade, do you feel that there's a failure of
5 regulation in our system?

6 MR. GREENSPAN: There was a -- there was a
7 failure of regulation in the critical part of it,
8 namely in the private counterparty risk management
9 system, this is the system which evolved over 50
10 years, spawned numerous Nobel Prize winners, was
11 accepted by academia, the regulatory agencies, and
12 especially the Federal Reserve. That turned out to be
13 a major mistake.

14 Is it an indictment of the total system?
15 By no means, because it's not the conceptual framework
16 of how to regulate, but the actual application of it.
17 We did not have enough capital in the system to
18 contain the type of crisis, which in my judgment,
19 happens once in a hundred years. This financial
20 crisis is, best I can judge, is the most severe in
21 history. It's not the same thing as saying that it's
22 the severest economic crisis. That was the Great
23 Depression.

24 But there is no example that I've been
25 able to find of a breakdown in short-term financial

1 availability, which is the critical issue in a
2 financial crisis, in any history that I can see on --
3 on our global scale that occurred within days
4 following the Lehman Brothers' bankruptcy.

5 CHAIRMAN ANGELIDES: All right. And
6 Mr. Vice Chair?

7 VICE CHAIRMAN THOMAS: On that statement,
8 Mr. Chairman, I would ask you a follow-up question,
9 and that was quite a contextual position for your
10 statement that you do not, given your background,
11 understanding, history, see any comparable collapse.

12 In that regard I'd have to say,
13 notwithstanding the difficulties we're still in, the
14 experiences that we had previously, in my opinion I
15 want your reaction, allowed us to take some actions
16 which mitigated, notwithstanding all of the damage
17 that has been done, an even greater crisis; is that
18 accurate?

19 MR. GREENSPAN: I'm sorry, may I answer
20 that for the record, Mr. Thomas?

21 VICE CHAIRMAN THOMAS: We'll get that for
22 the record, because I think at some point the whole
23 concept of bubbles is, you didn't know, you didn't
24 anticipate, this time is different.

25 If this is to the magnitude that you

1 indicated different than in the past, notwithstanding
2 the damage, all of the understanding of what we need
3 to lead to, it could have been worse.

4 MR. GREENSPAN: Well, this is the critical
5 period that we're going to have to -- we're going to
6 have to look at how this thing ultimately evolves
7 before we fully understand what the consequences are.
8 But let me respond to your question in more detail on
9 the record.

10 VICE CHAIRMAN THOMAS: In writing, yes.
11 Thank you. Certainly yield a minute to Commissioner
12 Georgiou.

13 COMMISSIONER GEORGIOU: Just one question I
14 would ask you, and ask you to respond to it if you
15 could, in writing.

16 We, our capital, I think we've all come to
17 the conclusion that -- and your advice has been --
18 that the capital and liquidity requirements
19 historically haven't really -- weren't adequate to
20 avoid the consequences of the financial crisis.

21 And I take it that means that we ought to
22 implement some more significant capital requirements
23 on a go-forward basis. Would that be fair to say?

24 VICE CHAIRMAN THOMAS: Mr. Chairman, these
25 questions can be recorded but I think they ought to be

1 answered in writing --

2 COMMISSIONER GEORGIU: Right.

3 VICE CHAIRMAN THOMAS: Given the current
4 circumstances.

5 COMMISSIONER GEORGIU: I understand, but I
6 thought he nodded his head yes. Is that correct?

7 THE AUDIENCE: No. No, the witness can't
8 hear. We have to have a hard stop.

9 VICE CHAIRMAN THOMAS: I believe
10 Mr. Wallison wants a question for the record and we'll
11 submit these in writing if you can phrase it.

12 COMMISSIONER WALLISON: Quickly.

13 VICE CHAIRMAN THOMAS: Yes.

14 COMMISSIONER WALLISON: And my question is
15 this: The unprecedented theme about our current
16 situation is the total number, it seems to me, of
17 subprime and Alt-A mortgages in our economy, 26
18 million, which as I said at the outset, is about half
19 of all mortgages in our economy.

20 When you are responding in writing to the
21 question of what caused this financial crisis I would
22 like you also to consider whether, in addition to less
23 capital than was required, what effect this
24 substantial number of bad mortgages might have had.

25 CHAIRMAN ANGELIDES: So those would be

1 submitted in writing to Mr. Greenspan.

2 What I just want to say, Mr. Greenspan, you
3 gave a lights-out performance today. I want to -- I
4 want to thank you very much for your time; thank you
5 very much for coming before us; thank you for your
6 service to the country.

7 And we are going to adjourn for 30 minutes,
8 and hopefully we'll have lights and power when we
9 return. Thank you all very much.

10 MR. GREENSPAN: Thank you very much.

11 **(Session ended at 11:53 a.m.)**

12 CHAIRMAN ANGELIDES: The meeting of the
13 financial crisis, lights power and all, will come to
14 order. Thank you very much, witnesses, for joining us
15 today.

16 What I'm going to ask you all to do at this
17 time is please rise, because as we do with all
18 witnesses, in the past and in the future, we'll swear
19 you in.

20 Mr. Bowen, can we swear you in along with
21 everyone else? Thank you.

22 Do you solemnly swear or affirm, under the
23 penalty of perjury, that the testimony you are about
24 to provide the Commission will be the truth, the whole
25 truth and nothing but the truth to the best of your

1 knowledge?

2 MR. BOWEN: I do.

3 MR. BITNER: I do.

4 MS. LINDSAY: I do.

5 MS. MILLS: I do.

6 CHAIRMAN ANGELIDES: Thank you very much.

7 This panel is about subprime origination and
8 securitization, and we are going to ask each of the
9 panelists -- you've submitted to us your written
10 testimony, and we are going to ask each panelist to
11 provide a five-minute opening statement. Please don't
12 repeat your written testimony and please do keep this
13 to five minutes.

14 There will be a light that comes on in
15 front of you that at one minute will indicate one
16 minute to go. And then red when the five minutes is
17 there.

18 So with that, we are going to start with
19 Mr. Bitner and then go left to right or right to left
20 depending on where you're sitting.

21 And just so for the audience, one of the
22 reasons we're doing that is certainly with respect to
23 Mr. Bitner and Ms. Lindsay, they were on the end of
24 selling mortgages to Citigroup, and so we thought we'd
25 take this in order. So, let's do that. Mr. Bitner.

1 MR. BITNER: Thank you.

2 VICE CHAIRMAN THOMAS: Microphone, please.

3 CHAIRMAN ANGELIDES: Yes, and then punch
4 your microphone.

5 VICE CHAIRMAN THOMAS: You have to turn it
6 on at the base.

7 MR. BITNER: There we go. Is that okay?

8 CHAIRMAN ANGELIDES: Yes.

9 MR. BITNER: Good afternoon, members of the
10 Commission. For the record, my name is Richard
11 Bitner. I am a 15-year veteran of the mortgage
12 banking industry, who owned a subprime lending company
13 from the years 2000 to 2005.

14 Additionally, I am the author of
15 Confessions of a Subprime Lender: An Insider's Tale
16 of Greed, Fraud, and Ignorance, and I currently
17 publish several housing, finance, and real
18 estate-related periodicals, notably Housing Wire
19 Magazine.

20 Arguably, securitization could be the
21 single greatest innovation that has ever come into the
22 world of mortgage lending. Before loans were
23 securitized, a consumer relied on a bank to supply the
24 money to fund a mortgage.

25 And that entire process, from origination

1 to servicing, stayed with the same institution. Now,
2 since banks owned every aspect of the loan and were
3 heavily regulated, they were motivated to manage risk
4 and to treat borrowers fairly.

5 In addition to creating a renewable source
6 of capital, mortgage securitization also fragmented
7 the industry. So instead of one institution that
8 functioned in a true cradle-to-grave capacity, that
9 functionality of the industry became diversified.

10 This fragmentation gave each player a claim
11 of what I like to call plausible deniability.
12 Mortgage brokers simply maintained that they only
13 originated the loan, so any concern about the loan's
14 quality were the lender's responsibility.

15 The lender underwrote the deal using the
16 guidelines provided by the investment firms. So they
17 merely delivered the final products investors wanted
18 to buy.

19 The Wall Street firms who packaged the
20 securities and the investors who purchased them
21 claimed to be holders in due course, which protected
22 them from any liability when lenders and brokers acted
23 illegally.

24 And while the entire food chain contributed
25 to the problems, fragmentation allowed each player to

1 point an accusatory finger at someone else,
2 effectively promoting what we now know is the
3 originate-to-distribute model of lending.

4 With minimal barriers to entry and
5 historically low-interest rates, loan originators
6 entered the business by droves. By some estimates,
7 the number of new -- the new -- excuse me -- new loan
8 originators working for mortgage brokers increased by
9 100,000 between the years of 2001 and 2006.

10 During the early years of subprime
11 lending -- subprime lending, very few states actually
12 had licensing requirements, which meant that the
13 barriers to entry were minimal. And even when states
14 began requiring licenses, the typical prerequisites
15 were disproportionately easy to meet, such as passing
16 multiple choice tests and not having any felony
17 convictions.

18 This ease of entry meant that the level of
19 fraud we experienced as a lender when reviewing files
20 originated by mortgage brokers was unprecedented. In
21 my firm's experience, between the years of 2003 to
22 2005, more than 70 percent of all brokered loan files
23 that were submitted for initial review were somehow
24 deceptive, fraudulent, or misleading.

25 The issue is further complicated by the

1 fact that little could be done to rid the system of
2 these violators. For example, if a lender found a
3 broker was acting improperly, in fact committing
4 fraud, the options for enforcement were minimal. Many
5 states did not have licensing requirements, and those
6 that did have weak enforcement standards.

7 Assuming there was a state licensing
8 authority, a lender could submit documentation in an
9 effort to rescind a broker's license. But in many
10 cases, however, the path of least resistance was
11 simply for the lender to place the broker on the "do
12 not do business with" list, which meant the broker was
13 effectively barred from doing business with that firm,
14 leaving them to go somewhere else to conduct business.

15 Determining a property's value posed a
16 number of challenges for firms like mine. Subprime
17 lenders usually conducted a second-party review for
18 most broker-ordered appraisals, because frankly, the
19 majority of appraisals were considered to be
20 unreliable. To put things in perspective, during my
21 company's history, nearly half of all the loans we
22 underwrote -- that we underwrote were originally
23 overvalued, in our opinion, by as much as 10 percent.

24 Interestingly, our experience also showed
25 that 10 percent was the most an appraisal could be

1 overvalued and still be purchased by any one of our
2 four major investors.

3 Another quarter of the appraisals that we
4 reviewed were overvalued by anywhere from 11 to
5 20 percent. And the remaining 25 percent of
6 appraisals that we initially underwrote were so
7 overvalued that they defied all logic. Throwing a
8 dart at a board while blindfolded would have produced
9 more accurate results.

10 The implication of this trend becomes
11 evident once doing the math. If multiple properties
12 in an area are overvalued by 10 percent they, in turn,
13 become comparable sales for future appraisals. Then
14 the process repeats itself. And we saw this on
15 several occasions.

16 We would close a loan, for example, in
17 January and see the subject property show up as a
18 comparable sale in the same neighborhood six months
19 later. Except this time, the new subject property was
20 being appraised for 10 percent more than the
21 comparable sale six months earlier. In the end, I
22 believe it was the subprime industry's willingness to
23 consistently accept overvalued appraisals that
24 significantly contributed to the run-up in property
25 values that were experienced throughout the country.

1 To complicate matters further, the mortgage
2 industry experienced a gradual shift between what was
3 and what was not an acceptable form of risk. While
4 credit score had been an excellent indicator of loan
5 performance, its reliability was predicated on holding
6 other credit factors constant, these included, but
7 were not limited to, a borrower's rental history, job
8 stability, and cash reserves.

9 Unfortunately, the industry's inability to
10 apply logic when underwriting a loan file would serve
11 as its undoing. No other example is more prevalent to
12 illustrating this point than identifying how a
13 borrower's housing payment history was verified.

14 During this time period many lenders moved
15 from requiring a borrower to provide 12 months'
16 cancelled rent checks or verification or rental
17 history from a management company to simply allowing
18 for a private verification. In other words, when a
19 note from a borrower's mother became an acceptable
20 form of rental history, there should be no surprise
21 that loans defaulted at an alarming rate.

22 CHAIRMAN ANGELIDES: Thank you very much.
23 And there will be plenty of time for questions. Thank
24 you.

25 Ms. Lindsay? And if can pull those mics

1 towards you and put them on, thank you.

2 MS. LINDSAY: Okay. Good afternoon. Thank
3 you for inviting me to participate this afternoon. My
4 hope for today's session is that I can bring a unique
5 perspective to the -- into subprime lending.

6 I have a unique background in that I grew
7 up in the subprime industry. My father was a hard
8 money lender. So I actually learned what Fannie Mae
9 was when I was six years old. I don't want to tell
10 you how old I am, but Freddie Mac wasn't around yet.

11 VICE CHAIRMAN THOMAS: Just a minute, let
12 me do the math.

13 MS. LINDSAY: So basically I grew up
14 with -- you know, my father would show me how to
15 evaluate a loan, what characteristics to look at, and
16 when I was 16 years old, 1979, okay, you can do the
17 math again, I learned how to service the loans and
18 learned how to look at loans, looked at properties.

19 And the biggest thing was with hard money
20 lending, these were borrowers who didn't have good
21 credit histories. So to offset that poor credit
22 history, they would have a lot of equity in the
23 properties.

24 We had three Cs that we looked at: We had
25 the credit, collateral, and the capacity. The

1 borrowers clearly didn't have the credit, which later
2 on, in subprime, they didn't have the credit, but then
3 they didn't have the collateral either. And then we
4 found out they didn't have the capacity.

5 They would -- they switched to stated
6 income loans, and they would just state whatever would
7 qualify them for the loan, usually led by the brokers,
8 because the brokers were the professionals in the
9 industry who would know what they needed in order to
10 qualify for the loan.

11 Those loans were submitted to lenders, like
12 New Century Mortgage, who then sold them to investors
13 on Wall Street where they were packaged and resold
14 into securities.

15 I joined New Century as a wholesale
16 underwriter in 1997. I was kept on as part of a
17 skeleton crew after we declared bankruptcy in April of
18 2007. I was kept there to help wind down part of the
19 bankruptcy.

20 I found the lending standards at New
21 Century significantly different than what I had grown
22 up in the subprime lending industry. Also I had
23 worked at Beneficial Mortgage from December of 1996
24 until I was hired on at New Century in December of
25 1997.

1 Beneficial was one of the original subprime
2 lenders. They, too, would work with borrowers who had
3 poor credit history, and they would offset it with the
4 protective equity. So in other words, if the
5 borrowers were going to default, they would protect
6 their portfolio by having the equity. So the borrower
7 could either get out by selling the property or they
8 could refinance or possibly do something else in order
9 to -- to get out of their loan.

10 As Mr. Bitner mentioned, the -- the growth
11 and subprime industry grew because of the
12 securitizations on Wall Street. Before the banks,
13 like Beneficial, like some of the other local banks,
14 they kept their loans on portfolio or they would sell
15 them off to Fannie Mae or Freddie Mac if they
16 qualified for those loans.

17 With the advent of the securitizations,
18 loans were just sold in droves to Wall Street. There
19 was a huge demand for the product because of the
20 returns. The problem with the returns, though, is
21 they were based on a product that would, if anything
22 hiccupped, like the property values, they were going
23 to potentially default.

24 New Century was not able to originate loans
25 without the use of warehouse lines of credit. We

1 didn't have our own funds to loan. We were not a
2 banking institution. We didn't take deposits.

3 So we got our money from warehouse lenders.
4 These warehouse lenders provided us the ability to
5 make these loans, and they were usually provided by
6 the same people who would purchase our loans on Wall
7 Street. There was such a huge demand for our product
8 that our loans were forward-sold two and three months
9 ahead of time.

10 We had approximately -- we were making, at
11 our peak, approximately 20,000-plus loans per month,
12 about 5 billion dollars in product every month that
13 was being sold, and those loans were forward-sold.

14 One of the other things that changed was
15 the originate-to-distribute model. A definition of a
16 good loan used to be a loan that paid. It changed to
17 a definition of a loan that could be sold.

18 We did track the performance of the loans
19 that we could, because we would always say that our
20 loans performed better than the others. The problem
21 with that was we couldn't track all of the loans
22 because, like I said, most of the loans were sold and
23 we didn't know what happened to them unless we were
24 asked to repurchase.

25 One of the other problems was the loose

1 guidelines. We have layered risk. We had people who
2 didn't have credit. They didn't show the capacity and
3 they didn't have the collateral because they were at
4 100 percent financing.

5 And then we added the interest-only loans,
6 and then there were the teaser rates that would
7 readjust after two years of being fixed.

8 And to finalize my opening statement, just
9 basically at the end of the day, we had a system that
10 went into a downward spiral because of layering risk
11 rather than mitigating the risk, and we just need to
12 go back to the core values of the three Cs. Thank
13 you.

14 CHAIRMAN ANGELIDES: Thank you. Thank you
15 very much. Ms. Mills?

16 MS. MILLS: Chairman Angelides, Vice
17 Chairman Thomas, and members of the Commission, thank
18 you for inviting me to appear today. My name is Susan
19 Mills and I'm the head of the mortgage finance group
20 at Citigroup Global Markets, Inc.

21 My group is a part of the team responsible
22 for the securitization and underwriting of residential
23 mortgage-backed securities within Citi's investment
24 bank.

25 The Commission has asked me to address the

1 securitization activities of my group, including our
2 business model and our due diligence activities, with
3 an emphasis on the securitization of subprime and
4 Alt-A residential mortgages.

5 I have done so at greater length in a
6 written statement for the record. Let me address a
7 few key points for you now.

8 First, our mortgage trading and
9 securitization activities were part of an
10 intermediation business; that is, we purchased
11 mortgage loans from originators and sold RMBS
12 securities to any sophisticated institutional
13 investors.

14 Simply stated, our objective in purchasing
15 mortgages was to securitize them and distribute the
16 resulting mortgage bonds to meet the demand from our
17 fixed-income investors.

18 Secondly, Citi's RMBS business was smaller
19 than the RMBS business at many other Wall Street
20 firms. Publically available league tables showed that
21 we ranked seventh in underwriting us mortgage-backed
22 securities in 2004; 10th in 2005; 11th in 2006; and
23 10th in 2007.

24 A significant reason for this was that
25 unlike many other firms, in the period leading up to

1 the market dislocation in 2007, we did not operate
2 what is known as a mortgage conduit, which is an
3 entity used to acquire mortgages on an ongoing basis
4 through established relationships with originators.
5 In addition, Citi's investment bank did not have a
6 direct relationship with an affiliated mortgage
7 originator from which we had the ability to directly
8 source mortgages for our securitizations. This meant
9 that instead of originating and servicing mortgages
10 in-house for securitization business, as many of our
11 peers did, we exclusively purchased loans from
12 originators in the marketplace in arm's-length
13 transactions.

14 As a result, we underwrote our RMBS
15 according to the guidelines of the loan originators
16 and not our own set of guidelines.

17 Our due diligence had two principal
18 components. First, before ever purchasing loans from
19 a particular seller, we would evaluate the seller and
20 their operations, typically through an on-site review.
21 If we were not comfortable with a particular seller,
22 we would not do business with them.

23 Secondly, with respect to pools of loans
24 that we were purchasing, we would perform a due
25 diligence review focused on ensuring that the loans

1 met the originator's underwriting guidelines. To
2 conduct this review we engaged third-party diligence
3 providers that we actively supervised.

4 Once we had aggregated a pool of loans of
5 sufficient size, we would then securitize those loans.
6 As a part of this process, we submitted loan level
7 information to credit rating agencies to determine the
8 dollar amount of bonds in each rating category for the
9 RMBS.

10 We would market the RMBS bonds to
11 investors, solicit feedback from those investors
12 regarding the transaction, and finalize the structure
13 and pricing.

14 Our offering documents described the
15 underwriting standards of the originator or
16 originators of the loans in the pool and also provided
17 extensive narrative and stratifications concerning the
18 loans themselves.

19 I understand that the Commission is
20 particularly interested in our efforts to monitor the
21 mortgage market and detect fraud. Our due diligence
22 reviews served as the primary and, I believe, highly
23 effective means by which we evaluated the loans we had
24 purchased and securitized.

25 If we identified issues with the loans in a

1 pool of mortgages that we had agreed to purchase,
2 including concerns about potential fraud, we would
3 perform additional diligence until we were satisfied
4 that our level of diligence was appropriate.

5 We would not purchase loans that failed to
6 meet the applicable underwriting guidelines of the
7 originator or that violated any compliance regulations
8 or that appeared fraudulent.

9 We also monitored the performance of the
10 loans that we purchased, and we typically negotiated
11 the right to require the seller of loans that
12 experienced early payment defaults, an indication of
13 potential fraud, to repurchase those loans.

14 To assist us with these efforts, starting
15 in 2006, we established a unit within mortgage finance
16 to monitor the performance of the loans that we
17 securitized and to manage our repurchase requests.

18 Unfortunately, our diligence practices did
19 not detect what we now know to be the most significant
20 downturn in the us housing market for generations. As
21 a result of the unprecedented housing collapse, which
22 led to the decline of the value of all mortgage loans,
23 many of our RMBSs have not performed as well as
24 expected.

25 However, we continue to believe, despite

1 the financial crisis and the collapse of residential
2 home prices, that the securitization of non-agency
3 mortgages plays a vital role in making capital
4 available to institutions to enable individuals to
5 purchase homes.

6 And we are encouraged that we are slowly
7 starting to see the mortgage securitization market
8 return.

9 For our part, we at Citi are committed to
10 applying thorough diligent practices as we adapt our
11 businesses to the changing marketplace.

12 I appreciate the opportunity to discuss
13 some of those practices with the Commission today, and
14 I look forward to answering your questions.

15 CHAIRMAN ANGELIDES: Thank you very much,
16 Ms. Mills. Mr. Bowen?

17 MR. BOWEN: Thank you, Mr. Chairman. I am
18 very grateful to the Commission.

19 VICE CHAIRMAN THOMAS: The mic, is it on?

20 MR. BOWEN: Is the light on?

21 CHAIRMAN ANGELIDES: Pull it towards you.
22 Thank you so much.

23 MR. BOWEN: I'm very grateful to the
24 Commission to be able to give me testimony today. If
25 it wasn't for this commission, if it wasn't for you,

1 then my story could not have been told.

2 My name is Richard Bowen. I was promoted
3 to business chief underwriter for Citi in early 2006.
4 I had responsibility for underwriting for over 90
5 billion dollars annually of mortgage loans.

6 These mortgage loans were not made by Citi.
7 They were made by other mortgage companies and Citi
8 purchased them. And it was my responsibility to make
9 sure that these mortgages met Citi's credit policy
10 standards.

11 During 2006 and 2007, I witnessed business
12 risk practices which made a mockery of Citi credit
13 policy. I believe that these practices exposed Citi
14 to substantial risk of loss. And I warned my business
15 unit management, repeatedly, during 2006 and 2007
16 about the risk -- risk issues I identified.

17 I then felt like I had to warn Citi
18 executive management. I had to warn the board of
19 directors about these risks that I knew existed.

20 On November the 3rd, 2007, I sent an e-mail
21 to Mr. Robert Rubin, Mr. Dave Bushnell, the chief
22 financial officer and the chief auditor of Citigroup.
23 I outlined the business practices that I had witnessed
24 and had attempted to address.

25 I specifically warned Mr. Rubin about the

1 extreme risks and unrecognized financial losses that
2 existed within my business unit.

3 I also requested an investigation. And I
4 asked that this investigation be conducted by officers
5 of the company outside of my business unit. My
6 warnings to Mr. Rubin involved two different areas
7 within my responsibility.

8 The first one was called delegated flow.
9 The delegated flow channel purchased 50 billion
10 dollars annually of prime mortgages. These mortgages
11 were purchased one mortgage at a time. These
12 mortgages were not underwritten by Citi before they
13 were purchased, but the underwriters reviewed a sample
14 of the files after they were purchased. This was to
15 make sure that Citi's credit standards were
16 maintained.

17 Most of the mortgages were sold to Fannie
18 Mae, Freddie Mac, or other investors. Even though
19 Citi did not underwrite these mortgages, Citi did
20 provide reps and warrants to the investors who
21 purchased them. These reps and warrants guaranteed to
22 the investors that the mortgages were underwritten to
23 Citi credit guidelines.

24 In June of 2006, I discovered that over
25 60 percent of the mortgages in delegated flow were

1 defective. And by defective, I mean the mortgages
2 were not underwritten to Citi policy guidelines.

3 Citi had given reps and warrants to the
4 investors that these mortgages were not defective.
5 And the investors could force Citi to repurchase many
6 billions of dollars of these defective mortgages.
7 This represented a large risk of loss to the
8 shareholders of Citi.

9 I attempted to get management to address
10 this critical risk issue. I started issuing warnings
11 in June of 2006. These warnings were in the form of
12 e-mail, weekly reports, committee presentations and
13 discussions. I even requested a special investigation
14 from the management that was in charge of internal
15 controls. And that investigation confirmed that we
16 had very serious problems. And I continued my
17 warnings through 2007. But Citi continued to purchase
18 and sell even more mortgages in 2007. And defective
19 mortgages during 2007 increased to over 80 percent.

20 I told you that my warnings to Mr. Rubin
21 involved two areas of the responsibility. Delegated
22 flow was the first area. The second area involved was
23 Wall Street subprime. Wall Street subprime purchased
24 pools of subprime mortgages.

25 CHAIRMAN ANGELIDES: Mr. Bowen, can you try

1 to also just wrap up just as quickly as you can just
2 because of time?

3 MR. BOWEN: Wall Street subprime purchased
4 pools of subprime mortgages from other mortgage
5 companies. And the underwriters were responsible to
6 make sure that the mortgages in those pools met Citi
7 credit policy standards.

8 Beginning in 2006, I witnessed many changes
9 in the way the credit risk in these pools was
10 evaluated. As an example, the credit decision on
11 purchasing a pool of subprime mortgages was based upon
12 the numbers of approved decisions given by the
13 underwriters.

14 In some subprime pools, large numbers of
15 underwriter decisions were changed. The decisions
16 were changed from turndown to approved and the pools
17 were purchased. There were many other variances to
18 Citi policy.

19 Beginning in 2006, I issued many warnings
20 to management. And many identified pools were
21 purchased anyway over my specific objections.

22 Thank you Mr. Chairman.

23 CHAIRMAN ANGELIDES: Thank you very much.
24 And there will be lots of time for questions. And I
25 really appreciate the brevity of all the witnesses.

1 MR. BITNER: For me it was a combination of
2 a couple of things, starting as early as 2003. Let's
3 forget about the fact that we have a subprime business
4 model. We had a model which makes widgets and, you
5 know, and every month you're making more of them and
6 you're making less. And yet what you're also noticing
7 is that the quality of the widget that you're
8 producing is of a decreased quality. And you're
9 watching this trend, and of course --

10 VICE CHAIRMAN THOMAS: Hey, can you sell
11 them?

12 MR. BITNER: What's that?

13 VICE CHAIRMAN THOMAS: Can you sell them?

14 MR. BITNER: Well, yeah, we can sell them.

15 VICE CHAIRMAN THOMAS: So you feel guilty
16 about the decreased quality of the widgets?

17 MR. BITNER: You know, there's --

18 VICE CHAIRMAN THOMAS: If people stopped
19 buying them, that would be a signal to you, wouldn't
20 it?

21 MR. BITNER: No. There's a combination of
22 a couple of things going on here. One is the fact
23 that -- well, all right, let me get out of the widget
24 example. Let's go back to the mortgage example.

25 We're producing mortgages that clearly are

1 assuming greater levels of risk, because we're being
2 told by someone that we're selling them to that this
3 is now an acceptable form of risk, whereas maybe a
4 year or two ago, that wasn't the case. In October of
5 2005, several things actually happened to me, one of
6 which was --

7 VICE CHAIRMAN THOMAS: If I interrupt you,
8 I apologize, but I do want to nail down some points as
9 we go forward.

10 They were an acceptable level of risk
11 because you were running out of the other mortgages
12 that were more familiar to you and better quality? Or
13 could you still do those but not at the volume that
14 you could do these?

15 MR. BITNER: No. What I refer to as an
16 acceptable level of risk could simply be by referred
17 to by looking at a matrix that was put out by an
18 investor, whether it was the Citi Financial or
19 whichever group, saying, you know, in order to get a
20 95 percent loan-to-value loan or hundred percent
21 loan-to-value loan, the loan must now meet this
22 criteria.

23 So it wasn't a case of whether I had more
24 or less of those that were available to me; it's just
25 that the decision making capabilities were being

1 pushed --

2 VICE CHAIRMAN THOMAS: Your targets
3 changed?

4 MR. BITNER: Your targets changed,
5 absolutely.

6 So what ultimately happened, by the time I
7 hit October of 2005, is a couple things occurred.
8 One, we had a record-setting month in terms of volume,
9 in terms of the number of loans that we had closed.

10 Number two, we also found ourselves in the
11 situation where, as we were looking at it from a
12 risk -- risk perspective and analyzing the volume of
13 loans that we did, we noticed that we had also hit
14 record level numbers of stated income loans, record
15 level number of hundred percent finance loans, which
16 was very different from when we started.

17 When we started in 2000, much as Chairman
18 Greenspan alluded to, I think we had a business model
19 that was more of a minor part of the business sector
20 of mortgage lending, where the average down payment
21 was 10 to 15 percent, you know, stated income loans
22 only made 15 --

23 VICE CHAIRMAN THOMAS: Okay, Mr. Bitner, I
24 have a time limit as well as you.

25 What I want to focus on is that those of

1 us, again, who grew up in Southern California were
2 well aware that the first thing you tried to do is to
3 get enough money up, borrow from your parents, do
4 whatever you can, to get into a home, because the home
5 would appreciate. And that was one of your principal
6 forms of saving. And that over time, you could then
7 get equity out of that house and buy another one.

8 These events were occurring because that
9 was just the climate we were in. Do you feel you got
10 to a point -- and I noticed you're from Texas, and it
11 was savings and loans problems in Southern California
12 and savings and loans problems in Texas, and there was
13 a way to apparently make the machine work faster. Did
14 you see a level of what I guess we could call fraud at
15 some point get the appreciation higher by virtue of
16 the relationship between the appraiser and the real
17 estate agent in terms of buying and selling homes or
18 flipping them, is a term?

19 MR. BITNER: It was one of the greatest
20 problems that we had, but I don't know if
21 necessarily -- and I talk about this at somewhat in
22 great depth in the book -- that there's really an
23 issue of the relationship between the appraiser and
24 the agent.

25 What we're really talking about here is the

1 fact that the appraisal is ordered directly from the
2 broker, the mortgage broker in this particular case,
3 not the real estate agent.

4 And one of the things that I concluded and
5 my belief is that -- and hear me through for a second,
6 let me finish this -- is that the broker did not need
7 to apply any direct pressure to an appraiser.

8 The way the industry worked was pretty
9 simple. You placed an order in front of the appraiser
10 and you said, I need \$235,000. So that appraiser --
11 if that appraiser was not able to hit that level, then
12 ultimately they went to somebody else.

13 VICE CHAIRMAN THOMAS: I understand. And
14 so you didn't sell your product and that's how you
15 make money. So people conformed to a certain business
16 practice to make sure they could sell their product?
17 Was there a degree of uniformity on how you began to
18 produce these mortgages?

19 MR. BITNER: Could you be a little bit more
20 specific?

21 VICE CHAIRMAN THOMAS: There's a slow way,
22 there's an old-fashioned way, there's a 3C way, or
23 there's the quickest way to get it done under the new
24 rules.

25 Was there a general understanding that your

1 job was to produce these so you could make money, and
2 therefore you do it in the fast, most -- fastest, most
3 convenient way possible?

4 MR. BITNER: Well, see, the easiest way to
5 answer that question --

6 VICE CHAIRMAN THOMAS: Why did you get out
7 of the business?

8 MR. BITNER: Why did I get out of the
9 business?

10 VICE CHAIRMAN THOMAS: Mm-hmm.

11 MR. BITNER: Because my house caught on
12 fire. Now, you're going to go, what does one have to
13 do with the other.

14 And I can tell you when you have moments
15 and changes in your life, when things like that happen
16 and you look and you start watching the house -- in
17 this case, interestingly, the house that the profits
18 from the subprime built begin to burn, you start
19 questioning the validity of the work that you've been
20 doing over time and whether or not it's providing the
21 value that it provided five years ago when you started
22 the business, and the answer, to me, was pretty clear
23 that it wasn't.

24 VICE CHAIRMAN THOMAS: Do you think much of
25 that self-examination and, frankly, what we used to

1 call guilt was evident on Wall Street in terms of the
2 continued desire to purchase whatever it was you're
3 producing? Because when you stepped aside, there were
4 others who filled your shoes fairly quickly.

5 MR. BITNER: That's correct. And I can't
6 speak for all of Wall Street but what I know is when I
7 left, it certainly meant sleep -- it certainly meant
8 that it was a little easier to sleep at night.

9 VICE CHAIRMAN THOMAS: Okay. Let me
10 reserve my time and I'll come back on a second round
11 so that everybody gets a chance to get into the
12 questions, Mr. Chairman.

13 CHAIRMAN ANGELIDES: Terrific. Ms. Murren?

14 COMMISSIONER MURREN: Thank you.

15 EXAMINATION BY COMMISSIONER MURREN

16 COMMISSIONER MURREN: My first question is
17 for Mr. Bitner and for Ms. Lindsay.

18 You had referenced the fact that some of
19 the requests from your customers for the types of
20 products that they had wanted had evolved over time.

21 And I was curious as to whether you could
22 comment on whether their due diligence practices also
23 evolved over time?

24 MS. LINDSAY: For New Century Mortgage I
25 was primarily in charge of the fraud detection and

1 prevention. And I will say I did try to keep up
2 with -- with that piece of it, one of the problems
3 that I had specific to fraud prevention was the advent
4 of stated income loans.

5 So in other words, if you couldn't prove
6 the fraud, it became a business decision. The only
7 time we had any teeth, risk management on the back
8 end, was when we could prove the fraud, when we had
9 something in writing, when we could hand-production
10 something and show them.

11 Otherwise, they would say, well, prove
12 it -- it -- show me it's a bad loan. And then you
13 couldn't, and therefore it was a business decision and
14 we would move on. So, I don't know, did that answer
15 your question at least somewhat?

16 COMMISSIONER MURREN: It did. It does.

17 MR. BITNER: I very much agree with what
18 Ms. Lindsay said. There are several things I would
19 add to that point.

20 We -- and let me use the example of the
21 stated income loan, because I don't think that our
22 processes and procedures changed any; it just became
23 very much sort of that same challenge.

24 You know, you get a -- you get a particular
25 documentation or a file that comes in with a person

1 who claims to be -- to make an income that appears to
2 be relatively reasonable for that particular
3 occupation in that particular -- in that particular
4 market.

5 And the way I say "appears to be
6 reasonable" is that there were ways that we could
7 check that. We could go to salary.com and other ways
8 that you could at least try to make sure that you
9 didn't have, as we've all come to know, the strawberry
10 picker who is making, you know, \$450,000 a year.

11 COMMISSIONER MURREN: Did the person that
12 was purchasing the loans from you though, their due
13 diligence when they came in to look at the products
14 that you generated, did they change their due
15 diligence practices over time, the Citibanks of the
16 world, who would --

17 MR. BITNER: No, I don't think so. I think
18 it was fairly -- I mean, for what it's worth, I mean,
19 I thought we had fairly strong due diligent practices.
20 They didn't change relative to those types of loans in
21 terms of what we were looking for, because again, we
22 still felt, and one of the reasons why, for those of
23 us who have been lifelong in this mortgage industry,
24 and I came from the side of having worked for the
25 investor before, was that at the end of the day, the

1 one thing that always drove our opinion was our
2 belief: Can this person make this loan, can this
3 person make this payment, at the very basic level.

4 And if the answer is no then we probably
5 don't have a reason to be doing this loan.

6 COMMISSIONER MURREN: One short question,
7 when you look back on this do you think that there
8 should have been some sort of regulatory supervision
9 of your business activities and that of your industry,
10 specifically that segment that was not necessarily
11 monitored by the Federal Reserve, as a -- as a bank
12 would be?

13 MS. LINDSAY: I think the person who's
14 investing the money should know what they're investing
15 in. As a hard money lender myself, I actually loaned
16 my personal funds, and I grew up in the industry. I
17 need to know the risk that I'm taking and -- and know
18 what it involves.

19 I don't think the people who ultimately
20 invested their money in this knew any -- had any idea
21 what the risks were involved.

22 So I think that there should be some
23 regulation to the effect of showing the investors who
24 are at the end of the day the ones who are purchasing
25 the loans, the bonfires or the retirees who are

1 investing; I think everybody needs to understand what
2 the risk is so they can make an informed decision, so
3 in that respect, yes, definitely.

4 COMMISSIONER MURREN: There is a little bit
5 of a conflict in that, in that you both just stated
6 that you felt that due -- that the due diligence
7 practices that were exercised by people that
8 ultimately were either passing through these loans or
9 they were end-use investors were adequate.

10 But yet, clearly, as we've seen, they
11 didn't fully understand the risks that they were
12 taking. And I guess that's -- is that correct?

13 MS. LINDSAY: That is correct. They had --
14 they had a set of underwriting guidelines, so they
15 were kind of following the guidelines, but they didn't
16 understand what the underlying risk was.

17 I think they kept -- we would run out of
18 product; we would run out of customers with a certain
19 product; they could no longer qualify because the
20 property values had gone up so much. So here comes
21 the interest-only loans. It just kept layering the
22 risks.

23 And the people who -- it wasn't the Wall
24 Street investors who were purchasing these who were
25 taking the losses. They were passing them along, who

1 were passing them along, passing them down the line,
2 five or six levels, and that's where the money was
3 coming from.

4 So I just think the person who is
5 ultimately investing in these needs to be aware of
6 what the risk is, I think there are too many levels
7 that it went through.

8 COMMISSIONER MURREN: Thank you.

9 MS. LINDSAY: You're welcome.

10 COMMISSIONER MURREN: To follow up really,
11 on that topic, which is risk and the assessment of
12 risk, both, I guess, from Ms. Mills and Mr. Bowen, if
13 perhaps, Ms. Mills, you could talk a little bit about,
14 first, within your unit, what contribution or what
15 importance did risk have in the way you ran your
16 business?

17 MS. MILLS: Risk meaning the department
18 risk or just the evaluation of risk?

19 COMMISSIONER MURREN: The evaluation of
20 risk and then, in particular, where I'm headed with
21 this is to try to determine to what extent your
22 ability to understand the underlying risk of your
23 business was related to your performance in your
24 duties within your unit. So was your performance
25 review based in part on your ability to determine

1 risk?

2 MS. MILLS: When we bid on pools of loans
3 from originators, so people who were aggregating
4 loans, we purchased or we agreed to bid on pools of
5 closed loans.

6 There was a, on average, a 30-day time
7 period from when we were awarded the transaction to
8 when we actually had to pay for the loans. And in
9 that 30-day period is when we conducted our due
10 diligence.

11 And our due diligence was -- had two
12 components when it came to loan file diligence or
13 three components. We looked at valuations, so we
14 looked to the property; we looked at credit, so we
15 made sure that the loan was originated to the
16 originator's guidelines; and then we looked at
17 compliance to make sure the loan didn't violate any
18 state or local lending laws.

19 And we -- sometimes we do a hundred percent
20 diligence. More often than not, we would use a
21 sampling methodology where we would select both random
22 and -- randomly selected and adversely selected loans.

23 The randomly selected loans were to just
24 get a snapshot of is the pool as described on the loan
25 level data file that you got from the seller.

1 The adverse selection was to try to
2 identify the riskier loans in the pool and to spend a
3 little bit more time focusing on the riskier loans to
4 make sure that, in fact, that they were as described.

5 COMMISSIONER MURREN: But then when you get
6 to the end of the year, when we determine, or when
7 compensation is determined --

8 MS. MILLS: My own personal compensation?

9 COMMISSIONER MURREN: Yes.

10 MS. MILLS: I don't know exactly what
11 factors go into my own personal compensation. I know
12 that the people who worked for me, their compensation
13 was based on the way that they did their job, whether
14 or not they were performing adequately and up to the
15 standards that I maintained; it was based on the
16 profitability of the business, and it was based on the
17 profitability of the firm.

18 COMMISSIONER MURREN: Was there a revenue
19 component to it?

20 MS. MILLS: That's, yes, that's what
21 profitability is.

22 COMMISSIONER MURREN: Well, arguably,
23 profitability is after you take losses or any kind of
24 expenses related to the revenue stream.

25 MS. MILLS: Yes, well, the way that the

1 firm keeps the books and records, it's a calendar
2 year. So there was a cutoff, and we knew how much
3 money the business made at the end of the year, and
4 there's a bonus pool allocation amongst the various
5 businesses.

6 And, you know, my management decides the
7 final word on who got paid what, I didn't have the
8 final word, I just made recommendations.

9 COMMISSIONER MURREN: But your -- was risk
10 discussed with you during the time of your performance
11 evaluation, risk to the firm, risk to your unit?

12 MS. MILLS: I can't remember specifically.
13 It's -- it's -- because our business model is one of,
14 you know, intermediation, in that we buy loans and we
15 distribute bonds, and we think that we disclose the
16 risk to our investors in the offering documents, which
17 we believe are compliant with all required securities
18 laws, and we sold bonds that had ratings, there was
19 risk that was monitored and maintained on the trading
20 desk itself.

21 I'm not a trader though, so that was -- it
22 was not my responsibility to manage the risk of the
23 firm.

24 COMMISSIONER MURREN: When you interact --
25 you've had some interactions, I believe, with the SEC

1 and with FINRA related to your business unit, as part
2 of the fact that the regulatory body that governs the
3 investment bank would be the SEC, primarily, not so
4 much the Federal Reserve; is that right?

5 MS. MILLS: I've only had interaction with
6 FINRA.

7 COMMISSIONER MURREN: Okay. And could you
8 talk a little bit about your interactions with the
9 regulators just in terms of the kinds of interest that
10 they might have had when they were evaluating your
11 business and its importance to the parent company?

12 MS. MILLS: My interaction with FINRA was
13 related to some inquiries that they made,
14 transaction-specific. So they had some questions on
15 some securities that we had issued off of our shelf.

16 And I had some meetings with our counsel
17 and then I had one in-face meeting with FINRA, where
18 they asked me questions about the deals that they had
19 questions about, that they were specifically related
20 to issues with the reporting of delinquencies and was
21 I aware of situations where delinquencies may have
22 been misreported on remittance reports.

23 COMMISSIONER MURREN: When you think about
24 the regulatory regime that governs the investment
25 bank, is there any discussion within the firm about

1 how that relates to the overall safety and soundness
2 of the parent company? Was that discussed?

3 MS. MILLS: Those are not discussions I
4 would be involved in.

5 COMMISSIONER MURREN: Thank you. And
6 Mr. Bowen, if I may, you had stated in your testimony
7 that there were a number of practices that you had
8 raised with regard to the quality of the loans that
9 were being generated in your unit. If you could talk
10 a little bit, you know, similar line, which is, to
11 what extent was there any kind of regulatory oversight
12 of this particular issue, to your knowledge, and to
13 what extent, again, did you feed back to management or
14 did management relate to you the importance of that to
15 the parent company in total?

16 MR. BOWEN: I did not interface with any
17 regulators. Underwriting was considered to be a part
18 of risk. And I escalated all of my concerns up
19 through the risk structure, as my manager did.

20 As it relates to the quality of the loans,
21 again, as I indicated when I took over this
22 responsibility in early 2006, I was charged with
23 ensuring that the mortgage loans that came through my
24 area were underwritten according to Citi policy
25 guidelines.

1 And I attempted to follow through on that
2 and identified those that came through my area that
3 did not meet that criteria.

4 COMMISSIONER MURREN: And do both of you
5 report up to the same risk management unit?

6 MR. BOWEN: I reported up through -- I'm
7 sure, ultimately, they met at the chief risk officer
8 at the Citigroup level. I was in a completely
9 different part of the organization.

10 COMMISSIONER MURREN: So the concerns might
11 not have been shared within your two divisions, then,
12 if there were any concerns about the quality of the
13 underlying assets; is that correct?

14 MR. BOWEN: I do not know.

15 MS. MILLS: I don't know, either, where
16 risk intersected from the two businesses.

17 COMMISSIONER MURREN: Okay. Thank you.
18 I'm done.

19 CHAIRMAN ANGELIDES: Thank you, Ms. Murren.
20 Mr. Wallison?

21 COMMISSIONER WALLISON: Thanks,
22 Mr. Chairman.

23 EXAMINATION BY COMMISSIONER WALLISON

24 COMMISSIONER WALLISON: I have so many -- I
25 have a lot of questions for all of you, and I would

1 like you to be as concise as you can be. I will try
2 to make these questions that don't require a lot of
3 expansion.

4 Let me start with you, Mr. Bitner, and then
5 I'll try to go along the line.

6 What you described in your testimony was an
7 industry engaged in what might be called mortgage
8 fraud, defrauding lenders and possibly investors with
9 a quality of the things that you -- that the industry
10 was selling, not you personally -- did you ever come
11 across predatory lending?

12 MR. BITNER: Well, I would say, I mean,
13 yes. I think we experienced it in terms of watching
14 loans that I knew that we denied, which I thought was
15 a blatant effort on the top -- on the part of a broker
16 to act in a predatory manner that were then
17 subsequently taken to somewhere else and eventually
18 hearing that it was closed with another lender, yes.

19 COMMISSIONER WALLISON: So, but in terms of
20 the percentage of what I would call making -- taking
21 an advantage of the naiveté, perhaps, or the greed of
22 the lender or the investor, as compared to predatory
23 lending, that is, taking advantage of the borrower,
24 what do -- what relative percentage would you see
25 there?

1 MR. BITNER: I don't know that given the
2 microcosm of the world that I lived in that I would be
3 accurate. I can give you -- I may be giving you my
4 best guess, 10 to 20 percent.

5 COMMISSIONER WALLISON: Okay.

6 MR. BITNER: My Very best guess.

7 COMMISSIONER WALLISON: When you sold a
8 loan did you make reps and warranties?

9 MR. BITNER: Absolutely. That was contract
10 with every -- every contract that I had with my --

11 COMMISSIONER WALLISON: And did loans ever
12 get returned to you?

13 MR. BITNER: Yes, and I was required for
14 repurchase.

15 COMMISSIONER WALLISON: What kind of
16 percentage of loans were actually returned to you, and
17 can you generalize for me between the kind of
18 institution that did return them?

19 MR. BITNER: Yeah, absolutely. The
20 repurchase requests were fairly small. They were
21 pretty consistent, meaning in terms of guidelines,
22 either usually first payment default, borrower did not
23 make their first payment. In the case of Countrywide,
24 they were a little bit different, had guidelines that
25 said if a borrower went as late as 90 days in their

1 first one year the loan was on the books.

2 But in most cases it was because of some
3 sort of a case of fraud. Typically if a borrower came
4 behind on their loan that loan would go through a very
5 strict quality control process by the part of the
6 investor we sold it to, and it was usually the next
7 level of investor, so specifically, for me, that was
8 GMAC, HSBC, formerly Household Finance, Citi
9 Financial, and Countrywide.

10 COMMISSIONER WALLISON: And they would
11 return those loans to you? And what percentage were
12 returned?

13 MR. BITNER: Small, maybe 2 to 4 percent.

14 COMMISSIONER WALLISON: So despite the fact
15 that they were very poorly underwritten, as far as you
16 could tell --

17 MR. BITNER: Oh, no, no, no, no, now you're
18 talking about my underwriting qualities.

19 COMMISSIONER WALLISON: Ah, your
20 underwriting was better?

21 MR. BITNER: Right. Because when you said
22 that they were poorly underwritten, remember I was the
23 one --

24 COMMISSIONER WALLISON: Okay. I accept --
25 I accept your correction.

1 MR. BITNER: Yeah.

2 COMMISSIONER WALLISON: But these were
3 risky loans?

4 MR. BITNER: They were subprime loans, of
5 course.

6 COMMISSIONER WALLISON: And nevertheless,
7 the returns were relatively small?

8 MR. BITNER: The repurchase requests --

9 COMMISSIONER WALLISON: Yes.

10 MR. BITNER: -- were relatively small.

11 COMMISSIONER WALLISON: So they probably
12 weren't as risky from the point of view of the
13 underwritten qualities of the loans?

14 MR. BITNER: I don't know that they were
15 necessarily any more or less risky. I mean, I believe
16 we had a very strict diligence process. Like anything
17 else, I had separate people who were, much like in
18 your department, checking facts for fraud, trying to
19 make sure that they were vetted out for that.

20 COMMISSIONER WALLISON: You talked a lot
21 about loans to Wall Street. A lot of the loans, I
22 think you said, went to Wall Street. Were you aware
23 that Fannie and Freddie were buying loans? Did you
24 ever -- were you aware of where your loans ultimately
25 went when you sold them?

1 MR. BITNER: Yeah. Actually, I don't know
2 that I would say my loans directly went to Wall
3 Street. The four institutions that I mentioned, well,
4 I mean, I guess, you can call Citi, yes, I mean, a
5 conduit, you could call that technically a Wall
6 Street -- a Wall Street firm.

7 So, I apologize, what was the second part
8 of that question.

9 COMMISSIONER WALLISON: Were you aware
10 that -- if any of your loans went to Fannie Mae and
11 Freddie Mac?

12 MR. BITNER: No, I was not aware, once they
13 got sold to the end investor.

14 COMMISSIONER WALLISON: Were you aware that
15 Fannie Mae and Freddie Mac plus FHA actually held more
16 or guaranteed more subprime and Alt-A loans, in 2008;
17 that is to say, on their books in 2008 than Wall
18 Street?

19 MR. BITNER: I was very familiar with that,
20 yes.

21 COMMISSIONER WALLISON: How did you become
22 familiar with that?

23 MR. BITNER: Well, I run what I think is a
24 somewhat respected media outlet, and we report on that
25 information. By then I was already --

1 COMMISSIONER WALLISON: Oh, but you were --
2 were you aware of it at the time that you were making
3 these loans?

4 MR. BITNER: This is -- you're talking
5 about 2007?

6 COMMISSIONER WALLISON: Yes.

7 MR. BITNER: 2008?

8 COMMISSIONER WALLISON: Yes.

9 MR. BITNER: Yes, I had already exited the
10 industry at that point.

11 COMMISSIONER WALLISON: Right. When you
12 were in the industry, were you aware that Fannie and
13 Freddie were buying these loans?

14 MR. BITNER: About -- about 2006 it really
15 came to my attention, when I left my organization,
16 joined a different firm, and really started noticing
17 things like the Community Home Buyer program, which,
18 incidentally, if you looked at it from Fannie Mae's
19 underwriting guidelines, very much resembled the
20 hundred percent financing program we underwrote to our
21 major investors.

22 COMMISSIONER WALLISON: Okay, good. Thanks
23 very much for your time on this.

24 Ms. Lindsay, may I ask you a few questions?

25 Were you aware of what companies were

1 buying New Century loans?

2 MS. LINDSAY: Yes.

3 COMMISSIONER WALLISON: And do you know
4 whether the loans ultimately went to Wall Street or
5 went to the GSEs?

6 MS. LINDSAY: We did have some that went to
7 the GSEs. I actually met with some of the
8 representatives from Fannie Mae to show them what we
9 were doing in order to prevent fraud, showed them all
10 of our detection and prevention measures.

11 But, yeah, we had pretty much every Wall
12 Street investor who was securitizing buying our loans.

13 COMMISSIONER WALLISON: Did -- did -- did
14 you actually sell loans directly to Fannie and
15 Freddie, or was it to a conduit that eventually went
16 to Fannie and Freddie?

17 MS. LINDSAY: I believe they bought them
18 directly. I believe they put them in a security
19 specific to our loans. That was my understanding.

20 COMMISSIONER WALLISON: That is to say,
21 your -- your loans were --

22 MS. LINDSAY: New Century, yes, subprime.

23 COMMISSIONER WALLISON: -- in a pool?

24 MS. LINDSAY: New Century, yes.

25 COMMISSIONER WALLISON: New Century put

1 them in a pool and they eventually got to Fannie and
2 Freddie?

3 MS. LINDSAY: Yes.

4 COMMISSIONER WALLISON: Through some
5 intermediary or directly?

6 MS. LINDSAY: I believe it was directly. I
7 read in one of our SEC filings that we completed a
8 securitization to Freddie Mac. I believe that was in
9 2002 or 2003.

10 And then I met with Fannie Mae probably
11 around 2003. And I'm not sure when, but I know that
12 they were buying our loans, and I don't believe it was
13 through a conduit.

14 COMMISSIONER WALLISON: Now you spoke
15 during your earlier testimony about the fact that as
16 prices increased, it became much more difficult to
17 make loans to people who are at least subprime
18 borrowers and maybe even prime borrowers.

19 Are you -- you are, I suppose, aware of the
20 expression "affordability gap"?

21 MS. LINDSAY: Yes.

22 COMMISSIONER WALLISON: And is that what
23 you think you were encountering at that point?

24 MS. LINDSAY: Yes.

25 COMMISSIONER WALLISON: In other words,

1 would you explain the affordability gap, then, to --
2 to us?

3 MS. LINDSAY: Basically the housing prices
4 soared so much that they exceeded the normal income.
5 I'm not sure what it's called, the income allocations
6 for specific areas. They have -- and I can't remember
7 what it's called but --

8 COMMISSIONER WALLISON: You're talking
9 about Fannie and Freddie, though, here; right? They
10 had a certain loan limit?

11 MS. LINDSAY: Oh, I'm sorry, no. Okay.

12 COMMISSIONER WALLISON: I'm talking about
13 something different.

14 MS. LINDSAY: Okay.

15 COMMISSIONER WALLISON: I'm talking about
16 the affordability gap; that is to say, prices got so
17 high for loans that many people could no longer
18 qualify for a 30-year loan that amortized over the
19 30-year period. They wanted an interest-only loan
20 or --

21 MS. LINDSAY: Yes, exactly, and so, yes,
22 then -- then that was the advent of the interest-only
23 and just kept expanding the limits.

24 We also started doing a 40-year loan to
25 stretch it out a little bit more. So, yes, we kind of

1 accommodated -- you know, the snowball started going
2 down the hill and it got bigger and bigger.

3 COMMISSIONER WALLISON: Let me ask you the
4 same kind of question I asked Mr. Bitner, and that is,
5 most of what you are describing in your testimony and
6 in your prepared testimony and so forth is, something
7 close to misleading investors or -- or possibly the
8 buyers of these loans or the lenders that were buying
9 the loans. Did you encounter any predatory lending?

10 MS. LINDSAY: It was my understanding that
11 the people who were buying the loans were the ones who
12 approved the guidelines. And they're the ones who
13 said, we'll take that risk, we'll buy that hundred
14 percent interest-only loan, for whatever reason.

15 I have no idea why somebody would want to
16 do that but apparently they did.

17 COMMISSIONER WALLISON: But did you
18 encounter any loans in which the -- there was
19 advantage taken of the borrower rather than the lender
20 or the investor?

21 MS. LINDSAY: We ran across that
22 occasionally.

23 COMMISSIONER WALLISON: How often would
24 that be?

25 MS. LINDSAY: It was pretty rare, as

1 Mr. Bitner mentioned. If we ever saw it, we would
2 decline it. Every once in a while we would have
3 somebody from one of the local law enforcement
4 agencies contact us regarding predatory lending, or we
5 would contact them if we knew of it.

6 COMMISSIONER WALLISON: Were those
7 high-interest?

8 MS. LINDSAY: But it was a very small
9 amount.

10 COMMISSIONER WALLISON: Were these loans
11 high-interest loans or were they normal-interest
12 loans?

13 MS. LINDSAY: They were all subprime so
14 they were higher than a traditional bank loan, yes.

15 COMMISSIONER WALLISON: How much higher,
16 would you -- do you recall how much higher they were?

17 MS. LINDSAY: It depended on the product.
18 At least 2 or 3 percent, depending on the product.

19 There was actually one time in our history
20 that the subprime interest rates were lower than the
21 prime interests rates for about two months.

22 So we had a lot of people coming to us for
23 loans because we can get them done quicker than the
24 traditional bank could and the interest rate was --

25 COMMISSIONER WALLISON: And there was a lot

1 of competition for those loans, wasn't there?

2 MS. LINDSAY: And there was absolutely a
3 lot of competition.

4 COMMISSIONER WALLISON: Tremendous amount
5 of competition, that's right.

6 MS. LINDSAY: Yes.

7 COMMISSIONER WALLISON: Okay. I'm sorry
8 that I can't take more time with you, Ms. Lindsay.
9 Maybe there will be additional questions to the question
10 period, later, but I would like to talk to Ms. Mills
11 for a while.

12 You and Mr. Bowen were at the same
13 institution?

14 MS. MILLS: Correct.

15 COMMISSIONER WALLISON: But your
16 descriptions of the risk management in that
17 institution are wildly different. Can you explain
18 that in any way?

19 MS. MILLS: I can only explain it in the
20 context that we worked in businesses that had
21 different business models. And being a part of the
22 investment bank and being -- and working for a
23 broker-dealer and working in the fixed-income
24 division, our job was to meet demand from our
25 fixed-income investors.

1 And there was tremendous demand from our
2 investors to buy mortgage-backed securities, prime or
3 Alt-A or subprime.

4 So in -- in the context of us being a
5 market maker and an underwriter of securities, which
6 is our primary business, we either underwrote
7 securities or we bought whole loans and issued and
8 underwrote securities.

9 COMMISSIONER WALLISON: Okay. Your
10 investors were?

11 MS. MILLS: Our investors were
12 institutional investors, sophisticated institutional
13 investors, typically pension funds, money managers,
14 insurance companies.

15 COMMISSIONER WALLISON: They bought
16 directly from you?

17 MS. MILLS: They bought, yes.

18 COMMISSIONER WALLISON: Fannie Mae and
19 Freddie Mac?

20 MS. MILLS: Yes.

21 COMMISSIONER WALLISON: What percentage to
22 Fannie Mae and Freddie Mac?

23 MS. MILLS: I don't know.

24 COMMISSIONER WALLISON: Can you give us
25 kind of a ballpark, 50 percent, 30 percent,

1 60 percent?

2 MS. MILLS: I would have to follow up on
3 that.

4 COMMISSIONER WALLISON: Can you provide
5 that later?

6 MS. MILLS: Yes.

7 COMMISSIONER WALLISON: I'd appreciate that
8 very much.

9 You said in your testimony that you
10 underwrite -- you underwrote to originator standards,
11 not Citi's standards?

12 MS. MILLS: Right.

13 COMMISSIONER WALLISON: Now, this is quite
14 interesting, because Mr. Bowen's group underwrote to
15 Citi's standards.

16 Why was there this different business
17 model? Why would a customer want loans underwritten
18 to the originator's standard instead of Citi's
19 standards?

20 MS. MILLS: We mostly bought from large,
21 well-capitalized originators, who were known in
22 market. And so there was an acceptance of New
23 Century's guidelines, for example, or Ameriquest's
24 guidelines, or Wells Fargo's guidelines.

25 And so in the offering document for the

1 prospectus, we would be technically the issuer but we
2 would describe the originator's guidelines.

3 COMMISSIONER WALLISON: You mentioned three
4 companies that were largely subprime lenders, is
5 that -- is that what you're talking --

6 MS. MILLS: They were large counterparties
7 of ours. We bought --

8 COMMISSIONER WALLISON: You bought from
9 them?

10 MS. MILLS: Yes.

11 COMMISSIONER WALLISON: They were the
12 originators?

13 MS. MILLS: Yes.

14 COMMISSIONER WALLISON: But they were
15 largely subprime originators, at least they were
16 during that period.

17 MS. MILLS: The pools that we bought were
18 subprime pools.

19 COMMISSIONER WALLISON: They were subprime?

20 MS. MILLS: Wells Fargo originates many
21 different types of loans, so I -- we don't want to say
22 that they're just a subprime originator.

23 COMMISSIONER WALLISON: So your buyers were
24 actually perfectly happy with the originator's
25 standards of underwriting?

1 MS. MILLS: I don't know that I would use
2 the word happy. I think that they were --

3 COMMISSIONER WALLISON: Well, that's what
4 they went to you for.

5 MS. MILLS: They were accepting of it
6 and -- and -- but what they bought were rated
7 securities. So they bought, you know, Triple-A down
8 to Triple-B and then there was --

9 COMMISSIONER WALLISON: You had gotten the
10 ratings.

11 MS. MILLS: Yes.

12 COMMISSIONER WALLISON: But the underlying
13 loans they understood to be subprime loans.

14 MS. MILLS: Yes.

15 COMMISSIONER WALLISON: Bought from these
16 well-known subprime originators.

17 MS. MILLS: Yes, as did the rating
18 agencies.

19 COMMISSIONER WALLISON: Okay. Thank you
20 very much.

21 May I go on now to Mr. Bowen. I have a few
22 questions for you.

23 What percentage, Mr. Bowen, of the
24 mortgages that were improperly underwritten were prime
25 mortgages, and what percentage were subprime, or could

1 you make a distinction between them?

2 MR. BOWEN: The -- there were different
3 channels that originated each. The largest volumes
4 were on the prime side.

5 COMMISSIONER WALLISON: And so it -- did --
6 let me ask this -- when the mis-underwriting, like
7 mis-underestimating, when the mis-underwriting occurred,
8 did it occur more frequently with the subprime or with
9 the prime, or did it not matter; it just happened
10 generally?

11 MR. BOWEN: By virtue of the larger volume
12 in the prime side the absolute numbers were certainly
13 greater.

14 COMMISSIONER WALLISON: Okay. So the
15 percentages would have been about the same. The --
16 but the numbers were greater because there were more
17 prime loans?

18 MR. BOWEN: I -- I cannot make the
19 comparison.

20 COMMISSIONER WALLISON: Okay, understood.
21 That's perfectly good.

22 Do you know of any difference between the
23 reactions of the GSEs, Fannie and Freddie, and the
24 reactions of the Wall Street firms to improperly
25 underwritten the loans?

1 MR. BOWEN: I did not interface with any of
2 that area.

3 COMMISSIONER WALLISON: So you wouldn't
4 know if investors forced Citi to repurchase or whether
5 the GSEs forced Citi to repurchase some of these
6 loans?

7 You were aware of the risks that Citi was
8 taking because of the possibility of repurchase, but
9 you don't know whether it actually happened.

10 MR. BOWEN: No. That was a different area
11 of the organization.

12 COMMISSIONER WALLISON: Okay. And do you
13 know of the actual delinquency rates on these loans
14 that were improperly underwritten?

15 MR. BOWEN: On the prime side, there was
16 reporting that was developed at the end of 2007 that
17 did indicate -- and this was the first reporting, to
18 my knowledge, that had been developed -- that did
19 indicate a significantly higher delinquency rate among
20 those.

21 COMMISSIONER WALLISON: That was the first
22 time in 2007 when that seemed to be occurring?

23 MR. BOWEN: This was as of 2007, but it
24 looked at all of the loans that were underwritten from
25 2006 to 2007.

1 COMMISSIONER WALLISON: Okay. And then I
2 have one more --

3 MR. BOWEN: That was -- that was solely on
4 the prime side, Commissioner.

5 COMMISSIONER WALLISON: Thank you. Thank
6 you. That's interesting.

7 Mr. Chairman, I only have one questions,
8 and that is, your memo to Robert Rubin.

9 CHAIRMAN ANGELIDES: Let me yield
10 additional --

11 COMMISSIONER WALLISON: I just need a
12 minute.

13 CHAIRMAN ANGELIDES: Well, I'll give you
14 two.

15 COMMISSIONER WALLISON: Thanks. Your memo
16 to Robert Rubin, extraordinary document that we have
17 been privileged to see and that in fact was -- it was
18 quite candid. Did you ever receive a response from
19 anyone?

20 MR. BOWEN: At what point, Commissioner?

21 COMMISSIONER WALLISON: Well, that's a good
22 question. From that time until the time you left the
23 institution?

24 MR. BOWEN: From the point -- I'm
25 attempting to clarify -- from the point at which I

1 sent the e-mail to Mr. Rubin?

2 COMMISSIONER WALLISON: Right, that e-mail.

3 MR. BOWEN: I was -- I sent the e-mail on
4 November the 3rd, I received a very brief phone call
5 on Tuesday, November the 6th, I guess, from a general
6 counsel within the company.

7 He said that they had received my e-mail,
8 they took it seriously, they were doing some
9 background investigation, and they really didn't need
10 to talk to me at that point in time.

11 I sent two follow-up e-mails to the general
12 counsel: One in November and one in December of 2007.
13 I explained that there were details that he needed to
14 know in this background investigation that posed
15 extreme risk to Citi shareholders and to please
16 contact me.

17 I was not contacted until January the 7th
18 of 2008.

19 COMMISSIONER WALLISON: And when you were
20 contacted in 2008, what were you told?

21 MR. BOWEN: We initiated a series of
22 conference calls. I spent over five hours in
23 conference calls with the general counsel, and he
24 involved another general counsel over internal
25 investigations, going into the details underlying my

1 e-mail to Mr. Rubin.

2 COMMISSIONER WALLISON: And as far as you
3 could tell, was any action taken? Other than
4 contacting you, was any action taken with respect to
5 people who were involved in the underwriting process.

6 MR. BOWEN: I do not know.

7 COMMISSIONER WALLISON: When did you leave
8 the bank?

9 MR. BOWEN: Physically or from their
10 employ?

11 COMMISSIONER WALLISON: Wow. Are you a
12 lawyer? I would say their employ.

13 MR. BOWEN: I left the organization
14 officially January the 23rd of 2009.

15 COMMISSIONER WALLISON: So you were there
16 about a year after the point where you had had that
17 conversation with the general counsel's office.

18 MR. BOWEN: I was not there physically.

19 COMMISSIONER WALLISON: Oh, please, would
20 you enlarge upon this a little bit so we can
21 understand what you mean by this? Were you sent
22 somewhere else? Were you in prison?

23 CHAIRMAN ANGELIDES: Well, can I make an
24 observation? I do not believe that -- that a subject
25 that we should be discussing are specific employment

1 matters, Mr. Wallison.

2 COMMISSIONER WALLISON: All right. I won't
3 ask any further questions.

4 Thank you all for your indulgence in
5 answering my questions so quickly and with such
6 concision.

7 CHAIRMAN ANGELIDES: Mr. Georgiou?

8 COMMISSIONER GEORGIOU: Thank you.

9 EXAMINATION BY COMMISSIONER GEORGIOU

10 COMMISSIONER GEORGIOU: I guess to
11 initially to Mr. Bitner and Ms. Lindsay, what
12 incentives were there on the part of the originating
13 brokers and others involved in the originations to
14 do -- to deliver higher interest rate loans, if any?

15 MR. BITNER: There was standard operating
16 procedure that broker could be compensated in one of
17 two ways: They could either charge the borrower an
18 origination fee and/or they could sell it above market
19 interest rate.

20 And by doing that they would be paid a
21 yield spread premium typically up to a maximum of
22 2 percent of the loan amount. In most cases there's a
23 maximum upside for them, so significant financial
24 gain.

25 COMMISSIONER GEORGIOU: Right. Now, when

1 you say yield spread premium, that's above the amount
2 that they would otherwise receive as a brokerage fee
3 for originating the loan?

4 MR. BITNER: That's correct. And a very
5 quick example, today's rate may be 7 percent; if the
6 sell 7.5 percent on a subprime loan, they may be
7 paying an additional 1 percent. At 8 percent, they
8 may get paid 2 percent on top of that.

9 COMMISSIONER GEORGIU: And who pays that
10 additional amount?

11 MR. BITNER: That comes directly from the
12 lender, in this case, companies like myself and New
13 Century who were doing business directly with the
14 broker.

15 COMMISSIONER GEORGIU: And would you then
16 pass that additional cost on to the ultimate purchaser
17 of the loan?

18 MR. BITNER: Well, that would have been
19 factored in, yes, to the ultimate fee that I would
20 have been able to or any lender would have been able
21 to obtain by selling the loans then in bulk to the
22 larger investors in the food chain.

23 COMMISSIONER GEORGIU: Okay. Now if --
24 let's assume for the sake that the broker gets a
25 higher fee for originating a higher interest rate

1 loan, say at the high end, where they're getting
2 2 percent. Would there be any -- ever be any
3 circumstances under which the broker -- anybody would
4 go back to the broker in the event that that person
5 who signed onto that loan weren't able to perform
6 under it?

7 MR. BITNER: Well, boy, I wish we really
8 could have, and that's really where the rubber meets
9 the road here, because the average broker typically
10 may have had a net worth in the organization of
11 somewhere between 5- to 25,000 dollars. And good luck
12 getting blood out of a turnip.

13 So the answer is we would have loved to but
14 the practicality of it was it couldn't be done.

15 COMMISSIONER GEORGIU: And -- and now
16 if -- and did you charge a differential fee? Going up
17 the chain, basically, from your company to whomever it
18 is that you were selling them to, did you charge a
19 differential fee for having originated a loan that
20 charged higher interest?

21 MR. BITNER: I'm not sure if I understand
22 what you mean by a differential fee.

23 COMMISSIONER GEORGIU: Well, I mean, did
24 you -- you paid -- you bought the loan; you sold the
25 loan. Did you get an additional amount for having

1 originated a higher interest rate loan?

2 MR. BITNER: Well certainly at the end of
3 the day, if I put pools of loans together that had
4 higher interest rates on them, they would be of
5 greater value to myself or any lender that -- that was
6 trying to sell them in the open market, yes.

7 COMMISSIONER GEORGIOU: Okay. And did --
8 and, now, there's been discussion that some of the
9 acquirers had recourse back to you in the event that
10 there was an early payment default.

11 MR. BITNER: Or fraud.

12 COMMISSIONER GEORGIOU: Or fraud. And was
13 it your testimony that 2 -- 2 percent of the loans
14 were repurchased or in that range?

15 MR. BITNER: I would say roughly in that
16 range, yes. Less than 5 percent.

17 COMMISSIONER GEORGIOU: Okay. Turning to
18 you, Ms. Lindsay, did you -- did you incentivize
19 mortgage brokers to provide loans at a higher interest
20 rate?

21 MS. LINDSAY: Yes. We had a rate sheet.
22 So we -- the brokers could basically pick their rates
23 that they were doing. They're supposed to discuss it
24 with their clients, the borrowers, and they would have
25 what's called par, meaning the broker doesn't pay --

1 or the borrower doesn't pay, and the lender doesn't
2 pay the broker.

3 And then in the same token the borrower can
4 also buy down their rate at a discount. So it can go
5 either way: If it's a lower rate, the borrower would
6 pay for that; if it was a high rate, the lender would
7 pay the broker for that.

8 COMMISSIONER GEORGIU: The lender, in your
9 case, being New Century --

10 MS. LINDSAY: Correct, yes.

11 COMMISSIONER GEORGIU: -- would pay that?

12 MS. LINDSAY: Yes.

13 COMMISSIONER GEORGIU: And then would you,
14 in turn, of course, obtain a higher price from
15 whomever you sold it to?

16 MS. LINDSAY: Yes. We -- how we sold our
17 loans were in bulk sale. So we would sell a hundred
18 million dollars at 1 or 2 percent, depending on what
19 the market would -- would bear.

20 COMMISSIONER GEORGIU: I'm sorry, at 1 or
21 2 percent?

22 MS. LINDSAY: Of -- of the whole package,
23 so we would package them in one big bulk.

24 COMMISSIONER GEORGIU: Right.

25 MS. LINDSAY: So a hundred million dollars,

1 and some investors would pay us 1 or 2 percent, in the
2 early days we would get as much as six or 7 percent,
3 but later on it was one to 2 percent.

4 COMMISSIONER GEORGIU: And you'd get that
5 as a -- as an upfront fee when you sold the loan?

6 MS. LINDSAY: Yes. So -- so if we have a
7 hundred million dollars, the investor would wire us a
8 check for 2 percent over the hundred million dollars,
9 and we would send them all the loans.

10 COMMISSIONER GEORGIU: And you would be
11 able to sell the higher interest rate loans?

12 MS. LINDSAY: Yes. And -- and the
13 pricing --

14 COMMISSIONER GEORGIU: At a higher price?

15 MS. LINDSAY: Yes. And the investors would
16 look at that, and they would evaluate what price they
17 were willing to pay us. And that was probably the
18 difference between the 1 and 2 percent that they were
19 going to pay on the whole package.

20 COMMISSIONER GEORGIU: Right. Now,
21 Commissioner Wallison asked you about whether there
22 were predatory lending practices, which would be
23 practices that were intended to take advantage
24 effectively of the borrower, as opposed to mortgage
25 fraud, which was by the borrower against the lender or

1 the investor at the end of the day.

2 MS. LINDSAY: Right.

3 COMMISSIONER GEORGIU: Were there
4 practices that could be characterized as predatory in
5 that they attempted to steer borrowers to higher
6 interest rate loans who might otherwise qualify for
7 lower ones?

8 MS. LINDSAY: Not that I'm aware of. I'm
9 sure it probably happened. We had about 7500
10 employees in our organization at one time. So I'm
11 sure that some people did. It was discouraged though.

12 We had our policies and procedures, we had
13 our fair lending group, we had a compliance group, and
14 we would talk about predatory lending. And for
15 example, we would -- we would look at somebody's
16 income potential. So if somebody was of retirement
17 age, for example, we would not put them in an
18 interest-only loan or in some sort of an
19 adjustable-rate mortgage.

20 COMMISSIONER GEORGIU: Right.

21 MS. LINDSAY: So we did do things to
22 discourage anything that would appear to be predatory.

23 COMMISSIONER GEORGIU: Okay. Mr. Bitner,
24 can you respond to that particular point?

25 MR. BITNER: That's actually a very good

1 question. I can give you an example of that. I think
2 perhaps the best example might come where we would
3 have seen a loan file come in that to use something
4 specific might have had a 620 or 640 credit score, and
5 it was a loan that we clearly were able to do with our
6 guidelines.

7 And we would question to ourselves, why did
8 the broker not take this loan and perhaps run it
9 through Fannie Mae's or Freddie Mac's automated
10 underwriting system, because it appeared that it's
11 very possible they could have gotten a slightly better
12 rate and a better deal for the borrower in doing that.
13 What we saw, I think, was such a large influx of new
14 originators who came in, who were so heavily called
15 upon by firms like mine and others, that I think the
16 path of least resistance for people who were not
17 seasoned in the industry was simply to say, I'm going
18 to send a loan to Kallmer, to New Century, to Citi, or
19 whoever I am, and they're going to take it, turn
20 quickly for it -- turn the loan quickly around, we're
21 going to close it, going to make our money and go down
22 the road.

23 So I think we started seeing a lot of that
24 type of a thing, where a borrower may very well have
25 gotten an interest rate that could have been

1 three-quarters of a point or a point, or maybe even a
2 little better, with a little bit greater diligence on the part of
3 the broker.

4 COMMISSIONER GEORGIOU: And how is it that
5 you capitalized your company to be buying all this
6 huge volume of loans? Did you have any warehouse
7 lines from anyone?

8 MR. BITNER: I did have warehouse lines.
9 When I entered the industry, the -- the -- and I spent
10 a fair amount of time talking about this in the book,
11 the dollar amounts that were needed to fund a company
12 like mine were substantially less than they were maybe
13 by the time I exited the industry in 2005.

14 So it was -- it was loans from parents and
15 a variety of other things to capitalize the company
16 with several hundred thousand dollars that got me into
17 the business.

18 COMMISSIONER GEORGIOU: Right. But then
19 you had -- you had a line of credit available to you
20 from somebody to actually provide the loans?

21 MR. BITNER: Correct. Actually through
22 Citi's warehouse division and through GMACs, correct.

23 COMMISSIONER GEORGIOU: Okay. And what did
24 they charge you for that privilege?

25 MR. BITNER: I'd have to go back and remind

1 myself but I think it was -- one was Libor baseline
2 Libor plus a couple of points and, you know, typically
3 50 -- 25- to 50-dollar transaction fee per -- per --
4 per loan, so, you know --

5 COMMISSIONER GEORGIU: And would they --
6 would they then buy -- would the party that provided
7 the warehouse line of credit customarily buy all the
8 loans that you originated pursuant to it?

9 MR. BITNER: Well, it depended. I mean,
10 they were -- in this case, for example, GMAC, which
11 was our largest investor, they were also our largest
12 warehouse line. So there were two separate divisions
13 with GMAC that, yes, did one and the same and actually
14 offered us better terms if we were able to use both
15 their warehouse line and send -- sell the loan to
16 them.

17 COMMISSIONER GEORGIU: Okay. I guess,
18 turning to Ms. Mills, if I could. How often did you
19 require parties from whom you bought the loans to
20 purchase the loan back because of early payment
21 default or any other provision that you had in the
22 agreement?

23 MS. MILLS: Initially, when we first
24 started to purchase large blocks of loans in 2005, we
25 saw about 2 percent of the loans be early -- early pay

1 defaults. And the last number that I remember in 2007
2 is about 5 or 6 percent early pay defaults.

3 COMMISSIONER GEORGIU: Uh-huh. And so
4 now, and then you would go back to an institution like
5 Bitner's and --

6 MS. MILLS: No. We dealt with larger
7 institutions. So we wouldn't have bought loans
8 directly from a firm like Mr. Bitner's. And we did
9 not buy loans from Mr. Bitner's firm.

10 So for the -- in the example of Wells
11 Fargo, just because they're still around --

12 COMMISSIONER GEORGIU: Right.

13 MS. MILLS: -- if we bought loans from
14 them, and we had early pay defaults, we had a system
15 that tracked them. And then we had a unit inside of
16 my department that worked with all of the firms that
17 we bought loans from, and we pursued these repurchase
18 requests.

19 And it was a -- it was somewhat of an
20 iterative process. You know, we would send them a
21 notice that said, you sold us these loans and they
22 didn't make their payment and you need to buy them
23 back.

24 COMMISSIONER GEORGIU: And they weren't
25 happy. They weren't happy with that.

1 MS. MILLS: It was a fair amount of
2 back-and-forth.

3 COMMISSIONER GEORGIU: Well, I -- I know
4 this is going to be difficult to answer, and maybe you
5 can't, but how often were you able to actually enforce
6 these buy-back provisions?

7 MS. MILLS: Fairly often.

8 COMMISSIONER GEORGIU: And I take it you
9 could only enforce it from people who were liquid and
10 adequately capitalized down the chain from whom you
11 had bought these loans?

12 MS. MILLS: It was very purposeful in our
13 business model that we only dealt with
14 well-capitalized institutions for a lot of the reasons
15 that we're talking about today.

16 We placed a lot of value on the reps and
17 warrants that we got from the sellers when we bought
18 the loans, but we also felt it was important that they
19 had capital to back up those reps and warrants.

20 And so we were fairly successful in getting
21 firms to repurchase early pay defaults until those
22 firms went out of business.

23 COMMISSIONER GEORGIU: Right. And then
24 you were stuck. Somebody was stuck anyway.

25 MS. MILLS: We were stuck.

1 COMMISSIONER WALLISON: Tell me, were you
2 involved in the securitization, thereafter? I mean
3 after collecting all these loans, were you involved in
4 the process of structuring them and selling them as
5 RMBS?

6 MS. MILLS: My group was involved in
7 preparing the offering documents. So not only did we
8 perform the diligence on the whole loans when we
9 purchased the pools, then once we actually owned the
10 loans, we worked with our trading desk in deciding
11 what loans would be securitized.

12 COMMISSIONER GEORGIU: Right.

13 MS. MILLS: And it was my group that worked
14 with the rating agencies and the lawyers and the
15 accountants to put together the prospectuses that were
16 used to sell the securities to our investors.

17 COMMISSIONER GEORGIU: So you're the
18 perfect witness to answer the question I'm about to
19 ask.

20 At the last hearing when we had some of the
21 heads of these organizations before us, and recently
22 I've been sort of reflecting that perhaps the system
23 might have worked better if a variety of people along
24 the way had additional skin in the game, if you will,
25 or had to eat their own cooking was the term that I

1 used, where maybe rather than take all their fees in
2 cash at every step of the process, including the
3 mortgage brokers, the intermediate purchasers, the
4 purchasers, yourselves, you know, the lawyers who
5 wrote the prospectuses, the investment bankers who did
6 the -- got paid on the underwriting, the credit rating
7 agencies, that maybe they ought to take them in the
8 actual securities, themselves, some portion of their
9 fee, so that they are actually long in the security
10 and that maybe, under those circumstances, they would
11 have a greater incentive to do appropriate diligence
12 and to be certain, more certain that they would
13 perform in accordance with the representations that
14 they made to the investors.

15 Have you given any thought to that question
16 or anything similar? Do you think that Citi could
17 operate your securitization of these mortgages if you
18 got paid, at least in significant part, in the
19 security itself?

20 MS. MILLS: In the context of when we
21 purchased loans as principal and then securitized
22 those loans, there is always a risk that we would wind
23 up not being able to sell all of the bonds and we
24 would have some of the bonds left in our position.

25 COMMISSIONER GEORGIU: Right.

1 MS. MILLS: Also, when we did subprime
2 securitizations, there's a component of the
3 securitization where it's an equity piece that there
4 was no market for that we wound up owning in almost
5 all of the transactions where we bought whole loans.

6 COMMISSIONER GEORGIU: Well, would that be
7 CDOs or is that --

8 MS. MILLS: No.

9 COMMISSIONER GEORGIU: -- the first round
10 of securitizations? You still couldn't sell a portion
11 of those?

12 MS. MILLS: There's a piece, it's called
13 the equity off of the NIM.

14 COMMISSIONER GEORGIU: Right.

15 MS. MILLS: NIM is net interest margin
16 security.

17 COMMISSIONER GEORGIU: But that's pretty
18 marginal, isn't that like 2 percent of the offering or
19 thereabouts?

20 MS. MILLS: It is. It varies depending on
21 the loans that are in the particular securitization.

22 COMMISSIONER GEORGIU: Right. But you
23 would charge maybe a 7 percent underwriting fee off
24 the -- just say you issued a billion-dollar RMBS, I
25 mean, you -- you'd customarily get a 70-million-dollar

1 fee.

2 MS. MILLS: I'm not sure where those
3 numbers are coming from. In the context of us buying
4 whole loans and selling bonds, the only way that the
5 business makes money is if you sell the bonds for more
6 than you paid for the loans.

7 COMMISSIONER GEORGIOU: Okay. All right.
8 So you're saying that your pricing so that
9 ultimately -- but I thought that the impression that I
10 got was that you had pretty ready and willing buyers
11 for these bonds; is that not fair?

12 MS. MILLS: We did, but depending on market
13 circumstances or, you know, investor appetite, it is
14 possible that we would have bonds left in our
15 position. But we're a market maker and we have bonds
16 in our position all the time.

17 COMMISSIONER GEORGIOU: Right, of course.

18 MS. MILLS: And bonds that we buy in the
19 secondary market.

20 COMMISSIONER GEORGIOU: Right. And you
21 wouldn't be acquiring them without the intention
22 ultimately of selling them.

23 MS. MILLS: No, it was always our intention
24 to distribute.

25 COMMISSIONER GEORGIOU: Okay. And I

1 guess --

2 CHAIRMAN ANGELIDES: Would you like some
3 additional time?

4 COMMISSIONER GEORGIU: Just a minute or
5 two, if I could.

6 CHAIRMAN ANGELIDES: I'll yield you two
7 minutes.

8 COMMISSIONER GEORGIU: Thank you.

9 CHAIRMAN ANGELIDES: Three minutes, take
10 your time.

11 COMMISSIONER GEORGIU: And I take it your
12 compensation or your group's compensation -- I guess
13 somebody touched upon this already, probably
14 Heather -- but depended, to some extent, on the amount
15 of revenue that you generated through the
16 securitization process for your group; is that right?

17 MS. MILLS: I believe that is a component,
18 yes.

19 COMMISSIONER GEORGIU: Right. Now, did
20 you ever -- did any of these securities ultimately
21 fail in the hands of the investors, if you know?

22 MS. MILLS: Fail is a difficult word to use
23 because it's not a pass-fail scenario.

24 COMMISSIONER GEORGIU: How about lose
25 value?

1 MS. MILLS: I can tell you that they lost
2 value and they performed worse than we expected.

3 COMMISSIONER GEORGIU: Okay. Now, at any
4 time, did they come back to Citi?

5 MS. MILLS: As a market maker, you always
6 have the possibility that someone that you sold bonds
7 to comes back to you and says, I don't like this bond;
8 I want you to buy it back from me.

9 COMMISSIONER GEORGIU: Right, but how often
10 did that happen?

11 MS. MILLS: I'm not on the trading desk. I
12 couldn't really answer that appropriately.

13 COMMISSIONER GEORGIU: Okay. Let me ask you
14 this: If you're on the incentive-based, compensation
15 of your group was -- was dependent on the origination
16 fees of creating those securities, were you -- do you
17 ever have an occasion when they didn't perform as well
18 as expected of any clawback of compensation that went
19 to the group?

20 MS. MILLS: That's not a Citi policy as far
21 as I know.

22 COMMISSIONER GEORGIU: Okay. Okay. I
23 guess, Mr. Bowen, I guess I'm not entirely certain I
24 understand -- thank you very much, Ms. Mills -- I'm
25 not certain I understand the -- the different area

1 that you had.

2 You had an area that was reviewing the
3 acquisition of loans, and for what purpose at Citi?

4 MR. BOWEN: I was business chief
5 underwriter of the correspondent area. We actually
6 purchased loans. The -- that part of the organization
7 did not originate mortgages. Other mortgage companies
8 originated those loans and they were purchased by
9 Citi.

10 COMMISSIONER GEORGIU: Right. For what
11 purpose?

12 MR. BOWEN: Again, the -- it was my
13 understanding on the prime side most of them were
14 sold off to investors.

15 COMMISSIONER GEORGIU: And were they
16 securitized? I guess they were.

17 MR. BOWEN: I was -- I was not on that side
18 of the business.

19 COMMISSIONER GEORGIU: Okay. All right.
20 Well, then -- then, I think, thank you very much, all
21 of you. I think I've exhausted my questions here.

22 CHAIRMAN ANGELIDES: Thank you very much.
23 Mr. Thompson?

24 COMMISSIONER THOMPSON: Thank you,
25 Mr. Chairman.

1 EXAMINATION BY COMMISSIONER THOMPSON

2 COMMISSIONER THOMPSON: And good afternoon
3 ladies and gentlemen.

4 Mr. Bitner, it's not often that someone
5 would have an epiphany quite like yours that would
6 cause you to change your career. And so I -- I
7 applaud you, not so much for the disaster that you
8 had, but the fact that you chose to take some action
9 as a result of that.

10 I'm struck, however, by the fact that there
11 would appear to be no state regulations over this part
12 of the business. But you yourself and many others who
13 participate in this could see where there were obvious
14 flaws, that actions should have been taken.

15 So, in your opinion, were there obvious
16 steps that state or federal regulators should have
17 taken that would have reigned in this crisis long
18 before it got out of hand?

19 MR. BITNER: I always felt, you know, it's
20 very interesting when you look at people in the
21 financial world who are responsible for managing money
22 for individuals, a series of people have to get
23 Series 7 licences, things of that nature, I think most
24 financial professionals, CFBs, go through some pretty
25 strenuous testing.

1 It always amazed me that to become a lender
2 or a broker, which arguably is the greatest investment
3 as most of us as humans will ever make in the course
4 of our lives, oftentimes requires nothing more than a
5 fingerprint check and a multiple-choice test.

6 I always use the state of Texas as an
7 example, which has probably the most stringent
8 standards, and is truly just a pass-fail, 70 percent,
9 multiple-choice test, not exactly what I would
10 consider to be rocket science for the purposes of
11 entry.

12 So, yes, I would have liked to have seen --
13 frankly, I would have liked to have seen stricter
14 standards just to get into the business as a baseline,
15 both for lenders and brokers.

16 COMMISSIONER THOMPSON: So you obviously
17 saw up the food chain as well, and that is, the people
18 who were buying the bundles of loans from you. What
19 would you say about regulations in that sector?

20 MR. BITNER: Well, I'm a very big believer,
21 and I realize this panel is not focusing on the rating
22 agencies. I have a very strong belief --

23 VICE CHAIRMAN THOMAS: Au contraire, we
24 will.

25 MR. BITNER: No, I'm sorry, for purposes

1 of --

2 CHAIRMAN ANGELIDES: Oh, today.

3 MR. BITNER: The purposes of this
4 discussion, excuse me, I know you will but --

5 VICE CHAIRMAN THOMAS: You're in line ahead
6 of them; that's the only difference.

7 MR. BITNER: I'm sorry?

8 VICE CHAIRMAN THOMAS: You're in line ahead
9 of them; that's the only difference.

10 MR. BITNER: And I feel fortunate for that,
11 thank you.

12 The reality is this, we talked about the
13 originate-to-distribute model, we talked about a
14 situation where one institution used to hold all of
15 the responsibility.

16 Securitization broke that up where, again,
17 no one truly had skin in the game. The only impartial
18 group, really, that was supposed to act in here were
19 the rating agencies.

20 And it just -- it still continues, to this
21 day, to boggle my mind that three years later there
22 has been literally nothing that has been done, and
23 this is not a sign of this commission, because I
24 realize that's not what this commission is tasked
25 with, to do anything to either get back to the days

1 where we could create an arm's-length distance between
2 the investment banks and the rating agencies or find
3 some other ways for which they are compensated that
4 has nothing to do with the volume of work that they
5 do.

6 COMMISSIONER GEORGIOU: We are going to try
7 to do a little bit about that at some point down the
8 road here.

9 COMMISSIONER THOMPSON: Well, that's
10 certainly an area, as Mr. Georgiou says, has come to
11 our attention, and we'll look into it a little bit
12 later.

13 Ms. Lindsay, can I move to you in just a
14 moment, please?

15 MS. LINDSAY: Yes.

16 COMMISSIONER THOMPSON: Don't take this
17 question the wrong way, but given the collapse of New
18 Century, I mean, it literally imploded.

19 MS. LINDSAY: Yes.

20 COMMISSIONER THOMPSON: Would it be fair to
21 say that the risk management function, as it existed
22 within the organization, was more window dressing by
23 senior management to get this fraud perpetrated on as
24 many people as they possibly could?

25 MS. LINDSAY: With respect to my

1 department, I strictly was in charge of fraud
2 detection and prevention. So I'd like to think that
3 we did a pretty good job.

4 As far as the rest of the business unit
5 goes, as far as producing loans that borrowers
6 couldn't afford, the guidelines that were created,
7 yeah, I think -- I think it was a mess.

8 One of the problems was, since values kept
9 going up, one of the questions -- for example, I dealt
10 with repurchase requests as part of my job, and when I
11 started seeing some of the repurchase requests come
12 in, specifically the 80/20s, the hundred percent
13 financing, I would bring that to the attention of
14 senior management, and they would say, well, that's
15 just one loan or two loans. We made 20,000 loans last
16 month, you know.

17 So there were no significant numbers
18 because the values kept going up. And the -- all of
19 the fraud was masked. And production always wanted to
20 see the numbers. Show me the numbers; show me where
21 we're taking a loss. That was the big thing. We
22 couldn't show anybody that we were taking a loss
23 because we were in such an upswing.

24 And then by the time we figured out that
25 there was a problem, it was too late and New Century

1 exploded or imploded, both.

2 COMMISSIONER THOMPSON: So it would --
3 would it be fair to say that you were pressured by
4 senior management to ignore those things that your
5 normal barometer would have said are problematic?

6 MS. LINDSAY: We were basically told to
7 stick to the fraud. If we had concerns about a loan,
8 we had risk managers that were put throughout the
9 country to review loans.

10 And some of their requests were ignored,
11 some of the production teams would override their
12 decisions, and other groups were really good and would
13 sit down with them and figure out why they were making
14 the recommendations they were.

15 Part of the problem was the lack of -- lack
16 of depth or knowledge in the industry. And so the
17 sales people -- since it was such a new industry, we
18 had so many new employees throughout the country in
19 subprime that had never been in mortgage lending
20 before. So I think part of it was just their
21 inability to understand what the problems were to make
22 informed decisions.

23 And so they did ignore the more seasoned
24 professionals who may have had a better insight into
25 it.

1 tables were not something that people talked about,
2 but I can tell you that there was never pressure to do
3 business just to gain league table position in -- in
4 my business.

5 So my management was focused on being
6 profitable and being a presence in the market. But
7 there was never any pressure to be one, two, or -- or
8 three. It is, you know, do business that makes sense,
9 buy loans where you think you can make money and
10 distribute the bonds, and I -- I -- I'm not aware of
11 any pressure to just do business to be higher in the
12 league tables.

13 COMMISSIONER THOMPSON: So you were an
14 island in the sea of Wall Street or an island in the
15 sea of Citi, because other parts of Citi certainly had
16 pressure on league tables.

17 MS. MILLS: I can only speak about my
18 business and my interactions with my management.

19 COMMISSIONER THOMPSON: Okay. Thank you
20 very much. I yield, Mr. Chairman.

21 CHAIRMAN ANGELIDES: Thank you very much.
22 Ms. Born?

23 COMMISSIONER BORN: Thank you very much.

24 EXAMINATION BY COMMISSIONER BORN

25 COMMISSIONER BORN: Mr. Bitner, you've just

1 spoken about the inadequacy of state regulation or
2 oversight of mortgage lenders and brokers. You also
3 say in your written testimony that there were two
4 statutes in the early 1980s that you think laid --
5 laid the groundwork for subprime lending.

6 And I wondered if you would comment on
7 those. They're the depository institutions
8 Deregulation and Money Control Act of 1980 and the
9 Alternative Mortgage Transaction Parity Act of 1982.

10 What role did they play in laying the
11 groundwork for subprime lending.

12 MR. BITNER: Well, I would be remiss if I
13 said or inadequate if I said that I was truly expert
14 on these. When I was researching my book and -- and
15 attempting to find where sort of a foundational point
16 for the industry began, several different scholars had
17 pointed me to these particular acts as sort of
18 starting points where we begin to say we actually saw
19 foundations for that.

20 The depository, the monetary -- the
21 money -- Money Control Act, excuse me, was by and
22 large allowed businesses to, and lenders, to charge
23 higher rates and fees to borrowers that had not been
24 in place at times. So there was some structure that
25 was put in and around that.

1 The Alternative Mortgage Transaction Parity
2 Act in '82 also really gave rise to the use of
3 variable interest rates or what we really now refer to
4 now as ARMs or adjustable rate mortgages.

5 Those two, in and of themselves, were
6 certainly a starting point. I think what really
7 started to kick the industry into gear, although those
8 were fairly minor, the third really sort of occurred
9 in the early '90s, when we came out of a refinance
10 wave in '93.

11 And subsequently, like with most
12 originators, when you find yourself -- this time I was
13 actually not originating in the industry -- when
14 interest rates go higher and there's no other ways to
15 do loans because people stop refinancing, you look for
16 alternative forms of opportunities.

17 And that's really when subprime lending
18 began to enter the market. It really wasn't until a
19 few years later that we began to see the
20 securitization of these products. Initially that was
21 just more portfolio lending at that time.

22 COMMISSIONER BORN: So basically the role
23 that those two statutes played was to give the
24 flexibility to design new kinds of mortgage products?

25 MR. BITNER: Correct. And, again, at that

1 time we really just saw people dipping their toes in
2 the water; it was not any sort of a major entry point.

3 COMMISSIONER BORN: Thank you.

4 MR. BITNER: Yeah.

5 COMMISSIONER BORN: Ms. Lindsay, may I ask
6 you about New Century?

7 MS. LINDSAY: Yes.

8 COMMISSIONER BORN: It was, we have heard,
9 the third largest subprime lender in the country from
10 2005 to 2007, and I wondered what, in your view,
11 caused it to go bankrupt?

12 MS. LINDSAY: That's a good question. We
13 just -- we just grew too fast. It got really
14 competitive. And then that, coupled with the
15 repurchase requests starting to come in as the market
16 kind of flattened out as the values stopped going up,
17 to mask any fraud or any problems, it -- we started
18 seeing repurchase requests.

19 We had reps and warrants with all of our
20 investors as well, and the primary reason to
21 repurchase loans were fraud or first payment defaults.

22 We also had compliance issues and missing
23 documentation. But the first payment default started
24 growing exponentially. It was pretty -- pretty busy.
25 The middle of '06 we created a specific repurchase

1 desk to handle all of the repurchases. And I just
2 think we couldn't keep up with them.

3 COMMISSIONER BORN: So in other words, you
4 just -- because a larger number of your -- the loans
5 that you were selling were slow in payment or not
6 paying, you had a lot of liability with respect to
7 them?

8 MS. LINDSAY: That's correct, yes.

9 COMMISSIONER BORN: And was it also because
10 the mortgage market itself was slowing down, the
11 originations were slowing down?

12 MS. LINDSAY: Originations were slowing
13 down. I think we had pretty much exhausted all of the
14 products. We got out as far as we could, and there
15 were no new borrowers out there. I think that was
16 part of it as well.

17 COMMISSIONER BORN: Thank you.

18 Ms. Mills, you describe in your testimony
19 how diligently your operation has been doing due
20 diligence on the underlying loans for your
21 mortgage-backed securities and also how you cut back
22 on purchases when you saw problems in the housing
23 market.

24 Did your operation incur any losses
25 relating to the implosion of the housing markets and,

1 if so, what were they caused by and how great were
2 they?

3 MS. MILLS: I can't give you the specific
4 loss numbers. I will tell you that whole loan prices
5 started to drop because of the dislocation that was
6 occurring in the market.

7 We had loans in our position that we owned
8 that suddenly were worth less just by virtue of the
9 fact as to what was happening in the market. We had
10 loans on our books that were supposed to be
11 repurchased by companies that had gone out of
12 business, and there was nobody to go to to repurchase
13 those loans.

14 We also had a large book of whole loans
15 that we bought at distressed values. And those loans
16 also lost value.

17 So the business lost a lot of money. We
18 can follow up on the exact dollar amount but as the
19 securitization market went away, there was no venue
20 for us to sell the loans and securitize them.

21 And because our business is not running a
22 portfolio, you know, we spent a lot of time in the
23 last couple years managing the whole loans that we
24 owned.

25 COMMISSIONER BORN: So has that been a

1 primary focus of your group in the last couple years?

2 MS. MILLS: Yes.

3 COMMISSIONER BORN: I would appreciate it
4 if you could provide the information on the losses --

5 MS. MILLS: Okay.

6 COMMISSIONER BORN: -- to the Commission.

7 MS. MILLS: Okay.

8 COMMISSIONER BORN: Mr. Bowen, you
9 described the significant problems with Citi's
10 implementation of its -- and its -- of its
11 underwriting standards for mortgages.

12 And you said that you saw a significant
13 number of defective products being purchased in 2006
14 and 2007 and that you tried to alert people and that
15 the purchases, nonetheless, went forward.

16 What do you think the motivation of the
17 impetus for going forward with these noncomplying loan
18 purchases were?

19 MR. BOWEN: Again, that -- that would call
20 on speculation from my part and I -- I don't know.

21 COMMISSIONER BORN: Thank you. I'll yield
22 the rest of my time.

23 CHAIRMAN ANGELIDES: All right. Thank you
24 very much. Mr. Thomas.

25 VICE CHAIRMAN THOMAS: Thank you.

1 Commissioners, need any additional time for any
2 follow-ups?

3 COMMISSIONER WALLISON: I want --

4 VICE CHAIRMAN THOMAS: How long? Go ahead,
5 Mr. Wallison.

6 CHAIRMAN ANGELIDES: How much time do you
7 need, Mr. Wallison?

8 VICE CHAIRMAN THOMAS: I'll give you four
9 and a half.

10 COMMISSIONER WALLISON: Oh, okay.

11 VICE CHAIRMAN THOMAS: We'll negotiate to
12 five. Go ahead.

13 CHAIRMAN ANGELIDES: Microphone,
14 Mr. Wallison.

15 EXAMINATION BY COMMISSIONER WALLISON

16 COMMISSIONER WALLISON: That's right. I
17 have some questions for Ms. Lindsay.

18 You refer to buyers of securitized subprime
19 mortgages as unsophisticated. And that's quite
20 interesting, to me. These are buyers after all.
21 They're people who are in this business all the time.

22 Why do you regard them as unsophisticated?

23 MS. LINDSAY: They were sophisticated in
24 putting financial deals together. The reason I used
25 the word unsophisticated is because they didn't know

1 the risk of the underlying product. These were all
2 very high-risk loans.

3 COMMISSIONER WALLISON: And they didn't
4 know that. You thought of them as putting together
5 the pools very well and negotiating, I suppose, about
6 how these pools would be eventually marketed?

7 MS. LINDSAY: Right.

8 COMMISSIONER WALLISON: But you didn't
9 think they understood the underlying loans? Why --
10 why would that be true? I mean, why do you think that
11 is what I mean.

12 MS. LINDSAY: Well, my personal opinion is,
13 because of what I had learned growing up and working
14 in finance and working for hard money lenders and
15 other subprime lenders who actually had a stake in the
16 game, who had an interest in whether the loan
17 performed or not, these were extremely risky loan.

18 And so if they would look back at a
19 Beneficial mortgage, for example, the highest
20 loan-to-value Beneficial mortgage would have loaned somebody
21 with a poor credit score, and if they had spots on
22 their credit or on their employment history, they
23 wouldn't loan them any more than 65 percent
24 loan-to-value. So they would have to come up with
25 that other 35 percent.

1 So the default -- so, basically, if anybody
2 defaulted on these loans, the lender was going to take
3 a loss immediately. There was no -- there was no
4 protective equity.

5 COMMISSIONER WALLISON: Right.

6 MS. LINDSAY: No cushion.

7 COMMISSIONER WALLISON: You sold loans to
8 Fannie Mae and Freddie Mac?

9 MS. LINDSAY: Yes.

10 COMMISSIONER WALLISON: Were they
11 unsophisticated, in your view?

12 MS. LINDSAY: I don't know what --

13 COMMISSIONER WALLISON: Well, was there any
14 difference --

15 MS. LINDSAY: -- what they were thinking.

16 COMMISSIONER WALLISON: Was there any
17 difference -- of course not, but you don't know about
18 the others, either.

19 I mean, the point is, did you think from
20 looking at what they were buying that they might also
21 be unsophisticated?

22 MS. LINDSAY: Yeah, I didn't see the actual
23 products that they were buying other than they were
24 buying the higher -- the subprime loans that had the
25 higher credit risk or the lower credit scores.

1 I'm not sure what loan-to-values they were
2 using. So I'm not sure which packages. They may have
3 been buying a particular pool of loans that had a
4 lower loan-to-value. I don't know the answer to that
5 question.

6 COMMISSIONER WALLISON: Okay. Ms. Mills,
7 in February of 2007 you started reducing your subprime
8 exposure. Why? What signaled you to do that? And
9 that February of 2007 was early.

10 MS. MILLS: We had started to see a
11 deterioration in the quality of the loans that were
12 being originated and a deterioration -- deterioration
13 in the whole loan prices that -- where loans could be
14 sold.

15 And so because we lent money to a lot of
16 the people that we also bought from, we had access to
17 their financial statements. Part of what they were
18 required to do was to send us quarterly financial
19 statements.

20 And there were all sorts of financial
21 covenants related to their profitability. So on a
22 very sort of micro level we started to see that the
23 types of loans that were originating, these companies
24 were not making money.

25 And that, in combination with the fact that

1 whole loan prices continued to drop, we had already
2 started to step away a little bit from the business in
3 the middle of 2006. We slowed down our purchase
4 activity; we stipulated our bids; we tried to buy the
5 -- if there is such a term -- sort of like the core,
6 subprime products, nothing that was really like an
7 outlier as far as risks because the credit -- the
8 rating agencies were increasing their credit
9 enhancement levels, which was reducing the amount of
10 proceeds that you could raise by selling bonds.

11 So we had to pay less for loans. And
12 because everything we bought was competitive bid, we
13 also weren't winning pools.

14 COMMISSIONER WALLISON: Who were you
15 bidding against?

16 MS. MILLS: Primarily other Wall Street
17 firms.

18 COMMISSIONER WALLISON: And did they do the
19 same thing that you were doing, or you were selling on
20 to others, it seemed to me, from what you were saying,
21 they were selling directly to investors?

22 MS. MILLS: In very general terms, most of
23 the firms that were in our space I believe bought
24 loans and securitized them, but I'm not -- I can't
25 speak, you know, definitively, that that's all they

1 did.

2 COMMISSIONER WALLISON: Okay. But the
3 bidding was still strong?

4 MS. MILLS: There was still a lot of
5 activity, yes.

6 COMMISSIONER WALLISON: One more question.
7 You described the process of working with investors
8 and a credit rating agency. You said that you would
9 get a dollar amount and a rating for the RMBS; then
10 you would market to investors and solicit feedback.
11 This sounds like a very iterative process, and I think
12 all of us would like to understand a little bit more
13 how this really -- how this really worked.

14 MS. MILLS: Okay.

15 COMMISSIONER WALLISON: Please.

16 MS. MILLS: Once we owned a pool of loans,
17 we would send a data file to the rating agencies. We
18 primarily dealt with Moody's, S&P and Fitch. Each
19 rating agency had their own data requirements, so what
20 data they wanted to see and what format they wanted to
21 see it in. We would send them the information. The
22 rating agencies have models that they sort of run the
23 cash flows of the underlying mortgage loans through
24 this model.

25 And they would come back to us and tell us

1 how many bonds we could issue that were rated
2 Triple-A, Double-A, Single-A, Triple-B, and then what
3 the over collateralization amounts underneath the
4 Triple-B needed -- needed to be.

5 And then, based on -- that was sort of how
6 we sized the bonds in the offering process. And then
7 we went out to investors and you went out with
8 pricing. So you might try to sell the Triple-A at
9 Libor plus a spread.

10 And you either had investor interest or you
11 didn't. If you had investor interest you might be
12 able to tighten the spread; if you didn't have
13 investor interest, you would have to widen the spread.

14 COMMISSIONER WALLISON: Tighten the spread,
15 widen the spread, did the rating agency have any role
16 in the interest --

17 CHAIRMAN ANGELIDES: I'm going to yield
18 additional, by the way, an additional, we're over, so
19 I'll just an additional --

20 COMMISSIONER WALLISON: Sure, this is
21 important, Mr. Chairman, I appreciate the additional
22 time.

23 CHAIRMAN ANGELIDES: Three minutes, total.

24 COMMISSIONER WALLISON: Did the rating
25 agency have any role after you got the initial

1 structure from the rating agency?

2 MS. MILLS: You don't technically get the
3 structure from the rating agency. You just get bond
4 sizes and other features of the deal that are related
5 to credit enhancement.

6 They're involved up until the actual day
7 that the deal closes. It is an iterative process, and
8 the pool could change during the marketing time. The
9 loans could drop out; loans could go delinquent. So
10 there's always this sort of final true-up that goes
11 on, and on the day that the deal closes you get a
12 letter from the rating agency that says I -- I, rating
13 agency, you know, in relation to this security, will
14 let you issue this many Triple-A's and so on.

15 COMMISSIONER WALLISON: Did you ever go
16 back to the rating agency during the time you were in
17 the middle of talking to the investors and say, we
18 need a change here in this structure or that part of
19 the rating or the number of bonds involved and that
20 kind of thing so that they changed their assessment
21 and responded to your request?

22 MS. MILLS: I don't have any specific
23 recollection of that happening in the subprime space.
24 I do remember, and I know that we're not focused on
25 prime, but in the prime securitization market, I do

1 remember instances where investors wanted more credit
2 enhancement levels than the rating agencies were
3 requiring.

4 CHAIRMAN ANGELIDES: All right,
5 Mr. Wallison, we'll move on, thank you. Ms. Murren,
6 you have a couple minutes, if you like, and then
7 Mr. Georgiou, two minutes each.

8 COMMISSIONER MURREN: Thank you.

9 EXAMINATION BY COMMISSIONER MURREN

10 COMMISSIONER MURREN: I have a question,
11 actually, for all of you, but it may be a simple yes
12 or no answer.

13 In listening to your commentary, it appears
14 that we've talked about declining underwriting
15 standards and the fact that this is a business where
16 there were fairly low barriers to entry and that the
17 price of loans declined over the course of the boom.

18 So when you think about, in your own minds,
19 weighing the factors that drove the boom, was it
20 demand-driven or was it supply-driven when you think
21 about the relative importance of these two things?

22 And then, in consideration of that, do you
23 think that had we had better oversight and reasonable
24 barriers to entry, that things might have been
25 different?

1 MR. BITNER: I guess I'll take that first.

2 I think it's a combination of both. I
3 don't think one happens without the other. And, yes,
4 I very much believe that had there been some barriers
5 to or some -- I'm sorry, not barriers to -- greater
6 levels of oversight that we could have prevented this
7 mess from happening or at least minimized it to a
8 certain degree.

9 MS. LINDSAY: Yeah, I agree. As far as the
10 loan originators go there needs to be more oversight
11 with that, definitely, there, as Mr. Bitner pointed
12 out there were several states that didn't even require
13 licensing. And they were allowed to originate loans.
14 And that was part of the problem.

15 MS. MILLS: From my perspective, I think it
16 was both supply- and demand-driven. I don't really --
17 I can't really speak that well about the impact of
18 regulation just because the people that we bought from
19 we believed were regulated or well run or well
20 capitalized.

21 So I didn't have the same sort of negative
22 experience in dealing with smaller unregulated
23 counterparties.

24 MR. BOWEN: I was not involved in the
25 actual origination of the loans. These had already

1 been originated by the time that I reviewed them, so I
2 really can't opine on that.

3 CHAIRMAN ANGELIDES: All right.

4 COMMISSIONER MURREN: Thank you.

5 CHAIRMAN ANGELIDES: Mr. Georgiou?

6 COMMISSIONER GEORGIOU: Thank you,
7 Mr. Chairman.

8 EXAMINATION BY COMMISSIONER GEORGIOU

9 COMMISSIONER GEORGIOU: Ms. Mills, could
10 you tell us, in the typical structure that you had
11 when you did these bonds, how were the credit rating
12 agencies paid?

13 MS. MILLS: They were paid a fee that was
14 driven by the transaction size.

15 COMMISSIONER GEORGIOU: So it was --

16 MS. MILLS: Typically they got a certain
17 number of basis points up to a maximum cap dollar
18 amount, and then they were sort of capped out at the
19 dollar amount.

20 COMMISSIONER GEORGIOU: Right. But they
21 got basis points based on the size of the issue.

22 MS. MILLS: The dollar amount of the
23 transaction, yes.

24 COMMISSIONER GEORGIOU: All right. Okay.
25 And that didn't matter how they rated it.

1 MS. MILLS: No.

2 COMMISSIONER GEORGIU: They got paid.

3 How many times did you take to market or
4 attempt to take to market a pool of loans that didn't
5 receive ratings that you thought were necessary to
6 sell them?

7 MS. MILLS: I'm not sure I understand the
8 question.

9 COMMISSIONER GEORGIU: Did you ever -- did
10 the rating agencies ever provide a rating that was too
11 low for you to be able to market effectively the --
12 the pool of loans that you securitized.

13 MS. MILLS: What the rating agencies gave
14 us was the dollar amount of bonds in each rating
15 category. So you've always had bonds in each rating
16 category. And there was typically appetite for bonds
17 with various ratings.

18 COMMISSIONER GEORGIU: All right.
19 Differential -- differential returns?

20 MS. MILLS: Different risk appetites and
21 yield requirements.

22 COMMISSIONER GEORGIU: Okay. You provided
23 warehouse lines to Argent to the tune of about three
24 and a half billion dollars; is that right?

25 MS. MILLS: It was the Argent, slash,

1 Ameriquest platform. I think most of our warehouse
2 lines were technically with Ameriquest.

3 COMMISSIONER GEORGIU: Right.

4 MS. MILLS: I think we might have had one
5 smaller warehouse line with Argent.

6 COMMISSIONER GEORGIU: But then you -- you
7 bought -- later in the process, you folks ended up
8 buying Argent; is that right?

9 MS. MILLS: Yes.

10 COMMISSIONER GEORGIU: How did that work
11 out for you?

12 MS. MILLS: Could have been better.

13 COMMISSIONER GEORGIU: That's good enough,
14 I think. Thank you.

15 CHAIRMAN ANGELIDES: Mr. Thomas?

16 EXAMINATION BY VICE CHAIRMAN THOMAS

17 VICE CHAIRMAN THOMAS: Couple of quick
18 follow-ups along that line and then moving in another
19 direction.

20 In terms of the rating agencies and you're
21 sending your materials to them and getting them back,
22 was there ever something that could be described as
23 negotiations; that is, you got something back from
24 them, you argued back, they reexamined or looked at
25 it, was there anything that could be fairly

1 characterized as negotiating with the rating agencies
2 in coming up with the final package and agreement?

3 MS. MILLS: What you could do is you could
4 change the composition of the pool. So in other
5 words, if you got back credit enhancement levels where
6 there weren't a sufficient enough number of Triple-A
7 bonds, you could remove some of the riskier loans from
8 the pool and resubmit it to the rating agencies.

9 VICE CHAIRMAN THOMAS: When it was
10 submitted to you in that regard, was there any
11 guidance or a clear understanding of what you could do
12 to make it work?

13 MS. MILLS: What do you mean?

14 VICE CHAIRMAN THOMAS: Were there any
15 negotiations with the rating agencies? If you send me
16 a package and I send it back to you --

17 MS. MILLS: Right.

18 VICE CHAIRMAN THOMAS: -- I can give it to
19 you cold and you've got to figure out what to do or I
20 can give you a couple of hints in terms of moving it
21 in a particular direction, but of course it would be
22 up to you to make that decision?

23 MS. MILLS: I don't believe so. I think
24 that we knew if you pulled out riskier loans you could
25 have less credit enhancement.

1 VICE CHAIRMAN THOMAS: I could even
2 probably handle that level of understanding. So you
3 mixed it up and sent it back.

4 Were there situations where you had to send
5 it back two or three times to get what you were
6 looking for?

7 MS. MILLS: I'm not sure that I know how to
8 answer that.

9 VICE CHAIRMAN THOMAS: Do you recall?

10 MS. MILLS: I don't know that I can answer
11 that.

12 VICE CHAIRMAN THOMAS: Well, the answer is
13 yes or no or I don't know. So you don't know?

14 MS. MILLS: I don't know.

15 VICE CHAIRMAN THOMAS: Okay. And I want to
16 say this, I appreciate your willingness, because
17 unlike others, you are in a current position, and
18 we're asking you questions about your employer. And
19 so I'm very sensitive to that, and having said that,
20 I'm going to ask both of you a series of questions.

21 COMMISSIONER THOMPSON: Can I make a
22 follow-up to the last question?

23 VICE CHAIRMAN THOMAS: Go.

24 COMMISSIONER THOMPSON: Were there ever
25 instances where you might have given the same bundle

1 of loans to two different rating agencies to
2 essentially shop for the best rating?

3 MS. MILLS: There was a requirement from
4 investors, primarily on the Triple-A side, that bonds
5 have two ratings. And there was typically Moody's and
6 S&P. Most of our deals had Moody's, S&P, and Fitch.
7 But the demand for rating agencies was driven by the
8 investors so that we could sell bonds.

9 COMMISSIONER THOMPSON: So the answer is
10 yes?

11 MS. MILLS: Typically, well, I don't like
12 the word shop, because that wasn't really the process.

13 The process was that in order to sell
14 bonds, you needed to have more than one rating agency.

15 COMMISSIONER THOMPSON: Thank you.

16 VICE CHAIRMAN THOMAS: Did you ever choose
17 the worst one? No.

18 We currently have what's called a new party
19 or an emerging party; it's called the Tea Party.

20 In the history there was a political party
21 called the Know-Nothing Party. And that was the
22 response that people would give when questions were
23 answered.

24 What I heard from both of you, one formerly
25 employed, one currently employed, is I think one of

1 the reasons I was interested in looking at Citibank
2 was in terms of its structure.

3 And basically the answer that we have
4 gotten back from you whenever we wanted to inquire
5 about what I think most of us would think would be an
6 aspect of the work you were in or a partnership in
7 some way, the answer was, I don't know because they
8 were somewhere else.

9 I know it's an enormous operation, and I
10 know that the history was more of a kind of a
11 conglomerate than a synthesizing integrating
12 structure. Was this done just because of the way the
13 company was built or did you feel that there might
14 have been a design to the separation in terms of the
15 information?

16 And, Ms. Mills, if you want to, you can
17 take a pass on that question. Mr. Bowen?

18 MR. BOWEN: Mr. Vice Chairman, I cannot
19 render an opinion as to why the organization structure
20 was why it was. I -- it was very heavily segmented.

21 VICE CHAIRMAN THOMAS: Yeah.

22 MR. BOWEN: And I was responsible for my
23 piece, and other people were responsible for theirs.

24 VICE CHAIRMAN THOMAS: And let's revisit
25 your e-mail, once again, very briefly. Was that the

1 first e-mail you ever sent?

2 MR. BOWEN: To Mr. Rubin?

3 VICE CHAIRMAN THOMAS: Yes.

4 MR. BOWEN: Yes.

5 VICE CHAIRMAN THOMAS: Did you send them to
6 others?

7 MR. BOWEN: At corporate management.

8 VICE CHAIRMAN THOMAS: I'm just asking you,
9 were you an e-mailer in terms of communicating with
10 folk higher up the chain about what you saw as
11 problems?

12 MR. BOWEN: There are in excess of hundreds
13 of pages of documents that I submitted.

14 VICE CHAIRMAN THOMAS: I'm looking at
15 something that could be characterized as sending an
16 e-mail to higher-ups in this segmented operation to
17 try to explain something that concerned you.

18 MR. BOWEN: I know that the warnings went
19 to the highest levels within my business unit, which
20 was called the consumer lending group.

21 VICE CHAIRMAN THOMAS: I mean, your
22 analysis of what was going on was akin to the fellow
23 in the field who calls an air strike on his location
24 because his position is being overrun, and that was
25 about the only way that you could resolve the problem

1 that you were in. So I was just wondering if you had
2 found yourself in those predicaments more than once?

3 MR. BOWEN: You're talking about prior to
4 Citi or are you -- I -- I don't understand the
5 question.

6 VICE CHAIRMAN THOMAS: No. Let me ask you,
7 it was segmented and you wanted to send an e-mail, and
8 you have, I assume, a book with people who are in your
9 company, and you have a choice of selecting who it is
10 you want to send it to. My question would be, why did
11 you pick Rubin and not Prince.

12 MR. BOWEN: There was speculation in the
13 press leading up to that weekend that Mr. Prince would
14 no longer be with the company. There was announced
15 that there was going to be a special board meeting.

16 VICE CHAIRMAN THOMAS: There's no water
17 cooler where folks in the company had this info? You
18 had to go find out about it in the press rather than
19 the scuttlebutt in the company?

20 MR. BOWEN: I don't understand your
21 question, Mr. Vice Chairman, I'm sorry.

22 VICE CHAIRMAN THOMAS: Then we'll just
23 leave it at that. But you decided, based upon what
24 you read in the press, there may be a structural
25 change in your company, and that prompted you to send

1 the e-mail to Rubin. Was that because he wasn't
2 speculated as being removed?

3 MR. BOWEN: I was -- I knew that there were
4 issues that were being considered by executive
5 management and the board of directors. And I felt
6 like I needed to get these in front of them because,
7 to my knowledge, they had no -- they had no knowledge
8 of my issue.

9 VICE CHAIRMAN THOMAS: And if you were
10 getting it to the board of directors, it made sense
11 that it could have been Rubin, given his structure
12 within the board of directions. Was that a motive to
13 get it to Rubin?

14 MR. BOWEN: It was, again, speculated in
15 the press going up to that weekend that Mr. Rubin was
16 taking over for Mr. Prince.

17 VICE CHAIRMAN THOMAS: Thanks. I'm
18 interested, because I don't know anything about it,
19 how you operated in terms of rela- -- I would say
20 relatively small amounts of money. Mr. Bitner, you
21 talked about how you got your company up and going.

22 And would it be correct to say that there
23 was no chance of growing that company, save for the
24 warehouse concept where you could use these other
25 folks' money to do what you would otherwise do,

1 because you couldn't bootstrap yourself; is that
2 accurate?

3 MR. BITNER: Well, I think, if I understand
4 your question, we did grow the company. The reality
5 is warehouse lenders are based on an amount of
6 leverage, you know, typically a 10 or 15 to one
7 leverage off of a net worth.

8 So you're correct. The amount of loans
9 that I could fund was, I think, initially limited to
10 maybe 10 or 15 million dollars on a monthly basis.

11 But, you know, the route my company chose
12 and other companies that I knew also, we took most of
13 our money, put it back into the company, grew our net
14 worth to continue to make ourselves more competitive,
15 to grow the size of our warehouse lines, to try to be
16 able to fund more business.

17 VICE CHAIRMAN THOMAS: And, Ms. Lindsay, at
18 least in terms of New Century, you were involved in
19 that as well?

20 MS. LINDSAY: Yes.

21 VICE CHAIRMAN THOMAS: I guess I'm trying
22 to figure out how you find out about this stuff. We
23 discussed earlier state regulation and, perhaps,
24 problems that weren't there?

25 You have professional organizations, don't

1 you? Where there are newsletters that were going out?
2 Did you -- you talked a lot -- were you as silo'd as
3 Citigroup in terms of talking --

4 MS. LINDSAY: With respect --

5 VICE CHAIRMAN THOMAS: -- to others who
6 were in the business and you were looking at what you
7 were doing and how were you doing it?

8 MS. LINDSAY: No, we all talked.

9 VICE CHAIRMAN THOMAS: Were you members of
10 the Know-Nothing Party as well?

11 MS. LINDSAY: No, we all knew everything.

12 No, we all talked. I mean, my niche was fraud, so we
13 would talk about fraud. I spoke at several different
14 seminars. I worked with the MBA. You know, my
15 specific area was fraud detection and prevention.

16 How can we, with our changing guidelines,
17 how do we prevent fraud. And, you know, we did talk
18 about that. Nobody ever talked about -- well, some
19 groups did talk about the increasing risk with the
20 interest-only loans and when they readjust. And that
21 was more of our compliance department and fair lending
22 group who would talk about stuff like that.

23 VICE CHAIRMAN THOMAS: And was there a
24 discussion, as you got into the whole business of
25 warehouse lines and the rest, about the risk

1 associated with that?

2 MS. LINDSAY: The risk with borrowing the
3 money to make the loans? If we didn't sell the loans.
4 Then that would probably pose the biggest risk to us.

5 VICE CHAIRMAN THOMAS: But there was plenty
6 of opportunity?

7 MS. LINDSAY: There was plenty of
8 opportunity for a long time, yes.

9 VICE CHAIRMAN THOMAS: Long time is what in
10 your business?

11 MS. LINDSAY: Well, we were founded in --
12 we made our first loan in January of 1996, and then we
13 declared bankruptcy in April of 2007.

14 VICE CHAIRMAN THOMAS: That was a long run?

15 MS. LINDSAY: For subprime, sadly, yes.

16 VICE CHAIRMAN THOMAS: You were in at the
17 beginning and collapsed when everyone else did?

18 MS. LINDSAY: Yeah.

19 VICE CHAIRMAN THOMAS: Thank you,
20 Mr. Chairman.

21 EXAMINATION BY CHAIRMAN ANGELIDES

22 CHAIRMAN ANGELIDES: Thank you, Mr. Thomas.
23 Terrific. Let me -- I have questions, first, for
24 Mr. Bowen and Ms. Mills, and then for Mr. Bitner and
25 Ms. Lindsay. And Mr. Bowen, I'm going to start with

1 the comment that what was happening made a mockery of
2 Citi's business practices. So I do want to just go to
3 your e-mail, again, on November 3rd.

4 And I guess, apropos of the Vice Chair's
5 comments, I believe Mr. Prince stepped down, what, on
6 the 5th? So he stepped down a couple days later. But
7 looking at your memo and having looked at the
8 transcripts of the interview of our staff with you, it
9 appeared that with respect to the purchasing from
10 mortgage companies and the sale to third parties, you
11 indicate that that's about a 50-billion-dollar-a-year
12 business, and that you underwrite a small sample of
13 those to see to what extent -- I want to get clear to
14 what extent they met your policy criteria.

15 Now, as I understand it there were two
16 issues here: You were concerned that the sample size
17 was too small, that the policy called for a 5 percent
18 sample, is that correct, and that you believe there
19 was under sampling?

20 MR. BOWEN: Yes, that is correct.

21 CHAIRMAN ANGELIDES: Okay. And then,
22 secondly, I understand -- I want to understand if
23 46 percent of the files are either outside of the
24 policy criteria or have documentation missing from the
25 files and then it rose to 80 percent, tell me really

1 specifically what that means?

2 They -- these were standards that Citi was
3 setting for what it would buy, or was it verification
4 that the loans were what the sellers represented they
5 were? In other words, is it a standard you set or are
6 you sampling these things to see if they actually meet
7 the standards that the sellers say they meet?

8 MR. BOWEN: The sellers represented that
9 they sold to Citi according to our standards. And it
10 was our standards I measured those loans against.

11 So, again, I'm trying to understand your
12 question, Mr. Chairman.

13 CHAIRMAN ANGELIDES: Well, I guess what I'm
14 understanding is you had standards then. They had to
15 meet X standard. And you're saying they were
16 deficient in meeting X standard. But the purchasers
17 were happy, notwithstanding that; correct?

18 MR. BOWEN: The purchasing of the mortgages
19 was against our standards.

20 CHAIRMAN ANGELIDES: Yeah.

21 MR. BOWEN: But the recommend -- we did not
22 underwrite all of the -- in fact, we did not
23 underwrite any of the mortgages there prior to their
24 being purchased.

25 CHAIRMAN ANGELIDES: Correct. So what are

1 you judging? What I'm saying is, when you say these
2 were deficient, just tell me how they were deficient.

3 MR. BOWEN: They were deficient in one of
4 two ways: One, they were not underwritten against the
5 express guidelines by Citi, or they were underwritten
6 and then they purported to be against the underwriting
7 guidelines by Citi.

8 But they did not have documents that were
9 required by Citi policy to support the assumptions
10 that were put into or made in the underwriting
11 decision by the originating lender.

12 CHAIRMAN ANGELIDES: Okay. And what were
13 the risks that flowed from that, that you would be
14 getting loans obviously that were suboptimal, that
15 weren't underwritten properly, that had risks and risk
16 layering that would be inappropriate, you believe, for
17 mortgages you would hold and potentially resell;
18 correct?

19 MR. BOWEN: The risks, from my standpoint,
20 as I outlined in my memo to Mr. Rubin, was that we, in
21 turn, being Citi, represented to the investors that
22 these mortgages were made according to our guidelines.

23 CHAIRMAN ANGELIDES: And they were not?

24 MR. BOWEN: And they were not.

25 CHAIRMAN ANGELIDES: All right. And is

1 that also -- does that also apply to the corresponding
2 fundings to Wall Street bulk purchases, same essential
3 problem?

4 MR. BOWEN: We did do underwriting in the
5 Wall Street subprime channel.

6 CHAIRMAN ANGELIDES: But you were
7 overwritten; is that a fair statement?

8 MR. BOWEN: In many instances, that is
9 correct, sir.

10 CHAIRMAN ANGELIDES: You said, I'm
11 underwriting this, I don't believe it's something we
12 ought to hold, you believe the risks are too great,
13 and you're being overridden?

14 MR. BOWEN: There were many instances where
15 my underwriters' decisions were reversed.

16 CHAIRMAN ANGELIDES: And was this -- did
17 this accelerate? I mean, how long have you been in
18 risk management business? I mean, having run a
19 business; there's always someone I can think of, you
20 know, Mr. Thompson the same, you know, you're running
21 a business, there's always people who recommend for
22 and against certain transactions, but did you see a
23 market change?

24 MR. BOWEN: I'm sorry, Mr. Chairman, I'm
25 having a hard time following what --

1 CHAIRMAN ANGELIDES: I guess what I'm
2 saying is did you see more overrides?

3 MR. BOWEN: Absolutely.

4 CHAIRMAN ANGELIDES: In other words --
5 okay, that's fine. So you saw accelerating overrides?
6 All right.

7 Let me talk to you about another matter.
8 The Argent purchase to which Mr. Georgiou referenced,
9 and Ms. Mills, the one you said could have turned out
10 better, this was the acquisition of Ameriquest, which
11 was one of the biggest, most aggressive subprime
12 lenders located in the State of California.

13 And as I understand it, from looking at
14 documents that our staff's put together, there was --
15 and interviews -- there was a desire to captive -- to
16 buy -- to acquire a captive subprime originator to
17 give you a flow of loans.

18 You reviewed that transaction, didn't you,
19 Mr. Bowen? Were you involved with Mr. Davis, your
20 supervisor?

21 MR. BOWEN: I was involved, as Mr. Davis
22 was, in the due diligence of that acquisition.

23 CHAIRMAN ANGELIDES: And you recommended
24 against it?

25 MR. BOWEN: Yes.

1 CHAIRMAN ANGELIDES: And on the basis of?

2 MR. BOWEN: We sampled the loans that were

3 originated by Argent, and we found large numbers that

4 did not -- that were not underwritten according to the

5 representations that were there.

6 CHAIRMAN ANGELIDES: Okay. Large numbers,

7 what kind of percentage? That's a question from the

8 Vice Chair and me.

9 MR. BOWEN: I do not recall, Mr. Chairman.

10 CHAIRMAN ANGELIDES: Could you check,

11 perhaps, for us?

12 MR. BOWEN: I have no access to that

13 document.

14 CHAIRMAN ANGELIDES: Okay. You don't have

15 access to that document?

16 VICE CHAIRMAN THOMAS: It was enough to

17 cause you some concerns, because obviously you state

18 that as the reason for your decision.

19 MR. BOWEN: Yes.

20 VICE CHAIRMAN THOMAS: Among other items.

21 MR. BOWEN: Yes.

22 VICE CHAIRMAN THOMAS: So it was a lot.

23 MR. BOWEN: Yes, sir.

24 VICE CHAIRMAN THOMAS: Whatever that means.

25 CHAIRMAN ANGELIDES: Terrific, let me move

1 on, now, to Ms. Mills.

2 You mentioned that there were certain
3 underwriters that you just wouldn't feel comfortable
4 doing business with, but as a predicate, were you
5 involved in the warehouse lending business?

6 MS. MILLS: Yes.

7 CHAIRMAN ANGELIDES: All right. So just by
8 way of reference for the public and the Commission, my
9 understanding is that Citi extended about 11 billion
10 dollars of warehouse lines, credit facilities to
11 subprime originators.

12 So in a sense, and I'm sure there were many
13 other institutions who provided these, so that you
14 were providing fairly significant credit support to
15 subprime originators. And I guess, by my count, there
16 are about 26 of them across the country.

17 Let me start by actually picking up and
18 saying, when you said, there was some people we
19 wouldn't feel comfortable with, give me an example or
20 two of entities you didn't feel comfortable with
21 supporting, either purchasing their loans or providing
22 a warehouse line.

23 MS. MILLS: Sometimes when we would go to
24 visit a company that perhaps was not a startup but
25 hadn't been in business for that long, we would go out

1 and conduct an on-site review and meet with senior
2 management.

3 And having done this for many, many years
4 and having people on my team that had done it for
5 many, many years to a certain extent there is an
6 instinctual reaction as to whether or not the company
7 knows what they're doing, and whether that's the
8 management team that they've put together, the state
9 of their office, the state of their files, whether or
10 not they're making money, what the business plan is.
11 So there are concrete examples that you can look at,
12 such as profitability.

13 But there is also the sense that, you know,
14 maybe they're just not ready to do business with us,
15 and maybe they need to have a little bit more time
16 under their belt before we would be comfortable that
17 they had worked out the kinks; for instance, if it was
18 a new platform.

19 CHAIRMAN ANGELIDES: Would you normally, in
20 the course of extending your warehouse line, also get
21 a commitment of having them funnel product to you?
22 Were they linked agreements?

23 MS. MILLS: No.

24 CHAIRMAN ANGELIDES: But, of course, there
25 was a relationship.

1 MS. MILLS: Part of the reason that we lent
2 was to establish relationships with these originators.
3 But there was no direct linkage.

4 CHAIRMAN ANGELIDES: There were 26
5 different companies to which you extended warehouse
6 lines, I believe, Jim and you, which I believe is --
7 excuse me, sir?

8 VICE CHAIRMAN THOMAS: Would you yield for
9 just briefly?

10 CHAIRMAN ANGELIDES: Yeah, and then I want
11 to --

12 VICE CHAIRMAN THOMAS: My concern is how
13 many you instinctually rejected.

14 MS. MILLS: I mean, I can't remember. Like
15 I said, I've been doing this for a long time. I know
16 that there were companies we went to see that we did
17 not lend money to. I know that there are companies
18 that we had warehouse lines with that we did not
19 renew, because we were uncomfortable with the
20 operation.

21 VICE CHAIRMAN THOMAS: Did you have a
22 batting average? Was it lots?

23 MS. MILLS: Our minimum capital
24 requirements were fairly high. So in the subprime
25 space, it's not like there were hundreds of companies

1 to choose from. You know, I really would not want --
2 I wouldn't want to speculate.

3 VICE CHAIRMAN THOMAS: You round up with 26
4 so it was like a 1200 batting average?

5 MS. MILLS: Well, I think the list that you
6 have right now of 26 is every warehouse line that
7 we've ever done.

8 And some of the warehouse lines that are on
9 that sheet are -- have nothing to do with subprime.
10 They are current lines where we are financing Fannie,
11 Freddie, and FHA loans.

12 VICE CHAIRMAN THOMAS: Thank you,
13 Mr. Chairman.

14 CHAIRMAN ANGELIDES: Yeah, there's some
15 agency and there's non-agency on this list; correct?

16 MS. MILLS: Right.

17 CHAIRMAN ANGELIDES: And then it's one of
18 the documents which I'm sure the staff can classify.
19 All right, let me proceed on this.

20 One thing that Mr. Prince -- and we'll have
21 a chance to talk to him tomorrow morning. One of the
22 things he said -- he actually said two things. I want
23 to see if you share his views on these matters.

24 He said, I believe, in hindsight, the lack
25 of adequate regulation of the origination or mortgages

1 created a situation where the demand side, the pull
2 side of that equation, found a place where more raw
3 material could be created and could be created safely.

4 So there was more and more and more of
5 these subprime mortgages created as raw material --
6 raw material for the securitization process. Not
7 surprisingly, in hindsight, more and more of it was
8 lower and lower in quality.

9 And at the end of that process the raw
10 material going into it was actually bad quality, it
11 was toxic quality, and that is what ended up coming
12 out of the other end of the pipeline. Wall Street
13 obviously participated in that flow of activity.

14 The second thing he said is, I found out at
15 the end of my tenure -- this is about the warehouse
16 lines -- so he said he found out that they had been
17 extended is how I interpret this. I did not know it
18 before, so it's 11 billion dollars of warehouse loans.
19 I think that getting that close to the origination
20 function, being that involved in the origination of
21 some of these products, is something that I wasn't
22 comfortable with.

23 On reflection, do you share his view about
24 the toxicity of products flowing into the system and
25 do you share his view that it was a business mistake

1 to be that close to originators, to mix the business
2 lines between what you did, as a kind of a third-party
3 buyer, and the sellers of those loans, the originators
4 and sellers?

5 MS. MILLS: I'm not sure what Mr. Prince
6 was referring to when he talked about the types of
7 loans that he referenced.

8 I don't think it was a mistake for us to
9 lend money to originators. I think it was a way to
10 facilitate the business that we were in, and that is
11 to create mortgage-backed securities to be sold to
12 sophisticated institutional investors.

13 We specifically were not that close to the
14 origination side of the business, because we bought
15 loans that closed in other entities' names; we never
16 sent money directly to an originator; we set up our
17 warehouse lines so that there were mechanisms where we
18 could never be deemed to be the originator.

19 So we really were in a different --
20 different position than an originator of loans,
21 themselves. And we had complete control over what we
22 bought and what we were willing to finance.

23 Our warehouse lines had restrictions as to
24 the types of loans that we would finance. We would
25 not finance every type of loan that originated, would

1 originate.

2 We had limits as far as types of loans,
3 geographics, LTVs, seasoning of the loans, how long
4 the loan could stay on the line. It wasn't -- it
5 wasn't a blank check to an originator that we would
6 just finance anything that they originated.

7 CHAIRMAN ANGELIDES: All right. Let me --

8 VICE CHAIRMAN THOMAS: John would like one
9 more?

10 CHAIRMAN ANGELIDES: Okay. John, do you
11 want to ask one more.

12 COMMISSIONER THOMPSON: I'll let you
13 finish.

14 CHAIRMAN ANGELIDES: Yeah, okay, it will be
15 hopefully surgical here, but this is an important
16 point. And after Mr. Thompson asks his question, I
17 may return to ask all of you this question.

18 I want to go to the responsibility of a
19 market maker. You know, everyone here at some level
20 has their business model. They're originating;
21 they're securitizing. And you've said today, and
22 others have said, you're not alone in this; look,
23 we're market makers; whatever people wanted to sell
24 us, whatever people want to buy, we'll be market
25 makers.

1 What's the responsibility of a market maker
2 to ensure that the product that they are moving into
3 the marketplace is a good and sound product? In other
4 words, to undertake the reasonable level of due
5 diligence that you would feel absolutely comfortable
6 warranting that this is the kind of product you want
7 to move, akin to a manufacturer who makes a technology
8 product or a, you know, a toy manufacturer
9 understanding whether or not that toy manufacturer,
10 perhaps in another country, had lead in it, what's the
11 responsibility of market makers in the financial
12 system essentially to warrant the products they're
13 moving?

14 MS. MILLS: To -- what was the last part of
15 what you said?

16 CHAIRMAN ANGELIDES: To warrant, to stand
17 behind the quality of the products they're moving
18 through the system and just -- you know, it's a large
19 question, to the extent that everyone's saying, I'm
20 just passing this along, where is the responsibility
21 along the chain for ensuring the quality of the
22 products that are moved into the system? Because I
23 understand that, can I ask you a question, just so I'm
24 clear? You did not have your own underwriting
25 standards?

1 MS. MILLS: Correct.

2 CHAIRMAN ANGELIDES: You relied on the
3 underwriting of others; correct?

4 MS. MILLS: Correct. We believed that we
5 conducted the appropriate diligence so that when we
6 created offering documents, prospectuses, which is the
7 document that you deliver to investors, that we had
8 high confidence that what we were telling investors
9 about the loans was accurate.

10 There were pages and pages of
11 stratifications with information about the loans.
12 There were pages of risk factors where we told
13 investors every possible scenario that could describe
14 something that would go wrong with these securities.
15 There were pages that described the origination
16 guidelines of whoever the originator was for that
17 particular pool. There were ratings from rating
18 agencies on these bonds.

19 And our job, as an underwriter, is to, you
20 know, comply with securities laws and, you know, this
21 business is regulated by the SEC. We used extensive
22 amounts of outside counsel to make sure that Citi, as
23 a firm and as an underwriter, was -- was protected,
24 and that we were also telling investors what they
25 needed to know. And it's the investor's decision to

1 buy the bond.

2 CHAIRMAN ANGELIDES: All right. Well, you
3 did have different standards for the loans you were
4 buying to hold; correct? Ostensibly different
5 standards. In other words, in the business of
6 securitization, you just accepted whatever was given
7 to you subject to your verification that it met those
8 other folks' standards; correct?

9 MS. MILLS: I believe so, yes.

10 CHAIRMAN ANGELIDES: Okay. And then on the
11 other side of the business where Citi was originating
12 to hold, they had a higher standard, is my
13 understanding.

14 MS. MILLS: I'm not that familiar with what
15 their standards were.

16 CHAIRMAN ANGELIDES: Are you familiar with
17 the differential standards, Mr. Bowen?

18 MR. BOWEN: I was not involved in the
19 origination channels, Mr. Chairman.

20 CHAIRMAN ANGELIDES: Do you agree with
21 Ms. Mills' characterization of the responsibility of
22 the market makers?

23 MR. BOWEN: I -- I can't express an opinion
24 on that, sir.

25 VICE CHAIRMAN THOMAS: Last question?

1 CHAIRMAN ANGELIDES: All right, last
2 question here. Yes, Mr. Thomas, do you have a --

3 EXAMINATION BY VICE CHAIRMAN THOMAS

4 VICE CHAIRMAN THOMAS: The phrase market
5 maker, I guess, in your analogy, which I would like to
6 follow through on, that you have people who make
7 products. And you were talking about what motive they
8 had to make sure that the product wasn't toxic, or if
9 you sell a baby blanket, you're supposed to make sure
10 that it doesn't burn easily.

11 The problem is you have a whole tort system
12 to back you up on that, and you do it, and there are
13 actionable -- plus you got other folks looking at it.
14 Ms. Lindsay, you started off your testimony indicating
15 that it was really the responsibility of the people
16 who were buying the product to understand.

17 I mean, the good old-fashioned caveat
18 emptor, you know, we're putting it out there, but it
19 doesn't have anything to do with us. If it goes the
20 direction that apparently almost everything was going,
21 Ms. Mills, I was hearing a little bit of that out of
22 you as well.

23 Commissioner Georgiou said maybe if you had
24 some skin in the game. Do you think if you were
25 actually on the line -- well, obviously you wound up

1 with a lot of losses -- in terms of each and every
2 product you put out there, it would have been sobering
3 in terms of decision making, or there was just so much
4 to make that, you know, 20,000 out of 2 million isn't
5 that big of a number so keep shoving product, which
6 was one of the things we heard?

7 MS. LINDSAY: Yeah, I think that if you
8 have skin in the game, obviously you're going to
9 protect it more.

10 I think it got so overwhelming, at the end,
11 to try to get product to the -- to sale that the
12 product did go downhill. But, yeah, the having the
13 skin in the game is very important.

14 VICE CHAIRMAN THOMAS: Yeah, and everyone
15 uses skin in the game as a euphemism.

16 MS. LINDSAY: Right.

17 VICE CHAIRMAN THOMAS: I'm beginning to
18 think more and more if it wasn't a euphemism, it would
19 be even better.

20 EXAMINATION BY CHAIRMAN ANGELIDES

21 CHAIRMAN ANGELIDES: Just to very quickly,
22 then wrap up.

23 Mr. Bowen, I did have one question for you.
24 You, when you referred to the Wall Street bulk
25 purchases, was that Ms. Mills' shop?

1 MR. BOWEN: No.

2 CHAIRMAN ANGELIDES: It was not? Okay.

3 So when you're talking about the exceptions
4 and the overrides, that doesn't refer to Ms. Mills'
5 shop?

6 MR. BOWEN: No, sir.

7 CHAIRMAN ANGELIDES: Okay, thank you. My
8 final question, Ms. Mills, is for you, and that is,
9 from what we've learned, you began to slow down.
10 You're privileged, you're lucky that you're getting
11 the questions.

12 No, you, it looked like, from what we see,
13 is you began to slow down because of the risks you saw
14 in the market.

15 I actually have two questions: One is I'm
16 looking at a March 28th, 2007, non-agency strategy
17 memo. I don't know if this was yours and I don't --
18 it was not yours? Okay.

19 Because -- would you know whose it was,
20 just because it speaks about even as late as March 28,
21 2007, it talks about gaining additional access to
22 mortgage origination, both flow and bulk, to enable
23 Citi to grow its whole loan purchase business. Do you
24 know from whence this would have emanated and where it
25 ended up?

1 MS. MILLS: I believe that that
2 presentation was put together by the business
3 management unit of global securitized markets.

4 CHAIRMAN ANGELIDES: Which would have been
5 above you or --

6 MS. MILLS: Business management is sort
7 of --

8 CHAIRMAN ANGELIDES: All right.

9 MS. MILLS: They manage the business.

10 CHAIRMAN ANGELIDES: But it was not your
11 document?

12 MS. MILLS: No.

13 CHAIRMAN ANGELIDES: Okay. So I'll put
14 that aside, and we'll find out whose document it is,
15 and we'll ask them about that document.

16 But I do understand that you slowed down
17 your purchases, but at the same time, and they'll be
18 here later today, the collateralized debt obligation
19 desk in the investment bank was ramping up. It was
20 raising its limits from about 30 billion dollars to 35
21 billion dollars, and this was a unit that ultimately
22 had, I think, about 30 billion dollars in write-downs.

23 Was there any communication between you,
24 directly, as someone who's buying, seeing things in
25 the markets and securitizing, and the folks on the

1 other desk, who are ramping up, buying their
2 residence, you know, their mortgage-backed
3 collateralized debt obligations, in the sense they
4 need to ramp up their profile, their risk profile, at
5 the same time you're pulling down?

6 MS. MILLS: No.

7 CHAIRMAN ANGELIDES: All right, thank you.
8 Mr. Thompson?

9 EXAMINATION BY COMMISSIONER THOMPSON

10 COMMISSIONER THOMPSON: So, Ms. Mills,
11 pardon me for my preoccupation with league tables.

12 So if they didn't matter, why buy Argent?
13 And were you involved in that transaction at all?

14 MS. MILLS: I was involved in the diligence
15 that went on for the Argent platform because they were
16 a client of ours that I had done business with over
17 the years. At that time in the market, a lot of other
18 Wall Street firms were buying originators, and
19 their -- we didn't -- we didn't think that the end was
20 there. We didn't think that it was over. We didn't
21 think that it was the end of subprime.

22 COMMISSIONER THOMPSON: So league tables
23 did matter?

24 MS. MILLS: This -- this is not about
25 league tables. This is about having access --

1 COMMISSIONER THOMPSON: Market share did
2 matter?

3 MS. MILLS: This is -- I didn't say that.
4 This is about having access to originations so that we
5 could supply bonds to our fixed-income investors.

6 And so with all of the other originators,
7 independent originators in the market being bought by
8 other Wall Street firms, for our business and our
9 business of creating mortgage-backed securities, we
10 were concerned about having access to supply of
11 mortgages, and so Argent was a platform that was
12 available, and it was someone that we knew, and it was
13 a very long, you know, months and months of diligence
14 process.

15 And in that time, call it the summer of
16 2007, the subprime market and securitization
17 essentially dried up, was our view. I think we
18 thought of it as akin to a fall of '98 sort of
19 situation, where the capital markets sort of froze for
20 a couple of months, but then they became unfrozen.

21 And Argent had essentially stopped
22 originating loans, because our purchase was pending,
23 and our thought was, until subprime came back, we
24 would use the platform, which was just an origination
25 platform that didn't have any loans in it, and we

1 would originate agency-eligible loans and FHA-type
2 loans until subprime came back.

3 And because it was our platform, we could
4 control the types of loans that were originated. And
5 we all know how that worked out.

6 COMMISSIONER THOMPSON: Okay, thank you.

7 MS. MILLS: Sure.

8 VICE CHAIRMAN THOMAS: On that -- on that
9 question, at some point somebody decided it would be
10 better to have them in-house than the business model
11 you were following.

12 MS. MILLS: To buy the platform?

13 VICE CHAIRMAN THOMAS: Yeah.

14 MS. MILLS: In the context that there
15 weren't that many independent originators left.

16 VICE CHAIRMAN THOMAS: And it was easier
17 not to do that because you didn't have that, another
18 silo, to attach to Citibank? Do you know where that
19 decision came from? Where were the groups that
20 discussed moving in that direction?

21 MS. MILLS: Moving in the direction of?

22 VICE CHAIRMAN THOMAS: Of purchasing
23 Argent?

24 MS. MILLS: I know that I discussed it
25 with -- with my management. And I know that there

1 were -- I was involved in some discussions with the
2 two gentlemen or the one -- one of the two gentlemen
3 who ran fixed income. After that, I was not involved
4 in any direct discussions.

5 VICE CHAIRMAN THOMAS: Would you say that
6 you were, rightfully so, kind of one of the
7 originators of the idea?

8 MS. MILLS: No.

9 VICE CHAIRMAN THOMAS: No? Do you know
10 where it was originated?

11 MS. MILLS: No.

12 VICE CHAIRMAN THOMAS: Okay. Consistent.
13 Thanks.

14 CHAIRMAN ANGELIDES: All right. Members,
15 we are close to on time, considering our lights-out
16 problem earlier in the day.

17 I want to thank all of you for the time
18 you've given us and for your answers to our questions;
19 appreciate it very, very much.

20 We are going to take a ten-minute break,
21 ladies and gentlemen, and we'll be back here in ten
22 minutes. Thank you very, very much.

23 (Session ended at 2:56 p.m.)

24 CHAIRMAN ANGELIDES: The meeting of the
25 Financial Crisis Inquiry Commission will come back

1 into order.

2 We are now in our final session of the day.
3 We will be hearing from our panelists in our third
4 session, which is called Citigroup CDOs,
5 collateralized debt obligations, and Risk Management.

6 Let me ask each of you or all of you if you
7 would please stand to be sworn in and, again, let me
8 say, as I say to everyone, this is a customary
9 swearing in, that we have done for all witnesses and
10 will in the future.

11 Do you solemnly swear or affirm, under the
12 penalty of perjury, that the testimony you are about
13 to provide the Commission will be the truth, the whole
14 truth and nothing but the truth, to the best of your
15 knowledge?

16 MR. BARNES: Yes, I do.

17 MR. BUSHNELL: I do.

18 MR. DOMINGUEZ: I do.

19 MR. MAHERAS: Yes, I do.

20 CHAIRMAN ANGELIDES: Thank you very much.

21 VICE CHAIRMAN THOMAS: Mr. Chairman, prior
22 to your moving forward, can I ask all of you, would
23 you be more than willing to respond in writing to
24 questions sent to you, in writing, as we move forward
25 in this investigation?

1 Each one of you need to say yes to the
2 microphone.

3 MR. BUSHNELL: Yes.

4 MR. MAHERAS: Yes.

5 MR. DOMINGUEZ: Yes.

6 MR. BARNES: Yes.

7 VICE CHAIRMAN THOMAS: Thank you very much.
8 Thank you, Mr. Chairman.

9 CHAIRMAN ANGELIDES: Thank you. So,
10 gentlemen, thank you very much. You've all submitted
11 written testimony, and we're going to ask each of you
12 to provide up to five minutes, you can be briefer if
13 you choose, but no more than five minutes of oral
14 testimony to commence this session.

15 We're going to start with you,
16 Mr. Dominguez and move across the table, from my
17 vantage point left to right. And I would appreciate
18 when you first introduce yourselves, while we know who
19 you are, for the folks watching, if you could just
20 also briefly describe your position in the
21 institution, it would be very helpful.

22 So, Mr. Dominguez, if you would start off?
23 And, by the way, at one minute, you'll see the little
24 timer in front of you, the light. The light will go
25 from green to yellow and then to red when the five

1 minutes is up, all right? Thank you very much,
2 Mr. Dominguez.

3 MR. DOMINGUEZ: Chairman Angelides, Vice
4 Chairman Thomas, and members of the Commission, thank
5 you very much for inviting me to appear before you.

6 My name is Nestor Dominguez. I hope that
7 my experience with Citigroup can shed light, with the
8 benefit of hindsight, on the important issues before
9 the Commission.

10 I understand that the Commission is
11 interested in Citi's business activities with respect
12 to collateralized debt obligations or CDOs.

13 I was involved in Citi's CDO activities
14 from 1999 until I left Citi on November 1st of 2007.
15 From 2006 to 2007, I served as co-head of Citi's
16 global CDO business that focused on cash CDOs.

17 I was responsible for overseeing the
18 structuring, distribution, and trading units of that
19 business. I believe then and still believe now that
20 Citi's CDO business was performing an important
21 function in the capital markets in creating
22 securitized products to meet investor demand for
23 exposures to specific asset classes and to specific
24 cash flow profiles.

25 Citi completed many successful and

1 productive transactions in numerous asset classes
2 during a time of dramatic global expansion of the CDO
3 industry as a whole.

4 Citi expanded its involvement in the
5 structuring of ABS CDOs from 2001 to 2007. Over a
6 number of years, up to the fall of 2007, Citi rose to
7 become one of the leading global originators and
8 traders of all types of CDOs, including those backed
9 by RMBS securities, corporate credits, and several
10 other categories of collateral.

11 The cash CDO business that I co-headed
12 generated approximately 400 million in total annual
13 revenues in 2005 and in 2006. This revenue came from
14 one-time structuring fees of between one half a
15 percent to 2 percent of the assets in each CDO deal we
16 structured and from secondary trading and warehousing
17 activities.

18 Our CDO business model called for
19 distributing all the securities that resulted from our
20 CDO structuring activities except the most senior
21 tranches of specific transactions that were structured
22 to be held on Citi's balance sheet.

23 These retained positions were referred to
24 in the market as super senior because they -- because
25 they were structurally senior in the cash flow

1 waterfall to tranches that themselves had virtually
2 zero expected loss based on analytical modeling.

3 This tranche, this other tranche was
4 subordinate to the super senior tranche, was rated
5 Triple-A by the rating agencies.

6 The view that super senior tranches carried
7 virtually no risk was widely held at Citi, based on,
8 among other things, the level of structural
9 subordination beneath these retained securities and
10 our modeling and stress analysis.

11 We, at Citi, believed that the retained
12 super senior tranches were an efficient use of capital
13 and Citi's balance sheet with an extremely remote risk
14 of impairment of interest or principal repayment.

15 Citi retained certain super senior tranches
16 in two forms. First, in a product referred to as
17 liquidity puts. For certain cash CDO transactions,
18 between 2003 and 2006, the senior-most level of the
19 capital structure was funded by the issuance of
20 short-term asset-backed commercial paper, which at
21 that time was a large and deep market with a long
22 history of stability during previous times of stress.

23 To facilitate the issuance of this
24 commercial paper, Citi issued a renewable 364-day
25 liquidity facility to the CDO as a backstop source of

1 funding in case of either a significant widening in
2 credit spread or a temporary inability to issue
3 commercial paper.

4 Second, Citi also retained portions from
5 both cash and synthetic form of super senior notes of
6 certain CDOs issued in 2006 and 2007 by both the CDO
7 desk based in New York and as a result of synthetic
8 CDO structuring activities in London.

9 In both super senior programs, the risk of
10 loss on the retained super senior exposure and the
11 liquidity puts was examined extensively, and based on
12 those stress tests and models, the likelihood of
13 losses was considered extremely remote.

14 Ultimately, Citi recognized significant
15 mark-to-market losses on its CDO exposures. These
16 losses occurred as a result of cataclysmic and
17 unprecedented market events: Housing price declined
18 and mortgage defaults not seen since the Great
19 Depression, and anticipated by virtually no one,
20 including those of us who dedicated ourselves to
21 building a business we believed was good for our
22 clients and for the shareholders of our company.

23 I hope I can be of some help to the
24 Commission in putting into perspective the nature of
25 Citi's CDO business. I look forward to answering your

1 questions.

2 CHAIRMAN ANGELIDES: Impeccable timing.

3 Thank you. Mr. Barnes?

4 MR. BARNES: Chairman Angelides, Vice
5 Chairman Thomas, and members of the Commission, thank
6 you for the opportunity to appear today.

7 My name is Murray Barnes and I served as a
8 managing director in the independent market risk
9 management group of Citi's investment bank with the
10 responsibility for overseeing Citi's global credit
11 markets trading businesses from 2005 until early this
12 year.

13 The Commission has asked me to address risk
14 management issues related to CDOs backed primarily by
15 subprime RMBS, including the setting of risk limits
16 for these products and valuation and pricing issues.

17 Generally speaking, the role of independent
18 market risk is to work with the business to limit and
19 manage market risks that trading businesses are
20 exposed to in a manner that is consistent with the
21 company's risk appetite.

22 In my role, I reported directly to the head
23 of market risk management for the investment bank who,
24 in turn, reported directly and exclusively to Citi's
25 chief risk officer.

1 This reporting line was fully independent
2 of the business. This meant that, among other things,
3 compensation for independent risk managers was not
4 determined by the business, nor was it tied to the
5 performance of the businesses that we covered.

6 One of the primary risk management tools
7 that we employed with respect to CDO activities and
8 all other trading functions involved the setting of
9 risk limits.

10 Market risks set risk limits on overall
11 trading activity. In the case of the CDO business,
12 there were several applicable limits, including limits
13 that applied to assets the desk warehoused for future
14 securitizations and limits that applied to any
15 positions the desk retained from past securitizations,
16 including the super seniors.

17 Market risk independently monitored
18 compliance of risk limits and reviewed risk limits in
19 light of market developments.

20 During my tenure, market risk assessed
21 potential exposures in a variety of ways, including
22 through the use of stress tests, which employed
23 assumptions using historical data to stress for
24 potential loss.

25 Stress tests were performed at the division

1 level, desk level, and for individual market factors
2 in an effort to dimension risk in as many ways as
3 possible. As part of this process, we routinely
4 engaged in a dialogue with the business concerning the
5 proper stress levels to employ, although the levels
6 ultimately applied were the responsibility of market
7 risk management.

8 In accordance -- in accordance with
9 Citigroup's pricing policies, responsibility for
10 marketing trading positions resided with each
11 business, including the CDO desk.

12 Prior to the market events in late 2007,
13 Citigroup relied on using comparable analysis to value
14 its CDO super senior exposures. It did this by
15 comparing the spreads on similarly Triple-A-rated
16 first-pay tranches that it recently priced. This
17 resulted in such exposures generally being carried at
18 par through June 30th, 2007.

19 These marks reflected the widely held
20 belief, both within the company and throughout the
21 market, that the super senior positions bore almost no
22 risk of loss.

23 As the unprecedented market events unfolded
24 in 2007 and new issuances of CDOs froze, the business
25 developed a model to price its super senior positions

1 based in part on an intrinsic cash flow methodology of
2 the CDOs underlying RMBS collateral.

3 I understand, with the benefit of
4 hindsight, why one might conclude that Citi's
5 independent market risk management function failed to
6 set appropriate limits on the CDO business.

7 The issues, however, are significantly more
8 complex. Indeed, given the widely held view that
9 super senior positions posed only an extremely remote
10 risk of loss prior to the events of 2007, it is still
11 difficult to imagine how the severity of the decline
12 in house prices and its effect on the CDO market could
13 have been predicted, let alone modeled.

14 Throughout the challenging market
15 conditions of late 2007 and beyond I believe that
16 Citi's independent risk management function was fully
17 engaged for the business and had access to and
18 utilized the risk management tools that were then
19 available.

20 Our downside risk assessments included what
21 we then understood to be extreme loss scenarios, and
22 market risk set limits for the business on the basis
23 of that analysis.

24 With the benefit of hindsight, we realize
25 that certain stressful assumptions were not adequate.

1 Ultimately, I believe that the rapid growth of complex
2 structured credit products presented unique challenges
3 that in some respects outpaced the market's ability to
4 develop the necessary tools to fully evaluate the
5 risks of those products.

6 The impact of this increasing complexity
7 was exacerbated by the commonly held belief that house
8 prices could not fall by anything like the 30
9 percent-plus decline that we have seen.

10 I appreciate the difficulty of the task
11 facing this Commission and look forward to answering
12 your questions.

13 CHAIRMAN ANGELIDES: Another piece of
14 impeccable timing. Thank you very much. Mr. Maheras?

15 MR. MAHERAS: Tough act to follow.
16 Chairman Angelides, Vice Chairman Thomas, and members
17 of the Commission, I also thank you for the
18 opportunity to appear here today.

19 My name is Tom Maheras and I served as
20 Citi's co-head of the investment bank from January
21 2007 until I left the bank in the early part of
22 October 2007.

23 Let me begin by placing Citi's CDO business
24 in context. When I was co-head of the investment
25 bank, we provided a very broad range of products and

1 services in more than 80 countries around the globe,
2 and we employed more than 40,000 people.

3 The CDO business was at all times a very
4 small part of the investment bank's overall business.
5 To give you some perspective, in the fiscal year 2006,
6 the investment bank had a balance sheet of about or a
7 little over 1.3 trillion dollars and revenue -- and
8 revenues in excess of over 27 billion dollars.

9 The entire CDO business in that year, its
10 best year ever, comprised 1 and change to under
11 2 percent of those revenues.

12 I believe that the business was
13 appropriately supervised by experienced and highly
14 competent managers and by an independent risk group
15 and that I was properly apprised of the general nature
16 of our work in this area and its attendant risks.

17 I also strongly believe that our board of
18 directors and our most senior management were provided
19 with the appropriate information and guidance about
20 Citi's investment banking business activities.

21 When issues arose in early 2007 regarding
22 the more junior CDO tranches we held and when issues
23 regarding our safest super senior CDO holdings arose
24 later that year, senior management and the board took
25 reasonable steps to evaluate and address the

1 unprecedented- -- unprecedented events that rapidly
2 unfolded.

3 How then did our investment bank end up
4 incurring such large losses on its CDO positions?
5 What went wrong?

6 The losses that Citi incurred that related
7 to the CDO business principally arose from the
8 extremely high-rated CDO tranches, the so-called super
9 seniors that everyone at the bank and most in the
10 industry believed were among the safest instruments in
11 the capital markets.

12 These super seniors were rated above
13 Triple-A. They were senior to those securities in the
14 same structures that were rated Triple-A, which meant
15 that their chances of default were deemed to be
16 extremely low.

17 It is difficult now to put ourselves back
18 to the time before the financial crisis. But it is
19 important to understand the following critical point:
20 Citi's losses from its CDO business did not result
21 from its fixed-income group placing high risk bets in
22 its proprietary trading business on esoteric
23 cutting-edge trades in a reach for outsized profits.
24 To the contrary, our primary CDO losses stemmed from
25 client-driven activities resulting in the holding by

1 Citi of very low-interest yielding, very low-interest
2 yielding, and what were understood to have been super
3 safe securities that later unexpectedly depreciated in
4 value.

5 My focus on the CDO business increased when
6 we began to see deterioration in the subprime market
7 and related financial fallout in early 2007. This is
8 when the lower-rated, the lower-rated CDO securities
9 started to decline in value, when we took significant
10 steps to reduce our exposure to these riskier CDO
11 positions.

12 But even in the summer and fall of 2007, I
13 continued to believe, based on what I understood and
14 had gathered from the experts in the business, that
15 the bank's super senior CDO holdings were safe. It
16 was only later in the fall of '07 that the banks
17 started to see mark-to-market losses on these
18 positions.

19 And it was only after I left the bank and,
20 thereafter, when the rating agencies downgraded these
21 securities in a sweeping and unprecedented series of
22 moves that these positions were significantly marked
23 down.

24 What could have been done to prevent these
25 losses? I have asked myself this question so many

1 times. Given the extraordinary losses that were
2 eventually imposed on the company shareholders, I
3 understand that it would be somehow more reassuring to
4 concluded that we made an ill-conceived trading bet or
5 that we invested in a business that was overly risky
6 or even that we lacked proper controls, but I do not
7 believe any of these to be the case, any of those to
8 be the case.

9 Knowing what we knew at the time and
10 looking back on this part of our business, I cannot
11 fault the fact that the business and most everyone in
12 the industry, including our own regulators, regarded
13 these super senior CDO securities to be extremely
14 safe.

15 What I can tell you with the benefit of
16 hindsight is that we, like many other experienced
17 members of the industry, failed to recognize that
18 there was a real possibility of the kind of
19 catastrophic residential real estate crash that our
20 country has experienced over the past several years.

21 We were certainly not alone in failing to
22 predict that real estate prices would plunge 30 to 40
23 percent, with homeowners walking away from their homes
24 en masse for the first time ever.

25 I regret that I and my colleagues did not

1 see that coming, but we did not.

2 Going forward, we must recognize the
3 ever-present vulnerability of our financial system to
4 serious and unanticipated widespread shocks and
5 continue to evolve risk measurement and risk
6 management practices accordingly.

7 I thank you and would be pleased to answer
8 the questions you might have.

9 CHAIRMAN ANGELIDES: Thank you very much.
10 Mr. Bushnell?

11 MR. BUSHNELL: Chairman Angelides, Vice
12 Chair --

13 CHAIRMAN ANGELIDES: Microphone, please.

14 MR. BUSHNELL: Sorry. Chairman Angelides,
15 Vice Chairman Thomas, and members of the Commission, I
16 am pleased to participate in today's hearing and to
17 assist in your important and challenging inquiry.

18 My name is David Bushnell and I was the
19 chief risk officer of Citigroup from 2003 to 2007 and
20 the chief administrative officer of Citigroup in the
21 latter part of 2007.

22 I've submitted a longer statement for the
23 record, and I would like to begin my testimony today
24 by addressing what is, in my view, the single-most
25 contributing factor to Citi's significant write-downs

1 and losses.

2 As you know, beginning in 2007, an
3 unprecedented collapse in the United States'
4 residential real estate market was the primary
5 instigator of a global crisis in the world's financial
6 system. As with many other market participants, Citi
7 was severely impacted by this sudden downturn.

8 In particular, Citi suffered massive
9 unanticipated losses in connection with its
10 approximately 43-billion-dollar position in a specific
11 asset class exposed to the subprime residential real
12 estate.

13 These were the so-called super senior
14 tranches of collateralized debt obligations. In the
15 fourth quarter of 2007 alone, Citi took a
16 14.3-billion-dollar write-down on this single asset
17 class.

18 These super senior CDO tranches have come
19 under tremendous scrutiny, and rightfully so. To
20 understand their contribution to Citi losses however,
21 it is important to understand how these investments
22 were perceived at the time.

23 First, in 2007 this 43-billion-dollar
24 position represented less than 2 percent of Citi's
25 2.3-trillion-dollar balance sheet.

1 Second, prior to late 2007, these
2 securities were rated above Triple-A, an extremely
3 high credit rating.

4 Citi and the rest of the market shared the
5 view that super seniors were safe and presented an
6 extremely low risk of default or depreciation in
7 value.

8 Thirdly, the views of the credit rating
9 agencies were reinforced, in part, by risk models
10 employed by Citi. These risk models, like those of
11 most other financial institutions, tested for what
12 were believed to be extreme-loss scenarios for
13 residential real estate.

14 We now know that even the most pessimistic
15 assumptions in these models did not foresee the
16 severity of the downturn.

17 As the chief risk officer during this
18 relevant period, I've given a great deal of thought to
19 the lessons to be learned from these events.

20 First, the write-downs associated with
21 CD -- with our CDO positions far exceeded anything
22 predicted in our stress tests and were materially
23 greater than was anticipated using a statistical
24 approach.

25 Second, the complexity and sophistication

1 of these structured products obscured the importance
2 of understanding the risk characteristics of the
3 ultimate underlying collateral, that is, residential
4 mortgages.

5 Third, at the most sophisticated level,
6 none of us fully appreciated the consequences of such
7 a collapse would have for even the senior most
8 tranches of these structured products.

9 In short, we did not anticipate these
10 extraordinary developments or comprehend their
11 interactions. We made a rational but, in retrospect,
12 mistaken business judgment to retain the super senior
13 tranches of CDOs.

14 As chief risk officer, I was responsible
15 for communicating risk and compliance issues to the
16 executive management, to the board of directors, and
17 to external regulators. I communicated almost daily
18 on an ad hoc basis with the CEO, Chuck Prince, and had
19 a regular, weekly one-on-one meeting with him.

20 I was also a member of Citi's business
21 group heads. This group met weekly and included all
22 of Citi's senior-most executives from the firm's
23 business and administrative and control functions. I
24 provided regular risk reports to the full board of
25 directors and participated in its audit and risk

1 management committee and subcommittee meetings.

2 Citi's independent risk organization was
3 organized across business lines with a geographic
4 overlay. All of these reported up through me through
5 a chain of increasingly senior risk managers in order
6 to assure their independence. In all, I oversaw a
7 risk organization of approximately 2,700
8 highly-qualified risk professionals.

9 Citi's risk discipline framework included
10 risk policies, limits, the value at risk and stress
11 testing for what we then considered extreme-loss
12 scenarios.

13 All of these procedures were well known to
14 our regulators and were conducted in accordance with
15 the then-global capital regulatory standards.

16 All extensions of credit required the
17 approval of risk management. If there was a
18 disagreement between our risk group and the business
19 as to an appropriate limit, independent risk had the
20 final say.

21 I would like to conclude by noting that
22 Citi's risk managers were dedicated well-trained
23 professionals with the independence, authority, tools,
24 and technology to deliver best in class risk
25 oversight. That does not change the fact that in this

1 case, our method of analysis was not good enough.

2 I hope that my participation in this
3 hearing will help contribute in some small way to the
4 important work of the Commission to better protect the
5 financial system in the future. And I will be happy
6 to answer questions that you have.

7 CHAIRMAN ANGELIDES: Thank you very much,
8 Mr. Bushnell. We will now go to -- I will do what I
9 did in the last session, members, which is reserve my
10 questionings till the end. We'll start with the Vice
11 Chairman.

12 VICE CHAIRMAN THOMAS: Thank you,
13 Mr. Chairman. I'll ask some questions and in the end,
14 reserve time, as we did previously.

15 EXAMINATION BY VICE CHAIRMAN THOMAS

16 VICE CHAIRMAN THOMAS: Mr. Bushnell, I
17 didn't come back out of retirement to sit back on a
18 thing I've done for 28 years to try to protect the
19 financial system.

20 A consequence of what we try to do in our
21 job of trying to explain to Americans what happened, I
22 can assure you, probably won't contain one word of
23 what you folks just told us.

24 Did any of you, and I'll just ask a show of
25 hands, and I assume you'll be honest in your response,

1 lose one night of sleep over what happened? No? No
2 hands. You didn't lose one -- oh, no, I didn't prompt
3 you. I said, did you lose one night of sleep?

4 MR. MAHERAS: I lost a lot of sleep.

5 VICE CHAIRMAN THOMAS: The answer is
6 supposed to be yes. You're supposed to raise your
7 hand. Once you got it, you raised your hand.

8 You lost a lot of sleep?

9 MR. MAHERAS: Yes.

10 VICE CHAIRMAN THOMAS: Well, for someone
11 who earned as much money as the most highly-paid
12 player on the New York Yankees -- at least he can show
13 a World Series win for what he got.

14 And if they do various things that are
15 against the rules, they got to pay fines and do other
16 stuff.

17 I'm not going to dwell on the money. I
18 can't comprehend it. Obviously, you weren't
19 supervised by competent people or what happened
20 wouldn't have happened. And the argument is what
21 happened to everybody else, then no one is competent.

22 The argument that none of you ever heard
23 the phrase, "what goes up must come down," you thought
24 somehow housing was unique? Or are you familiar with
25 other areas that never go down? Or why in the world

1 would you pay anybody for risk management in the area
2 of dealing with these securities when housing never
3 goes down?

4 I mean, you would think that's not an area
5 where you would invest money. You would stick more
6 into the products that don't go down.

7 I just have to tell you that I'm frankly
8 more concerned about you than some of the guys at the
9 top, because I'm always familiar about guys at the
10 top, and they make a lot of money, and I don't -- this
11 has nothing to do with you, Mr. Thompson, because I
12 now know you as a person.

13 You guys were at a level, paid handsomely.
14 And what I heard was we took somebody's word who rates
15 them and we pay them to get the rating but we took
16 their word for it. We had models, and nobody could
17 model what happened.

18 It did. So you didn't know what you were
19 doing or, yes, you did, you knew what you were doing
20 until you didn't. Mr. Dominguez at what point did you
21 know that you didn't know?

22 MR. DOMINGUEZ: We became concerned late --
23 mid to late summer of 2007 as the markets froze, the
24 CDO markets froze.

25 VICE CHAIRMAN THOMAS: That was across the

1 board in terms of your company, or were some other
2 folks not getting it? Were they still conducting
3 themselves in a way that they thought this was going
4 to continue, that their models were right, the rating
5 agencies were correct, or did you all pretty much
6 realize it about the same time throughout the silos of
7 your company?

8 MR. DOMINGUEZ: Well, in August of 2007, we
9 began -- we began extensive discussions about the
10 implications of the decline, the dramatic decline of
11 the underlying subprime markets, and how that would
12 feed into the super senior positions.

13 We had already seen it feed through into
14 the lower-rated tranches, you know, earlier that
15 summer and late that spring. So that's when the
16 dialogue began -- began in earnest.

17 VICE CHAIRMAN THOMAS: When no one wanted
18 to purchase is that, in a general sense, the
19 low-interest yielding super senior tranches, they were
20 low interest, why? Because they was as good as gold,
21 like treasury notes? How come no one wanted to
22 purchase something as secure as that?

23 MR. DOMINGUEZ: Well, the -- the -- there
24 was several types of super seniors, by and large --

25 VICE CHAIRMAN THOMAS: I'm trying to stay

1 above the details you want to go down. To make a
2 point I'm more than willing to descend with you.

3 MR. DOMINGUEZ: By and large we distributed
4 the most senior tranches on almost all our CDOs except
5 for a program liquidity puts which was specifically
6 intended to be held on balance sheets.

7 So, there was a market. It was -- it was
8 all institutional. It traded between banks with
9 commercial paper conduits, with protections from the
10 mono-line. So there was a market and by and large --

11 VICE CHAIRMAN THOMAS: On the whole, did
12 you keep them because you thought they were really
13 good and you wanted to keep them, or that you couldn't
14 really move them or figure out a way to package them
15 to move them? I mean, is there a --

16 MR. DOMINGUEZ: The -- the -- the only
17 program specifically designed to be kept on the
18 balance sheet was the liquidity put program.

19 VICE CHAIRMAN THOMAS: Mm-hmm.

20 MR. DOMINGUEZ: The rest of the super
21 seniors that we got caught with in the fall, late
22 summer, fall of 2007, was really as a result of the
23 freezing up of the markets.

24 And the market had been through -- I've
25 been involved in the market since '99, as I mentioned.

1 The market had been through a number of very stressful
2 situations: September -- September 11th, the Iraqi
3 war, and spreads widen and narrow, participant's
4 capital comes in and -- and goes out of the markets.

5 So we've been through stressful times
6 before, and of course those -- those senior most
7 tranches are specifically designed to take a lot of
8 stress, and so people viewed them as very robust. And
9 so we expected the market to come back. But, of
10 course, what happened in -- in October and November is
11 the market -- the underlying market for RMBS, as
12 represented by the ABS Index, for example, declined
13 even more dramatically.

14 VICE CHAIRMAN THOMAS: Things go down, but
15 not according to somebody's model, not according to
16 somebody's rating agency, so it's someone else.

17 Mr. Maheras, you made a lot of money. Do
18 you believe now, looking back on that situation, that
19 you earned all of it?

20 MR. MAHERAS: I appreciate the topic of
21 Wall Street compensation. It -- it is very --

22 VICE CHAIRMAN THOMAS: It's not the topic
23 of Wall Street compensation. I've got a group of
24 people in front of me. I'm looking at these numbers.
25 I'm no longer in Congress. I don't have a

1 constituency, but I moved back to my home.

2 And they've asked me questions, and I'm
3 basically conveying to you the questions they're
4 asking me.

5 Do you think you earned that money?

6 MR. MAHERAS: I was paid very handsomely.
7 I was paid in a manner consistent with the market at
8 the time.

9 VICE CHAIRMAN THOMAS: Kind of like the
10 rating agencies and the models, it wasn't associated
11 with what you did before or after; it was some model
12 that you put yourselves up against.

13 My question was a bit more personal than
14 that. Do you personally believe you earned that money
15 in terms of what happened?

16 MR. MAHERAS: Well, in -- in the year of
17 2007, when things came to pass that ended up costing
18 the firm, I didn't get paid any money.

19 VICE CHAIRMAN THOMAS: No money,
20 whatsoever, you worked for nothing?

21 MR. MAHERAS: I'm sorry, I'm
22 sorry, I did not get paid a bonus. I got paid a zero
23 bonus. In the prior years --

24 VICE CHAIRMAN THOMAS: Well you got paid

1 something.

2 MR. MAHERAS: I was paid a salary that
3 year. In the prior years, when I was very handsomely
4 paid, it was at a time when Citigroup was paid, at a
5 time when Citigroup did very well, performed very well
6 economically, and my pay was part cash and nearly half
7 the shares of the company, which aligned our interest.

8 VICE CHAIRMAN THOMAS: `07, you only got
9 your base salary?

10 MR. MAHERAS: Yes.

11 VICE CHAIRMAN THOMAS: You didn't get a
12 bonus. In `08 -- when did you leave the company?

13 MR. MAHERAS: I left in early October of
14 `07.

15 VICE CHAIRMAN THOMAS: Of `07? Did you get
16 anything in `08?

17 MR. MAHERAS: No.

18 VICE CHAIRMAN THOMAS: So you left when
19 you, in fact, only had your salary?

20 MR. MAHERAS: I left at a time when I had
21 only earned a salary to that point, and I was not
22 given a bonus for that year.

23 VICE CHAIRMAN THOMAS: And you had
24 remuneration that would continue to go on, it wasn't
25 just cash, that you got?

1 MR. MAHERAS: I had shares in the company,
2 granted in prior years, which had three or four years of
3 vesting requirement. And it had -- it was a number of
4 shares. So at the time when I received the stock, it
5 was at much, much lower levels.

6 VICE CHAIRMAN THOMAS: So you lost at least
7 one night's sleep.

8 At any time during that night or however
9 many nights it was, did you ever consider perhaps
10 voluntarily not taking the total package that you knew
11 you were walking away from based upon what was left of
12 the company that paid you handsomely? Did you owe
13 them anything? Did you owe somebody anything about
14 the decisions that you were responsible for?

15 MR. MAHERAS: Per the standards of the
16 compensation system, I would have happily played by
17 those rules if that was the way the packages worked,
18 sir, but, no, I didn't.

19 VICE CHAIRMAN THOMAS: Well, I'm talking
20 about an internal rule that would make you feel better
21 based upon what happened, not some company model,
22 because I know full well in terms of clawback, which
23 changed in '08, I'm aware of the changes that were
24 made. I'm just trying to talk to you as a person. I
25 don't know you.

1 MR. MAHERAS: Well, as I said before, I did
2 lose a lot of sleep. It wasn't -- it was about the
3 fact that a company I cared a lot about and had worked
4 at for 23-plus years and many, many people I cared a
5 lot were going -- about a lot were going through a
6 very difficult period after I left the firm.

7 The losses that have been well detailed
8 occurred well after I left the firm. And I felt
9 terrible that I was not there to be part of the
10 solution.

11 Had I -- had I known what was going to
12 come, I would never -- I would not have left the firm,
13 Mister --

14 VICE CHAIRMAN THOMAS: But you were there
15 as part of the problem.

16 MR. MAHERAS: I was. I was there when
17 those securities were put on the balance sheet and I
18 was there --

19 VICE CHAIRMAN THOMAS: And you didn't know
20 it then, of course, because you were relying on
21 ratings services and all the other things that let you
22 sleep at night.

23 MR. MAHERAS: I barely --

24 VICE CHAIRMAN THOMAS: And so when you
25 walked away, when you walked away, it hadn't fallen.

1 So if someone builds a building and it
2 didn't fall down when they walked away but it did
3 after they left, with more than two decades of
4 dedication to that structure? I don't -- I mean,
5 obviously, I'll -- I'll better appreciate it as we go
6 along, and I've got a lot of specific questions,
7 Mr. Chairman, but at this point I'll reserve my time.

8 CHAIRMAN ANGELIDES: All right. Thank you,
9 Mr. Vice Chairman. Ms. Murren?

10 COMMISSIONER MURREN: Thank you.

11 EXAMINATION BY COMMISSIONER MURREN

12 COMMISSIONER MURREN: I have maybe two
13 observations and then some questions.

14 Number one is Citigroup has a very large
15 and a number of extremely talented fundamental
16 analysts, both in the equity research department and
17 in fixed income. So the notion that the four of you
18 were unable to determine the value of underlying
19 securities because you relied completely on a
20 financial model is somewhat disingenuous.

21 The bottom line is there is fundamental
22 ability to determine whether assets are risky or not.
23 So I think that, you know, the notion that somehow
24 it's all about the model is a little bit disingenuous.

25 And then, to follow on to that, you know,

1 the other thing that's a little disingenuous is the
2 notion that you didn't get paid in 2007.

3 I mean, let's face it, those things that
4 were -- those decisions that were made in the earlier
5 years are ultimately what led to what happened, so to
6 some degree you do bear responsibility for that.

7 The line of questioning that I'd like to
8 pursue, though, is one that I'm very focused on, and
9 that is regulation, and then secondarily,
10 compensation, but not so much the amount of
11 compensation; to me that's almost secondary; it's
12 really how you got paid, which relates to the amount
13 of risk that you're willing to take and the way in
14 which you approach it; what are your timetables. My
15 guess is they were annual.

16 But, to begin with, I'm interested in each
17 of you commenting on your interactions with the
18 regulators. Could you please talk a little bit about,
19 number one, your understanding of risk-focused
20 regulation and what that meant to you personally in
21 managing your areas? Mr. Maheras, if you could start?

22 MR. MAHERAS: Sure. My interaction with
23 the regulators was most frequently with the OCC. And
24 then, I would say, the Fed would follow that. Other
25 regulators, the frequency was much, much lower.

1 And the interaction with the regulators was
2 around business conditions, business strategies,
3 planning, risk-management-type topics. They were
4 appropriately focused, consistent with the independent
5 risk management group of the firm and the management
6 of the firm; appropriately focused on ensuring
7 alignment of independent risk with business products;
8 they were particularly focused on these meetings,
9 particularly focused on new products; ensuring that
10 new products enjoyed internally an infrastructure,
11 systems technology, risk management, financial
12 accounting and all that was on par with or could keep
13 up with fast business growth, again, particular in the
14 new areas. That's my recollection of interaction with
15 the regulators.

16 COMMISSIONER MURREN: How often did you
17 interact with them, and to what extent was part of
18 your responsibility an awareness that the regulatory
19 division that supervised the investment bank also had
20 a responsibility to convey information to the Federal
21 Reserve that related to the safety and soundness of
22 the bank holding company?

23 How keenly did you think about that on a
24 regular basis, and to what extent was it factored into
25 your business decisions, either in terms of those

1 things you chose to approach, or when we get to the
2 next question, how did that factor into your
3 compensation?

4 MR. MAHERAS: I -- I can -- I can answer
5 part of that. I -- I -- I would say that I can defer,
6 also, to members of the panel here who would have had
7 much more interaction with the regulators.

8 The -- to my eyes, there was -- I'm sorry,
9 can you repeat the first part of your question,
10 Commissioner?

11 COMMISSIONER MURREN: If you look back at
12 your interactions with the regulators, to what extent
13 were you personally aware of the fact that your
14 division needed to represent information to the
15 holding company regulators that would affirm or not
16 the safety and soundness of the overall enterprise?

17 MR. MAHERAS: We were keenly aware of that
18 as a topic. The framework was built around the safety
19 and soundness of the institution. Capital measures
20 were built around ensuring that we met safety and
21 soundness standards and certainly rating standards as
22 well. So we were keenly aware of that imperative.

23 COMMISSIONER MURREN: And did you feel that
24 the regulators did an adequate job of supervising your
25 activities and evaluating the risks that you were

1 exposed to?

2 MR. MAHERAS: Well, I think we in the
3 industry and the regulators, missed this particular
4 aspect of risk management. We were -- we were
5 negative on subprime, as a matter. We were, from the
6 very earliest part of `07 and the end of `06, we were,
7 in most of our business areas, reducing our risk
8 around subprime.

9 What we're trying to convey here is that we
10 were not focused on those areas, logically not focused
11 on those areas where we all believed the system-wide,
12 that these -- these securities were safe enough to
13 withstand very significant pressure.

14 We weren't sitting there twiddling our
15 thumbs and assuming that housing could never go down.
16 We had in our base case that housing was going down
17 during `07 and would likely continue.

18 But what it took to lose money in these
19 securities where we took the most pain, what it took
20 was a very significant step function down in housing
21 prices, which was, unfortunately, well outside our
22 sights and our frame of reference. I'm sorry.

23 COMMISSIONER MURREN: Do you think that you
24 would have been more focused on that aspect of it if
25 the formula or at least the basis for how everyone

1 gets compensated at your firm were less related to
2 revenue growth, return on equity, which by definition
3 means that you would want to be levered, and earnings
4 per share growth, which, of course, is what will
5 likely drive the stock price; if there were more of an
6 orientation internally, towards evaluating risk and
7 being able to handicap that as opposed to growth?

8 MR. MAHERAS: Well, I -- I can't accept the
9 premise of the question that there was not more.
10 There was a very, very significant internal focus on
11 risk. I -- I -- you correctly point out that
12 compensation constructs were generally, you know,
13 significantly correlated to the performance, the
14 bottom line performance, of the business.

15 But I don't believe that there was a lack
16 of focus on risk. I think that to the contrary, I
17 think Citigroup probably had the largest risk
18 management infrastructure in the business.

19 COMMISSIONER MURREN: Bigger isn't better.

20 MR. MAHERAS: We missed -- we missed
21 something. We missed something. And the senior-most
22 securities, after having appropriately recognized that
23 the housing as an asset class was coming down some,
24 appropriately recognized and acted accordingly by
25 reducing our risk in the junior areas, the risky

1 areas, those areas that were perceived to be risky or
2 that could have some risk.

3 We were actively engaged and successful at
4 reducing risks all over the firm. There was one
5 place, and it was that place that was furthest from
6 our focus, unfortunately, with the benefit of
7 hindsight, where we took a loss.

8 But risk management was at all times
9 incredibly prioritized and consumed a lot of our time
10 and focus.

11 COMMISSIONER MURREN: You each actually
12 observed in your testimony that you thought your risk
13 management practices were excellent. That has not
14 been necessarily the opinion of outside observers.

15 Perhaps, if you could comment on that,
16 Mr. Bushnell?

17 MR. BUSHNELL: I would be happy to weigh
18 in, and I might also follow on with a question that
19 you asked about the regulatory interface because
20 they're sort of combined.

21 I'm confident that amongst the panel
22 members, I had the most interaction with regulators
23 around the world. My interactions with them were
24 daily. And that was a combination of regularly
25 scheduled briefings on a periodic basis, weekly,

1 monthly, quarterly, to ad hoc calls.

2 And they were worth, if you will, the
3 alphabet soup, everywhere from the OCC to the Fed to
4 the FSA in London to the FSA in Japan to the Hong Kong
5 monetary authority, all of the regulatory authorities
6 that we dealt with, so I would be happy to follow up
7 on that.

8 The linkage in the question is we had
9 feedback from the regulators themselves. I didn't
10 have any indication during my tenure in 2003, 2004, at
11 these periodic meetings or in their annual reports to
12 the board of directors about risk management that
13 there were inadequacies and that we were second-rate
14 in our risk management in comparison to their peers.

15 Indeed, we had other instances, in certain
16 areas, that felt that we were ahead of our peers.

17 COMMISSIONER MURREN: Could you talk a
18 little bit about those meetings? And their way of
19 expressing it is risk-focus -- risk-focused
20 regulation, which really is an evaluation of your
21 internal controls and internal communication with
22 regard to risk.

23 In your opinion, was that an effective way
24 to measure the risk at your firm?

25 MR. BUSHNELL: I think that based upon the

1 base fundamental, and I know we don't like to keep going back to
2 these model, I think the framework of risk, everything
3 from its independence, its structure, the usage of
4 limits and policies, is the right way to go.

5 The fundamental area that we missed and I
6 think the regulators missed etcetera, Tom said we
7 stressed real estate losses. We stressed them to what
8 had been not seen, you know, in history, but we still
9 didn't stress them enough.

10 And that was at the baseline of all of
11 this. So I think that that's why, in my testimony, I
12 tried to indicate that our method of analysis was
13 wanting.

14 And, indeed, the -- if I could, I'd like to
15 get one thing across to the Commission, the usage of
16 statistical models, without stress tests and thinking
17 of things that have never happened before as part of
18 those stress tests is important.

19 COMMISSIONER MURREN: And in that -- those
20 conversations with the regulators, were they asking
21 questions about the underlying asset classes, or were
22 they simply asking questions about the methodology of
23 your modeling?

24 MR. BUSHNELL: Both.

25 COMMISSIONER MURREN: And did they look at

1 the CDO business?

2 MR. BUSHNELL: They did. They looked at
3 the structured finance business, of which the CDO
4 business was a part.

5 COMMISSIONER MURREN: And at any point were
6 the underlying assets tested as part of that or,
7 again, was it really just an evaluation of your risk
8 modeling?

9 MR. BUSHNELL: I don't know what their
10 internal -- we saw reports off that, but I don't know
11 if they did any of their own stress testing, if you
12 will, of those positions.

13 COMMISSIONER MURREN: But that wouldn't be
14 stress testing. It would actually be going into the
15 portfolio and looking at the assets as opposed to
16 determining if there's an event that's cataclysmic
17 that would affect the whole asset class; is that not
18 right?

19 MR. BUSHNELL: Yes.

20 COMMISSIONER MURREN: So there was none of
21 that type of thing?

22 MR. BUSHNELL: I -- I -- I don't know what,
23 in their work papers and in their examinations, what
24 they looked at specifically. I saw the -- a final
25 report, if you will, of these areas, but I don't know

1 what -- what detail they went into in coming up with the
2 summarizing report.

3 COMMISSIONER MURREN: In those final
4 reports, what was the conclusion?

5 COMMISSIONER HENNESSEY: My recollection
6 was that there were no major findings in the credit
7 structuring business. There may have been certain
8 instances, though, of what I would call minor issues,
9 but nothing major off of that.

10 COMMISSIONER MURREN: Thank you.

11 CHAIRMAN ANGELIDES: That's it? All right.
12 Mr. Wallison?

13 COMMISSIONER WALLISON: Thank you,
14 Mr. Chairman.

15 EXAMINATION BY COMMISSIONER WALLISON

16 COMMISSIONER WALLISON: Let me make a
17 couple of prefatory remarks. Everyone knew that the
18 bubble was going to deflate. Many bubbles had
19 occurred in the past, and then they deflated, but no
20 bubble's deflation ever caused a worldwide financial
21 crisis.

22 Even assuming that the Great Depression
23 wasn't a deflation of a bubble. So I'm not going to
24 cast blame when something completely unprecedented
25 happens that is not only -- not only not within the

1 experience of the people who confronted it and were
2 involved in it, but was not within the experience of
3 anyone alive today.

4 So I want to just, with that prefatory
5 remark, I would like to just talk about what was known
6 at the time. I'll start with you, Mr. Dominguez, and
7 then move across.

8 You referred to what happened as a
9 cataclysmic and unprecedented event. And I don't
10 think anyone can doubt that. Did you know how many
11 subprime and Alt-A mortgages were outstanding at the
12 time in 2007 when you were creating CDOs and marketing
13 them?

14 MR. DOMINGUEZ: Were outstanding in the
15 market?

16 COMMISSIONER WALLISON: Outstanding in the
17 market, exactly.

18 MR. DOMINGUEZ: No.

19 COMMISSIONER WALLISON: Do you have a guess
20 of how many were outstanding?

21 MR. DOMINGUEZ: I'd say 200 billion
22 subprime and another --

23 COMMISSIONER WALLISON: Okay. Would it
24 have made any difference to you, in terms of knowing
25 what the risks were, if you knew that half of all

1 mortgages outstanding in 2007 were subprime and Alt-A?

2 When I say half of all mortgages
3 outstanding, we're talking about over 4 trillion
4 dollars in mortgages, almost 5 trillion dollars in
5 mortgages, would that have made a difference in terms
6 of what you could imagine would happen?

7 Now, it might not have been your business
8 to understand that, but I think what it does is
9 suggest that a cataclysmic and unprecedented event is
10 not so far off the radar screen in a situation like
11 that. I'll address this question to all of you, but I
12 just want to go back to Mr. Dominguez with a couple of
13 other questions and details about CDOs, if you don't
14 mind.

15 Why was it necessary to have a super senior
16 tranche in a CDO?

17 MR. DOMINGUEZ: Well, the super senior
18 tranche is the most senior tranche.

19 COMMISSIONER WALLISON: Right.

20 MR. DOMINGUEZ: It's called super senior
21 simply because there's another tranche below it, and
22 it is senior to that tranche, and that happens to be
23 rated Triple-A.

24 COMMISSIONER WALLISON: Right. Let me
25 rephrase it, then. There are a whole series of

1 tranches.

2 MR. DOMINGUEZ: Yes.

3 COMMISSIONER WALLISON: And the ones that
4 were generally sold to the public were Triple-A and
5 then Double-B and so on down?

6 MR. DOMINGUEZ: Yes.

7 COMMISSIONER WALLISON: And then there was
8 an equity piece at the very bottom, which, in fact,
9 was the riskiest piece of all, and someone even bought
10 that because there was a lot of profit associated with
11 it if everything worked out.

12 I don't understand the economics, the
13 financial economics yet of why it was necessary, and
14 it seems to have been necessary, to have created a
15 piece at the top that was super senior that were
16 superior to the ones that were actually marketed to
17 investors. I'm talking about the economics of the
18 business. Why -- why was that necessary?

19 MR. DOMINGUEZ: It wasn't necessary.
20 Some -- some -- some transactions had senior pieces,
21 super senior pieces, that were marketed to conduits
22 and other -- other investor categories. As I
23 mentioned before, there's a specific program called
24 the liquidity put program that was specifically
25 designed --

1 COMMISSIONER WALLISON: Let me stop you
2 there. My time, of course, is limited. So it was
3 done because this was something from Citi's business
4 that it wanted to do; it wanted to hold those super
5 seniors; is that right?

6 MR. DOMINGUEZ: On that program, yes.

7 COMMISSIONER WALLISON: Okay. As you
8 described it, the CDO consisted of more than just
9 mortgages; am I correct about that? Other assets were
10 included in some of these CDOs?

11 And what were those assets, and why were
12 they included, and were those the sorts of things that
13 were demanded by investors?

14 MR. DOMINGUEZ: Well, in my statement, what
15 I said was that there's -- there's several kinds of
16 CDOs, RMBS pools. Securitized RMBS pools are but one
17 type.

18 COMMISSIONER WALLISON: Right.

19 MR. DOMINGUEZ: So there's collateralized
20 loan obligations, there's CDOs made up of Tier 1
21 capital securities from middle market banks; there's
22 middle market loans. And so there are various
23 investor types that tend to gravitate towards specific
24 types of CDOs. There are those investors who only buy
25 RMBS CDOs, and there are investors who only buy

1 collateralized --

2 COMMISSIONER WALLISON: Were there mixed
3 CDOs, that is, consisting of residential
4 mortgage-backed securities plus other kinds of
5 asset-backed securities? Were they mixed in any way?

6 MR. DOMINGUEZ: The -- the -- the
7 percentage limitations, which defined in the
8 transactions, which defined the eligible collateral
9 securities, allowed for several asset classes. And
10 the asset classes that were allowed was determined in
11 negotiations with the investors.

12 COMMISSIONER WALLISON: Okay.

13 MR. DOMINGUEZ: Who indicated to us --

14 COMMISSIONER WALLISON: I understand. So
15 this was marketing -- marketing, and the investors
16 wanted certain kinds of assets on their balance
17 sheets, and you accommodated them by creating those
18 pools --

19 MR. DOMINGUEZ: That's right.

20 COMMISSIONER WALLISON: -- that they
21 wanted. Okay.

22 Did your potential customers care whether a
23 CDO they purchased was synthetic or not?

24 MR. DOMINGUEZ: Some investors didn't.
25 What -- what -- what happened in the marketplace, the

1 synthetic ABS CDO and the cash ABS CDO developed
2 somewhat independently, but by 2005, 2006, those
3 markets were converging as investors -- many investors
4 were reasonably agnostic to how they got that
5 exposure.

6 What they were interested in and the
7 investors we dealt with -- the institutional investors
8 we dealt with wanted to take certain exposures to the
9 asset class. And many of them, whether it was
10 synthetic or cash form, were agnostic to that; some
11 weren't.

12 COMMISSIONER WALLISON: Okay. Mr. Barnes,
13 I have questions for you.

14 How many subprime and Alt-A mortgages did
15 you think were outstanding before what you call the
16 unprecedented -- unprecedented events in 2007? Did
17 you know?

18 MR. BARNES: On a relative basis, I thought
19 it represented around 15 percent of the total
20 residential mortgage -- residential real estate
21 market.

22 COMMISSIONER WALLISON: There was obviously
23 a widely held view that there could not be a
24 disastrous fall in house prices, such as occurred in
25 2007 and subsequently.

1 Would there have been such a view if people
2 had known, at least in your view, if people had known
3 that almost half of all mortgages in the financial
4 system were subprime and Alt-A?

5 MR. BARNES: I think clearly the fact that
6 an increasing amount of mortgages were
7 subprime-related. And what became clear, in
8 retrospect, was the underwriting standard associated
9 with those was definitely substandard.

10 But at the same time, even given a decline
11 in house prices, given the various levels of
12 subordination provided by the underlying mortgages,
13 the RMBS that was actually backed by those mortgages,
14 and the CDOs that were backed by the RMBS, certainly
15 the -- the consensus within the firm as well as across
16 the industry of the market participants was that
17 the -- the likelihood of losses hitting the super
18 senior was extremely remote.

19 COMMISSIONER WALLISON: Okay. You said
20 that after the events of 2007, it was necessary to
21 change the methodology for valuing super senior CDOs.

22 And you called -- you used something you
23 called an intrinsic cash flow method evaluating CDOs
24 and the underlying collateral.

25 Please explain how this was done as

1 concisely as you can?

2 MR. BARNES: Basically the I -- the --
3 the -- the methodology was to look at the underlying
4 residential mortgage-backed securities that backed the
5 CDO and look at common loan characteristics within
6 each of those RMBS.

7 And we effectively used some kind of
8 historical regression model. But based on certain
9 input assumptions, which were judgmental, tried to
10 predict what the timing and level of defaults were, as
11 well as the severity of losses.

12 And this is a very iterative process and
13 one challenged by the fact that 2007 was still
14 extremely out of sample with what we had experienced
15 historically.

16 And so even developing this much more
17 sophisticated model that looked through the CDO
18 through to the underlying collateral, and even through
19 the RMBS to various -- the various loan pools and
20 allocating them into -- into buckets that had similar
21 features, that was -- it still was not a very good
22 predictor of future defaults, delinquencies, defaults.

23 COMMISSIONER WALLISON: Right, I understand
24 that part, but what is an intrinsic cash flow system
25 of methodology for --

1 MR. BARNES: What it -- what it really did
2 was by looking through to the loans and looking at the
3 RMBS and the priority of payments that exist within
4 the RMBS structure, according to the performance of
5 the underlying loans, the forecasted performance, the
6 model then looked at how those cash flows, whether
7 they were a hundred percent of the --

8 COMMISSIONER WALLISON: And then you
9 discounted -- you knew what the cash flows were, and
10 then you discounted them in some way?

11 MR. BARNES: Well, first, we had to
12 actually wash them through the RMBS waterfall --

13 COMMISSIONER WALLISON: Yes.

14 MR. BARNES: -- in terms of the various
15 tranches.

16 COMMISSIONER WALLISON: Right.

17 MR. BARNES: -- and then, to the extent
18 that there was CDO, which was referencing those RMBS,
19 we then went through that process again, and then that
20 effectively came up with what -- what in -- what, in
21 the firm's opinion, was a sort of an expected future
22 value of those cash flows. And then we had to
23 discount them using some discount.

24 COMMISSIONER WALLISON: And -- and did your
25 auditors approve that?

1 MR. BARNES: We went through a rigorous
2 process, including a review of the assumptions, a
3 review of the -- a review of the model itself and that
4 process was, frankly, a challenge because of us being
5 so out of sample and relying on input switch couldn't
6 really be properly validated or verified in the
7 marketplace.

8 But the decision was made that in the
9 absence of an observable market to actually assess the
10 fair value of these securities, that was a decision
11 that was made by senior management, by finance and
12 risk.

13 COMMISSIONER WALLISON: With the auditors?

14 MR. BARNES: I'm sure. I wasn't involved
15 in the discussions with the external auditors, but
16 certainly that model or an early version of it was
17 included in the initial substantial losses that were
18 taken and that were included in eight phase in the
19 fourth quarter of `07.

20 COMMISSIONER WALLISON: All right, thank
21 you very much.

22 Mr. Maheras, the losses on the CDOs were
23 large, as we know, but as you point out, the whole CDO
24 business was only 2 percent of the revenue of the
25 investment bank that you were running.

1 Incidentally, investment bank was a
2 mythical idea, was it not? I mean, there wasn't an
3 actual entity? All of Citi's operations were divided
4 among a commercial bank, an investment bank, and a
5 consumer bank, as I recall.

6 So you had a whole lot of different
7 entities under the investment bank no matter where
8 they were in the unit. Correct me if I'm wrong about
9 that. But then the question I want to ask is, the
10 investment bank, did it have a profit?

11 And although there was severe losses in
12 case -- in the case of the CDOs if you include over a
13 trillion dollars in assets that were in the investment
14 bank, was that a profitable investment for the bank?

15 MR. MAHERAS: I'm sorry, you're asking if
16 the CDOs --

17 COMMISSIONER WALLISON: The entire -- the
18 entire operation under your control, 1.X trillion
19 dollars in Citigroup assets, was that ultimately
20 profitable despite the losses on the 2 percent of
21 revenue that the super senior CDOs represented?

22 MR. MAHERAS: Let me clarify, the under
23 2 percent number is the number that would represent
24 revenues from the CDO business in 2006.

25 COMMISSIONER WALLISON: Mm-hmm.

1 MR. MAHERAS: It was an under 2 percent
2 number. In 2006, the investment bank, for which I was
3 co-head of, had a 7 -- a little over 7 billion dollars
4 of after-tax net income performance, so it was very
5 profitable.

6 In 2007, by the end of the year, I don't
7 know exactly what -- what the performance was. At the
8 time I left, we were -- we were profitable on a
9 year-to-date basis through the end of the third
10 quarter at around 4 to 5, around 5 billion dollars
11 after-tax net income.

12 COMMISSIONER WALLISON: Okay.

13 MR. MAHERAS: The losses that were
14 suffered, which were substantial, were in the fourth
15 quarter.

16 VICE CHAIRMAN THOMAS: Mr. Chairman?

17 COMMISSIONER WALLISON: Thank you very
18 much.

19 VICE CHAIRMAN THOMAS: Mr. Chairman, I
20 yield Commissioner Wallison another five minutes.

21 COMMISSIONER WALLISON: Oh, thank you very
22 much. I actually don't think I'll need all of that,
23 but I appreciate it.

24 CHAIRMAN ANGELIDES: We'll pick up what you
25 leave on the table.

1 large number, that we've never had anything remotely
2 like that.

3 MR. BUSHNELL: I think that we knew in our
4 research areas and in outside services, such as Case
5 Schiller, that we employed in risk management, that
6 the proportion of mortgages that were both being
7 originated and in the totality of the mortgage market
8 was -- was favoring subprime, you know, it was
9 increasing in that.

10 What -- what we still didn't appreciate,
11 and none of those outside experts appreciated, was the
12 risk that that provided, again, how much of a -- back
13 to the -- back to the loss scenarios that would have
14 said that means you should not double historical
15 losses but triple historical losses. I don't think
16 that pitch was made, Commissioner.

17 COMMISSIONER WALLISON: Thank you very much
18 and thank all of you.

19 CHAIRMAN ANGELIDES: Thank you very much,
20 Mr. Wallison. And Mr. Georgiou?

21 COMMISSIONER GEORGIU: So many questions,
22 so little time. Let me -- let me start, if I can,
23 just about the CD -- CDOs.

24 Mr. Maheras, I think that maybe there was a
25 misunderstanding with regard to this 2 percent number.

1 The way I saw it is you were, at one point, you said
2 that the 43 billion dollars was only 2 percent of
3 Citi's two-trillion-dollar balance sheet. Did you
4 mention that or did somebody --

5 MR. MAHERAS: Actually, that --

6 MR. BUSHNELL: That was in my --

7 COMMISSIONER GEORGIOU: That was
8 Mr. Bushnell?

9 MR. BUSHNELL: Yes.

10 COMMISSIONER GEORGIOU: Right. Okay.

11 And -- but of course that would be just the balance
12 sheet that was reported on the balance sheet; that
13 wouldn't be taking in any of the other assets that
14 were off?

15 MR. BUSHNELL: Right. It would have been a
16 less even a smaller component of what we would have
17 thought of as our risk balance sheet, our exposure
18 balance sheet.

19 COMMISSIONER GEORGIOU: Right.

20 MR. BUSHNELL: Not just our gap balance
21 sheet.

22 COMMISSIONER GEORGIOU: And these CDOs, you
23 know, I -- we're all here; we're not experts in this
24 area; we're learning. You know, I try to understand
25 it. You've got -- basically you take, as I understand

1 it, you take in an RMBS CDO you take a whole bunch of
2 Triple-B-rated mezzanine tranches from RMBS bonds and
3 then you slice up the cash flow streams to create the
4 CDO.

5 And in the model that we have here, you end
6 up with 60 percent of the resultant CDO tranches being
7 rated Triple-A-plus super senior, 20 percent Triple-A,
8 6 percent Double-A, 5 percent A, 2 percent Triple-B,
9 2 percent Double-B, and 5 percent equity.

10 So, 91 percent of the result is rated at A
11 or above and 80 percent of it is rated Triple-A or
12 Triple-A-plus.

13 Now, I guess I would just ask that I know
14 that all of you have said that the financial crisis
15 con- -- the occurrence of the drop in all the housing
16 prices, which ended up impacting mortgages which
17 underlie the RMBS and then effectively also the CDOs,
18 wasn't -- wasn't comprehensive, wasn't really
19 contemplatable at the time or wasn't within your risk
20 models.

21 But doesn't anyone question whether you can
22 effectively do what I would liken to sort of the
23 medieval alchemy, where you're taking base metals,
24 lead, Triple-B-rated tranches of mezza- -- of RMBS,
25 and slicing and dicing them and ending up with

1 products that are essentially senior and super senior,
2 Triple-A and Triple-A-plus, turning them into gold.

3 I mean, doesn't anyone wonder whether
4 that's possible and whether that the -- there ought to
5 be some question as to the legitimacy of the ratings
6 that resulted in those tranches? Did that ever occur
7 to you, Mr. Barnes, for example?

8 MR. BARNES: I mean, certainly looking at
9 the -- the level of subordination, you know, the way
10 you described it, you know, intuitively, if it's new
11 to you, it does seem quite extreme.

12 Having said that, you know, our assumption
13 was that these securities were being packaged by loans
14 which were diversified across the country. The -- the
15 country -- not all of the country had the degree of
16 price appreciation and the subsequent correction that
17 the likes of California and Las Vegas and some of the
18 other parts of the states have, you know, has been
19 well -- well publicized.

20 And we looked to the -- the -- the credit
21 enhancement provided on the actual mortgage itself the
22 5 percent first loss protection, which is provided by
23 the residual piece on the RMBS, will be the equity, as
24 you just described it.

25 COMMISSIONER WALLISON: Right.

1 MR. BUSHNELL: And then the additional 30
2 to 50 percent, well, let's say 40 percent, that was
3 effectively provided -- provided a further degree of
4 credit enhancement from the tranches beneath the super
5 senior. Now, in retrospect, you know if --

6 COMMISSIONER GEORGIOU: Well, but -- but
7 wait a second. No, the super senior was 60 percent,
8 the Triple-A was 20 percent. I mean, the resultant
9 security had 93 percent that was rated either Triple-B
10 or above; that is, the constituent securities you were
11 working with, Triple-B tranches of mezzanine,
12 mezzanine securities, as I understand it, and then you
13 were -- you were change -- taking the cash flows and
14 assigning them to other tranches that were rated
15 differently, in the resultant CDO.

16 Not -- setting aside, for the moment, the
17 synthetic CDOs. But I guess all I'm trying to say,
18 and, again, I don't want to spend all of our time
19 analyzing how it is that the CDOs were constructed,
20 but it's not so implausible, is it, that a structure
21 like this, which becomes ever more complex, which is a
22 security-structured from a pool of other securities
23 that have already been structured and which you're, of
24 course, making a structuring fee, presumably 50 basis
25 points or 200 basis points, depending on the deal, so

1 you're taking that off the top, that the resultant
2 product might not perform as well as characterized,
3 that is, 60 percent of it being Triple-A-plus, so
4 essentially risk-free.

5 And -- and I want to focus on the capital
6 behind it, because one of the questions that I asked
7 Dr. Greenspan this morning, and which I would -- which
8 I also reiterate to you, is that -- and I'm not trying
9 to pick just on Citi, because a lot of people did
10 this. I mean this is not -- it just happens that
11 you're here today talking about Citi, but this has
12 happened throughout the industry. Part of the reason
13 why this was done, as we understand it, is that the --
14 the liquidity puts per the super senior tranches you
15 essentially had to hold no capital for.

16 The -- the -- there's -- we had an
17 interview with a senior person from the -- our staff
18 did -- from the -- the deputy director of the Division
19 of Banking Supervision and Regulation at the Federal
20 Reserve Board who said that the trade, if these were
21 held in trading assets, as I understand some of them
22 were, that you effectively had to hold almost no
23 capital. The leverage ratio was as much as 750 to 800
24 to one.

25 And that -- and the liquidity puts, as

1 opposed, for example, to a stand -- an actual direct
2 letter line of credit that would stand behind
3 commercial paper customarily, you would have to have
4 capital for on your balance sheet of the bank.
5 Whereas, if you did it with the liquidity puts, there
6 was essentially no capital required.

7 Can anybody speak to that, or was that a
8 factor in your decision making in moving into the CDO
9 market so aggressively?

10 MR. DOMINGUEZ: No. There was not a
11 factor. The amount of capital that the liquidity put
12 program or other programs used within kind of broad
13 ranges was not a determining factor.

14 We weren't out to minimize number -- the
15 amount of capital or anything of that nature.

16 COMMISSIONER GEORGIU: Well, of course,
17 the capital really wasn't the capital of the
18 investment bank, right, because the liquidity puts
19 were provided by the bank.

20 MR. DOMINGUEZ: The bank.

21 COMMISSIONER GEORGIU: So, the losses that
22 were suffered, were suffered on the bank's P&L when
23 they had to honor the liquidity puts; isn't that
24 correct?

25 MR. DOMINGUEZ: No. I don't believe that's

1 the case. When -- when the program -- when commercial
2 paper stopped rolling, when the A and B commercial
3 paper markets actually disappeared --

4 COMMISSIONER GEORGIU: Right.

5 MR. DOMINGUEZ: -- the features of that
6 program were that you would automatically create a --
7 I believe it was a ten-year note of Libor plus 40, and
8 that went into the broker-dealer.

9 COMMISSIONER GEORGIU: So you had to
10 write -- so you had to take losses in the
11 broker-dealer?

12 MR. DOMINGUEZ: Yes.

13 COMMISSIONER GEORGIU: On that note?

14 MR. DOMINGUEZ: Yes.

15 COMMISSIONER GEORGIU: And I guess that
16 goes back to a question that was raised earlier. I
17 mean, I don't know where, within the bank, the bank
18 and the broker-dealer, where the losses, ultimately,
19 from all of this write-down went.

20 But of course your compensation was based
21 on the production of these among other -- other
22 securities that produced during those years.

23 And, of course, when they were written
24 down, there were no clawbacks that were -- were
25 enforced against anyone taking back any of the money

1 that was made based on the revenues that came from
2 these CDOs that were written down; isn't that correct?

3 MR. DOMINGUEZ: That's correct.

4 COMMISSIONER GEORGIU: Okay. And do you
5 think that there might have been -- I guess I'm
6 trying -- you know, Alan Greenspan told us today that
7 he felt that one of the major problems was that there
8 was inadequate capital and inadequate liquidity in the
9 system at essentially all of the bank holding
10 companies and financial holding companies throughout
11 the system, that all of which either -- most of which
12 either failed or would have failed but for the
13 infusion of extraordinary taxpayer capital, which is,
14 after all, our charge here is supposed to be to
15 investigate all of those institutions.

16 So could you -- do you think that an
17 increased capital requirement at the investment bank
18 would be a significant deterrent to doing any of these
19 activities that got you into trouble? Maybe,
20 Mr. Maheras, maybe you could address that?

21 MR. MAHERAS: There's certainly a
22 connection between capital requirements and the amount
23 of business a business entity's going to conduct. But
24 with or without a specified amount of capital required
25 at the actual underlying security level, the bank is

1 still operating within constraints, overall leverage
2 ratios, Tier 1 ratios, or a whole mix of myriad of
3 different capital ratios.

4 But to be fair to your point, if you had
5 higher capital requirements across the board, across
6 all the activities, you would have had a lesser
7 overall balance sheet in the industry and you would
8 have probably seen less of the -- the ebullience that
9 built up over a couple of years.

10 You know, one thing that probably hasn't
11 come across is people weren't creating these
12 securities and just trying to find a way to sell them.
13 This wasn't, you know, the perception of Wall Street
14 of old, you'd create products and you'd find a way to
15 sell them.

16 The businesses evolved over the last five
17 to ten years to one where the investor classes have
18 grown so large, and their demand for yield and their
19 demand for securities with specific yield
20 characteristics drove a lot of this activity.

21 They -- they -- they drove Nestor's
22 business to create products, because they had a bid
23 for some of those underlying tranches, leaving Nestor
24 with a piece or two to then sell on the aftermarket.
25 But the -- the -- the --

1 COMMISSIONER GEORGIU: But the --

2 MR. MAHERAS: The availability of liquidity
3 and financing to purchase those things with investors
4 coupled with the fact that regulatory capital
5 requirements in some asset classes, with the benefit
6 of hindsight, were a little low --

7 COMMISSIONER GEORGIU: Right.

8 MR. MAHERAS: -- you know, conspired to --
9 to probably exacerbate the problem.

10 COMMISSIONER GEORGIU: But weren't they --
11 weren't the investors buying principally the ones that
12 had nice yield, the more -- the lower-rated tranches,
13 really, within the CDOs?

14 MR. MAHERAS: Well, you had all different
15 types of investors. Insurers were focused on, and
16 some of these conduits Nestor talked about, and
17 re-insurers were focused on the senior-most, the
18 super senior and Triple-A's.

19 COMMISSIONER GEORGIU: Right.

20 MR. MAHERAS: You had asset managers
21 focused on the Double-A's, and Triple-A's, and
22 Single-A's, and Triple-B's. You had hedge funds
23 focused on Triple-B's and --

24 COMMISSIONER GEORGIU: And equity.

25 MR. MAHERAS: -- and equity. So you had

1 the full array of investor types across the ratings
2 spectrum of these various structures.

3 COMMISSIONER GEORGIU: Right. But when
4 you talk about the 25-billion-dollar liquidity put
5 program, that was -- those were securities that were
6 super senior that you didn't sell to anybody that you
7 effectively moved off your balance sheet because, you
8 know, they were off in a -- in a -- in a special
9 investment vehicle, with special purpose vehicle
10 off-balance-sheet, right?

11 And basically no risk was attributed to
12 them because the risk, the liquidity put risk, the 25
13 billion dollars that was ultimately paid was paid by
14 the bank itself.

15 MR. DOMINGUEZ: Well, yes, there --
16 there -- there was risk attributed to them, and you
17 can see in the documents provided to the staff where
18 the -- the notional amount of the super senior related
19 to the liquidity put is itemized.

20 So we've always looked at the risk as if
21 they were on balance sheet even though the liquidity
22 facility, we call the continued credit facility,
23 didn't -- didn't have to be exercised for it to show
24 up on our balance sheet for --

25 COMMISSIONER GEORGIU: So what was the

1 risk that you attributed to the 25 billion dollars
2 that was ultimately paid for those, to bring those
3 assets back on the balance sheet?

4 MR. DOMINGUEZ: What was the capital?

5 COMMISSIONER GEORGIU: What you say --
6 what -- you did evaluate the risk --

7 MR. DOMINGUEZ: Well, those --

8 COMMISSIONER GEORGIU: How did you
9 quantify the risk.

10 MR. DOMINGUEZ: Well those -- we quantify
11 them in very similar ways.

12 COMMISSIONER GEORGIU: Do you know the
13 amount, by any chance?

14 MR. DOMINGUEZ: I'm sorry?

15 COMMISSIONER GEORGIU: Do you know the
16 amount that you calculated.

17 MR. DOMINGUEZ: Those positions were
18 generally held at par, and there was -- until -- until
19 late 2007. There was a lot of analysis done on those
20 positions and both with respect to looking through the
21 underlying assets and with respect to comparables such
22 as they existed in the market, and they were marketed,
23 I believe, to 10 basis points running.

24 COMMISSIONER GEORGIU: 10 basis points?

25 MR. DOMINGUEZ: Per annum, yeah.

1 COMMISSIONER GEORGIU: Okay. Well, I
2 mean, I guess the other -- the other thing, I guess
3 there is an issue about regulatory -- capital
4 regulatory arbitrage because, as I understand it --
5 I'm sorry, could I have a minute or two more?

6 CHAIRMAN ANGELIDES: You can have a minute.
7 Why don't you take two minutes.

8 COMMISSIONER GEORGIU: The -- the
9 securitization rule was changed in 2001 which addressed
10 some portions of the capital arbitrage system, the
11 rule established risk ratings -- risk weightings based
12 on the credit ratings of each tranche of
13 securitization.

14 And they allowed liquidity puts on
15 asset-backed commercial paper tranches to get a
16 10 percent risk rating resulting in a capital charge
17 of eight-tenths of a percent basically on liquidity
18 puts.

19 And one of the Citi executives to whom we
20 spoke said that Citi made the decision to support the
21 growing CDO business with its own capital because the
22 regulatory capital associated with holding the super
23 senior Triple-A tranches was close to zero.

24 And I wonder, I guess I'm trying to get to
25 what we can do on a go-forward basis in the future

1 here to avoid another meltdown. You know, obviously
2 mistakes were made. You now, all of you, are -- agree
3 that you wouldn't have done -- you wouldn't have
4 invested in those -- created those securities, had you
5 known what was going to happen to them. We all
6 recognize that. The question, I guess, is, on a
7 go-forward basis, to avoid future catastrophes,
8 similar catastrophe, we probably have to change
9 something.

10 So what is it that we're going to change?
11 One -- one -- again, Dr. Greenspan suggested
12 greater -- significantly greater capital and
13 significantly greater liquidity requirements. And
14 a -- an end to this capital arbitrage where, by simply
15 moving assets from one legal structure within your
16 organization to another, from one unit to another or
17 moving it off-balance-sheet, that you could
18 essentially create an opportunity to create a product
19 that doesn't require you to hold any capital against
20 it.

21 So some people have suggested that there
22 should be a principle that the total amount of capital
23 required for a pool of assets should be the same after
24 a securitization as before, and it reduces. It
25 reduces from the point of view of a mortgage down into

1 an RMBS and from an RMBS to a CDO. Do any of you have
2 any thoughts? Mr. Bushnell is shaking his head. If
3 you can respond to that?

4 CHAIRMAN ANGELIDES: By the way, I will
5 yield two additional of my minutes. So therefore try
6 to keep it within Mr. Georgiou's time or he'll be in
7 the penalty box.

8 VICE CHAIRMAN THOMAS: I'll take a minute
9 of that time.

10 CHAIRMAN ANGELIDES: There you go.

11 MR. BUSHNELL: I do have some thoughts on
12 that. I overheard your questioning of Mr. Greenspan,
13 and I think the problem is really twofold.

14 One, there needs to be more capital in the
15 system, and you need to end the opportunities for
16 regulatory arbitrage.

17 I would make a comment that says, as
18 opposed to the reason there is an arbitrage that
19 exists, is because there are multiple regulators. If
20 there were not multiple regulators you could not
21 arbitrage regulatory capital requirements.

22 COMMISSIONER GEORGIU: Right.

23 MR. BUSHNELL: And that more emphasis needs
24 to be placed on, if not having a single purveyor of
25 regulatory capital, at least a complete agreement

1 amongst the various agencies, both in the U.S. and
2 worldwide because some of the --

3 COMMISSIONER GEORGIU: Because you said --
4 you said you dealt a lot with the OCC. And we heard
5 from one of the OCC people who said the following to
6 our staff: The CDO business was managed outside the
7 bank; it changed from an agency business to a
8 principal business, We didn't know that; that's
9 outside of our jurisdiction.

10 Gramm-Leach-Bliley wouldn't let us look
11 into that, yet the bank had these liquidity puts that
12 were not reported in any risk system that we had.

13 Now, that's the OCC examiner talking about
14 this circumstance.

15 So obviously they regarded themselves as
16 constrained by the law from asking you about anything
17 other than, you know, other than what asking the
18 banker, banking people, about your business, really,
19 and so forth, and which is obviously a major problem.

20 And I suspect that really the only issue
21 regarding compensation, which I would toss out just as
22 something to reflect upon, is that if you all had a
23 longer timetable for you to earn your bonuses so that
24 you could track through the process, the creations
25 that you had, to ensure that they didn't crater and

1 ultimately have a clawback that resulted from that
2 cratering, wouldn't that enhance your diligence in the
3 timing and in the -- in the -- in the effectiveness of
4 your -- of your issuance of these securities?

5 CHAIRMAN ANGELIDES: Two final minutes for
6 Mr. Georgiou.

7 COMMISSIONER GEORGIOU: Yeah. Mr. Maheras,
8 could you speak to that?

9 MR. MAHERAS: I -- I don't know that
10 anything would have been different if there were a
11 clawback. I don't think that people put these
12 positions on, you know, arbitraging some compensation
13 scheme.

14 I think -- I don't think there's any issue
15 with, and I think it could be a healthy variant of the
16 compensation construct to possibly use clawbacks more.

17 But I don't know that there would be any
18 difference as it relates to the events of the last
19 couple of years.

20 COMMISSIONER GEORGIOU: Right. I mean, one
21 of the great frustrations to the public, I think, is
22 that you made significant compensation. Nobody
23 begrudges you that compensation if it ultimately
24 produces value for your organization or for anybody
25 else, but what ended up happening is significant

1 losses were suffered and the taxpayers got stuck
2 holding the bag and having to backstop all these
3 institutions.

4 And nobody really, at your level, above
5 your level, below your level, ever had to come out of
6 pocket with any money of their own to backstop the
7 institution for the failures that resulted.

8 And this is what -- if there's one thing
9 that I hear about all the time that angers the
10 taxpayer more than anything else is that there was no
11 consequence to people at your level and in your
12 position for the failures that resulted on your watch.

13 And I just leave you with that reflection
14 and yield the balance of my time. Thank you,
15 Mr. Chairman.

16 CHAIRMAN ANGELIDES: Thank you so much.
17 Let's move on now to Mr. Thompson. I think I'm doing
18 this in the right order.

19 COMMISSIONER THOMPSON: Thank you,
20 Mr. Chairman.

21 EXAMINATION BY COMMISSIONER THOMPSON

22 COMMISSIONER THOMPSON: I guess, if I were
23 to think about this industry, much has been said about
24 the rate and pace of innovation and the inability in
25 many respects to really characterize the risk

1 associated with some of that innovation.

2 One might also argue, however, that
3 innovation in this industry is as much about
4 regulatory arbitrage as it is some unique new product,
5 because it's still, when it's all said and done, a
6 dead instrument that underpins what you're doing in
7 the marketplace.

8 And so my question is, in light of
9 Dr. Greenspan's comments this morning and the current
10 state of the industry, should we be doing more to test
11 new products in some controlled way in this industry,
12 given the systemic and societal risks that are
13 associated with them, just like we do in other
14 industries, where there's huge societal risk with new
15 product introduction, pharma, airlines, I mean, you
16 pick it, so I'll start with you, Tom.

17 MR. MAHERAS: Me?

18 COMMISSIONER THOMPSON: Yes.

19 MR. MAHERAS: Well, to my eyes, there was a
20 lot of testing of new products from the regulators.
21 You know, clearly certain things went wrong. And it
22 could -- I'm not sure what form it would take.

23 I would point out, though, that a lot of
24 things have been done. If you think about the impact
25 of FAS 166 and 167, it forces consolidation back on

1 the balance sheets for a lot of financial
2 intermediaries who may have taken advantage of balance
3 sheet arbitrage or the regulatory capital arbitrage
4 you cited.

5 FAS 166 and 167 recently instituted go a
6 long way towards helping that situation.

7 Increased capital requirements, I can't
8 think, as I sit here, but I would be happy if I have
9 any other thoughts to share them with you in writing
10 at a later point. But I think certain things are in
11 motion that are of substance.

12 COMMISSIONER THOMPSON: Mr. Bushnell, would
13 you comment?

14 MR. BUSHNELL: I think if -- if one wanted
15 to have some sort of further control around a new
16 products process, there are several ways to accomplish
17 that. Most of the institutions, and we can argue,
18 again, observe that they didn't seem to work.

19 But in their own boundaries have a new
20 capital, a new product screening committee, that --
21 that -- and I think Tom mentioned it, that would
22 address a bunch of issues in terms of everything from
23 internal, can we settle it, can we account for it,
24 what's the customer reaction going to be, what's --
25 what are the taxation concerns that our customers

1 might have all sorts of things.

2 MR. MAHERAS: Suitability.

3 MR. BUSHNELL: Suitability for customers.

4 You could conceptually expand that to have, you know,
5 in essence, an agency of the government that would
6 look with those types of disciplines as part of it.

7 Another methodology would simply be to put
8 the tax of extra capital on a new product. You don't
9 necessarily have to have an agency that just says,
10 until this, somebody would have to make a decision
11 that says -- until this product is tried and tested in
12 a time of stress, we're gonna have to acquire an
13 extra -- an excess amount, however you want to define
14 that, of capital for all those who originate it.

15 So I think my comment is I think there are
16 several different ways that if that's thought to be
17 unnecessary adjunct to the regulatory framework, there
18 are several ways to accomplish that.

19 COMMISSIONER THOMPSON: Well, you had a
20 pretty unique view because you were not just chief
21 risk officer, but you were the chief administrative
22 officer. And that would suggest that your purview
23 looked across not just risk but how the organization
24 itself functioned, how does information flow, how does
25 the IT systems infrastructure work, on and on and on

1 and on. And that might suggest that given that Citi
2 is an amalgamation of companies that were brought
3 together over the course of the last 15 years or so,
4 that perhaps we didn't anticipate the stability of the
5 organization and its ability to absorb the combination
6 of market risk and all of the turmoil and stress that
7 might have been going on as you tried to integrate
8 many, many, many entities that you bought over the
9 last 15 or 20 years.

10 In your judgment at this point, should the
11 company have looked for greater organizational
12 stability before it pressed into some of these new
13 markets where the risk was really unknown?

14 MR. BUSHNELL: I -- I -- I don't think so,
15 in that, in the integration process, one of our first
16 things that we required, sort of all new members of
17 the Citigroup family that we acquired or merged with
18 and came involved with, was integrations of risk
19 systems and risk policies that said, you know, whether
20 it was an overseas institution or a domestic
21 institution, I don't care how you were dealing with
22 your risk policies, here's how you will do it on a
23 going-forward basis.

24 So at least from a risk perspective it was
25 one of our primary areas of focus to get integrated as

1 fast as we could. Clearly other areas, as chief
2 administrative officer, areas like technology is a
3 tough one, it -- it takes, I'm sure you're aware, in
4 the business, a long time to get legacy systems and
5 get a consistent methodology for that.

6 But I think we tried to prioritize,
7 therefore, our integration process with special
8 attention to compliance issues, policy issues, risk
9 issues as being the ones that were the most important
10 to get consolidated first, if you will.

11 COMMISSIONER THOMPSON: So let me turn my
12 attention to Mr. Dominguez and Mr. Barnes, for a
13 moment.

14 If you think about risk and you have very
15 scientific models that give you a sense of whether or
16 not a given market or a given product is, in fact,
17 risky to a certain level, I guess the question is, at
18 what point did you or might you have talked to people
19 who were really on the ground, the traders, the
20 analysts, the people who really had a sense of what
21 was going on in the market around these products as
22 you were making your call as to whether or not the
23 business was sound or not?

24 Oftentimes traders will have a much closer
25 insight into what's going on than perhaps someone

1 who's sitting, you know, in your role. So were they a
2 part of your process or not? And how was that
3 incorporated in a model that you yourselves have said
4 was more statistically driven as opposed to human
5 judgment core unit?

6 MR. DOMINGUEZ: So in the process of
7 warehousing and creating an ABS CDO transaction for
8 each piece of collateral, that is, each security that
9 ultimately went into the collateral pool, and there
10 may be 50 to 75 different pieces of collateral or
11 secure -- individual securities in there, we conferred
12 with the secondary trading desk.

13 And because they not only were in the
14 market to see if there was -- they were hearing
15 anything about that underwriter or -- or even that
16 particular transaction, but they could make a judgment
17 on where that piece of collateral was trading relative
18 to the market.

19 So clearly, if it was trading much wider
20 than the rest of the market or much tighter, that
21 always raised bells and whistles.

22 The second part, which you know we haven't
23 talked about here yet, is for each of these CDO
24 transactions there is a third-party collateral manger.
25 And there's two types of CDOs, the static CDOs and the

1 so-called arbitrage CDOs, which was -- is largely
2 Citi's business.

3 And a third-party collateral manager was
4 hired for every transaction. I should say most
5 transactions, so we did some static transactions. And
6 that manager typically was -- had an expertise and
7 track record in the particular asset class of the CDO
8 we were -- we were creating. So -- so as a multi- --
9 we did talk to other people, we talked to other
10 markets, we had --

11 COMMISSIONER THOMPSON: How about the guys
12 that were actually writing the mortgages? I mean,
13 Citi's a conglomerate. It does a little bit of
14 everything. And so you'd have a sense of the quality
15 of what is coming into the hopper if you talk to the
16 guys who were actually originating the paper.

17 MR. DOMINGUEZ: Well, that's true, but our
18 belief was that -- that would be reflected in the
19 market prices. And so that's why that factor was very
20 important.

21 And also the diligence done by the
22 third-party asset managers. And I really need to
23 emphasize that these were very well known, in many
24 cases had longstanding reputations in that particular
25 asset class and managed other portfolios in that asset

1 class, so -- so that was the process.

2 CHAIRMAN ANGELIDES: Mr. Thompson, do you
3 would like some additional time?

4 COMMISSIONER THOMPSON: Yeah, I'm just --

5 CHAIRMAN ANGELIDES: I yield a couple
6 minutes.

7 COMMISSIONER THOMPSON: I'm just struck by
8 the fact that for a lack of a better term, we can hide
9 behind statistical models, and leadership by and large
10 is about intuitive sense and judgment.

11 And at some point somebody had to make a
12 call, independent of what the model produced, and so
13 it just seems odd to me that we'd say, well, our
14 models told us this and therefore this is the way we
15 behave.

16 Where was the intuitive leadership judgment
17 that says something may not be right in this market?

18 MR. BARNES: If I can just comment? And I
19 think on the risk management side, I think working
20 closely with the business, and I think we already
21 viewed ourselves as partners with the business, and we
22 were on the desk interacting with them to a dialogue
23 on a daily basis, I interacted with my counterpart who
24 covered the global securitized markets. This is the
25 market making in -- in -- in subprime RMBS, made sure

1 that we were consistent in terms of our methodologies.
2 As Mr. Dominguez mentioned, while assets were in the
3 warehouse as they were being ramped up ahead of a
4 planned CDO, they were being mark-to-market daily,
5 even though if the securitization went ahead,
6 effectively Citi would recover its cost.

7 But we reflected that mark-to-market
8 volatility through P&L on a daily basis. We relied on
9 market surveillance, everything from our own internal
10 RMBS research or mortgage research department as CDO
11 and CLO research group.

12 And then we also looked at other market
13 indicators, the fact that CDOs were pricey. Recently
14 priced deals were still commanding extremely tight --
15 extremely tight spreads, whether it was from major
16 insurers, the bond insurer's model lines, or other
17 banks not only in the us but also in Europe, who
18 continued to view it as, you know, as extremely safe
19 risk.

20 And then the final thing is that the -- the
21 other thing is while we saw the market deteriorate,
22 the business was actually very proactive at reducing
23 some of the low order risks, some of the first order
24 risks.

25 So in terms of getting rid of more junior

1 tranches accelerating the warehousing process
2 throughout the summer of 2007. And in retrospect, you
3 know, the error, and I know this is starting to become
4 a bit of a broken record, but it was -- the focus was
5 not on the super senior position.

6 And even the super senior positions of the
7 liquidity puts were really only intended to be held
8 temporarily. And the assumption was the market would
9 always be there for that, so that was -- that was my
10 sort of assessment of how we were looking at risk
11 what was admittedly a very fluid situation with the
12 a lot of, you know, significant market volatility. But
13 we -- we -- that was part of our job to rely on that
14 type of market surveillance.

15 COMMISSIONER THOMPSON: All right. So,
16 Mr. Maheras, can you answer that from the business
17 perspective as opposed to the risk management
18 perspective?

19 MR. MAHERAS: I think so.

20 CHAIRMAN ANGELIDES: Let's take -- if we
21 can just take about a minute and a half, at most, I'm
22 only concerned because there's a time we have to get
23 out of here.

24 But, John, I want you to -- I want you to
25 get that. No, Mr. Maheras, please respond.

1 MR. MAHERAS: Okay. I think it's a very
2 good question. You started with the point about the
3 intuitive leadership. And, you know, again, it's
4 probably hard to imagine that existed here given the
5 story we're telling, but I can assure you that the
6 managers of the structured credit business to whom
7 Dr. Nestor Dominguez reported were actively focused on
8 subprime risks and actively focused on risk reduction
9 in the area and were effectively -- effectuating that,
10 again, and the -- and where they saw the risk, and
11 that was happening actively.

12 The mortgage people, who were a different
13 business unit within fixed income, you heard from
14 Ms. Mills earlier today, she was in that unit, their
15 supervisors were actively managing down exposures with
16 a negative and quite concerned view.

17 They were -- these units were getting
18 intuitive leadership. We were all very focused on
19 that I think, as a general matter, in companies like
20 ours, it's very important to make sure that silos of
21 expertise are communicating with each other and, to
22 the maximum extent possible that it was encouraged; it
23 was a best practice.

24 And to varying degrees it was done
25 extremely well. And certain places, where

1 communications should be had, and other places it was
2 suboptimal, but it was a best practice, it was an
3 important one, and I think you made that point.

4 COMMISSIONER THOMPSON: Thank you very
5 much, gentlemen.

6 CHAIRMAN ANGELIDES: Thank you,
7 Mr. Thompson. Ms. Born?

8 COMMISSIONER BORN: Thank you.

9 EXAMINATION BY COMMISSIONER BORN

10 COMMISSIONER BORN: I would like to
11 understand a little bit better what synthetic
12 collateralized debt obligations are. I think I'm
13 beginning to understand cash CDOs, but I would
14 appreciate it, Mr. Dominguez, if you could indicate
15 for us what the difference between a cash CDO and a
16 synthetic CDO is. My understanding right now is that
17 in a synthetic CDO, rather than containing actual
18 RMBS's, for example, it would include credit default
19 swaps or other kinds of derivatives on asset-backed
20 securities; is that correct?

21 MR. DOMINGUEZ: That's the essential
22 difference. There were some other technical
23 differences, but that's the key difference.

24 COMMISSIONER BORN: And how much of the
25 issuance of CDOs by Citi were synthetic and how much

1 were cash in terms of the proportion?

2 MR. DOMINGUEZ: It was primarily cash. The
3 synthetic ABS CDO market, which was run out of London,
4 our London operation, which did not report to me, was
5 a new and growing market, and I don't have the exact
6 numbers. There's a proportion, but it's on the order
7 of about a third, a third to a quarter of our
8 positions.

9 COMMISSIONER BORN: Perhaps we can ask Citi
10 to provide exact statistics on that.

11 Why was it growing at that point of time?
12 Was it because it was more difficult to get the assets
13 for the cash CDOs?

14 MR. DOMINGUEZ: I think that's part of it.
15 When you're warehousing collateral, you're effectively
16 limit -- limited to what's out there in the market and
17 trading, so that's part of it.

18 The other part of it is that the managers,
19 the third-party managers, who were often hired to --
20 to select a collateral liked or -- in fact, investors
21 liked the ability to reference any asset of any
22 vintage if -- if there was a willing counterparty to
23 play among the dealer community willing to write the
24 other side of the contract.

25 So it allowed more flexibility. And, as I

1 mentioned before, a number of investors, an increasing
2 number of investors, were -- were agnostic to whether
3 they got the exposure synthetically or in cash.

4 COMMISSIONER BORN: So essentially, by
5 synthetic, we mean that there are aren't any actual
6 assets, just the derivatives obligations?

7 MR. DOMINGUEZ: That's the pure -- pure
8 synthetic CDO.

9 COMMISSIONER BORN: Although I assume there
10 were some hybrids with actual RMBS.

11 MR. DOMINGUEZ: And that's what they were
12 called.

13 COMMISSIONER BORN: And some synthetic
14 assets? They were called hybrids.

15 MR. DOMINGUEZ: Yes.

16 COMMISSIONER BORN: Do you think, and let
17 me maybe ask Mr. Barnes this. I understand that you
18 suggested to the staff that the synthetic CDOs being
19 built on the credit default swaps essentially allowed
20 deals to be created faster than if you had to actually
21 accumulate all the assets.

22 MR. BARNES: That was --

23 COMMISSIONER BORN: Is that correct?

24 MR. BARNES: That was my observation, yes.
25 One of the challenges is that in actually building a

1 portfolio of RMBS or other types of securities to go
2 into the CDO, typically the market is more of a buy
3 and hold market. And so you had to wait for the new
4 issuance of the underlying securities such as the ones
5 that Ms. Mills described earlier.

6 Whereas, as long -- to -- to
7 Mr. Dominguez's point -- as long as you can actually
8 find a willing buyer of the CDS protection on a
9 particular RMBS you could effectively build this
10 portfolio significantly more quickly.

11 COMMISSIONER BORN: So did the use of
12 synthetic CDOs allow, in effect, more securitization
13 to occur than if you had to wait for the RMBS to be
14 actually issued and available?

15 MR. MAHERAS: Probably at the margin, but it's
16 important to remember that it was really the
17 investors, was the limiting factor. If there are no
18 investors, it didn't matter how quickly you can create
19 the deal. So, at the margin, I would say that's
20 right.

21 COMMISSIONER BORN: But you suggested that
22 investors were, in fact, interested?

23 MR. MAHERAS: They are. They are.

24 COMMISSIONER BORN: In the --

25 MR. MAHERAS: But so -- so it's -- it's a

1 question of -- what I'm trying to suggest is that
2 there wasn't an infinite capacity to do this because
3 your ultimate limitation would be the investors,
4 whether they wanted that risk at all.

5 But, as I said, at the margin it allowed
6 for an easier and cleaner execution of the
7 transaction.

8 MR. BARNES: And while the investors were
9 there the -- from a risk standpoint, the fact that
10 shortened the horizon period or the hold,
11 holding period for the warehousing, that was actually
12 viewed as a sort of a risk mitigate. And -- and --
13 and it was actually the underlying market that was
14 more concerting for us in 2007.

15 COMMISSIONER BORN: Well, as the underlying
16 market began to close down, did the synthetic CDOs
17 allow you to continue securitization longer than you
18 otherwise would have been able to?

19 MR. MAHERAS: No, no. They -- they -- they
20 pretty much shut down around the same time.

21 COMMISSIONER BORN: So investors were
22 scared off --

23 MR. MAHERAS: Exactly.

24 COMMISSIONER BORN: -- by the freeze in the
25 mortgage market essentially?

1 MR. MAHERAS: That's right.

2 COMMISSIONER BORN: So you don't think that
3 the synthetic CDOs in any way contributed to extending
4 the period of securitization or the appear --
5 appearance of the housing bubble?

6 MR. MAHERAS: Well --

7 MR. BARNES: From my standpoint, I would
8 say that to the extent it allowed more deals to print,
9 then probably it resulted in losses being larger in
10 aggregate than had those deals not occurred.

11 COMMISSIONER BORN: Well, that was my next
12 question, whether, you know, Citi experienced greater
13 losses because of the securitization of synthetic CDOs
14 than it otherwise would have. I assumed there were
15 losses on the synthetic CDOs --

16 MR. MAHERAS: Yes.

17 MR. BARNES: Yes.

18 COMMISSIONER BORN: -- as well as the cash
19 CDOs?

20 MR. MAHERAS: Yes. But in answer to your
21 question, I don't think it extended the housing bubble
22 because it didn't require any origination.

23 COMMISSIONER BORN: All right. I yield
24 back the rest of my time.

25 CHAIRMAN ANGELIDES: Terrific. Ms. Murren.

1 EXAMINATION BY COMMISSIONER MURREN

2 COMMISSIONER MURREN: Just a follow-up
3 question on our conversation earlier about the
4 regulators.

5 You had mentioned that both you,
6 Mr. Maheras, and you, Mr. Bushnell, that you were
7 sensitive to the fact that your regulators needed to
8 convey information to the Fed about the safety and
9 soundness of the parent company.

10 And you had talked about your interactions
11 with the OCC and a little bit with the Fed, but you
12 didn't mention the SEC. And I think, if I'm not
13 mistaken, that the SEC is the functional regulator for
14 the investment bank; is that right?

15 MR. BUSHNELL: For the us portion of the
16 investment bank.

17 MR. MAHERAS: And I would say the
18 investment bank, I think it may have -- Commissioner
19 Georgiou may have mentioned this -- the investment
20 bank conducted activities in a number of different
21 legal entities.

22 It conducted activities on the bank balance
23 sheet and it conducted activities at the holding
24 company, conducted activities at Citigroup global
25 markets. Global markets was the broker-dealer entity

1 which was regulated by the SEC.

2 COMMISSIONER MURREN: And did you have
3 interactions with the SEC.

4 MR. MAHERAS: My earlier reference to
5 having less interaction there was a personal one. My
6 interaction with the SEC was lower than that of my interaction with OCC
7 and the Fed. I can't speak to the frequency of
8 interaction in other parts of the firm with the SEC.

9 COMMISSIONER MURREN: And could you talk a
10 little bit about their approach to supervising that
11 entity, the investment bank?

12 MR. BUSHNELL: Would you like me to address
13 that?

14 COMMISSIONER MURREN: Either one or both of
15 you, which -- whoever.

16 MR. BUSHNELL: I think that I, too, saw
17 relatively less of the SEC amongst my regulatory
18 contacts. They were there and a lot of times the
19 regulators did try to share information. They would
20 send each other their exam reports of different
21 trading desks or different divisions throughout the
22 world.

23 And this included not only the OCC and the
24 Fed, and the Fed of the OCC, but as you say, foreign
25 regulators, certain of the large regulators would get

1 a piece of that. The SEC in some instances would get
2 pieces of that but I -- I -- not as frequently.

3 I would say, when I saw groups of
4 regulators, the Fed was always there. The OCC was
5 always there. I mentioned the FSA in London for all
6 of our legal entities was always there. The SEC would
7 occasionally be there, in part because sometimes the
8 issues being discussed weren't relevant to the U.S.
9 broker-dealer, but that was my experience.

10 COMMISSIONER MURREN: Thank you.

11 CHAIRMAN ANGELIDES: Mr. Thomas? A burst
12 of energy as we come around the turn.

13 VICE CHAIRMAN THOMAS: Thank you,
14 Mr. Chairman.

15 EXAMINATION BY VICE CHAIRMAN THOMAS

16 VICE CHAIRMAN THOMAS: I asked if you would
17 be willing to respond to us in writing over a period
18 of time about issues that we're dealing with. We
19 didn't talk about it today, but I am, based upon my
20 background in Ways and Means and the particular
21 profile of your company, with such a significant
22 presence outside of the United States, what are you,
23 50/50, 60/40?

24 MR. BUSHNELL: I think 50/50 --

25 VICE CHAIRMAN THOMAS: Internal versus

1 external --

2 MR. BUSHNELL: -- I think for assets or
3 income is a reasonable estimate. It has varied over
4 time.

5 VICE CHAIRMAN THOMAS: I mean, this was
6 worldwide. You folks deal in markets around the world
7 and we're working on our problem, focused on our
8 needs, and repairing our problems.

9 But if we don't do this on a broad
10 international basis, we're not going to accomplish a
11 whole lot. And -- and there's going to be an even
12 greater reaction to people who are supposed to know
13 what they're doing, not doing it on that basis.

14 Now, obviously we have tried to move some
15 things internationally, but I would very much like to
16 pick your brains, if that's a word that I can use,
17 on -- based on what you do with one foot in the world,
18 especially Europe, and one foot here, what would make
19 more sense?

20 I'm more than willing to talk about a
21 structure which is fair, but I also would like to talk
22 about a structure that gives us a modest advantage in
23 terms of not being dumb about changes that we're going
24 to make.

25 I mean, when you look at an international

1 situation, we somehow don't want to have product and
2 financing linked in a way that you can make a sale on
3 a one-stop shop when most of the rest of the world
4 operates that way in dealing with folks.

5 So if you're willing to do that, that would
6 be very helpful to me.

7 I just want to make a couple of comments,
8 in part, Mr. Maheras, about your statement in terms of
9 constant contact notwithstanding the silo structure in
10 communications. In the interview, Mr. Bushnell, on
11 the question, were you aware that Citi global
12 securitized markets, which I believe are under the
13 direction of Susan Mills who was here before us
14 earlier, they were decreasing their purchases in
15 securitization of subprime mortgages due to concerns
16 with the mortgage market, in a real time situation
17 were you aware that that division or department was
18 doing what it was doing at the time it was doing it?

19 MR. BUSHNELL: Commissioner, at that point
20 in time, for that specific area, I was not. I knew
21 that we had several different areas where, both in
22 risk management and the business of their own volition
23 if you will, were looking at subprime exposures and
24 increasing loan loss reserves, tightening underwriting
25 standards on the consumer side, et cetera, but as the

1 didn't get a feel for what you believe. I mean, I
2 heard, should you want to conceptually expand that, I
3 always love ephemeral, non-committed, general
4 philosophical discussions. You guys made an
5 impassioned plea that you were worth what you got. So
6 I want to get something back in terms of after what
7 you went through -- and I'm really looking at all of
8 you, notwithstanding the fact that I'm looking at
9 Mr. Bushnell -- I want to know, from your experience,
10 and I understand that it was an extraordinary
11 circumstance, but then there should be a willingness
12 to be extraordinary about your openness and
13 frankness about what would help.

14 I understand additional capital, but once
15 again, the standards that we had. I'm not going to
16 ask you now what you think of the financial regulation
17 moving through Congress, because there's going to be a
18 whole series of legislation moving through Congress,
19 but I do want to enter into a discussion, we'll
20 structure it, give you plenty of time if you will be
21 willing to respond back.

22 And I know, Mr. Maheras, you took umbrage
23 with my talk about you not thinking things go down. I
24 believe you said that you didn't anticipate so many
25 people walking away from their houses. That was a

1 statement you made.

2 Most of them wouldn't call them houses.
3 They call them homes. And they didn't walk away from
4 them. They were dragged away from them, through
5 circumstances they believe that were beyond their
6 control, but somebody other than themselves was at
7 fault.

8 So if you put the context of what we're
9 looking at in trying to explain it to people, when you
10 get these kinds of responses, it makes it very, very
11 difficult to fairly talk about you in the
12 circumstances you were in, regardless of remuneration
13 and structure of financial reward, that you get it.
14 That's all. It's tough.

15 Thank you, Mr. Chairman.

16 CHAIRMAN ANGELIDES: Thank you, Mr. Thomas.
17 All right. Commissioners and witnesses, this is the
18 stretch run, here. I have a number of questions.
19 I'll try to see if we can't get yes, no's, pretty
20 quick answers to these.

21 EXAMINATION BY CHAIRMAN ANGELIDES

22 CHAIRMAN ANGELIDES: I want to get a sense
23 of your view on a couple big matters.

24 So the first is just the size and
25 complexity of Citigroup, an institution that had

1 assets, I think, that were about 690 billion or so in
2 1998, grew to -- by 2007 to 2.188 trillion on balance,
3 another 1.26 trillion off-balance-sheet, so 3.4
4 trillion.

5 Leverage, I think, by 2008, of tangible,
6 common equity assets were 61 to 1. When you take the
7 off-balance-sheet, 97 to 1, I'm going to ask you,
8 Mr. Maheras, and particularly because you said you
9 spent -- I think in one of your interviews -- you
10 spent about 1 percent of your time thinking about CDOs
11 which ultimately produced a 30-plus-billion-dollar
12 write-off. Is this institution just too big to
13 manage, too big to regulate, too complex?

14 MR. MAHERAS: It's an important question.
15 I -- by the way, I was given different points in time,
16 and 1 percent referred to an earlier time when it
17 was -- it warranted less focus. Later in '07, it was
18 much more than that.

19 But in terms of Citigroup being too large
20 of a -- too complex to manage? I don't -- I don't
21 necessarily subscribe to that, I think it's more
22 complicated to manage a company with the breadth and
23 range of activities of a Citigroup than that of a
24 mono-line investment bank, but I don't think it's too
25 big.

1 I think you have examples out there of
2 firms that are just as large that are perceived to be
3 well managed. And so I don't think that, by
4 definition, Citigroup is too big to manage.

5 CHAIRMAN ANGELIDES: All right.

6 Mr. Bushnell, Mr. Thomas referred you to, I believe, a
7 meeting you attended with Mr. Rubin, but albeit, I
8 guess he attended it briefly. This was the November
9 17th, 2007, meeting with the senior supervisors from
10 the Federal Reserve of New York, Federal Reserve
11 Board, the OCC, the SEC, the UK FSA.

12 He referred -- and in that, and I don't
13 expect you to have these notes in front of you, but
14 you did make a number of comments about poor
15 communication across businesses. You said that the
16 firm did not have adequate firm-wide consolidated
17 understanding of its risk factor sensitivities.
18 Senior management business and risk management did not
19 fully appreciate the market risk of the leverage loan
20 pipeline, the routine super senior CDOs.

21 These are actually notes, these aren't
22 verbatim, these are notes of your comments. You left
23 the institution, too big to manage, too complex,
24 because your comments here indicate a significant
25 level of concern about the ability to manage this well.

1 MR. BUSHNELL: I think that there was very
2 definitely I had lessons learned and was trying to --
3 I set those forth to our board of directors during the
4 crisis, as they come into my mind, and at that meeting
5 with the regulators, I said, here's areas that we
6 could improve upon given what's happened, et cetera.

7 As to that relation to complexity, Chairman
8 Angelides, I'd answer it slightly differently, and it
9 has to do with the nature of our global economy, et
10 cetera. I think that from customer's side, when you
11 think of customers in a broad sense, the inevitability
12 of an institution that can service global capital
13 flows will be a reality, whether it's going to be in
14 the United States or somebody else is going to take us
15 over from that, that by nature, will mean that there's
16 multiproduct, multi-types of customers, corporate
17 customers, consumer customers, institutions, et
18 cetera.

19 So I think we have to sort of face the
20 reality that we will have these huge global financial
21 institutions and, therefore, concentrate on their
22 governance and regulations rather than saying, no,
23 that we're going to somehow make them smaller.

24 CHAIRMAN ANGELIDES: All right. Let me
25 move on, I want to talk about these super senior CDOs,

1 that the various tranches, but I want to see if I can
2 simplify them. I mean, in the end, Commissioner
3 Georgiou I think made a good point. You are taking a
4 pile of blank and taking stuff in the middle or the
5 bottom of that, and all of the sudden shoving it to
6 the top, and the lead becomes gold.

7 And I want to pick up on something that
8 Mr. Thompson said, just about intuitive. It is very
9 clear you didn't really underwrite the underlying
10 collateral. I think it was -- was it Ms. Duke who
11 reported up to you or vice versa?

12 MR. BARNES: Vice versa.

13 CHAIRMAN ANGELIDES: You reported to
14 Ms. Duke?

15 MR. BARNES: Right.

16 CHAIRMAN ANGELIDES: She said her comment
17 in an interview with us, we were seduced by
18 structuring and failed to look at the underlying
19 collateral.

20 So just reflecting on these CDOs, these --
21 you know, you take an original loan with original
22 collateral, and just by way of background, I'm a real
23 estate person, so sticks and bricks is what I relate
24 to real value, real assets.

25 You take it through the next stage; it

1 securitizes as an RMBS. Now you take it to the next CDO,
2 and then you can have synthetic CDOs. And I guess I
3 want to talk about the underlying value of these,
4 because the fact is, I don't know what kind of stress
5 test you did but here's just some basic facts. From
6 `90 to `91, real home prices did drop nationwide in
7 this country by a cumulative 3 percent. By the fourth
8 quarter of 2007, at which point these CDO super --
9 super senior tranches are in free fall and market
10 value, you write off 18 billion, but home prices have
11 only fallen 5 percent.

12 So I guess what I'm saying is, what was the
13 stress test? Was it never going down? They'd fallen
14 from `90 to `91 at 3 percent, and I know I lived it.
15 I was in California and in the land development
16 business.

17 So the question is how -- how stressful was
18 the stress test? Doesn't seem like much, 5 percent is
19 all the prices had dropped by the time you guys had
20 taken an 18-billion-dollar write-off.

21 MR. BARNES: Let me -- let me comment on
22 that, because I think, you know, one of the things,
23 and I referred to the Commissioner earlier about the
24 intrinsic cash flow model, and that was really the
25 first quarter was actually it was in October, I

1 believe, that -- that the initial loss, the 8- to
2 10-billion-dollar estimate of the fourth quarter was
3 disclosed.

4 And based on this model, based on an
5 assumed further decline in home prices, which was
6 produced out of our economics and market analysis
7 group, the bulk of the super seniors, I believe, all
8 of the liquidity puts which were backed by older
9 vintage collateral, did not break, in other words,
10 they -- they recovered a future value of par. But
11 because we were required to mark to fair value under
12 the accounting standards and there really was no
13 market, it was really the -- the use of a very large
14 discount factor applied to those future cash flows
15 that contributed to that large write-down.

16 CHAIRMAN ANGELIDES: Well, so here's the
17 problem with models, again having been in real estate,
18 you know, sometimes you can use your Argus models, but
19 at some point the lease either renews or it doesn't.
20 They either buy your lots or they don't. And it
21 doesn't sound like this was very binary and calculated
22 in this possibility. I mean, that's obviously -- it
23 did not calculate this in, correct?

24 MR. BARNES: And the bine- -- the binary
25 reference is critical because this really is an

1 out-of-the-money option, which suddenly has -- has
2 zero intrinsic value to then suddenly has a
3 substantial loss associated with it.

4 CHAIRMAN ANGELIDES: But that happens in
5 markets.

6 MR. BARNES: Yeah, and based on the market
7 surveillance that we got, the market was commanding a
8 very, very small premium across not just banks, like
9 ourselves, but other market participants, including
10 insurers and the mono lines.

11 In hindsight, we didn't -- we didn't
12 develop the models. We didn't look through not only
13 to the RMBS, but looked through to the underlying
14 rentals.

15 CHAIRMAN ANGELIDES: Right, the real
16 assets.

17 MR. BARNES: The real factors --

18 CHAIRMAN ANGELIDES: Both the real assets
19 and the real borrowers.

20 MR. BARNES: And the real factor that
21 actually drove the losses, which is something which is
22 extremely difficult to model, was the fact that it was
23 actually massive ratings downgrades, which because of
24 the underlying characteristics of the RMBS and
25 specifically the CDOs that were backed by RMBS,

1 altered the allocation of cash flows associated with
2 those downgraded securities. And, as a result,
3 effectively, these CDOs got starved of cash because
4 they were actually backed by these mezzanine tranches
5 of RMBS.

6 CHAIRMAN ANGELIDES: Right, right, which
7 were subordinate to the senior, which goes back to the
8 very nature of the product.

9 MR. BARNES: And that was something which
10 the industry didn't model well. And -- and -- and
11 it's to some degree given the challenges that the
12 rating agencies have had, is rather behavioral. When
13 they elected to downgrade securities by multiple
14 notches --

15 CHAIRMAN ANGELIDES: But lead does melt.

16 MR. BARNES: I'm sorry?

17 CHAIRMAN ANGELIDES: That's the point, lead
18 melts where gold doesn't, and so the underlying
19 collateral is a huge flaw in this.

20 All right, let me ask this next question
21 about how things were booked. So here's a basic
22 question I have, and it really goes to how you booked
23 these assets, because it goes to how Citigroup was
24 able to report profits and executives were able to
25 take compensation.

1 I think we understand the fact that you
2 really couldn't sell these super senior tranches;
3 correct? No, you really -- and, well, you didn't sell
4 much.

5 MR. BARNES: I think in the case of the
6 liquidity puts, most of which predated my time and the
7 risk management group covering the business, but my
8 understanding was that it wasn't an intention to sell
9 the liquidity puts. But there were other deals where
10 the super seniors were sold to European banks, U.S.
11 banks, as well as bond --

12 CHAIRMAN ANGELIDES: At par?

13 MR. DOMINGUEZ: Yes.

14 MR. BARNES: Yes.

15 CHAIRMAN ANGELIDES: But what kind of
16 trading volumes? Because here's my --

17 MR. DOMINGUEZ: The typical trade would be
18 very chunky. So, in other words, a -- a conduit would
19 buy 500 million in one transaction or a billion. It
20 was -- it was common to do billion-dollar.

21 CHAIRMAN ANGELIDES: Well, this is
22 something I think we can explore in a written
23 interrogatory, but here's my question: If you had
24 these assets, and I guess in the spring of '07 for the
25 first time under that new FASB rules you did have to

1 lay out your Level 1, your Level 2, your Level 3
2 assets, and these were Level 3 assets, correct, for
3 which there was no discernible market activity in
4 pricing?

5 But you booked them at a hundred percent,
6 which then of course allowed Citi until you did write
7 them down, to book profits, which then resulted in
8 compensation. So the organization in a sense is
9 booking profits on these values.

10 I have a basic question. I'll make it
11 simple for everyone watching this. If I have a home I
12 think is worth 200,000 but there's no market for it
13 and no one would pay me 200, it's not going to be
14 worth 200.

15 So I guess I would ask, and maybe if you
16 have a quick answer, how the heck did you book these
17 at par and keep them there so long?

18 MR. BARNES: I'm not an accountant but in
19 terms -- I have been involved in the -- in the
20 discussions around that, and from my standpoint, we
21 looked, as I said in my opening statement, we looked
22 at comparable analysis, and other deals were pricing
23 at similar levels.

24 We were able to -- we were able to buy
25 protection from bond insurers at very, very tight

1 spread levels, ten basis point spread levels.

2 And in the absence of an observable market
3 I think it is acceptable to use the most comparable
4 analysis that you can in what was always a very
5 illiquid and non-traded market.

6 CHAIRMAN ANGELIDES: All right. I think I
7 want to probe this, because I want to understand
8 whether across the industry, these things were booked
9 at levels that just weren't reflective of reality,
10 they were illiquid assets, they were put in Level 3,
11 and I -- and in -- and so I -- I -- I think we would
12 like to explore that, a couple --

13 MR. MAHERAS: I think --

14 CHAIRMAN ANGELIDES: Yes, go ahead,
15 Mr. Maheras.

16 MR. MAHERAS: I think -- I think you said
17 that they were booked at par. When they were booked
18 at par, my recollection is it's when these things were
19 trading at par, when there were observable quotes.

20 I think what these gentlemen are referring
21 to is when the market stopped and there were no longer
22 observable, quote, trading activity. That's when they
23 began --

24 CHAIRMAN ANGELIDES: All right. Well,
25 that's what I would like to see.

1 MR. MAHERAS: There were other
2 methodologies to mark them which resulted in them
3 taking current markdowns.

4 CHAIRMAN ANGELIDES: Because the ABX does
5 start moving down slightly, but I would like to at
6 least look at where the ABX was. Yes.

7 Let me see if I can move quickly through
8 these. I want to just talk about risk, for a minute,
9 and then I have one final set of questions, members,
10 and that is, Mr. Bushnell or Mr. Dominguez, let me see
11 if I can get the right document here. In October of
12 2006, your financial control group wrote a memo that's
13 addressed to you about liquidity puts, and they say,
14 the liquidity risk and the liquidity puts is the risk
15 that Citigroup must purchase the ABCP, the
16 asset-backed commercial paper, long-term notes that
17 cannot quickly be sold enough to prevent or minimize a
18 loss.

19 Part of liquidity risk and liquidity puts
20 is the risk of a Citi downgrade, which can lead to 26
21 billion dollars in liquidity put exercises hitting our
22 balance sheet simultaneously, in this scenario
23 Citigroup is faced with severe concentration risk.

24 Did you do anything about that or look at
25 that or --

1 MR. DOMINGUEZ: Yes.

2 CHAIRMAN ANGELIDES: Or at that point were
3 you stuck?

4 MR. DOMINGUEZ: No, no, that -- that
5 working paper engendered a lot of discussion,
6 reexamination of how we were treating it. There were
7 many more people involved that were on that
8 distribution list.

9 And, again, it was decided that the -- the
10 product was priced appropriately, it was marked
11 appropriately, because we were seeing products that
12 had as many comparable elements, sufficient comparable
13 elements, at tighter levels than that.

14 And again, as I said before, the credit
15 risk component was marked as if it was already on the
16 books.

17 CHAIRMAN ANGELIDES: All right. Here's the
18 final set of questions. And I just want to tell you,
19 Mr. Bushnell, I am going to submit some questions to
20 you. You made a presentation, just to let you know,
21 on October 30th, '07, internally, and it was a
22 presentation to the board of directors.

23 And so I am going to ask some questions for
24 you about that presentation, which was basically
25 review of the current environment, and I do want to

1 ask you, so you might begin preparing. You had noted
2 a bunch of significant events, like HSBC announcing
3 losses associated with mortgage delinquencies, the
4 Bear Stearns asset management funds having their
5 problems, and I really would like to get a picture
6 as these things happened in `07 what you did to react
7 to those, so I'll get that to you.

8 But here's my final question, and I would
9 like to see if anyone would like to comment on it. I
10 want to understand the timeline, and these are
11 questions I will pose to Mr. Prince and Mr. Rubin
12 tomorrow.

13 June 30th, as I understand it, you still
14 have everything marked, correct, at par?

15 MR. BARNES: Par.

16 CHAIRMAN ANGELIDES: All right. On July
17 20th, in an earnings call, your CFO, Mr. Crittedon,
18 basically tells the world you have 13 million dollars
19 in subprime exposure.

20 On October 15th, on an earnings call, it's
21 announced, and I believe it's -- I can't remember who
22 made the announcement -- but, again, Citigroup has 13
23 billion dollars of exposure and then, of course, on
24 November 4th, it's, whoops, we've got 55 billion.

25 At what point did senior management know

1 that 13 had become 55? No one? I mean, you are
2 senior, but when did someone else above CEO level/board --
3 know that 13 had become 55.

4 MR. BUSHNELL: If my recollection goes into
5 that, it comes into the definition of exposure and
6 what we thought was possibly a loss. So I think that
7 presentations to senior management, certainly the
8 super senior numbers was not included in the July
9 number that you've referenced there.

10 And we started to have discussions with
11 that in early September in terms of a senior
12 management standpoint. And we had some board
13 tutorials and updates that struck me as late
14 September, maybe the first week in October.

15 CHAIRMAN ANGELIDES: Is it fair to say that
16 the CEO and the board did not know about the liquidity
17 puts and the direct senior exposure, senior -- super
18 senior exposure prior to that September time period?

19 MR. BUSHNELL: I think that's fair.

20 CHAIRMAN ANGELIDES: Anyone have a
21 different recollection?

22 MR. MAHERAS: My recollection is pretty
23 close to David's, except I -- I think I recall hearing
24 about the exposure sometime in August and immediately
25 elevated it. I can't tell you if it's August or late

1 August or early September, but it would be around that
2 month, you know, within a month of David's
3 recollection.

4 CHAIRMAN ANGELIDES: Okay. I assume you
5 have nothing to add?

6 MR. DOMINGUEZ: I'm not involved in those
7 discussions.

8 CHAIRMAN ANGELIDES: Okay. All right.
9 Those are all my questions. Any other Commissioners
10 have anything that they want to put on the table?

11 Gentlemen, thank you very much for coming
12 today. We do appreciate your time and your answers
13 and we will have additional questions. And we
14 appreciate it all very much.

15 Thank you to the public, who has joined us
16 today, and thank you, the Commissioners, for all their
17 hard work. This meeting is recessed or adjourned
18 until tomorrow morning at 9:00 A.M.

19 (FCIC Hearing adjourned at 5:30 P.M.)

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